



# Product Review

## Yarra Australian Bond Fund

ISSUE DATE 21-09-2023

### About this Review

|                      |                  |
|----------------------|------------------|
| ASSET CLASS REVIEWED | FIXED INTEREST   |
| SECTOR REVIEWED      | AUSTRALIAN BONDS |
| TOTAL FUNDS RATED    | 13               |

### About this Fund

|                             |  |
|-----------------------------|--|
| ASIC RG240 CLASSIFIED       | NO   |
| FUND REVIEWED               | YARRA AUSTRALIAN BOND FUND   |
| APIR CODE                   | TYN0104AU  |
| PDS OBJECTIVE               | TO OUTPERFORM THE BLOOMBERG AUSBOND COMPOSITE 0+YR INDEX OVER ANY THREE-YEAR ROLLING PERIODS, BEFORE FEES, EXPENSES AND TAXES. |
| INTERNAL OBJECTIVE          | OUTPERFORM THE BENCHMARK BY 0.50% TO 0.75% P.A., GROSS OF FEES OVER ROLLING THREE-YEAR PERIODS.                                |
| STATED RISK OBJECTIVE       | NOT TARGETED. TRACKING ERROR IS EXPECTED TO BE 1.25% P.A. OVER ROLLING THREE YEAR PERIODS.                                     |
| DISTRIBUTION FREQUENCY      | QUARTERLY  |
| FUND SIZE                   | \$227M (28 FEBRUARY 2023)  |
| FUND INCEPTION              | 03-07-2000   |
| ANNUAL FEES AND COSTS (PDS) | 0.3% P.A.  |
| RESPONSIBLE ENTITY          | YARRA FUNDS MANAGEMENT LIMITED   |

### About the Fund Manager

|                                 |  |
|---------------------------------|--|
| FUND MANAGER                    | YARRA CAPITAL MANAGEMENT LIMITED             |
| OWNERSHIP                       | 40% STAFF & 40% TA ASSOCIATES & 20% NIKKO AM |
| ASSETS MANAGED IN THIS SECTOR   | \$4.2BN (30 JUNE 2023)                       |
| YEARS MANAGING THIS ASSET CLASS | 30   |

### Investment Team

|                          |                                      |
|--------------------------|--------------------------------------|
| PORTFOLIO MANAGER        | DARREN LANGER                        |
| INVESTMENT TEAM SIZE     | 9                                    |
| INVESTMENT TEAM TURNOVER | MODERATE                             |
| STRUCTURE / LOCATION     | PM & ANALYSTS / SYDNEY AND MELBOURNE |

### Investment process

|                                    |  |
|------------------------------------|--|
| BENCHMARK                          | BLOOMBERG AUSBOND COMPOSITE 0+YR INDEX |
| DURATION RISK LIMIT                | +/- 1.5 YEARS                          |
| MAXIMUM SUB-INVESTMENT GRADE       | NIL                                    |
| MINIMUM CREDIT QUALITY AT PURCHASE | BBB-                                   |
| MAXIMUM SINGLE ISSUER LIMIT        | VARIOUS - DEPENDS ON THE ISSUER        |
| NON-AUD EXPOSURE                   | FULLY HEDGED (TOLERANCE +/- 2%)        |
| GEARING / ECONOMIC LEVERAGE        | NOT PERMITTED                          |

### Fund rating history

|                |                    |
|----------------|--------------------|
| SEPTEMBER 2023 | RECOMMENDED        |
| SEPTEMBER 2022 | HIGHLY RECOMMENDED |
| AUGUST 2021    | HIGHLY RECOMMENDED |

### What this Rating means

The 'Recommended' rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

### Strengths

- Experienced investment team, led by Keenan and Langer with both substantial credit and fixed income experience and proprietary relative value tools.
- Conservatively managed with tight risk constraints. Risk is integral to portfolio management and investment philosophy.
- The Fund is competitively priced versus the relevant Lonsec peer group.

### Weaknesses

- The Fund has shown a lack of consistency in meeting the internal objective over the medium term with peer median like returns across most periods.
- With the recent team departures following the acquisition, Lonsec will require time to assess team stability and quality of new hires.
- Management of the Fund is now highly reliant on Langer.
- Investment team being split between two locations may not maximize potential synergies from the merger.

### Fund Risk Characteristics

|                               | LOW | MODERATE | HIGH |
|-------------------------------|-----|----------|------|
| BUSINESS SUSTAINABILITY RISK  |     | ●        |      |
| CAPITAL VOLATILITY            |     | ●        |      |
| CREDIT RISK                   | ●   |          |      |
| FOREIGN CURRENCY EXPOSURE     |     | ●        |      |
| INTEREST RATE (DURATION) RISK |     |          | ●    |
| LEVERAGE RISK                 | ●   |          |      |
| REDEMPTION RISK               |     | ●        |      |
| SECURITY CONCENTRATION RISK   |     | ●        |      |
| SECURITY LIQUIDITY RISK       |     | ●        |      |

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

### BIometrics

#### Aggregated risks

|                  | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|------------------|---|---|---|---|---|---|---|
| STD RISK MEASURE |   |   |   | ● |   |   |   |

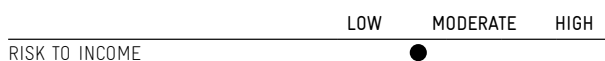
A Standard Risk Measure score of 4 equates to a Risk Label of 'Medium' and an estimated number of negative annual returns over any 20 year period of 2 to less than 3. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

**We strongly recommend that potential investors read the product disclosure statement** Lonsec Research Pty Ltd ABN 11 151 658 561 • AFSL No. 421 445 • This information must be read in conjunction with the warning, disclaimer, and disclosure at the end of this document. This report supersedes all prior reports.

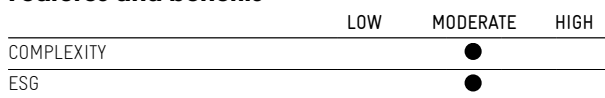
ANALYST: MIKE GRDOSIC | APPROVED BY: ISRIN KHOR

# Yarra Australian Bond Fund

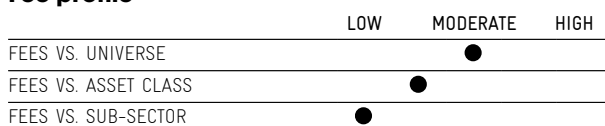
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## Features and benefits



## Fee profile



Fee BIometrics are a function of expected total fee as a percentage of expected total return.

## What is this Fund?

- The Yarra Australian Bond Fund (the 'Fund') is a conservative Australian Fixed Interest strategy that invests a diversified portfolio of investment grade Australian fixed income assets which are issued by governments, quasi-government entities, corporates.
- The Fund seeks to outperform Bloomberg Ausbond Composite 0+Yr Index (the 'Benchmark') by 0.50% to 0.75% p.a., gross of fees over rolling three-year periods.
- The Fund is managed by Yarra Capital Management ('Yarra', 'YCM' or the 'Manager').
- Excess return is expected to be derived from sector allocation (40%), duration (10%), yield curve positioning (15%) and credit spread (35%), although this may vary over the course of a market cycle.
- Derivatives such as interest rates futures or interest rate swaps and credit default swaps may be used to manage risk.
- Up to 5% of the Fund may be invested in non-A \$ securities. The Fund aims to be fully currency hedged, although a 2% hedging tolerance applies.
- The Fund's PDS dated 20 March 2023 disclosed Annual Fees and Costs ('AFC') totaling 0.30% p.a. This fee comprises (1) Management Fees and Costs of 0.30% p.a., and (2) Net Transaction Costs of 0.0% p.a. In-line with RG97, some fees and costs have been estimated by the issuer on a reasonable basis. Actual fees and costs may vary to these estimates.
- The Fund charges buy/sell spreads set at 0.05%/0.05%. These spreads can be subject to change, most notably during periods of market volatility, and can be sourced from the Manager's website.

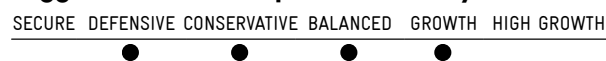
## Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- Lonsec notes that the Manager has produced a Target Market Determination ('TMD') which forms part of its design and distribution arrangements for the Fund. Lonsec has collected the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of Target Market and Review Triggers.

- Australian Bond funds can provide sound diversification benefits when combined with equities as part of a diversified investment portfolio, although they have more limited use as standalone income producing products.
- Australian Bond funds will typically form part of the defensive component of a multi-asset investment portfolio or as a core allocation of a multi-sector debt portfolio.
- Australian Bond funds typically perform better during periods of declining or stable interest rates and contracting or stable credit spreads. Conversely, they will typically perform worse during periods of increasing interest rates (particularly when interest rates increase sharply) and deteriorating credit spreads. Diversification and active management can mitigate some of these risks.
- Australian Bond funds generally have lower default risk and higher credit quality than Alternative Income funds and Diversified Fixed Interest funds.

## Suggested Lonsec risk profile suitability



For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

## Changes Since Previous Lonsec Review

- In May 2023, Senior Portfolio Manager, Chris Rands, who was a direct support for Darren Langer who manages core fixed income products, departed the firm.
- In June 2023, Jessica Ren joined the firm as an Investment Manager, working closely alongside Darren Langer.
- There are no changes to the philosophy or process since the last review.

## Lonsec Opinion of this Fund

### People and resources

- Yarra Capital Management ('Yarra') was established in January 2017 as a boutique fund manager following the management buyout of Goldman Sachs Asset Management ('GSAM'). The buyout which was backed by private equity firm TA Associates ('TA'), included GSAM's Australian fixed income, equities and fund platform businesses. TA has a long history of co-investing in active fund managers, with the expertise to help portfolio companies grow and add value. Lonsec is comfortable with TA Associates as a long term partner. Furthermore, Yarra appears to be well-positioned financially and operationally to execute its business plans
- Following Yarra's acquisition of Nikko AM's Australian business in April 2021, both fixed income investment teams have been fully integrated and there has not been any material disruption to the day-to-day management of the Fund. The combined investment team of nine is co-led by Roy Keenan and Darren Langer. Lonsec has high regards for Keenan and Langer who both each have over 30 years of industry experience. As portfolio manager of the Fund, Langer is responsible for duration positioning and sector allocation within the Fund.

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- Lonsec considers the team expansion has further improved the experience, skillsets and size of the overall team. The combined team has an average of over 20 years of experience, although co-tenure is low. In Lonsec's opinion, the expanded team size is adequate and in line with local peers. The additional credit resourcing is expected to increase the Manager's breadth and depth of their credit coverage, which could potentially ease some of the workload. Lonsec believes the Melbourne and Sydney team brings extensive and complementary skillsets. The former Nikko AM team is more focused on core, conservative fixed income strategies, while Yarra manages credit strategies on the higher risk spectrum. Lonsec notes the teams have some differences in philosophy, processes and risk profile of the products they manage. Both co-heads are fostering collaboration and interaction between both the Sydney and Melbourne based teams, although the teams will continue to manage their respective strategies.
- Although the team integration has been progressing well, disappointingly, there have been four departures in two years, including the recent departure of Chris Rands. It is noteworthy that only two of the original five resources based in Sydney remain in the team following the recent turnover. The team has reallocated responsibilities across the team as expected, with most credit resources now in Melbourne. There have been three recent hires over the last 12 months. Lonsec notes a longer period is required to assess the overall team stability cohesiveness and interaction which appears to be waning given the recent departures. Lonsec will continue to monitor on this aspect in future reviews.
- Lonsec does note that the team is able to draw on broader resources within the firm. Head of Macro and Strategy Tim Toohey is a well-regarded economist, and his role sees him aiding the wider investment team in forming the Manager's macro views. In addition to Toohey, the fixed interest team may also collaborate with the equities team given the crossover in company coverage. This creates the opportunity for collaboration, idea sharing and combined company meetings which Lonsec views as beneficial.
- Key person risk for this Fund is centred on Langer. Lonsec takes some comfort that Langer is an equity owner and is 'locked in' via a vesting schedule of five years.
- In Lonsec's opinion, the investment team's alignment of interest with investors is moderate to strong, driven by the equity ownership by some senior investment team members. For other investment staff, the incentives to remain with the firm seem not to be as strong given the number of departures over recent years. Additionally, the investment team continues to be rewarded with a combination of a fixed base salary and variable discretionary compensation. For portfolio managers, the discretionary component is linked to fund performance versus benchmark and peers (assessed over one-, three- and five-year periods), team contributions and risk management. This remuneration structure is largely in line with peers.

### Research and portfolio construction

- No changes to the philosophy or process following the acquisition of Nikko AM's Australian business. Lonsec expects there could be further process enhancement and integration over time particularly in the credit research and top down/macro analysis, which Lonsec views positively.
- The Manager believes the main focus in managing fixed income portfolios should be risk – the returns will look after themselves. As an active fixed interest manager, the Manager seeks to exploit market mispricings, adding value through skill/experience and sound fundamental analysis. Lonsec views the systematic enhancements of in-house systems including MOSAIC to streamline this analysis as a positive development in terms of resourcing and process efficiency.
- Lonsec is pleased that the Manager undertakes a formal credit approval process. Yarra employs a multi-sector 'Credit Risk Model' for analysis of Australian credit securities. The model assesses securities on four key areas – Financials, Business, ESG and Market. Further, the team can supplement its research using insights from global peers (useful when analysing 'kangaroo bonds' and local markets), and equity teams. The portfolio also allocates to off-benchmark mortgage and asset-backed securities. Lonsec believes these types of securities display a different risk profile to other types of fixed income securities and in times of severe market dislocation may be negatively impacted by liquidity constraints. Lonsec notes the allocation to asset-backed securities has risen in recent years. Pleasingly the Fund only invests in highly rated tranches of these types of assets.
- The Fund is managed with the view that the risk being taken in the portfolio is commensurate with achieving the alpha target of 50-75 bps. While the conservative nature of this measure means the Fund will have an upper limit on its returns, Lonsec views the discipline of tight risk controls in a positive light. As the lead Portfolio Manager of the Fund, Langer is primarily responsible for implementing the team's views and is also ultimately accountable for the Fund's performance.

### ESG Integration

- Lonsec's ESG integration assessment considers how rigorous, robust and structured the ESG process for the Fund is as well as how well it integrates into the overall investment process and the Manager's overall policy and reporting framework. The assessment is not intended to assess the underlying holdings of the Fund's portfolio or the Manager's adherence to any form of impact, green / sustainable or ethical standards.
- At the corporate level Lonsec views the Manager's overall ESG policy framework and disclosure as behind peers. The Manager has articulated a commitment to the integration of ESG within their investment process, however there is limited evidence in their public positioning. The ESG policy is freely available on the firm's website, with the overall strength of the policy framework seen as adequate but weaker than leading peers. While the Manager has a proxy voting policy in place, the policy is not publicly available and lacks depth

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compared to peers. No reporting on voting outcomes has been published at the time of review. Lonsec notes that the Manager does not provide any details on engagement outcomes or policy.

- The Manager has indicated that their Responsible Investment style is “ESG Integration” and as such they take Environmental, Social and Governance factors into consideration when assessing investment opportunities. With a primary ESG style of “Filters or Screens” the Manager is likely using predetermined rules to either include or exclude companies from their investable universe. They may undertake further ESG analysis or use these screens as the sole ESG measure. Refer to the third dot point in this section for further details. Note that such an approach does not automatically ensure that the resulting portfolio will adhere to any particular structure or provide any particular level of ethicalness, greenness or sustainability.
- Within the management of this specific Fund Lonsec notes:
  - While the Manager is sourcing data from an external ESG data provider it is less comprehensive than some peers. While data collection is systematised, storage is less robust than peers.
  - While the Manager has demonstrated a clear ESG component within their overall stock research platform, supporting frameworks and systems are weaker than in leading managers. While research is undertaken in a structured manner it provides less measurable outputs than in some leading managers. Research storage and calibration is not as strong as in leading managers.
  - There are defined links from the Manager’s research to the stock selection process through the application of their universe reduction process. This adjustment is applied in a standardised and structured manner.
  - While there is monitoring of ESG characteristics of the portfolio across a number of ESG and sustainability dimensions, this plays no clear role in overall portfolio construction. There are no Portfolio level ESG based limits or targets in place for the fund.
  - While engagement is a component of the Manager’s approach, is managed in a less structured manner than with some leading peers. There is no structured system for prioritising engagements or for measuring success. Evidence of clear engagement activities is light
  - ESG does not form a component of the Managers broader compliance framework and overall transparency provided to investors is lagging.”

### Risk management

- Lonsec believes that risk management is integral to the portfolio management philosophy. Reflecting the insurance origins of the Australian team, there is a focus on risk first with returns a secondary consideration. This is viewed positively in a fixed income manager, as the asset class is inherently meant to be more defensive in nature.
- A notable feature of the Manager’s risk focus is its conservative approach to credit. This is demonstrated

by selectively diversifying credit exposures across sectors and diversifying by the number of credit securities held. Additionally, the Fund may utilise iTRAXX indices to reduce credit risk within the portfolio, but usage is deemed minimal at present.

- Portfolio risk is measured and monitored on a daily basis by the fixed income team, and by a separate compliance team. Yarra’s risk measures capture both product volatility characteristics and the probability of negative returns. The ongoing risk management process includes the assessment of market conditions and security-specific events which Lonsec considers to be thorough.
- Yarra calculates the attribution statistics daily using FactSet. Lonsec considers the daily reporting of performance attribution as a strength of the monitoring process, which serves to ensure performance accountability, especially given the sophisticated nature of the Fund’s underlying assets.
- All compliance breaches are reported directly to Langer and Yarra’s compliance team and escalated to Yarra’s Board of Directors where necessary. Yarra has established the Board, Audit, Risk and Compliance Committee (BARCC) to assist the Boards of the Australian Financial Licensees (AFSL), of which YFML is included, to oversee various audit, risk and compliance obligations. Lonsec views Yarra’s current risk management framework to be reasonable.

### Capacity Management

- Although the Manager has no formal capacity target for this Fund, Lonsec has conviction capacity is not a limitation for the Fund given the broad nature of its mandate and is comforted the Manager monitors capacity of its funds and strategies on an ongoing basis.

### Fees

- The Fund’s Annual Fees and Costs (‘AFC’) is estimated to be 0.30% p.a. This comprises a base management fee of 0.30% p.a. and net transaction costs of 0.0% p.a. Lonsec considers the total fee load, as measured by the disclosed AFC, for the Fund as low in comparison to its ‘Australian Bond’ Lonsec peer group.

### Product

- The Fund is an Australian Fixed Interest strategy investing across a range of relatively liquid securities across a range of sectors. Lonsec does not consider it to be operationally challenging to implement. The Manager employs high quality service providers, including its counterparties.
- Lonsec notes the Fund uses a related party Responsible Entity (‘RE’) which may lead to potential conflicts of interest. While the use of external REs is Lonsec’s preferred operating model, Lonsec notes the RE has built experience in operating and managing a number of registered managed investment schemes over an extended period and is expected to have a structured governance framework in place.
- The Fund’s size as of February 2023 was \$227m. Together with a 2000 inception and the track-record of the Yarra investment team, Lonsec views the wind-up risk of the Fund to be low.

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## Performance

- The Funds aims to exceed the Bloomberg Ausbond Composite 0+ Year Index by 50-75 bps p.a. (before fees) over rolling three-year periods.
- To 31 August 2022, the Fund returned -2.9% p.a. and 0.7% p.a. net of fees over the three and five-year periods respectively. The Fund has performed ahead of the benchmark before fees over three and five years but is below its internal target over the same period.
- Compared to peers in the Lonsec Australian Bond sector, to 31 August 2023 the Fund's three and five year returns were marginally above peer median. The Fund's annualised standard deviation was around that of peers over the three and five-year periods, but the Fund exhibited a slightly larger drawdown than the peer median over both periods. Lonsec observes performance is below what is expected from its premier rated managers.
- The Fund's peer median like returns and similar annualised standard deviation outcomes have resulted in Sharpe ratios that are around the peer median over the three-year and five-year periods to 31 August 2023.

## Overall

- Lonsec has downgraded the Fund's rating to **'Recommended'** at its recent review as Lonsec is seeking stronger peer relative performance from a premier rated manager over the medium to longer term. Lonsec is also seeking more consistency in comfortably meeting its internal objectives in the medium to longer term.
- However, Lonsec has conviction in the team who have evolved the process and tools to efficiently blend top-down macro, bottom-up credit with additional alpha from relative value. The outcome has been a conservative, competitively priced Australian fixed interest fund. The recent team expansion has further improved resourcing, skillsets and experience of the overall team. Lonsec is comfortable with the current team integration following the acquisition, however, will need a longer time to assess team stability and cohesiveness given the recent team departures and hires.

## People and Resources

### Corporate overview

Yarra Capital Management ('Yarra') was established in 2017, following the management buyout of Goldman Sachs Asset Management Australia's domestically focused investment capabilities and operating platform, with the backing of TA Associates ('TA').

Founded in 1968, TA is a global growth private equity firm with a long history of investing in funds management companies.

On 12 April 2021, Yarra completed the acquisition of Nikko Asset Management's (Nikko AM) Australia business, where Nikko AM retains a 20% stake in the combined business. The total assets under management for the combined business was approximately \$20bn as at 30 June 2022.

Yarra is now 40% owned by TA, 40% owned by staff, with the remaining 20% owned by Nikko AM.

Nikko AM's Australian fixed income business will be combined with Yarra's growing fixed income operations. The business is jointly led by Roy Keenan (Yarra's Head of Australian Fixed Income) and Darren Langer (Nikko AM's Head of Australian Fixed Income), as Co-Heads of Australian Fixed Income

## Size and experience

| NAME                       | POSITION                           | EXPERIENCE<br>INDUSTRY /<br>FIRM |
|----------------------------|------------------------------------|----------------------------------|
| DARREN LANGER <sup>^</sup> | CO-HEAD OF AUSTRALIAN FIXED INCOME | 33 / 15                          |
| ROY KEENAN                 | CO-HEAD OF AUSTRALIAN FIXED INCOME | 37 / 31                          |
| LEO LESLIE <sup>^</sup>    | SENIOR PORTFOLIO MANAGER           | 43 / 11                          |
| PHIL STRANO                | SENIOR PORTFOLIO MANAGER           | 28 / 6                           |
| TINA EVERIST               | INVESTMENT MANAGER                 | 17 / 17                          |
| RHYS CORRY                 | INVESTMENT MANAGER                 | 7 / 1                            |
| ROY MAO                    | INVESTMENT MANAGER                 | 5 / 1                            |
| LUKE WYND                  | PORTFOLIO ANALYST                  | 3 / 3                            |
| TIM TOOHEY                 | HEAD OF MACRO AND STRATEGY         | 29 / 5                           |
| JESSICA REN <sup>^</sup>   | INVESTMENT MANAGER                 | 4 / <1                           |

<sup>^</sup>Sydney based

## Team structure

Langer and Roy Keenan co-lead the Australian fixed income team of team based in Sydney and Melbourne. Langer has been with Yarra / Nikko AM for 15 years and prior to that was a Senior Portfolio Manager at Perpetual for 12 years.

Senior team member Langer, has responsibility for a specific alpha source (duration, sector and credit, respectively). Langer has replaced a recent senior departure, Chris Rands, who served as support for this product with Jessica Ren, who has close to four years industry experience.

For the management of this Fund, Langer is supported by Co-head Keenan, Senior Portfolio Managers Strano, Leslie, Investment Managers Everist, Corry, Mao, and Portfolio Analyst Wynd. Strano is primarily tasked with the management of credit portfolios but also contributes to credit research along with Keenan. Leslie focuses on high yield credit and global opportunities. Toohey works closely with both the Fixed Interest and Equities teams, advising on the macroeconomic outlook and assisting with asset allocation decisions.

## Research Approach

### Overview

### Macroeconomic research

Top-down strategies are based on the team's overall views on the economic and business environment, and the likely effects on yields, liquidity and credit risk premiums. Further, the team will typically meet with banks, economists, global and local issuers and government departments to deepen its insights.

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The team utilise the MOSAIC system to assist with the analysis of large datasets. MOSAIC sources data for various fixed income benchmarks, closing market yield curves, macroeconomic data, commodity and FX prices. Specifically, the data is used to create as many spreads as possible, which currently includes over 500 different interest rate spreads, plus an additional 1000 credit spreads. This data is used to help identify the most attractive spreads on offer which then warrant further discussions by the team.

Proprietary models are also actively employed, such as monetary bias indicator, event risk indicator and relative value models, including MoSAic. Model outputs are combined with the team's macroeconomic outlook to inform decisions around the Fund's yield curve, duration and sector positioning. All decisions must fit with the teams' fundamental views, the quantitative tools are used to support decisions and give an accurate view of markets.

### Credit research

Fundamental credit research aims to screen out investments that present unacceptable credit, sector or liquidity risks. This process is focused on identifying three to five key factors that are expected to determine whether a bond/sector will outperform or underperform, which involves analysing specific credits (e.g., business and financial risks), scenario analysis and synthesising company news.

Typically, the team will interact with company management, external sell-side analysts as well as Yarra's own equity analysts to assist in identifying trends and the outlook for individual issues. These findings are further supplemented by the research of external rating agencies, as well as the internal credit risk model. Security valuations are determined using a range of proprietary models.

## Portfolio Construction

### Overview

|                                 |  |
|---------------------------------|--|
| BENCHMARK                       | BLOOMBERG AUSBOND COMPOSITE 0+YR INDEX |
| SUB-INVESTMENT GRADE            | NIL                                    |
| TYPICAL NO. OF HOLDINGS         | 70-130                                 |
| PORTFOLIO CONSTRUCTION APPROACH | TOP-DOWN AND BOTTOM-UP                 |

The Fund's investment universe comprises investment grade debt securities issued by governments (Commonwealth, State/Territory), corporates and mortgage and asset-backed securities. It is expected to predominantly consist of securities domiciled in Australia but there is the scope to invest in securities domiciled in offshore currencies (up to 5% and fully hedged).

The team's consensus view of the likely direction of interest rates, the expected performance of different fixed income sectors and the individual selection of credit securities, drive active positioning.

Portfolios are constructed such that the team believes each position is adequately compensating the portfolio for the risk taken. Positions are generally entered into expecting to double the returns for any given risk exposure. Strict stop loss rules are designed to assist in curtailing risk.

The team also seeks to minimise transaction costs in portfolio construction. Physical bonds are often purchased on a hold-to-maturity basis with active

interest rate management implemented via a combination of futures and interest rates swaps due to greater liquidity and lower relative transaction costs. This cost minimisation philosophy carries through to credit securities, where transactions are conducted on a duration-neutral switch basis where possible. The exception is a security at risk of a deteriorating credit profile, in which case it must usually be sold immediately.

## Risk Management

### Risk limits

|                                       |   |
|---------------------------------------|---|
| DURATION RISK LIMIT                   | BENCHMARK DURATION +/-1.5 YEARS   |
| MIN. ISSUER CREDIT RATING AT PURCHASE | BBB-  |
| MAX. SINGLE ISSUER WEIGHT             | GOVERNMENT 100%; SEMI-GOVERNMENT 30%; A1+ RATED AUSTRALIAN BANKS (EX. GOVT GUARANTEE) 15% (ALL OTHERS 5%); A1 RATED AUSTRALIAN BANKS (EX. GOVT GUARANTEE) 7% (ALL OTHERS 3%); A2 AND BELOW RATED AUSTRALIAN BANKS (EX. GOVT GUARANTEE) 2% (ALL OTHERS 1%) |
| CURRENCY EXPOSURE                     | 5% (FULLY HEDGED, WITH TOLERANCE BAND OF +/-2%)   |

The risk limits stated are 'hard' limits which must be adhered to.

### Risk monitoring

Responsibility for legal, regulatory and operational risks sit with the Board, Audit, Risk and Compliance Committee (BARCC). The BARCC's membership is comprised of a majority of non-executive independent board members (with one director representative from YFML), the Managing Director and the General Counsel. The BARCC is also supported by a Breaches and Incidents Working Group where senior members of management meet to triage incidents, breaches or potential breaches, for reporting to the BARCC and ultimately to the relevant Board. The BARCC meets on a quarterly basis and receives regular reporting regarding the audit, risk and compliance obligations from the relevant areas of the business, including the Legal, Risk & Compliance, Operations, Finance and IT teams. The BARCC reports on a quarterly basis to the AFSL Boards, of which the YFML Board is included.

The Investment & Risk Oversight Committee, a YFM Board sub-committee, monitors and oversees the investment portfolios managed by YFM. The committee is focussed specifically on matters including portfolio management, performance, and risk with regard to portfolio-specific client objectives, while considering the overall risk within the portfolios.

Yarra utilises FactSet for calculating the Fund's performance and attribution.

Trade planning, pre-trade compliance and booking is done using thinkFolio, a third party order management system. The portfolio management team also uses thinkFolio to rebalance portfolios.

Citi provides middle office administrative support including trade management support and post-trade compliance reporting.

ANALYST: MIKE GROOSIC | APPROVED BY: ISRIN KHOR

## Yarra Australian Bond Fund

### Currency management

The Fund is permitted to hold non-A\$ denominated assets (up to 5%). Where non-A\$ assets are held, the currency exposure will be fully hedged using one month currency forwards or cross currency swaps with a tolerance band of +/-2%. Currency hedging is implemented by the local investment team using a passive approach (i.e. not for alpha generation).

### Risks

**An investment in the Fund carries a number of standard investment risks associated with investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the PDS and should be read in full and understood by investors. Lonsec considers the major risks to be:**

#### Interest rate (or duration) risk

Changes to interest rates can, directly and indirectly, impact investment value and returns. For example, an increase in official interest rates can result in a fall in the value of fixed interest securities, while a decrease in interest rates can result in an increase in value. The magnitude of these changes to the value of an investment will depend mainly on the term to maturity of the security. Generally, a security with a longer term to maturity is likely to be more affected by interest rate changes.

#### Company-specific (or credit) risk

Credit risk refers to the risk that the issuer of a debt security fails to meet its obligations, such as defaulting under a mortgage, a mortgage-backed security, a hybrid security, a fixed interest security or a derivative contract. This creates an exposure to underlying borrowers and the financial condition of issuers of these securities.

#### Derivative risk

The Fund may use derivatives to manage risk (e.g., duration, currency) and take positions in certain markets. Derivatives are not used to gearing purposes.

#### Counterparty risk

A special case of credit risk, where a fund is indirectly exposed to the credit risk of a counterparty for the completion of a trade or investment, e.g., over-the-counter derivatives such as interest rate swaps. The use of over-the-counter swaps and options is confined to counterparties with an S&P rating of A- or higher. For exposure limits, counterparty exposure is rolled into the individual risk limits. For domestic interest rate swaps, the margin is 2% of the gross fair value.

#### Currency risk

The Fund can invest in assets that are denominated in non-A\$ currencies. A rise in the relative value of the A\$ vis-à-vis the currencies in which the assets are denominated will negatively impact the market value of the assets (and vice versa) from an Australian investor perspective. The Fund is managed on a 'currency hedged' basis with the aim of minimising the impact of currency movements.

# Yarra Australian Bond Fund

ISSUE DATE 21-09-2023

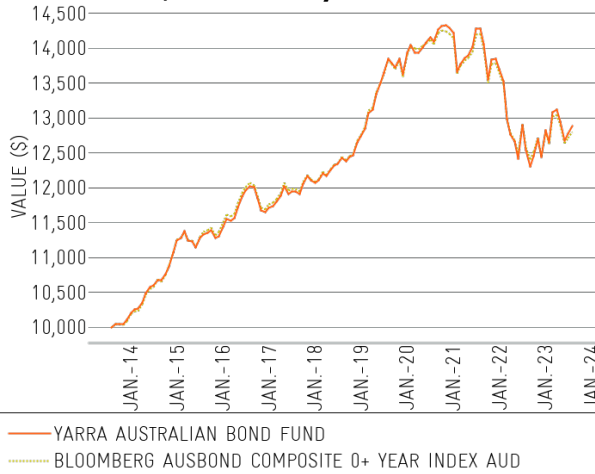
## Quantitative Performance Analysis - annualised after-fee % returns (at 31-8-2023)

### Performance metrics

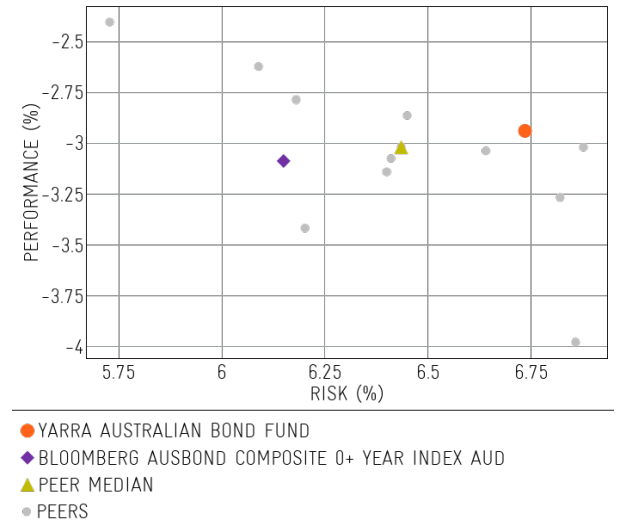
|                             | 1 YR  |             | 3 YR   |             | 5 YR   |             | 10 YR  |             |
|-----------------------------|-------|-------------|--------|-------------|--------|-------------|--------|-------------|
|                             | FUND  | PEER MEDIAN | FUND   | PEER MEDIAN | FUND   | PEER MEDIAN | FUND   | PEER MEDIAN |
| PERFORMANCE (% PA)          | 2.82  | 2.51        | -2.94  | -3.02       | 0.72   | 0.63        | 2.57   | 2.48        |
| STANDARD DEVIATION (% PA)   | 6.84  | 6.23        | 6.73   | 6.43        | 5.70   | 5.68        | 4.40   | 4.37        |
| EXCESS RETURN (% PA)        | 1.04  | 0.73        | 0.15   | 0.07        | 0.16   | 0.09        | 0.07   | 0.06        |
| OUTPERFORMANCE RATIO (% PA) | 66.67 | 75.00       | 58.33  | 58.33       | 61.67  | 58.33       | 55.83  | 55.83       |
| WORST DRAWDOWN (%)          | -3.37 | -3.05       | -14.12 | -13.80      | -14.12 | -13.96      | -14.12 | -14.01      |
| TIME TO RECOVERY (MTHS)     | NR    | NR          | NR     | NR          | NR     | NR          | NR     | NR          |
| SHARPE RATIO                | -0.08 | -0.13       | -0.62  | -0.65       | -0.09  | -0.11       | 0.19   | 0.17        |
| INFORMATION RATIO           | 1.18  | 1.22        | 0.20   | 0.14        | 0.24   | 0.10        | 0.14   | 0.12        |
| TRACKING ERROR (% PA)       | 0.89  | 0.58        | 0.75   | 0.52        | 0.67   | 0.62        | 0.51   | 0.55        |

PRODUCT: YARRA AUSTRALIAN BOND FUND  
 LONSEC PEER GROUP: FIXED INTEREST - AUSTRALIAN BONDS  
 PRODUCT BENCHMARK: BLOOMBERG AUSBOND COMPOSITE 0+ YEAR INDEX AUD  
 CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD  
 TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

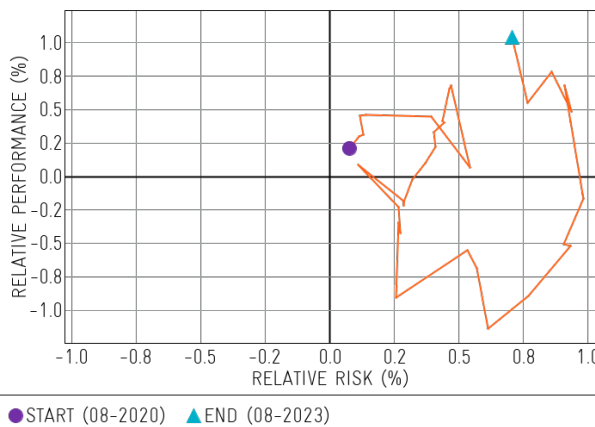
### Growth of \$10,000 over 10 years



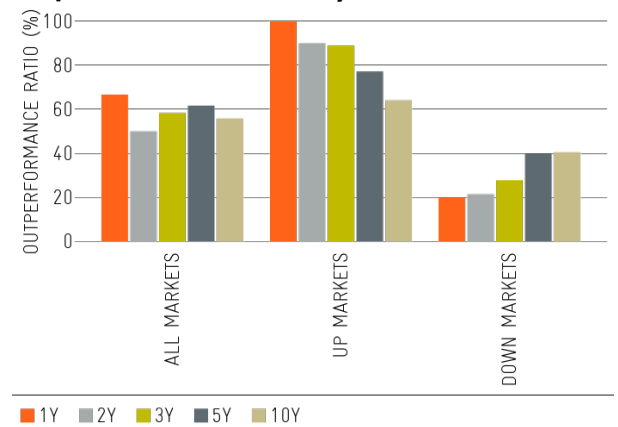
### Risk-return chart over three years



### Snail trail



### Outperformance consistency



ANALYST: MIKE GRODOSC | APPROVED BY: ISRIN KHOR



# Yarra Australian Bond Fund

## Glossary

**Total return** ‘Top line’ actual return, after fees  
**Excess return** Return in excess of the benchmark return  
**Standard deviation** Volatility of monthly Absolute Returns  
**Tracking error** Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)  
**Sharpe ratio** Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)  
**Information ratio** Relative reward for relative risk taken (Excess Returns / Tracking Error)  
**Worst drawdown** The worst cumulative loss (‘peak to trough’) experienced over the period assessed  
**Time to recovery** The number of months taken to recover the Worst Drawdown  
**Snail Trail** A trailing 12-month relative performance and relative risk measurement over the benchmark. The trail is generated using a 12-month rolling window over the specified period

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## Analyst Disclosure and Certification

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