YARRA
CAPITAL MANAGEMENT

Investment Commentary
Month to 29 February 2024

Yarra Australian Equities Fund

Gross returns as at 29 February 2024

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Australian Equities Fund	1.57	8.88	10.48	10.58	8.54	7.56	10.50
S&P/ASX 200 Accumulation Index†	0.79	9.39	10.64	9.31	8.60	7.95	9.23
Excess return (before fees)‡	0.77	-0.51	-0.16	1.27	-0.06	-0.39	1.27

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 29 February 2024

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Australian Equities Fund	1.49	8.63	9.49	9.59	7.57	6.57	9.50
S&P/ASX 200 Accumulation Index†	0.79	9.39	10.64	9.31	8.60	7.95	9.23
Excess return (after fees)‡	0.70	-0.76	-1.15	0.28	-1.03	-1.38	0.27

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 prepared on an exit to exit basis – they include all ongoing fees and expenses and assume reinvestment of all distributions.

* Inception date Yarra Australian Equities Fund: July 1996

† The benchmark for the Yarra Australian Equities Fund has been amended since the Fund's inception. Effective 28 February 2008 the benchmark is the S&P/ASX 200 Accumulation Index, replacing the S&P/ASX 200 ex Property Accumulation Index Monthly. Further information on changes to the Fund's benchmark is available upon request.

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

Market review

The Australian Equities market moved higher for the month of February.

The S&P/ASX 200 Accumulation Index returned +0.8% for the month taking its 12-month return to +10.6%. Comparatively, the S&P/ASX 300 Accumulation Index generated a +1.0% return, and globally, the MSCI World Index jumped by +4.1%.

The largest sector contributor was Financials (+3.5%) with Westpac (WBC, +9.0%) rallying after a stellar Dec quarter result. Similarly, National Australia Bank (NAB, +3.8%) and ANZ (ANZ, +4.6%) outperformed on the back of their results release. Another notable contributor is QBE Insurance (QBE, +9.1%) after their annual profit figure doubled.

Consumer Discretionary (+9.2%) rallied during the month, with Wesfarmers (WES, +16.2%) largely explaining the outperformance. The Australian conglomerate reported robust earnings exceeding expectations, and an interim dividend of 91 cents per share. Another surging sector performance was Information Technology (+22.0%), companies such as WiseTech (WTC, +29.4%) and NEXTDC (NXT, +25.9%) benefitted from the Artificial Intelligence (AI) hype during the month.

In contrast, Energy (-6.0%) was the most lagged sector performance. Woodside Energy (WDS, -6.3%) underperformed following weak FY23 results, where revenue dropped ~17% to ~$17bn. Santos (STO, -6.4%) and Whitehaven Coal (WHC, -17.1%) also contributed to the underperformance.

Portfolio review

Key Contributors

Reliance Worldwide (RWC, overweight) – the plumbing supplies company outperformed with an encouraging 1H24 result ahead of consensus driven by the core American division. We anticipate recovering activity estimates (USA, EMEA) as CY24 unfolds. New construction data is gaining momentum, and RWC is executing well, rolling out its new product range at better margins. We believe that current stock valuation doesn't give appropriately 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.

NEXTDC (NXT, overweight) – Australia's leading data centre owner reported a solid 1H24 result with contracted capacity of 149MW. Whilst the result was solid, NXT's qualitative outlook commentary was much stronger than expected, pointing to very large deals in their sale pipeline and hyperscale pricing 20-30% above average levels. The company has a unique

combination of structural long term growth earnings growth profile combined with infrastructure like characteristics, solid returns on capital and backed by a tangible asset base.

Xero (XRO, overweight) – the SaaS provider of cloud accounting, payroll and payment solutions outperformed the market in the lead-up to its inaugural investor day on 29 February 2024. While FY24 guidance was reiterated on the day, the company provided more detail around its strategies to grow, and to grow more efficiently. XRO set out plans to grow through both subscriber growth and annual revenue per user (ARPU) expansion, the latter of which is a new strategy for the company. The company has made considerable inroads over the last 12 months in improving its US product and go-to-market strategy in the US. The market also liked XRO's plan to grow more efficiently in the future, and better balance investment in the business with providing a free cash flow return to investors.

Key Detractors

Wesfarmers (WES, underweight) – the diversified conglomerate outperformed during the period by delivering a strong result underpinned by Kmart which has come in ahead of market expectations and has been a clear beneficiary as a value retailer coupled with drop through leverage and cost control. While we believe that WES' core retail businesses (Bunnings/Kmart) will trade well in the current environment, WesCEF. earnings are expected to moderate with commodity pricing and its lithium exposure will continue to drag on the business.

ResMed (RMD, overweight) – the medical equipment company underperformed with no specific news flow during the month. Despite the focus on GLP-1 risk, we expect RMD to show continued top-line growth in the medium-term, driven by both devices and masks sales. We expect to see a gradual improvement in gross margins following a period of elevated COGS inflation with our longer-term positive view predicated on our favourable view of RMD's large and underpenetrated market (sleep apnoea), clear operating leverage over time (SG&A and R&D) and the company's strong track record of capital deployment as the business shifts further into digital, connected care solutions.

Sims (SGM, overweight) – the steel recycler underperformed during the period following a weak 1H24 result driven by lower metal trading margins and inflationary pressures. We believe Sims is trading below mid-cycle earnings and represents attractive value at these levels. SGM remains a highly cyclical stock with valuable strategic assets that offers good trading opportunities. A skew towards improving environmental performance on increased capital spend should position the business favourably relative to peers, as environmental regulations tighten.

Key Purchases

Bapcor (BAP) – we added to our existing position in the automotive supplier, reflecting our view that BAP's trade and wholesale businesses remain attractive despite a period of management turnover. While Autobarn has been impacted by a softer consumer, Bursons has remained relatively resilient despite a deferral of service volumes and retains an entrenched position within the aftermarket category.

Transurban (TCL) – we took the opportunity to increase the portfolio's weighting in Transurban, following a solid 1H24 result. Transurban is generating very strong cash flow (1H24 dividend was 106% cash covered) and we see material upside to consensus dividend estimates over the forecast period as the company moves through a commissioning phase for major development assets. TCL trades on 23.9-times FY24 EV/EBITDA and 4.7% dividend yield, which we view as attractive given the risk profile and distribution upside.

Key Sales

Lottery Corporation (TLC) – we reduced our position in the lottery operator after a period of recent outperformance, which was driven by favorable jackpot activity in early 2024. With cash generative assets underpinned by long-dated licenses, we still view TLC as an attractive blend of growth and yield at a reasonable asking price for what we view as a high-quality business (15.8-times FY25 EV/EBITDA, 3.5% div yield).

Telstra (TLS) – the decision to trim our position in the telecommunications company was predicated on our view of a tougher outlook for the business, as earnings growth from its key mobile division becomes more challenging and weakness in fixed and enterprise persists. Telstra has done a good job in recent years linking mobile pricing more to CPI-linked increases, although this dynamic may prove more challenging moving forward as inflation eases and cost pressures persist. Proceeds from TLS reduction have been used to fund more attractive investment ideas.

Region Group (RGN) - we resized our position in Region in light of the risk-adjusted return (10%+ equity IRR proposition) following a solid 1H24 result update. Funds were reallocated within the real asset universe (assisted to fund TCL purchases). RGN continues to remain an attractive position delivering .6.3% dividend yield, and trading at 8% discount to NTA.

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 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.

Reliance Worldwide (RWC) – we view the plumbing supplies company as a compelling opportunity, with cyclical upside as end-markets recover over the period ahead and improved product mix rolls out. We believe this 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.

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 35-times FY25 earnings trading multiple is relatively undemanding given these tailwinds.

Key Active Underweights

National Australia Bank (NAB) – we remain underweight the Australian bank reflecting our negative sector view. Australia's banks are facing 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.

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 (27.8 times P/E, 19.5- times EV/EBITDA) as overly attractive, with a preference for ResMed in the large cap healthcare space.

Wesfarmers (WES) – we retain an underweight position in the diversified conglomerate. While we believe that WES's core retail businesses (Bunnings/Kmart) will trade well in the current environment, WesCEF. earnings are expected to moderate due to commodity pricing and its lithium exposure will continue to drag on the business. With the company still trading on a premium FY24 forward earnings multiple of 29.3-times P/E (vs 18.5 times 10-year P/E) and a 3% dividend yield we believe better opportunities can be found elsewhere.

Market outlook

The financial market strength of late 2023 continued into the first two months of 2024 with the Australian equity market returning 2% CYTD and global equity markets returning an exceptional 10.3%. Indeed, the past 3 months have delivered the best 3 month returns in over 10 years.

Optimism continues to be driven by financial markets becoming increasingly convinced that central banks are now preparing to ease interest rates around mid-2024.

Good news on inflation has also been met with signs of economic resilience in the US and Japan. Although Europe continues to toy with a technical recession, 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 expect China to deliver on a more meaningful infrastructure package into 2024 and further encourage credit expansion to the real economy which should underpin economic growth of around 5% in 2024 – a target that the Chinese government also adopted in recent days. As such we expect China to begin to provide a more meaningful support to global economic growth as we move through 2024.

Turning to Australia's prospects despite a weak finish for economic growth in 2023 – expanding just 0.2%qoq and 1.5%yoy - 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.

As we move into 2024 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 has 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 a change to the details of the Stage 3 income tax cuts the package is equivalent to 1.0% of disposable income. In conjunction 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, there are 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 Utilities, Information Technology, and Industrials sectors, and are underweight Financials, Health Care and Consumer Staples.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	6.72	3.90	2.82
Consumer Discretionary	8.55	7.41	1.14
Consumer Staples	0.00	4.08	-4.08
Energy	4.41	4.89	-0.48
Financials	20.59	30.16	-9.58
Health Care	5.37	9.61	-4.24
Industrials	10.51	6.86	3.65
Information Technology	6.62	2.83	3.79
Materials	23.23	22.44	0.79
Real Estate	6.25	6.48	-0.23
Utilities	5.50	1.34	4.17

Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP Group	10.82	9.71	1.11
Commonwealth Bank of Australia	6.38	8.51	-2.13
Westpac Banking	5.30	4.03	1.27
Woodside Energy	4.41	2.51	1.90
Transurban	4.33	1.82	2.51

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
ResMed	3.90	0.59	3.31
Reliance Worldwide	3.38	0.19	3.19
CAR Group	3.24	0.60	2.63
Underweights			
National Australia Bank	0.00	4.62	-4.62
CSL	1.47	6.03	-4.56
Wesfarmers	0.00	3.30	-3.30

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	4.17	-2.37	-5.38	-3.07
Distribution return	5.32	11.97	12.95	9.64

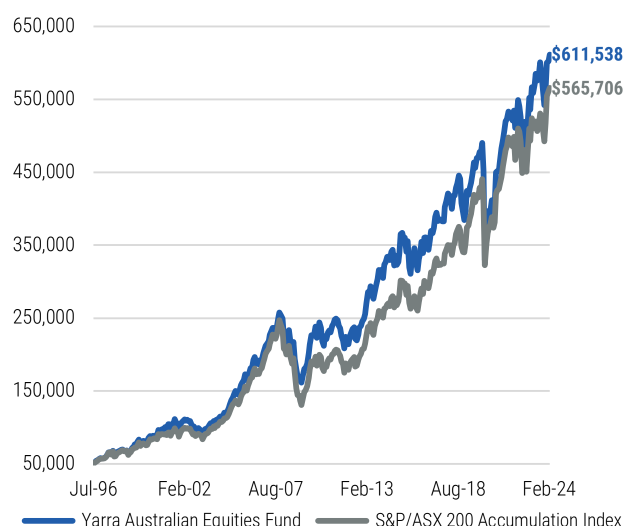
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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 companies listed on the Australian Securities Exchange. In doing so, the aim is to outperform the S&P/ASX 200 Accumulation Index over rolling 3-year periods.
Recommended investment time frame	5 - 7 + years
Fund inception	July 1996
Fund size	A$120.1 mn as at 29 February 2024
APIR codes	JBW0009AU
Estimated management cost	0.90% p.a.
Buy/sell spread	+/- 0.15%
Platform availability	Asgard Ausmaq BT Panorama BT Super Wrap FirstWrap GrowWrap Hub24 IOOF Pursuit Macquarie Wrap Netwealth Oasis Powerwrap

Investment performance comparison of $50,000

After fees, since inception of the Yarra Australian Equities Fund, July 1996 to February 2024.



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 S&P/ASX 200 Accumulation Index is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index. Note that the minimum initial investment amount for the Yarra Australian Equities Fund is $10,000.

Applications and contacts

Investment into the Yarra Australian Equities Fund can be made by Australian and New Zealand resident investors only.

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