

Yarra Emerging Leaders Fund (Direct)

Gross returns as at 31 May 2024

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception [^] % p.a.
Yarra Emerging Leaders Fund (Direct)	-1.09	-0.79	6.16	5.98	8.87	9.83	12.78
Emerging Leaders Combined Benchmark [†]	0.24	1.65	10.10	3.08	7.15	8.79	8.13
Excess return (before fees) [‡]	-1.32	-2.44	-3.94	2.90	1.72	1.04	4.65

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 May 2024

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception [^] % p.a.
Yarra Emerging Leaders Fund (Direct)	-1.25	-1.26	4.17	4.01	6.73	7.54	10.49
Emerging Leaders Combined Benchmark [†]	0.24	1.65	10.10	3.08	7.15	8.79	8.13
Excess return (after fees) [‡]	-1.48	-2.91	-5.93	0.92	-0.42	-1.26	2.36

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 Emerging Leaders Fund (Direct): November 1994

[†] Comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index

[‡] Excess return: The difference between the Fund's return and the benchmark return.

Market review

The Australian mid and small cap market was close to flat for the month of May.

The Emerging Leaders Benchmark returned +0.2% for the month, taking its 12-month return to +10.1%. By comparison, the broader S&P/ASX 300 Accumulation Index rose 0.9% for the period. Globally, the MSCI World Index recorded a +4.2% return.

Health Care (+0.3%) was the best sector performer during the month. Telix Pharmaceuticals (TLX, +20.6%) was main driver of outperformance as the biopharmaceutical company saw its share price increase following positive drug trial results. Pro Medicus (PME, +7.8%) and Neuren Pharmaceuticals (NEU, +12.7%) were also strong performers during the period.

Information Technology (+2.5%) was also a positive sector contributor during May as sentiment surrounding AI technologies continue to grow. WiseTech Global (WTC, +4.2%) was the main sector contributor with NEXTDC (NXT, +6.6%), Technology One (TNE, +9.7%) and Life360 (360, +11.1%) all performing strongly during the period.

In contrast, Consumer Discretionary (-4.1%) was the worst performing sector during the month. Eagers Automotive (APE, -19.9%) was the largest detractor following weak 1H results.

JB Hi-Fi (JBH, -4.6%) and Super Retail Group (SUL, -10.8%) were also negative contributors during the period, also due to poorly received trading updates.

Financials (-5.8%) was also a poor performing sector. Block (SQ2, -14.1%) underperformed following the announcement of a federal investigation into financial transactions at the fintech company. Washington H Soul Pattinson (SOL, -5.0%) and Perpetual (PPT, -9.2%) were also notable detractors during the month.

Portfolio review

Key Contributors

Pinnacle Investment (PNI, overweight) – the fund manager reported strong Jan-Apr 2024 flows of +\$4.5b despite a tough market. We are seeing an acceleration in revenue growth with material longer term growth potential as market conditions normalise from depressed levels, inflows reaccelerate across the diverse range of products and from international distribution, performance fee increasing from depressed levels and new products mature. Furthermore, margin expansion will be supported by the high fixed cost nature of funds management businesses while new manager formation both organically and via acquisitions, will create additional shareholder value.

NO LONGER AVAILABLE FOR NEW INVESTMENT

PEXA (PXA, overweight) – the online property exchange platform outperformed following its announcement of a strategic partnership with UK bank NatWest. The partnership will see the lender utilise PEXA's world-leading digital property exchange technology to deliver 48-hour remortgage transactions to its customers. PXA remains attractive as it 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.

NEXTDC (NXT, overweight) – the data centre owner and developer outperformed on limited company specific news flow, more than reversing the prior months underperformance, as the market again focused on the company's strong long-term outlook. NXT has an enviable position as Australia's leading co-location data centre provider, leaving it well placed to capture the surging demand for data centre capacity driven by public to private cloud switching, growing data usage and artificial intelligence.

Key Detractors

Reliance Worldwide (RWC, overweight) – the plumbing supplies company underperformed during the period, notwithstanding the company reiterating earnings guidance in a trading update early in the period. The key repair market that RWC serves is generally demonstrating resilience, 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 and RWC has solid leverage to higher volumes in the US, which we expect is likely following Fed interest rate cuts.

Sims (SGM, overweight) – the steel producer underperformed following an operational update that disappointed relative to expectations. The company expects to report an underlying 2H EBIT marginally lower than that achieved in 1HFY24. The outlook for SGM near term remains tough given China continues to over-produce steel and export the excess, but with the stock trading below NTA, and evidence that NAM is finally turning a corner, we are happy to retain our overweight position.

Iluka (ILU, overweight) – the mineral sands company was a modest underperformer during the period on soft China sentiment. We believe the end markets for mineral sands continue to show signs of improvement, and ILU remains well placed to capture improving volumes and pricing. We remain attracted to ILU's dominant position as a mineral sands producer, and while the company's rare earths strategy faces near-term pricing headwinds, we see longer-term optionality.

Key Purchases

Incitec Pivot (IPL) – we added to our position in IPL following the company's 1H24 result. The company should soon conclude the sale process for its Fertiliser division. A resolution either way on the sale process will allow the company to commence its \$900m buyback (16% of \$5.8bn market cap). The outlook for Dyno Nobel is strong given trends in the global explosives markets. In addition, IPL have

announced a largely capital light plan to lift ROIC from 5.1% to double digits.

Key Sales

Link Administration (LNK) – the acquisition of the third party administrative and share registry service company by Mitsubishi UFJ Trust & Banking Corporation was completed during the month leading to the full exit of the position.

Pinnacle Investments (PNI) – we trimmed a small portion from our existing position in Pinnacle Investments post its recent outperformance. We continue to hold an overweight position in PNI given acceleration in revenue growth with material longer term growth potential as market conditions normalise from depressed levels, inflows reaccelerate across the diverse range of products and from international distribution, performance fees increase from depressed levels and new products mature.

Sandfire (SFR) – we elected to trim some of our overweight position in copper producer Sandfire following recent outperformance linked to rising copper prices. We favour copper as a commodity given its leverage to electrification as a key material in batteries and electric motors and retain an overweight position in SFR as the best pure-play exposure to the commodity on the ASX.

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.

CAR Group (CAR) – we are overweight the online vehicle classifieds company which has strong growth potential across Australia (42% revenue), Trader Interactive (25% revenue), and Webmotors (16% revenue). CAR Group has materially stepped-up investment into product development recently which should permit for further yield growth across all geographies. In Australia, CAR's market position has strengthened in the private segment. The offshore businesses are less mature and have further runway for growth as key learnings (i.e. dynamic pricing) from the Australian business are applied offshore. The visibility on CAR's medium term revenue growth has improved, and we think the 34.0 times FY25 earnings trading multiple is relatively undemanding given these tailwinds.

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.

Key Active Underweights

WiseTech (WTC) – we remain underweight the leading developer of software solutions for the logistics industry with a preference for other names in the technology sector given WTC's demanding valuation of 87.7 times FY24 forward P/E. We believe WTC have and are continuing to build an exceptional product in CargoWise which should continue to attract and retain large freight forwarders.

REA Group (REA) – we hold an underweight position in Australia's largest online residential real estate platform business, and instead gain indirect preferred exposure to the online real estate segment via Domain Holdings (DHG) through the portfolio's position in Nine Entertainment (NEC) (which owns 60% of DHG). REA trades on a multiple of 44.7 times FY24 P/E and we see superior risk adjusted returns in other high-growth online businesses such as Carsales.com (CAR) which trades on 34.0-times FY24 P/E.

Orica (ORI) – we retain an underweight position to the Australian-based explosives company ORI. From a chemicals exposure perspective, our stock preference is Incitec Pivot (IPL). Notwithstanding a number of improvements in the visibility of earnings growth for ORI (repricing low margin contracts, premiumization strategy in detonators), we believe the stock factors in these benefits with the company trading on a FY25 P/E of in excess of 18.4 times.

Market outlook

Global equity markets have clearly had a very strong rally from the October lows and, in the first half of calendar year 2024 developed market equities have returned 11.2%. Despite the sharp reappraisal of risk in April our expectations of a bounce back in May and June were realised as investors became less focussed on spillover risks from Gaza and the growth and inflation data both turned more supportive of major economy interest rate reduction.

After the stronger inflation data in 1Q and the sharp shift in interest rate expectations that attended the data, more recent data and communication from the US Federal Reserve supports the bigger picture view that inflation will continue to moderate and the easing cycle for US interest rates is still likely to commence in 2024. Specifically, core-PCE was better behaved than the CPI data and the subsequent data on producer prices, import prices and key labour market measures suggest little threat to the overarching theme that inflation is more likely to moderate than accelerate through the remainder of 2024.

Indeed, interest rate easing commenced with the Swiss National Bank in March, which was followed by Sweden's Riksbank in May and the Bank of Canada and ECB both cutting on June 6. The Bank of England and Norges are also likely to ease in 3Q. We continue to expect the Fed to ease in September and December this year.

Turning to Australia's prospects, a weak finish for economic growth in 2023 – expanding just 0.3%qoq, the start of 2024 was similarly unimpressive, expanding by just 0.1%qoq and

1.1%yoy. This completed four consecutive quarters of contracting GDP per capita, declining 1.3%yoy. Our view that Australia would avoid a technical recession appears to have been met and we continue to suggest that the economy will likely accelerate sequentially through 2024 with the improving global backdrop acting as a tailwind. No one should be disputing that the past 12 months 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. Indeed, 2Q2024 has continued to be a subdued operating environment with retail sales, building approvals and consumer confidence all printing below market expectations. The RBA is caught between a relatively weak economy and persistent wage growth and consumer inflation, nevertheless, the bank should be buoyed by signs that the decline in productivity appears to have passed and wage pressures appear to have peaked. With respect to the latter, the 3.75% increase in awards, compared to the 5.75% in 2023, will help expedite an easing in wage pressures through 2H2024.

Australia, like many of its developed nation peers, also printed above consensus inflation in 1Q. However, we believe the upside surprise in Australia's CPI overstates the real-time price pressures. Much of the upside came via government administered prices, which tend to reflect where inflation was in the prior year rather than current cost pressures, and the prevalence of residual seasonality in inflation pressures at the start of the calendar year. Traded goods prices are trending lower and once administered prices are removed, private sector services prices expanded at a relatively subdued 0.7% qoq in 1Q. We remain of the view that underlying inflation will finish 2024 inside the RBA's target band of 2-3% and the RBA will commence a modest easing cycle for interest rates in 4Q 2024.

Against this moderation in inflationary pressure, we expect economic growth to accelerate sequentially through 2024. We expect the upswing in global industrial production to provide a tailwind for Australian economic growth. Rising capex intentions in concert with investment backlogs should support business investment growth and the consumer outlook should be supported by a recovery in real household income growth driven by ongoing wage growth, income tax cuts, cost of living support delivered in the Budget and the commencement of the rate easing cycle later in 2024.

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 2.0% v a consensus forecast of 1.4%, bond yields to finish the year at 4.5%, the \$A/\$US to reach 72c, and Australian equities to return 10% in in large caps and 15% in small caps.

We are most overweight stocks within the Communication Services, Real Estate and Financials sectors, and are underweight Energy, Consumer Discretionary and Consumer Staples.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	10.83	6.47	4.36
Consumer Discretionary	7.44	10.44	-3.00
Consumer Staples	0.50	2.83	-2.33
Energy	0.00	6.93	-6.93
Financials	14.33	12.03	2.29
Health Care	7.69	5.94	1.76
Industrials	13.78	13.94	-0.16
Information Technology	9.15	10.30	-1.15
Materials	20.81	20.55	0.26
Real Estate	13.06	9.51	3.55
Utilities	0.00	1.06	-1.06

Top 5 holdings

	Portfolio %	Benchmark %	Active %
NEXTDC	6.90	1.83	5.06
CAR Group	6.67	2.26	4.41
Evolution Mining	4.82	1.34	3.48
Worley	4.65	1.18	3.47
Reliance Worldwide	4.52	0.66	3.87

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
NEXTDC	6.90	1.83	5.06
CAR Group	6.67	2.26	4.41
Reliance Worldwide	4.52	0.66	3.87
Underweights			
WiseTech Global	0.00	3.04	-3.04
REA Group	0.00	1.65	-1.65
Orica	0.00	1.52	-1.52

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	3.36	2.92	5.81	6.59
Distribution return	0.81	1.08	0.92	0.95

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 small and medium sized Australian companies that are considered to possess strong capital growth potential. In doing so, the aim is to outperform the benchmark over rolling 3-year periods.
Recommended investment time frame	5 - 7 + years
Fund inception	November 1994
Fund size	A\$97.2 mn as 31 May 2024
APIR codes	JBW0007AU
ARSN code	089 909 106
Distribution frequency	Semi-Annually
Estimated management cost	1.90% p.a.
Buy/sell spread	+/- 0.20%

The Yarra Emerging Leaders Fund (Direct) is not available for new investment. Where existing reinvestment instructions are in place, distributions may be reinvested.

Applications and contacts

The Yarra Emerging Leaders Fund (Direct) 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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