

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 31 July 2022

	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	3.56	7.04	-6.85	-0.21	3.64	6.07	8.89	7.26
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	5.44	8.00	-7.22	-2.58	3.58	NA	NA	NA
Excess return (before fees) <sup>‡</sup>	-1.88	-0.96	0.36	2.37	0.06	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 2022

	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	2.62	6.96	-7.06	-1.10	2.71	5.04	7.66	6.02
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	5.44	8.00	-7.22	-2.58	3.58	NA	NA	NA
Excess return (after fees) <sup>‡</sup>	-2.82	-1.04	0.15	1.48	-0.87	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 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.

<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 rallied sharply during July, following the 9% decline in June, as market expectations increased that interest rate expectations have peaked.

The S&P/ASX300 Ex-20 Accumulation Index returned +8.0% for the month, taking its 12-month return to -2.6%. In comparison, the broader ASX300 gained 5.9% for the month and global indices were positive (MSCI World Index +7.9%).

Within Information Technology (+15.4%), Tyro Payment (TYR, +37.5%), Data#3 (DTL, +32.3%) and Megaport (MP1, +20.8%) all outperformed as the sector benefitted from a rally in the longer dated end of the yield curve.

Elsewhere, Real Estate (+10.7%) bounced back from recent underperformance, led by outperformance from Lend Lease (LLC, +12.7%) and Lifestyle Communities (LIC, +24.1%).

Conversely, the worst performing sector was Consumer Staples (+2.4%). Australian Agricultural Company (AAC, -14.3%), Elders (ELD, -10.4%) and Costa (CGC, -10.1%), which

had previously been safe haven stocks and have negative correlations with inflation.

### Portfolio review

#### Key Contributors

**Link Administration (LNK, overweight)** – the company outperformed following the announcement of a revised offer by Dye and Durham priced at \$4.81 that was agreed to by LNK's Board. The revised offer includes structural undertakings on Dye and Durham's behalf to divest its Australian conveyancing software assets, which should see it placate concerns previously raised by the ACCC.

**Xero (XRO, overweight)** – the cloud accounting SaaS provider outperformed as the technology sector benefitted from a rally in the longer dated end of the yield curve. We maintain an overweight position based on the opportunity from migration to the cloud across all geographies, in particular in the US and UK where cloud penetration is lower today compared to the higher rates in Australia and New Zealand. The UK's Making

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Tax Digital initiative is a nearer-term catalyst for the migration in the UK. Longer term, we believe there is a strong runway for growth in Xero's Platform revenue across Payments, Panday and Payroll.

**South32 (S32, underweight)** – our underweight position in South32 was a positive contributor to performance in July. While the company reported generally solid operations in its June quarterly report, commodity price declines were a major headwind, particularly coking coal (-37% to US\$191/t), manganese (-13% to US\$6.30/dmtu) and alumina (-10% to US\$330/t). Weak FY23 guidance for the company's only copper asset – Sierra Gorda – disappointed the market and raises questions around asset quality for this newly acquired mine. S32 is experiencing significant cost inflation across its aluminium smelters due to higher energy prices and realised 15-20% higher costs in the second half of FY22, well ahead of peer Rio Tinto's (RIO) 10% cost increase.

### Key Detractors

**Atlas Arteria (ALX, overweight)** – the toll road operator underperformed during the month after IFM, which had built an approximate 15% stake in the company at above market levels the prior month, announced they were not in a position to make a bid at this time. We maintain an overweight position as we see a path towards significant value creation for ALX through concession extensions at APRR, achieved as a means of funding expansion projects, and settling the Dulles Greenway tolling regime. With IFM having put ALX into play, we do currently believe a privatisation transaction of some form remains a likely outcome.

**QBE Insurance (QBE, overweight)** – the insurer underperformed during the month on limited news flow outside of the announcement of a \$75m charge relating to the mispricing of historic policies, which we do not view as overly material. We have a favourable view on the insurance industry and QBE is performing well with strong premium rate increases and volume growth driving a strong top line, and declining attrition claim ratios and higher investment yields improving the underlying combined operating ratio. The portfolio has expressed its positive industry view through positions in QBE and IAG.

**Worley (WOR, overweight)** – the energy services firm underperformed as crude oil WTI declined from the peak of US\$120/bbl as economic data from China and the US continued to deteriorate. We remain overweight WOR. Following years of underinvestment in oil & gas projects, and with the more recent supply disruptions stemming from the war in Ukraine, expectations for project spend across WOR's traditional customer base has increased to 27% growth (YoY). There is also a strong pipeline of margin accretive capital spend required to decarbonise energy production and provide more sustainable solutions across chemical and resources customers.

### Key Purchases

**Carsales.com (CAR)** – we participated pro-rata in CAR's equity raising during the period to acquire the remaining 51% of Trader interactive, CAR's US based classifieds business. There

is strong potential for growth from various drivers across the trader Interactive business, including: an uplift in dealer penetration, moving from a subscription based to a leads-based and higher yielding model, and an improvement in inventories on the site.

**NextDC (NXT)** – we took the opportunity to add to the portfolio's position in NXT during the month. NXT, along with its technology peers, has lagged the market in the calendar year to date. We believe the high recurring nature of NXT's revenues, its infrastructure-like characteristics and tangible asset base are attractive. NXT has been excessively discounted and see no diminution to its growth trajectory. NXT trades on 23.6 times FY24 EV/EBITDA, which compares favourably to its more mature global peers.

### Key Sales

**Atlas Arteria (ALX)** – we took the opportunity to trim the ALX position following the outperformance that resulted from IFM's approach. Despite IFM not following through with a formal bid (at this stage), we maintain an overweight position as we see a path towards significant value creation for ALX through concession extensions at APRR to help fund expansion projects and settling the Dulles Greenway tolling regime. With IFM having put ALX into play, we do believe a privatisation transaction of some form remains a likely outcome.

**Sandfire Resources (SFR)** – we reduced our exposure to the company during the period. With the DeGrussa project ceasing production in the coming months, Sandfire's production will soon be entirely dependent on the MATSA project in southern Spain prior to the start-up of Motheo in Namibia. Sandfire is a higher cost producer than peer OZ Minerals (OZL) and with a higher risk growth profile, in our view. We believe the recent fall in copper prices is now largely complete given cost curve support. Consequently, we are happy to retain our exposure to copper, but have reduced our Sandfire position in preference to OZ Minerals.

**TPG Telecom (TPG)** – we modestly reduced our position in the Australian telco following recent outperformance. We retain a positive view on the company given the defensive earnings stream and leverage to re-opening international borders, with a relatively high mix of migrants and students in its mobile phone customer base. Our thesis is premised on the improving outlook for the mobiles market, recovery in volumes post COVID and the recently completed Vodafone merger, which in our view will unlock significant synergies. The combined entity is well placed to harness its infrastructure, scale and balance sheet to disrupt incumbents Telstra (TLS) and Optus through its lower-cost structure, as well as new products such as Fixed Wireless.

### Key Active Overweights

**Worley (WOR)** – following years of underinvestment in oil & gas projects, and with the more recent supply disruptions stemming from the war in Ukraine, expectations for project spend across WOR's traditional customer base has increased to 27% growth (YoY). There is also a strong pipeline of margin accretive capital spend required to decarbonise energy production and provide more sustainable solutions for

chemical and resources customers. We also believe incremental margins could be higher going forward after the company's \$375mn cost-out program during COVID.

**Atlas Arteria (ALX)** – we maintain a high-conviction overweight as we see a path towards significant value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime. With IFM having put ALX into play, we do believe a privatisation transaction of some form remains a likely outcome. ALX is currently trading on less than 11.0 times normalised EV/EBITDA.

**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 the infrastructure-like characteristics of its property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies.

### 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 remain unsustainably high despite recent price falls. While manganese and coking coal prices have declined, they remain well above cost curve support. With these two commodities representing around 50% of S32's earnings, we see earnings risk skewed to the downside, based on supply and demand fundamentals. The company faces increasing inflation pressures across its portfolio from rising energy and labour costs. 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.

**ASX Limited (ASX)** – we remain underweight because we believe ASX's valuation is unjustified in the context of modest EPS growth. ASX trades on a 12-month forward P/E of 29.5 times, well above its long-run average and higher than global peers with a similar revenue mix. While the defensive nature of its earnings is attractive in the current environment, at present levels the stock offers a forecast dividend yield of only 3.1%, well below the broader market at 3.6%.

**Sonic Healthcare (SHL)** – we are underweight the company on the grounds that normalisation of COVID-19 testing volumes are likely to create an earnings headwind for the company in contrast to recent significant earnings support from these services. While short-term earnings will remain robust, we expect EBITDA to decline in FY23 as fewer COVID-19 tests are issued. We do not regard its valuation as sufficiently compelling versus alternatives, with the company trading on 19.1 times elevated forward earnings.

## Market outlook

Financial markets have now embraced the risk of recession in the US and Europe over the past quarter and the gap between our more pessimistic forecasts for the global economy and the consensus has narrowed. Indeed, with the Fed signalling that financial conditions are close to neutral, we are edging closer to the point where the pace of monetary tightening will slow, providing some scope for risk markets to recover some lost ground.

Indeed, the period of excess inflation is starting to recede with prior surges in commodity prices retreating, an easing in supply constraints, and signs of slowing demand likely to compress elevated sales margins. As central banks continue to await firmer signs that inflation expectations have stabilised and for labour demand to ease, financial markets are faced with the positive news of less restrictive monetary policy and the negative news of likely weaker company earnings.

In a world of heightened concerns of recession in major developed economies, subdued economic activity in China and ongoing conflict between Russia and the Ukraine which has contributed to commodity shortages, high inflation and rising interest rates, the Australian economy presents as a relative safe haven.

Australia's economic data has remained robust in 1H2022, and although we do expect economic activity to slow in FY23 we do not expect a recession in Australia due to three 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 1H2022. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position.
2. The household sector continues to hold a significant buffer of over \$150bn of excess savings (approximately 7% of GDP) relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses to 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.
3. Low levels of spare productive capacity, strong profit and low corporate debt have contributed to robust capital investment intentions.

Over the medium term we believe a recovery in net immigration levels into Australia and Australia's exposure to the key commodities crucial to the global energy transition – including copper, lithium and iron ore – will provide a solid underpin for future economic growth.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 are likely to come via both significantly higher cash rates and a stronger currency. While we expect that the RBA Cash Rate

will finish the year at less than 2.5%, below market expectations of 3.0%, the A\$ risk continues to skew to the upside. Australia's external accounts are in their best position since the early 1970s, providing an incentive for the A\$/US\$ to commence an appreciation cycle, together with the attractive carry on offer, improving China economic data and the prospect the US\$ uptrend will peak as the Fed pivots from its aggressive hiking strategy. We expect the A\$ will finish 2022 at around 76 cents.

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

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	15.14	4.37	10.77
Consumer Discretionary	8.93	7.78	1.15
Consumer Staples	0.00	4.50	-4.50
Energy	5.10	4.38	0.72
Financials	12.31	14.57	-2.26
Health Care	4.70	9.11	-4.41
Industrials	11.69	10.02	1.67
Information Technology	14.75	8.27	6.49
Materials	21.18	20.66	0.52
Real Estate	0.00	12.81	-12.81
Utilities	4.19	3.54	0.64

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
Atlas Arteria	5.33	0.88	4.44
Carsales.com	5.16	0.86	4.30
Worley	5.10	0.63	4.47
QBE Insurance	4.97	2.03	2.94
ResMed	4.70	1.59	3.12

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Worley	5.10	0.63	4.47
Atlas Arteria	5.33	0.88	4.44
Link Administration	4.66	0.27	4.39
Underweights			
South32	0.00	2.10	-2.10
ASX	0.00	2.03	-2.03
Sonic Healthcare	0.00	1.95	-1.95

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	-3.60	0.62	2.47	4.86
Distribution return	2.50	2.09	2.57	2.80

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\$11.1 mn as at 31 July 2022	
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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