

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 31 August 2023

	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	5.78	-2.22	0.48	13.20	10.84	4.72	7.57	7.85
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	5.92	-1.42	2.79	6.62	7.82	5.68	N/A	N/A
Excess return (before fees) <sup>‡</sup>	-0.14	-0.80	-2.31	6.57	3.02	-0.95	N/A	N/A

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 August 2023

	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	4.83	-2.29	0.26	12.19	9.85	3.78	6.40	6.63
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	5.92	-1.42	2.79	6.62	7.82	5.68	N/A	N/A
Excess return (after fees) <sup>‡</sup>	-1.10	-0.87	-2.53	5.57	2.03	-1.90	N/A	N/A

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. 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 weakened during the August month on the back of a volatile reporting season.

The S&P/ASX 300 Ex-20 returned -1.4% for the month, taking its 12-month return to +6.3%. In comparison, the broader S&P/ASX 300 reported a decline of 0.8% for the period and globally, the MSCI World Index was down by 2.3%.

Communication Services (+3.3%) outperformed during the month with Carsales.com (CAR, +15.6%) largely influencing the sector performance. On the back of its solid FY23 financial results, the online auto classifieds also shared a positive outlook around its expected strong growth in revenue, adjusted EBITDA and NPAT for FY24.

Another positive sector contributor was Consumer Discretionary (+2.4%) with several retailers rallying during the month amidst FY23 results that were in line with downgraded expectations. Notable stocks within the sector were Premier Investments (PMV, +16.1%), Domino's Pizza (DMP, +11.0%) and G.U.D Holdings (GUD, +24.0%).

In contrast, Health Care (-6.2%) was among the weakest performing sectors. Although Cochlear (COH, +13.5%) delivered a solid month following its FY23 earnings release, its commendable contribution was overshadowed by the underperformance of Resmed (RMD, -24.0%). Sonic Healthcare (SHL, -8.5%) and Ramsay Health Care (RHC, -12.6%).

## Portfolio review

### Key Contributors

**Carsales.com (CAR, overweight)** – the online auto classifieds company outperformed during the month following its full-year results. The results proved up CAR's investment case of the recent acquisitions of Trader Interactive in the US business and Webmotors in Brazil with both businesses demonstrating double digit yield growth as dynamic pricing models were introduced. Combined with a strengthened market position in Australian private car sales, there is now much greater visibility around continued price and yield increases across the business.

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**WiseTech (WTC, underweight)** – the logistics industry software solutions provider underperformed during the period following its full-year result, where earnings guidance for the next financial year fell well short of consensus estimates. The miss was driven by higher-than-anticipated investment expenses and margin dilution from recent acquisitions.

**NEXTDC (NXT, overweight)** – data centre operator NEXTDC continued to perform strongly during the month after announcing another large step-up in contracted capacity. NXT has signed 25MW of capacity mainly in its M2 (Melbourne) data centre. This brings NXT to a 60MW (70%) increase in contracted capacity in the last three months, highlighting a step change in demand for data centre capacity and the company's market leading capability.

### Key Detractors

**Resmed (RMD, overweight)** – our overweight position in the medical equipment manufacturer detracted during the month following its full-year results. A number of characteristics driving this share price weakness includes an increased focus on the potential future impact of weight loss drugs GLP-1s on the sleep-apnoea market; the return of competitor Phillips into the sleep-apnoea device market in the USA; and, to a lesser extent degree of gross margin disappointment following delivery of the company's full year result. Notwithstanding the above factors, we continue to see a solid market penetration outlook for RMD's CPAP devices, and hence believe these are factored into expectations at current levels with the stock trading on an attractive valuation (21.6x P/E NTM vs 28.1x long-term average).

**Alumina (AWC, overweight)** – our overweight position in the alumina producer was a detractor during the month following its half-year results. We are concerned that environmental approvals to mine, close to the Serpentine dam may not be received in a timely manner, and the company has less than 12 months of remaining low-grade ore to mine at Huntly. We see a material risk that the Kwinana and Wagerup refineries may be forced to curtail production or even close at a time where the company's debt levels are approaching unsustainable levels. This has led us to exit the position.

**Iluka (ILU, overweight)** – our overweight position in the mineral sands company was a detractor during the month. Iluka reported a 10% decline in mineral sands revenue and a 22% decline in underlying EBITDA in its FY23 results. Additionally, the market was concerned over the short-term outlook for mineral sands demand, notwithstanding ILU's commentary of flat pricing in the second half. We continue to like mineral sands markets long-term and favour ILU's leverage as the world's largest Zircon producer and fifth largest producer of titanium feedstocks. Iluka is moving into Rare Earths production through the Eneabba refinery and would be a critical component producer for the EV industry.

### Key Purchases

**APA Group (APA)** – we initiated a position in the gas transmission pipeline company via participation in an equity raising used to fund Alinta's Pilbara assets. The acquisition of the Alinta assets gives APA an attractive platform to deploy

capital into the decarbonisation of mining operations in the Pilbara through the development of renewable generation and transmission infrastructure. APA trades on a valuation of 11.5x FY24 EV/EBITDA and a 6.5% dividend yield, which we view as an attractive entry point.

**Resmed (RMD)** – we added to our RMD position to take advantage of recent share price weakness following the release of the FY23 results. The stock sold off due to concerns around a range of factors including gross margins, competitive landscape and the potential for emerging weight loss drugs to impact the addressable market for sleep-apnoea devices. We are not as bearish on these issues, with our favourable view predicated on RMD's large and underpenetrated market (sleep and COPD, chronic obstructive pulmonary disease), clear operating leverage over time (SG&A and R&D) and strong track record of capital deployment as the business shifts further into digital, connected care solutions for its patient base. Subsequently, we took the opportunity to add to the position with the stock trading at an attractive valuation (21.6x P/E NTM vs 28.1x long-term average).

**JBH (JBH)** – we increased our position in the retailer reflecting our confidence in JBH, as it continued to take share and overcome the broader weakness in the consumer electronics and home appliances category. We view JBH as a best-in-class operator that is well positioned to navigate the volatility ahead despite a softening consumer environment, with strong cash generation and a robust balance sheet. Unlike its peers, consensus earnings already reflect a -28% EPS correction in FY24, resulting in JBH trading at a discount vs. history which we believe is unwarranted (13.3 times P/E vs. 14.3 times long-term average).

### Key Sales

**Alumina (AWC)** – we exited our position in the alumina producer following the company's FY23 interim result. We are concerned that environmental approvals to mine close to the Serpentine dam may not be received in a timely manner and the company has less than 12 months of remaining low-grade ore to mine at Huntly. We see a material risk that the Kwinana and Wagerup refineries may be forced to curtail production or even closed at a time where the company's debt levels are approaching unsustainable levels.

**Worley (WOR)** – we took the opportunity to trim the size of the WOR overweight following a strong performance following the release of the company's 1H23 result. The company continues to grow engineering service revenues into both traditional and renewable energy end markets at strong double-digit rates, with margins continuing to improve over time.

### Key Active Overweights

**Carsales.com (CAR)** – we are overweight the online car classifieds company which has demonstrated strong yield growth potential across all of its operating segments. In Australia, which represents approximately 50% of CAR's valuation, CAR is seeing improving yields from products such as Instant Offer and Select in Australia along with a

strengthened competitive position in private sales. CAR's recent acquisition of US business, Trader Interactive and Brazilian business Webmotors have demonstrated strong yield growth as new dynamic pricing models are introduced. The visibility on CAR's medium term revenue growth has improved which makes the 32.2 times FY24 earnings multiple the stock trades on relatively undemanding given the tailwinds.

**Reliance Worldwide (RWC)** – we view the plumbing supplies company as a compelling opportunity, with the market capitalising FY24 earnings at a P/E of only 14.9 times vs 17.0 times mid cycle) which we believe doesn't give appropriate credit to the mid-cycle earnings power of the group considering the resilience of its end markets, the majority of which relates to more non-discretionary, repair-type housing activity.

**Worley (WOR)** – we remain overweight the leading provider of global engineering services. WOR's earnings recovery is in its early stages following COVID-19 impacts across FY20-22. Revenue is expected to grow 13-15% in FY24, 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 increase over the coming years as WOR benefits from a more consolidated industry structure, operating leverage, and active mix management.

### Key Active Underweights

**Brambles (BXB)** – we remain underweight the global provider of pallet-pooling solutions to various FMCG producers. Supported by a favourable pricing environment, Brambles currently has strong momentum generating 14% revenue growth and 19% EBIT growth in FY23, with improving free cash flow. Looking forward however, we are cautious on the sustainability of the current high level of profit growth as customer demand and pricing dynamics normalise.

**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 approximately 20 times forward P/E. Our preferred building materials company remains Reliance Worldwide (RWC), which trades on 14.9 times forward earnings.

**Cochlear (COH)** – we remain underweight the global producer of hearing technologies. While COH's key developed and emerging markets have largely recovered following COVID as hospital capacity issues normalise, we are cautious on the outlook for some operating costs in the higher inflation environment, and on the implied stock valuation metrics at current levels of 48.8-times forward P/E and 31.5-times EV/EBITDA for FY24. Given strong underlying ear implant

demand globally – supported by COH's ongoing investment into clinical awareness – we do think the company is well positioned to return to its historical growth rates, and indeed should be supported by the release of its new Nucleus 8 sound processor.

### Market outlook

With the major central banks declaring that further interest rates are now data dependent and as evidence continues to accumulate that inflation continues to moderate, our long-held view that mid-2023 would mark the top of the interest rate cycle appears to be broadly on track. Crucially, both labour markets and core services inflation have eased in recent months and forward indicators suggest further progress should be made through the rest of 2023.

Moreover, the pessimistic tone of the economic activity data in the US that threatened a technical recession has given way to slightly more updated data in recent weeks encouraging the belief that the US will escape a technical recession in 2023. Indeed, some leading indicators are suggesting that a broader turn in the global industrial cycle is at hand, which should encourage a rotation from a narrow mega-cap tech led equity market rally to broader participation in 2023.

Indeed, our leading indicators suggest the negative EPS revisions trend has now largely run its course, which when combined with a levelling out in economic momentum and an end to the interest rate tightening cycle, will likely provide greater confidence in underlying valuations and a shift from bearish equity positioning. Bond yields continue to provide the more significant challenge to equity market valuations, albeit the lift in bond yields into mid-2023 can largely be attributed to a significant lift in the supply of US bonds as the US budget deficit continues to increase sharply, thereby providing a counter cyclical boost to economic growth.

Economic growth has also slowed in Australia, recording just 0.4%q/q growth in the June quarter, similar to the languid growth recorded in the March quarter. Indeed, with population growth running at a 2.5% annualised pace in the six-months to June and economic growth expanding at an annualised 1.8% pace over the same period, Australia has recorded its first per capita recession since mid-2006 (excluding the COVID lockdown period). It is clear the prior tightening of monetary policy is having a material impact on the interest rate sensitive parts of the economy. For instance, discretionary consumption volumes have declined 0.6% (six-month annualised) as non-discretionary household expenses and interest costs soared by 16%yoy – the fastest annual increase since 1989. Building approvals continue to decline – now down 45% from the 2021 peak - and are likely to fall further in coming months as declining housing affordability outweighs the impact of an under supplied housing market.

Nevertheless, the good news is that after a pause in the tightening cycle in July, The Reserve Bank of Australia (RBA) has remained on hold and flagged that future monetary policy adjustments will be data dependent. To be clear, the RBA retains a tightening bias, however an update of their inflation forecasts now has inflation returning to inside the target band

in 2025, providing a signal that absent any unexpected inflation shocks the RBA's rate tightening cycle is complete. The RBA also revised down economic growth modestly to just 1.0% in 2023, acknowledging that local economic growth had faltered. It is of note that the RBA's forecasts for domestic growth are now below our own for the first time since 2019.

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 slow nominal GDP growth quickly over the next six 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 domestically 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 second largest copper resource. LNG is an important energy transition fuel – it currently accounts for 23% of global electricity generation – and 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 2.5% 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. While interest rate hikes in Australia will remain a month-to-month proposition, our analysis suggests that the RBA should have concluded its hiking cycle. Moreover, we do expect that the RBA will commence a modest easing cycle in 1H24, most likely commencing in May 2024.

The A\$/US\$ had been under downward pressure as markets grappled with a seemingly more hawkish Fed and a relatively more dovish RBA and poor sentiment on the economic outlook for China. However, 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 re-emerge as the Fed pivots from its hiking strategy to an easing cycle in early 2024, we expect the A\$/US\$ will appreciate to the low-70s towards mid-20. We are most overweight stocks within the Communication Services, Information Technology and Utilities are underweight Health Care, Industrials and Real Estate.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	15.11	4.83	10.28
Consumer Discretionary	10.69	7.70	2.99
Consumer Staples	0.00	3.61	-3.61
Energy	0.00	3.23	-3.23
Financials	12.53	15.72	-3.20
Health Care	4.27	8.60	-4.32
Industrials	9.06	13.14	-4.08
Information Technology	12.61	7.03	5.58
Materials	17.54	21.26	-3.72
Real Estate	7.46	11.15	-3.69
Utilities	7.91	3.74	4.17

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
Carsales.com	5.44	1.23	4.21
Origin Energy	5.37	1.70	3.66
QBE Insurance	5.16	2.53	2.62
Worley	4.64	0.74	3.90
NEXTDC	4.48	0.79	3.69

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Carsales.com	5.44	1.23	4.21
Reliance Worldwide	4.42	0.37	4.05
Worley	4.64	0.74	3.90
Underweights			
Brambles	0.00	2.36	-2.36
James Hardie	0.00	2.33	-2.33
Cochlear	0.00	2.03	-2.03

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	10.13	7.55	1.45	3.78
Distribution return	2.06	2.31	2.32	2.62

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\$11.9 mn as at 31 August 2023	
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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