

Yarra Ex-20 Australian Equities Fund

Gross returns as at 31 August 2021

	From 25 July 2018 ^A	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	6.08	4.32	8.81	22.77	4.33	7.65	9.60	8.31
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	9.64	5.10	9.32	24.71	9.45	NA	NA	NA
Excess return (before fees) [‡]	-3.57	-0.78	-0.51	-1.95	-5.12	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 31 August 2021

	From 25 July 2018 ^A	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	5.11	4.24	8.57	21.67	3.38	6.52	8.33	7.04
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	9.64	5.10	9.32	24.71	9.45	NA	NA	NA
Excess return (after fees) [‡]	-4.54	-0.86	-0.75	-3.04	-6.07	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.

^A 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.

[#] 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.

[‡] Excess return: The difference between the Fund's return and the benchmark return.

Market review

Australian equities delivered their best monthly return since November 2020 during reporting season, overcoming uncertainty relating to protracted lockdowns in NSW and VIC and negative earnings revisions across the market.

The S&P/ASX 300 Ex-20 Accumulation Index lifted by 5.1% in August, taking its 12-month return to +24.7%. In comparison, the broader ASX300 Index returned 2.6% and the MSCI Global Index returned 2.7%. However, FY21 reporting season saw more misses than beats despite recording +28% growth (y/y), while FY22 forecasts were revised down at -1.2% for the ASX200 and -1.5% for the Small Ords¹.

Nevertheless, equity valuations rose globally amid lower bond yields, with the US 10-year bond yield declining 21 bps to 1.23% in response to dovish commentary from the US Fed.

At a sector level, Financials (+8.8%) were the top performers. Insurance companies QBE Insurance (QBE, +9.6%), Suncorp

(SUN, +12.3%) and Insurance Australia Group (IAG, +10.7%) benefited from a higher pricing environment, while asset managers including Pinnacle Asset Management (PNI, +32.4%) and Australian Ethical Investment (AEI, +30.4%) saw strong FUM growth amid record-high equity markets.

Elsewhere, Information Technology (+8.0%) was supported by strong results from Wisetech Global (WTC, +57.0%), Xero (XRO, +8.2%) and Infomedia (IFM, +26.8%), while Real Estate (+7.4%) saw strong gains from REITs exposed to Australia's stronger housing market, such as Mirvac Group (MGR, +9.1%), and a rally in Retail REITs such as Scentre Group (SCG, +12.6%) and Vicinity Centres (VCX, +11.3%).

Conversely, Energy (-1.0%) and Utilities (+1.0%) continued to underperform. In the former, lower oil prices (Brent Crude -6.1%) weighed on Santos (STO, -5.0%) and Beach Energy (BPT, -11.7%). In the latter, AGL Energy (AGL, -6.4%) issued its third downgrade to earnings guidance in 12 months as challenging market conditions persist.

¹ Source: GS Investment Research.

Portfolio review

Key Contributors

Star Entertainment (SGR, overweight) – the casino operator outperformed following a better-than-expected FY20 result. Investors appeared to look through the impact of NSW's latest lockdown restrictions and FY21 earnings of \$430mn, which were flat (y/y) and met consensus forecasts, and instead rewarded the company for several value-accretive initiatives. SGR is investigating dividing its business into its operating and property divisions, additional slots in Sydney and selling an interest in the Brisbane Treasury buildings for \$220mn. While the latest outbreak delays SGR's recovery, we remain overweight the company. In our view SGR has available liquidity and debt headroom to withstand further disruption from the COVID-19 crisis, with net debt to EBITDA now standing at 2.7 times (from 3.2 times at FY20) and an extremely flexible cost base that is phased in line with revenue and demand. Moreover, SGR is a significant beneficiary of the post-COVID recovery once restrictions ease. In the long term, our overweight position is premised on the belief that the market underestimates SGR's ability to enhance asset performance through operational improvements and capex programs.

James Hardie (JHX, overweight) – the building materials company outperformed after announcing a strong 1Q22 result. Revenue and EBIT were 6.5% and 4.5% ahead of consensus forecasts respectively. Importantly, earnings from the US division beat expectations by 8.4%, with the lower beat from the group attributed to higher R&D and general corporate costs. We continue to believe JHX is well positioned to benefit from the stronger US housing environment, particularly in the R&R market which grew +15% (y/y) in the June quarter. JHX continues to take market share and increase margins in the key part of its business (North America comprises 70% of value), with input costs moderating from elevated levels. 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.

Carsales.com (CAR, overweight) – the online automotive company outperformed as its FY21 result came in at the top end of guidance issued in May, with revenue and NPAT growing 4% and 11% respectively (y/y). While prolonged lockdowns in NSW and VIC cloud the outlook, CAR still expects 'solid growth' in underlying NPAT for FY22. A new product launch called "carsales Select" – a digital offering allowing consumers to purchase used cars directly off dealers – also impressed investors. We remain overweight the automotive online classifieds company. Our positive view is premised on the belief CAR should benefit from attractive earnings growth, conservative accounting (with low capitalisation of R&D investment), product initiatives to drive long-term growth (such as transitioning from a leads-based model to a transaction-based model) and undervalued international businesses.

Key Detractors

Link Group (LNK, overweight) – the share registry company underperformed in response to a disappointing FY21 result. While operating NPATA of \$113.2mn was only 2% below consensus, management guided to broadly flat operating EBIT in FY22 – well below consensus for 15% growth. The market was anticipating an earnings recovery in FY22, but this appears to have been pushed out to FY23 due to further investment in operations and higher costs. We remain overweight the company because we continue to see compelling value in its base share registry business and electronic conveyancing business PEXA. Notwithstanding the PEP/Carlyle consortium walking away from its takeover proposal, we continue to see value in PEXA (with the company retaining its 45% stake in the IPO subsequent to month-end). Our positive view of PEXA is premised on infrastructure like characteristics of the property settlement exchange upon maturity supplemented by numerous growth opportunities in immediate adjacencies. Excluding PEXA, LNK trades at a forward P/E of less than 10-11 times, a substantial discount to peer Computershare (CPU) at 22.3 times.

Ansell (ANN, overweight) – the protective equipment manufacturer underperformed as its FY21 result missed market expectations. FY21 EPS came in at \$1.29 – below consensus by 3% – as performance from its Industrial division was underwhelming despite the manufacturing rebound in the US. Further, FY22 EPS of \$1.75-1.95 was 4% below consensus as management cautioned that COVID-related sales would fade and COVID outbreaks were disrupting its manufacturing plants in 1H22. Nevertheless, we remain overweight the company. Though we expect an air pocket in exam and single-use earnings as higher capacity in the market suppresses pricing, we expect ANN's underlying earnings to reclaim its FY21 COVID peak by FY23 as underlying earnings grow. More broadly, we expect both divisions to benefit from internal programs to increase operational efficiency, higher margins from new distributor agreements and shifts towards higher-value products. Lastly, ANN has a strong balance sheet; we estimate \$220mn of buy-back capacity. We do not believe this is captured by consensus; the stock trades at 14.5 times, a large discount to the wider Industrials ex-Financials at 31.0 times.

Worley (WOR, overweight) – the engineering firm underperformed during the period despite delivering a solid FY21 result. While revenue declined 5% (h/h), EBITDA grew +26% as management delivered on its cost initiatives, contributing to a +4% NPATA beat versus consensus forecasts. Moreover, management expects revenue to pick-up in FY22 as key end markets recover; its backlog has grown 8% and its total sales pipeline has lifted 16%, driven largely by sustainability projects (+17%). However, Brent crude declined 6% during the month to US\$73/bbl and the market remains concerned about structurally challenged global energy markets. We believe WOR is in a strong position to withstand a lower-than-expected recovery in its traditional work. 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 15.4 times forward earnings, a sharp discount to the Industrials ex-Financials at 31.0 times.

Key Purchases

Northern Star (NST) – we increased our overweight to the gold miner during the period. While NST's valuation – at a 12-month forward EV/EBITDA of 6.5 times – limits our exposure, we believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine in February this year.

Qantas (QAN) – we increased our position in the airline during the period. Notwithstanding short-term disruption from border restrictions, our positive view is predicated on QAN emerging from COVID with a significantly improved industry structure and more competitive cost base in both its domestic and international businesses. We are particularly optimistic on the domestic side of the business, where we expect the improved industry structure, operating leverage and cost out initiatives (up to \$300mn) to drive significant earnings upside versus consensus forecasts. We expect relative multiples to retrace to historic averages as confidence in the recovery builds (trading at or above pre-COVID multiples on normalised earnings).

QBE Insurance (QBE) – we increased our position in the general insurer during the period. QBE is 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 12.8 times forward earnings and offering a 4.3% dividend yield.

Key Sales

Healius (HLS) – we exited our position in the company during the period. We hold a positive view of its pathology and diagnostic imaging divisions, while the sale of the medical centre business last year enables management to focus on and invest in the pathology, day surgery and diagnostic imaging businesses, which are return on invested capital (ROIC) accretive and have significant margin opportunities. That being said, we believe this is more fully reflected in its valuation.

Santos (STO) – we reduced our holdings in the oil & gas company during the period as its valuation appeal has subsided, and now maintain a small underweight position. We remain positive towards the company on a fundamental basis, premised on its resilient low-cost base business (break-even <US\$25/bbl); a diversified asset base across multiple basins, customers and products (with 60% oil exposure); latent value in its midstream infrastructure and a defined pathway to net zero emissions, though we note its heavy reliance on scaling carbon capture and storage (CCS) and hydrogen.

Lendlease (LLC) – we reduced our holding during the period, but retain a small overweight position the property group. LLC's FY21 result revealed its strategy targets have been pushed out to FY24 (from FY23/24 previously) as COVID continues to impact LLC's real estate markets.

Notwithstanding greater uncertainty over the outlook, we expect the strong growth in LLC's development pipeline over the last 3 years (to \$114bn) should allow it to step up its annual rate of production from \$4.3bn to \$8bn by FY24. In addition, LLC plans to move 48% of developed assets onto its Investments Platform. The combined uplift in Development and Investments earnings should drive significant double-digit growth in earnings in the next few years, well ahead of consensus expectations. In our view, estimates are too cautious over the medium term (~20-30% below LLC's potential rate of deployment) which could drive earnings upgrades beyond FY21. Lastly, we expect a greater consistency and earnings quality will drive LLC's valuation (currently at around 11 times FY24 earnings) to higher multiples.

Key Active Overweights

James Hardie (JHX) – we continue to believe JHX is well positioned to benefit from the stronger US housing environment following the resolution of the COVID-19 crisis. JHX continues to take market share and increase margins in the key part of its business (North America comprises 70% of value), with input costs moderating from elevated levels. 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.

Iluka Resources (ILU) – we are overweight the mineral sands producer based on improving confidence that zircon and rutile markets are improving, with the current pace of the recovery exceeding our expectations amid the global economic recovery. We regard the industry structure as attractive (consolidated supply), with less pricing volatility compared to previous cycles. As a result, we see ILU's valuation as attractive at 6.8 times EV/EBITDA. While the outlook for rare earths appears promising in the context of a strong demand profile (as a component for electric vehicles) and potential government support, we ascribe limited value given it is a long-dated opportunity with significant execution risks. We ascribe zero to ILU's valuation from Sierra Rutile after the company suspended operations due to ongoing poor financial performance.

Atlas Arteria (ALX) – we maintain a high-conviction overweight position based on ALX's strong liquidity and balance sheet position, discounted valuation and exposure to traffic recovery in Europe and the US. ALX on less than 11.0 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. Beyond traffic normalisation, we see a path towards value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime.

Key Active Underweights

Sydney Airport (SYD) – we are underweight on the grounds that, absent a higher takeover price from the IFM-backed consortium, the recovery of international travel will be protracted and there are underappreciated risks arising from airline and tenant agreements and the prospect of higher interest rates in the long term. Most airline agreements are scheduled for renewal in July 2021 which, if they are not extended, may result in adverse pricing outcomes for the airport operator. SYD rejected a takeover proposal from the consortium at a bid of \$8.25 implies 21 times F24 EV/EBITDA (VA consensus), in-line with other major airport transaction multiples such as Gatwick and Copenhagen (20-21 times) in 2017.

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, in 2020, saw significant earnings support from its COVID-19 testing services. While short-term earnings will remain robust, we expect EBITDA to decline in FY22 as fewer tests are issued. We no longer view its valuation as sufficiently compelling versus alternatives, with the company trading at 21.4 times elevated forward earnings.

Xero (XRO) – we are underweight the accounting software provider because we believe its strong growth outlook is fully factored into its valuation, but its potential risks are not. XRO trades at 19.0 times EV/sales, reflecting lofty expectations for subscriber growth to accelerate as the company continues to expand overseas and for add-on products and services to drive higher average revenue per user (ARPU). However, international expansion carries significant risks due to greater competition in more fragmented markets, with significant ongoing product reinvestment required for XRO to maintain its advantages relative to peers.

Market outlook

The Australia economy completed 1H2021 with strong momentum, prompting the RBA and consensus to upgrade expectations for both 2021 and 2022 calendar year growth. Both the size of the economy and the number of people employed comfortably exceed pre-pandemic levels. Clear highlights were the unemployment rate declining from a peak of 7.5% in July 2020 to just 4.6% in July 2021 and June quarter GDP rising 0.7%, well ahead of expectations. Nevertheless, renewed COVID-related lockdowns in Melbourne and Sydney will sharply impact the data in 3Q21 and materially alter our growth forecasts for the remainder of 2021 and 2022.

We believe the interruption to economic growth from renewed lockdowns will be an aberration within an improving trend, rather than a view altering event. Indeed, the fundamentals that will drive the economic recovery remain in place. The recovery in labour market income has been sufficient to offset the gradual withdrawal of temporary fiscal support. Moreover, the accumulation of an estimated \$171bn in excess household saving, in concert with strong asset price gains, leaves the consumer uniquely positioned to underpin economic growth in

2021-22. Dwelling investment is set to provide solid support for economic growth over the next 12 months following a surge in demand for new housing construction, and a broader-based lift in business investment expectations is an important step in ensuring a sustained economic recovery. We expect the global economy to expand 6.5% and the Australian economy to expand 4.75% in 2021, a downward revision from our pre-lockdown forecast of 6%. We expect another strong year of economic growth in 2022 of 4.0%.

While we continue to expect US inflation to surprise on the upside over the remainder of 2021, the biggest inflation surprises are now behind us and our expectation that global business surveys would likely peak around mid-2021 appears to have been realised. The peak in global business surveys, in concert with slower bond issuance relative to central bank buying, helped push real bond yields to record lows over recent weeks. As the Federal Reserve signals increased willingness to taper its purchases and global economic and inflation indicators remain elevated, we expect bond yields will again start to move higher through the remainder of 2021. We expect US 10 year yields to approach 1.80% by the end of 2021.

The A\$/US\$ has recently been buffeted by concerns of a peak in global industrial growth indicators, slowing China economic momentum and recent declines in iron ore prices.

Nevertheless, Australia's external accounts are in their best position since the early 1970s, and despite some moderation in commodity prices the A\$/US\$ should remain supported by global reflationary forces through 2021-22. Reflecting the factors above, we have lowered our expectations for the A\$/US\$ somewhat over the remainder of 2021, and now expect the A\$/US\$ to finish the year in the 76-78c range, down from a forecast 81-83c range previously.

We are most overweight stocks within the Communication Services, Materials and Utilities sectors, and are underweight Real Estate, Financials and Industrials.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.29	4.78	8.51
Consumer Discretionary	9.99	8.96	1.04
Consumer Staples	2.90	4.34	-1.44
Energy	3.71	4.37	-0.66
Financials	8.83	14.68	-5.85
Health Care	7.17	9.49	-2.32
Industrials	6.14	9.84	-3.70
Information Technology	8.22	7.35	0.86
Materials	22.58	20.24	2.34
Real Estate	5.63	12.66	-7.03
Utilities	5.09	3.30	1.80

Top 5 holdings

	Portfolio %	Benchmark %	Active %
James Hardie Industries	6.40	2.49	3.91
QBE Insurance	5.18	1.84	3.34
Atlas Arteria	4.31	0.69	3.62
Iluka Resources	4.06	0.45	3.62
ResMed	3.77	1.49	2.27

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
James Hardie Industries	6.40	2.49	3.91
Iluka Resources	4.06	0.45	3.62
Atlas Arteria	4.31	0.69	3.62
Underweights			
Sydney Airport	0.00	2.27	-2.27
Sonic Healthcare	0.00	2.19	-2.19
Xero	0.00	1.94	-1.94

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.	Since inception % p.a.
Growth return	19.32	1.02	3.77	4.29
Distribution return	2.35	2.35	2.76	2.75

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\$14.0 mn as at 31 August 2021	
APIR code	JBW0052AU	
Estimated management cost	0.90% p.a	
Buy/sell spread	+/- 0.15%	
Platform availability	Asgard BT Panorama BT Wrap Hub24	Macquarie Wrap Accumulator Macquarie Wrap Consolidator

Applications and contacts

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

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