YARRA CAPITAL MANAGEMENT

Investment Commentary
Quarter to 30 September 2021

Yarra Enhanced Income Fund (Direct)

Gross returns as at 30 September 2021

	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)	0.38	0.16	7.33	4.59	6.01	6.62	6.51
Yarra Enhanced Income Fund (Direct) (incl. franking)	0.38	0.16	7.33	4.74	6.35	7.06	7.15
RBA Cash Rate	0.01	0.02	0.11	0.65	0.99	1.84	3.42
Excess return‡	0.37	0.14	7.22	4.09	5.37	5.22	3.73

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 30 September 2021

	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)	0.28	-0.14	5.98	3.05	4.41	4.97	4.78
Yarra Enhanced Income Fund (Direct) (incl. franking)	0.28	-0.14	5.98	3.20	4.75	5.41	5.42
Growth return†	0.03	-0.89	2.52	0.09	1.38	1.34	-0.07
Distribution return†	0.25	0.76	3.46	3.11	3.37	4.07	5.49
RBA Cash Rate	0.01	0.02	0.11	0.65	0.99	1.84	3.42
Excess return‡	0.28	-0.16	5.86	2.55	3.76	3.57	2.00

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 (Direct)'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.

Portfolio review

The Yarra Enhanced Income Fund (Direct) returned -0.14% (net basis, including franking) over the quarter, underperforming the RBA Cash Rate by 16 basis points. On a 12-month view the Fund returned 5.98%, outperforming by 586 bps on a net basis (including franking).

A flurry of new deals came to market through the quarter, as corporates sought to lock in record low rates. Among the new deals the Fund participated in was Qantas' new senior offering. The deal priced significantly wider than similarly rated corporates due to ongoing challenges faced by the aviation sector, with the steep yield curve and likely rebound in sector activity presenting an attractive risk-adjusted return.

Market review

The September quarter can be broken into two contrasting halves. Through July and much of August investors continued to enjoy the manifestation of abundant stimulus and accommodative economic conditions. Corporate earnings were robust, as was liquidity, the result of which saw significant dividends and a plethora of share buy-backs.

The euphoria of a strong reporting season was short-lived, however, as we entered a tumultuous September. China's tightening of limits to its domestic property developers proved a key catalyst in inducing market volatility. The regulatory changes are dire for Chinese property developers, with many, including Evergrande, now teetering on the edge of default. Exacerbating the negative outlook were power shortages

NO LONGER AVAILABLE FOR NEW INVESTMENT

across much of Europe and China, which acted to inflate energy prices, increasing fears of potential stagflation.

Sovereign yields closed the quarter largely in line with where they entered it, notwithstanding some large moves in between. As the Delta outbreak gained traction across the globe, delayed QE tapering looked increasingly likely, driving yields lower. Following the rally, sovereign bonds sold-off through September as inflationary pressures from the energy crisis, elevated shipping costs and labour shortages (particularly in the UK) took hold. Yields rose even higher following the release of the Fed Reserve dot plot which showed half of its 18 members now expect the first rate hike to come in 2022.

The Australian 10-year yield tracked largely in line with global government bonds. While the delta outbreak and consequential expectations of delayed tapering saw the 10-year rally, inflationary pressures drove a sell-off in the back half of the period, ultimately seeing it settle nearer where it started the quarter.

The Reserve Bank of Australia (RBA) remained dovish over the quarter. Australia's central bank again stressed the importance of wage price growth in driving any significant policy change. One notable adjustment was QE falling from $5bn a week to $4bn. Late in the quarter the RBA Governor Lowe gave a very dovish speech arguing markets were pricing in rate hikes far sooner than they should.

Signs of weaker economic conditions following long and stringent lockdowns across Victoria, NSW and ACT began to seep into data. The unemployment rate continued to grind lower, down to 4.5%, although lockdowns dragged on both the number of jobs and job vacancies which fell, albeit from high bases. Retail sales also lost strong momentum, with the decline concentrated across the lockdown states, though we believe they will quickly rebound as the economy re-opens.

Corporate credit and hybrids continue to perform in the face of an increasingly bearish outlook, proving to be somewhat insulated from broader market weakness thanks to the attractiveness of yield in a such low rate environment. This is particularly the case at the long end where curve steepness is presenting a number of attractive opportunities.

Outlook

Global economic conditions remain uncertain and the risk of stagflation continues to grow, with the Chinese property sector continuing to hurt and power shortages across Europe and China driving energy prices higher.

Domestically, a large portion of the population remains subject to stringent restrictions as state governments seek to manage the latest COVID-19 outbreak. As the road out becomes increasingly clear, it appears likely we will see a strong economic rebound in the first half of 2022 as abundant household liquidity and pent-up demand set to drive a robust consumer into year-end and beyond. The RBA has stressed its intention to avoid a rate hike until at least 2024, further supporting favourable economic conditions.

We remain constructive on the Australian credit and hybrid market. The local market remains more attractive than global peers due to its superior credit quality, industry structure and floating rate nature. Corporate credit and hybrid spreads have continued to contract as investors seek out yield.

Although the pace of the rally in spreads has eased, we continue to see well supported deals and strong market liquidity. Steepness in the yield curve has presented a number of attractive long-dated opportunities, and we expect to see strong returns from the sector throughout the remainder of calendar 2021.

Portfolio profile

Portfolio characteristics

	Portfolio
Running yield (incl franking credits) (%)	3.17
Option Adjusted Spread	2.57
Average weighted issue credit rating	BBB-
Average weighted ESG Rating	BBB
Estimated yield to maturity (%)	3.25
Fund duration (yrs)	0.11
Spread duration (yrs)	3.62
Number of securities	82
Listed	35
Unlisted	47

Sector allocation

	Portfolio %
Asset Backed	2.49
Banks	31.30
Communication Services	1.92
Consumer Discretionary	3.58
Consumer Staples	0.00
Diversified Finance	13.08
Energy	4.07
Health Care	3.30
Industrials	16.13
Information Technology	0.00
Insurance	10.00
Materials	1.20
Mortgage Backed	0.00
Real Estate	5.45
Utilities	1.12
Derivatives	-12.64
Cash and equivalents	18.99

Top 10 holdings

Issuer	ISIN	Portfolio %
National Australia Bank	AU3FN0055224	5.60
Ampol Limited	AU3FN0057683	4.07
Crown Resorts	AU0000CWNHB7	3.58
Qube Holdings	AU0000QUBHA8	3.19
Macquarie Bank Ltd	AU0000088429	2.66
AMP Life	AU3FN0057691	2.64
National Australia Bank	AU0000NABPE2	2.55
Challenger Life Company	AU3FN0039426	2.55
Brisbane Airport Corp.	AU3CB0272854	2.42
Insurance Australia Group	AU3FN0047544	2.22

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	31.03
Callable	47.34
At Maturity	21.63

Security profile

	Portfolio %
Floating rate	75.01
Fixed rate	18.64
Cash & Other	6.35

Credit rating profile

	Portfolio %
AA	1.45
A	0.74
A-	1.13
BBB+	8.34
BBB	20.33
BBB-	26.70
BB+	17.84
BB	13.50
BB-	0.00
B+	1.80
B	1.20
B-	0.49
Not rated or below	0.14
Cash and Derivatives	6.35

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	A$7.6 mn as at 30 September 2021
APIR code	JBW0118AU
ARSN code	101 266 755
Distribution frequency	Monthly
Estimated management cost	1.20% 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

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Disclaimers

The Yarra Enhanced Income Fund (Direct) is substantially invested in the Yarra Enhanced Income 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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