Yarra Australian Real Assets Securities Fund

Gross returns as at 31 October 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^ % p.a.
Yarra Australian Real Assets Securities Fund	7.33	8.50	-7.29	-4.99	-0.60	5.79	8.96	7.75
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index*	6.28	8.85	-8.13	-4.87	-1.34	4.48	NA	NA
Excess Return†	1.05	-0.35	0.83	-0.12	0.73	1.32	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 October 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^ % p.a.
Yarra Australian Real Assets Securities Fund	6.42	8.42	-7.49	-5.79	-1.44	4.90	8.04	6.84
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index	6.28	8.85	-8.13	-4.87	-1.34	4.48	NA	NA
Excess Return†	0.14	-0.43	0.64	-0.92	-0.10	0.43	NA	NA
Growth Return‡	NA	NA	NA	-27.83	-15.17	-12.83	-4.45	-2.46
Distribution Return‡	NA	NA	NA	22.04	13.73	17.74	12.49	9.31

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.
* 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.
† 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

The Custom Infrastructure, Utilities and A-REITs Accumulation Index increased 8.85% during the month, rebounding from a weak prior month and paring its 12-month losses to 4.87%. In comparison, the broader S&P/ASX 300 Index returned 6.0% in October and, globally, the MSCI World Index returned 7.1%.

The strength in October across the sector was broad based, with REITs +9.9%, Utilities +7.2% and Infrastructure +7.3%. Small-Mid cap REITs saw the largest appreciation over the month with names like Arena (ARF, +18.0%), National Storage (NSR, +17.0%) and Centuria Industrial (CIP, +17.0%) all strongly outperforming.

The Australian Real Assets portfolio largely kept pace with the strong index move, increasing 8.5% during October. Regulated telecommunications infrastructure provider Chorus (CNU, +15.5%) was the biggest contributor during the month, while Data Centre owner Next DC (NXT, -5.7%) was the key drag on portfolio performance.

Portfolio review

Key Contributors

Chorus (CNU, overweight) – the regulated utility outperformed during the month as the build out of its fibre network comes to an end and investors increasingly appreciate the strong free cash flow generation, low balance sheet leverage and strong line of sight on regulatory revenues. Based on current market metrics, CNU would earn a 100bp higher regulatory return in the next regulatory period from July 2024, providing further upside to the medium-term dividend yield.

AGL Energy (AGL, underweight) – the company underperformed during the month as it continues to face high levels of uncertainty around its future governance and strategy. Despite providing a strategy update late last month which highlighted its ambitions to transition away from carbon intensive coal generation, this strategy remains very much in flux pending the appointment of a new CEO and board composition to be settled.

GPT Group (GPT, overweight) – our overweight position in the Australian REIT added value as the stock rose +12.5% for the month. While there was no significant news flow, outperformance was likely driven by investors seeking out REITs with high quality asset bases and a degree of floating rate debt exposure following the slight retracement in yield outlook expectations (10-year bond rate declined 13 bps to 3.76%). GPT exhibits both these characteristics. The company's valuation remains supportive, trading at a large -37% discount to last stated NTA, offering 6.1% dividend yield.

Key Detractors

NEXTDC (NXT, overweight) – the data centre operator underperformed the market during the month on limited news flow. We believe the high recurring nature of NXT's revenues, its infrastructure like characteristics and tangible asset base are attractive. NXT has been excessively discounted and we see no diminution to its growth trajectory. NXT trades on 20.1 times FY2024 EV/EBITDA, which compares favorably to its more mature global peers.

Scentre Group (SCG, underweight) – investors pushed retail exposed REITs relatively higher during the period, while the announcement that Steve McCann will join the board was well received. Fundamentally, SCG was supported as recognition grows around the benefit it will derive from a high degree of inflation linkages in its lease structures with retail tenants.

Port of Napier (NPH, overweight) – the port operator underperformed during the month on limited news flow. We continue to maintain an overweight position; improving global supply chains and shipping reliability is positive for NPH and the resumption of cruise line activity, although likely below pre-COVID levels, will add high incremental margin revenues.

Key Purchases

Scentre Group (SCG) – we have increased our expectations around the capacity for the retail REIT to capture better rents in the medium term as a result of higher inflation, given the high level of inflation linked leases. Additionally, while we do expect retail exposed REITs to face increased pressures in CY23 as higher interest rates impact on the consumer, we give SCG credit for owning the highest quality malls in the sector.

Centuria Industrial REIT (CIP) – we added further to CIP after initiating a position in the prior month, following the release of the passive trust's FY22 results. Pleasingly, October saw the group reaffirm FY23 FFO (17cps) and DPS (16cps) guidance. The update also showed ongoing strength in industrial, with strong +18% re-leasing spreads, 10 new leases secured and portfolio occupancy at 99.6%. We believe expectations of asset value decline have gone too far for the Trust (last cap rate 4.19%) given its high-quality nature (average lease tenure 8+ years, capital city locations) and attractive rental outlook. The valuation is attractive, with the stock trading at 0.63 times asset backing (NTA) and offering an attractive 6.4% dividend yield.

Key Sales

Goodman Group (GMG) – we moved underweight the industrial property developer over the period to reflect our expectation of slower earnings growth for the business, driven by the implications of the cap rate cycle turning for industrial assets, and development activity and returns slowing from peak levels. While we believe GMG remains well placed to continue to grow earnings well above sector peers (FY23 EPS guidance is for 11% y/y) we have recalibrated our expectations given an elevated valuation at 17 times P/E 12-months forward and offering a more modest 1.9% dividend yield.

Waypoint REIT (WPR) – we took the opportunity to reduce our position and free up capital for more compelling ideas. WPR was supported in the period, with the REIT actively buying back $33mn of worth of its own shares as part of its buy-back program. We do see a greater degree of valuation risk this cycle with some of WPR's more marginal regional service station assets, and with the stock implying improved valuation metrics of 0.79 times NTA and a 6.5% dividend yield, we reduced the overweight position size.

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 <30%) and high level of liquidity provide us with confidence that the company is appropriately positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become even more attractive, at 0.63 times trailing NTA and 6.1% dividend yield.

Chorus (CNU) – the quality regulated utility trades on a 6.1% 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 with a strong line of sight on regulatory revenues. Based on current market metrics, CNU would earn a 100 bps higher regulatory return in the next regulatory period from July 2024, providing further upside to the medium-term dividend yield.

Vicinity (VCX) – the portfolio holds an overweight position owing to a relatively positive view on the retail sub-sector. This view reflects continued resilience in the domestic consumer, VCX's attractive asset mix across Regional, sub-Regional, CBD and DFO centres, and management expertise, whereby assets are being well leased (>98%), supporting robust rental cash flow stream. Additionally, VCX is in a sound funding position, with modest debt levels, and supportive stock valuation (0.75 times NTA and offering 6.3% dividend yield).

Key Active Underweights

APA Group (APA) – we remain underweight the pipeline operator company on the grounds that APA's initiatives to shift its business model towards electrification will prove insufficient. We expect to the company will be dwarfed by the discount increasingly being applied to its gas pipeline business, particularly as planned government policies accelerate the shift to zero emissions sources. As a result, we no longer regard its valuation (at a 12-month EV/EBITDA of 12.5 times) as sufficiently compelling when compared to large cap infrastructure alternatives.

Stockland (SGP) – our underweight position is premised on long-term concerns about 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 exposures to second-tier shopping centres (40% of NTA), where structural change is likely to accelerate, and to residential profitability (34% earnings, and 20% of NTA), where we see softer demand in the medium-term as Homebuilder stimulus rolls over and lower migration levels impact demand.

Aurizon (AZJ) – our underweight position reflects our view that AZJ is a well-managed company facing a difficult task to transition earnings away from a heavy reliance on coal haulage. Aurizon has a difficult job ahead of it to divest its East Cost Rail coal business at a price comparable to which it was recently acquired through the One Rail acquisition. Whilst AZJ's 6.6% FY24 dividend yield appears attractive, we do not believe there is enough value to compensate investors for the elevated risk profile of this business.

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 Custom Infrastructure, Utilities and A-REITs Accumulation Index offers a 12-month forward forecast dividend yield of approximately 4.6%, an attractive 0.8% premium above the 10-year Australian bond rate of 3.8%, with the index dividend yield to increase in future years as traffic levels normalise on patronage-based infrastructure assets.

We see opportunities in high quality infrastructure companies with strong inflation protection and exposure to recovering economies, qualities both present within the transportation infrastructure sector. Tollroads are at the forefront of the post COVID-19 recovery and at Atlas Arteria (ALX) we see several catalysts on the horizon and are unsurprised to see recent corporate interest in the company. Chorus (CNU) is a quality regulated utility trading on a 5.97% FY24 dividend yield and with medium term upside in regulatory returns. We remain cautious towards utilities with high reliance on fossil fuels and difficulty in transitioning to a lower carbon environment, namely AGL Energy (AGL) and APA Group (APA).

We see a mixed outlook across REIT sub-sector exposures as we approach CY23. Positively, we see recovering occupier demand – particularly as office workers return to the offices, and shoppers return back to shopping malls – following an elongated period of COVID-disruptions and restrictions concentrated in the major cities of Melbourne and Sydney (combined >50% A-REIT asset exposure). For example, Scentre Group reports that footfall is now back to 90% of pre-COVID levels. We expect this to drive improved leasing outcomes and support the rent collection trajectory. Additionally, a number of the REITs also have rents linked to CPI increases, providing an effective hedge to increasing inflation.

Accompanying this recovery, however, we expect the prospect of higher interest rates into CY23 will begin to slow and even decrease capital values (i.e. REIT NTA's) as investor acquisition return requirements begin to increase, and REITs see an end of the multi-year trend of falling borrowing costs (an important driver of earnings and dividend growth over the past three years).

Top 5 holdings

	Portfolio	Benchmark	Active
Transurban	19.71	18.98	0.73
Goodman	12.86	13.47	-0.62
GPT	8.16	3.85	4.31
Vicinity Centres	5.99	3.51	2.48
Mirvac	5.81	3.81	2.00

Key active positions

Overweights	Portfolio	Benchmark	Active
GPT	8.16	3.85	4.31
Chorus	4.88	1.58	3.30
Vicinity Centres	5.99	3.51	2.48
Underweights			
APA	0.00	5.78	-5.78
Stockland	0.00	4.01	-4.01
Aurizon	0.00	3.11	-3.11

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
Infrastructure	**38.16**	**30.87**	**7.29**
Airport Services	0.00	0.70	-0.70
Highways & Railtracks	24.37	22.73	1.64
Communication Services	5.86	1.81	4.05
Railroads	0.00	3.11	-3.11
Marine Ports & Services	5.64	2.52	3.12
Information Technology	2.29	0.00	2.29
Utilities	**3.30**	**12.16**	**-8.86**
Electric Utilities	3.30	4.47	-1.18
Gas Utilities	0.00	5.78	-5.78
Multi-Utilities	0.00	1.90	-1.90
Real Estate Investment Trusts (REITs)	**57.71**	**56.97**	**0.74**
Specialized REITs	5.59	4.13	1.46
Diversified REITs	13.97	17.37	-3.40
Industrial REITs	15.40	14.50	0.90
Office REITs	5.65	4.84	0.81
Retail REITs	15.35	15.47	-0.12
Other	1.76	0.67	1.09
Cash and receivables	**0.84**	**0.00**	**0.84**

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$19.0 mn as at 31 October 2022	
APIR code	JBW0030AU	
Estimated management cost	0.85 p.a.	
Buy/sell spread	+/- 0.15	
Platform availability	Asgard BT Panorama	Hub24

Applications and contacts

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

Website www.yarracm.com

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