Yarra Australian Equities Fund

Gross returns as at 30 November 2018

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Australian Equities Fund	-3.05	-11.07	-2.88	6.66	5.85	9.83	10.69
S&P/ASX 200 Accumulation Index†	-2.21	-9.28	-0.96	7.68	5.82	8.98	9.01
Excess return (before fees)‡	-0.84	-1.78	-1.92	-1.03	0.03	0.86	1.68

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 November 2018

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Australian Equities Fund	-3.12	-11.28	-3.79	5.65	4.85	8.80	9.69
S&P/ASX 200 Accumulation Index†	-2.21	-9.28	-0.96	7.68	5.82	8.98	9.01
Excess return (after fees)‡	-0.91	-1.99	-2.83	-2.03	-0.97	-0.18	0.68

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 Australian Equities Fund: July 1996

† The benchmark for the Yarra Australian Equities Fund has been amended since the Fund's inception. Effective 28 February 2008 the benchmark is the S&P/ASX 200 Accumulation Index, replacing the S&P/ASX 200 ex Property Accumulation Index Monthly. Further information on changes to the Fund's benchmark is available upon request.

‡ Excess return: The difference between the portfolio's return and the benchmark return.

Market review

Weaker commodity prices and a stronger Australian dollar sent Australian equities lower in November, with the local index underperforming global markets.

The S&P/ASX 200 Accumulation Index declined 2.2% in the month, taking its 12-month total return to -1.0%. In comparison, the MSCI World Index and the S&P500 lifted by 1.2% and 2.0% respectively in November.

While nine out of 11 sectors fell in the month, the worst detractors from the Index's return were Energy (-10.3%) and Metals & Mining (-4.9%). All Energy stocks fell in value in response to Brent crude dropping 21% to $US59 per barrel, with the worst performers including Santos (STO, -16.9%), Woodside Petroleum (WPL, -10.9%) and Origin Energy (ORG, -11.1%). In Metals & Mining, BHP (BHP, -4.7%) and Rio Tinto (RIO, -4.1%) both underperformed as the iron ore price fell 12% to $US63 per tonne.

Elsewhere, Consumer Discretionary (-5.0%) also underperformed as company updates and weaker-than-expected retail sales data revealed a softer consumer trading environment. The worst performers included Star Entertainment (SGR, -7.6%), Bapcor (BAP,-10.1%) and Breville (BRG, -10.7%).

Conversely, the Banking sector (+2.5%) outperformed in the month after delivering results largely in line with expectations despite a challenging operating environment. All banks rose in value, led by ANZ Bank (ANZ, +6.5%) and Commonwealth Bank (CBA, +2.9%).

Portfolio review

Key contributors

ANZ Bank (ANZ, overweight) – the stock outperformed in the month after the banking industry delivered results largely in line with expectations despite a challenging operating environment. ANZ released its FY18 result at the end of October, which was 1% ahead of consensus at the pre-provision earnings level and demonstrated momentum on costs and a strong capital position (with around $4bn of capital to be returned). Notwithstanding the uncertainty and potential risks posed by the Financial Services Royal Commission – including slower credit growth, higher costs and reduced pricing power – we believe ANZ is well placed to continue returning capital to shareholders. ANZ 's recent repricing of its standard variable rate (SVR) also sets it up for reasonable growth heading into 1H19. We view the company's discount to peers as attractive at a P/E multiple of 11.4 times and a price to book multiple of 1.3 times.

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CSL (CSL, underweight) – the biotechnology company underperformed without any material company-specific news, retracing strong outperformance from prior months. We remain underweight CSL based on its forward valuation (28.6 times P/E and 20.1 times EV/EBITDA on a 12-month forward basis), which we believe more than captures the current earnings outlook. The growth outlook for CSL's key plasma products remains robust, with the company continuing to strengthen its relative market position through long-term investment in capacity, product innovation and collection centres.

Seek (SEK, overweight) – the online recruitment company outperformed after affirming its FY19 earnings guidance at its AGM during the month, alleviating concerns about slowing domestic jobs growth. Management expects revenue growth of 16-20% and EBITDA growth of 5-8% for FY19, which we believe the company is well positioned to achieve. We remain overweight the stock, with product developments set to deliver new revenue opportunities and strengthen the existing businesses, both domestically and internationally. The structural growth of SEK's earlier stage markets should also support international growth, particularly in China.

Key detractors

Santos (STO, overweight) – the oil & gas producer underperformed as Brent crude fell 21% to $US59 per barrel. We remain overweight the stock based on a positive view of its recent Quadrant acquisition and the company's strong free cash flow profile. The Quadrant acquisition, which was approved by the ACCC during the month, was made at an attractive price (4.4 times trailing EBITDAX), did not require a capital raising and will be highly EBITDAX accretive. The acquisition also diversifies STO's portfolio across Australia (reducing its reliance on East Coast gas), with the company consolidating its position in the Western Australian gas market at around a 36% combined market share. STO remains significantly cash flow positive at current oil price levels, with the balance sheet expected to deleverage to less than 30% by the end of 2019.

James Hardie (JHX, overweight) – the building materials company underperformed after delivering a worse-than-expected 1H19 result. Management downgraded FY19 net profit to $280-320mn (-6.3% at the mid-point) as a result of a weaker US volume and margin outlook. While FY19 guidance was underwhelming, we remain confident about the market share outlook in the medium to long-term; we expect primary demand growth to accelerate as JHX wins business following resolution of US supply and manufacturing issues. Secondly, JHX should be able to offset margin pressure through product re-pricing (which it does annually). Lastly, JHX now trades at a more supportive 15.1 times forward earnings, an attractive discount to the ASX Industrials sector.

Origin Energy (ORG, overweight) – the energy company underperformed in response to Brent crude falling 21% to $US59 per barrel and uncertainty over retail electricity prices, with intense regulatory pressure and the potential introduction of a default pricing offer expected to impact retail margins in FY20. We remain overweight ORG; with the stock trading at 9.2 times forward earnings we believe the implied valuation of both the Energy Markets business and APLNG remains conservative. In our view an eventual demerger of both businesses or the sale of APLNG remains the critical next step in crystallising this value.

Key purchases

Sydney Airport (SYD) – we established a position in the airport owner and operator in the month, taking advantage of the recent sell-off. In our view SYD is set to benefit from a supportive demand backdrop (the airport captures approximately 40% of Australia's inbound air passengers) and with strong barriers to entry as Sydney's only international airport. Higher prices and robust passenger numbers support strong revenue growth which, when combined with its high operating leverage, enables SYD to grow its dividend by approximately 10% per annum on a five-year compound annual growth rate.

Transurban (TCL) – we increased our position in the toll road operator in the month, increasing the portfolio's exposure to defensive equities. TCL has a strong growth outlook (with a number of new project and expansion plans), asset diversification and offers an attractive risk adjusted total return. If inflation returns, its compounding effect will provide a meaningful offset to higher discount rates (on a net present value basis), given the majority of TCL's revenue growth is linked to CPI.

NextDC (NXT) – we established a position in the data centre operator during the month. In our view, the business is structurally set to benefit from the increasing adoption of cloud technology and is accelerating its expansion to meet the demands of its clients. To this end, the company is currently building three new data centres which will support significant medium to longer term earnings growth. The outlook for NXT appears attractive given the company's growth profile, infrastructure-like characteristics at maturity, and supportive valuation.

Key sales

Clydesdale (CYB) – we exited our position in the UK bank following its FY18 result in the month. While FY18 earnings were only modestly below expectations, disappointing FY19 guidance invalidated our investment thesis. CYB guided to net interest margins (NIMs) of 160-170 bps, well below consensus of 179 bps, due to a contraction in the recently acquired Virgin Money portfolio. The main driver was customers rolling off Virgin Money's higher margin back book to the lower margin front book, which we expect will cause ongoing pressure. In the context of deteriorating fundamentals, a weaker industry structure than we had perceived and ongoing Brexit uncertainty, we don't find the stock attractive despite appearing cheap at 0.8 times tangible book value and 8 times forward earnings.

Macquarie Group (MQG) – we reduced our position in the investment bank during the month following strong outperformance. We remain positive on the company's outlook given its robust capital position, strong earnings momentum and apparent success in avoiding the majority of issues from the Financial Services Royal Commission. However, we believe this is fully captured in MQG's valuation, with the stock trading at 13 times forward earnings and 2.2 times book value. Further, MQG is leveraged to global economic growth, which appears to be slowing following a strong run.

JB Hi-Fi (JBH) – we trimmed our overweight position in the electronics retailer during the month, but remain overweight the stock. While The Good Guys subsidiary has a more conservative outlook amid heightened price competition, we believe the business is better equipped to deal with these issues through its new sales commission system and that significant synergy, sales and margin opportunities remain. Our medium-term investment thesis remains in place, being that concerns regarding Amazon's entry into the Australian market are overplayed with respect to JBH. Compared to its overseas counterparts, JBH has a more resilient business to withstand new competition, with lower prices and costs, greater sales density and a more sophisticated online offering.

Key active overweights

Atlas Arteria (ALX) – we maintain a favourable view towards ALX based on the continued strong operational performance of its attractive, long-dated assets and its discounted valuation of 11 times EV/EBITDA, which in part reflects the complicated ownership structures of its assets. Securityholders approved the internalisation of ALX's management in May, a change we believe is a significant step towards ultimately simplifying the ownership structures of ALX's two key assets and, in doing so, fully reflecting their intrinsic value. We believe ALX now has a credible strategy for achieving this goal in the near term which will result in significant upside.

Seek (SEK) – our overweight position reflects our positive view towards the online recruitment company's products following sustained and significant investment. We expect product developments will deliver new revenue opportunities and strengthen the existing businesses, both domestically and internationally. The structural growth of SEK's earlier stage markets should also support international growth, particularly in China. The company's early stage businesses also contain latent value when considering SEK's strong track record and current earnings losses. SEK has a strong balance sheet (FY18 net debt to EBITDA 1.2 times) which can support further accretive acquisitions, including through lower risk increases to existing investments.

TPG Telecom (TPM) – our overweight position is based on a positive view of the proposed merger with Vodafone. We expect the combined entity will unlock significant synergies and harness its infrastructure, scale and balance sheet to disrupt incumbents Telstra (TLS) and Optus through its lower-cost structure. As a result, we anticipate market share gains will accelerate across the Mobile, Fixed and Corporate divisions. Furthermore, we expect the combined entity will now be able to acquire 5G spectrum at lower cost in the upcoming auction.

Key active underweights

CSL (CSL) – we remain underweight CSL based on its forward valuation (28.6 times P/E and 20.1 times EV/EBITDA on a 12-month forward basis), which we believe more than captures the current earnings outlook. The growth outlook for CSL's key plasma products remains robust with the company continuing to strengthen its relative market position through long-term investment in capacity, product innovation and collection centres.

National Australia Bank (NAB) – we do not hold a position in the bank, with our preferred banking exposures being Commonwealth Bank (CBA), Westpac (WBC) and ANZ Bank (ANZ). NAB's domestic business is a clear underperformer relative to peers, with pre-provision earnings stagnant over a number of years and significant catch-up investment required as evident by its move to accelerate costs and investment in FY18 together with a large ($755mn) restructuring charge. After a large 5-8% step-up in costs in FY18, NAB has guided to flat cost growth in FY19 and FY20, which we believe is unsustainable. We do not regard NAB's valuation – at 10.5 times forward earnings and 1.3 times book value – as being appealing when considering these headwinds.

BHP Billiton (BHP) – our underweight position reflects our cautious medium to longer term view towards BHP's commodity exposures, particularly iron ore and coal. We believe fundamentals point to lower prices as new supply comes onto the market and China's demand wanes from strong, stimulus-induced levels. Furthermore, the ability for BHP to support earnings through lower costs appears increasingly challenged – cost inflation is building (as evidenced in the company's FY18 results) and capex will need to increase to more historic levels.

Market outlook

We believe fundamentals point to a solid earnings cycle for the Australian equity market. Consensus sees Resources driving mid-single-digit earnings growth, moderated by lower earnings growth from Industrials and Financials.

Australian equities are priced in line with long-term averages based on forward earnings estimates, though valuations remain attractive relative to alternatives such as fixed interest. The S&P/ASX 200 Index yields 5.1% on a 12-month forward basis (before franking) versus 2.6% from the Australian 10-year government bond yield.

We remain alert to economic and geopolitical risks, including lower house prices domestically, rising interest rates in the US, the impact of tariffs and China's real rate of growth.

We see significant value in certain sectors but believe others to be overvalued based on earnings and cash flow expectations. We remain overweight the Industrials, Communication Services and Energy sectors, but are underweight Real Estate, Metals & Mining and Consumer Staples.

We see significant value in certain sectors but believe others to be overvalued based on earnings and cash flow expectations. We remain overweight the Consumer Discretionary, Industrials and Communication Services sectors, but are underweight Real Estate, Metals & Mining and Consumer Staples.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	10.25	3.64	6.61
Consumer Discretionary	8.68	6.36	2.32
Consumer Staples	0.00	5.61	-5.61
Energy	8.88	5.38	3.50
Financials	33.28	33.27	0.01
Health Care	5.43	8.37	-2.94
Industrials	16.50	7.95	8.54
Information Technology	0.63	2.16	-1.53
Materials	12.23	17.61	-5.38
Real Estate	0.00	7.69	-7.69
Utilities	0.00	1.96	-1.96

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Commonwealth Bank of Australia	10.90	8.23	2.67
ANZ Banking	8.33	5.09	3.24
Westpac Banking	8.15	5.85	2.30
Atlas Arteria	4.89	0.29	4.60
Seek	3.77	0.43	3.34

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Atlas Arteria	4.89	0.29	4.60
Seek	3.77	0.43	3.34
TPG Telecom	3.42	0.16	3.26
Underweights			
CSL	0.00	5.27	-5.27
National Australia Bank	0.00	4.41	-4.41
BHP Billiton	2.47	6.46	-4.00

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	-8.19	1.39	-1.23	1.20
Distribution return	4.39	4.26	6.08	7.60

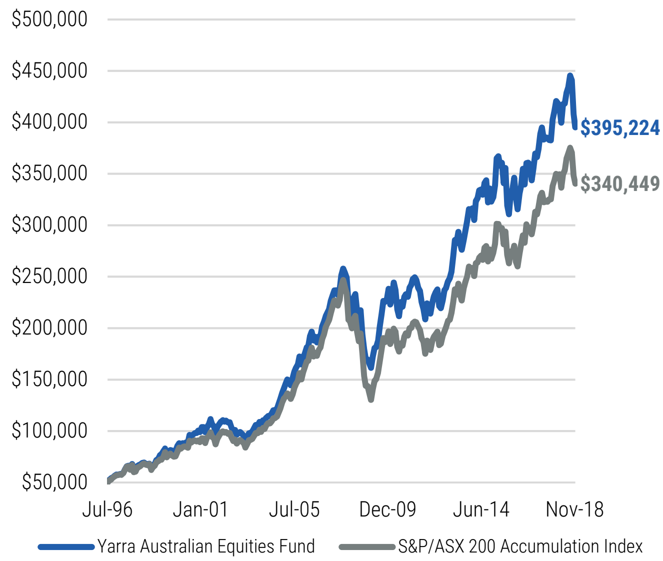
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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 companies listed on the Australian Securities Exchange. In doing so, the aim is to outperform the S&P/ASX 200 Accumulation Index over rolling 3-year periods.
Recommended investment time frame	5 - 7 + years
Fund inception	July 1996
Fund size	Pooled Fund A$536.16 mn as at 30 November 2018
APIR codes	JBW0009AU
Estimated management cost	0.95% p.a.
Buy/sell spread	+/- 0.15%
Platform availability	AMP PortfolioCare AMP Wealthview AMP Flexible Lifetime North Asgard BT Wrap BT Panorama Colonial FirstWrap IOOF Pursuit Select Macquarie Wrap Consolidator Macquarie Wrap Accumulator OnePath PortfolioOne Oasis ANZ Grow Wrap Netwealth SimpleWrap PowerWrap SmartWrap Hub24

Investment performance comparison of $50,000

After fees, since inception of the Yarra Australian Equities Fund, July 1996 to November 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 S&P/ASX 200 Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.

Applications and contacts

Investment into the Yarra Australian Equities Fund can be made by Australian and New Zealand resident investors only.

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Disclaimers

The Yarra Australian Equities Fund is substantially invested in the Yarra Australian Equities Pooled Fund ('Pooled Fund'). References in this document to the underlying assets or investments of the Fund generally relate to the assets held in the Pooled Fund.

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