

Yarra Ex-20 Australian Equities Fund

Gross returns as at 31 May 2023

	From 25 June 2018 ^A	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	5.98	-0.79	5.94	12.56	13.91	6.73	8.00	7.97
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	5.64	-1.48	0.94	2.28	9.42	NA	NA	NA
Excess return (before fees) [‡]	0.34	0.69	4.99	10.29	4.50	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 May 2023

	From 25 June 2018 ^A	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	5.02	-0.87	5.70	11.56	12.90	5.76	6.82	6.74
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	5.64	-1.48	0.94	2.28	9.42	NA	NA	NA
Excess return (after fees) [‡]	-0.62	0.62	4.75	9.28	3.48	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.

^A 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. 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 Australian equities market fell in May on the back of the RBA's hawkish move and global growth factors including the U.S. debt ceiling debate and reports of weak growth out of China. The 10-year bond rate rose to 3.6% following the resumption of cash rate hikes.

The S&P/ASX 300 Ex-20 Index generated -1.5% for the month, taking its 12-month return to +2.3%. The broader S&P/ASX 300 Accumulation Index returned -2.5% for the month, while the MSCI World Index recorded -0.9% return.

Information Technology (+9.7%) rallied for the month. Xero (XRO, +17.8%) was a key contributor to the sector's overall returns, following the company's announcement of a solid result with subscribers, revenue in line with expectations and EBITDA ahead of estimates. Other strong performers during the period were Wisetech (WTC, +9.2%) and NEXTDC (NXT, +11.2%).

Another sector that delivered positive returns for the month of May was Utilities (+1.1%), led by AGL (AGL, +13.1%) as the

market became increasingly comfortable with the electricity generator and energy retailer's near-term earnings outlook, supported by higher wholesale electricity costs.

By contrast, Consumer Staples (-8.2%) was the worst performer during the month, driven primarily by Treasury Wine Estates (TWE, -16.6%) which guided to a 2-3% drop in sales (y/y) for FY23.

Just behind was Consumer Discretionary (-6.3%), with IDP Education (IEL, -22.5%) tumbling after the Canadian government's decision to widen access to its Student Direct Scheme, further pressuring the sector's performance during the month. Several discretionary retailers including Lovisa (LOV, -22.5%), Premier Investment (PMV, -13.9%) and Super Retail (SUL, -15.5%) were also among the negative contributors to the sector return, reflecting concerns over tougher months ahead as household costs continue to rise.

Portfolio review

Key Contributors

NEXTDC (NXT, overweight) – following the announcement of its largest ever individual contract the previous month, the data centre provider continued to outperform as the market's conviction in Artificial Intelligence (AI) applications as a driver of demand growth grew. Most notably, global leading specialist chip maker Nvidia's commentary around AI driven demand growth supported previous comments made by NXT management.

Xero (XRO, overweight) – the online accounting software provider outperformed during the month after announcing a solid result, with subscribers and revenue in line with expectations and EBITDA ahead of estimates. The result saw XRO's new CEO provide more detail about the company's shift towards more disciplined growth with an increased focus on yield as a growth lever along with subscriber growth.

Worley (WOR, overweight) – our overweight position in the leading provider of global engineering services was a source of outperformance in May. The company provided a strong operating update at its annual investor day, with leading indicators (Factored Sales Pipeline +36%, Rolling 12 Month Bookings +28%, Backlog +8%) all improving. Additionally, WOR reported 39% of revenue for the half was higher margin sustainability-related work. We expect revenue to grow 13-15% in FY23, with leading indicators (Factored Sales Pipeline +36%, Rolling 12 Month Bookings +28%, Backlog +8%) and structural drivers (capital investment required to decarbonise) pointing to strong top-line growth. Margins are also set to accelerate over the coming years as WOR benefits from a more consolidated industry structure, operating leverage, and active mix management.

Key Detractors

Tyro (TYR, overweight) – the domestic payments provider underperformed in May after prolonged takeover negotiations came to an end. During the nine-month period that TYR has been under takeover, the stock has delivered four upgrades to its FY23 earnings guidance, demonstrating strong operating leverage and allaying prior concerns on the ability of the business to grow profitably. The stock now trades on 13.4 times FY24 EV/EBITDA which we regard as relatively undemanding given the company's growth profile.

James Hardie (JHX, underweight) – the leading fibre cement sheeting manufacturer to the housing industry outperformed in the period following the release of its FY23 financial results. While the result was broadly in-line, the company provided forward guidance for the June-quarter that was 10% ahead of market expectations, underpinned by solid volume and margin outcomes. While a quality building materials name, we remain cautious of the sustainability in end markets for JHX (a portion of discretionary renovation spend) making it difficult to support the stock at current valuation of 20.3 times forward P/E. Instead, we maintain a preference for plumbing supplies company Reliance (RWC), which trades on 15.3 times forward P/E.

Nine Entertainment (NEC, overweight) – the media company underperformed during the month following a trading update which guided to total full year television revenue growth declining by low single digits. NEC also reduced group EBITDA guidance for the full year, in part due to continued soft advertising conditions expected in the fourth quarter of the financial year, but most materially a reduction in the earnings contribution from its holding in Domain Group (DHG).

Key Purchases

Stockland (SGP) – we initiated a position in Australia's largest land subdivider, reflecting our expectations of the resilience of SGP's Trust assets (underpinned by suburban shopping malls) and the likely improvement in residential development sentiment and activity in CY24 as the RBA likely eases cash rates. Additionally, we like the strategic direction under the stewardship of CEO Tarun Gupta, shifting to a more capital light business model. New partnerships with large global investors such as Mitsubishi Estate Asia, in our mind, validate the strategy. The stock's valuation is attractive to initiate a small position, trading at 1.02 times net asset backing, and offering a 5.9% dividend yield.

Region (RGN) – we initiated a position in the suburban shopping mall owning REIT in the period. We believe RGN's retail asset base, which comprises 96 predominantly neighbourhood shopping centres, will prove to be resilient during the consumer downturn. This is supported by its high skew to supermarket/anchor tenant income (46% total Net Operating Income), affordable specialty rents (8.7% average occupancy cost) and high overall portfolio occupancy (98%). The stock valuation is attractive, at 0.95 times net asset backing and offering a 5.8% dividend yield.

Chorus (CNU) – we established a position in the high-quality regulated telecommunications utility during the month, which trades on a 5.8% FY24 dividend. As the build out of CNU's fibre network comes to an end, CNU will move to strong free cash flow generation, with a balance sheet that is under levered vs target gearing, and strong line of sight on regulatory revenues. Based on current market metrics, CNU would earn a nearly 300bp higher regulatory return in the next regulatory period from July 2024, providing further upside to the medium-term dividend yield.

NEXTDC (NXT) – we added to our position in the data centre provider during the period. Following the announcement of its largest ever individual contract the previous month, NXT has continued to outperform as the market's conviction in Artificial Intelligence (AI) applications as a driver of demand growth grew. Most notably, global leading specialist chip maker Nvidia's commentary around AI driven demand growth supported previous comments made by NXT management.

Key Sales

Northern Star Resources (NST) – we trimmed our position in the gold miner during the period as part of our decision to reduce our overweight to the gold sector. With gold prices trading above US\$2,000/oz during May, we see less commodity price upside at these levels. NST remains our preferred gold exposure given its asset quality and strong cost

control. Aspirations to grow the business from current production of ~1.5Moz pa to >2Moz pa by 2026 are achievable within the current portfolio led by the Thunderbox mill expansion project and improving grades at Pogo (Alaska).

Evolution Mining (EVN) – we trimmed our position in the gold miner during the period. With gold prices trading above US\$2,000/oz during May, we now see less commodity price upside at these levels. As a result, we chose to reduce the size of the overweight position to the gold sector. We continue to favour EVN for its rapidly improving balance sheet and increasing free cash generation, while resource upside at Ernest Henry and further turnaround potential at Red Lake lend additional support to our positive view.

Qantas (QAN) – the portfolio's position in Qantas was reduced during the month. The airline has experienced a period of unprecedented profitability with high demand and limited capacity coming out of COVID. While we believe some of the improvements in market structure that QAN is enjoying will persist, it is clear that profitability will reduce from current peak levels, warranting a smaller position.

Key Active Overweights

Reliance Worldwide (RWC) – the market is showing concern for a weaker demand environment for the manufacturer and distributor of plumbing and heating parts, with RWC's FY23 earnings estimates now lowered after recent market updates. We view RWC as a compelling opportunity; while the market is pricing for a significant decline in earnings (P/E of only 15.3 times vs 17.0 times mid-cycle), we remain constructive on the demand environment given the defensive nature of RWC's revenue base of which the majority relates to non-discretionary repair activity.

Worley (WOR) – we remain overweight the leading provider of global engineering services. WOR's earnings recovery is in its early stages following COVID impacts across FY20-22. Revenue is expected to grow 13-15% in FY23 with leading indicators (Factored Sales Pipeline +36%, Rolling 12 Month Bookings +28%, Backlog +8%) 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 WOR benefits from a more consolidated industry structure, operating leverage, and active mix management.

NEXTDC (NXT) – the portfolio holds an overweight position in NXT which we view as holding a leading position in the domestic data centre market with a proven ability to deploy capital into its data centres at attractive returns. NXT's recent and very large 36MW increase in contracted capacity demonstrates the continued structural growth of demand for data centre capacity in the Australian market, mirroring global trends. We view NXT's current 29 times FY25 EV/EBITDA multiple as attractive given these trends.

Key Active Underweights

Brambles (BXB) – we remain underweight the global provider of pallet pooling solutions to various FMCG producers. Brambles currently has strong momentum (16% underlying

profit growth in 1H23), with expectations for 17-19% growth over FY23 and improving free cashflow. We are cautious, however, on the sustainability of the current high level of profit and believe the market is already factoring in improving free cash flow at current levels.

Sonic Healthcare (SHL) – our underweight position in Australia's largest pathology provider is premised on our view of a sluggish outlook for business-as-usual operational volume growth, lower future earnings as high margin COVID testing services continue to normalise, and a tough cost environment given industry wide staffing and funding challenges. Finally, SHL's valuation is not yet compelling, with the stock trading on 23.1-times forward P/E and 10.5 times EV/EBITDA.

James Hardie (JHX) – we retain an underweight position in the leading building materials supply company. Notwithstanding a number of quality aspects to JHX's business (i.e. share growth, a responsive operational and manufacturing footprint) we remain cautious of the ongoing strength in end markets for JHX (a portion of discretionary renovation spend, often labelled as remodelling activity). These factors are suggestive of future earnings vulnerability, making it difficult to support the stock at current valuation of 20.3 times forward P/E. Our preference remains for Reliance Worldwide (RWC), which trades on 15.3 times forward earnings.

Market outlook

We have been of the view that the June quarter 2023 will mark the top of the interest cycle for most of the developed world, however, global central banks are seemingly prepared to continue hiking interest rates despite evidence inflation is moderating, lending availability tightened and economic growth is faltering. With respect to the latter, we have received confirmation that the Euro Area entered recession and the Federal Reserve staff have retained their forecast that a modest recession in the US is likely. Nevertheless, it seems the appetite for policy makers to persist with the tightening cycle into Q3 has remained, with central bankers seemingly perplexed at why services inflation has yet to ease and why the labour market has yet to ease appreciably. It is possible that a pause in the hiking cycle in June by the Fed will set the scene for a pause across most of the developed world, however, the risk of overtightening and even weaker economic activity is now a real prospect. We believe the US labour market is set to post more modest employment gains from mid-23 which in concert with improving labour supply will continue to moderate wage growth and help underwrite the commencement of a gradual easing cycle in the US by the end of 2023. However, we have to acknowledge that the message from most central banks is that further hikes may be required and an interest rate easing cycle is not in prospect.

This weak economic growth narrative in concert with enthusiasm over the potential impacts from AI has seen large cap 'growth' stocks drive a narrow but strong equity market rally. This has largely hidden from view an ongoing negative earnings revision cycle which in concert with rising bond yields

is leaving aggregate markets valuations looking more challenging.

Economic growth has also slowed in Australia, recording just 0.3% qoq growth in the March quarter and much of this growth can merely be traced to strong population growth and ongoing engineering construction projects. It is clear the prior tightening of monetary policy is having a material impact on the interest rate sensitive parts of the economy. Nominal retail sales have slowed to 0% six-month annualised, following on from declining volumes in recent quarters. Building approvals continue to decline and are likely to decline further in coming months as declining housing affordability outweighs the impact of an under supplied housing market. Moreover, it is also clear that despite the Federal Budget forecast to return to surplus, that government demand growth is waning even faster than private demand growth.

Nevertheless, after describing the May decision to increase interest rates as finally balanced, the Reserve Bank of Australia (RBA) followed up with a further hike in June and has flagged that further tightening may be required. The RBA has clearly shifted its focus to worrying about weak productivity growth and high unit labour costs as the main reason for fearing inflation may be higher than it forecasts. We think this ignores the fact that average compensation per hour has not risen sharply, and the main reason for high unit labour costs is a surge in hours worked and employment as the influx in immigration is absorbed into a slowing economy. This shift in the RBA's focus risks a further hike in July or August, however, in our view the RBA would have been better served to pause after the May rate hike, rather than risking a harder economic landing.

Australia should still be able to avoid a technical recession due to four key reasons:

1. Australia has been a net beneficiary of global commodity shortages and the prior surge in commodity prices. Commodity prices are now off their peaks, and although they remain very elevated from a historical perspective, the impact of moving through the peak will be for nominal GDP growth will slow quickly over the next 6 months, removing some of the cushion that has protected corporate profits, tax receipts and wage growth.
2. The household sector continues to hold a significant buffer of excess savings which can be used to smooth consumption growth amid acute cost of living pressures. Nevertheless, our analysis suggests that the residual of the savings buffer skews to older households, leaving younger and more indebted households exposed. As such we remain particularly cautious on discretionary retail spending.
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. The limiting factor nearer term is that escalating costs and project delays risk pushing out the economic benefits.

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 has occurred in recent months, ensuring that Australia's population growth will exceed 2% in 2023. This will be the primary mechanism keeping Australia out of recession, yet it comes with the complication of exacerbating the rental shortage evident across all capital cities.

While the RBA has been later than most other developed nations we believe financial conditions are now firmly in the restrictive zone. 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. Surprisingly, the RBA cited the A\$ and house prices as a catalyst for the May rate hike, neither of which had risen materially. While interest rate hikes in Australia will remain a month-to-month proposition for the next six months, our bias is that the RBA should have concluded its hiking cycle yet an ever-shifting RBA framework suggest they may hike again in July or August. It is unlikely that policy easing will be delivered in 2023, however, we do expect that the RBA will commence a modest easing cycle in 1H24.

The A\$/US\$ had been under downward pressure as markets grappled with a seemingly more hawkish Fed and a relatively more dovish RBA. However, the RBA has recently sounded more hawkish than the Fed the A\$ has started to appreciate. 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 hiking strategy to an easing cycle in 2023, we expect the A\$/US\$ will appreciate to the mid-70s towards the end of 2023.

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

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	14.06	4.49	9.58
Consumer Discretionary	10.56	7.24	3.32
Consumer Staples	3.28	3.96	-0.69
Energy	0.00	3.82	-3.82
Financials	12.18	14.69	-2.51
Health Care	4.58	9.30	-4.73
Industrials	10.72	12.75	-2.04
Information Technology	13.74	6.88	6.86
Materials	21.51	21.69	-0.18
Real Estate	3.90	11.50	-7.59
Utilities	5.22	3.68	1.54

Top 5 holdings

	Portfolio %	Benchmark %	Active %
QBE Insurance	5.30	2.51	2.79
Origin Energy	5.22	1.66	3.56
Reliance Worldwide	4.78	0.38	4.40
Worley	4.66	0.70	3.95
Nextdc	4.60	0.76	3.85

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Reliance Worldwide	4.78	0.38	4.40
Worley	4.66	0.70	3.95
Nextdc	4.60	0.76	3.85
Underweights			
Brambles	0.00	2.21	-2.21
Sonic Healthcare	0.00	1.96	-1.96
James Hardie	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	8.26	10.53	3.38	4.04
Distribution return	3.30	2.36	2.38	2.78

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\$12.0 mn as at 31 May 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

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

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