YARRA
CAPITAL MANAGEMENT

Quarterly Investment Commentary
As at 30 September 2023

Yarra Growth Fund

Net returns as at 30 September 2023

	1 month %	3 months %	6 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception % p.a.
Total Fund return (net)	-3.26	-2.01	0.71	9.05	7.26	4.25	6.65	6.64
Fund growth return (net)	-3.26	-2.01	-0.22	7.36	4.32	-0.39	-0.07	1.32
Fund distribution return (net)	0.00	0.00	0.94	1.69	2.95	4.64	6.73	5.32
Benchmark*	-2.96	-0.35	2.95	14.79	8.93	6.97	8.57	7.96

Source: YFML, Citi. Total Fund net returns are post fees, pre tax using redemption prices and assume reinvestment of distributions. Fund growth return is the change in redemption prices over the period. Fund distribution return equals Total Fund minus Fund growth return. Past performance is not an indicator of future performance. Inception date: February 1996.
* The Fund's benchmark is a composite index constructed using the applicable asset class index, weighted according to the Fund's benchmark asset allocation of: 15% of Bloomberg AusBond Composite 0+ YR Index for Australian fixed interest, 30% of S&P/ ASX 200 Accumulation Index for Australian shares, 50% of MSCI All Countries World Index Net Total Return AUD Index (unhedged) for overseas shares, 0% of S&P/ASX 300 Australian Real Estate Investment Trusts (A-REITs) Accumulation Index for property securities (effective 16 December 2013. Prior to this was the S&P/ASX 200 A-REITs Accumulation Index), and 5% of Bloomberg AusBond Bank Bill Index for Cash.

Portfolio review

The Fund returned -2.01% for the quarter, underperforming its composite benchmark return of -0.35% by 166 basis points (bps).

Australian Equities

The Fund's allocation to Australian equities underperformed the overall market during the quarter. The S&P/ASX 200 Accumulation Index returned a negative -0.77% over the same period.

At the sector level, there was evident disparity, with energy (+11.16%) benefiting from the surge in oil prices, along with strong performance in consumer discretionary (+5.33%) and financials (+2.38%). While, health care (-8.59%), consumer staples (-5.88%), and information technology (-5.81%) experienced substantial declines. The remaining sectors, real estate (-3.15%), industrials (-2.91%), materials (-2.44%), utilities (-1.88%), and communication services (-1.59%), saw more modest decreases in their performance.

Notable contributors to performance included CSL, Carsales.com and QBE Insurance.

An underweight position in CSL, benefitted the Fund as the stock weakened on disappointing earnings guidance, which was about 10% below consensus expectations for group FY24 NPATA. The weaker operating outlook was driven by lower growth in the core blood plasma business, Behring, as cost pressures pushed out the margin recovery story.

Carsales.com outperformed on strong results. Recent acquisitions in the US and Brazil, demonstrated double-digit yield growth as dynamic pricing models were introduced. A strengthened market position in Australian private car sales also enhances the visibility of continued price and yield increases across the business.

QBE Insurance outperformed due to rising bond yields, which generally benefit general insurance companies as it boosts their investment income from the premium float invested in cash and bonds.

The main detractors from performance included ResMed, Iluka and Chalice Mining.

ResMed underperformed during the month, primarily due to concerns regarding the potential impact of weight loss drugs (GLP-1s) on the sleep-apnea market. Additionally, the eventual return of competitor Phillips to the sleep-apnea device market in the USA also contributed to share price weakness following the release of ResMed's full-year results.

Iluka underperformed after it reported a 10% decline in mineral sands revenue and a 22% decline in underlying EBITDA in its FY23 results, with the market concerned over the short-term outlook for mineral sands demand notwithstanding ILU's commentary of flat pricing in the second half.

Chalice Mining underperformed following its scoping study release for the Gonneville project, with concerns over the absence of a strategic partner and the outlook for platinum group element pricing, which is primarily used in internal combustion engine exhaust systems.

Global Equities

The Fund's Global equities equities allocation underformed over the quarter. Global equity markets weakened significantly in September (with the MSCI ACWI falling close to 4% in AUD terms) as markets reacted to rising oil prices and a back-up in bond yields, with the US 10-year yield reaching 4.5% by quarter-end, surpassing the levels that preceded the swoon in markets towards the end of 2022. This more than offset gains made earlier in the quarter and indices fell slightly over the 3

months as a result (with the MSCI ACWI down -0.37% in AUD terms).

The jury is still out in terms of the cause of this rise in bond yields. Some believe that it is attributable to the upward pressure exerted on inflation by rising energy costs, which will diminish the attractiveness of bonds. Others believe that the issue is the coming glut of bond supply, as the US Government issues debt, to fund its spiralling fiscal deficit. With a Presidential election approaching, and the country seemingly united behind the geopolitical strategic imperative of preserving technological leadership, this spending (and debt issuance) certainly looks likely.

Whichever the cause, rising interest costs are beginning to have a more pronounced impact on economic growth – with small firms in the US noting the rising cost of credit and bank lending standards tightening. Although much-watched data points like the spread between treasuries and BBB-rated companies continue to look well contained (and measures of equity market volatility such as the VIX remain becalmed) tensions are building in economically sensitive areas, such as mortgage-backed securities.

The energy sector was the best performing sector this quarter, as the oil price rose towards USD100 per barrel on evidence of maintained supply discipline by OPEC+ and with the US pausing its drawing down of its Strategic Petroleum Reserve. Other cyclical sectors fared less well, however. Information technology, consumer discretionary and industrials all fell more than the market.

That is not to say that traditional defensives all outperformed. Whilst parts of health care and communication services did beat the market, the more yield-sensitive sectors (real estate and utilities) underperformed to a greater extent than the cyclicals.

Financials outperformed over the quarter, as both banks and insurance shares responded positively to September’s back up in bond yields, and the associated steepening of the yield curve.

Regionally, Europe and resource-heavy markets such as Australasia and Canada underperformed as concerns grew over the world’s economic performance. Japan, on the other hand, resumed the outperformance that the country had enjoyed earlier in the year. Its relatively closed economy and its relative value tilt likely helped. The US performed broadly in line with the benchmark this quarter.

The key contributors to performance included Samsonite International S.A., Booking Holdings Inc. and PT Bank Mandiri (Persero) Tbk.

Samsonite International S.A. and Booking Holdings Inc. were among the best performing stocks held this quarter. Whereas Booking responded well to good results in July, Samsonite was particularly strong in August, on the back of its own strong set of quarterly numbers, with sales in all regions returning to pre-COVID levels and significantly stronger margins because of the new expense structure. Management commentary on continued global travel demand was very encouraging.

Indonesia’s PT Bank Mandiri (Persero) Tbk performed well during the quarter. The share price had consolidated over the course of the year. Results in the latter part of July were strong. Loan growth grew 12% and margins improved. Importantly asset quality was also very strong and non-performing loans declined.

Notable detractors from performance included Masimo Corporation , Hexagon AB and Amadeus IT Group SA .

Masimo Corporation's weaker performance in July was driven by challenges in both their Healthcare and non-Healthcare divisions. In Healthcare, delayed contracts were due to staffing and budget issues in hospitals, while in the non-Healthcare sector, a slowdown in US housing activity affected their consumer audio business.

Hexagon AB's shares dropped following allegations of exaggerated organic growth. However, the manager finds no evidence of exaggerated organic growth, as the company complies with accounting standards and admits that a substantial part of growth is acquisition-driven.

Amadeus IT Group SA underperformed due to concerns about a slower recovery in their travel booking business, particularly in Europe, as they continue to invest in long-term growth drivers, which could impact short-term margins.

Australian Fixed Interest

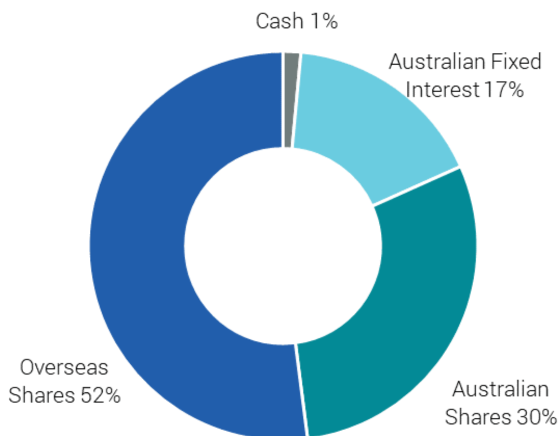
The Fund’s Australian fixed interest allocation outperformed over the quarter. The Australian bond market (as measured by the Bloomberg AusBond Composite 0+ Yr Index) returned -0.28%.

The Fund maintained an overweight duration position, as the manager believes the market is pricing a higher terminal cash rate and suspect that the RBA has reached the end of their hiking cycle. Bond yields fell in the first half of the quarter, after consecutive months of weak data. However, sentiment shifted after more hawkish statements from the Federal Reserve and positive employment data. As a result, 3-year bond yields closed the quarter 4 basis points higher at 4.08%, while 10-year bonds surged 46 basis points to 4.48%, on prospects of a “soft landing”. The fund’s curve steepening position benefited from this yield curve movement. The fund’s sector allocation currently favours semi-government issuers, in the 5-15 year maturities. Semi-government spreads narrowed over the quarter, which was a contributor to outperformance over the quarter. An overweight credit position in the 0-5 maturities contributed to performance. While a higher than benchmark running yield was a slight contributor for performance.

Strategic Asset Allocation

Asset Class	Target Allocation (%)	Range (%)
Australian Shares	30	20-45
International Shares (unhedged)	50	35-65
Property Securities	0	0-10
Total growth assets	80	70-95
Australian Fixed Interest	15	5-25
Cash	5	0-20
Total income assets	20	5-30

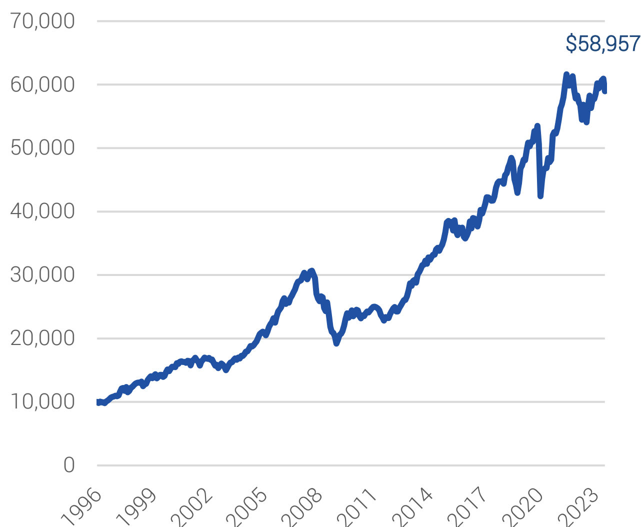
Asset Allocation at Quarter End



Source: YFM, Citi

Performance Graph

Value of $10,000 invested in the Yarra Growth Fund since inception:



Source: Citi & YFM. Past performance is not an indicator of future performance.

Market Outlook

With the major central banks declaring that further interest rates are now data dependent and as evidence continues to accumulate that inflation continues to moderate, our long-held view that mid-2023 would mark the top of the interest rate cycle appears to be broadly on track. Crucially, both labour markets and core services inflation have eased in recent months and forward indicators suggest further progress should be made through the rest of 2023.

Moreover, the pessimistic tone of the economic activity data in the US that threatened a technical recession has given way to slightly more upbeat data in recent weeks encouraging the belief that the US will escape a technical recession in 2023. Indeed, some leading indicators are suggesting that a broader turn in the global industrial cycle is at hand, which should encourage a rotation from a narrow mega-cap tech led equity market rally to broader participation in 2023.

Indeed, our leading indicators suggest the negative earnings per share revisions trend has now largely run its course which when combined with a levelling out in economic momentum and an end to the interest rate tightening cycle will likely provide greater confidence in underlying valuations and a shift from bearish equity positioning. Bond yields continue to provide the more significant challenge to equity market valuations, albeit the lift in bond yields into mid-2023 can mostly be attributed to a significant lift in the supply of US bonds as the US budget deficit continues to increase sharply, thereby providing a counter cyclical boost to economic growth.

Economic growth has also slowed in Australia, recording just 0.4%q/q growth in the June quarter, repeating the same languid growth recorded in the March quarter. Indeed, with population growth running at a 2.5% annualised pace in the six-months to June and economic growth expanding at an annualised 1.8% pace over the same period, Australia has recorded its first per capita recession since mid-2006 (excluding the COVID lockdown period). It is clear the prior tightening of monetary policy is having a material impact on the interest rate sensitive parts of the economy. For instance, discretionary consumption volumes have declined 0.6% (six-month annualised) as non-discretionary household expenses and interest costs soared by 16%yoy – the fastest annual increase since 1989. Building approvals continue to decline – now down 45% from the 2021 peak - and are likely to fall further in coming months as declining housing affordability outweighs the impact of an under supplied housing market.

Nevertheless, the good news is that after a pause in the tightening cycle in July, The Reserve Bank of Australia (RBA) has remained on hold and flagged that future monetary policy adjustments will be data dependent. To be clear, the RBA retains a tightening bias, however an update of their inflation forecasts now has inflation returning to inside the target band in 2025, providing a signal that absent any unexpected inflation shocks the RBA's rate tightening cycle is complete.

The RBA also revised down economic growth modestly to just 1.0% in 2023, acknowledging that local economic growth had faltered. It is of note the that the RBA's forecasts for domestic growth are now below our own for the first time since 2019.

Australia should still be able to avoid a technical recession due to four key reasons:

1. Australia has been a net beneficiary of global commodity shortages and the prior surge in commodity prices. Although commodity prices remain elevated from a historical perspective, they are now off their peaks., The impact of moving through the peak will be for nominal GDP growth to slow quickly over the next six months, removing some of the cushion that has protected corporate profits, tax receipts and wage growth.

2. The household sector continues to hold a significant buffer of excess savings which can be used to smooth consumption growth amid acute cost of living pressures. Nevertheless, our analysis suggests that the residual of the savings buffer skews to older households, leaving younger and more indebted households exposed. As such, we remain particularly cautious on discretionary retail spending.

3. Australia remains incredibly well placed to benefit from the global energy transition. Lithium is already a A$10bn export industry domestically and Australia is the world's dominant producer. Electric Vehicle sales are forecast to increase 10 times by 2030 and Australia has the world's second largest copper resource. LNG is an important energy transition fuel – it currently accounts for 23% of global electricity generation – and Australia just happens to be the world's equal largest exporter of LNG. The limiting factor nearer term is that escalating costs and project delays risk pushing out the economic benefits.

4. Net migration into Australia contracted in 2021 for the first time since 1945. However, a very strong recovery was recorded through 2022 and a record level of net migration has occurred in recent months, ensuring that Australia's population growth will exceed 2.5% in 2023. This will be the primary mechanism keeping Australia out of recession, yet it comes with the complication of exacerbating the rental shortage evident across all capital cities.

While the RBA has been later than most other developed nations, we believe financial conditions are now firmly in the restrictive zone. While interest rate hikes in Australia will remain a month-to-month proposition, our analysis suggests that the RBA should have concluded its hiking cycle. Moreover, we do expect that the RBA will commence a modest easing cycle in 1H24, most likely commencing in May 2024.

The A$/US$ had been under downward pressure as markets grappled with a seemingly more hawkish Fed relative to the RBA and poor sentiment on the economic outlook for China. However, with Australia's external accounts remaining in excellent health, our expectation that Australia's economic growth will prove more robust, and the prospect the US$ down trend will re-emerge as the Fed pivots from its hiking strategy to an easing cycle in early 2024, we expect the A$/US$ will appreciate to the low-70s towards mid-2024.

Fund Objective

The Fund aims to provide a modest level of capital growth and income over the medium to long-term, with total returns (before taxes, fees and expenses) above the Fund's benchmark over rolling five-year periods.

Key Facts	
Responsible Entity Yarra Funds Management Limited	**Management Cost** 1.15% p.a.
APIR Code SUN0021AU	**Buy/Sell Spread** 0.15%/0.15%
Fund Size AUD 69.8 million	**Distribution Frequency** Half Yearly
Minimum Investment AUD 2,000	

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