Yarra Ex-20 Australian Equities Fund

Gross returns as at 31 December 2023

	From 25 June 2018^	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	5.79	6.95	6.37	14.38	9.10	9.59	6.89	7.80
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	5.88	6.60	6.37	9.89	5.69	8.94	N/A	N/A
Excess return (before fees)‡	-0.09	0.35	0.00	4.49	3.41	0.65	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 31 December 2023

	From 25 June 2018^	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	4.83	6.87	6.13	13.36	8.13	8.61	5.74	6.59
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	5.88	6.60	6.37	9.89	5.69	8.94	N/A	N/A
Excess return (after fees)‡	-1.05	0.27	-0.24	3.47	2.44	-0.33	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.

^ **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.

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.

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

Market review

Australian equities rebounded strongly during the December quarter reversing the third quarter narrative.

The S&P/ASX 300 Ex-20 Accumulation Index returned +6.3% for the quarter, taking its 12-month return to +9.9%. In comparison, the broader ASX300 gained +8.4% for the quarter and, globally, the MSCI World Index rallied strongly returning +11.5% for the quarter.

Real Estate (+14.7%) was the best performing sector during the period, with the majority of its constituents closing higher for the quarter as the sector was well supported following the decline in bond yields (Australian 10-year bond rate fell 52bps). The main stock contributors were Centuria Capital (CNI, +32.7%), HMC Capital (HMC, +30.8%) and Charter Hall (CHC, +29.2%).

Health Care (+11.7%) was another strong sector performer, led by Cochlear (COH, +17.0%) with the sector also benefiting from the decline in bond yields. Neuren Pharmaceutical's (NEU, +125.8%) Phelan-McDermid phase 2 trial in December propelled the stock higher. More broadly the healthcare sector globally saw a strong rally during the period.

In contrast, the sector with the weakest performance in the period was Utilities (-2.1%) largely explained by the underperformance of Origin Energy (ORG, - 3.5%) following the likely failure of its takeover deal. AGL Energy (AGL, -11.7%) also declined as the market viewed the firm's medium-term outlook to be weaker.

Portfolio review

Key Contributors

Link Administration (LNK, overweight) – the third party administrative and share registry service company performed strongly during the period following a trifecta of positive news flow. The stakeholder vote for the proposed scheme of LNK's obligations resulting from its Fund Solutions business passed with an overwhelming majority and LNK renewed its largest client in its Retirement and Shareholder Solutions business, Australian Super, until 2028. These positive events were very quickly super ceded by a Board approved cash bid for the company by Mitsubishi UFJ Trust & Banking Corporation at $2.26, a 33% premium to LNK's prior closing price.

Northern Star Resources (NST, overweight) – the gold producer performed strongly with gold prices increasing by around 10% during the quarter to close at US$2,067/oz. The company retained full year cost and production guidance, with expectations for a stronger 2HFY24 from grade improvements at KCGM and Jundee, ramp up of the Thunderbox mill and improved production at Pogo.

Liontown Resources (LTR, underweight) – our underweight position in the lithium producer contributed as LTR 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.

Key Detractors

James Hardie (JHX, underweight) –the global leader in fibre cement building products to the construction industry performed strongly in the period, 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 by its US exposure, from better volume and margin expectations, and demonstrates the business quality and resilience.

Iluka Resources (ILU, overweight) – the mineral sands company was a source of underperformance during the period. ILU's share price has been impacted by the market's concern over the short-term outlook for mineral sands. The Chinese property market remains stagnant with rutile markets being pressured. We continue to like the mineral sands market long-term and favour ILU 's leverage as the world's largest Zircon producer and fifth largest producer of titanium feedstocks. Iluka is moving into Rare Earths production through the Eneabba refinery, and which will be a critical component producer for the EV industry.

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 Victorian wagering license tender and regulatory alignment between retail and digital operators.

Key Purchases

Pilbara (PLS) – we have shifted our lithium exposure from IGO to PLS. PLS is a pure-play lithium producer and with lithium prices approaching trough levels, we are seeking to increase our leverage to the commodity. Additionally, we see lower capex and new project timeline risk within PLS relative to IGO.

Evolution Mining (EVN) –we took the opportunity to initiate a position in the gold and copper producer Evolution Mining via their equity placement (at an 8.2% discount to the closing price) used to fund their North Parkes acquisition. We view North Parkes as a classic EVN-type asset, the acquisition multiples are broadly consistent with where the company is trading, and the funding mix is consistent with current gearing. More broadly, the acquisition adds some additional portfolio diversification and a 50% increase in copper exposure to 30% of group revenues.

Vicinity Centres (VCX) – we increased our position in the shopping mall owning REIT in the period. Key supportive factors include VCX's retail asset mix, with over half its asset base exposed to more advantaged segments of bricks & mortar retailing (i.e. luxury, DFO outlets and recovering CBDs), more resilient in-place leases with high occupancy and fewer holdovers. Additionally, VCX has a strong balance sheet (gearing 25.6% as at June-23) and attractive valuation, with the stock trading at 0.75-times net asset backing and offering a dividend yield in excess of 6.5%.

Key Sales

TPG Telecom (TPG) – we took the opportunity to exit TPG, following the potential $6.3bn sale of its Vision/EG&W assets (and prior to the deal subsequently breaking). While we see evidence of improved operating momentum, the proposed sale would concentrate 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 postpaid pricing.

IGO (IGO) – we have shifted our lithium exposure from IGO to PLS. PLS is a pure-play lithium producer and with lithium prices approaching trough levels. We are seeking to increase our leverage to the commodity. Additionally, we see lower capex and new project timeline risk within PLS relative to IGO.

Stockland (SGP) – we reduced our position in SGP over the month. The main driver of the decision was the superior risk-return outlook offered by the portfolio's other REIT positions. Relative share price moves encouraged us to concentrate our REIT investments into VCX and RGN, while exiting SGP.

Incitec Pivot (IPL) – we took the opportunity to trim the position size of IPL in light of our ongoing 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 aspects, in our mind, 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 demonstrated strong yield growth as new dynamic pricing models are introduced. The visibility on CAR's medium term revenue growth has improved, meaning the 29.4 times FY25 earnings trading multiple is relatively undemanding given these tailwinds.

Reliance Worldwide (RWC) – we view the plumbing supplies company as a compelling opportunity, despite the softer FY24 earnings year. We believe the valuation 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.

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 (FY24 23.1x P/E, 17.2x EV/EBITDA) given the growth opportunity ahead.

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 24.1-times FY24 P/E. Our preferred building material company remains Reliance Worldwide (RWC), which trades on 16.8-times forward earnings.

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.

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. Against this backdrop the stock valuation (17.4-times FY24 P/E) looks to capture the remaining upside.

Market outlook

Financial market's finished 2023 on a particularly strong note with the ASX200 returning 7.3% in the month of December and REITs returning an astounding 10%. For those awaiting a bond rally a 2.9% gain in December provided most of the 4.9% annual return in the final month. Optimism was driven primarily by financial markets becoming increasingly convinced that central banks are now finished tightening monetary policy in the major developed economies and the prospect for easing in interest rates is starting to come into view.

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 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 encouraging credit expansion to the real economy which should underpin economic growth of around 5% in 2024. As such we expect China to begin to provide a more meaningful support to global economic growth next calendar year.

Turning to Australia's prospects we continue to suggest that not only will Australia avoid a recession it will likely accelerate sequentially through 2024 with the improving global backdrop acting as a tailwind. No one should be disputing that 2023 likely felt like a recession for many Australians. A per capita recession and a negative income shock for those with high debt and young families has cascaded into weak discretionary spending as high interest rates coalesced with surging insurance, utilities, rates, education and food prices. Nevertheless, economic growth was held up by several unusual features this economic cycle vis-à-vis prior cycles;

1. Commodities. Prior commodity price strength continued to underwrite double digit nominal economic growth and profitability.

2. Backlogs. Much has been made of the backlog of work in housing construction that has nullified the typical cyclical shock that is transmitted via the housing construction sector during rate hiking cycles. Approvals and affordability are at very poor levels yet the level of home building has barely declined at all. The backlog in work yet to be done is now peaking at a very high level suggesting we shouldn't be looking at the housing sector as a source of new economic growth, but equally we shouldn't be expecting a precipitous collapse in 2024. That may come in 2025 if interest rates remain at current levels, but that is not our expectation. But less has been made of the backlogs in non-residential building (led by offices, warehouses, health and transport) which equates to 7% of GDP and the backlog of engineering construction (led by roads, railways, electricity and mining) which equates to 16% of GDP. This enormous backlog of work has kept upward pressure on the labour market and on input prices at a time when typically, a global slow down would have seen investment tumble between 10-15%.
3. Buffers and Asset prices. Newly indebted households without other forms of income producing assets feel the full force of rate hikes. However, the economy wide impact of interest rates is diluted the more that growth in income producing assets outstrip the growth in debt. The rising trend in net household assets as a share of income over time means that income from term deposits, financial assets and investment property ownership have all risen over time and all produce an income stream which even after 13 rate hikes this cycle is still in excess of the rise in interest payments on the outstanding debt. This explains the bifurcated nature of spending growth. Older asset rich households are largely impervious to the rate hikes and as such luxury spending categories remain strong whereas younger indebted households cashflow has turned negative and spending is being seriously challenged. In aggregate a rate hike pack less of punch compared to prior cycles but the young and indebted are taking a disproportioned beating.
4. Population pump priming. Net immigration has surged well through government projections taking population growth close to 2.5%yoy growth in 2H23. Quite simply, it is very hard to record a recession with that type of population growth at your back. We do expect net migration to slow in 2024 as the government seeks to tighten up some education programs and entitlements, yet the risk remains that the flood of people entering Australia surprises on the upside until a more material rise in the unemployment rate is realised.

In the concluding weeks of 2023, some additional factors are worth noting that support a more positive outlook into 2024.

1. Commodity prices are rising again. A falling USD and stronger global demand have seen commodity prices rising in Q4 which will provide a fillip for profits, tax revenue and nominal economic growth.
2. Fiscal support and tax cuts. Despite pressure for change, Stage 3 income tax cuts remain an election commitment of the ALP. The cut is equivalent to 1.1% of disposable income and skews to higher income households which under our analysis suggests over 50% of the tax cuts will be saved. Nevertheless, with the Federal Budget in surplus, the RBA rate cycle likely complete and an election looming in 2025 is likely that addition fiscal support will be announce in 1H24 to support lower- and middle-income households.
3. Inflation moderation to drive rate cuts. We expect inflation to move into the top of the RBA target band before the end of 2024, setting up the prospect of the RBA easing in August and again in November 2024. While we are expecting a relatively shallow rate easing cycle it will likely come earlier than most expect and importantly the RBA has renewed firepower to drive a more powerful economic recovery should inflation surprise on the downside.
4. Capex intentions have lifted. We were pleasantly surprised to see that the ABS measure of investment intentions rose through 2H23 and now suggests business investment will rise 10% in 2023-24 – well above the RBA's 1-2% forecast. Indeed, not only has business investment been robust, but there are also signs it is accelerating.

As a consequence, we are relatively optimistic on the outlook for the Australian economy and constructive on the equity market outlook for 2024. We expect economic growth to average 2.25% v a consensus forecast of 1.5%, bond yields to finish the year at 4.0%, the $A/$US to reach 74c, and Australian equities to return 10% in in large caps and 15% in small caps.

We are most overweight stocks within the Communication Services, Utilities and Information Technology and underweight Financials, Industrials and Health Care.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.49	4.98	7.51
Consumer Discretionary	10.28	7.65	2.63
Consumer Staples	0.00	3.26	-3.26
Energy	0.00	3.55	-3.55
Financials	11.29	15.42	-4.14
Health Care	5.22	9.23	-4.01
Industrials	8.76	12.79	-4.03
Information Technology	10.62	6.83	3.80
Materials	17.56	21.39	-3.82
Real Estate	8.70	11.46	-2.75
Utilities	7.62	3.44	4.18

Top 5 holdings

	Portfolio %	Benchmark %	Active %
CAR Group	5.37	1.29	4.08
ResMed	5.22	1.42	3.80
Origin Energy	4.92	1.60	3.32
Northern Star Resources	4.56	1.72	2.83
QBE Insurance	4.54	2.43	2.11

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
CAR Group	5.37	1.29	4.08
Reliance Worldwide	4.37	0.38	3.98
ResMed	5.22	1.42	3.80
Underweights			
James Hardie Industries	0.00	2.72	-2.72
Cochlear	0.00	2.15	-2.15
Brambles	0.00	2.08	-2.08

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	12.03	5.97	6.41	3.18
Distribution return	1.34	2.15	2.19	2.56

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$34.8 mn as at 31 December 2023
APIR code	JBW0052AU
Estimated management cost	0.90% p.a
Buy/sell spread	+/- 0.15%
Platform availability	BT Panorama Praemium Hub24

Applications and contacts

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

Website www.yarracm.com

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