Investment Commentary
Quarter to 30 June 2022

Yarra Investment Fund

Gross returns as at 30 June 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Investment Fund^	-8.40	-12.10	-6.68	3.16	5.42	9.13	NA
S&P/ASX 200 Accumulation Index†	-8.77	-11.90	-6.47	3.34	6.82	9.29	NA
Excess return (before fees)‡	0.37	-0.19	-0.22	-0.17	-1.40	-0.16	NA

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 June 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Investment Fund^	-8.52	-12.45	-8.19	1.49	3.71	7.36	9.53
S&P/ASX 200 Accumulation Index†	-8.77	-11.90	-6.47	3.34	6.82	9.29	NA
Excess return (after fees)‡	0.25	-0.55	-1.73	-1.84	-3.11	-1.93	NA

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 Investment Fund: December 1984.
^ This Fund is no longer available for new investment. The Reinvestment of distributions is still allowed where an existing Reinvestment instruction is in place.
† Since April 2008 the benchmark for the Yarra Investment Fund is the S&P/ASX 200 Accumulation Index
‡ Excess return: The difference between the Fund's return and the benchmark return (S&P/ASX 200 Accumulation Index).

Market review

Australian equities declined sharply during the June quarter as Australia's first interest rate hike since 2010 pressured valuations, with only the Energy and Utilities sectors recording positive returns.

The S&P/ASX 200 Accumulation Index returned Index returned -11.9% for the quarter, taking its 12-month return to -6.5%. Globally, the MSCI World Index fell 14.2%. The ASX 200's forward P/E declined from 16.0 times to 12.5 times as the RBA lifted the official cash rate by 75 bps to 0.85%.

Within Energy (+1.5%), Woodside Energy (WDS, -0.8%) held value amid the global energy crisis given its relatively high exposure to the European gas market. Elsewhere, Worley (WOR, +10.3%) continued to rally amid growing demand for its engineering services in both oil & gas and sustainability projects, while oil refiner Ampol (+11.7%) benefited from the widening spread in the price of crude oil and petrol.

Within Utilities (+1.7%), AGL Energy (AGL, +6.9%) outperformed amid higher wholesale electricity prices, even as its proposed demerger (into coal generation and energy retailing businesses) was rejected by shareholders. Gas pipeline operator APA Group (APA, +8.2%) outperformed given its inflation-linked revenues and a renewed focus on its opportunities in the energy transition.

Conversely, the worst performing sectors included Consumer Discretionary (-14.9%) and Information Technology (-27.3%). In particular, JB Hi-Fi (JBH, -29.1%) and Nine Entertainment (NEC, -38.6%) declined in response to the deteriorating consumer environment, while Xero (XRO, -25.1%) delivered a disappointing full-year result and, as a high P/E firm, was pressured amid higher real rates.

Elsewhere, Real Estate (-17.8%) also experienced widespread declines given its negative correlation to higher rates, led by Charter Hall Group (CHC, -33.2%), Scentre Group (SCG, -15.1%) and Dexus (DXS, -16.6%).

Portfolio review

Key Contributors

Atlas Arteria (ALX, overweight) – the toll road operator outperformed due to its transparent inflation hedge and, moreover, as IFM's global infrastructure fund took a 14.96% stake in the company, causing speculation of a possible takeover bid. We maintain an overweight position based on ALX's strong liquidity and balance sheet position, discounted valuation and exposure to traffic recovery in Europe and the

US. ALX trades on less than 11.0 times normalised EV/EBITDA, which sufficiently captures the disruption from COVID-19 as travel restrictions and lockdowns reduce traffic volumes in the short term. Beyond traffic normalisation, we see a path towards value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime.

Worley (WOR, overweight) – the engineering services firm outperformed due to expectations the global energy crisis will stimulate capex for both oil & gas and energy transition projects. We remain overweight the company. Following the Jacobs ECR acquisition, the business is diversified across different markets and is, in our view, well positioned to capture higher structural demand from energy transition work to low carbon solutions in addition to its traditional work for the oil & gas industry. We believe WOR's valuation provides significant support at current levels, with the stock trading on 18.9 times consensus forward earnings, a sharp discount to the Industrials ex-Financials at 25.5 times.

Amcor (AMC, overweight) – the plastic packaging company outperformed after announcing a stronger-than-expected trading update. Earnings per share in the third quarter came in at US20.4 cents per share, 4% above consensus and 13% above the prior year. Further, management upgraded full-year guidance for 9.5-11% EPS growth, above its prior guidance for 7-11%. The update supported our thesis for owning the stock. We view AMC as a defensive stock with a strong dividend yield (+4.0%) that should generate strong EPS growth in FY22 (+13%), before returning to more normal levels from FY23 onwards (mid-single digit). While AMC's Flexibles division faces volume headwinds as customers turn away from non-recyclable plastics, we believe the company is moving in the right direction from the point of view of producing more recycled product and using more post-consume resin. Further, shifts to higher margin customers (pharmaceutical and medical) and cost-out initiatives will provide an offset.

Key Detractors

Tyro Payments (TYR, overweight) – the payment solutions provider underperformed as the outlook for higher real rates pressured the stock's valuation and, secondly, after the surprise departure of the chief executive. We remain overweight on the grounds that short-term headwinds (wage inflation, increased investment spending) are more than reflected in TYR's valuation. As the lead provider of software that allows payment terminals to be integrated into point-of-sale (POS) systems, TYR, in our view, remains in a defendable position versus peers such as the banks which rely on a clunky intermediary.

Northern Star (NST, underweight) – the gold miner underperformed alongside the gold price (-6% to $US1,817/oz) and in response to a disappointing 3Q22 result. While NST held FY22 guidance at 1.55-1.65mn ounces, it lifted all-in sustaining cost (AISC) guidance by $125/oz as it steps up development costs at its Pogo asset. We remain overweight the gold miner. We believe the company will benefit from higher-than-expected production and reserves/resource outcomes at its flagship KCGM SuperPit Mine, and we see the company's valuation as attractive at 3.7 times forward EV/EBITDA, which is only marginally above the wider Gold sector despite a superior growth outlook. More broadly, we have a selective exposure to the commodity, balancing the prospect of higher inflation with an uncertain rate hike path in the US (which is generally a headwind to the gold price).

CSL (CSL, underweight) – the blood plasma company outperformed as foot traffic continued to improve across its collection centres, with commentary suggesting that volumes are now broadly in line with pre-COVID levels. We remain underweight CSL based on its forward valuation (31.6 times P/E and 21.9 times EV/EBITDA on a 12-month forward basis), which we believe appropriately captures the earnings outlook at this time. While CSL is a key beneficiary of the post-COVID re-opening theme, we believe this is already reflected in consensus forecasts. However, in our view the prospect of higher costs going forward is underappreciated by the market, with donor fees and other collection centre costs likely to be higher for longer. We continue to prefer ResMed (RMD) within the Health Care sector, where we see better growth prospects and a strong competitive position versus peers.

Key Purchases

Xero (XRO) – we initiated a position in the accounting software company during the period, taking advantage of recent underperformance. While consensus continues to view XRO as a subscriber growth story, we see significant upside from higher average revenue per user (ARPU) and expansion into financial services. Regarding financial services (i.e. invoicing, payments), early stage growth is positive and, we believe, could grow to around 50% of revenues in the next 5 years. For ARPU, we expect growth to materialise as a result of XRO' strategy to have an open platform, use M&A to purchase the most successful adjacent apps to bring into its platform, and justify price rises by including them into the core platform. Lastly, on valuation grounds subscriber total lifetime value (LTV) fell below 1.2 times and will be less than 1 times by FY23, thus the stock no longer requires an extended period of time to grow into the valuation.

Chalice Mining (CHN) – we established a position in the palladium project developer during the period. Following its announcement of a maiden Julimar Resource last year, CHN has, in our view, substantially de-risked its world-class project based in Western Australia. The project comprises one of the few, large scale and high-grade deposits of palladium-group metals outside of Russia, which historically produced around 40% of global palladium supply. In regard to the market more broadly, we acknowledge demand is set to weaken in the long term for its traditional use to make catalytic converters (and reduce emissions) for internal combustion engine (ICE) vehicles. However, palladium also has a unique ability to absorb hydrogen (can absorb >900-times its own volume under suitable conditions), providing a range of potential future facing demand applications.

The Lottery Corporation (TLC) – we increased our position in the company following its de-merger from Tabcorp (TAH). Our investment thesis is premised on Lotteries as having a defensive revenue stream, significant pricing power and growth opportunities driven by online penetration (which currently sits at 32%, below the global average of 50%). In particular, we see TLC as resilient in the current market environment, holding a strong market position in a heavily regulated industry with high barriers to entry. While TLC carries ESG risk as a gaming company, we view Lotteries as a low-risk part of the market given small average ticket sizes, limiting player harm, and we see TLC as a global leader relative to peers.

Key Sales

Ansell (ANN) – we exited our position in the company to reflect greater uncertainty around the outlook for earnings. In the short term, raw materials costs and slowing demand for its single-use/exam gloves (to pre-COVID levels) represent significant risk to consensus forecasts. In the medium to long term, the company has significant exposure to slowing global economic growth through its Industrials division. As a result, we no longer saw the company's valuation as attractive at a headline P/E of 12.0 times on a 12-month forward basis.

Metcash (MTS) – we exited our position in the wholesale distributor during the period after strong outperformance. Within Food & Liquor, we continue to see MTS as a beneficiary of higher inflation as the supermarket industry remains rational in passing through higher prices. However, we anticipate the softening macro environment in Australia may limit any further market share gains, with the "shop local" theme likely to dissipate as consumers search for value. Within Hardware (now 41% of group EBIT), we support management's store rollout and refurbishment strategy, but expect we expect this will be more than offset by Australia's slowing housing market. As a result, we no longer see MTS's headline valuation (at a 12-month forward P/E of 14.2 times) as attractive given the risk to earnings as the cycle persists.

Amcor (AMC) – we reduced our position in the plastic packaging company during the period following strong outperformance, but remain overweight. We view AMC as a defensive stock with a strong dividend yield (+4.0%) that should generate strong EPS growth in FY22 (+13%), before returning to more normal levels from FY23 onwards (mid-single digit). While AMC's Flexibles division faces volume headwinds as customers turn away from non-recyclable plastics, we believe the company is moving in the right direction from the point of view of producing more recycled product and using more post-consume resin. Further, shifts to higher margin customers (pharmaceutical and medical) and cost-out initiatives will provide an offset.

Key Active Overweights

Link Group (LNK) – we are positive on the company because we see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 15.0 times forward earnings, a discount to the Industrials ex-Financials at 21.8 times.

Aristocrat Leisure (ALL) – our positive investment view remains premised on ALL's dominant position in Land-Based Games and significant opportunities from Digital, which offers a wide range of outcomes. We see the disruption from its exposure to Ukraine as temporary. Around 1,000 (40%) of its employees within the Digital business work in Ukraine, most of whom have now moved to safer regions of the country or to Poland. We see ALL's valuation as undervalued at 18.7 times forward earnings when considering the Industrials Ex-Financials trades at 23.3 times and ALL's superior long-term growth potential.

Worley (WOR) – we believe the company is in a strong position to benefit from the recovery in its traditional work and, increasingly, new sustainability projects. Following the Jacobs ECR acquisition, the business is diversified across different markets and is well positioned to capture higher structural demand from energy transition work to low carbon solutions. We believe WOR's valuation provides significant support at current levels, with the stock trading on 17.9 times consensus forward earnings, a sharp discount to the Industrials ex-Financials at 21.8 times.

Key Active Underweights

CSL (CSL) – we remain underweight CSL based on the challenge the business faces returning to pre-COVID profitability, coupled with its forward valuation (31.6 times P/E and 21.9 times EV/EBITDA on a 12-month forward basis), which we believe appropriately captures the earnings outlook at this time. While CSL is a key beneficiary of the post-COVID re-opening theme from a blood collection perspective, we believe this is already reflected in consensus forecasts. However, in our view the prospect of higher costs going forward is underappreciated by the market, with donor fees and other collection center costs likely to be higher for longer. We continue to prefer ResMed (RMD) within the Health Care sector, where we see better growth prospects and a strong competitive position versus peers.

National Australia Bank (NAB) – we remain underweight the bank, due to our negative sector view, following recent outperformance. Favourable dynamics of excess provisions and capital are now well understood, while low bad debts and significant buybacks have seen the sector re-rate to trade at peak multiples versus pre-provision earnings. We believe consensus estimates for pre-provision forecasts are too high in the absence of revenue growth – with earnings quality deteriorating in recent years as abnormal items take up a larger proportion – and an inability for the industry to meaningfully take costs out. We hold small overweight positions in Westpac Bank (WBC) and ANZ Bank (ANZ), where the valuations are more supportive at current levels.

Macquarie Group (MQG) – we remain underweight the stock based on the view the recent earnings uplift is driven by its lower quality and highly cyclical businesses, which we see as unsustainable into the medium term. We see significant downside risk to consensus forecasts beyond FY22, which currently reflects a strong contribution from lumpy items including gains on sale, performance fees and low loan-loss provisions. Meanwhile, we do not expect growth in the more stable business to be able to offset this. As a result, we regard MQG's headline forecast P/E multiple of 15.3 times consensus forward earnings as unattractive.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.18	3.93	8.25
Consumer Discretionary	9.52	6.86	2.66
Consumer Staples	1.22	4.76	-3.53
Energy	5.28	3.78	1.50
Financials	23.28	28.79	-5.51
Health Care	5.57	9.07	-3.50
Industrials	5.19	5.46	-0.27
Information Technology	7.27	3.60	3.67
Materials	26.32	25.75	0.57
Real Estate	0.00	6.72	-6.72
Utilities	2.31	1.29	1.01

Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	11.43	11.83	-0.40
Commonwealth Bank of Australia	6.76	8.15	-1.39
Westpac Banking	5.72	3.83	1.88
Telstra	3.91	2.10	1.81
ANZ Banking	3.89	3.51	0.38

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	3.62	0.12	3.50
Aristocrat Leisure	3.83	1.11	2.72
Worley	2.76	0.22	2.54
Underweights			
National Australia Bank	0.00	4.74	-4.74
CSL	1.61	5.80	-4.19
Macquarie Group	0.00	3.31	-3.31

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	-23.69	-9.19	-7.60	-3.42
Distribution return	15.50	10.68	11.31	10.78

The Growth Return is measured by the movement in the Fund's unit 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 capital distributions.

Features

Investment objective	To outperform the S&P/ASX 200 Accumulation Index over rolling 3-year periods.
Recommended investment time frame	5 + years
Fund inception	December 1984
Fund size	A6.9 mn as at 30 June 2022
APIR codes	JBW0005AU
ARSN code	090 047 662
Estimated management cost	1.65% p.a.
Buy/sell spread	+/- 0.15%

Applications and contacts

The Yarra Investment Fund is no longer available for new investment. The reinvestment of distributions is still allowed where an existing reinvestment instruction is in place.

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