

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 31 July 2021

	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	4.81	0.21	4.28	24.05	4.81	6.44	8.77	7.96
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	8.17	0.87	4.44	24.62	8.37	NA	NA	NA
Excess return (before fees) <sup>‡</sup>	-3.36	-0.66	-0.16	-0.58	-3.56	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 July 2021

	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	3.85	0.14	4.05	22.94	3.86	5.32	7.50	6.69
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	8.17	0.87	4.44	24.62	8.37	NA	NA	NA
Excess return (after fees) <sup>‡</sup>	-4.32	-0.74	-0.40	-1.68	-4.52	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 shares rose modestly in July despite ongoing lockdowns across the east coast of the country.

The S&P/ASX 300 Ex-20 Accumulation Index returned 0.9% for the month, taking its 12-month return to 24.6%. However, the market lagged overseas indices, with the S&P500 returning 2.4% during the month amid an upbeat US corporate earnings season.

Metals & Mining ex-Gold (+10.3%) was the top contributor to the index, supported in most part by miners leveraged to the electric vehicle theme. Top stock performers included Mineral Resources (MIN, +17.3%), Lynas Rare Earths (LYC, +28.5%), IGO Limited (IGO, +22.0%) and Pilbara Minerals (PLS, +22.1%).

Corporate activity increased during the period, with Sydney Airport (SYD, +34.9%) and Spark Infrastructure (SKI, +23.8%) receiving takeover bids during the period. The SYD board rejected the bid on the grounds that it was opportunistic and not in the best interest of shareholders. SKI granted due diligence after receiving a third takeover bid – at \$2.95 per

share up from \$2.80 per share previously – from a consortium comprising KKR and OTPP.

Conversely, sectors leveraged to the re-opening theme underperformed during the period. The main detractors were in Consumer Services (-4.4%), Media & Entertainment (-4.5%) and Retailing (-2.7%). At a stock level, Crown Resorts (CWN, -27.7%) was among the worst performers over concern it would be stripped of its gaming licenses in Victoria and Star Entertainment (SGR) withdrawing its merger offer.

## Portfolio review

### Key Contributors

**IGO Limited (IGO, overweight)** – the diversified miner outperformed after announcing the completion of its Greenbushes lithium acquisition late in the prior period and, secondly, a strong June quarter production report. While no guidance was outlined for Greenbushes, production and costs at Nova were well ahead of consensus estimates and FY22 guidance was broadly in line with forecasts. Our positive view

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is premised on the recent Greenbushes lithium acquisition, which gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes its suite of battery commodities, with the company already producing nickel, copper and cobalt. We also believe the purchase price was reasonable, with Greenbushes likely to be NPV and EPS accretive by FY23. We also hold a positive view of IGO's Nova asset, a world-class reserve which supports an increasing production profile.

**Incitec Pivot (IPL, overweight)** – the explosives and fertiliser maker outperformed after delivering a positive market update during the period. Management announced its WALA ammonia plant returned to full production from 1 June and the turnaround at its Moranbah AN plant was successfully completed. We remain overweight as we continue to believe the risk is skewed to the upside at current levels (at 14.8 times forward earnings). Lead indicators suggest higher demand for key commodities (urea and DAP) will sustain current spot prices, resulting in consensus upgrades. Meanwhile, the explosives business is experiencing more stable pricing as mining demand normalises in North America.

**Iluka Resources (ILU, overweight)** – the mineral sands producer outperformed following a strong June quarter result. Management announced that, from 1 July, the zircon price will increase by a minimum of US\$125/t (9.5%) and the rutile price will increase by 9% for welding customers. The company also returned to full production settings, with zircon rising from 70kt to 72kt and rutile lifting 20% (q/q). We remain positive on the company: in our view zircon and rutile markets are improving, with current conditions 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. We do not believe the positive outlook for the company is sufficiently captured at 6.7 times EV/EBITDA (on a 12-month forward basis).

### Key Detractors

**Sydney Airport (SYD, underweight)** – the airport operator outperformed after receiving a takeover proposal from an IFM-backed consortium. The bid, which was priced at \$8.25 per share, implying a valuation of 21 times FY24 EV/EBITDA which is in-line with other major historic airport transaction multiples (e.g. Gatwick and Copenhagen, which were priced 20-21 times EV/EBITDA). The SYD board rejected the bid on the grounds that it was opportunistic and not in the best interest of shareholders. We remain underweight on the grounds that, absent a higher takeover price, 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 not extended, may result in adverse pricing outcomes for the airport operator.

**Ansell (ANN, overweight)** – the protective equipment manufacturer underperformed without any material news during the period. We remain overweight the company. In the short term, we continue to believe the Health Care division (55% of EBIT) will support earnings as it provides crucial

equipment to combat the COVID-19 virus, more than offsetting likely short-term disruption from its Industrial division (45% of group EBIT). More broadly, we continue to view the business favourably as it undergoes internal programs to increase operational efficiency and improve margins from new distributor agreements, and shifts towards higher-value products. We do not believe this is captured by consensus; the stock trades at 15.8 times, a large discount to the wider Industrials ex-Financials at 29.2 times.

**Worley (WOR, overweight)** – the engineering services company underperformed without any material news, partially retracing outperformance from the prior period when it gave an upbeat investor day presentation. We believe WOR is in a strong position to withstand an economic slowdown and disruption to activity caused by the lower oil prices, with significant refinancing headroom and business diversification across different markets. We believe WOR's valuation provides significant support at current levels, with the stock trading on 15.5 times forward earnings, a sharp discount to the Industrials ex-Financials at 29.2 times.

### Key Purchases

**PEXA (PXA)** – we participated in the IPO of the electronic conveyancing business during the period. Our investment thesis is premised on the infrastructure like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies (data and new markets). We see significant earnings upside as cost reductions are realised as the business transitions from a growth phase towards more of a utility phase, supporting higher sustainable EBITDA margins going forward.

**Qantas (QAN)** – we established a small underweight position in the airline during the period. Notwithstanding short-term disruption from border restrictions, our more 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) will 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).

**IGO Limited (IGO)** – we increased our position in the diversified miner during the period. Our positive view is premised on the recent Greenbushes lithium acquisition, which gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes its suite of battery commodities, with the company already producing nickel, copper and cobalt. We also believe the purchase price was reasonable, with Greenbushes likely to be NPV and EPS accretive by FY23. We also hold a positive view of IGO's Nova asset, a world-class reserve which supports an increasing production profile.

## Key Sales

**Seven Group (SVW)** – we exited our small overweight position in the conglomerate following recent outperformance. In our view the WesTrac and Coates businesses have strong long-term outlooks. The former, which provides equipment to the mining and construction industries, is set to benefit from customers both upgrading and purchasing new fleet following years of underinvestment. For the latter, we see improved utilisation and pricing of its equipment as infrastructure activity increases and is pushed out (extending the loan period for its products). However, the company's increased stake in Boral (BLD) – now at almost 80% with SVW taking control – dilutes the value of WesTrac and Coates and increases exposure to Australia's housing market, where we believe growth rates will slow following its record stimulus induced rally.

**Healius (HLS)** – we reduced 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.

**APA Group (APA)** – we reduced our position in the gas pipeline operator during the period. We believe management is appropriately shifting its business model towards renewables and transmission as Australia's energy mix decarbonises. However, potential upside from the shift is dwarfed by the discount increasingly applied to its gas pipeline business, particularly as planned government policies accelerate the shift to zero emissions sources. As a result, we no longer regard its valuation (at a 12-month EV/EBITDA of 11.9 times) as being sufficiently compelling when compared to infrastructure alternatives. Within infrastructure and utilities, we continue to prefer Atlas Arteria (ALX) given its discounted valuation and exposure to the traffic recovery in Europe and the US.

## Key Active Overweights

**Iluka Resources (ILU)** – we are overweight the mineral sands producer based on 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 regard 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.

**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.

**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 trades on less than 11.0 times normalised EV/EBITDA, which more than captures the disruption from COVID-19 as travel restrictions and lockdowns impact 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, that there are underappreciated risks arising from airline and tenant agreements, and given the prospect of higher interest rates in the long term. Most airline agreements are scheduled for renewal in July 2021 which, if 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, or 21-times F24 EV/EBITDA (VA consensus), in-line with other major airport transaction multiples in 2017 such as Gatwick and Copenhagen (20-21-times).

**Sonic Healthcare (SHL)** – we are underweight the company on the grounds that 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 will decline in FY22 as fewer tests are issued. We no longer view its valuation as sufficiently compelling versus alternatives, with the company now trading at 23.5 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 because its potential risks are not. XRO trades at 19.6 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 Australian 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 people employed comfortably exceed pre-pandemic levels. The unemployment rate declining from a peak of 7.5% in July 2020 to just 4.9% in June 2021 is the clear highlight. Nevertheless, renewed COVID-related lockdowns in Melbourne, Sydney and South East Queensland 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 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 Telecommunication Services, Media & Entertainment and Utilities sectors, and are underweight Financials, Real Estate and Industrials.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.48	4.64	8.84
Consumer Discretionary	10.52	8.83	1.69
Consumer Staples	3.53	4.23	-0.71
Energy	5.67	4.63	1.04
Financials	8.69	14.18	-5.49
Health Care	8.02	9.47	-1.45
Industrials	5.05	9.94	-4.88
Information Technology	8.71	7.11	1.60
Materials	21.26	21.20	0.06
Real Estate	6.70	12.35	-5.66
Utilities	5.69	3.42	2.27

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
James Hardie Industries	6.03	2.23	3.79
QBE Insurance	4.95	1.76	3.19
Iluka Resources	4.41	0.46	3.95
Atlas Arteria	4.31	0.66	3.64
Incitec Pivot	4.02	0.57	3.44

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Iluka Resources	4.41	0.46	3.95
James Hardie Industries	6.03	2.23	3.79
Atlas Arteria	4.31	0.66	3.64
Underweights			
Sydney Airport	0.00	2.32	-2.32
Sonic Healthcare	0.00	2.10	-2.10
Xero	0.00	1.87	-1.87

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	20.57	1.49	2.59	3.93
Distribution return	2.38	2.37	2.73	2.76

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\$13.5 mn as at 31 July 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

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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)

**Investor Services Team** 1800 034 494 (Australia) +61 3 9002 1980 (Overseas) [IST@yarracm.com](mailto:IST@yarracm.com)

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