Investment Commentary
Quarter to 30 September 2018

Yarra Income Plus Fund

Total returns as at 30 September 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	-0.29	0.74	3.81	4.38	4.43	5.78	5.98
Growth return†	-0.79	0.24	1.27	0.03	0.26	1.06	0.69
Distribution return†	0.50	0.50	2.54	4.34	4.17	4.73	5.29
Bloomberg AusBond Bank Bill Index	0.16	0.52	1.87	1.94	2.19	3.19	4.47
Excess return‡	-0.45	0.22	1.94	2.44	2.25	2.59	1.51

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.
Due to differences in business dates at month end, Fund performance returns are provided as at 27 September 2018, and benchmark performance returns are provided as at 30 September 2018. The monthly, quarterly and annual performance returns have been impacted.
* 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 0.74% over the September quarter, outperforming the Bloomberg AusBond Bank Bill Index by 22 bps on a net basis. The return was largely driven by the Fund's exposure to Hybrids and FRNs, while all other asset classes also had a positive quarter. On a 12-month view, the Fund has returned 3.81%, outperforming the Bloomberg AusBond Bank Bill Index by 194 bps on a net basis. We maintained our tactical asset allocation during the quarter: a neutral position in Australian listed property, infrastructure and utilities, as well as overweight positions in hybrids and FRNs and cash. We also maintained our underweight positions in global high yield and Australian fixed interest.

Market review

US-China trade tensions continued to feature prominently during the September quarter. The US imposed a 10% tariff on US$200bn of imports from China effective late September. US trade relations with the rest of the world (including Mexico and Canada, Korea and Japan) improved. In Europe, Brexit negotiations remained challenging and Italy's planned fiscal expansion continued to be a concern.

Sovereign bond yields were mostly higher over the quarter. The US Federal Reserve (Fed) increased rates as expected at its September meeting, and their projections indicated they expected rates to increase at the same pace as their previous forecasts. i.e. one further hike in December and three further hikes in 2019. Economic conditions were strong, with the Fed more confident on the inflation outlook. The European Central Bank sounded more confident on inflation and repeated it would reduce asset purchases to EUR15bn per month from October until December, and keep interest rates at its current low level until at least after the summer of 2019. The Bank of England increased rates in August for only the second time since 2007 and signalled a gradual and limited ongoing tightening in policy.

Australia economic data were mostly positive. Q1 GDP was a strong 0.9%q/q, 3.4%y/y. Consumption notably grew at 3.0%y/y as household spending was solid across a broad range of categories including retail. Employment growth helped household incomes, but there was little sign of wage inflation accelerating. Employment rose 44k in August, with large gains in full time jobs reported. The pace of jobs growth was steady at 2.5% and the unemployment rate at 5.3%. Wage growth was slightly higher but remained relatively slow at 2.1%y/y.

Q2 headline CPI was below expectations at 0.4%q/q, 2.1%y/y. The biggest drivers of inflation were petrol, seasonal increases in health costs and the tobacco excise tax. Excluding fuel, inflation rose only 0.1%q/q. Core inflation rose 0.5%q/q, 1.9%y/y as expected. Terms of trade fell -1.3%q/q as import prices increased, but was still +2.1%y/y.

Consumer sentiment was neutral in September at 100.5 on mortgage rate increases and political instability, which saw Scott Morrison replacing Malcolm Turnbull as the party leader and Prime Minister. Business conditions remained at a historically high +15 as trading conditions, profitability and employment all remained firm. S&P reaffirmed Australia's AAA rating and changed the outlook to AAA/stable from AAA/negative following the expectation that the government's fiscal position will return to surplus by 2020.

Sector review

Australian Listed Property, Infrastructure and Utilities

The market cap weighted index of Australian listed property, infrastructure and utilities returned -0.6% over the quarter, underperforming the S&P/ASX 200 Accumulation Index, which returned 1.5%. Australian real assets also underperformed global equities, with the MSCI World Index returning 4.5%. By sector, Utilities and Infrastructure stocks fell by 3.0% in the quarter, weighed by regulatory uncertainty and stock specific capital requirements, while Australian REITs rose 1.9%.

Global High Yield

Having outperformed in the first half of the year, high yield spreads to investment grade were stable over the quarter. Over the quarter, the ICE BofA Merrill Lynch Global High Yield Constrained Index returned 4.19% in AUD, with half of the returns due to movements in the currency. Option Adjusted Spreads narrowed by 35 bps, to close at 364 bps over treasuries and bond yields (yield to worst) decreased 16 bps to finish the quarter at 6.08%.

Investment Grade Corporate Credit

Australian credit spreads for both financials and corporates widened over the quarter. Increasing US-China trade tensions and geopolitical risks drove spreads wider, and high issuance had an impact. Spreads in the hybrid market also widened despite waning supply. In credit derivatives, the Markit iTraxx Australia Index narrowed 6 bps to finish the quarter at 84.3 bps.

Australian Fixed Income

The Reserve Bank of Australia (RBA) left the cash rate on hold at 1.50%. While the RBA 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 increasing risks to the RBA's outlook base case, especially from international developments on trade, emerging markets and the potential for faster-than-expected tightening of US monetary policy. There were small changes to medium term growth projections in the Statement on Monetary Policy. More notably, inflation projections were lowered on expected one-off falls in administered prices. The RBA projects that core inflation will fall below its 2-3% target band in 2018 and remain at the bottom of the range until end-2019. The Australian yield curve steepened by 5 bps over the quarter: the 3-year government bond yield fell 1 bp to 2.05% and the 10-year government bond yield rose 4 bps to 2.67%. The Bloomberg AusBond Composite Bond Index returned 0.54% over the quarter.

Portfolio strategy

We maintained our tactical asset allocation during the quarter: a neutral position in Australian listed property, infrastructure and utilities, as well as overweight positions in hybrids and FRNs and cash. We also maintained underweight positions in global high yield and Australian fixed interest.

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 an appreciable increase in 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†	16.0	15.0	Neutral	5.4
Global High Yield‡	3.2	10.0	Underweight	6.3
Hybrid and FRNs†	25.3	15.0	Overweight	4.9
Australian fixed interest‡	15.7	20.0	Underweight	2.6
Cash‡	39.9	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%.

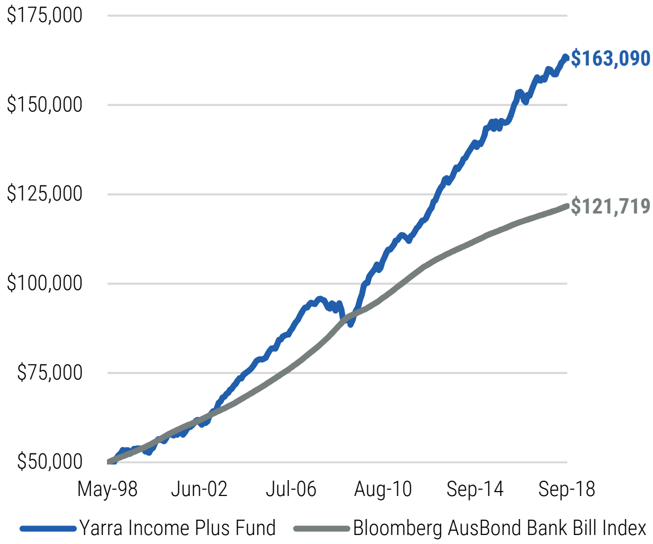
‡ These asset classes combined must be within a range of 50–100%.Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future 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$97.72 mn as at 30 September 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 September 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.

Website www.yarracm.com

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