Yarra Emerging Leaders Fund (Direct)

Gross returns as at 31 October 2023

	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)	-6.52	-12.72	3.23	6.03	6.86	8.95	12.46
Emerging Leaders Combined Benchmark†	-6.20	-11.42	-4.63	1.26	5.12	7.20	7.66
Excess return (before fees)‡	-0.32	-1.30	7.86	4.76	1.75	1.75	4.80

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 2023

	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)	-6.67	-13.13	1.31	4.04	4.72	6.65	10.17
Emerging Leaders Combined Benchmark†	-6.20	-11.42	-4.63	1.26	5.12	7.20	7.66
Excess return (after fees)‡	-0.47	-1.71	5.93	2.78	-0.40	-0.55	2.51

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

The Australian mid and small cap market declined in October, erasing its gains from the past 12 months performance.

The Emerging Leaders Benchmark returned -6.2% for the month, pushing its 12-month return into the red (-4.6%). By comparison, the broader S&P/ASX 300 returned -3.8% for the period. Globally, the MSCI World Index declined by 2.9%.

Utilities (+0.2%) was flat, and it was the only sector to close with a positive return. Continuing to position for the energy transition, electricity generator and retailer AGL was the primary contributor to the sector's return.

By contrast, the Health Care (-9.4%) sector was among the worst sector performers. Telix Pharmaceuticals (TLX, -22.5%) dropped substantially following release of a weaker quarterly production update. Other notable detractors were Pro Medicus (PME, -10.6%) and Healius (HLS, -21.3%).

Financials (-8.5%) was another lagging sector for the month, with all sub-sectors closing in negative territory. AMP (AMP, -16.7%) and Credit Corp (CCP, -37.7%) were the main drivers of underperformance. Debt buyer CCP plummeted following a downward revision to FY24 guidance reflecting a ~14% impairment of its purchased debtor ledgers business due to worsening US market credit conditions.

Portfolio review

Key Contributors

Liontown Resources (LTR, underweight) – the lithium producer underperformed during the month after Albemarle's $3/share takeover offer collapsed. Liontown is now in the process of raising equity at $1.80 per new share. Combined with debt funding, the company believes it is fully funded through to production at the Kathleen Valley lithium project. We continue to see downside risks from easing EV demand on slowing economic conditions and incremental mine supply, while pricing remains above cost curve support.

Evolution Mining (EVN, overweight) – the gold miner was a positive contributor during the period. Gold prices increased by 7.1% to US$ 1,996/oz during October. From a commodity perspective, macro uncertainty continues to provide a supportive backdrop for the gold price. At a company specific level, EVN continues to have drilling success across the portfolio, with updated resource/reserves expected in early 2024.

CAR Group (CAR, overweight) – the online auto classifieds company outperformed during the month on limited news flow outside of its AGM where the company reiterated its full year guidance. We retain an overweight in CAR which has

demonstrated strong yield growth potential across all its operating segments.

Key Detractors

IGO (IGO, overweight) – the lithium and nickel miner underperformed following the company's release of its September quarter production update. News flow on JV partner Tianqi's decision to defer purchasing half of its offtake from the Greenbushes mine, coupled with ongoing production issues at the Kwinana LiOH refinery and nickel business weighed on the stock. Within the lithium sector, we continue to favour IGO given its high-quality, low cost and long-dated lithium assets, coupled with diversity offered by the company's nickel business.

Netwealth (NWL, overweight) – the leading independent wealth management platform underperformed following the release of its quarterly update which showed net cash inflows were below expectations, prompting 5-8% earnings cuts. We believe NWL is set to continue delivering strong revenue growth for the foreseeable future, capturing an outsized level of funds under administration as Australia's wealth management industry fragments away from the historically dominant players. In our view, the company's 21.5 times EV/EBITDA multiple for FY25 does not capture its long-term growth opportunity, high incremental margins, conservative accounting, and strong cash flow generation.

Megaport (MP1, overweight) – our overweight position in the software technology company underperformed following the release of its quarterly result, after having been a strong contributor in the prior quarter. While revenue and EBITDA growth were consistent with FY24 guidance, operating metrics were softer than expected, in particular new customer growth which led to underperformance during the period. We continue to hold the position as we believe customer volume trends will improve in the medium to long term as market conditions and execution improves. Furthermore, we would highlight that yield growth, low customer churn, margin expansion (including cost reduction programs) and lower capex will support a transition to free cashflow positive in CY24 with significant cashflow potential longer term.

Key Purchases

IGO (IGO) – we took the opportunity to add to our position in the lithium and nickel producer during the month. With lithium prices having retraced significantly from recent highs, we are now seeking to increase our leverage to the commodity. Within the lithium sector, we favour IGO given its high-quality, low cost and long-dated lithium assets, coupled with diversity offered by the company's nickel assets.

Key Sales

TPG Telecom (TPG) – we decreased our position in the Australian telco following the announcement of the potential $6.3bn sale of its Vision/EG&W assets. While we see evidence of improved operating momentum, the proposed sale also concentrates TPG's exposure in mobiles, with medium term earnings growth contingent on repricing and ongoing mobile rationality. This may prove more challenging as inflation eases and CPI-linked increases moderate, while the outlook for mobile competition remains a risk given Optus has yet to move its postpaid pricing.

Collins Foods (CKF) – we modestly reduced the position in the quick service restaurant provider following a period of outperformance and to fund other opportunities. We continue to hold a significant overweight position given the improving Australian KFC earnings outlook, as margins increase from depressed levels given continued defensive sales growth, pricing increases and lower commodity costs. Furthermore, the European KFC business has a strong growth outlook, in particular given the significant new store growth outlook and the Taco Bell business currently being valued negatively.

Incitec Pivot (IPL) – we took the opportunity to trim the position size in light of our risk assessment around the likely set of outcomes from IPL's expected upcoming fertilizer division sale, coupled with the stock risk/return outlook. A number of developing challenges may limit the quantum of proceeds (future gas supply reliability, long-term sulphur supply visibility and FIRB considerations, in the event of an overseas buyer) which have seen us re-size the position.

Key Active Overweights

CAR Group (CAR) – we are overweight the online car classifieds company which has demonstrated strong yield growth potential across all its operating segments. In Australia, which represents approximately 50% of its valuation, CAR is seeing improving yields from products such as Instant Offer and Select in Australia, along with a strengthened competitive position in private sales. CAR's recent acquisitions of US business, Trader Interactive, and Brazilian business Webmotors have both demonstrated strong yield growth as new dynamic pricing models are introduced. The visibility on CAR's medium term revenue growth has improved, meaning the 29.0 times FY25 earnings trading multiple relatively undemanding given these tailwinds.

Reliance Worldwide (RWC) – we view the plumbing supplies company as a compelling opportunity, with the market capitalisation a softer FY24 earnings year which we believe doesn't give appropriate credit to the mid-cycle earnings power of the group considering the resilience of its end markets, the majority of which relates to more non-discretionary, repair type housing activity.

Worley (WOR) – we remain overweight the leading provider of global engineering services. WOR's earnings recovery is in its early stages following COVID-19 impacts across FY20-22. Revenue is expected to grow 13-15% in FY24, with leading indicators (Factored Sales Pipeline +36%, Rolling 12 Month Bookings +28%, Backlog +8%) and structural drivers (capital investment required to decarbonize) pointing to strong top-line growth ahead. Margins are also set to increase over the coming years as WOR benefits from a more consolidated industry structure, operating leverage, and active mix management towards higher margin sustainability work.

Key Active Underweights

WiseTech (WTC) – we remain underweight the leading developer of software solutions for the logistics industry, with a preference for other names in the technology sector given WTC's demanding valuation of 76.3-times FY24 P/E. We believe WTC has – and is continuing to build – an exceptional product in CargoWise, which should continue to attract and retain large freight forwarders. However, the opportunity appears fully priced at current levels.

Washington H Soul Pattinson (SOL) – we do not hold a position in the diversified investment company. At this time, we see better direct investment opportunities available than those offered through SOL's broad suite of investments across the telco, mining, manufacturing, healthcare, and funds management sectors. We also remain cautious on the company's exposure to thermal coal via its 38% stake in coal miner New Hope (NHC).

Ampol (ALD) – we retain an underweight position, with structural challenges from declining retail fuel/tobacco volumes and dilutive returns from the EV transition expected to persist over the longer-term. While ALD has continued to execute against its Convenience strategy, the nature of the format is uncertain and cyclical refining margins remain elevated. With the company trading on a FY24 earnings multiple of 11.3-times and a 6.2% dividend yield, we believe better opportunities can be found elsewhere.

Market outlook

Major central banks have become more strident in declaring that interest rates are now likely at the peak. In the case of the UK, the Bank of England (BoE) has effectively endorsed the markets expectations for interest rate declines in 2024. Moreover, in the US, the Federal Open Market Committee (FOMC) have yet to walk back their guidance of material rate reductions in 2024 and 2025. The primary force behind this shift is the ongoing accumulation of evidence that inflation continues to moderate, inclusive of easing stresses in the labour market and in core services inflation. Forward indicators suggest further progress should be made through the rest of 2023 and early 2024.

Moreover, the pessimistic tone of the economic activity data in the US that threatened a technical recession has given way to more updated data in recent months 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 and 1H24.

The negative EPS revisions trend has now run its course. Annual growth in EPS is moving positive which, when combined with better-than-expected economic momentum and an end to the interest rate tightening cycle, provides 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% growth (q/q) 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% (y/y) – the fastest annual increase since 1989. Building approvals continue to decline – now down 43% from the 2021 peak – and are likely to fall further in coming months as declining housing affordability outweighs the impact of an undersupplied housing market.

Post the September quarter CPI print, the Reserve Bank of Australia (RBA) was left with little option but to hike interest rates by 25bps. Both the quarterly print and the composition of the inflation print was sufficient to lift the RBA's forecast path for inflation at a time when the RBA had already declared minimal tolerance for a slower normalisation in inflation. To be clear, the RBA retains a tightening bias. However, their updated guidance is 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. Commodity prices are now off their peaks, and although they remain very elevated from a historical perspective, the impact of moving through the peak will be that nominal GDP growth will 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 which is 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 2H24, most likely commencing in August 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.

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

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.93	6.70	6.23
Consumer Discretionary	8.63	11.75	-3.13
Consumer Staples	1.17	2.86	-1.69
Energy	0.00	6.67	-6.67
Financials	11.90	12.17	-0.27
Health Care	7.09	4.62	2.47
Industrials	15.36	13.68	1.67
Information Technology	8.36	8.30	0.06
Materials	17.82	22.32	-4.50
Real Estate	12.05	9.58	2.47
Utilities	0.00	1.35	-1.35

Top 5 holdings

	Portfolio %	Benchmark %	Active %
CAR Group	6.75	2.15	4.60
Worley	5.14	1.25	3.89
NEXTDC	5.07	1.25	3.82
Reliance Worldwide	4.81	0.57	4.24
Evolution Mining	4.24	1.35	2.88

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
CAR Group	6.75	2.15	4.60
Reliance Worldwide	4.81	0.57	4.24
Worley	5.14	1.25	3.89
Underweights			
WiseTech Global	0.00	2.19	-2.19
Washington H. Soul Pattinson	0.00	1.70	-1.70
Ampol	0.00	1.57	-1.57

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	0.11	3.04	3.88	5.70
Distribution return	1.20	1.00	0.84	0.95

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$87.5 mn as 31 October 2023
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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