Yarra Australian Real Assets Securities Fund

Gross returns as at 30 November 2020

	From 17 December 2015	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception^ % p.a.
Yarra Australian Real Assets Securities Fund	9.50	8.76	8.37	-6.46	7.03	8.08	9.79	8.53
S&P/ASX Custom Infrastructure, Utilities and A-REITs Index*	7.82	10.38	7.44	-9.98	4.45	NA	NA	NA
Excess Return†	1.68	-1.62	0.93	3.52	2.58	NA	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 November 2020

	From 17 December 2015	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception^ % p.a.
Yarra Australian Real Assets Securities Fund	8.58	8.69	8.15	-7.25	6.13	7.17	8.87	7.61
S&P/ASX Custom Infrastructure, Utilities and A-REITs Index*	7.82	10.38	7.44	-9.98	4.45	NA	NA	NA
Excess Return†	0.76	-1.69	0.71	2.73	1.68	NA	NA	NA
Growth Return‡	NA	NA	NA	-17.48	-12.89	-8.56	-1.16	-0.71
Distribution Return‡	NA	NA	NA	10.23	19.02	15.73	10.03	8.32

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 prepared on an exit to exit basis – they include all ongoing fees and expenses and assume reinvestment of all distributions.

^ Inception date of Yarra Australian Real Assets Securities Fund: December 2005.
* The Fund's benchmark is a market cap weighted index of infrastructure, utilities and REIT securities included in the S&P/ASX300
† Excess return: The excess return figures shown represent the difference between the portfolio's return and the benchmark return.
‡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

Australian Real Assets rose alongside global markets in November, driven by positive vaccine news and a decisive US election outcome.

The S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Accumulation Index increased 10.4% during the month, taking its 12-month return to -10.0%. The monthly return was largely in line with the broader market, with the ASX 300 returning 10.2%. Markets surged globally after three major COVID-19 vaccine candidates were announced as highly effective in extensive trials, and after Joe Biden was declared the winner of the US Presidential Election.

Within Infrastructure (+7.6%), positive vaccine news accelerated the timeline for a recovery in road and air travel. Top performers included toll road operator Atlas Arteria (ALX, +14.9%) and airport operators Sydney Airport (SYD, +23.1%) and Auckland International Airport (AIA, +11.8%). However, Utilities companies weighed on the benchmark. In particular, APA Group (APA, -1.3%) underperformed given its lack of leverage to the COVID re-opening trade which drove the broader market.

Australian REITs rebounded +12.9% as sub-industries which were hit hardest by COVID-19 rallied sharply following the positive vaccine news, led by Retail, Diversified and Office REITs. Conversely, Industrial REITs – which had benefited from the accelerated shift to e-commerce during the downturn – underperformed during the period. At a stock level, Unibail-Rodamco-Westfield (URW, +73.1%) was the top performer after new activist shareholders took control of the Board, persuading enough investors to reject the company's plan to raise capital. Elsewhere, Australian shopping mall owners Scentre Group (SCG, +33.3%) and Vicinity Centres (VCX, +36.4%) delivered positive trading updates, indicating most of their stores are now open and foot traffic has recovered following the easing of restrictions across the country.

Portfolio review

Key Contributors

Vicinity Centres (VCX, overweight) – the shopping mall owner outperformed following a strong quarterly update, as movement and border restrictions were eased domestically and in response to the positive vaccine news. In the update, management revealed foot traffic has partially recovered and that cash collection has improved, with 56% of gross rent billings collected in the quarter (76% excluding Victoria). While we continue to believe that shopping mall REITs face accelerated structural issues, we now believe this is negativity is currently overplayed, with VCX trading at a 28% discount to last NTA – implying a 21% discount to June 2020 gross asset values. Due to its large exposure to Victoria (53% NTA), we expect short-term support as the state eases lockdown restrictions. Further, VCX's balance sheet can withstand further disruption following the $1.4bn equity raising in June, with gearing falling to 25%.

GPT Group (GPT, overweight) – the diversified REIT outperformed as movement and border restrictions were eased domestically and in response to the positive vaccine news. We remain overweight GPT, as we believe the stock offers investors exposure to a high-quality, diversified commercial real estate portfolio. Its conservative balance sheet (gearing at 25%) and high level of liquidity ($1.2bn) provide us with confidence that the company is well positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become more attractive at 0.72 times NTA, which implies a 25% fall in gross asset values – a more significant fall than our base expectations of 10-15% through the COVID-19 crisis.

Mirvac Group (MGR, overweight) – the diversified REIT outperformed as the outlook for the residential housing market improved, supported by federal and state stimulus, as movement and border restrictions were eased domestically and in response to the positive vaccine news. Our positive investment thesis is premised on several factors. Firstly, we expect active residential development earnings (~17% of expected earnings in FY21) to rebound in FY22 and FY23, driven by improved lot volumes. Secondly, we view MGR's office portfolio (61% of its passive portfolio) as best-in-class in the A-REIT sector. Weighted average lease expires (WALES) are at 6.5 years, significantly longer than peers such as GPT Group (GPT) at 5.5 years and Dexus Property (DXS) at 4.5 years. Lastly, we do not believe its strong overall growth profile (~10% EPS growth in FY22 and FY23) is captured in its current valuation, trading at 1.0 times NTA versus its Diversified REIT peer group at 1.1 times.

Key Detractors

Scentre Group (SCG, underweight) – the shopping mall owner outperformed following a strong quarterly update, as movement and border restrictions were eased domestically and in response to the positive vaccine news. SCG revealed 92% of its stores were now open, with more to open in coming weeks. Rent collections increased to 96% in October, well above the 69% collected in 1H20, but were boosted by backdated rent payments (at around 13%). Our underweight position remains predicated on SCG's unsustainable balance sheet on a longer-term view, as asset values continue to move lower. Gearing to common equity increased to 38% as at June 2020, up from 31% in the prior year, with 10% further de-valuations likely to come in the next 6 to 18 months. Further, SCG is taking a tougher stance on negotiations with non-SME tenants, which we expect may lead to increased vacancy risks across the portfolio. We prefer peer Vicinity Centres (VCX), which has a more conservative balance sheet position (25% gearing) following its $1.4bn equity raising in June.

APA Group (APA, overweight) – the gas pipeline owner underperformed during the period without any materially negative news. The company announced the construction of a $460mn pipeline that connects gas fields in the Perth Basin to the Goldfields Region in Western Australia, which we view as positive for its growth outlook. We remain overweight APA, as we believe its valuation – at an EV/EBITDA of 12.8 times and with a 4.9% forecast dividend yield – is attractive when considering its exposure to increasingly important gas markets and dominant market share position. We view APA's balance sheet as very strong with $2bn of liquidity and no refinancing requirements until FY22, particularly considering that the COVID-19 pandemic has had minimal impact on earnings. In the medium term, we see dividend upside given the company's relatively high funding costs and conservative balance sheet position.

NEXTDC (NXT, overweight) – the data centre operator partially retraced prior outperformance despite reaffirming its FY21 guidance during the period. Management expects underlying EBITDA in the range of $125-130mn next financial year, up 20-24% (y/y). We continue to believe NXT is structurally set to benefit from increasing adoption of cloud technology, and is accelerating its expansion to meet client demands by building new data centres which will support significant medium to longer term earnings growth.

Key Purchases

Vicinity Centres (VCX) – we increased our position in the shopping mall owner during the period. While we continue to believe that shopping mall REITs face accelerated structural issues, we now believe this is well recognised with VCX trading at a 28% discount to last NTA – implying a 21% discount to June 2020 gross asset values. Due to its large exposure to Victoria (53% NTA), we expect short-term support as the state eases lockdown restrictions. Further, VCX's balance sheet can withstand further disruption following the $1.4bn equity raising in June, with gearing falling to 25%.

Sydney Airport (SYD) – we increased our position in the airport operator during the period. We see SYD's valuation as attractive on the grounds that the recent positive vaccine news accelerates the timeline for a recovery in international traffic, and that once the COVID-19 disruption has passed, SYD is set to benefit from a supportive demand backdrop. The airport captures approximately 40% of Australia's inbound air passengers and has strong barriers to entry as Sydney's only international airport (with its lease from the government not set to expire until 2097). In the meantime, we expect a recovery in domestic travel will provide a meaningful offset following the relaxation of state borders.

Key Sales

NEXTDC (NXT) – we trimmed our position following recent outperformance, but remain overweight the data centre operator. We continue to believe NXT is structurally set to benefit from increasing adoption of cloud technology, and is accelerating its expansion to meet client demands by building new data centres which will support significant medium to longer term earnings growth.

Waypoint REIT (WPR) – we reduced our position in the petrol station REIT after it rallied to pre-COVID levels, but remain overweight. We regard the REIT as being well positioned in the current environment, particularly compared to its Retail and Office peers which face vacancy and rental pressure amid the COVID-19 crisis. WPR owns a portfolio of 469 service stations with 100% occupancy from sole tenant Viva Energy Group (VEA). The rental terms are attractive, with 3% per annum fixed rental increases and a weighted average lease expiry of 11.7 years. We view WPR's capital position as adequate, with 30% gearing and undrawn debt of $250mn.

Charter Hall Social Infrastructure REIT (CQE) – we trimmed our position following recent outperformance, but remain overweight the child care centre REIT. We continue to see CQE as well positioned to benefit from the re-opening Australian economy, with participation rates to normalise as lockdown measures are eased. CQE has a well-diversified portfolio of 410 centres, anchored by larger tenants (top-5) that pay 76% of its net operating income. Its lease terms are attractive, with a 12.7-year average duration, with <5% expiring within the next 5 years and rent increasing by a prescribed amount each year. Further, its balance sheet has now de-geared materially following the equity raise, falling to 16% LTV, and we view its valuation as supportive (at 1.03 times NTA).

Key Active Overweights

GPT Group (GPT) – we believe GPT offers investors exposure to a high-quality, diversified commercial real estate portfolio. Its conservative balance sheet (gearing at 25%) and high level of liquidity ($1.2bn) provide us with confidence that the company is well positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become more attractive at 0.75 times NTA, which implies a 25% fall in gross asset values – a more significant fall than our base expectations of 10-15% as a result of the COVID-19 crisis.

APA Group (APA) – our overweight position is based on our view that APA's valuation – at an EV/EBITDA of 12.9 times and with a 4.9% forecast dividend yield – is attractive when considering its exposure to increasingly important gas markets and dominant market share position. We view APA's balance sheet as very strong with $2bn of liquidity and no refinancing requirements until FY22, particularly considering that the COVID-19 pandemic has had a minimal impact on earnings. In the medium term, we see dividend upside given the company's relatively high funding costs and conservative balance sheet position.

Atlas Arteria (ALX) – we maintain a high-conviction overweight position based on ALX's strong liquidity and balance sheet position, which leaves it well placed to weather the COVID-19 related downturn in revenues for FY20, and a positive long-term view. ALX holds attractive, long-duration assets and trades at a discounted valuation (10.0 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. We continue to believe the intrinsic value of ALX's assets will eventually be realised following the simplification of its ownership structure in the past two years, resulting in significant upside.

Key Active Underweights

Scentre Group (SCG) – our underweight position is predicated on SCG's unsustainable balance sheet on a longer-term view. Gearing increased to 38% as at June 2020, up from 31% in the prior year, with 10% further de-valuations likely to come in the next 6-18 months. Further, SCG is taking a tougher stance on negotiations with non-SME tenants, which we expect may lead to increased vacancy risks across the portfolio. We prefer peer Vicinity Centres (VCX), which has a more conservative balance sheet position (25% gearing) following its $1.4bn equity raising in June.

Stockland (SGP) – our underweight position is reflects our long-term concerns about SGP's asset values beyond COVID-19. SGP's valuation faces downside risk given its exposure is to 2nd tier shopping centres (43% of NTA), where structural change is likely to accelerate, and to residential (22% of NTA), where we see softer demand in the medium-term as the HomeBuilder housing stimulus rolls over and migration levels moderate.

AGL Energy (AGL) – we remain underweight AGL because we believe the company faces significant earnings headwinds in future years. In the short term, we expect declining electricity wholesale prices to weigh on earnings, with prices likely to remain depressed in FY21 before recovering to a level that can incentivise new generation. In the longer term, we believe AGL's transition away from being a fully integrated electricity generator is likely to create material earnings pressure over time, including via the planned closure of the Liddell power station in 2023 which currently represents 15-20% of earnings.

Market outlook

We maintain our conviction in the Real Assets sector, underpinned by solid fundamentals and attractive underlying valuation support. The S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Accumulation Index offers a 12-month forward forecast dividend yield of 4.0%, a compelling 3.1% premium above the 10-year Australian bond rate.

Within Infrastructure, we believe that in the long run strong fundamentals and attractive growth opportunities should continue to support the likes of Transurban (TCL) and Atlas Arteria (ALX). In the nearer term we expect toll roads to be at the forefront of the post COVID-19 recovery in activity levels amongst patronage-based infrastructure assets. We remain cautious towards infrastructure providers with exposure to cyclical end markets such as AGL Energy (AGL) with a strong preference within Utilities for APA Group where we see substantial scope for operating cash flow growth and higher dividends over the medium term.

Within A-REITs, we maintain a strong preference to being exposed to high quality asset owners with strong balance sheets at more attractive valuations such as GPT Group (GPT). We believe the structural headwinds facing shopping mall owners are likely to persist – changing consumer preferences are directing an increasing proportion of retail sales away from malls to online – and we continue to maintain a highly selective approach across the sector, steering away from owners of malls lacking strong competition barriers and steering towards resilient sectors with attractive long-term leases (10-years+) to high quality tenants such as service station owner Waypoint REIT (Viva Energy). We expect COVID19 will create patches of short term uncertainty for earnings and distributions, as tenants exposed to the Australian consumer and SME customer are faced with escalating operating constraints in the current period. Robust balance sheets (average gearing levels around 25% net debt / total assets), solid levels of liquidity and strong in-place occupancy levels suggest REITs are well positioned overall to see through the current dislocation.

Sector allocation

	Portfolio %	Benchmark %	Active %
Infrastructure	36.48	34.58	1.90
Airport Services	8.15	8.15	0.01
Highways & Railtracks	24.87	18.79	6.08
Communication Services	0.00	1.94	-1.94
Railroads	0.00	3.43	-3.43
Marine Ports & Services	1.91	2.27	-0.36
Information Technology	1.54	0.00	1.54
Utilities	9.90	11.62	-1.72
Electric Utilities	0.00	2.93	-2.93
Gas Utilities	9.90	5.15	4.76
Multi-Utilities	0.00	3.55	-3.55
Real Estate Investment Trusts (REITs)	52.93	53.80	-0.87
Specialized REITs	8.18	2.63	5.55
Diversified REITs	18.75	18.00	0.74
Industrial REITs	12.22	13.83	-1.61
Office REITs	1.73	5.78	-4.04
Retail REITs	10.56	12.57	-2.01
Other	1.48	0.98	0.50
Cash and receivables	0.69	0.00	0.69

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Transurban	18.22	16.17	2.05
Goodman Group	12.22	13.10	-0.89
APA Group	9.90	5.15	4.76
GPT Group	8.87	3.88	4.99
Sydney Airport	8.15	7.63	0.52

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
GPT Group	8.87	3.88	4.99
APA Group	9.90	5.15	4.76
Atlas Arteria	6.65	2.62	4.03
Underweights			
Scentre Group	1.44	6.13	-4.69
Stockland	0.00	4.57	-4.57
AGL Energy	0.00	3.55	-3.55

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.

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$24.82 mn as at 30 November 2020
APIR code	JBW0030AU
Estimated management cost	0.85% p.a.
Buy/sell spread	+/- 0.15%
Platform availability	Asgard BT Panorama BT Wrap Hub24 IOOF Pursuit Select Macquarie Wrap Consolidator OneVue PowerWrap SmartWrap

Applications and contacts

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

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