YARRA CAPITAL MANAGEMENT

Yarra Growth Fund

Net returns as at 31 December 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)	3.46	3.70	1.61	8.57	5.19	7.32	6.60	6.72
Fund growth return (net)	2.88	3.12	1.05	6.96	2.21	2.50	-0.15	1.42
Fund distribution return (net)	0.58	0.58	0.57	1.61	2.98	4.83	6.75	5.30
Benchmark*	3.51	5.69	5.32	15.50	7.90	9.60	8.62	8.10

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 3.70% for the quarter, underperforming its composite benchmark return of 5.69% by 199 basis points (bps).

Australian Equities

The Fund's allocation to Australian equities underperformed the broader market during the quarter. The S&P/ASX 200 Accumulation Index returned 8.40% over the same period.

The quarter witnessed significant divergence in sector returns. Real estate led with a 15.78% surge, driven by the perception that interest rates may have peaked and potential cuts may be on the horizon. The materials sector rose by 13.35% on higher iron ore prices, while health care (13.08%) and financials (8.22%) also outperformed. Communications services (6.83%), information technology (6.80%), consumer discretionary (6.04%), and industrials (5.76%) performed well but lagged behind the broader market. Consumer staples (0.14%) and utilities (-2.06%) underperformed, the best-performing sector in the previous quarter, energy, was this quarters worst performing sector, falling -9.08% on lower oil prices.

The largest relative contributors to performance were Rio Tinto, Woolworths, Liontown Resources, Brambles and BHP. Robust steel production in China provided substantial support to iron ore prices throughout the quarter, leading to a strong performance by iron ore miners Rio Tinto and BHP. The nil position in Woolworths had a positive impact on relative performance. Historically, supermarkets served as effective safeguards against inflation. However, with cooling inflation rates, investors shifted away from defensive positions. A nil holding in Liontown Resources had a positive impact on performance, as the market witnessed a further downturn in lithium prices, prompting a selloff in lithium miners. The nil holding in Brambles contributed to performance, after the company underwhelmed investors by failing to upgrade its full year guidance and mentioned that there has been “a slight increase in competitor activity”.

The largest detractors to relative performance over the quarter were IGO, Iluka Resources, QBE Insurance, Woodside Energy and Fortescue Metals. Falling lithium prices saw the funds holding in IGO negatively impact performance. Iluka Resources underperformed on negative sentiment in mineral sands pricing. QBE Insurance shares declined due to a significant retracement in bond yields, negatively affecting investment earnings on its premium float. Additionally, adverse weather events in December further weighed on the stock. Woodside Energy traded down on weaker oil prices and analyst downgrades to its earnings forecasts. A nil holding in Fortescue Metals detracted from performance, the stock was up on higher iron ore prices.

Global Equities

The Fund's Global equities equities allocation underperformed over the quarter. The MSCI AC World Index, measured in AUD and unhedged, recorded a gain of approximately 5% over the quarter, outperforming most asset classes. However, commodities, especially those tied to energy, significantly lagged behind in performance. Leading regions included Europe ex-UK, which exceeded the S&P500, largely due to its composition and in particular the continued price appreciation of its largest constituent, Novo Nordisk. Other regions to fare well included Australia and Latin America, both benefiting from a depreciating US dollar. The worst regions included Hong Kong, Singapore & Asia as the ripple effect from China's weak post COVID-19 recovery continues to dampen investor enthusiasm about a much hoped for, but long time coming, cyclical bounce. Japanese equities benefited less than other markets from central bank tailwinds. The UK equity market also lagged due to a combination of higher exposure to underperforming energy and material stocks and British pound sterling strength.

The best performing sector this quarter was unsurprisingly information technology, rising more than 11%, closely followed by Real Estate, which recovered somewhat from a poor year's performance in the face of rising rates. Both Industrials & Financials also outperformed, albeit only marginally. The worst performing sector by far was Energy, which retraced prior month's gains on the back of falling crude and natural gas prices. This was particularly surprising given the escalation in Middle East hostilities.

Key contributors to performance included Hexagon AB, Netflix Inc and Microsoft Corporation. Following Hexagon's capital markets day, its shares traded up as it became clear that the company's medium-term guidance is conservative, paving the way for potential upgrades in 2024 for the industrial technology company. Netflix Inc outperformed on release of its third quarter results & management's outlook were ahead of expectations amid stronger subscription gains and accelerating revenue growth. Microsoft shares climbed following better-than-expected quarterly results, delivering strong performance in both Cloud and Professional businesses. The company's exposure to Artificial Intelligence (AI) was additionally viewed as a potential growth driver in the future.

Notable detractors to performance over the quarter included Rentokil Initial, Schlumberger N.V. and ChampionX Corporation. Rentokil Initial, a commercial pest control and hygiene services company, provided a third quarter trading update which highlighted disappointing performance in their North American business. Organic growth was only slightly below expectations; however, they have recently acquired a large US competitor, Terminix, and investors are concerned about the integration of this asset. Their nearest competitor, Rollins, has been gaining market share, which suggests Rentokil has an issue which might lead to pressure on 2024 forecasts. Oilfield services company Schlumberger underperformed despite strong quarterly results in October. The oil price has drifted lower as the conflict in the Palestine has not escalated as feared and OPEC has struggled to agree on any additional production cuts. ChampionX, a company that focuses on upstream & midstream oilfield technologies, underperformed, following underwhelming quarterly results in October.

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 3.79%.

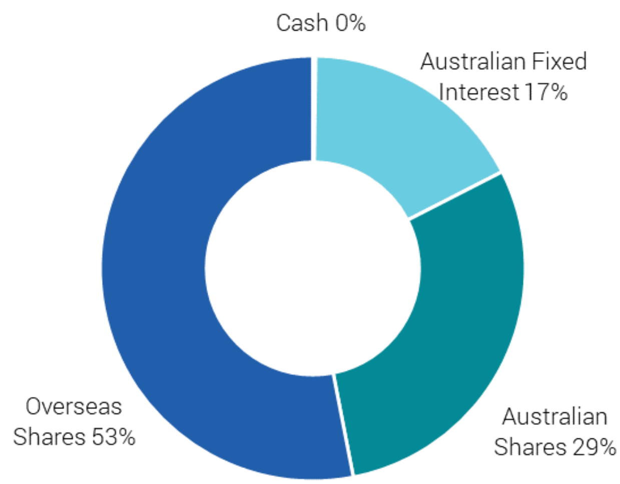
The Fund held an overweight duration position in the quarter, anticipating the end of interest rate hikes by the RBA. This performed well as global sentiment shifted in November, indicating the likely conclusion of the rate hike cycle. Monetary policy tightening has appeared to have slowed down the economy and cooled inflation. The position contributed to December's outperformance as markets priced in rate cut probabilities for 2024. The manager has taken profits, reduced duration, and intend on increasing the position closer to the actual rate cuts.

Our curve position benefited from steepening in October; the manager has taken profits and are monitoring opportunities to adjust based on central bank actions. The current sector allocation favours 5-15 year semi-government issuers, with narrowed spreads contributing to outperformance. Overweighting credit in 0-5 maturities has also boosted performance. A higher-than-benchmark running yield, driven by supranational and credit securities, was also a key contributor.

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

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. .

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

APIR Code
SUN0021AU

Fund Size
AUD 70.5 million

Minimum Investment
AUD 2,000

Management Cost
1.15% p.a.

Buy/Sell Spread
0.15%/0.15%

Distribution Frequency
Half Yearly

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