Investment Commentary
Quarter to 30 June 2022

Yarra Ex-20 Australian Equities Fund

Gross returns as at 30 June 2022

	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	1.90	-8.88	-13.00	-6.58	3.16	4.70	8.46	6.70
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	3.56	-10.23	-14.45	-9.01	2.48	NA	NA	NA
Excess return (before fees)‡	-1.66	1.35	1.45	2.43	0.68	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 30 June 2022

	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	0.97	-8.94	-13.20	-7.41	2.24	3.67	7.23	5.47
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	3.56	-10.23	-14.45	-9.01	2.48	NA	NA	NA
Excess return (after fees)‡	-2.59	1.29	1.26	1.60	-0.24	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 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

Australian equities declined sharply during the June quarter as Australia's first interest rate hike since 2010 pressured valuations, with only the Energy and Utilities sectors recording positive returns.

The S&P/ASX 300 Ex-20 Accumulation Index returned -14.5% for the quarter, taking its 12-month return to -9.0%. In comparison, the broader ASX300 declined 12.2% for the quarter and, globally, the MSCI World Index fell 14.2%. The benchmark's forward P/E declined from 16.5 times to 12.9 times as the RBA lifted the official cash rate by 75 bps to 0.85%.

Within Energy (+1.5%), coal producers continued to rise in value amid the global energy crisis, with thermal coal rising another 49% to $US386/t during the quarter. Whitehaven Coal (WHC) climbed +16.6% and New Hope Corporation (NHC) lifted +10.5%. Elsewhere, Worley (WOR, +10.3%) continued to rally amid growing demand for its engineering services in both oil & gas and sustainability projects, while oil refiners Viva Energy (VEA, +23.0%) and Ampol (+11.7%) benefited from the widening spread in the price of crude oil and petrol.

Within Utilities (+1.7%), AGL Energy (AGL, +6.9%) outperformed amid higher wholesale electricity prices, even as its proposed demerger (into coal generation and energy retailing businesses) was rejected by shareholders. Gas pipeline operator APA Group (APA, +8.2%) outperformed given its inflation-linked revenues and a renewed focus on its opportunities in the energy transition.

Conversely, the worst performing sectors included Consumer Discretionary (-17.7%), Information Technology (-26.3%) and Communication Services (-18.9%). In particular, retailers JB Hi-Fi (JBH, -29.1%) and Premier Investments (PMV, -28.3%) and media companies Nine Entertainment (NEC, -38.6%) and News Corporation (-26.4%) declined in response to the deteriorating consumer environment.

Elsewhere, Real Estate (-16.3%) also experienced widespread declines given its negative correlation to higher rates, led by Charter Hall Group (CHC, -33.2%), Scentre Group (SCG, -15.1%) and Dexus (DXS, -16.6%).

Portfolio review

Key Contributors

Atlas Arteria (ALX, overweight) – the toll road operator outperformed due to its transparent inflation hedge and, moreover, as IFM's global infrastructure fund took a 14.96% stake in the company, causing speculation of a possible takeover bid. We maintain an 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 sufficiently 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.

Worley (WOR, overweight) – the engineering services firm outperformed due to expectations the global energy crisis will stimulate capex for both oil & gas and energy transition projects. We remain overweight the company. Following the Jacobs ECR acquisition, the business is diversified across different markets and is, in our view, well positioned to capture higher structural demand from energy transition work to low carbon solutions in addition to its traditional work for the oil & gas industry. We believe WOR's valuation provides significant support at current levels, with the stock trading on 18.9 times consensus forward earnings, a sharp discount to the Industrials ex-Financials at 25.5 times.

Block (SQ2, underweight) – the digital payments company underperformed as the outlook for higher real rates pressured the tech sector's premium valuation. We are underweight on the grounds that its valuation (at a 12-month forward P/E of 50.4 times) more than captures the company's attractive growth outlook. In regard to Afterpay, we are negative on the BNPL industry given the prospect of heightened regulation (e.g. expense verification), increased competition, higher bad debts and the sustainability of current attractive margins.

Key Detractors

Nine Entertainment (NEC, overweight) – the media company underperformed despite delivering a solid trading update during the period, with the market more focused on the deteriorating macro environment. Management expects FY22 EBITDA to be up 22% y/y, unchanged versus its previous guidance, supported by slightly stronger underlying metrics. Our positive view remains premised on a supportive valuation, its high-quality digital assets (Stan, 9Now and Domain), and a number of cost saving initiatives in the short term. We believe the ad market's recovery is only partially factored into NEC's valuation, with the stock trading at 9.1 times forward earnings. At these levels, we also do not believe sufficient value is attributed to its subsidiaries when considering their long-term growth profile.

Northern Star (NST, underweight) – the gold miner underperformed alongside the gold price (-6% to $US1,817/oz) and in response to a disappointing 3Q22 result. While NST held FY22 guidance at 1.55-1.65mn ounces, it lifted all-in sustaining cost (AISC) guidance by $125/oz as it steps up development costs at its Pogo asset. We remain overweight the gold miner. We believe the company will benefit from higher-than-expected production and reserves/resource outcomes at its flagship KCGM SuperPit Mine, and we see the company's valuation as attractive at 3.7 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).

Tyro Payments (TYR, overweight) – the payment solutions provider underperformed as the outlook for higher real rates pressured the stock's valuation and, secondly, after the surprise departure of the chief executive. We remain overweight on the grounds that short-term headwinds (wage inflation, increased investment spending) are more than reflected in TYR's valuation. As the lead provider of software that allows payment terminals to be integrated into point-of-sale (POS) systems, in our view, TYR remains in a defendable position versus peers such as the banks which rely on a clunky intermediary.

Key Purchases

Xero (XRO) – we initiated a position in the accounting software company during the period, taking advantage of recent underperformance. While consensus continues to view XRO as a subscriber growth story, we see significant upside from higher average revenue per user (ARPU) and expansion into financial services. Regarding financial services (i.e. invoicing, payments), early stage growth is positive and, we believe, could grow to around 50% of revenues in the next 5 years. For ARPU, we expect growth to materialise as a result of XRO' strategy to have an open platform, use M&A to purchase the most successful adjacent apps to bring into its platform, and justify price rises by including them into the core platform. Lastly, on valuation grounds subscriber total lifetime value (LTV) fell below 1.2 times and will be less than 1 times by FY23, thus the stock no longer requires an extended period of time to grow into the valuation.

Chalice Mining (CHN) – we established a position in the palladium project developer during the period. Following its announcement of a maiden Julimar Resource last year, CHN, in our view, has substantially de-risked its world-class project based in Western Australia. The project comprises one of the few, large scale and high-grade deposits of palladium-group metals outside of Russia, which historically produced around 40% of global palladium supply. In regard to the market more broadly, we acknowledge demand is set to weaken in the long term for its traditional use to make catalytic converters (and reduce emissions) for internal combustion engine (ICE) vehicles. However, palladium also has a unique ability to absorb hydrogen (can absorb >900-times its own volume under suitable conditions), providing a range of potential future facing demand applications.

The Lottery Corporation (TLC) – we increased our position in the company following its de-merger from Tabcorp (TAH). Our investment thesis is premised on Lotteries 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%). In particular, we see TLC as resilient in the current market environment, holding a strong market position in a heavily regulated industry with high barriers to entry. While TLC carries ESG risk as a gaming company, we view Lotteries as a low-risk part of the market given small average ticket sizes, limiting player harm, and we see TLC as a global leader relative to peers.

Key Sales

Metcash (MTS) – we exited our position in the wholesale distributor during the period after strong outperformance. Within Food & Liquor, we continue to see MTS as a beneficiary of higher inflation as the supermarket industry remains rational in passing through higher prices. However, we anticipate the softening macro environment in Australia may limit any further market share gains, with the "shop local" theme likely to dissipate as consumers search for value. Within Hardware (now 41% of group EBIT), we support management's store rollout and refurbishment strategy, but expect we expect this will be more than offset by Australia's slowing housing market. As a result, we no longer see MTS's headline valuation (at a 12-month forward P/E of 14.2 times) as attractive given the risk to earnings as the cycle persists.

James Hardie (JHX) – we reduced our holdings to reflect the increased uncertainty and capture earlier outperformance. We continue to believe JHX can sustain growth ahead of the market and sell higher value products, which will likely compensate for risks around growth rates normalising and higher borrowing costs. 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 in the Repair & Remodel market) and the resolution of US supply and manufacturing issues.

Ansell (ANN) – we exited our position in the company to reflect greater uncertainty around the outlook for earnings. In the short term, raw materials costs and slowing demand for its single-use/exam gloves (to pre-COVID levels) represent significant risk to consensus forecasts. In the medium to long term, the company has significant exposure to slowing global economic growth through its Industrials division. As a result, we no longer saw the company's valuation as attractive at a headline P/E of 12.0 times on a 12-month forward basis.

Key Active Overweights

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 sufficiently 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. M&A risk, expressed in the period, suggests scope for the value gap to be closed on a shorter time frame.

Worley (WOR) – we believe the company is in a strong position to benefit from the recovery in its traditional work and, increasingly, new sustainability projects. Following the Jacobs ECR acquisition, the business, in our view, 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 17.9 times consensus forward earnings, a sharp discount to the Industrials ex-Financials at 21.8 times.

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 15.0 times forward earnings, a discount to the Industrials ex-Financials at 21.8 times.

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.

Sonic Healthcare (SHL) – we are underweight the company on the grounds normalisation of COVID-19 testing volumes are likely to create an earnings headwind for the company which has seen 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 view its valuation as sufficiently compelling versus alternatives, with the company trading 19.1 times elevated forward earnings.

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%, below the broader market at 3.6%.

Market outlook

Geopolitical events and surging commodity prices have taken centre stage in 2022, shaking risk sentiment and challenging consensus' optimistic forecast for global growth. 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 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 to try to contain rising inflation expectations. The reality for 2022 is likely 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 1H 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 settings at a 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 and improving government finances which suggests Australian economic growth in 2022 will remain more robust than its developed economy peer group. In CY2022 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) and further wage pressure will become evident into mid-2022.

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. 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, together with the attractive carry on offer. 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 Materials sectors, and are underweight Real Estate, Health Care and Consumer Staples.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.28	4.67	8.61
Consumer Discretionary	8.91	7.67	1.24
Consumer Staples	0.00	4.74	-4.74
Energy	5.26	4.36	0.90
Financials	12.74	14.73	-1.99
Health Care	3.86	9.06	-5.20
Industrials	11.73	10.12	1.61
Information Technology	12.89	7.69	5.20
Materials	23.41	20.72	2.70
Real Estate	0.00	12.55	-12.55
Utilities	4.19	3.69	0.50

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Atlas Arteria	5.75	0.99	4.76
QBE Insurance	5.44	2.30	3.14
Worley	5.26	0.68	4.59
TPG Telecom	4.74	0.28	4.46
Link Administration	4.63	0.25	4.38

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Atlas Arteria	5.75	0.99	4.76
Worley	5.26	0.68	4.59
TPG Telecom	4.74	0.28	4.46
Underweights			
South32	0.00	2.33	-2.33
Sonic Healthcare	0.00	2.02	-2.02
ASX	0.00	2.02	-2.02

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	-9.75	0.16	1.13	4.44
Distribution return	2.34	2.08	2.54	2.79

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$10.7 mn as at 30 June 2022	
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

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