Yarra Ex-20 Australian Equities Fund

Gross returns as at 28 February 2022

	From 25 July 2018^	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	4.68	1.51	-2.11	13.04	7.44	7.01	8.79	7.76
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	6.89	1.36	-4.26	11.36	8.73	NA	NA	NA
Excess return (before fees)‡	-2.21	0.15	2.16	1.68	-1.29	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 28 February 2022

	From 25 July 2018^	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	3.73	1.44	-2.32	12.03	6.47	5.93	7.54	6.51
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	6.89	1.36	-4.26	11.36	8.73	NA	NA	NA
Excess return (after fees)‡	-3.16	0.08	1.94	0.67	-2.26	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.

^ **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 defied a fall in global markets during February, rising on a better-than-expected earnings season even as uncertainty spiked over Russia invading Ukraine and resulting sanctions.

The S&P/ASX 300 Ex-20 Accumulation Index increased by 1.2% during the month, taking its 12-month return to 11.3%. While global indices fell (S&P500 -3.0%), a solid set of 1H22 earnings held up the domestic market. Around 36% of companies received consensus upgrades for the full year (two times the long-run average)[1] as strong top line growth more than offset rising input costs.

At a sector level, Consumer Staples (+6.8%) and Metals & Mining (+7.9%) were the top performers. Staples saw strong results from Endeavour Group (EDV, +14.0%) and Graincorp (GNC, +15.4%), while Metals & Mining was supported by Gold (+17.9%) and base metals miner South32 (S32, +24.9%).

Conversely, Information Technology (-7.5%) declined the most in value. Losses were widespread in the tech sector as the prospect of higher interest rates compressed valuations, with notable declines including Xero (XRO -17.0%), Life360 (360, -37%), Novonix (NVX, -32.9%) and Tyro Payments (TYR, -31.5%). Communication Services (-5.6%) also weighed on the index, led by TPG Telecom (TPG, -5.3%), Uniti Group (UWL, -21.3%) and online media services companies REA Group (REA, -9.3%), Domain Group (DHG, -15.4%) and Carsales.com (CAR, -7.0%).

Portfolio review

Key Contributors

Northern Star (NST, overweight) – the gold miner outperformed as the commodity increased by 6% to $US1,910 per ounce in response to growing uncertainty around the Ukraine-Russia conflict. The company also delivered its 1H22 result, with cash NPAT of $430mn between guidance for $425-440mn. For the full year, FY22 guidance was unchanged at

[1] Source: Goldman Sachs Investment Research.

1.55-1.65mn ounces at an all-in sustaining cost of $1,475-1575/oz. We remain overweight NST. We believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine last year. We see the company's valuation as attractive at 6.4 times forward EV/EBITDA, which is only marginally above the wider Gold sector despite a superior growth outlook. More broadly, we have a selective exposure to the commodity, balancing the prospect of higher inflation with an uncertain rate hike path in the US (which is generally a headwind to the gold price).

Xero (XRO, underweight) – the accounting software company underperformed alongside the wider sector during the period as higher interest rates presented a headwind to its valuation. We remain 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 17.4 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.

Genworth Mortgage Insurance (GMA, overweight) – the residential mortgage insurer outperformed after delivering a strong FY21 result, with underlying NPAT of $161mn ahead of consensus forecasts on better underwriting profit. Moreover, as a result of its strengthened capital position management announced a special dividend (12 cents per share) in addition to a fully-franked dividend yield of 12 cents per share and on top of its previously announced $100mn buy-back. We continue to view GMA as an attractive exposure to Australia's robust housing market through lower claims expense and higher new business volumes along with being the most positively exposed insurer to rising interest rates.

Key Detractors

South32 (S32, underweight) – the base metals miner outperformed alongside higher commodity prices and after delivering a better-than-expected 1H22 result. The company announced EBITDA of $US1.87bn, roughly 10% ahead of consensus, mostly driven by higher metallurgical coal and aluminium prices. At spot commodity prices, S32 is set to generate 140% higher earnings in FY23 with a free cash flow yield in excess of 30%. Nevertheless, 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.

Tyro Payments (TYR, overweight) – the payment solutions company underperformed after delivering a worse-than-expected 1H22 result. Gross profit was ahead of forecasts, but this was more than offset by wage inflation and increased investment spending. While the result was still disappointing, we believe the stock was oversold and remain overweight. Short-term headwinds are more than reflected in TYR's valuation, with the stock trading at 2.2 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 defendable position versus peers such as the banks which rely on a clunky intermediary.

Aristocrat Leisure (ALL, overweight) – the gaming company underperformed after its proposed acquisition of US-based Playtech fell through. While we view the outcome as disappointing, ALL still has significant opportunities to enter Real Money Gaming – a market which has compelling growth prospects – through other potential acquisitions. More broadly, our positive investment view remains premised on ALL's dominant position in Land-Based Games and significant opportunities from Digital, which offers a wide range of outcomes. We see ALL's valuation as undervalued at 22.0 times forward earnings when considering the Industrials Ex-Financials trades at 24.5 times and ALL's superior long-term growth potential.

Key Purchases

Tabcorp (TAH) – we established a position in the wagering & lotteries company during the period. Our positive investment thesis is premised on its Lotteries business (70% of FY21 EBITDA), which we see as having a defensive revenue stream, significant pricing power and growth opportunities driven by online penetration (which currently sits at 32%, below the global average of 50%). We expect the planned spin-off, announced in July, will crystallise value for the division. While we are more negative towards TAH's wagering & media business (30% of FY21 EBITDA), recent takeover bids have placed a floor under the division's valuation. Assuming the division is valued at $3.5bn – the highest bid that TAH rebuffed – the lotteries business trades at 15 times EBITDA, well below peers including reseller Jumbo Interactive (JIN) at 30 times.

ResMed (RMD) – we increased our position in the sleep apnea device maker during the period. Our positive view is based on RMD's strong market position in both the short and long term. In the short term, the product recall from a key competitor has allowed RMD to take significant market share at a time when the market is rebounding post-COVID. Our long-term investment thesis remains intact, with benefits accruing from a positive product cycle in the flow generator and mask segments. New software and integration with the customer is supporting device sales versus competitors. While RMD trades at a headline 36.0 times forward earnings, in reality we see it as much lower given meaningfully better-than-expected NPAT outcomes likely in the medium term.

Worley (WOR) – we increased our position in the engineering services company during the period. We believe the company is in a strong position to benefit from a recovery in its traditional oil & gas work and 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 17.8 times forward earnings, a sharp discount to the Industrials ex-Financials at 24.5 times.

Key Sales

Aventus (AVN) – we exited our position in the large format retail REIT following recent outperformance and, secondly, as the proposed merger raises governance concerns with the stock. While we continue to view the merged entity favourably compared to shopping mall peers, with 'essential services' making up significantly more NOI, we are concerned about the external management structure. We believe this leads to inherent conflict and an ESG discount relative to internally managed peers.

Incitec Pivot (IPL) –we reduced our position size following recent outperformance and as another operational issue increased the risk profile. That being said, we remain overweight. 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 maintain its improved plant performance (running at nameplate capacity).

Genworth Mortgage Insurance (GMA) – we reduced our position size following recent outperformance but remain overweight. We continue to view GMA as an attractive exposure to Australia's robust housing market through lower claims expense and higher new business volumes along with being the most positively exposed insurer to rising interest rates.

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 21.6 times forward earnings, a discount to the Industrials ex-Financials at 24.5 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 3.9% dividend yield.

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

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.

Santos (STO) – we remain positive towards the company on a fundamental basis, premised on its resilient low-cost base business, a diversified asset base across multiple basins, customers and products (with 60% oil exposure) and latent value in its midstream infrastructure. However, we note its emissions reduction strategy relies heavily on scaling carbon capture and storage (CCS) and hydrogen – two unproven technologies at scale – without committing significant capital to shifting the business to a low carbon world. We view the recently completed merger with Oil Search (OSH) as logical from a financial perspective, however at this stage it is unclear how the merger affects the group's climate change strategy.

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.

Market outlook

Geopolitical events and surging commodity prices have taken centre stage this month, shaking risk sentiment and challenging consensus' optimistic forecast for global growth in 2022. 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 growth and 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 in an attempt to contain rising inflation expectations. The reality for 2022 is that 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 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 setting at a more 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 with 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), with further wage pressure to 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, with the consumer well placed to absorb 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 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 Communication Services, Information Technology and Consumer Discretionary sectors, and are underweight Real Estate, Health Care and Consumer Staples.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.89	4.55	8.34
Consumer Discretionary	7.56	8.35	-0.78
Consumer Staples	2.24	4.37	-2.13
Energy	4.34	6.13	-1.78
Financials	14.44	13.88	0.56
Health Care	6.26	8.89	-2.63
Industrials	7.87	8.27	-0.40
Information Technology	10.02	7.21	2.81
Materials	24.87	23.55	1.32
Real Estate	1.63	11.74	-10.11
Utilities	3.69	3.08	0.61

Top 5 holdings

	Portfolio %	Benchmark %	Active %
QBE Insurance	6.00	1.95	4.06
Link Administration	5.15	0.31	4.84
Northern Star Resources	5.08	1.38	3.70
Atlas Arteria	4.76	0.72	4.05
Worley	4.34	0.51	3.83

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	5.15	0.31	4.84
QBE Insurance	6.00	1.95	4.06
Atlas Arteria	4.76	0.72	4.05
Underweights			
South32	0.00	2.57	-2.57
Santos	0.00	2.54	-2.54
Sonic Healthcare	0.00	1.93	-1.93

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	9.99	4.36	3.43	4.73
Distribution return	2.05	2.11	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$12.1 mn as at 28 February 2022
APIR code	JBW0052AU
Estimated management cost	0.90% p.a
Buy/sell spread	+/- 0.15%
Platform availability	BT Panorama Praemium Hub24

Applications and contacts

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

Website www.yarracm.com

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