YARRA
CAPITAL MANAGEMENT

Investment Commentary
Quarter to 30 June 2018

Yarra Income Plus Fund

Total returns as at 30 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 Income Plus Fund	0.75	2.09	3.18	4.15	4.77	5.76	6.02
Growth return†	-0.01	1.32	0.54	-0.32	0.57	0.99	0.69
Distribution return†	0.76	0.77	2.64	4.47	4.20	4.77	5.34
Bloomberg AusBond Bank Bill Index	0.15	0.49	1.78	1.95	2.22	3.34	4.50
Excess return‡	0.60	1.60	1.40	2.20	2.55	2.42	1.52

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 of Yarra Income Plus Fund: May 1998.
† The Growth Return is measured by the movement in the Fund's units 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 distributions amounts deemed as capital distributions.
‡ Excess Return: The excess return figures shown represent the difference between the Fund's return and the benchmark return.

Portfolio review

The Yarra Income Plus Fund returned 2.09% over the June quarter, outperforming the Bloomberg AusBond Bank Bill Index by 160 bps on a net basis. The return was largely driven by the Fund's exposure to Australian listed property, infrastructure and utilities, followed by hybrids and FRNs. On a 12-month view, the Fund has returned 3.18%, outperforming the Bloomberg AusBond Bank Bill Index by 140 bps on a net basis.

Adjustments to asset allocation during the quarter resulted in the portfolio shifting from an overweight to a neutral position in Australian 'real assets' (listed property, infrastructure and utilities), offset by a larger overweight in hybrids and FRNs. The prior switch into an overweight position in real assets proved timely as we captured its strong recovery over the quarter. Elsewhere, we maintained our underweight positions in global high yield and fixed income and shifted to an overweight position in cash.

Market review

Geopolitics continued to dominate headlines over the June quarter. Global risk sentiment deteriorated on fears of an anti-EU Italian government forming. US trade tensions with other countries (China in particular, as well as Europe, Mexico and Canada) intensified. Reports of the US-North Korea summit oscillated between being strongly positive and negative, ultimately ending the quarter on an optimistic tone. Corporates warned that manufacturing jobs in the US and UK were at risk due to the trade outlook, threating to move factories offshore.

Performance of sovereign bond yields were mixed over the quarter. The US Federal Reserve (Fed) increased rates as expected at its June meeting, and their projections indicated they saw rates hiking at a faster pace than previously expected. Economic conditions were strong, with the Fed more confident on the inflation outlook. The European Central Bank signalled it would maintain its asset purchases at EUR30bn per month until September, then reduce to EUR15bn per month until December. It then indicated it would keep interest rates at its current low level until at least after the summer of 2019, a longer time than many had expected.

Australia economic data were mostly positive. Q1 GDP was a strong 1.0%q/q, 3.1%y/y, helped by a large contribution of 0.5 ppt from net exports. Consumption was only 0.3%q/q, supported by the non-discretionary services as retail spend was broadly flat. The terms of trade improved sharply by 3.3% as export prices rose. Q1 headline CPI was below expectations at 0.4%q/q, 1.9%y/y though core was a little stronger, at 0.5%q/q, 2.0%y/y. This was the first time since 4Q15 that core CPI printed within the RBA's target range.

The Australian government budget showed a return to surplus a year earlier than previously expected and included personal tax cuts while maintaining commitments to infrastructure investment. Consumers viewed the budget positively, but sentiment was still a little lower on the quarter to be at 102.1 in June. Business conditions fell 5 pts from near-record highs but remains well above long-term averages.

Gains in the labour market slowed, rising 12k in June. The pace of growth slowed to 2.5%y/y and the unemployment rate fell to 5.4%, though this was due to a lower participation rate. Despite jobs gains over the past year, the unemployment rate has remained in a 5.4-5.6% range. Underemployment rose by 0.1%. The spare capacity in the labour market saw Q1 wages growing at a subdued 0.5%q/q, 2.1%y/y. The announced annual minimum wage increase of 3.5%, effective July 1, was the largest since 2010.

Sector review

Australian Listed Property, Infrastructure and Utilities

The market cap weighted index of Australian listed property, infrastructure and utilities returned 9.3% over the quarter, outperforming the S&P/ASX 200 Accumulation Index, which returned 8.5%. Australian real assets also outperformed global equities with the MSCI World Index returning 3.8%. A number of corporate actions supported real assets. By sector, Utilities and Infrastructure stocks rose by 8.4% in the quarter, and Australian REITs rose 10.0% over the quarter.

Global High Yield

In line with most risk assets, global high yield market continued to face increased volatility as spreads widened further. Over the quarter, the ICE BofA Merrill Lynch Global High Yield Constrained Index returned 2.49% in AUD, with all of the returns due to movements in the currency. Option Adjusted Spreads widened 38 bps, to close at 399 bps over treasuries and bond yields (yield to worst) increased 54 bps to finish the quarter at 6.24%.

Investment Grade Corporate Credit

Australian credit spreads for both financials and corporates widened over the quarter. Increasing trade tensions and geopolitical risks drove spreads wider. High issuance also had an impact. The hybrid market ended the month positively. In credit derivatives, the Markit iTraxx Australia Index widened 10 bps to finish the quarter at 80.5bps.

Australian Fixed Income

The Reserve Bank of Australia (RBA) left the cash rate on hold at 1.50%. While it stated that the next move in rates was likely to be up, it repeatedly emphasised that progress towards its economic targets – and thus the outlook for rate hikes – was gradual. The RBA sounded more confident on the economy, especially around non-mining business investment and activity. While also positive on the labour market, the RBA's main concern was that it could not reach its inflation target without a sustained increase in wages. The RBA remained cautious on high levels of household debt. There were some increasing risks to the RBA's outlook base case from international developments on trade, political uncertainty in Italy and emerging markets. Medium term growth projections in the Statement on Monetary Policy were mostly unchanged, though inflation projections were marginally higher. The RBA projects that core inflation will remain at the bottom of its 2-3% target band until end-2019. The Australian yield curve steepened by 2 bps over the quarter: the 3-year government bond yield rose 1 bp to 2.06% and the 10-year government bond yield rose 3 bps to 2.63%. The Bloomberg AusBond Composite Bond Index returned 0.82% over the quarter.

Portfolio strategy

We have shifted from an overweight to neutral position in Australian listed property, infrastructure and utilities. The sector rebounded strongly over the quarter as fears of rising bond yields eased. While we continue to see appeal for real assets due to their earnings resilience, attractive yields and inflation hedge properties, valuations now appear to be fair.

We increased our overweight position in corporate credit over the quarter, expressed via an overweight position in domestic investment grade hybrids and FRNs, partially offset by an underweight position in global high yield credit. Our bias to investment grade hybrids and FRNs is mostly driven by their floating rate interest exposure versus global high yield, which exposes the Fund to interest rate duration risk. In addition, we expect volatility and dispersion among sectors and issuers to increase as we advance into the economic and credit cycle.

From a domestic perspective, we continue to believe Australian credit will remain attractive versus global peers due to its higher quality and lower duration (high floating rate exposure). Should outright yields rise aggressively, we expect the asset class to outperform on a relative basis. We expect credit fundamentals (i.e. issuer quality) will continue to support credit spreads in Australia. Australian corporates continue to display a disciplined approach to their balance sheet and liability management and there appears to be little evidence of Australian Corporates appreciably increasing leverage. The domestic major banks also continue to be proactive, in raising capital and remain committed in their quest to become "unquestionably strong". Any new issuance will likely be met with strong demand, as supply/demand trends continues to be favourable, placing upward pressure on corporate credit and hybrid pricing.

We have maintained an underweight position in Australian fixed income over the quarter. We expect the RBA will leave the cash rate unchanged at 1.50% throughout 2018. With a low inflation outlook and wage pressures remaining subdued, we believe that the RBA will have little reason to lift the cash rate. Pleasingly, leading indicators are pointing to a firm employment outlook, but with underemployment remaining relatively high, the economy continues to retain spare capacity. Overall, the growth outlook remains solid, helped significantly by strong infrastructure investment, particularly in NSW and Victoria. As a result, we believe there will be little change to short-term bond yields. Long-term bond yields, however, will likely increase, as the economic business cycle returns to normal.

Asset allocation

	Portfolio %	Neutral position %§	Strategy	Yield %*
A-REITs, Infrastructure and Utilities†	15.3	15.0	Neutral	5.2
Global High Yield‡	3.0	10.0	Underweight	6.2
Hybrid and FRNs†	25.6	15.0	Overweight	5.2
Australian fixed interest‡	15.2	20.0	Underweight	2.6
Cash‡	40.9	40.0	Overweight	1.5

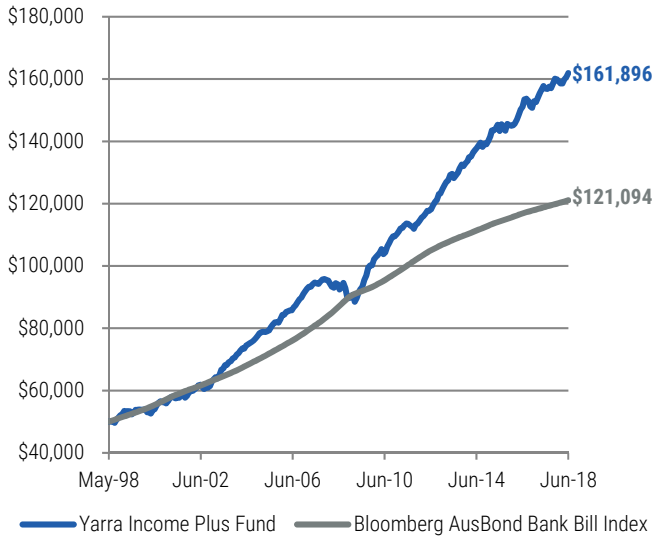
Source: Yarra Capital Management. Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.
§ Neutral position is calculated by Yarra Capital Management and is believed to be the optimal asset allocation for this portfolio over the long term.
* Projected estimation as at the date of this commentary.
† Maximum combined exposure to hybrid and property, infrastructure and utilities securities is 50%.
‡ These asset classes combined must be within a range of 50–100%.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.

Features

Investment objective	To provide regular income and to achieve medium term capital growth through exposure to cash, money market products, domestic fixed interest and a range of high yielding investments, including domestic hybrid investments, property, infrastructure and utilities securities and international fixed interest assets. In doing so, the aim is to outperform the Bloomberg AusBond Bank Bill Index over rolling 3-year periods.	
Benchmark	Bloomberg AusBond Bank Bill Index	
Fund inception	May 1998	
Fund size	Pooled Fund A$100.43 mn as at 30 June 2018	
APIR code	JBW0016AU	
Estimated management cost	0.68% p.a.	
Buy/sell spread	+/- 0.10%	
Distribution frequency	Quarterly	
Platform availability	Asgard BT Wrap BT Panorama Colonial FirstWrap Macquarie Wrap Consolidator MLC Wrap	OnePath PortfolioOne Oasis Netwealth PowerWrap SmartWrap Hub24

Investment performance comparison of $50,000

After fees, since inception of the Yarra Income Plus Fund, May 1998 to June 2018.



For illustrative purposes only. Past performance does not guarantee future results, which may vary. The total net fund returns shown are prepared on an exit to exit basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the Bloomberg AusBond Bank Bill Index is for comparative purposes only.

Applications and contacts

Investment into the Yarra Income Plus Fund can be made by Australian resident investors only.

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