YARRA
CAPITAL MANAGEMENT

Investment Commentary
Quarter to 31 March 2019

Yarra Enhanced Income Fund (Direct)

Gross returns as at 31 March 2019

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Enhanced Income Fund (Direct)	0.90	2.07	7.63	8.17	6.21	10.89	6.82
Yarra Enhanced Income Fund (Direct) (incl. franking)	1.07	2.26	8.33	8.80	6.77	11.54	7.56
Growth return†	0.05	1.23	4.50	5.03	2.88	6.53	1.70
Distribution return†	1.02	1.03	3.83	3.77	3.89	5.01	5.86
RBA Cash Rate	0.12	0.37	1.50	1.54	1.82	2.75	3.87
Excess return‡	0.95	1.89	6.83	7.26	4.95	8.79	3.69

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. Returns inclusive of franking credits are calculated by attributing a cash value to each franking credit, and assuming that amount is re-invested, along with all other distributions. Figures including franking credits should not be relied upon as an exact indication of performance or be compared to returns of other managed funds which do not include amounts for franking credits. The level of franking of distributions may vary.

Net returns as at 31 March 2019

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Enhanced Income Fund (Direct)	0.76	1.68	5.94	6.46	4.53	9.14	5.06
Yarra Enhanced Income Fund (Direct) (incl. franking)	0.94	1.86	6.63	7.10	5.09	9.79	5.79
Growth return†	-0.08	0.83	2.80	3.33	1.20	4.78	-0.07
Distribution return†	1.02	1.03	3.83	3.77	3.89	5.01	5.86
RBA Cash Rate	0.12	0.37	1.50	1.54	1.82	2.75	3.87
Excess return‡	0.82	1.49	5.13	5.56	3.27	7.04	1.92

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. Returns inclusive of franking credits are calculated by attributing a cash value to each franking credit, and assuming that amount is re-invested, along with all other distributions. Figures including franking credits should not be relied upon as an exact indication of performance or be compared to returns of other managed funds which do not include amounts for franking credits. The level of franking of distributions may vary.

* Inception date Yarra Enhanced Income Fund (Direct): August 2002
† Growth returns are measured by the movement in the Yarra Enhanced Income Fund's unit price, ex-distribution. Distribution return is the proportion of the total return which is paid to unitholders by way of distribution. It does not include distribution amounts deemed as capital distributions. Returns inclusive of franking credits are calculated by attributing a cash value to each franking credit, and assuming that amount is re-invested, along with all other distributions. Figures including franking credits should not be relied upon as an exact indication of performance or be compared to returns of other managed funds which do not include amounts for franking credits. The level of franking of distributions may vary
‡ The excess return figures shown represent the difference between the Fund's return including franking and the RBA Cash Rate.

Market Summary

Concerns of slowing growth dominated the March quarter for markets and central banks around the world. In the US, the Federal Reserve (FOMC) shifted to a more dovish stance: while economic projections for GDP and inflation were lowered, the FOMC's expectations of its own interest rates showed no rate hikes in 2019 compared to the two hikes it had forecast at its December meeting. The FOMC maintained a tightening bias, though, with one hike expected in 2020. Economic data collection was likely affected by the government shutdown, increasing the volatility of the reported numbers. Nonfarm payrolls increased only by 20k in February, but average hourly earnings were at cycle highs (up 3.4% y/y). ISM surveys were mixed and retail sales rebounded somewhat after very weak December data.

In Europe, activity data slowed, most notably in manufacturing. The European Central Bank (ECB) surprised markets by announcing a new round of its targeted lending program (TLTRO-III) allowing banks to obtain cheap funding for business and consumer loans. This followed the ECB downgrading its economic forecasts and its view that the balance of risks are tilted to the downside. There remained little progress on Brexit negotiations, with the UK granted a delay to its exit date from the European Union.

Australian investment grade credit spreads ended the quarter tighter, with spreads for corporates tightening more than spreads for financials. While recessionary concerns impacted other fixed income markets, markets were less concerned by US-China trade wars. Hybrid securities delivered positive returns over the quarter, with credit margins overall falling. In credit derivatives, the Markit iTraxx Australia Index tightened 20 bps to finish the quarter at 74.7 bps.

The Reserve Bank of Australia (RBA) unexpectedly shifted from a tightening bias to neutral. Growth and inflation forecasts were downgraded in February, with GDP expected to peak at 3% in December 2019 and headline inflation to fall to 1.25% on temporary factors. The unemployment rate was still expected to fall to 4.75%, though a half year later. The RBA cited increased risks around the strength of household consumption and the housing market as reasons for becoming more cautious, though continued to emphasise the strength of the labour market. In contrast, markets have become much more pessimistic, pricing in a full rate cut by August 2019. The Australian yield curve flattened by 8 bps over the quarter: the 3-year government bond yield fell 46 bps to 1.39% and the 10-year government bond yield fell 54 bps to 1.78%. The Bloomberg AusBond Composite Bond Index returned 3.4% over the quarter.

Australian economic data were mixed. Q4 GDP growth was slower than expected at 0.2% q/q and 2.3% y/y. Household consumption was notably weak, rising only 2.0% (y/y), while government spending on healthcare and infrastructure was strong as anticipated. Mining investment remained a drag on growth in the quarter. CPI showed inflation slowing slightly, with both headline and core at 1.8% (y/y) and below the RBA's target. Wages grew a little below expectations, by 0.5%, leaving the annual rate unchanged at 2.5% (y/y). The unemployment fell to 4.9%, the lowest level since 2011, but job gains were below consensus forecasts at 4.6k. The retail sales rebound was smaller than expected at 0.1%. Residential building approvals rose, business conditions improved to +7, just above its long run average, but consumer sentiment deteriorated by 4.8% to 98.8.

Portfolio review and outlook

The Yarra Enhanced Income Fund returned 1.86% (net basis, including franking) over the March quarter, or 149 bps above the RBA cash rate. Returns over the period were predominately driven by strong performance from old style perpetual securities which contributed a combined 110 bps in return. On a 12-month view, the Fund has returned 6.63%, outperforming its benchmark by 513 bps on a net basis.

We believe Australian credit remains attractive relative to global peers, reflecting 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 Australian Corporates appreciably increasing leverage. The Australian major banks also continue to be proactive in raising Tier 1 capital, in support of commitments to meet "unquestionably strong" criteria. Finally, we expect any new issuance will be met with strong demand, as supply/demand trends remain favourable, placing upward pressure on corporate credit and hybrid pricing.

Portfolio profile

Portfolio characteristics

	Portfolio
Running yield (including franking credits) (%)	4.83
Option Adjusted Spread	2.66
Average weighted issue credit rating	BBB
Estimated yield to maturity (%)	4.36
Fund duration (years)	-0.41
Spread duration (years)	6.62
Number of securities	56
Listed	38
Unlisted	18

Sector allocation

	Portfolio %
Banks	42.28
Consumer Discretionary	6.33
Diversified Financials	11.09
Industrials	6.02
Information Technology	1.36
Insurance	14.51
Materials	3.88
Mortgages	3.71
Real Estate	4.63
Utilities	1.00
Cash and Equivalents	5.20

Top 10 holdings

Issuer	ISIN	Portfolio %
National Australia Bank	AU0000NABHA7	7.88
Macquarie Bank	AU0000MBLHB4	5.66
Commonwealth Bank of Australia	AU0000CBAPD7	5.48
Crown Resorts	AU0000CWNHB7	5.09
Suncorp-Metway	AU0000SBKHB3	4.52
Westpac Banking	AU0000WBCPG4	3.10
ANZ Banking	AU0000ANZPF8	3.01
Qube Holdings	AU0000QUBHA8	2.89
CNH Industrial	AU3FN0043907	2.70
ANZ Banking	AU0000ANZPE1	2.49

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.

Maturity profile

	Portfolio %
Perpetual/Callable	59.60
Callable	27.79
At Maturity	12.62

Security profile

	Portfolio %
Floating rate	93.55
Fixed rate	6.45

Credit rating profile

	Portfolio %
A	2.70
BBB+	10.17
BBB	12.82
BBB-	17.13
BB+	34.88
BB	12.26
BB-	-
B+	3.06
B	1.77
B-	-
Cash and Equivalents	5.20

Features

Investment objective	To earn higher returns than traditional cash management and fixed income investments (over the medium-to-long term) by investing in a diversified portfolio of fixed income and hybrid (debt/equity) securities.
Recommended investment time frame	3 – 5+ years
Fund inception	August 2002
Fund size	Pooled Fund A$73.88 mn as at 31 March 2019
APIR code	JBW0118AU
ARSN code	101 266 755
Distribution frequency	Quarterly
Estimated management cost	1.60% p.a.
Buy/sell spread	+/- 0.10%

The Yarra Enhanced Income Fund (Direct) is not available for new investment. Where existing reinvestment instructions are in place, distributions may be reinvested

Applications and contacts

The Yarra Enhanced Income Fund (Direct) is no longer available for new investment. The reinvestment of distributions is still allowed where an existing reinvestment instruction is in place.

Website www.yarracm.com

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