YARRA CAPITAL MANAGEMENT

Investment Commentary
Month to 29 February 2024

Yarra Ex-20 Australian Equities Fund

Gross returns as at 29 February 2024

	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	6.46	4.27	11.93	13.54	10.88	8.39	7.06	8.06
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	6.41	3.40	10.72	9.64	7.45	7.45	N/A	N/A
Excess return (before fees)‡	0.05	0.87	1.21	3.90	3.43	0.94	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 29 February 2024

	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	5.50	4.20	11.68	12.53	9.89	7.41	5.91	6.85
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	6.41	3.40	10.72	9.64	7.45	7.45	N/A	N/A
Excess return (after fees)‡	-0.91	0.80	0.96	2.89	2.44	-0.04	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

* 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

The Australian equities market was positive for the month of February.

The S&P/ASX 300 Ex-20 Accumulation Index gained 3.4% for the month, taking its 12-month return to +9.6%. In comparison, the broader ASX300 only returned +1.0% for the period. On a global scale, the MSCI World Index also generated a +4.1% return.

Information Technology (+19.4%) was the strongest performing sector with WiseTech (WTC, +29.4%) and Xero (XRO, +14.9%) largely contributing to the outperformance. WiseTech rallied during the period following the release of strong earnings with robust revenue and EBITDA figures, beating analysts' forecasts. Xero performed strongly over the period in the lead up to its investor day at month end. The market also responded well on the day, as more detail was provided regarding efficient growth strategies.

The Financials (+3.6%) sector was also a strong contributor for the month, with QBE Insurance (QBW, +9.1%) and Suncorp (Sun, +10.2%) leading the gains. QBE Insurance saw its share price increased due to FY23 full year results as claims figures were lower than budgeted, along with moderation in the inflation outlook adding to the positive momentum. Suncorp also outperformed due to strong 1H24 results, with earnings increasing by 14%.

In contrast, Energy (-5.0%) was the worst performing sector. Losses were led by Whitehaven Coal (WHC, -17.1%), with the share price falling following its weak first half results release. Key results included a decrease of revenue by 58% while EBITDA tumbled by 77%. Another detractor was Strike Energy (STX, -50.0%) after facing a setback in its South Erregulla project.

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.

Worley (WOR, overweight) – the leading provider of global engineering services outperformed during the period driven by a solid 1H24 result. The result confirmed a robust earnings outlook supported by progress towards a 7.5-8.0% EBITA margin target and double-digit revenue growth in the base business. WOR is back trading close to a market multiple (PE basis), but with above average earnings growth prospects. We are positive on the stock as the revenue is expected to grow 13-15% in FY24, with supportive leading indicators and structural drivers (capital investment required to decarbonize).

Key Detractors

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.

Nine Entertainment (NEC, overweight) – the media company underperformed during the period following its 1H24 result, as guidance signalled a deterioration in 3Q from 1H trends driven by metro FTA (Free-to-Air) and radio broadcasting. NEC remains well placed to participate in the eventual cyclical recovery of the advertising market with strong and growing FTA share, a dominant position in BVOD (Broadcast Video on Demand) and a quality set of digital assets including online print and Stan.

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.

Pexa (PXA) – we took the opportunity to add to our existing position in the online property exchange network company during the period. PXA has increased its focus on productivity enhancements in the base business and is strategically reducing cash flow drag from investments in the international and digital growth segments.

Iluka Resources (ILU) – we took the opportunity to add to our existing position in the mineral sands company during the month following the company's FY23 result which gave us increased confidence the company will remain disciplined and not grow inventory to unsustainable levels nor flood the market (key commodities: zircon and titanium dioxide). With green shoots emerging, pricing should remain robust in 2024, and volumes gradually improve. We continue to like the mineral sands market over the long-term and favour ILU 's leverage as the world's largest zircon producer and fifth largest producer of titanium feedstock. Iluka is moving into rare earths production through the Eneabba refinery and would be a critical component producer for the EV industry.

Key Sales

Stockland (SGP) – we exited our position in Stockland over the month. SGP has traded well supported by expectations of an improvement in residential end markets towards the back end of this calendar year, reducing the upside to valuation. We continue to like the SGP strategy of pushing further into capital partnering and lifting ROIC for shareholders. Proceeds have been re-allocated to superior risk-return ideas within the real asset sectors.

Region (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.

The Lottery Corporation (TLC) – we reduced our position in the lottery operator after a period of recent outperformance, which was driven by favourable 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).

Key Active Overweights

NEXTDC (NXT) – the portfolio maintains an overweight position in leading Australian data centre owner and developer NXT. The company has a unique combination of structural

long term earnings growth profile driven by the adoption of cloud and artificial intelligence capabilities, combined with infrastructure like characteristics, solid returns on capital and backed by a tangible asset base. NXT trades on 39.3 times FY25 EV/EBITDA, which compares favourably to global peers.

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.

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.

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 make earnings beats less likely in future periods in our view, making it difficult to support upside in the stock at the current valuation of 24.1-times FY24 P/E. Our preferred building material company remains Reliance Worldwide (RWC), which trades on 21.8--times forward earnings.

Cochlear (COH) – we remain underweight the global producer of hearing technologies. While we like the strong underlying ear implant demand outlook globally – supported by COH's ongoing investment into clinical awareness – we are conscious that COH's key developed, and emerging markets have now largely recovered following COVID as hospital capacity issues have normalized. Additionally, the upside from the successful product upgrade cycle (Nucleus 8 sound processor) is now well understood, making the valuation case difficult with the stock trading on 52.6-times NTM P/E.

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 valuation (18.3-times FY24 P/E) looks to capture the remaining upside.

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 Communication Services, Utilities and Consumer Discretionary sectors and underweight Industrials, Real Estate and Health Care.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.31	5.07	7.25
Consumer Discretionary	11.67	7.81	3.86
Consumer Staples	0.00	3.43	-3.43
Energy	0.00	3.51	-3.51
Financials	12.71	15.96	-3.25
Health Care	5.47	9.32	-3.84
Industrials	8.77	12.92	-4.15
Information Technology	10.96	7.94	3.02
Materials	17.63	19.76	-2.14
Real Estate	7.05	11.01	-3.96
Utilities	8.02	3.27	4.75

Top 5 holdings

	Portfolio %	Benchmark %	Active %
CAR Group	5.62	1.47	4.14
ResMed	5.47	1.44	4.03
QBE Insurance	5.29	2.75	2.54
Origin Energy	5.27	1.65	3.62
NEXTDC	5.21	0.97	4.24

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
NEXTDC	5.21	0.97	4.24
CAR Group	5.62	1.47	4.14
ResMed	5.47	1.44	4.03
Underweights			
James Hardie Industries	0.00	2.83	-2.83
Cochlear	0.00	2.44	-2.44
Brambles	0.00	2.23	-2.23

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	11.20	7.71	5.25	3.35
Distribution return	1.33	2.19	2.17	2.57

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$45.5 mn as at 29 February 2024
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.

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