YARRA CAPITAL MANAGEMENT

Investment Commentary
Month to 31 May 2024

Yarra Ex-20 Australian Equities Fund

Gross returns as at 31 May 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	6.33	-1.61	0.82	8.06	9.07	8.48	6.78	7.98
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	6.25	-0.93	0.66	9.33	5.33	6.66	N/A	N/A
Excess return (before fees)‡	0.08	-0.68	0.16	-1.27	3.75	1.82	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 31 May 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	5.37	-1.68	0.59	7.09	8.10	7.51	5.65	6.77
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	6.25	-0.93	0.66	9.33	5.33	6.66	N/A	N/A
Excess return (after fees)‡	-0.88	-0.76	-0.06	-2.23	2.77	0.85	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.** 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 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 ex-20 equities market was negative for the month of May.

The S&P/ASX 300 Ex-20 Accumulation Index fell -0.9% for the month, taking its 12-month return to +9.3%. In comparison, the broader S&P/ASX 300 returned +0.9% for the period. On a global scale, the MSCI World Index generated a +4.2% return.

Information Technology (+4.5%) was the strongest performing sector with Xero (XRO, +10.6%) driving the gains following stronger than expected FY24 results. Other contributors were WiseTech Global (WTC, +4.2%) and Technology One (TNE, +9.7%).

In contrast, Materials (-2.7%) was the worst performing sector during the period. James Hardie (JHX, -13.7%) was the main detractor following weaker than expected FY25 guidance. Other notable detractors were Pilbara Minerals (PLS, -6.7%), Bluescope Steel (BSL, -7.7%) and Northern Star Resources (NST, -4.0%).

Consumer Discretionary (-4.1%) was also a poor 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.

Key Contributors

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.

James Hardie (JHX, underweight) – the leading building materials supply company underperformed during the period driven by the release of the fourth quarter and full year update.

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Driving the weakness was the company missing fourth quarter profit expectations by 3%, with product sold into its core US market falling short by 1%. In addition, JHX's guidance for FY 2025 was well below the consensus estimate (-13% below). We retain an underweight position as we note an increasingly challenged market share outlook, particularly given the excellent year in FY 2024 for share gains. Indeed, guidance implies a massive contraction from 11% primary demand growth in FY24 to 2% FY25.

NEXTDC (NXT, overweight) – the Australian 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

Bapcor (BAP, overweight) – the auto parts retailer underperformed during the period following the release of a weak trading update (-18% EPS downgrade to FY24 consensus) and an announcement that incoming CEO Paul Dumbrell was no longer joining the company. Although revenue was only modestly weaker, margins were impacted by operating deleverage and cost pressures. With the stock trading at a discount to history (14.2 times FY25 P/E vs 18.2 times 10-year average), the valuation does not capture the defensive quality of BAP's trade and wholesale business despite some near-term uncertainty.

Tabcorp (TAH, overweight) – the wagering operator underperformed during the period with limited company specific news but reflected a broader de-rate in consumer-exposed businesses. TAH has been impacted by weaker conditions in the domestic wagering market and operating deleverage, with turnover down -4% across both retail and digital channels coupled with a step up in opex. While trading has remained soft in 2H24, TAH have retained share and will benefit from a market recovery as consumer pressures moderate.

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.

Key Purchases

Bapcor (BAP) – we added to our existing position 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 retains an entrenched position within the aftermarket category. With the stock trading at a discount to history (14.2 times FY25 P/E vs 18.2 times 10-year average), the valuation does not capture the defensive quality of BAP's trade and wholesale business despite some near-term uncertainty.

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 it's $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.

Resmed (RMD) - we trimmed our RMD position back to target active weight reflecting the attractive upside that remains from increasing the penetration rate of CPAP into deep-demand markets globally, demonstrating operating leverage and seeing the current stock multiple trade back closer to its long-term average (currently 25x P/E vs 29x LTA).

Origin (ORG) - we are encouraged by the progress ORG is making in unlocking value across each of its three operating segments of Energy Markets, Integrated Gas and Octopus Energy. Following a period of share price strength, we have taken the opportunity to trim the position back to target weight.

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.

Origin Energy (ORG) – the portfolio has an overweight position in ORG which is in a structurally strong position to participate in Australia's energy transition. Despite recent takeover interest we still believe the market is underappreciating the combined value across its three main assets of Energy Markets, APLNG and Octopus. We anticipate ORG's strong cashflow generation will be more highly valued as ORG proves out its ability to effectively participate in Australia's energy transition and the value in its Octopus holding to continue to grow over time.

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.

Key Active Underweights

Cochlear (COH) – we remain underweight the global producer of hearing technologies. While we like the strong underlying ear implant demand outlook – 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 is now well understood, making the valuation case difficult with the stock trading on in excess of 47.0 times NTM P/E.

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 on 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. JHX is expecting six of their eight largest input costs to rise from high single digits to low double digits in the next 12-months, against price increases of 3-4%. These factors make earnings beats harder moving forward, making it difficult to support upside in the stock at the current valuation. Our preferred building materials company remains Reliance Worldwide (RWC), which trades on a mid-teen earnings forward multiple (below historical 17.0 times forward earnings).

Suncorp (SUN) – whilst we maintain a favourable view on Australian general insurers, the portfolio is underweight SUN with positions held in preferred exposures of QBE Group (QBE) and Insurance Australia Group (IAG). Domestic insurers look set for a strong 2024 with widening margins following double-digit premium increases across home and motor portfolios.

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, Utilities and Consumer Discretionary sectors and underweight Industrials, Real Estate and Energy.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	11.44	4.73	6.72
Consumer Discretionary	10.93	7.14	3.79
Consumer Staples	0.00	3.43	-3.43
Energy	0.00	4.01	-4.01
Financials	9.54	13.30	-3.76
Health Care	7.84	9.88	-2.04
Industrials	7.98	13.30	-5.32
Information Technology	10.32	8.24	2.08
Materials	21.67	21.47	0.21
Real Estate	6.06	10.84	-4.78
Utilities	9.65	3.67	5.97

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Origin Energy	5.81	1.88	3.93
ResMed	5.66	1.99	3.66
NEXTDC	5.65	1.14	4.51
CAR Group	5.28	1.41	3.87
Xero	4.67	2.04	2.63

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
NEXTDC	5.65	1.14	4.51
Origin Energy	5.81	1.88	3.93
CAR Group	5.28	1.41	3.87
Underweights			
Cochlear	0.00	2.26	-2.26
James Hardie Industries	0.00	2.18	-2.18
Suncorp Group	0.00	2.16	-2.16

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	5.83	5.95	5.34	3.09
Distribution return	1.26	2.15	2.17	2.56

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$49.3 mn as at 31 May 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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