

# Yarra Australian Real Assets Securities Fund

## Gross returns as at 30 June 2023

	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	7.92	-0.07	2.89	9.19	7.89	6.74	8.74	7.99
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index <sup>*</sup>	6.95	0.09	3.33	7.72	7.94	5.21	NA	NA
Excess Return <sup>†</sup>	0.97	-0.16	-0.45	1.47	-0.05	1.53	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 30 June 2023

	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	7.01	-0.14	2.67	8.27	6.99	5.84	7.83	7.08
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index	6.95	0.09	3.33	7.72	7.94	5.21	NA	NA
Excess Return <sup>†</sup>	0.06	-0.23	-0.66	0.55	-0.96	0.63	NA	NA
Growth Return <sup>‡</sup>	-9.25	-9.53	-6.98	-3.43	-7.86	-8.97	-5.41	-2.55
Distribution Return <sup>‡</sup>	16.26	9.38	9.65	11.70	14.84	14.80	13.24	9.63

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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

Listed Real Assets – as proxied by the S&P ASX 300 Custom Infrastructure Utilities and A-REIT Index – rose a solid +3.3% in the June quarter, outperforming the broader S&P/ASX 300 Accumulation Index which returned +1.0%. In light of the macro backdrop of higher cash rates in the period (RBA Cash Rate stands at 4.10% as at the end of the period) in response to ongoing inflationary pressures, quarterly performance highlights the inflation protection embedded within Real Assets, coupled with a starting point of market expectations having already been recalibrated for the higher rate environment.

Within the Real Asset market, A-REITs, as proxied by the S&P/ASX 300 Property Accumulation Index, rose +3.2% in the June quarter. The major sector news over the period was A-REITs releasing the outcome of over \$50bn worth of property valuations for 30 June 2023. While the outcome resulted in

physical valuations declining by -4.0% to 30 June (which was modest compared to implied valuation falls of around 20%), the update provides investors incremental support for where valuations are trending.

Infrastructure and Utility stocks performed well through the quarter, up +3.6%. Within the sector, Utilities (+34.3%) performed best, supported by a large rally in AGL Energy (AGL, +34.3%) following a positive earnings update on the back of favourable wholesale energy markets. Road and rail infrastructure also performed strongly during the period (+16.7%) driven by strength in Aurizon Holdings (AZJ, +16.7%) as energy rotated towards reliable infrastructure.

### Portfolio review

#### Key Contributors

HMC Capital (HMC, overweight) – the diversified real estate fund manager outperformed in the period following the recent

acquisition – and associated equity raise – of a portfolio of 11 Healthscope anchored healthcare assets. We are attracted to the outlook for the real estate asset mix underpinning HMC's funds-growth (i.e. hospitals, large-format retail), the company's operational leverage – the business confirmed in the period it's expectation of growing to \$10bn of funds under management by the end of CY23 – and the attractive relative valuation compared to peer real estate funds management groups including Charter Hall and Centuria.

**NEXTDC (NXT, overweight)** – following the announcement of the data centre operator's largest ever individual contract in April and subsequent regional expansion into Malaysia and New Zealand, NXT continued to outperform as the market's conviction in Artificial Intelligence (AI) applications as a driver of demand growth grew. Most notably, global leading specialist chip maker Nvidia's commentary around AI driven demand growth supported previous comments made by NXT management.

**APA Group (APA, underweight)** – the gas transmission pipeline network owner underperformed during the period on limited news flow. Whilst a clearer strategy is emerging under the new CEO, we remain underweight the company given its difficult starting point in approaching the energy transition.

#### **Key Detractors**

**AGL Energy (AGL, underweight)** – the electricity generator and energy retailer outperformed during the period as the market became increasingly comfortable with its near-term earnings outlook, supported by higher wholesale electricity costs. The improved earnings power of the business – confirmed by the company during June with its release of FY23 and FY24 earnings upgrades – will assist AGL in funding its capital-intensive transition away from its high margin, carbon intensive electricity generation.

**Aurizon (AZJ, underweight)** – our underweight position in Aurizon was a source of underperformance for the period. AZJ outperformed during the quarter from depressed levels following multiple downgrades to FY23 earnings due predominantly to weather interruptions impacting coal haulage volumes. FY24 is shaping up to be a stronger period for earnings as coal haulage volumes recover, Network earnings step up with higher regulated returns and the full period impact of the bulk central acquisition.

**Port of Napier (NPH, overweight)** – the port owner and operator underperformed during the period after reducing its earnings guidance following Cyclone Gabrielle in February. We view this event as being one-off in nature and expect to see a strong earnings recovery in FY24.

#### **Key purchases**

**HMC Capital (HMC)** – we initiated a position in the diversified real estate funds management group during the period via an opportunity to bid into a discounted equity raising associated with the acquisition of a portfolio of 11 Healthscope anchored healthcare assets. We are attracted to the outlook for the real estate asset mix underpinning HMC's funds-growth (i.e. hospitals, large-format retail), the company's operational

leverage – the business is expected to approach \$10bn of funds under management by the end of CY23 – and the attractive relative valuation compared to peer real estate funds management groups including Charter Hall and Centuria.

**Dexus Industrial (DXI)** – we initiated a position in the domestically focused, passive rent collecting A-REIT during the period. The company has an appealing mix of industrial assets at this point in the cycle and is well placed to capture upward market rents upon lease expiry into what remain tight industrial markets. Importantly, balance sheet strength has recently been enhanced through proactive asset sales at values close to book value, setting the trust up well to navigate the period ahead. The valuation is attractive, with the stock trading at 0.77-times net asset backing and offering a dividend yield above 6%.

**Scentre Group (SCG)** – we reduced the size of our underweight position in Australia's largest high-quality shopping mall owner over the period. While SCG's high gearing (close to 40% on an effective basis) prevents us from moving overweight the stock, we are cognisant of the favourable inflation-linked lease escalators across the majority of the company's specialty leases, which we expect will drive impressive net operating income outcomes through this higher inflation period, in turn supporting earnings and dividends. Within Retail A-REITs, our preference remains Vicinity, GPT Group (40% retail) and Bunning Warehouse Trust.

#### **Key sales**

**PEXA (PXA)** – we exited PXA during the period. While we remain attracted to PXA's core Australian property settlements platform, much of the upside in the stock rests with the success of its UK startup, which we do not believe provides an appropriate fit for this investment strategy.

**Event Hospitality (EVT)** – we exited our position in the diversified entertainment business based on the sluggish domestic consumer outlook coupled with a corporate debt load which we expect will erode profit and dividend outcomes for investors into the medium term. Our updated outlook view translates to a slower recovery in earnings across EVT's two largest exposures – domestic hotels and cinemas. Proceeds from the sale have been deployed into more attractive risk-adjusted consumer related positions in the shopping mall REITs.

**Dexus (DXS)** – we further reduced our position in Australia's largest office landlord over the period. This decision was driven by our ongoing concern around the weak outlook for office operating metrics (i.e. lower rents), direct valuations as cap rates rise (i.e. lower valuations) and DXS's development pipeline in this environment which is capex heavy. With respect to office exposure, our preference is to gain exposure via our overweight in GPT Group, which also offers investors exposure to a recovering retail property portfolio (i.e. Melbourne Central) and a diversified industrial portfolio.

#### **Key Active Overweights**

**GPT Group (GPT)** – our overweight in the diversified commercial real estate owning A-REIT is predicated on asset

quality (A-grade, prime assets), diversified asset mix (retail, industrial, office), robust balance sheet and undemanding stock valuation. Notwithstanding our expectation of sectorial downside risks to retail and office sub-sectors over CY23, we view the stock as providing an attractive risk-reward, with appropriate gearing (29% LVR) and trading at a material discount to last stated net asset backing and, lastly, offering an attractive 6.0% dividend yield.

**Chorus (CNU)** – the high-quality regulated telecommunications utility trades on a 5.8% FY24 dividend yield and with medium term upside in regulatory returns. As the build out of CNU's fibre network comes to an end, the company will move to strong free cash flow generation, with a balance sheet that is under levered vs target gearing and strong line of sight on regulatory revenues. Based on current market metrics, CNU would earn a nearly 300 bps higher regulatory return in the next regulatory period from July 2024, providing further upside to the medium-term dividend yield.

**Centuria Industrial REIT (CIP)** – we remain overweight the domestically focused Industrial A-REIT. We view the industrial asset class as being more resilient than other sub-sectors through CY23. This was demonstrated by the release of CIP's June 2023 valuations which saw the portfolio value decline by a modest -2.1%, demonstrating the high-quality asset-asset base (average lease tenure 8+ years, capital city locations). Additionally, the March quarter trading update revealed very strong rental growth (re-leasing spreads of +28% for the nine-months to March 2023) which is helping to offset the rising cost of debt in the Trust. Meanwhile, the stock trades at an excessively steep discount to NTA, implying asset values will decline in excess of 15% from June 2023 valuations.

### Key Active Underweights

**APA Group (APA)** – we remain underweight the energy pipeline company as we retain a cautious stance towards the heavy load of capital investment required to transition the business away from its core gas transmission activities. Whilst APA's gas pipelines will continue to provide an important role in facilitating energy flows across the east coast of Australia for many years to come, the quality of this business has diminished as contracted revenue tenor is increasingly short in duration relative to the very long-dated nature of its assets.

**Stockland (SGP)** – we are underweight Australia's largest land subdivider, reflecting our expectations around the need for a recalibration of operating outcomes from the residential development side of the business (likely in FY24). We will reassess the stock position in this environment, when default rates revert to higher levels (we expect they will shift to ~10%, from 3% today) and expectations recalibrate accordingly. Outside of the residential exposure, we like the strategic direction under the stewardship of CEO Tarun Gupta, shifting SGP's business model to become more capital light. New partnerships with large global investors such as Mitsubishi Estate Asia, in our mind, validate the strategy.

**Aurizon (AZJ)** – the portfolio retains an underweight position in Aurizon due to the difficulties it faces and lack of genuine progress in transitioning its business model away from coal

haulage. For a long-dated infrastructure business, AZJ's fossil fuel exposure will impact the tenor and cost of long-term financing. Given the risk profile, we currently see better opportunities elsewhere given AZJ's trading multiples of 14-times P/E and 6% dividend yield.

### Market outlook

We continue to see a mixed outlook across the A-REIT sector for CY23. At a macro level, expectations that we have likely seen a peaking of interest rates and with the prospect for lower rates into 2024 provides a more supportive backdrop for investors to value both physical real estate and REIT distributions. Property types however are unlikely to fare evenly.

Positively, we see industrial and specialised-asset fundamentals (26% and 7% of sector assets respectively) as being favourable, as ongoing occupier demand outstrips supply, supporting significant real rental growth. Office and Retail sub-sectors (21% and 46% of sector assets respectively) face more challenged conditions in our view, as the work-from-home dynamic continues to constrain office leasing demand and retailers face moderating conditions as higher interest rates curtail consumer spending. Pleasingly in the current environment, a number of the A-REITs have rents linked to CPI increases, providing an effective hedge to increasing inflation.

Following broadly flat A-REIT valuations in the Dec-2022 half, we have now seen asset values fall -4.0% in the June-2023 half year across those REITs that have provided valuation updates. We see this as supportive for the sector overall, with passive A-REITs continuing to trade in excess of 25% discounts to last NTA. In this environment, we believe there is a heightened importance to maintain portfolio exposures to A-REITs with sustainable balance sheets that can navigate the period to come, continuing to generate attractive cash-backed dividends for investors.

Within infrastructure and utilities, we see opportunities in high quality companies with strong inflation protection. Chorus (CNU) has now fully bedded down its regulatory regime and has a healthy dividend yield of 6.0%, which we expect to grow through the remainder of the decade. We remain cautious towards infrastructure providers with carbon intensive operations such as APA Group (APA) who face large investment requirements to transition their businesses.

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
Transurban	21.28	19.34	1.94
Goodman	12.12	15.13	-3.01
Origin Energy	7.88	6.38	1.49
GPT	7.63	3.49	4.14
Chorus	5.15	1.50	3.65

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
GPT	7.63	3.49	4.14
Chorus	5.15	1.50	3.65
Centuria Industrial REIT	3.96	0.74	3.23
Underweights			
APA	0.00	5.04	-5.04
Stockland	0.00	4.24	-4.24
Aurizon	0.00	3.18	-3.18

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>34.33</b>	<b>30.96</b>	<b>3.37</b>
Airport Services	1.61	0.82	0.79
Highways & Railtracks	22.30	22.68	-0.37
Communication Services	5.15	1.77	3.38
Railroads	0.00	3.18	-3.18
Marine Ports & Services	3.15	2.51	0.64
Information Technology	2.11	0.00	2.11
<b>Utilities</b>	<b>7.88</b>	<b>14.27</b>	<b>-6.40</b>
Electric Utilities	7.88	6.38	1.49
Gas Utilities	0.00	5.04	-5.04
Multi-Utilities	0.00	2.85	-2.85
<b>Real Estate Investment Trusts (REITs)</b>	<b>55.15</b>	<b>54.77</b>	<b>0.38</b>
Specialized REITs	4.81	3.62	1.19
Diversified REITs	12.50	16.39	-3.89
Industrial REITs	17.60	16.11	1.49
Office REITs	2.89	4.43	-1.54
Retail REITs	15.46	13.58	1.89
Other	1.89	0.64	1.25
<b>Cash and receivables</b>	<b>2.65</b>	<b>0.00</b>	<b>2.65</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\$16.4mn as at 30 June 2023	
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)

**Investor Services Team** 1800 034 494 (Australia) +61 3 9002 1980 (Overseas) [IST@yarracm.com](mailto:IST@yarracm.com)

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