

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 30 April 2023

	From 25 June 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	6.27	3.94	6.73	8.35	16.15	6.98	7.62	8.09
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	6.07	3.29	0.82	-0.65	12.51	6.73	8.93	8.39
Excess return (before fees) <sup>‡</sup>	0.20	0.65	5.90	9.00	3.64	0.24	-1.30	-0.30

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 2023

	From 25 June 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	5.30	3.86	6.50	7.39	15.12	5.99	6.44	6.86
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	6.07	3.29	0.82	-0.65	12.51	6.73	8.93	8.39
Excess return (after fees) <sup>‡</sup>	-0.77	0.57	5.67	8.03	2.61	-0.74	-2.49	-1.53

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 June 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. 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 market performance improved in April (+1.8%) after the weak performance of the prior two months with every sector returning positive. The 10-year bond rate held relatively steady at 3.3%.

The S&P/ASX 300 Ex-20 Accumulation Index returned +3.3% for the month, taking its 12-month return to -0.8%. In comparison, the broader S&P/ASX 300 gained +1.8% and, globally, the MSCI World Index also climbed by 1.8%.

Real Estate (+5.9%) was the top gainer during the period with Mirvac (MGR, +15.9%), Stockland (SGP, +11.8%) and Vicinity Centre (VCX, +8.0%) all contributing. The sector was supported during the month following the RBA's decision to keep interest rates on hold.

Just behind was Information Technology (+4.2%) with NextDC (NXT, 9.7%) rallying after announcing a 36 megawatt increase in contracted volume, Wisetech (WTC, +5.2%) higher post the announcement of a \$600mn acquisition of Blume Global and Megaport's (MP1, +36.6%) share price rising following the

release of the company's third-quarter report and upgrade to guidance.

Conversely, the lagging sector was Utilities (+1.4%) with no major announcement, Origin (ORG, +0.6%) and APA Group (APA, +1.6%) both moved higher alongside the market movement during the month.

### Portfolio review

#### Key Contributors

**Reliance Worldwide (RWC, overweight)** – the manufacturer and distributor of plumbing and heating parts outperformed following the release of its March-quarter trading update. The trading update was broadly positive, demonstrating the resilience of its repair-focussed end markets (total sales growth of +14.2% for the nine months ending March-23) and a robust margin outlook supported by cost-out plans and easing raw material cost pressure. We view RWC as a compelling opportunity, with the market pricing for a significant decline in earnings (P/E of only 14.9 times vs 17.0 times mid cycle)

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whereas we remain constructive on the demand environment given the defensive nature of RWC's revenue base, the majority of which relates to repair and remodelling sales.

**Mineral Resources (MIN, underweight)** – our underweight position in the mining services and lithium producer outperformed in April. Lithium prices continued to weaken during the month on excess supply chain inventories, with both lithium hydroxide and lithium carbonate prices falling around 50%. In addition, MIN's March quarterly report released during the period was below consensus expectations across all divisions. Our preferred lithium exposure is IGO, given the higher quality of the company's low-cost Greenbushes asset.

**Northern Star Resources (NST, overweight)** – our position in the gold miner was a positive contributor during the period, as gold prices rose 8.8% during April to close at US\$1,988/oz. We see further support for the gold price given macro uncertainty, and an expectation that the current interest rate hiking cycle is nearing an end. We continue to favour NST's solid assets and strong cost control. Aspirations to grow the business from current production of ~1.5Moz p.a. to >2Moz p.a. by 2026 are achievable within the current portfolio, led by the Thunderbox mill expansion project and improving grades at Pogo (Alaska). In our view, NST remains the quality name in the gold sector.

#### Key Detractors

**United Malt (UMG, overweight)** – the global commercial malt processor and distributor underperformed during the period. UMG received a takeover bid from peer Malteries Soufflet priced at \$5.00/share (+45% premium to prior closing price) in the prior month and retraced modestly from its highs close to the deal terms. Malteries Soufflet is currently undertaking due diligence and we believe that the likelihood of a deal proceeding is high.

**PEXA (PXA, overweight)** – the digital property settlement exchange underperformed modestly during the month. PXA is a very high-quality business with a dominant market position and high incremental margins. Whilst PXA will see reduced earnings in FY23 as housing transactions reduce from cyclical highs, this does not detract from the long-term fundamentals of the business which remain attractive, in our view.

**The Lottery Corporation (TLC, overweight)** – the lottery services provider underperformed during the period, reflecting the impact of an adverse jackpot sequence across its core Powerball and Oz Lotto offerings, with just 11 large jackpots (>\$15mn) through to the end of April (vs 23 large jackpots in 1H22). While, in the short term, jackpot sequences are largely luck dependent and vary weekly, we expect this to normalise over time, with limited implications for our long-term view. With cash generative assets underpinned by long-dated licenses, we regard TLC as an attractive blend of growth and yield at a reasonable price for what we view as a high-quality business (16 times EV/EBITDA, 3.5% dividend yield).

#### Key Purchases

**Tabcorp (TAH)** – we initiated a position in the wagering operator, reflecting our view that TAH will be a net beneficiary of the upcoming Victorian wagering license tender and

regulatory alignment between retail and digital operators. In our view, TAH also remains well positioned to benefit from its refreshed TAB25 strategy and gradual consolidation in the sector, which we expect will assist in delivering on the company's medium-term 10% ROIC target.

**Iluka Resources (ILU)** – we increased our position in the mineral-sands producer during the period, reflecting solid structural support for key mineral sands commodities zircon and titanium dioxide as demand improves and existing mine supplies decline. ILU is the world's largest zircon producer and the fifth largest producer of titanium feedstocks. Additionally, the company is moving into rare earths production with the Eneabba refinery currently under development in Western Australia. Rare earths are a by-product of mineral sands mining, and a key component of permanent magnets that are critical to electric motors, including those in electric vehicles and wind turbines. With 90% of the world's rare earths currently produced in China, we see significant strategic value in ILU's rare earths business.

**NextDC (NXT)** – following the announcement of its largest ever individual contract leading to a 36 megawatt increase in contracted capacity, we took the opportunity to increase the portfolio's position in Australia's leading data centre owner. We believe the contract demonstrates that NXT has a long pipeline of value accretive growth, which is not reflected in its 23.0 times FY25 EV/EBITDA multiple.

#### Key Sales

**Aristocrat Leisure (ALL)** – we exited our position in the gaming content developer as the stock continued to re-rate higher, with evidence of a normalisation in Digital momentum after a period of elevated trading through COVID. We retain a positive view given ALL's position in Land-Based gaming and expect that Digital revenues will likely continue to stabilise in coming months, but remain wary that expectations for the business remain elevated (consensus EPS growth +14%/+8% in FY23/24) and P/E multiples are approaching long-run averages (19 times vs 21 times 10-year avg.). As a result, we believe better opportunities can be found elsewhere at this time.

**Qantas (QAN)** – the portfolio's position in the national airline carrier was reduced during the month. QAN has experienced a period of unprecedented profitability with high demand and limited capacity coming out of COVID. Whilst we believe some of the improvements in market structure that QAN is enjoying will persist, profitability will reduce from current peak levels, warranting a smaller position.

**Xero (XRO)** – the portfolio's position in the global leading cloud-based small business software provider was trimmed during the month following a period of recent outperformance. This outperformance followed the announcement of plans to reduce the size of its workforce by 15%. The cost-out will lead to a reduction in operating expenditure/sales from the recent levels of 83-85% over recent results down to a more sustained level of ~75% from FY24.

## Key Active Overweights

**Reliance Worldwide (RWC)** – the market is showing concern for a weaker demand environment for the manufacturer and distributor of plumbing and heating parts, with RWC's FY23 earnings estimates having been lowered after recent market updates. We view RWC as a compelling opportunity, with the market pricing for a significant decline in earnings (P/E of only 14.9 times vs 17.0 times mid cycle) whereas we remain constructive on the demand environment given the defensive nature of RWC's revenue base, the majority of which relates to repair and remodelling sales.

**Worley (WOR)** – we remain overweight the leading global provider of engineering services. WOR's earnings recovery is in its early stages following COVID impacts across FY20-22. Revenue is expected to grow 13-15% in FY23, with leading indicators (Factored Sales Pipeline +16%, Rolling 12 Month Bookings +23%, Backlog +7%) and structural drivers (capital investment required to decarbonise) pointing to strong top-line growth ahead. Margins are also set to accelerate over the coming years as WOR benefits from a more consolidated industry structure, operating leverage, and active mix management.

**Origin Energy (ORG)** – the portfolio remains overweight the energy company, which is currently subject to a binding takeover offer from Brookfield and EIG. ORG trades at a 9% discount to terms and while the transaction still requires ACCC and FIRB approval, we believe this will be received in due course.

## Key Active Underweights

**Brambles (BXB)** – we remain underweight the global provider of pallet pooling solutions to various FMCG producers. Brambles currently has strong momentum (16% underlying profit growth in 1H23), with expectations for 17-19% over FY23 and improving free cashflow trajectory. We are cautious however on the sustainability of the current high level of profit and believe the market is already factoring the positive swing in free cash flow at current levels.

**Sonic Healthcare (SHL)** – our underweight position in Australia's largest pathology provider is premised on our view of a sluggish outlook for business-as-usual operational volume growth, lower earnings in the coming period as high margin COVID testing services continue to normalise, and a tough cost environment given industry wide staffing and funding challenges. Despite this, we do see business capacity for acquisitive growth, with ongoing execution evidence demonstrated through April (i.e. Diagnosticum in Germany). Finally, SHL's valuation is not yet compelling, with the stock trading on 23.1-times forward P/E and 10.5 times EV/EBITDA.

**Cochlear (COH)** – we remain underweight the global producer of hearing technologies. While COH's key developed and emerging markets have largely recovered following COVID as hospital capacity issues normalise, we are cautious on the outlook for some operating costs in the higher inflation environment, and on the implied stock valuation metrics at current levels of 46.8-times forward P/E and 29.5-times EV/EBITDA. Given strong underlying ear implant demand

globally – supported by COH's ongoing investment into clinical awareness – we believe the company is well positioned to return to its historical growth rates, and indeed should be supported by the release of its new Nucleus 8 sound processor. Within the large-cap healthcare sector, our preference remains our overweight to the global sleep-apnoea device supplier ResMed.

## Market outlook

The June quarter 2023 will mark the top of the interest cycle for most of the developed world. With ongoing evidence of inflation moderating, tightening in lending availability and downgrades accumulating for economic growth, including the Federal Reserve staff formally forecasting a modest recession in the US, the appetite for policy makers to persist with the tightening cycle is rapidly evaporating. Although the Fed did choose to hike in May, the decline in headline inflation has returned real interest rates to zero and our nowcasting for US economic growth continues to suggest the US has been contracting modestly since late 2022. We believe the US labour market is set to post more modest employment gains from mid-23 which in concert with improving labour supply will continue to moderate wage growth and help underwrite the commencement of a gradual easing cycle in the US from September 2023.

We continue to argue that Australia presents as a safe haven from both the perspective of more robust growth relative to the G7 peer group and as having good leverage to signs of a trough in the economic cycle in China. Although both the RBA and we expect economic activity to slow significantly in 2023 to average just 1.5%, we believe Australia should be able to avoid a technical recession due to four key reasons:

Australia has been a net beneficiary of global commodity shortages. This surge in commodity prices saw Australia's export prices in A\$ terms move to their highest levels since the 1880s in 1H22, and even though commodity prices are now off their peaks they remain very elevated from a historical perspective. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position. Indeed, the Commonwealth Budget will likely be close to surplus for the 2023 financial year.

The household sector continues to hold a significant buffer of over \$270bn of excess savings relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses will curtail consumer spending, we do expect the combination of rising wage growth and a run down in the level of savings to continue to support consumption spending. Albeit we remain particularly cautious on discretionary retail spending, given most of the excess savings can be traced to older and wealthier households.

Australia remains incredibly well placed to benefit from the global energy transition. Lithium is already a A\$10bn export industry for Australia and Australia is the world's dominant producer. Electric Vehicle sales are forecast to increase 10 times by 2030 and Australia has the world's 2nd largest copper resource. LNG is an important energy transition fuel,

and currently accounts for 23% of global electricity generation. Australia just happens to be the world's equal largest exporter of LNG. Iron ore obviously remains Australia's biggest export and China the dominant customer. However, we expect the global energy transition will be steel intensive, opening up new customers.

Net migration into Australia contracted in 2021 for the first time since 1945. However, a very strong recovery was recorded through 2022 and a record level of net migration appears likely in coming months, ensuring that Australia's population growth will exceed 2% in 2023.

While the Reserve Bank of Australia (RBA) has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 have come via significantly higher cash rates, higher government bond yields and wider corporate bond spreads. Following the February, March and May rate hikes of 25 bps, we believe financial conditions are now in the restrictive zone and the RBA has now likely finished this tightening cycle. From our perspective, the RBA's focus on global growth, trends in household spending and the outlook for inflation and labour markets in informing their future decisions suggest that multiple additional hikes are unlikely to be required. Surprisingly, the RBA cited modest rises in the A\$ and house prices as a catalyst for the May rate hike, neither of which had risen materially. While interest rate hikes in Australia will remain a month-to-month proposition for the next six months, our bias is that the last hike has likely been delivered this cycle. It is unlikely that policy easing will be delivered in 2023, however, we do expect that the RBA will commence a modest easing cycle in 1H24.

The A\$/US\$ has been under downward pressure as markets grappled with a seemingly more hawkish Fed and a relatively more dovish RBA. Nevertheless, both central banks are in the concluding phases of the tightening cycle. With Australia's external accounts remaining in excellent health, our expectation that Australia's economic growth will prove more robust, and the prospect the US\$ down trend will persist as the Fed pivots from its aggressive hiking strategy to an easing cycle in 2023, we expect the A\$/US\$ will appreciate to the mid-70s through 2H 2023.

We are most overweight stocks within the Communication Services, Information Technology and Materials sectors and are underweight Real Estate, Health Care and Energy.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.41	4.57	7.84
Consumer Discretionary	9.63	7.61	2.02
Consumer Staples	3.15	4.26	-1.11
Energy	0.00	3.97	-3.97
Financials	12.23	14.52	-2.29
Health Care	4.72	9.50	-4.78
Industrials	10.90	12.57	-1.66
Information Technology	12.71	6.11	6.60
Materials	24.09	21.67	2.42
Real Estate	0.00	11.64	-11.64
Utilities	5.19	3.58	1.61

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
QBE Insurance	5.52	2.59	2.92
Origin Energy	5.19	1.64	3.55
Resmed	4.72	1.50	3.22
Reliance Worldwide	4.64	0.37	4.27
Carsales.Com	4.54	1.02	3.52

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Reliance Worldwide	4.64	0.37	4.27
Worley	4.37	0.64	3.73
Origin	5.19	1.64	3.55
Underweights			
Brambles	0.00	2.25	-2.25
Sonic Healthcare	0.00	1.94	-1.94
Cochlear	0.00	1.85	-1.85

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	4.21	12.71	3.61	3.67
Distribution return	3.17	2.41	2.38	2.77

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\$12.1 mn as at 30 April 2023	
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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