YARRA CAPITAL MANAGEMENT

Investment Commentary
Month to 28 February 2023

Yarra Ex-20 Australian Equities Fund

Gross returns as at 28 February 2023

	From 25 June 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	5.01	-0.05	2.61	6.25	6.31	5.94	7.22	7.64
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	5.74	-1.60	0.36	1.63	6.73	NA	NA	NA
Excess return (before fees)‡	-0.73	1.55	2.25	4.62	-0.42	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 2023

	From 25 June 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	4.06	-0.12	2.39	5.30	5.36	4.96	6.03	6.41
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	5.74	-1.60	0.36	1.63	6.73	NA	NA	NA
Excess return (after fees)‡	-1.68	1.48	2.02	3.67	-1.37	NA	NA	NA

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^ 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. 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

The S&P/ASX 300 Ex-20 Index returned -1.6% for the month, taking its 12-month return to +1.6%. The broader ASX300 returned -2.6% for the month, as did global indices (MSCI World Index, -2.4%).

Utilities (+3.4%) was among the top performing sectors during the month, led by Origin Energy (ORG, +9.4%) which outperformed on the proposed purchase of the business by suitors Brookfield and EIG.

Insurance (+6.5%) was a top performing sub-sector during the period within the Financials (+2.2%) sector, which outperformed on the back of strong 1H22 results reflecting higher interest rates. Notable stocks were QBE Insurance (QBE, +9.8%), AUB Group (AUB, +17.4%) and Steadfast (SDF, +12.4%).

Conversely, the largest lagging sector was Materials (-6.8%), with Metals & Mining (-8.8%) being the poorest performer. With Gold prices declining by 5% to US$1,817/oz at month end, the producers took a hit, in particular Northern Star (NST, -17.4%) and Evolution Mining (EVN, -14.4%).

Portfolio review

Key Contributors

Link Administration (LNK, overweight) – the outsourced services provider appreciated during the month as the company made material progress in resolving the uncertainty overhanging it UK Fund Solutions business. LNK announced that it had an in-principal agreement with potential acquirer Waystone to purchase its Fund Solutions business, with the UK regulator (FCA) agreeing that the proceeds from the sale would be sufficient to cover its restitution claims for unitholders in the collapsed Woodford funds.

Origin Energy (ORG, overweight) – the energy retailer outperformed during the month after updating the market on the proposed purchase of the business by suitors Brookfield and EIG. Despite speculation of the deal being repriced lower, the deal was recut only to include part of the consideration in

US dollars. At the close of the month, the value of the deal was above the initial $9.00 offer. The company's update increased the probability of a binding offer emerging in the near term.

QBE Insurance (QBE, overweight) – the general insurer performed strongly during the month, reporting a solid full year result which was largely in line with expectations, with guidance for gross written premium growth for 2023 of mid to high single digits leading to upgraded earnings expectations. QBE has made material progress in de-risking its portfolio which, combined with the strong revenue environment and the benefit to earnings from higher interest rates, have led to strong earnings and return outlook.

Key Detractors

Northern Star (NST, overweight) – the gold producer was a negative contributor during the month. Following a period of strong outperformance late in 2022, NST tracked the gold price lower in February, with gold declining 5% to US$1,817/oz at month end. We continue to favor 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 remain achievable within the current portfolio, led by the Thunderbox mill expansion project and improving grades at its Super Pit and Pogo (Alaska) assets. The company remains the quality name in the gold sector, in our view.

PEXA Group (PXA, overweight) – the electronic conveyancing company underperformed during the period, despite reporting a solid result for the six months to December 2022. With the background of the anticipated slowdown in house transaction volumes in Australia already an overhang on the stock, PXA guided to a slower roll out of its UK platform and higher than anticipated losses in its startup digital business.

Brambles (BXB, underweight) – the global provider of pallet pooling solutions outperformed as the company beat 1H23 expectations (+8% at EBIT) and lifted its EBIT guidance from 8-11% to 15-18% over FY23. Brambles currently has strong momentum, and we expect a return to positive FCF from FY24. Nevertheless, we are cautious on the sustainability of the current high level of profit and believe that current trading levels suggest that the market is already factoring in the positive swing in free cash flow.

Key Purchases

United Malt Group (UMG) – we increased our position in the global commercial malt processor and distributor during the period. The company has faced a number of short-term headwinds (e.g. Canadian drought, heightened freight, grain, and energy costs) and with ineffective contractual terms, which led to significantly reduced FY22 earnings. Most of these short-term pressures have already started to ease, and the company is advanced with regard to improving contractual terms which will see customers bear these risks going forward. We think investor concerns regarding the need to raise capital are overblown, and that this concern should ease as earnings improve.

Insurance Australia Group (IAG) – we added to our position in the general insurer during the month, following a period of underperformance as the market digested the impact on earnings in current and future years from flooding and cyclone events in New Zealand. IAG is achieving strong price increases to offset high claims, is seeing improved volume growth and appears to have passed the peak of claims inflation pressures.

Eclipx Group (ECX) – we increased our position in the fleet management company following a period of underperformance. Industry data indicating a moderation in used car prices could partly explain recent underperformance given the potential reduction in end of lease income, however this is already reflected in consensus earnings expectations and the valuation. Our positive view of ECX is supported by asset growth, which is underpinned by market share gains, cost reduction opportunities to offset inflation pressures, balance sheet strength to support continued share buybacks and potentially industry consolidation.

Key Sales

OZ Minerals (OZL) – we exited our position in OZ Minerals during the period. The $28.25/share takeover bid from BHP is supported by the OZL board and has been deemed "fair and reasonable" by the Independent Expert. As a result, we view risks to deal completion as low. OZL is trading close to deal terms, meaning we see limited potential for future outperformance.

Atlas Arteria (ALX) – the portfolio's position was reduced during the month as the toll road owner is now trading closer to an enterprise value equivalent to where it was trading prior to undertaking what we regard as a value destructive acquisition of the Chicago Skyway toll road.

JB Hi-Fi (JBH) – we reduced our position in the retailer during the period ahead of an anticipated deterioration in consumer spending, with growing evidence that high value/housing-related goods appear to be softening in response to rising interest rates. While we continue to regard JBH as a high-quality retailer that is well positioned to navigate the volatility ahead, we remain wary that earnings headwinds may persist for some time and weigh on the business. With strong cash generation and a robust balance sheet, we retain a position in JBH but await more certainty on the outlook.

Key Active Overweights

Reliance Worldwide (RWC) – the market is showing concern for a falling demand environment and the plumbing supplies company's FY23 estimates have been lowered after recent updates. We believe RWC is a compelling opportunity, with the market pricing for a significant decline in earnings (P/E of only 14 times vs 17 times mid cycle) whereas we remain constructive on the demand environment given the defensive nature of the majority of RWC's repair and remodelling sales.

Worley (WOR) – we remain overweight the professional project and asset services company. WOR's earnings recovery is in its early stages following COVID impacts across FY20-22: revenue is expected to increase 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 the company benefits from a more consolidated industry structure, operating leverage, and active mix management.

Carsales.com (CAR) – we remain overweight the online car classifieds company based on improving yields from products such as Instant Offer as well as a continuation of the post COVID recovery in inventories in Australia (~50% of CAR valuation). We are also constructive on the outlook for Trader Interactive (TI), CAR's US business (~30% CAR valuation), which is seeing stronger dealer penetration in Powersports after CAR acquired the remaining 51% stake in TI. With new incentives in place, we believe penetration should increase across other categories. Stronger yields are coming through from both pricing, depth (Top Spot), as well as other initiatives. We are attracted to the opportunity to improve the profitability of Encar, CAR's South Korean business.

Key Active Underweights

South32 (S32) – we maintain a negative medium to longer-term view towards the company. The company's asset suite is high cost, with relatively short mine lives and limited organic growth opportunities. While the divestment of its thermal coal assets in South Africa reduces both ESG and Sovereign Risks, we see better base metal exposure opportunities elsewhere.

Brambles (BXB) – we are underweight the global provider of pallet pooling solutions to various FMCG producers. Brambles currently have strong momentum (16% underlying profit growth in 1H23), with expectations for 15-18% over FY23 and we expect a return to positive FCF from FY24. We are cautious on the sustainability of the current high level of profit and believe that market is already factoring the positive swing in free cash flow at current traded levels.

Suncorp (SUN) – the portfolio has an underweight position in SUN but is overweight the insurance sector overall. SUN announced the sale of its bank to ANZ in July 2022, a transaction which is expected to complete in mid-2023, subject to regulatory approval. Subsequent to this and the associated capital return SUN will assume a smaller weight in the index, and as a result we maintain a preference in the insurance sector for peers QBE and IAG.

Market outlook

As we near the end of the March quarter, some of the initial enthusiasm for risk has started to fade on the combination of stronger than consensus expectations data in the US and the US Fed raising the prospect of returning to 50 bps hikes, after stepping down to a 25 bps increment in January. This combination of events has seen bond yields rise in an environment where earnings revisions remain in downward revision mode, resulting in a relatively sharp decline in equity risk premia and leaving the equity market somewhat more vulnerable from a valuation perspective.

On balance, the better data in the US in early 2023 can be mostly attributed to unusually warm weather and we still believe the US and Europe remain near recession-like economic growth conditions in 1H23 and inflation dynamics will change sufficiently for policy makers to conclude that the monetary policy is sufficiently restrictive to halt the tightening cycle in coming months.

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:

1. 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.
2. 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.
3. 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.
4. 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 be close to 2% in 2023.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 have come via both significantly higher cash rates, higher government bond yields and wider corporate bond spreads. Following the February and March rate hikes of 25 bps, we believe financial conditions are now in the restrictive zone and the RBA is now close to the finish of the tightening cycle.

Importantly, it is clear the RBA is now openly considering pausing the hiking 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. Interest rate hikes in Australia will remain a month-to-month proposition for the next six months, however, our bias is that the last hike has likely been delivered this cycle.

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, 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 Consumer Discretionary sectors, and are most underweight Real Estate, Health Care and Financials.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.80	4.34	8.45
Consumer Discretionary	7.71	7.58	0.13
Consumer Staples	2.73	4.39	-1.66
Energy	4.55	4.66	-0.11
Financials	11.67	14.48	-2.80
Health Care	4.39	8.84	-4.45
Industrials	10.48	10.24	0.24
Information Technology	13.95	7.75	6.20
Materials	19.58	22.27	-2.68
Real Estate	0.00	11.95	-11.95
Utilities	5.31	3.51	1.80

Top 5 holdings

	Portfolio %	Benchmark %	Active %
QBE Insurance	6.01	2.57	3.44
Origin Energy	5.31	1.58	3.72
Carsales.com	4.86	0.92	3.95
Worley	4.55	0.65	3.90
ResMed	4.39	1.41	2.98

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Reliance Worldwide	4.33	0.33	4.00
Worley	4.55	0.65	3.90
Carsales.com	4.86	0.92	3.95
Underweights			
South32	0.00	2.29	-2.29
Brambles	0.00	2.05	-2.05
Suncorp	0.00	1.86	-1.86

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	2.19	3.16	2.60	3.28
Distribution return	3.11	2.20	2.36	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$11.7 mn as at 28 February 2023	
APIR code	JBW0052AU	
Estimated management cost	0.90% p.a	
Buy/sell spread	+/- 0.15%	
Platform availability	BT Panorama Hub24	Praemium

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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