

Yarra Leaders Fund

Gross returns as at 31 December 2023

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Leaders Fund [^]	5.95	6.49	14.25	11.98	10.69	7.68	9.41
S&P/ASX 100 Accumulation Index	7.21	8.35	12.65	10.07	10.77	8.15	9.55
Excess return (before fees) [‡]	-1.26	-1.86	1.60	1.91	-0.07	-0.47	-0.14

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.	10 years % p.a.	Since inception* % p.a.
Yarra Leaders Fund [^]	5.82	6.10	12.61	10.38	8.97	5.88	9.10
S&P/ASX 100 Accumulation Index	7.21	8.35	12.65	10.07	10.77	8.15	9.55
Excess return (after fees) [‡]	-1.39	-2.24	-0.03	0.31	-1.80	-2.27	-0.46

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 Leaders Fund: October 1998

[^] This Fund is no longer available for new investment. The Reinvestment of distributions is still allowed where an existing Reinvestment instruction is in place.

[‡] Excess return: The difference between the Fund's return and the benchmark return (S&P/ASX 100 Accumulation Index).

Market review

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

The S&P/ASX 100 Accumulation Index returned +8.4% for the quarter, taking its 12-month return to +12.6%. On a similar note, the broader S&P/ASX300 also gained +8.4% for the period. Whilst globally, the MSCI World Index rallied strongly returning +11.5% for the quarter.

Real Estate (+16.5%) was the best performing sector during the period, with the majority of its constituents closing higher for the quarter as the sector benefited from the decline in bond yields (Australian 10-year bond rate fell 52bps). The main stock contributors were Goodman Group (GMG, +18.6%), Scentre (SCG, +21.5%) and Charter Hall (CHC, +29.2%).

Materials (+13.7%) was another strongly performing sector during the period, with the majority of its constituents closing higher for the month. The main stock contributors were Fortescue (FMG, +38.7%), James Hardie (JHX, +38.5%) and Rio Tinto (+19.5%).

By contrast, Energy (-9.6%) was among the weaker performing sectors. Woodside Energy (WDS, -14.9%) and Santos (STO, -3.8%) were the main detractors for the period, led by a 16% decline in Brent oil during the fourth quarter.

Portfolio review

Key Contributors

Northern Star Resources (NST, overweight) – the gold producer performed strongly with gold prices increasing by around 10% during the quarter to close at US\$2067/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.

Vicinity Centres (VCX, overweight) – the national retail mall landlord rebounded strongly during the quarter, contributing to overall portfolio returns. At a broader REIT sector level, large-cap REITs were supported over the quarter from lower bond yields (the Australian 10-year bond rate fell 52bps). VCX provided a 1Q24 update during the period which was positive. Despite tenant specialty sales growth moderating to +2.7%, the stock benefitted from the recovery in CBD located assets and strong operating metrics with occupancy and leasing spreads improving. Importantly, FY24 guidance was reaffirmed.

Woolworths (WOW, underweight) – our underweight position in the supermarket was a positive contributor during the period, led by growing concerns that softening food inflation

NO LONGER AVAILABLE FOR NEW INVESTMENT

(+1.8% ex tobacco in 1Q24) may negatively impact Australian Food earnings. Additionally, WOW's NZ business has softened (EBIT now expected to be below 1H23). WOW saw strong margin expansion in the previous period (Australian Food EBIT margins +70bps to 6.0% in FY23), but consensus expectations remain elevated, with margins expected to grow to 6.1% (vs 5.3% in FY20). We believe WOW's premium multiple is unwarranted relative to our growth expectations for the business.

Key Detractors

Woodside Energy (WDS, overweight) – our overweight position in the oil & gas producer was a source of underperformance during the period with the Brent oil price marker declining 16% in 4Q23. The company hosted its annual investor day during the period, leading to some concerns around near-term free cash generation ahead of the start-up of the Sangomar and Scarborough growth projects.

Fortescue (FMG, underweight) – our underweight position in the iron ore producer was a detractor during the period as the stock outperformed on rising iron ore prices. As a high-cost iron ore producer, Fortescue is highly levered to movements in spot iron ore prices. We continue to view iron ore prices as unsustainably high relative to cost curve support and remain cautious on the potential for China to stimulate its economy through steel-intensive industries. As a result, we are happy to remain underweight FMG. BHP is our preferred exposure to iron ore given higher grades, lower operating costs and a diversified commodity base.

QBE Insurance (QBE, overweight) – the global general insurer was a source of underperformance during the period reflecting concerns over potential claims from cyclone Jasper. We believe QBE will deliver strong earnings growth in 2024 and beyond, supported by sustained premium rate growth and the beneficial impact of higher interest rates on investment earnings. QBE has substantially improved its underwriting discipline and product focus over the last five years, and we believe its 8.7-times FY24 earnings multiple excessively discounts the risks inherent in its business model.

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 a 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%.

Transurban (TCL) – we added to our existing position in TCL, the portfolio's preferred infrastructure company. TCL is transitioning into a stronger period of free cash flow growth as assets are commissioned, underpinning attractive dividend growth in the medium term. Valuation is supportive with a dividend yield of 4.7% expected to grow at mid/high single digits in the medium-term creating an attractive double-digit return.

Key Sales

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 exited 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.

Telstra (TLS) – we took the opportunity to reduce our position in the telecommunications company, reflecting a more cautious view on the mobile market and an increased reliance on the segment for earnings growth. Mobile pricing accounted for the vast majority of group EBITDA growth in 2H23, as postpaid subscriber additions slowed, and churn increased. This dynamic may prove more challenging moving forward 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.

Key Active Overweights

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 favorable 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.

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.

Vicinity Centres (VCX) – we are overweight the shopping mall owning REIT. 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 Active Underweights

CSL (CSL) – we retain an underweight to the globally focused biotechnology company. Underpinning this position is our view that earnings growth from its core blood plasma division (approximately 65% of group earnings) will be more challenged due to elevated and sticky cost pressures, increased competition, relative product growth rates away from higher margin specialty products and longer-term product substitution risk. While its more recently acquired business Vifor (now approximately 15% of group earnings) does provide differentiation, we view the business as lower quality than CSL's core plasma franchise. Considering this operating outlook, we do not regard the current FY24 valuation (32.0-times P/E, 21.6-times EV/EBITDA) as overly attractive at this time, with a preference for ResMed in the large cap healthcare space.

National Australia Bank (NAB) – we remain underweight the Australian bank reflecting our negative sector view. Australia's major banks are facing material earnings pressures through declining net interest margins, elevated expense growth and a normalisation in bad debt expenses, meaning sector EPS is likely to decline in FY24 and FY25.

Macquarie Group (MQG) – we remain underweight the stock based on the view that the strong earnings delivered in FY22 and FY23 were driven by its lower quality and highly cyclical businesses, which we view as unsustainable into the medium term. This was evident in MQG's 1H24 result, which saw a 38% decline in earnings compared to the prior comparative period, reflecting a level that we regard as more indicative of its underlying earnings power. On this level of earnings, the business trades on 18.9 times FY24 earnings multiple. Consensus has factored in a sharp rebound in cyclical earnings streams in 2H24 and beyond, however we would prefer to revisit on a lower multiple.

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 additional fiscal support will be announced 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 large caps and 15% in small caps.

We are most overweight stocks within the Communication Services, Industrials and Utilities sectors and are underweight Financials, Consumer Staples and Health Care.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	9.02	3.82	5.20
Consumer Discretionary	5.58	5.66	-0.08
Consumer Staples	0.00	4.31	-4.31
Energy	5.28	4.76	0.53
Financials	20.77	30.10	-9.33
Health Care	6.02	9.78	-3.76
Industrials	11.30	6.73	4.57
Information Technology	5.80	2.27	3.53
Materials	23.16	25.43	-2.27
Real Estate	5.86	5.63	0.23
Utilities	5.91	1.51	4.40

Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	14.07	12.34	1.73
CBA	7.11	9.04	-1.93
Westpac	5.35	3.88	1.47
Woodside	5.28	2.85	2.44
Transurban	4.71	2.04	2.66

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
ResMed	4.30	0.62	3.68
Reliance Worldwide	3.55	0.17	3.38
Vicinity Centres	3.37	0.38	2.99
Underweights			
CSL	1.72	6.69	-4.96
NAB	0.00	4.64	-4.64
Macquarie Group	0.00	3.19	-3.19

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	0.75	-1.32	-2.57	-4.93
Distribution return	11.86	11.70	11.54	10.82

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 by investing in larger companies listed on the Australian Securities Exchange, and in doing so outperform the S&P/ASX 100 Accumulation Index over rolling 3-year periods.
Recommended investment time frame	5 - 7 + years
Fund inception	October 1988
Fund size	A\$46.1 mn as at 31 December 2023
APIR code	JBW0011AU
ARSN code	089 913 431
Estimated management cost	1.45% p.a.
Buy/sell spread	+/- 0.15%

Applications and contacts

The Yarra Leaders Fund 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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