

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 30 April 2022

	From 25 July 2018 <sup>A</sup>	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception % p.a.*
Yarra Ex-20 Australian Equities Fund	5.73	-0.03	6.29	11.72	8.93	7.03	8.96	8.07
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	7.89	-0.42	6.24	9.66	9.02	NA	NA	NA
Excess return (before fees) <sup>‡</sup>	-2.16	0.39	0.05	2.06	-0.09	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 April 2022

	From 25 July 2018 <sup>A</sup>	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception % p.a.*
Yarra Ex-20 Australian Equities Fund	4.77	-0.10	6.06	10.72	7.95	5.96	7.71	6.82
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	7.89	-0.42	6.24	9.66	9.02	NA	NA	NA
Excess return (after fees) <sup>‡</sup>	-3.12	0.32	-0.18	1.06	-1.07	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 prepared on an exit to exit basis – they include all ongoing fees and expenses and assume reinvestment of all distributions.

<sup>A</sup> Effective 25 July 2018 the Fund's investment strategy, name and benchmark was changed. Performance prior to 25 July 2018 is provided here for consistency purposes only – the historical performance data shown relates to the previous strategy and should not be used to assess past or future performance of the Fund. See [here](#) for further information.

Performance data relating to the previous strategy is available upon request. 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 Yarra Ex-20 Australian Equities Fund: August 2010.

<sup>#</sup> The benchmark for the Yarra Ex-20 Australian Equities Fund has been amended since the Fund's inception. Effective 25 July 2018, the benchmark is the S&P/ASX 300 ex S&P/ASX 20 Accumulation Index, replacing the S&P/ASX 300 Accumulation Index.

<sup>‡</sup> Excess return: The difference between the Fund's return and the benchmark return.

## Market review

Australian equities declined during April amid concerns over higher inflation and lower economic growth, but outperformed overseas markets.

The S&P/ASX 300 Ex-20 Accumulation Index declined by 0.4% during the month, taking its 12-month return to 9.7%. In comparison, the broader ASX300 declined 0.8% for the month while global indices recorded significantly larger falls, with the MSCI World Index down 6.9%. Locally, a higher inflation print sent the Australian 10-year bond yield up 30 bps to 3.12% and equities valuations lower, with the ASX300 forward P/E from 16 to 15 times.

At a sector level, Energy (+6.9%), Utilities (+9.3%) and Health Care (+3.0%) were the top performers. Notably, fuel providers Ampol (ALD, +10.5%) and Viva Energy (VEA, +19.6%), coal producers Whitehaven Coal (WHC, +18.6%) and New Hope Corporation (NHC, +12.1%) and oil & gas producers Beach Energy (BPT, +4.5%) and Strike Energy (STX, +6.5%) continued to rise alongside higher commodity prices. Elsewhere, Utilities

companies Origin Energy (ORG, +9.8%) and AGL Energy (AGL, +12.4%) benefited from strengthening wholesale electricity prices.

Conversely, Information Technology (-9.9%) and Consumer Discretionary (-3.1%) weighed on the index. In the former, large falls came from Block (SQ2, -21.7%), EML Payments (EML, -46.8%), Megaport (MP1, -37.6%), Life360 (360, -31.7%) and Tyro Payments (TYR, -28.7%). In the latter, stocks leveraged to the stay-at-home theme declined further in value, including Kogan (KGN, -31.3%), Redbubble (RBL, -26.5%) and Domino's Pizza Enterprises (DMP, -14.3%).

## Portfolio review

### Key Contributors

**Block (SQ2, underweight)** – the digital payments company underperformed as the outlook for higher real rates pressured the tech sector's premium valuation. We are underweight on the grounds that its valuation (at a 12-month forward P/E of 80.2 times) more than captures the company's attractive

growth outlook. In regard to Afterpay, we are negative on the BNPL industry given the prospect of heightened regulation (e.g. expense verification), increased competition, higher bad debts and the sustainability of attractive margins.

**Worley (WOR, overweight)** – the engineering services firm outperformed due to expectations the global energy crisis will stimulate capex for both oil & gas and energy transition projects. We remain overweight the company. Following the Jacobs ECR acquisition, the business is diversified across different markets and is well positioned to capture higher structural demand from energy transition work to low carbon solutions in addition to its traditional work for the oil & gas industry. We believe WOR's valuation provides significant support at current levels, with the stock trading on 18.9 times forward earnings, a sharp discount to the Industrials ex-Financials at 25.5 times.

**QBE Insurance (QBE, overweight)** – the insurer outperformed without any material company-specific news. Our positive view towards the general insurer is premised on the company benefiting from an ongoing global hardening cycle in commercial insurance along with a return to unit growth after several years of volume declines as the company exited sub economic exposures. QBE's recent result demonstrated that the company has sufficiently strengthened reserves against problematic North American long tail insurance lines, which was previously viewed as a key risk. We continue to see upside to its relative valuation, with the stock trading on 12.3 times forward earnings and offering a 4.0% dividend yield.

### Key Detractors

**Ramsay Health Care (RHC, underweight)** – the hospital operator outperformed after receiving a takeover offer during the period. A KKR-led consortium launched an indicative proposal of \$88 per share for the business, subject to due diligence. Otherwise, the group reported a weaker-than-expected 3Q22 update, with activity continuing to be impacted by COVID-related issues (staff absenteeism, surgical restrictions). We remain underweight, as we see the acquisition price as full (at a 12-month forward EV/EBITDA of 14.1, in line with recent transactions in the space).

**Alumina (AWC, overweight)** – the alumina producer underperformed after delivering a worse-than-expected 1Q22 result amid lower alumina prices. Alumina margins halved quarter-on-quarter to US\$88/t as higher caustic soda and energy prices lifted unit costs by \$44/t to US\$288/t. Management also guided to a further increase of US\$25/t for 2Q22, largely due to its Spanish refinery where energy prices have surged. In regard to the alumina market, prices declined around 30% since March-highs as smelter shutdowns in Europe support a surplus. We expect global aluminium demand to improve as the energy crisis is addressed and, more broadly, the drive to decarbonise increases demand for the lightweight metal. More broadly we continue to hold a positive view of AWC's high-quality assets and strong earnings, cash flow and capital management potential. As a result, we see its valuation (at a forward P/E of 10.6 times with a 9.3% forecast dividend yield) as attractive.

**Tyro Payments (TYR, overweight)** – the payment solutions provider underperformed without any company-specific news during the period. We remain overweight on the grounds that short-term headwinds (wage inflation, increased investment spending) are more than reflected in TYR's valuation, with the stock trading at 1.5 times forward sales – a significant discount to technology peers. As the lead provider of software that allows payment terminals to be integrated into point-of-sale (POS) systems, TYR remains in a defensible position versus peers such as the banks which rely on a clunky intermediary.

### Key Purchases

**Chalice Mining (CHN)** – we established a position in the palladium project developer during the period. Following its announcement of a maiden Julimar Resource last year, CHN has de-risked its world-class project based in Western Australia. The project comprises one of the few, large scale and high-grade deposits outside of Russia, which historically produced around 40% of global supply. In regard to the market more broadly, we acknowledge demand is set to weaken in the long term for its traditional use to make catalytic converters (and reduce emissions) for internal combustion engine (ICE) vehicles. However, palladium also has a unique ability to absorb hydrogen (can absorb >900x its own volume under suitable conditions), providing a range of potential future facing demand applications.

**Tyro Payments (TYR)** – we increased our position in the payment solutions provider during the period. We believe short-term headwinds (wage inflation, increased investment spending) are more than reflected in TYR's valuation, with the stock trading at 1.5 times forward sales – a significant discount to technology peers. As the lead provider of software that allows payment terminals to be integrated into point-of-sale (POS) systems, TYR remains in a defensible position versus peers such as the banks which rely on a clunky intermediary.

**Link Administration (LNK)** – we increased our position in the company during the period. We see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 20.3 times forward earnings, a discount to the ASX200 Industrials ex-Financials at 24.7 times.

### Key Sales

**James Hardie (JHX)** – we reduced our holdings to reflect the increased uncertainty and capture earlier outperformance. We continue to believe JHX can sustain growth ahead of the market and sell higher value products, which will more than compensate for risks around growth rates normalising and higher borrowing costs. We are confident in the company's market share outlook due to its high-quality and reliable

products, improved sales strategies (positioning the product as superior versus alternatives) and the resolution of US supply and manufacturing issues.

**Netwealth (NWL)** – we exited our modest position in the business during the period on the grounds that the positive outlook is largely captured in its valuation, with proceeds used to pursue better opportunities elsewhere. In our view NWL is a high-quality business; the company is Australia's largest independent investment platform provider with leading technology and a focus on customer service.

**Incitec Pivot (IPL)** – we reduced our position following recent outperformance but remain overweight the fertilizer and explosives maker. While we are likely near the top of the cycle for fertiliser prices, we believe this is mostly reflected in consensus expectations. However, persisting spot prices would result in significant earnings upgrades and potential capital management initiatives, particularly if IPL can improve its plant performance (running at nameplate capacity).

### Key Active Overweights

**Link Group (LNK)** – we are positive on the company because we see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 20.3 times forward earnings, a discount to the Industrials ex-Financials at 24.7 times.

**Worley (WOR)** – we believe the company is in a strong position to benefit from the recovery in its traditional work and, increasingly, new sustainability projects. Following the Jacobs ECR acquisition, the business is diversified across different markets and is well positioned to capture higher structural demand from energy transition work to low carbon solutions. We believe WOR's valuation provides significant support at current levels, with the stock trading on 19.8 times forward earnings, a sharp discount to the Industrials ex-Financials at 24.7 times.

**QBE Insurance (QBE)** – our positive view towards the general insurer is premised on the company benefiting from an ongoing global hardening cycle in commercial insurance along with a return to unit growth after several years of volume declines as the company exited sub economic exposures. QBE's recent result demonstrated that the company has sufficiently strengthened reserves against problematic North American long tail insurance lines, which was previously viewed as a key risk. We continue to see upside to its relative valuation, with the stock trading on 12.3 times forward earnings and offering a 4.0% dividend yield.

### Key Active Underweights

**South32 (S32)** – we maintain a negative medium to longer-term view towards the company: in our view S32's key commodity prices are unsustainable, with the prices of manganese and coking coal – around 50% of S32's earnings – skewed to the downside, based on supply and demand fundamentals. S32 appears devoid of growth opportunities, with short mine lives, no active exploration, increased capital intensity and material geopolitical risk from its South African operations.

**Sonic Healthcare (SHL)** – we are underweight the company on the grounds positive vaccine outcomes are likely to create an earnings headwind for the company which has seen significant earnings support from its COVID-19 testing services. While short-term earnings will remain robust, we expect EBITDA to decline in FY23 as fewer tests are issued. We no longer view its valuation as sufficiently compelling versus alternatives, with the company trading 16.2 times elevated forward earnings.

**ASX (ASX)** – we remain underweight because we believe ASX's valuation is unjustified in the context of modest EPS growth. ASX trades on a 12-month forward P/E of 31.7 times, well above its long-run average and higher than global peers with a similar revenue mix. While the defensive nature of its earnings is attractive in the current environment, at present levels the stock offers a forecast dividend yield of only 2.8%, below the broader market at 4.1%.

### Market outlook

Geopolitical events and surging commodity prices have taken centre stage in 2022, shaking risk sentiment and challenging consensus' optimistic forecast for global growth. From our perspective, although for the past six months our forecasts for global growth in 2022 have been below consensus, we believe a series of downgrades will soon be evident for global earnings growth in most major markets. Surging commodity prices and ongoing supply shortages have resulted in further upside to the inflation outlook and risks forcing the hand of central banks in coming months to try to contain rising inflation expectations. The reality for 2022 is likely to be a world of higher inflation, slower growth and higher financing costs awaits.

Australia does have some key natural advantages in such a climate. The most notable is that Australia's export dominance of iron ore, coal, LNG, gold, wheat and base metals contribute close to 80% of Australia's exports and each of these commodities have seen strong price rises in early 2022 which will likely translate into a large positive national income boost even if spot prices retreat in coming weeks. Indeed, Australia presents as a safe haven market which is far from the conflict in Europe, an exporter of in demand raw materials and given its own undershooting of its inflation target since 2015 it has ample room to adjust policy settings at a gradual pace.

Australia also has the benefit of recovering underlying household income growth, \$230bn in 'excess saving', strong

corporate profit growth, robust capex expectations in concert and improving government finances which suggests Australian economic growth in 2022 will remain more robust than its developed economy peer group. In both CY2022 and CY2023 we expect the Australian economy to expand at an above 'potential' rate of 3%. While this is slower than the 4% pace recorded in 2021 it is still sufficient to see further employment growth gains and we expect the unemployment rate will soon fall below 4% and below the RBA's estimate of non-accelerating inflation rate of unemployment (NAIRU) and further wage pressure will become evident into mid-2022. We expect the RBA will still take its time to assess the outlook for inflation and most likely will commence increasing interest rates in 4Q2022 with a 35bp hike. We expect a further four 25bp rate hikes in 2023 and we believe the consumer is well placed to absorb the initial interest rate rises.

While the RBA may well prove to be later than most other developed nations in tightening policy, tighter financial conditions in 2022 are likely to come via a stronger currency. The A\$/US\$ has in recent months been buffeted by concerns of a peak in global industrial growth indicators and slowing China economic momentum. Nevertheless, Australia's external accounts are in their best position since the early 1970s and surging commodity prices in early 2022 is providing an incentive for the A\$/US\$ to commence an appreciation cycle well before the RBA joins alongside other central banks in tightening interest rates later this year. We expect the A\$ will finish 2022 at around 76 cents, albeit the risk to this forecast is on the upside.

We are most overweight stocks within the Health Care, Industrials and Financials sectors, and are underweight Materials, Real Estate and Energy.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.78	4.61	8.17
Consumer Discretionary	8.14	8.28	-0.14
Consumer Staples	2.51	4.27	-1.76
Energy	4.88	3.87	1.01
Financials	13.35	13.65	-0.31
Health Care	5.73	8.50	-2.76
Industrials	9.52	9.58	-0.06
Information Technology	9.83	8.54	1.29
Materials	24.87	22.47	2.40
Real Estate	0.00	12.85	-12.85
Utilities	4.27	3.38	0.89

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
QBE Insurance	6.21	1.96	4.25
Link Administration	5.07	0.28	4.79
Worley	4.88	0.56	4.33
Atlas Arteria	4.70	0.72	3.98
Origin Energy	4.27	1.30	2.97

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	5.07	0.28	4.79
Worley	4.88	0.56	4.33
QBE Insurance	6.21	1.96	4.25
Underweights			
South32	0.00	2.39	-2.39
Sonic Healthcare	0.00	1.90	-1.90
ASX	0.00	1.81	-1.81

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.

## Income and growth

	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.
Growth return	8.69	5.80	3.47	4.90
Distribution return	2.03	2.14	2.50	2.81

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 capital distributions.

## Features

Investment objective	To achieve medium-to-long term capital growth through exposure to Australian Securities Exchange listed securities excluding the largest 20 by market capitalisation (as defined by the S&P/ASX 20 Index). In doing so, the aim is to outperform the S&P/ASX 300 ex S&P/ASX 20 Accumulation Index over rolling 3-year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	August 2010	
Fund size	A\$12.5 mn as at 30 April 2022	
APIR code	JBW0052AU	
Estimated management cost	0.90% p.a	
Buy/sell spread	+/- 0.15%	
Platform availability	BT Panorama Hub24	Praemium

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## Applications and contacts

Investment into the Yarra Ex-20 Australian Equities Fund can be made by Australian resident investors only.

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

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