YARRA CAPITAL MANAGEMENT

Investment Commentary
Quarter to 31 December 2018

Yarra Income Plus Fund

Gross returns as at 31 December 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	0.80	0.71	3.25	4.89	4.99	6.92	6.70
Growth return†	-0.02	-0.11	0.66	0.81	0.88	2.21	1.43
Distribution return†	0.82	0.82	2.59	4.08	4.11	4.71	5.27
Bloomberg AusBond Bank Bill Index	0.15	0.48	1.92	1.91	2.15	3.07	4.44
Excess return‡	0.64	0.23	1.32	2.98	2.84	3.86	2.26

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 December 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	0.74	0.54	2.55	4.18	4.28	6.15	5.93
Growth return†	-0.08	-0.28	-0.04	0.10	0.17	1.44	0.67
Distribution return†	0.82	0.82	2.59	4.08	4.11	4.71	5.27
Bloomberg AusBond Bank Bill Index	0.15	0.48	1.92	1.91	2.15	3.07	4.44
Excess return‡	0.59	0.06	0.63	2.27	2.13	3.08	1.50

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* 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% (net basis) over the December quarter, outperforming the Bloomberg AusBond Bank Bill Index by 59 bps. The return was largely driven by the Fund's overweight exposure to equities (property and infrastructure). The fall in long-term interest rates fuelled strong performance in property and infrastructure, with Fixed Income also benefiting. On a 12-month view, the Fund has returned 2.55%, outperforming its benchmark by 63 bps on a net basis.

During the quarter, we moved from a neutral to overweight position in property, infrastructure & utilities, and reduced our underweight position in fixed income. This was funded by moving from an overweight to slightly underweight position in cash. We continue to maintain an overweight position in Hybrids and neutral position in Diversified Credit.

Market review

Geopolitical events continued to impact markets in the December quarter. Despite a promising development following the G20 meeting, when a 90 day ceasefire in the US-China trade war was announced, the arrest of a senior Chinese telecommunications executive on allegations of violating US sanctions rekindled fears that relations between the US and China would once again deteriorate. In Europe, there was little progress on Brexit negotiations as the government delayed a parliamentary vote on a deal, though PM May survived a leadership contest. Economic activity in France appeared to be impacted by protests and German Chancellor Merkel announced she would not contest the next election.

Sovereign bond yields were lower over the quarter. Sentiment around global growth turned negative, reflecting a combination of trade tensions, concerns around the end of fiscal stimulus in the US and interest rate increases. The Federal Reserve (Fed) raised rates by 0.25% to a target range of 2.25-2.5%,

though markets had lowered their expectations for a rate hike prior to the meeting. The Fed lowered their interest rate projections for 2019 to from three additional rate hikes to two. US mid-term elections saw Democrats win control of the House and Republicans hold the Senate, dampening any remaining hope of major policy measures being passed. Policy disagreements over border security, meanwhile, led to a partial shutdown of the US government in December. US ISM surveys indicated activity was stronger than expectations, though payrolls were lower than expected, at 152K, while consumer spending during the holiday period was reported to have been strong. Some data releases in December, however, were delayed due to the government shutdown. Elsewhere, the European Central Bank confirmed it was ending its asset purchases in December 2018, and the Bank of England kept rates on hold amid Brexit uncertainty.

Australia economic data were mixed. Q3 GDP was notably weaker than expected at 0.3%q/q, though the annual pace was still in line with trend growth at 2.8%y/y. Consumption slowed, and at 2.5%y/y was the slowest quarterly growth since 2012. Housing weakness began to impact activity, with new housing construction negative in the quarter. Public spending however remained robust. Despite strong employment growth, there was still little sign of wage growth accelerating. Employment rose 37K in November – which saw the unemployment rate fall to 5.1% – though gains were confined to part time jobs. Wage growth was slightly higher but remained relatively slow at 2.3%y/y.

Sector review

Australian Listed Property, Infrastructure and Utilities

The market cap weighted index of Australian listed property, infrastructure and utilities returned -0.8% over the quarter, outperforming the S&P/ASX 200 Accumulation Index, which returned -8.2%. Australian real assets also outperformed global equities, with the MSCI World Index returning -13.0%. By sector, Australian REITs fell by 1.7% while Utilities and Infrastructure stocks rose by 0.2%, as investors increased allocations to defensive equities. M&A activity intensified in the sector in the December quarter.

Australian Hybrids and Credit

Australian credit spreads for both financials and corporates widened over the quarter. Spreads were impacted by international concerns, including geopolitics which drove risk-off investor sentiment. Hybrids delivered positive returns, reflecting strong performance in non-financials, with spreads consolidating after a heavy issuance in financials. Domestically, November primary issuance was the second largest on record, but was light in the remaining two months of the quarter. The Australian Prudential Regulatory Authority (APRA) announced its long awaited proposal on "Increasing the loss-absorbing capacity of ADIs to support orderly resolution", opting for the additional issuance of Tier 2 rather than the global standard of Tier 3. In credit derivatives, the Markit iTraxx Australia Index widened 20 bps to finish the quarter at 94.3 bps.

Australian Fixed Income and Cash

The Reserve Bank of Australia (RBA) left the cash rate unchanged at 1.5% and continued to signal that while there would be no near-term adjustment in policy, the next move in rates would be higher. It repeated that progress towards its economic targets – and thus the outlook for rate hikes – was gradual. The RBA was, however, more cautious on the economic outlook and the potential impact from the slowing housing market. In its quarterly forecasts, the RBA revised GDP higher by 25 bps to 3.5% in Dec 2018, the unemployment rate 50 bps lower to 5.0%, and the inflation rate rising to 2.25% six months earlier than previously forecast. Scepticism around the RBA's economic forecasts rose, however, especially on growth and its ability to increase interest rates, with markets expecting some chance of a rate cut by the end of 2019. The Australian yield curve flattened by 15 bps over the quarter: the 3-year government bond yield fell 20 bps to 1.85% and the 10-year government bond yield fell 35 bps to 2.32%. The Bloomberg AusBond Composite Bond Index returned 2.2% over the quarter.

Portfolio strategy

We have maintained an overweight position in Australian hybrids and neutral Diversified Credit, and moved from a neutral to overweight position in Real Assets (listed property, infrastructure and utilities). We continue to see appeal for real assets, in particular infrastructure and utilities, given their long duration and associated inflation hedge, earnings resilience and attractive yields, complemented by selective growth opportunities within Australian Infrastructure.

We have reduced our underweight position in fixed income and moved from an overweight to slightly underweight position in cash. We expect the RBA will leave the cash rate unchanged at 1.5% through 2019. Governor Lowe has emphasised the importance of wage growth in sustaining broader inflation within the RBA's target range, and while inflation is beginning to trend higher, wage growth remains slow despite the fall in the unemployment rate. Economic indicators remain positive, though indicate some likely slowing in growth, while business conditions remain firm. The outlook for economic growth is also supported by government investment in infrastructure, notably the large projects under construction in NSW and Victoria. However, international evidence suggests that an even lower unemployment rate will be required to lift wages. As a result, we expect little change in short-term bond yields. Long-term bond yields will likely increase from current levels as markets unwind current risk-off sentiment and refocus on the underlying strength of the Australia economy.

We believe Australian credit remains attractive relative to global peers, due to its higher credit quality, industry structure and lower duration (high floating rate exposure). Australian corporates continue to display a disciplined approach to their balance sheet and liability management and there appears to be little evidence of corporates appreciably increasing leverage. Major banks also continue to be proactive in raising Tier 1 capital, in support of commitments to meet "unquestionably strong" criteria. Finally, any new issuance will

likely be met with strong demand, as supply/demand trends remain favourable, placing upward pressure on corporate credit and hybrid pricing.

Asset allocation

	Portfolio %	Neutral position %§	Strategy
A-REITs, Infrastructure & Utilities	17.4	15.0	Overweight
Hybrid and FRNs	20.1	15.0	Overweight
Diversified Credit†	10.2	10.0	Neutral
Fixed interest	14.0	20.0	Underweight
Cash	38.4	40.0	Underweight

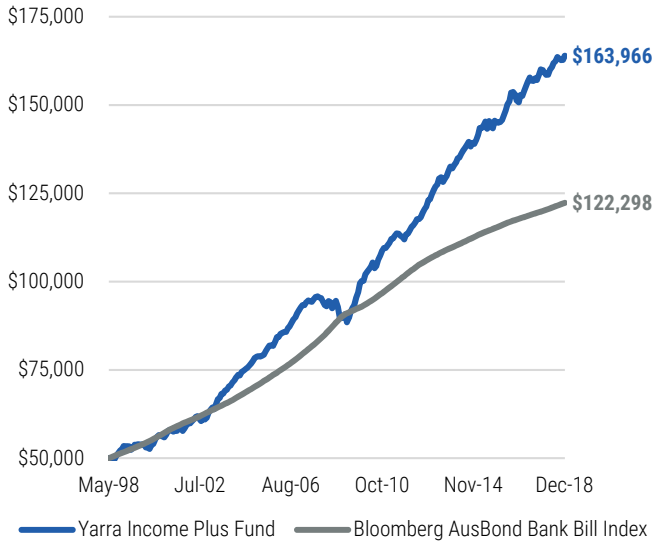
Source: Yarra Capital Management. Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not 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.
† Effective 25 October 2018 the Fund's asset allocation was modified, with Diversified Credit replacing Global High Yield. Further information in relation to this change can be found here.

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$94.92 mn as at 31 December 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 December 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

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