Investment Commentary
Quarter to 31 December 2023

Yarra Higher Income Fund

Gross returns as at 31 December 2023

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	Since inception^ % p.a.
Yarra Higher Income Fund*	1.07	2.55	9.56	5.78	4.68	4.62
RBA Cash Rate#	0.36	1.05	3.87	1.74	1.34	1.34
Excess return‡	0.71	1.49	5.69	4.04	3.34	3.27

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

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	Since inception^ % p.a.
Yarra Higher Income Fund*	1.02	2.38	8.86	5.10	4.01	3.94
Growth return†	0.38	0.46	3.07	-0.67	-0.99	-1.00
Distribution return†	0.64	1.92	5.79	5.77	4.99	4.94
RBA Cash Rate#	0.36	1.05	3.87	1.74	1.34	1.34
Excess return‡	0.65	1.33	4.98	3.36	2.67	2.60

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 15 March 2022, the Fund's name was changed to the Yarra Higher Income Fund. There was no change to the Fund's investment strategy.
^ Inception date: October 2018.
† Growth returns are measured by the movement in the Yarra Higher Credit Fund's unit price, ex-distribution. Distribution return is the proportion of the total return which is paid to unitholders by way of distribution. It does not include distribution amounts deemed as capital distributions.
\# The RBA Cash Rate is being used for comparative purposes only. The underlying assets of the Fund are of a higher risk profile than cash assets. When comparing performance of the Fund against the RBA Cash Rate, investors should take this into account.
‡ The excess return figures shown represent the difference between the Fund's return and the RBA Cash Rate.

Portfolio review

The Yarra Higher Income Fund returned 2.38% (net basis) in the December quarter, outperforming the RBA Cash Rate by 133 bps. On a 12-month view the Fund returned 8.86%, outperforming the RBA Cash Rate by 498 bps (net basis).

Carry continues to underpin positive Fund performance and is providing strong downside protection in volatile markets. As spreads tightened during the quarter, we observed particularly strong performance from Tier 2 and Senior securities. We also saw meaningful contribution from the Mortgage-Backed Securities and from Private Debt.

There was a substantial amount of activity in primary markets through the quarter. Judo Bank launched its inaugural Tier 1 deal, while Hollard Insurance Company came to market with a Tier 2 deal that was well received. We remained active in new deals and increased our exposure to the ABS and MBS sectors which have remained at attractive levels. We continue to actively trade to position for the best possible risk-adjusted returns.

Market review

The quarter started with a tumultuous time in global markets. Conflicts in Gaza drove an initial sell-off, pushing US 10-year yields above 5%. Hawkish commentary from the FMOC, RBA and BoE kept markets wary and saw further rate hikes priced in. By mid-quarter, stronger evidence of futures rate cuts from weaker data and easing geopolitical tensions saw the beginning of a rally that moved into December. US 10-year yields tightened substantially, closing out the year at 3.88%

Locally, the RBA increased the cash rate to 4.35%. However, softer than expected November CPI data (4.3% y/y vs. expectations for 4.4%) and weaker employment figures, diminish the likelihood of further hikes to come. The Australian 10-year yield tightened, closing the year at 3.96%

Corporate credit and hybrid spread generally moved tighter. Coupled with higher bond yields, outright returns appeared very attractive by period end. While issuance did slow towards the back end of the quarter due to the Christmas period, more deals are expected as refinancing pressures continue. The Australian iTraxx index tightened 6 bps to 70 bps.

There continued to be ample activity in the RMBS/ABS space during the quarter, closing out a record year for the sector. Spreads contracted over the quarter but remain at attractive levels. While borrowers continue to face the challenges associated with rising rates, a stabilisation of house prices and rental markets gives us further comfort in the sector. We see value in capturing deals at these levels but continue to closely monitor the tightening spreads.

Outlook

The RBA opted to keep interest rates unchanged at the beginning of December. While some observers entertain the possibility of an early 2024 rate hike, a subsequent increase now seems improbable. Weakening economic data from Europe and, to a lesser extent the United States, coupled with Australia's lagging position, suggests a more cautious approach to further rate adjustments.

Despite a stabilisation in inflation metrics, it is anticipated that the RBA will likely follow the lead of the US Federal Reserve, initiating a cycle of rate cuts toward the latter part of 2024. Considering this, a positive trajectory is anticipated for fixed-rate securities throughout the year.

Despite recent credit spread tightening, the appeal of the Australian corporate and hybrid markets remains strong. While deal flow tapered during the Christmas period, a resurgence in issuance is expected, with Tier 1 deals likely taking the lead prior to any regulatory alterations by APRA post their discussion paper.

Resilient balance sheets provide a buffer, meaning credit spreads will likely remain robust in the event of any economic slowdown impacting corporate earnings. We maintain a constructive outlook, with elevated outright yields and robust carry offering substantial downside protection.

We were active in new deals in the primary markets during the quarter and remain well positioned moving into 2024. With outright yields at attractive levels, we continue to actively trade to position for the best available risk-adjusted returns.

Portfolio profile

Portfolio characteristics

	Portfolio
Current yield (%)	6.79
Credit spread (bps)	305
Average weighted issue credit rating	BBB
Average weighted ESG rating	A-
Yield to expected maturity (%)	6.41
Effective duration (years)	0.12
Spread duration (years)	3.43
Number of securities	89

Sector allocation

	Portfolio %
Asset Backed Securities	1.44
Banks	28.16
Communication Services	-
Consumer Discretionary	-
Consumer Staples	-
Diversified Financials	4.92
Energy	2.56
Health Care	0.44
Industrials	8.49
Information Technology	-
Insurance	9.40
Materials	1.25
Mortgage-Backed Securities	15.19
Private Debt	5.02
Real Estate	6.36
Syndicated Loan	5.34
Utilities	3.85
Cash and Other	7.58

Security allocation

	Portfolio %
Tier 1	8.74
Tier 2	26.61
Subordinated	6.31
Mortgage Backed	15.19
Asset Backed	1.44
Senior	23.78
Private Debt	5.02
Syndicated Loan	5.34
Cash and Other (incl. derivatives)	7.58

Top 10 holdings

Issuer	ISIN	Portfolio %
National Australia Bank	AU3FN0055224	3.03
Aurizon Finance	AU3CB0278380	3.02
Firstmac Mortgage Funding Trust	AU3FN0076923	2.17
Macquarie Bank	US556079AF83	2.01
Lloyds Banking Group	AU3CB0302115	1.79
QBE Insurance Group	AU3FN0078747	1.72
QBE Insurance Group	AU3FN0082384	1.71
Commonwealth Bank of Australia	AU3FN0082251	1.71
Ausnet Services Holdings	AU3FN0056594	1.70
Insurance Australia Group	AU3FN0055497	1.69

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.

Credit rating profile

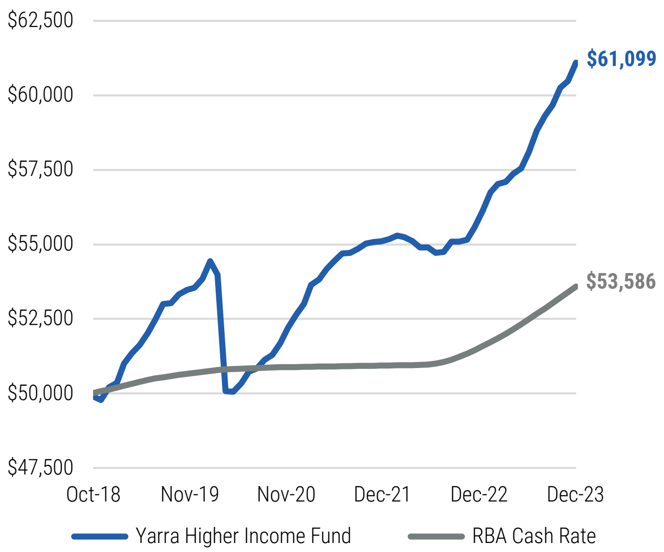
	Portfolio %
AA	5.18
AA-	10.60
A+	-
A	5.21
A-	-
BBB+	16.06
BBB	23.25
BBB-	16.08
BB+	5.93
BB	8.58
BB-	5.80
B+	2.45
B	0.84
B-	-
NR or Below	0.02

Features

Investment objective	Over the medium-to-long term, the Fund seeks to earn higher returns than traditional fixed income by investing in a highly diversified floating rate portfolio of predominantly Australian domiciled credit securities.
Fund inception	October 2018
Fund size	A$59.8 mn as at 31 December 2023
Estimated management cost	0.65% p.a.
Buy/sell spread	+/- 0.10%
Distribution frequency	Monthly
Platform availability	Hub24 Netwealth Macquarie Wrap

Investment performance comparison of $50,000

After fees, since inception of the Yarra Higher Income Fund, October 2018 to December 2023.



For illustrative purposes only. Past performance does not guarantee future results, which may vary. The total net fund returns shown are prepared on an exit to exit basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the RBA Cash Rate is for comparative purposes only. Note that the minimum initial investment amount for the Yarra Higher Income Fund is $10,000.

Applications and contacts

Investment into the Yarra Higher Income Fund can be made by Australian resident investors only.

Website www.yarracm.com

Investor Services Team 1800 034 494 (Australia) +61 3 9002 1980 (Overseas) IST@yarracm.com