

Yarra Emerging Leaders Fund (Direct)

Gross returns as at 31 October 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception [†] % p.a.
Yarra Emerging Leaders Fund (Direct)	4.82	-3.39	-9.91	4.02	7.89	11.27	12.81
Emerging Leaders Combined Benchmark [†]	6.77	-0.91	-10.79	6.01	6.85	8.88	8.13
Excess return (before fees) [‡]	-1.96	-2.47	0.88	-1.99	1.03	2.38	4.68

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 October 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception [†] % p.a.
Yarra Emerging Leaders Fund (Direct)	4.65	-3.84	-11.59	1.95	5.65	8.88	10.50
Emerging Leaders Combined Benchmark [†]	6.77	-0.91	-10.79	6.01	6.85	8.88	8.13
Excess return (after fees) [‡]	-2.12	-2.93	-0.80	-4.06	-1.20	0.00	2.38

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 Emerging Leaders Fund (Direct): November 1994

[‡] Comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index

[‡] Excess return: The difference between the Fund's return and the benchmark return.

Market review

Australian equities rallied sharply and gained 6.0% during October, following a 6.2% decline in September.

The Emerging Leaders Benchmark returned +6.8% for the month, taking its 12-month return to -10.1%. The broader ASX 300 gained also 6.0% for the month and global indices notched up strong gains in October (MSCI World Index, +7.2%).

Within Health Care (+12.0%), the largest contributors were led by Neuren Pharmaceuticals (NEU, +12.1%), Telix Pharmaceuticals (TLX, +46.5%) and Mesoblast Limited (MSB, +18.6%).

Real Estate was a strong performer (+12%) as investors started to revisit the sector post material underperformance and with the sector trading well below book value, led by National Storage REIT (NSR, +17.0%), Arena REIT (ARF, +18.0%) Unibail-Rodamco-Westfield CDI (URW, +19.9%).

Conversely, the weakest performing sector yet in positive territory was Energy (+2.7%), led by Worley (WOR, +12.1%), Paladin Energy (PDN, +12.6%) and negative performance in Cooper Energy (COE, -17.6%).

Portfolio review

Key Contributors

Link Group (LNK, overweight) – the company's share price recovered somewhat during the month following sharp underperformance in the prior month following termination of the agreed deal with Dye & Durham to buy the company. We still see considerable value in LNK and a pathway to crystalizing this value and regard the announced demerger of its stake in PEXA as an appropriate first step. LNK received a substantial bid from Dye & Durham for its Corporate Markets and Banking & Credit Markets businesses during the month which further highlights the value in the constituent parts of LNK.

Nanosonics (NAN, overweight) – the disinfection device company outperformed during the period despite no recent updates. The business continues to perform well with double digit growth in the installed base, the successful transition of the US distribution capability from GE and recovery in the consumables volumes as COVID disruption moderates. Despite this, the stock has been caught up in the growth sell-off and offers compelling value at these levels.

Flight Centre Travel (FLT, overweight) – the travel company outperformed despite no material company specific news. We remain overweight as we continue to see significant upside at

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current levels. The Leisure division (40% of pre-COVID EBIT) is set to benefit from pent-up travel demand, with improved margins following a material reduction in the cost base. The Corporate divisions (60% of pre-COVID EBIT) is rapidly expanding market share which will more than offset a smaller market caused by increased use of virtual meetings. Furthermore, as group earnings improve we believe there is additional value to be released from restructuring the balance sheet.

Key Detractors

Megaport (MP1, overweight) – the network as a service solutions company underperformed after releasing its September quarterly result, which was weaker than expected across customer volume metrics and confirmed higher than expected capex. We would note the June quarterly result beat expectations and that the September quarter is a seasonally less important one. Longer term we see strong growth from the core business connecting data centres to the cloud, with a strong global pipeline as businesses invest in IT projects. With its expansion into broader telecommunication services – which leverages the same infrastructure – the total addressable market more than doubles. The company is currently at an inflection point for earnings and cashflow; we believe it will turn positive in the next year with significant long-term earnings and cashflow potential.

OZ Minerals (OZL, overweight) – the copper miner was a negative contributor in October despite no incremental news, with BHP's takeover offer for the company weighing on share price performance. With the OZL board rejecting the initial offer, we recognize the potential for BHP to return with a higher bid and regard the potential for a counterbidder to emerge as limited, given BHP's significant available regional synergies. We retain our fundamental positive view on OZL due to its two high quality, long life, 100% owned copper mines in South Australia – Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia.

Reliance Worldwide (RWC, overweight) – the plumbing supplies company underperformed during the period following the release of its 1Q23 result which showed volumes are softening modestly across the business (-1.9% in 1Q) and expectations that volumes will be down mid-single digits in the Americas division over FY23. Margins were also weak at 21.4% (ex EZ Flo), with the price recovery for cost inflation insufficient to cover cost inflation in the quarter. Over the full year, raw material costs should deflate, which should mean that margins improve over the full year. Whilst the quarterly result was weak, we regard the sell-off as over-done and retain our conviction in the longer-term investment thesis.

Key Purchases

Netwealth (NWL) – we view NWL as a very high-quality company with a strong market position, high levels of recurring revenue, strong visibility on growth and a strong

track record of reinvestment at high levels of incremental returns. Having underperformed the index year to date despite no discernible deterioration in fundamentals we view this as an attractive point to increase the portfolio's position.

Sandfire (SFR) – we increased our exposure to the copper producer during the period, reflecting our conviction in the commodity given its leverage to electrification as a key material in batteries and electric motors. While we recognise risks of an oversupplied market in the near term, we believe recent falls in copper prices are now largely complete given cost curve support. While Sandfire faces near-term challenges including gearing levels, power costs at the MATSA project in southern Spain, and construction risk at the Motheo project in Namibia, we believe these risks have been significantly over-priced and see upside value at current share price levels.

Pinnacle Investment Management (PNI) – we increased the position in the investment manager during the period. We have a positive view of PNI given continued net inflows supported by a large number of strong products across multiple asset classes and international distribution, performance fee increases from depressed levels, further margin expansion supported by the fixed cost nature of funds management businesses and new manager formation both organically and via acquisitions which has created material shareholder value over time.

Key Sales

Australian Clinical Labs (ACL) – we reduced our position in the diagnostic services company following recent outperformance, maintaining a preference for healthcare companies Nanosonics (NAN) and Integral Diagnostics (IDX) following their underperformance. We continue to hold an ACL position given available non-COVID-19 market growth (upside from normalisation post COVID-19) and market share gains (in particular NSW / QLD), productivity programs and cost synergies which will support margin expansion and continued industry growth.

OZ Minerals (OZL) – we trimmed our position in Oz Minerals during the period. We retain our positive view on the company, underpinned by both our constructive view on copper, and the potential for an increase to BHP's recent \$25/sh takeover offer. Quality copper assets are scarce globally, and we remain positive on OZL due to its two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia.

AUB Group (AUB) – we continued to trim our overweight position in the insurance broker following strong relative performance as the market gained more confidence in the Tysers acquisition. We retain our positive view on AUB, and it remains a key overweight. Tysers has seen an acceleration in year-to-date revenue growth from 6% to 9%, which includes an FX benefit from the USD/GBP currency pair. Tysers revenues are ~50% USD denominated, but 90% of costs are in GBP.

More broadly industry updates on premium growth remain very strong.

Key Active Overweights

Worley (WOR) – following years of underinvestment in oil & gas projects, and with the more recent supply disruptions stemming from the war in Ukraine, expectations for project spend across WOR's traditional customer base have increased to 27% growth (y/y). There is also a strong pipeline of capital spend required to decarbonise energy production and provide more sustainable solutions across chemical and resources customers. We also think incremental margins could be higher going forward after the company's \$375m cost-out program during COVID.

Link Group (LNK) – despite the uncertainty created by the failed takeover bid from Dye & Durham and UK regulatory action on its Fund Solutions business, we still see considerable value in LNK's constituent parts and a pathway to crystalizing this value. In the interim LNK's two main operating businesses are performing well, with two upgrades to guidance provided in the last six months.

Reliance Worldwide (RWC) – we remain positive on the compelling opportunities within the plumbing supplies company. While the market pricing for a significant decline in earnings (as reflected in the forward P/E of only 11.0 times), we remain constructive on the demand environment – both in the trough and longer term – given the defensive nature of the majority of RWC's repair and remodelling sales. Approximately 80% of RWC's sales are repair and remodel, which is not tightly correlated with the housing sector, while 60% of US sales are for repairs which are more defensive in nature.

Key Active Underweights

WiseTech (WTC) – we remain underweight the Australian based provider of software services to the logistics industry, despite recent outperformance on the back of a strong 12% upgrade to FY22 EBITDA guidance. Historically, WTC's purchases have diluted group margins, with the lack of recent acquisitions helping to provide a margin boost. WTC has benefitted from the rally in the longer dated end of the yield curve, as per other technology stocks. We retain a preference for other names in the technology sector.

Allkem (AKE) – we are underweight Allkem, our preference is for Pilbara Minerals (PLS) amongst lithium exposures. While we recognize Allkem offers lithium supply diversity across both brine (Olaroz), and hard-rock (Mt Cattlin) operations, we are concerned with asset-specific risks. Olaroz has faced significant operating challenges associated with chemical processing at altitude, while hyperinflation challenges in Argentina present a macro risk overlay. Mt Cattlin is a smaller and higher cost spodumene mine than PLS's Pilgangoora operations.

Whitehaven Coal (WHC) – we remain underweight Whitehaven Coal. Coal prices continue to trade at significantly inflated levels, we view current prices for both thermal and metallurgical coal as unsustainable, and well in excess of cost

curve support. Additionally, we are cognizant of coal's diminishing role in the global energy mix as stationary energy systems shift to lower carbon intensity.

Market outlook

Financial markets have now embraced the risk of recession in the US and Europe over the past quarter, and the gap between our more pessimistic forecasts for the global economy and the consensus has narrowed. Indeed, with the Fed signalling that financial conditions are close to neutral, we are edging closer to the point where the pace of monetary tightening will slow, providing some scope for risk markets to recover some lost ground. The process clearly started in October with equities recovering most of the large declines recorded in September.

The period of excess inflation is starting to recede, with prior surges in commodity prices retreating, an easing in supply constraints, and signs of slowing demand likely to compress elevated sales margins. As central banks continue to await firmer signs that inflation expectations have stabilised and for labour demand to ease, financial markets are faced with the positive news of less restrictive monetary policy and the negative news of likely weaker company earnings.

In a world of heightened concerns of recession in major developed economies, subdued economic activity in China and ongoing conflict between Russia and the Ukraine which has contributed to commodity shortages, high inflation and rising interest rates, the Australian economy presents as a relative safe haven.

Australia's economic data has remained robust in 1H2022, although we do expect economic activity to slow significantly in 2023 to average just 1.5%. While a local recession is possible in 2023, we believe Australia should be able to avoid a technical recession due to three key reasons:

1. Australia has been a net beneficiary of global commodity shortages. This surge in commodity prices saw Australia's export prices in A\$ terms move to their highest levels since the 1880s in 1H2022. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position.
2. The household sector continues to hold a significant buffer of over \$260bn of excess savings relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses will curtail consumer spending, we do expect the combination of rising wage growth and a run down in the level of savings to continue to support consumption spending.
3. Low levels of spare productive capacity, strong profit and low corporate debt have contributed to robust capital investment intentions.

In the medium term we believe a recovery in net immigration levels into Australia and Australia's exposure to key commodities crucial to the global energy transition will provide a solid underpin for future economic growth.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 have come via both significantly higher cash rates, higher government bond yields and wider corporate bond spreads. We expect that the RBA cash rate will finish the year at 3.10%, which might well mark the peak for the RBA, well below market expectations of a 4.0% peak in 2H23. The A\$/US\$ has been particularly weak in recent months, albeit on a TWI basis the A\$ has been broadly stable. With Australia's external accounts are in their best position since the early 1970s and the prospect the US\$ uptrend will peak as the Fed pivots from its aggressive hiking strategy we expect the A\$/US\$ will appreciate to the mid-70s by end-2023.

We are most overweight stocks within the Health Care, Communication Services and Information Technology sectors, and are underweight Real Estate, Consumer Discretionary and Energy.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.64	5.81	6.82
Consumer Discretionary	9.35	11.25	-1.90
Consumer Staples	1.70	3.95	-2.25
Energy	4.36	8.13	-3.77
Financials	9.11	10.50	-1.39
Health Care	6.43	4.48	1.95
Industrials	11.74	11.50	0.24
Information Technology	8.76	8.33	0.42
Materials	24.26	25.51	-1.25
Real Estate	4.14	9.77	-5.63
Utilities	0.00	0.78	-0.78

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Pilbara Minerals	4.53	2.51	2.02
Worley	4.36	1.01	3.35
OZ Minerals	4.29	1.54	2.75
IGO	4.10	1.96	2.14
Carsales.com	3.89	1.36	2.53

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Worley	4.36	1.01	3.35
Link Administration	3.63	0.39	3.24
Reliance Worldwide	3.72	0.48	3.24
Underweights			
Wisetech Global	0.00	1.91	-1.91
Allkem	0.00	1.65	-1.65
Whitehaven Coal	0.00	1.64	-1.64

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	-12.71	1.27	4.87	7.87
Distribution return	1.12	0.68	0.78	1.01

The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), 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 achieve medium-to-long term capital growth through exposure to small and medium sized Australian companies that are considered to possess strong capital growth potential. In doing so, the aim is to outperform the benchmark over rolling 3-year periods.
Recommended investment time frame	5 - 7 + years
Fund inception	November 1994
Fund size	A\$92.9 mn as 31 October 2022
APIR codes	JBW0007AU
ARSN code	089 909 106
Distribution frequency	Semi-Annually
Estimated management cost	1.90% p.a.
Buy/sell spread	+/- 0.20%

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

Applications and contacts

The Yarra Emerging Leaders Fund (Direct) 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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Disclaimers

The Yarra Emerging Leaders Fund (Direct) is substantially invested in the Yarra Emerging Leaders 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. The Fund's benchmark comprises 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index.

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