Yarra Leaders Fund

Gross returns as at 31 March 2024

	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^	3.77	6.74	15.70	12.12	10.15	8.03	9.55
S&P/ASX 100 Accumulation Index	3.08	5.17	14.46	10.31	9.63	8.47	9.64
Excess return (before fees)‡	0.69	1.57	1.24	1.81	0.52	-0.44	-0.09

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 March 2024

	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^	3.64	6.36	14.04	10.52	8.45	6.24	9.22
S&P/ASX 100 Accumulation Index	3.08	5.17	14.46	10.31	9.63	8.47	9.64
Excess return (after fees)‡	0.57	1.19	-0.41	0.20	-1.18	-2.23	-0.42

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

The Australian equities market performed strongly during the first quarter of 2024.

The S&P/ASX 100 Accumulation Index returned +5.2% for the quarter, taking its 12-month return to +14.5%. The broader S&P/ASX300 gained +5.4% for the period. Whilst globally, the MSCI World Index rallied strongly returning +8.5% for the quarter.

Financials (+12.0%) was the best performing sector, with the major banks, Westpac (WBC, +14.0%), ANZ (ANZ, +13.4%), National Australia Bank (NAB, +12.8%) and Commonwealth Bank (CBA, +9.7%) all performing strongly during the period following positive quarter results. Real Estate (+28.2%) was another strong performing sector, with Goodman Group (GMG, +33.6%) primarily contributing to the outperformance following a positive H1 earnings update.

Consumer Discretionary (+13.9%) was also a strong performing sector with Wesfarmers (WES, +21.7%) leading the gains. The conglomerate rallied during the period on the back of posting strong quarterly results, beating market expectations.

By contrast, Materials (-7.0%) was the weakest performing sector. The largest detractor during the period was BHP Group (-10.0%), as the multinational mining and metals company revealed its half-yearly profit had dropped by 86%.

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 Americas division. We like the scope for recovering activity estimates (USA, EMEA) as CY24 unfolds. New construction data is starting to see green shoots of improvement, and RWC is executing well rolling out its new product range at better margins. We believe the current stock 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.

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 sales pipeline and hyperscale pricing 20-30% above average levels. The company has the unique combination of a structural long term earnings growth profile combined with infrastructure like characteristics, solid returns on capital and is backed by a tangible asset base.

QBE Insurance Group (QBE, overweight) – The company delivered a solid full year result in February, highlighting continued healthy premium growth across core product lines, decent unit growth and ongoing de-risking of the North American and property businesses. In addition to the result, QBE's positive qualitative outlook for 2024 combined with an improved outlook for short term interest rates and strong peer results has seen the stock perform well through the period.

Key Detractors

Goodman Group (GMG, underweight) – the industrial property giant performed strongly following the release of half year results. The result was stronger than expected which led to a modest EPS guidance upgrade for FY24, still falling short of the market consensus view. The key positive for the stock was the pull-forward of upside from the company's data centre opportunity, where GMG is in a strong position with in-demand future data centre sites, and a strong customer demand outlook. From a REIT perspective, with the dividend yield of just 1%, Vicinity would be our preferred stock within the REIT sector (FY24 dividend yield of 5.8%). Meanwhile the portfolio gains its data centre exposure through a position in market leader NXT.

Wesfarmers (WES, underweight) – the diversified conglomerate outperformed during the period following a strong result from Kmart, which came in ahead of market expectations and was a clear beneficiary of operating leverage and cost control. While we believe that WES's core retail businesses (Bunnings/Kmart) will trade well in the current environment, the stock is trading at record highs and its valuation remains stretched (currently trading a premium 12m forward earnings multiple of 27.7-times vs 18.6-times 10yr average).

Nine Entertainment Co. (NEC, overweight) – the media company underperformed during the period following its 1H24 result, guidance signals 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.

Key Purchases

Liontown Resources (LTR) - we have initiated our LTR position. We believe lithium prices have now troughed, and as a result we are seeking to increase our leverage to the commodity. LTR presents as an appealing name to add to in this context, with production and cash flows set to ramp up from its Kathleen Valley project over the next few years. Completion of the recently re-sized debt funding packages also helps derisk the project.

Iluka Resources (ILU) - we took the opportunity to add to our existing position in the mineral sands company during the period. The company's FY23 result gave us increased confidence that green shoots are emerging in the company's zircon and titanium dioxide markets. We continue to like mineral sands markets long-term and favour ILU 's leverage as the world's largest zircon producer and fifth largest producer of titanium feedstocks. Iluka is moving into rare earths production through the Eneabba refinery and would be a critical component producer for the EV industry.

Evolution Mining (EVN) – we took the opportunity to add to our position in the gold miner. Global macro uncertainty continues to provide a supportive backdrop for the gold price in our view. We remain attracted to EVN's long-life assets, and meaningful leverage to copper production at the Ernest Henry mine. Continued drilling success across the portfolio, should result in further resource/reserve increases in early 2024.

APA Group (APA) - we added to the portfolio's exposure to this high-quality infrastructure stock with an underappreciated base gas transmission business and optionality around its participation in the energy transition. The FY24 valuation is supportive with the stock trading on 11.8x EV/EBITDA and 6.7% dividend yield.

Key Sales

Region Group (RGN) - With upside to our target price reduced, we exited our RGN position with the stock now trading up to within 5% of its net asset backing (NTA) and the resilience of the portfolio (predominantly supermarket and non-discretionary retailers) better understood and valued by the market.

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.

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

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 an 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 34.5-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. The elevated valuations of the Australian banking sector is not reflective of the fundamental outlook, where we expect flat to deteriorating pre-provision profits through declining net interest margins, elevated expense growth and modest loan growth.

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 (30.5-times P/E, 20.9- times EV/EBITDA) as overly attractive at this time, 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 businesses (Bunnings/Kmart) will trade well in the current environment, its non-retail exposures (e.g. Lithium) will continue to dilute the quality of the business. With the company still trading on a premium 12m forward earnings multiple of 27.7-times vs 18.6-times 10yr average and a 3.1% dividend yield we believe better opportunities can be found elsewhere.

Market outlook

The Australian equity market returned a very solid 3.3% in March, completing a 5.3% gain for the March quarter – the strongest March quarter since 2019. In concert with the rally of late 2023 the ASX200 has delivered a six-month annualised return of 14%. Despite the strong performance in large caps, small capitalisation stocks outperformed, returning 4.8% in March and 7.5% for the quarter. The standouts in the month were REITS which have returned 9.2% in March and 16.6% CYTD and gold which returned 9.1% in March and 8.1% CYTD. The laggards in March were alternative assets and the Australian dollar.

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

Good news on inflation has also been met with signs of economic resilience. 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, and indeed survey evidence suggests a recovery in European demand has commenced. 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/positive rather than universally poor. We continue to expect China to deliver on a more meaningful infrastructure package in 2024 and further encourage credit expansion to the real economy which should underpin economic growth around 5% in 2024 – a target that the Chinese government also adopted in recent weeks. 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.

Some additional factors are worth noting that support a more positive outlook into 2024 and beyond.

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 it is likely that addition 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 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 Industrials, Utilities and Information Technology and are underweight Financials, Consumer Staples and Health Care.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	7.29	3.68	3.60
Consumer Discretionary	5.40	6.31	-0.91
Consumer Staples	0.00	4.17	-4.17
Energy	4.89	4.59	0.30
Financials	22.12	32.21	-10.08
Health Care	6.43	10.06	-3.63
Industrials	11.56	6.81	4.74
Information Technology	6.75	2.72	4.03
Materials	22.56	21.75	0.80
Real Estate	2.93	6.21	-3.28
Utilities	6.18	1.48	4.71

Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP Group	11.92	10.46	1.46
Commonwealth Bank of Australia	7.21	9.40	-2.18
Westpac Banking	5.74	4.26	1.48
Woodside Energy	4.89	2.70	2.19
ResMed	4.80	0.83	3.97

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
ResMed	4.80	0.83	3.97
Reliance Worldwide	3.92	0.21	3.71
CAR Group	3.51	0.63	2.87
Underweights			
National Australia Bank	0.00	5.02	-5.02
CSL	1.63	6.48	-4.85
Wesfarmers	0.00	3.62	-3.62

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	2.03	-1.19	-3.03	-4.61
Distribution return	12.01	11.70	11.48	10.85

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$47.5 mn as at 31 March 2024
APIR code	JBW0011AU
ARSN code	090 047 662
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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