

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 30 November 2023

	From 25 June 2018 <sup>^</sup>	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception % p.a.*
Yarra Ex-20 Australian Equities Fund*	4.58	4.23	-4.71	4.09	6.46	7.40	6.34	7.31
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	4.74	5.51	-4.57	-0.62	3.49	7.23	N/A	N/A
Excess return (before fees) <sup>†</sup>	-0.16	-1.28	-0.14	4.71	2.98	0.17	N/A	N/A

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 November 2023

	From 25 June 2018 <sup>^</sup>	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception % p.a.*
Yarra Ex-20 Australian Equities Fund*	3.63	4.15	-4.92	3.16	5.51	6.43	5.19	6.10
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	4.74	5.51	-4.57	-0.62	3.49	7.23	N/A	N/A
Excess return (after fees) <sup>†</sup>	-1.10	-1.36	-0.35	3.78	2.03	-0.80	N/A	N/A

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.

<sup>^</sup> Effective 25 June 2018 the Fund's investment strategy, name and benchmark was changed. Performance prior to 25 July 2018 is provided here for consistency purposes only – the historical performance data shown relates to the previous strategy and should not be used to assess past or future performance of the Fund. Performance data relating to the previous strategy is available upon request. 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 Ex-20 Australian Equities Fund: August 2010.

<sup>#</sup> The benchmark for the Yarra Ex-20 Australian Equities Fund has been amended since the Fund's inception. Effective 25 July 2018, the benchmark is the S&P/ASX 300 ex S&P/ASX 20 Accumulation Index, replacing the S&P/ASX 300 Accumulation Index.

<sup>†</sup> Excess return: The difference between the Fund's return and the benchmark return.

## Market review

The Australian Equities market rebounded strongly in November. The S&P/ASX 300 Ex-20 Accumulation Index returned +5.5% during the month, taking its 12-month return to -0.6%. As a comparison, the broader ASX300 returned +5.1% for the period, while globally, the MSCI World index rose by 9.4%.

Real Estate (+11.2%) was the best performing sector during the period, with majority of its constituents closing higher for the month as the sector was well supported by decline in bond yields (Australian 10-year bond rate fell 52bps). The main stock contributors were Stockland (SGP, +16.7%) and Scentre (SCG, +9.0%).

Health Care (+10.0%) was another strong sector performer, led by Cochlear (COH, +13.4%) with the sector also benefiting from the decline in bond yields. Further adverse news flow around the likely timing of the return of a key competitor to the US market, has propelled ResMed (RMD, +12.1%) to perform

strongly for the month. Pro Medicus (PME, 18.6%) also outperformed on the back of its positive AGM.

In contrast, the sector with the weakest performance in the period was Utilities (-6.0%) largely explained by the underperformance of Origin Energy (ORG, -9.8%) following likely failure of its takeover deal. AGL Energy (AGL, -12.3%) also declined as the market viewed a weaker medium-term outlook.

## Portfolio review

### Key Contributors

**ResMed (RMD, overweight)** – the global leader in sleep apnoea treatment via CPAP devices performed well over the month, contributing to overall portfolio returns. At a broader healthcare sector level, large-cap healthcare fared well, supported during the month by lower bond yields (Australian 10-year bond rate fell 52bps). At the company level, RMD was supported by further adverse news flow around the likely timing of the return of a key competitor to the US market. The market also digested news of some management changes, with a number of new hires to the executive leadership team.

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**Treasury Wine Estates (TWE, underweight)** – our underweight position in the wine business was a positive contributor for the month, with the company's proposed acquisition of DAOU Vineyards and corresponding capital raise weighing on the stock. While the acquisition was in line with TWE's strategy to increase its luxury exposure in its American portfolio, the deal has seen TWE pay a full multiple (12.8 times EV/EBITDAS; 8.9 times EV/EBITDAS post synergies) for a business that has seen outsized growth through Covid (EBITS 3-year CAGR of +61%), leaving us cautious on the opportunity remaining to TWE in a market where it has historically underperformed.

**NEXTDC (NXT, overweight)** – leading Australian data centre owner and developer NXT outperformed during the month on limited news flow. The company has a unique combination of a strong long-term earnings growth profile, infrastructure like characteristics, solid returns on capital and is backed by a tangible asset base. An 80% increase in contracted utilisation through 2024 demonstrates the ongoing strength of the demand profile.

### Key Detractors

**James Hardie (JHX, underweight)** – the global leader in fibre cement building products to the construction industry performed strongly in November, detracting from overall portfolio returns given our underweight position. A key driver of the strong performance was the company's earnings update in early November, which while in-line with expectations for 2Q, included an upbeat outlook for 3Q earnings above the market's expectations. This stronger outlook is largely driven from its US exposure, from better volume and margin expectations, demonstrating business quality and resilience.

**Origin Energy (ORG, overweight)** – the integrated energy producer and retailer underperformed during the month as the drawn-out takeover process from the Brookfield/EIG consortium headed towards an inevitable defeat. The consortium offered a restructured proposal at the eleventh hour, however this failed to gain the support of the ORG Board or its largest shareholder meaning the vote would fail to meet the required 75% approval at the early December scheme meeting.

**Tabcorp (TAH, overweight)** – the wagering operator underperformed following quarterly reporting from its offshore competitors (Entain/Flutter), who signalled ongoing market weakness in Australia that is expected to persist into 2024. TAH had previously reported a -6.1% decline in 1Q24 revenue as the wagering turnover softened, reflecting a moderation in activity post-Covid and broader consumer weakness. We continue to see an opportunity in the stock over the medium term, and view TAH as a net beneficiary of the upcoming Victorian wagering license tender and regulatory alignment between retail and digital operators.

### Key Purchases

**Tabcorp (TAH)** – we increased our position in the wagering operator, reflecting our view that changes to the wagering market structure will offer upside over the medium term. Although TAH reported a -6.1% decline in 1Q24 revenue, this has largely been in line with competitors (Entain/Flutter) and

represents a cyclical correction which has rebased wagering turnover to more normalised levels post-Covid. We continue to see an opportunity in the stock, and view TAH as a net beneficiary of the upcoming Victorian wagering license tender and regulatory alignment between retail and digital operators.

**The Lottery Corporation (TLC)** – we took the opportunity to add to our existing overweight position in the lottery operator. Infrequent jackpot activity has created short-term earnings volatility that we believe will normalise over time, creating a dislocation in a business that we view as highly defensive with low demand elasticity. With cash generative assets underpinned by long-dated licenses, we view TLC as an attractive blend of growth and yield at a reasonable asking price for what we view as a high-quality business (14.3 times FY25 EV/EBITDA, 4% div yield).

**Xero (XRO)** – we took the opportunity to increase the portfolio's weight in XRO following a selloff in the stock post its result. The market has fixated on weaker than expected subscriber growth in the UK in the half, however this overlooks the closure of low fee-paying inactive accounts and the strong run rate revenue growth driven by price increases. The stock is now trading below the lifetime value of its customer base, which we view as an attractive entry point.

### Key Sales

There were no key sales during the period.

### 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.

**ResMed (RMD)** – we remain overweight the medical equipment company which we view as the most attractive large-cap healthcare company on the ASX today. The stock has sold off due to concerns around a range of factors including the impact on its installed base of CPAP devices following the emergence of weight loss drugs (GLP-1s), recent gross margin slippage versus expectations and competitive landscape changes (Philips remains out of the market on hardware in the USA). We are not as bearish on these issues, with our favourable view predicated on RMD's large and underpenetrated market (sleep and COPD (chronic obstructive pulmonary disease), clear operating leverage over time (SG&A and R&D) and its strong track record of capital deployment as the business shifts further into digital, connected care solutions. Valuation is supportive with the stock trading on undemanding multiples (NTM 20.9x P/E, 15.6x EV/EBITDA) given the growth opportunity ahead.

**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 decarbonise) 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

**James Hardie (JHX)** – we retain an underweight position in the leading building materials supply company. Notwithstanding a number of quality aspects to JHX's business (i.e., share growth, a responsive operational and manufacturing footprint) we remain cautious of the ongoing strength in end markets for JHX (a portion of discretionary renovation spend, often labelled as remodelling activity) as well as the impact of normalising input costs on margins. These factors are suggestive of future earnings vulnerability, making it difficult to support the stock at current valuation of 17.5-times forward P/E. Our preferred building material company remains Reliance Worldwide (RWC), which trades on 13.7-times forward earnings.

**Brambles (BXB)** – we remain underweight the global provider of pallet pooling solutions to various FMCG producers. Supported by a favourable pricing environment, Brambles currently has strong operating momentum with improving free cash flow. Looking forward however, we are cautious on the sustainability of the current high level of profit growth as customer demand and pricing dynamics normalise. Stock valuation in this environment (17-times forward P/E) looks to capture the remaining upside.

**Cochlear (COH)** – we remain underweight the global producer of hearing technologies. While COH's key developed and emerging markets have largely recovered following COVID as hospital capacity issues normalise, we are cautious on the outlook for some operating costs in the higher inflation environment, and on the implied stock valuation metrics of 45-times forward P/E. Given strong underlying ear implant demand globally – supported by COH's ongoing investment into clinical awareness – we do think the company is well positioned to return to its historical growth rates, and indeed should be supported by the release of its new Nucleus 8 sound processor.

### Market outlook

Financial market optimism in November was driven primarily by financial markets becoming increasingly convinced that central banks have now finished tightening monetary policy in the major developed economies and the prospects for easing in interest rates is growing. Indeed, inflation has surprised on the downside in the past month in Europe and the US and in concert with declining globally traded goods prices and ongoing moderation in wages growth, the case for a more

sustained easing in inflationary pressures continues to strengthen.

Good news on inflation has also been met with signs of economic resilience in the US and Japan. Although Europe will likely record a technical recession into the conclusion of 2023, the strength of the recovery in Emerging Market industrial production bodes well for a recovery in European demand in 2024. This strength in Emerging Market growth has largely been in spite of China rather than because of China. Nevertheless, the bout of disinflation in China has largely run its course and economic data has become more mixed rather than universally poor. We continue to see China delivering on a more meaningful infrastructure package into 2024 and further encourage credit expansion to the real economy which should underpin economic growth around 5% in 2024. As such, we expect China to begin to provide a more meaningful support to global economic growth next calendar year.

Slower growth in costs and improving growth expectations has resulted in the negative EPS revisions trend having now run its course with annual growth in EPS moving positive. Perhaps the biggest surprise during the months was the peaking in the US\$ and a sharp decline in bond yields which have provided support to equity market valuations. While we expect bond yields could rally further in coming weeks, we expect the yield curve to steepen as we move through 2024 via reductions in shorter term interest rates.

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 43% 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.

Post the September quarter CPI print the 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 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 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 for 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 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 now 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\$ has finally started to appreciate, supported by financial markets' expected 150bps of rate cuts in the US through 2024 and relative flat interest rates in Australia, improving commodity prices and improving Chinese sentiment. With Australia's external accounts remaining in excellent health, the Federal Government positioned to post another surplus, our expectation that Australia's economic growth will prove more robust, and the prospect the US\$ down

trend, our long-expected rally in the A\$/US\$ into the low-70s before mid-2024 is now coming into grasp.

We are most overweight stocks within the Communications Services, Information Technology and Utilities, and are underweight Materials, Industrials and Energy.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.70	4.79	8.91
Consumer Discretionary	10.42	7.61	2.81
Consumer Staples	0.00	3.39	-3.39
Energy	0.00	3.60	-3.60
Financials	13.12	16.07	-2.95
Health Care	5.59	8.76	-3.17
Industrials	9.14	13.00	-3.87
Information Technology	10.44	6.83	3.62
Materials	16.46	21.15	-4.70
Real Estate	10.71	11.20	-0.48
Utilities	7.13	3.60	3.53

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
CAR Group	5.89	1.23	4.66
QBE Insurance	5.62	2.69	2.93
ResMed	5.59	1.12	4.47
Northern Star	4.96	1.72	3.24
Worley	4.78	0.73	4.04

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
CAR Group	5.89	1.23	4.66
ResMed	5.59	1.12	4.47
Worley	4.78	0.73	4.04
Underweights			
James Hardie Industries	0.00	2.52	-2.52
Brambles	0.00	2.18	-2.18
Cochlear	0.00	2.11	-2.11

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	1.27	3.30	4.05	2.60
Distribution return	1.89	2.21	2.38	2.59

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 achieve medium-to-long term capital growth through exposure to Australian Securities Exchange listed securities excluding the largest 20 by market capitalisation (as defined by the S&P/ASX 20 Index). In doing so, the aim is to outperform the S&P/ASX 300 ex S&P/ASX 20 Accumulation Index over rolling 3-year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	August 2010	
Fund size	A\$31.7 mn as at 30 November 2023	
APIR code	JBW0052AU	
Estimated management cost	0.90% p.a	
Buy/sell spread	+/- 0.15%	
Platform availability	BT Panorama Hub24	Praemium

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## Applications and contacts

Investment into the Yarra Ex-20 Australian Equities Fund can be made by Australian resident investors only.

**Website** [www.yarracm.com](http://www.yarracm.com)

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