YARRA CAPITAL MANAGEMENT

Investment Commentary
Quarter to 30 September 2019

Yarra Income Plus Fund

Gross returns as at 30 September 2019

	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	-0.30	1.17	7.81	5.21	5.50	6.55	6.80
Bloomberg AusBond Bank Bill Index	0.08	0.29	1.74	1.79	2.01	2.93	4.34
Excess return‡	-0.39	0.88	6.07	3.42	3.49	3.62	2.46

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 September 2019

	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	-0.36	1.00	7.09	4.50	4.78	5.79	6.03
Growth return†	-0.84	0.50	4.51	1.07	0.91	1.38	0.86
Distribution return†	0.48	0.49	2.58	3.43	3.88	4.40	5.17
Bloomberg AusBond Bank Bill Index	0.08	0.29	1.74	1.79	2.01	2.93	4.34
Excess return‡	-0.44	0.71	5.34	2.71	2.78	2.85	1.69

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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 0.99% (net basis) over the September quarter, outperforming the Bloomberg AusBond Bank Bill Index by 70 bps. The quarterly return was driven by our exposure to Real Assets (Property, Infrastructure & Utilities), closely followed by Fixed Income and Diversified Credit allocations. On a 12-month view, the Fund has returned 7.08%, outperforming its benchmark by 534 bps on a net basis.

Market review

The September quarter saw a continuation of market themes, including US-China "tit-for-tat" trade disputes and central bank monetary easing. Oil also suffered a supply shock following an attack on Saudi Arabia's oil production infrastructure, resulting in ~5% of global supply being temporarily impacted.

The US Federal Reserve cut interest rates by 25 bps in July and again in September to 1.75%-2.00%, in light of "global developments". The US also ended its balance sheet reduction on 1 August, two months earlier than markets had anticipated.

The European Central Bank deposit rate was lowered by 10 bps to a record low -0.5%, a tiered mechanism for bank deposits subject to negative rates was introduced and quantitative easing was resumed (EUR20bn of monthly bond purchases from November). The People's Bank of China, cut its 1-year Loan Prime Rate by 5 bps for two consecutive months, and central banks across Asia Pacific (New Zealand, India and Thailand) all aggressively lowered cash rates versus market expectations.

Locally, Australian company reporting period concluded in August with companies outperforming relative to very modest market expectations. There were some visible signs of leverage increasing, although debt serviceability fell as lower interest rates continued to make their way through the system. Australian data was somewhat mixed: the June quarter current account recorded its first surplus since 1975 and labour force data indicated another strong gain. However, positive labour data was not enough to meaningfully impact the employment rate, with a higher participation rate driving unemployment higher. Headline inflation was marginally higher than expected, helped by a large gain in petrol prices.

Sector review

Listed Property, Infrastructure and Utilities

The market cap weighted index of Australian listed property, infrastructure and utilities returned 1.07% over the quarter, underperforming the S&P/ASX 200 Accumulation Index by 129 bps. By sector, REITs increased by 1.1% over the quarter, largely driven by revaluation gains and equity raisings, while Infrastructure & Utilities increased by 1.00%.

Hybrids

The Australian regulator (APRA) released its final determination on Australia's approach to total loss-absorbing capacity, requiring major banks to increase total capital by 3% by 2024 through Tier 2 issuance (uplift of at least $50bn of Tier 2 issuance). Despite the strong supply, hybrids performed well over the quarter outperforming corporate bonds. The search for higher yielding assets gained momentum as investors contemplate a world where cash and term deposit rates will be below 1%. Hybrid margins contracted slightly as demand continues to outweigh supply.

Diversified Credit

Credit spreads ended the quarter 5-7 bps tighter. Major bank senior 5-year spreads continued their grind tighter, while Major Bank AAA RMBS and 5-year BBB corporate spreads compressed over the period. In credit derivatives, the Markit iTraxx Australia Index widened 4 bps to finish the quarter at 67 bps.

Fixed Income

The Australian yield curve flattened 9 bps over the quarter: the 3-year government bond yield closed 22 bps lower at 0.74% and the 10-year bond yield closed 31 bps lower at 1.02%. The Bloomberg AusBond Composite Bond Index returned 2.0% over the quarter, driven by interest rate cuts and the escalation in the trade war between the US and China.

Cash

The Reserve Bank of Australia (RBA) cut interest rates again to 1.0% in July, citing the need to reduce spare capacity further while still sounding optimistic on the fundamentals of the Australian economy. Despite RBA implying there would be a pause by adding that cuts could come 'if needed', market pricing continues to factor in further interest rate cuts as bank bill short term rates move to new record lows over the quarter. Subsequent to quarter end, the RBA cut interest rates to 0.75%.

Portfolio strategy

During the quarter, we moved further overweight in our Real Assets position. We continue to expect that the current low levels of interest rates will underpin underlying valuation support for Real Assets. The forecast dividend yield for real assets is also attractive, and provides a compelling 3.6% premium above the 10-year Australian bond rate.

We maintained our neutral position in Hybrids over the quarter. Major banks continue to be well capitalised and remain committed to meeting the regulators "unquestionably strong" criteria. Despite the strong supply of Tier 2 issuance in the market, we expect strong demand from investors as evidence by the recent oversubscription of domestic and offshore issuance. In addition, major banks are more likely to issue Tier 2 into global markets rather than into Australia.

We maintained our overweight position in Diversified Credit, which offers attractive risk versus reward across multiple sleeves. In particular, we continue to see value in Asset Backed, Residential Mortgage Backed and Private Debt segments of the market, characterized by attractively priced assets with signification credit support and strong convenient protections. With credit spreads above long term averages, we continue to believe Australian credit will remain attractive versus its global peers due to its superior credit quality, industry structure and its floating rate nature. We maintained our underweight position in fixed income. The Australian 10-year government bond closed 1.018% (60-year average ~8.0%), offering limited downside protection. We expect little change in short-term bond yields, while long-term bond yields will likely increase from current levels eventually, as markets refocus on the underlying strength of the Australia economy.

We moved to an underweight position in cash over the quarter. We believe the RBA is highlighting its willingness to go further, potentially cutting interest rates to 0.5% or lower, in its quest to reduce the unemployment rate from the current 5.3% to ~4.5%. While the possibility of the RBA undertaking Quantitative Easing in 2020 or 2021 remains a distinct possibility, we believe existing monetary and fiscal stimulus will be successful in sustaining stronger economic growth and employment.

Asset allocation

	Target %	Neutral position %§	Strategy
A-REITs, Infrastructure & Utilities	21.1	15.0	Overweight
Hybrid and FRNs	15.2	15.0	Neutral
Diversified Credit†	14.1	10.0	Overweight
Fixed interest	14.3	20.0	Underweight
Cash	36.3	40.0	Underweight

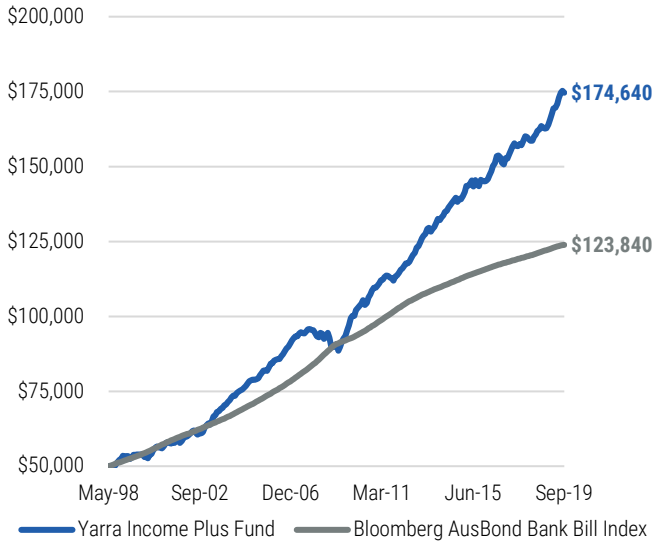
Source: Yarra Capital Management. Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not 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$97.39 mn as at 30 September 2019	
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 Hub24 Macquarie Wrap Consolidator MLC Wrap	Netwealth Oasis OnePath PortfolioOne PowerWrap SmartWrap Wealthtrac

Investment performance comparison of $50,000

After fees, since inception of the Yarra Income Plus Fund, May 1998 to September 2019.



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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Disclaimers

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

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