

# Yarra Australian Real Assets Securities Fund

## Gross returns as at 31 July 2022

	From 17 December 2015	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception <sup>^</sup> % p.a.
Yarra Australian Real Assets Securities Fund	8.85	7.78	-2.58	4.48	1.98	8.33	10.13	8.37
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index <sup>*</sup>	7.89	7.35	-4.83	6.54	1.45	7.23	NA	NA
Excess Return <sup>†</sup>	0.96	0.44	2.25	-2.07	0.53	1.10	NA	NA

Past performance is not a reliable indicator of future performance. Taxes payable by investors have not been taken into account. The figures shown have been provided for illustrative purposes – they are unaudited and subject to change. The total returns shown are gross of all fees, meaning they do not reflect the deduction of any investment management fees which would reduce returns and assume reinvestment of all distributions. Investment in the fund is not available on a fee free basis and this should be factored into any analysis of past performance.

## Net returns as at 31 July 2022

	From 17 December 2015	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception <sup>^</sup> % p.a.
Yarra Australian Real Assets Securities Fund	7.93	7.71	-2.79	3.59	1.12	7.42	9.20	7.45
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index	7.89	7.35	-4.83	6.54	1.45	7.23	NA	NA
Excess Return <sup>†</sup>	0.04	0.36	2.05	-2.95	-0.33	0.19	NA	NA
Growth Return <sup>‡</sup>	NA	NA	NA	-20.64	-12.97	-10.74	-3.42	-2.04
Distribution Return <sup>‡</sup>	NA	NA	NA	24.23	14.09	18.16	12.63	9.50

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<sup>^</sup> Inception date of Yarra Australian Real Assets Securities Fund: December 2005.

<sup>\*</sup> Effective 17 December 2015, the benchmark for the Yarra Australian Real Assets Securities Fund is the S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index: a market cap weighted index of infrastructure, utilities and REIT securities included in the S&P/ASX300.

<sup>†</sup> Excess return: The excess return figures shown represent the difference between the portfolio's return and the benchmark return.

<sup>‡</sup> The Growth Return is measured by the movement in the Fund's unit price, ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders by way of income distribution in a 12-month period. It does not include distribution amounts deemed as capital distributions.

### Market review

The Infrastructure, Utilities and A-REITs Accumulation Index returned +7.4% for the month, taking its 12-month return to +6.5%. In comparison, the broader ASX300 gained +5.9% for the month and global indices were positive (MSCI World Index +7.9%).

Real Estate (+11.8%), bounced back in July with positive returns led by Charter Hall (CHC, +17.6%), Goodman (GMG, +16.0%) and Home Consortium (HMC, +18.6%)

Conversely, Transportation Infrastructure (+0.4%) was flat during the month led by Altas Arteria (ALX, -3.9%), Transurban (TCL, +0.9%) and Qube Holdings (QUB, +1.1%).

### Portfolio review

#### Key Contributors

**APA Group (APA, underweight)** – the gas pipeline operator underperformed in the period on limited news flow. We remain underweight the company on the grounds that APA's initiatives to shift its business model towards electrification will not be sufficient. We expect it to be dwarfed by the discount increasingly applied to its gas pipeline business, particularly as planned government policies accelerate the shift to zero emissions sources. As a result, we do not see its valuation (at a 12-month EV/EBITDA of 13.5 times) as sufficiently compelling when compared to large cap infrastructure alternatives.

**Vicinity Centres (VCX, overweight)** – the shopping mall REIT continues its run of outperformance following a stronger-than-expected trading update and, moreover, due to its superior

debt position versus peers given the rising interest rate environment. Management upgraded FY22 FFO to at or above 12.6 cents per share, reflecting better cash collection and the reversal of past provisions. We continue to see relative upside in the shopping mall REIT as Australia emerges from the COVID crisis. While we continue to believe that shopping mall REITs face structural rental challenges, we now believe this is better recognised with VCX trading at 0.89 times trailing NTA and increasing direct transactional evidence at prices at or close-to prevailing NTA's. We view VCX as better positioned to navigate higher interest rates, with lower leverage and higher hedging than peers.

**AGL Energy (AGL, underweight)** – the utilities company underperformed during the period as extended plant outages at a time of high wholesale prices continued to weigh on the stock. We remain underweight AGL. Whilst acknowledging the potential for corporate activity, we feel any upside from this is likely to be modest in the context of the substantial risks AGL faces in transitioning away from its highly profitable but carbon intensive coal generation fleet. With the demerger plans now forgone and much of the executive team and Board exiting the business, we await a meaningful strategy update to assess AGL's path forward.

#### **Key Detractors**

**Charter Hall Group (CHC, underweight)** – the fund manager REIT outperformed over the month, reversing prior months of significant underperformance as growth related REITs such as CHC suffered amid concerns around higher real yields and the prospect for lower FUM growth as the commercial real estate valuation cycle moderates. Thus, outperformance over July can be partially attributed to the macro (moderating expectations of interest rate increases) and positive stock specific news flow with Charter Hall's Prime Office Fund (CPOF) confirming the 50% acquisition of the Southern Cross Towers precinct from Blackstone and Brookfield for approximately \$1bn in July. We remain underweight the stock based on our view that AUM growth and transaction volumes – which are running at elevated levels – will normalise in the medium term as the cap rate compression cycle reverses. As the growth rate of the business slows from impressive double-digit levels, we expect the multiple to contract, putting pressure on the share price outlook. Within the real estate fund manager space, our preference is with Goodman Group (GMG).

**Atlas Arteria (ALX, overweight)** – the toll road operator underperformed during the month after IFM, which had built an approximate 15% stake in the company at above market levels the prior month, announced they were not in a position to make a bid at this time. We maintain an overweight position as we see a path towards significant value creation for ALX through concession extensions at APRR, achieved as a means of funding expansion projects, and settling the Dulles Greenway tolling regime. With IFM having put ALX into play, we do currently believe a privatisation transaction of some form remains a likely outcome.

**Scentre Group (SCG, underweight)** – our underweight position in SCG detracted over the month as the stock added +12%, erasing much of the -14% price performance from the prior two months. The strong July rebound likely reflects industry evidence of retail valuations holding into June-22 (VCX and SCP declare cap rate tightening into June-22), and high levels of CPI linkages in leases, providing a degree of inflation projection in a rising inflationary environment. With the stock trading at 0.79 times NTA and offering a 5.3% dividend yield, we see superior risk adjusted returns in peer retail owners such as Vicinity Centres (VCX) and Bunnings Trust (BWP).

#### **Key Purchases**

**Dexus Property (DXS)** – we increased our position during the period, shifting from an underweight to an overweight position. While we acknowledge risks emanating from COVID-19 are not yet fully reflected in the operating performance (i.e. NOI growth, vacancy levels) we believe sufficient risk is embedded into the share price (stock trades at 0.81 times trailing NTA, 5.4% dividend yield) following the stock falling -19% over the two months to 30 June. We see DXS as a market leader in the office space domestically, however our position size is limited by our expectation of market vacancy rates remaining elevated for some time (Sydney CBD 13%, Melbourne CBD 14%, June 2022) limiting ability to see real rental growth. Lastly, DXS's continues to grow its funds management business, which we do not believe is appropriately valued by the market at this time.

#### **Key Sales**

**Qube Logistics (QUB)** – we trimmed the port and logistics operator during the period to fund other ideas. We still maintain a position in the company, however many of the catalysts for the stock have now played out and we expect the anticipated slowdown in the domestic economy will temper QUB's growth outlook.

**Atlas Arteria (ALX)** – following recent outperformance we trimmed our overweight. The company remains a high-conviction overweight in the portfolio based on its strong liquidity and balance sheet position, discounted valuation and exposure to traffic recovery in Europe and the US. ALX trades on less than 11.0 times normalised EV/EBITDA, which more than captures the disruption from COVID-19 as travel restrictions and lockdowns reduce traffic volumes in the short term. Beyond traffic normalisation, we see a path towards value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime.

**Transurban (TCL)** – while we continue to believe TCL has a strong growth outlook (with a number of new projects and expansion plans), we trimmed the portfolio's position during the month to fund other ideas. Our preferred toll road exposure is Atlas Arteria (ALX), where we see greater valuation support, particularly through concession extensions at APRR and settling the Dulles Greenway tolling regime.

## Key Active Overweights

**BWP Trust (BWP)** – we believe BWP trades at a compelling valuation versus peers – 1.1 times NTA (based on conservative cap rates) with above a 4% dividend yield – when considering its strong operating outlook, driven by well-located properties that encourage high rates of lease renewals from tenant Bunnings. Further, the REIT has the lowest gearing levels in the sector at <17% and is set to benefit from higher inflation given CPI leases account for around 53% of its lease structures.

**Vicinity Centres (VCX)** – we continue to see relative upside in the shopping mall REIT as Australia emerges from the COVID crisis. While we continue to believe that shopping mall REITs face structural challenges, we now believe this is well recognised with VCX trading at 0.89 times trailing NTA and increasing direct transactional evidence at prices at or close-to prevailing NTA's. Due to its large exposure to Victoria (53% NTA), we expect short-term support as COVID cases across the state continue to fall.

**GPT Group (GPT)** – we believe GPT offers investors exposure to a high-quality, diversified commercial real estate portfolio. Its conservative balance sheet (gearing at <30%) and high level of liquidity (\$1.2bn) provide us with confidence that the company is appropriately positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become more attractive at 0.75 times trailing NTA, which implies an approximate fall of 20% in gross asset values (when ascribing value to GPT's Funds Management business) – a more significant fall than our base expectations.

## Key Active Underweights

**APA Group (APA)** – we remain underweight the company on the grounds that APA's initiatives to shift its business model towards electrification will not be sufficient. We expect it to be dwarfed by the discount increasingly applied to its gas pipeline business, particularly as planned government policies accelerate the shift to zero emissions sources. As a result, we no longer see its valuation (at a 12-month EV/EBITDA of 13.3 times) as sufficiently compelling when compared to large cap infrastructure alternatives.

**Stockland (SGP)** – our underweight position is premised on long-term concerns around the sustainability of what is now becoming the tail-end of booming domestic residential conditions driven by pandemic-related stimulus programs, heavily supporting the first home buyer segment. Over time, SGP's valuation faces downside risk given its exposure to second-tier shopping centres (43% of NTA), where structural change is likely to accelerate, and to residential profitability (35% earnings, and 22% of NTA) where we see softer demand in the medium-term as housing stimulus (Homebuilder) rolls over and the impact of lower migration levels takes hold.

**Scentre Group (SCG)** – our underweight position in SCG reflects longer-term concerns around the sustainability of leasing growth, leading to concerns around dividend and valuation growth sustainability. While industry evidence of retail valuations largely held into June-22 (VCX and SCP disclosed cap rate tightening into June 2022) we see this as

temporary only and expect valuation declines in future periods. Additionally, SCG's relatively high level of debt and lower hedged position leaves it vulnerable compared to large cap retail peers, such as Vicinity Group. With the stock trading at 0.79 times NTA and offering a 5.3% dividend yield, we see superior risk adjusted returns in peer retail owners such as Vicinity Centres (VCX) and Bunnings Trust (BWP).

## Market outlook

We maintain our longer-term conviction in the Real Assets sector, underpinned by solid fundamentals and attractive underlying valuation support. The S&P/ASX 300 Infrastructure, Utilities and A-REITs Accumulation Index offers a 12-month forward forecast dividend yield of 4.6%, an attractive 0.9% premium above the 10-year Australian bond rate.

We see opportunities in high quality infrastructure companies with strong inflation protection and exposure to recovering economies. Toll roads are at the forefront of the post COVID-19 recovery and in Atlas Arteria (ALX) we see several catalysts on the horizon. Chorus is a quality regulated utility trading on a 5.8% FY23 dividend yield, with medium term upside in regulatory returns. We remain cautious towards utilities names with a high reliance on fossil fuels and difficulty in transitioning to a lower carbon environment, in particular AGL Energy (AGL) and APA Group (APA).

We see a mixed outlook across REIT sub-sector exposures moving into CY2022. Positively, we see recovering occupier demand – particularly as office workers return to the offices, and shoppers return to shopping malls – following an elongated period of COVID-disruption and restrictions concentrated in the major cities of Melbourne and Sydney (combined >50% A-REIT asset exposure). We expect this to drive improved leasing outcomes and support the rent collection trajectory. Additionally, a number of the REITs have rents linked to CPI, providing an effective hedge to increasing inflation. However, offsetting this to some extent rising interest rates will increase funding costs and increase capitalisation rates which will put pressure on valuations (REIT NTAs), seeing the end of a multi-year trend of falling funding costs, which have been an important driver of earnings and dividend growth over the past three years.

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
Transurban	21.09	19.84	1.25
Goodman	15.20	13.63	1.57
GPT	6.90	3.63	3.27
Vicinity Centres	6.64	3.19	3.45
Atlas Arteria	6.38	3.47	2.91

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
BWP Trust	4.54	0.88	3.66
Vicinity Centres	6.93	3.42	3.51
GPT	6.87	3.72	3.15
Underweights			
APA	0.00	5.87	-5.87
Stockland	0.00	3.92	-3.92
Scentre	3.05	6.43	-3.38

Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.

## Sector allocation

	Portfolio %	Benchmark %	Active %
<b>Infrastructure</b>	<b>37.58</b>	<b>29.90</b>	<b>7.68</b>
Airport Services	0.00	0.59	-0.59
Highways & Railtracks	24.34	22.19	2.15
Communication Services	5.52	1.66	3.86
Railroads	0.00	3.16	-3.16
Marine Ports & Services	5.22	2.30	2.92
Information Technology	2.50	0.00	2.50
<b>Utilities</b>	<b>2.23</b>	<b>12.75</b>	<b>-10.52</b>
Electric Utilities	2.23	4.47	-2.24
Gas Utilities	0.00	5.87	-5.87
Multi-Utilities	0.00	2.41	-2.41
<b>Real Estate Investment Trusts (REITs)</b>	<b>58.10</b>	<b>57.37</b>	<b>0.73</b>
Specialized REITs	3.72	3.13	0.59
Diversified REITs	11.44	16.56	-5.12
Industrial REITs	16.27	16.04	0.23
Office REITs	5.93	5.44	0.49
Retail REITs	18.87	15.47	3.40
Other	1.87	0.73	1.14
<b>Cash and receivables</b>	<b>2.12</b>	<b>0.00</b>	<b>2.12</b>

## Features

Investment objective	To achieve a balance of income and medium-to-long term capital growth by investing primarily in Australian listed infrastructure, utilities and REIT securities. In doing so, we aim to outperform the S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index over rolling three year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	December 2005	
Fund size	A\$18.4 mn as at 31 July 2022	
APIR code	JBW0030AU	
Estimated management cost	0.85% p.a.	
Buy/sell spread	+/- 0.15%	
Platform availability	Asgard BT Panorama	Hub24

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## Applications and contacts

Investment into the Yarra Australian Real Assets Securities Fund can be made by Australian resident investors only.

**Website** [www.yarracm.com](http://www.yarracm.com)

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