Lonsec

Recommended

Product Review
Yarra Enhanced Income Fund

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About this Review

ASSET CLASS REVIEWED	FIXED INTEREST
SECTOR REVIEWED	SPECIALISED HIGH INCOME
TOTAL FUNDS RATED	36

About this Fund

ASIC RG240 CLASSIFIED	NO
FUND REVIEWED	YARRA ENHANCED INCOME FUND
APIR CODE	JBW0018AU
PDS OBJECTIVE	TO EARN HIGHER RETURNS THAN TRADITIONAL CASH MANAGEMENT AND FIXED INCOME INVESTMENTS (OVER THE MEDIUM-TO-LONG TERM) THROUGH EXPOSURE TO A DIVERSIFIED PORTFOLIO OF FIXED INCOME AND HYBRID (DEBT / EQUITY) SECURITIES.
INTERNAL OBJECTIVE	TO OUTPERFORM RBA CASH RATE BY 2.3% TO 2.8% P.A., BEFORE FEES AND INCLUDING FRANKING, OVER THREE- TO FIVE-YEAR PERIODS.
STATED RISK OBJECTIVE	TO PRODUCE LESS VOLATILE RETURNS THAN ARE INHERENT IN EQUITY MARKETS, OVER THREE TO FIVE-YEAR PERIODS.
DISTRIBUTION FREQUENCY	MONTHLY. DISTRIBUTIONS MAY BE PARTIALLY FRANKED AND/OR TAX-DEFERRED
FUND SIZE	$581.0M (30 JUNE 2023)
FUND INCEPTION	01-06-2003
ANNUAL FEES AND COSTS (PDS)	0.58% P.A.
RESPONSIBLE ENTITY	YARRA FUNDS MANAGEMENT LIMITED

About the Fund Manager

FUND MANAGER	YARRA FUNDS MANAGEMENT LIMITED
OWNERSHIP	40% STAFF & 40% TA ASSOCIATES & 20% NIKKO AM
ASSETS MANAGED IN THIS SECTOR	$4,324M (30 JUNE 2023)
YEARS MANAGING THIS ASSET CLASS	21

Investment Team

PORTFOLIO MANAGER	ROY KEENAN
INVESTMENT TEAM SIZE	9
INVESTMENT TEAM TURNOVER	MODERATE
STRUCTURE / LOCATION	PM & ANALYSTS / MELBOURNE & SYDNEY

Investment process

BENCHMARK	RBA CASH RATE
TYPICAL NO. OF SECURITIES	60-100
MAX. SUB-INVESTMENT GRADE	60%
MIN. CREDIT QUALITY AT PURCHASE	B- (BASED ON EXTERNAL OR INTERNAL RATINGS)
MAX. SINGLE ISSUER LIMIT	VARIES BY CREDIT RATING
DURATION RISK LIMIT	-2.0 TO 3.5 YEARS (ABSOLUTE)
GEARING / ECONOMIC LEVERAGE	NOT PERMITTED
CURRENCY EXPOSURE	NON-AUD SECURITIES PERMITTED BUT FULLY CURRENCY HEDGED

Fund rating history

SEPTEMBER 2023	RECOMMENDED
AUGUST 2022	RECOMMENDED
AUGUST 2021	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.
- The Manager has strong expertise in the Australian hybrids market and applies a robust fundamentally driven investment approach.
- The Fund is competitively priced versus the relevant Lonsec peer group.

Weaknesses

- With the recent team departures following the acquisition, Lonsec will require time to assess team stability and quality of new hires.
- Investment team being split between two locations may not maximize potential synergies from the merger.
- Notable allocation to hybrids, which can be concentrated in financials and trade with equity-like characteristics. They experience bouts of illiquidity and drawdowns during times of stressed market conditions.

Fund Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK		●	
CAPITAL VOLATILITY		●	
CREDIT RISK			●
FOREIGN CURRENCY EXPOSURE	●		
INTEREST RATE (DURATION) 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 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

Yarra Enhanced Income Fund

	LOW	MODERATE	HIGH
RISK TO INCOME			●

Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY			●
ESG		●	

Fee profile

	LOW	MODERATE	HIGH
FEES VS. UNIVERSE		●	
FEES VS. ASSET CLASS	●		
FEES VS. SUB-SECTOR	●		

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

What is this Fund?

- The Yarra Enhanced Income Fund ('the Fund') provides exposure to a range of high yielding fixed income and hybrid securities through its investment in the Yarra Enhanced Income Pooled Fund. The Fund seeks to outperform the RBA Cash Rate (before fees and including franking) by 2.3% to 2.8% p.a. over three-to-five-year periods. It is expected to produce less volatile returns than those inherent in equity markets while offering modest capital growth and some franking credits.
- Yarra Capital Management ('Yarra', 'YCM' or the 'Manager') believes that active managers who are credit risk-focused and experienced, are able to derive excess returns in the hybrid/high-yield Australian credit market.
- The Fund invests in a range of high yielding fixed income and hybrid securities, as well as other financial products issued by government bodies, corporates and specialist financing vehicles. These investments, which may be listed or unlisted, include floating rate notes; convertible / converting securities (hybrids); corporate bonds; government and semi-government securities; structured / subordinated debt; perpetual (non-call) step-up preference securities; and high yield debt.
- Hybrid securities exhibit characteristics associated with both debt and equity markets. Typical issuers of these securities include banks and insurers looking to balance the competing objectives of regulators and shareholders. However, corporations have opportunistically issued as well as an alternative means of traditional debt financing. Investors should note the Fund generally has a heavy weighting towards the banking sector, making it particularly susceptible to negative sentiment and/or a deterioration in operating environment.
- Furthermore, Lonsec notes that hybrids as an income generating asset class are well favored among investors but cautions that the terms of some issues may permit the issuer to halt coupon payments as they are not obligatory. While this is highly unlikely to occur, it is important to note that stressors in the banking sector and broader economy, in extreme cases have the potential to trigger such events.
- The Fund typically does not have significant exposures to government or AAA rated securities. Aiming to maintain an average investment grade rating across the Fund, up to 60% of the Fund (by market value) may be held in sub-investment grade securities (i.e. below BBB-).
- Duration risk of the Fund is relatively lower than traditional fixed income funds given the portfolio is largely floating rate in nature.
- The Fund invests predominately in AUD domiciled assets, but may invest in securities denominated in foreign currencies which will be fully hedged to AUD. These are generally issued by Australian corporations where the Manager already has knowledge of the underlying credit risk.
- Lonsec highlights that its derived 'Standard Risk Measure' of six (6) may be different from that disclosed by the Manager. Differences in assumptions may be expected to result in these divergent outcomes. Lonsec has used widely accepted standardised superannuation industry methodology. The asset class returns/assumptions used by Lonsec are also freely available to subscribers via the Lonsec website.
- The Fund's PDS dated 31 March 2023 disclosed Annual Fees and Costs ('AFC') totaling 0.58% p.a. This fee comprises (1) Management Fees and Costs of 0.55% p.a., and (2) Net Transaction Costs of 0.03% 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 0.1%/0.1%. 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.
- Funds in the Specialised High Income sector are typically managed with the aim of generating returns that exceed a cash proxy (such as the Bloomberg AusBond Bank Bill Index) by a margin or are absolute return in nature. Volatility (Standard Deviation) is generally positioned as moderate, barring periods of exceptional market circumstances.
- Lonsec suggests that the Fund should only be considered for investors who are (a) seeking yields greater than cash or cash-like instruments and, more importantly, (b) those prepared to accept **moderate volatility** in the unit price.
- The Fund invests in a narrower range of securities than other Specialised High Income funds reviewed by Lonsec, focusing primarily on Australian hybrid and high yield securities. These securities typically sit between senior debt and equity in the capital structure of the borrowers or issuers of these securities. As such, hybrid securities attract higher

returns (and higher risk) than more senior debt securities but lower returns than direct equity investments. Given the level of risk, Lonsec considers that allocations to the Fund be made from growth allocation of an investor's portfolio and that the Fund may not be suitable for more conservative investors who require certainty of income and stability of unit price.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
	●	●	●	●	

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, Keenan is responsible for Fund. Senior Portfolio Manager Phil Strano is Keenan's primary support for this Fund. Strano is considered to be an experienced credit investor with over 20 years of industry experience.
- 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 team led by Langer is more focused on core, conservative fixed income strategies, while Keenan's team 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 acquisition. 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 assessment period is required to asses 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 Keenan. Given hybrids are a dominant allocation in the portfolio, the Fund's rating would be invariably revisited in the event of Keenan's departure. Lonsec takes some comfort that Keenan is an equity owner and is 'locked in' via a vesting schedule of five years. In addition, Strano's experience in managing hybrids mitigates some of the key person risk.
- 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.

Yarra Enhanced Income Fund

Research and portfolio construction

- No major changes to the philosophy or process following the acquisition of Nikko AM's Australian business. Lonsec notes some process enhancement and integration in the credit research and top down/ macro analysis, which Lonsec views positively.
- Lonsec believes the Manager has a well-structured investment process driven by bottom-up fundamental research and top-down macroeconomic insights. Lonsec considers the overall investment process to be adequately detailed and consistently implemented across its research universe.
- The investment process is relatively intuitive. The fundamental macroeconomic analysis is conducted to identify credit outlook and long-term industry trends to set the Fund's top-down strategic positioning. Lonsec believes the top-down analysis complements the bottom-up research, but the approach is not different from peers. Keenan has a high level of accountability for research, portfolio construction and implementation and also the primary driver of trade ideas and relative value calls. Strano is involved in portfolio construction and supports Keenan as back up wherever necessary. Strano and the balance of the team also contributes in terms of credit research and overall portfolio positioning.
- 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. Lonsec notes that Strano has used and progressively refined the model over the last eight years of his career. In Lonsec's opinion, the model follows a logical structure and covers core criteria for valuation and assessment.

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 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

- Risk is largely considered in an absolute sense and is a function of bottom-up security selection. The portfolio is reasonably diversified given the narrow underlying strategy, with the inclusion of 60-100 names and no substantial positions to particular issuers. However, the Fund is concentrated when compared to many global peers in this sub-sector, whom have broader opportunity sets.
- 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 Keenan 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.
- The Manager has continued with the removal of the 50% soft limit on unlisted securities given the rapid change of hybrid market composition from listed to over-the-counter market as well as the improvement in the Manager's liquidity monitoring. Lonsec notes that the liquidity monitoring process is adequate and will continue to monitor developments.

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 nature of its mandate, size of the strategy 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 0.58% p.a. This comprises a base management fee of 0.55% p.a. and net transaction costs of 0.03% p.a. Lonsec considers the total fee load, as measured by the disclosed AFC, for the Fund as 'Low' in comparison to its 'Specialised High Income' Lonsec peer group.

Product

- The Fund is an Australian Fixed Interest strategy investing in a range of high yielding fixed income and hybrid securities. 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 June 2023 was $581m. Together with a 2003 inception and the track-record of the Yarra investment team, Lonsec views the wind-up risk of the Fund to be low.

Performance

- The Fund aims to outperform the RBA Cash Rate by 2.3-2.8% p.a. (before fees and including franking) over three- to five-year periods.
- To 31 July 2023, the Fund returned 4.5% p.a. and 3.8% p.a. net of fees over three and five-years, respectively. The Fund has outperformed the benchmark before fees over three and five years and exceeded its internal performance objective.
- Compared to peers in the Lonsec 'Specialised High Income' sector, to 31 July 2023 the Fund's three and five year returns were above the peer median over both periods. The Fund's annualised standard deviation was below that of peers over the three and five-year periods, and the Fund also exhibited a lower drawdown than the peer median over both periods.
- The Fund's above peer median like returns and lower annualised standard deviation outcomes, have resulted in Sharpe ratios that are above the peer median over the three and five-year periods to 31 July 2023.

Overall

- Lonsec has maintained the Fund's **'Recommended'** rating at its latest review. Portfolio Manager Roy Keenan is held in high regard by Lonsec due to his firm tenure and experience within the asset class, particularly in hybrids. 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.
- Lonsec highlights that the Fund is predominantly exposed to hybrid securities, which exhibits equity-like characteristics and can experience illiquidity and large drawdowns in stressed markets conditions.

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

Yarra Enhanced Income Fund

Size and experience

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

^Sydney based

Yarra's fixed income team comprises of 8 investment personnel and is co-led by Head of Australian Fixed Income, Roy Keenan and Darren Langer based in Melbourne and Sydney.

For the management of this Fund, Keenan is supported by Co-head Langer, 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.

Keenan has over 30 years of investment experience both in asset management, trading and has been specialising in credit products since 1995. Keenan has managed the Fund's underlying strategy since its inception in 2002.

Research Approach

Overview

Research is undertaken by Keenan, Strano and the investment management team who are all primarily focused on credit investing. Toohey focuses on macro research.

Investment ideas may be generated from top-down economic and market analysis, as well as bottom-up fundamental credit research.

The fundamental macroeconomic analysis helps to set the Fund's top-down strategic positioning. This involves an assessment of economic indicators that tend to lead aggregate economic activity, which provides insights into the movements in monetary policy, inflation expected, international capital flows and the risk appetite of capital markets. This analysis is complemented by quantitative research of economic and market factors, as well as an understanding of local near-term market supply and demand dynamics.

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

FUND BENCHMARK	RBA CASH RATE
INTERNAL RETURN OBJECTIVE	+2.3-2.8% P.A. (GROSS OF FEES AND INCLUDING FRANKING) OVER THREE TO FIVE YEAR PERIODS. DELIVER CONSISTENT INCOME WITH LOWER CAPITAL VOLATILITY THAN EQUITIES.
STATED RISK OBJECTIVE	THE FUND IS EXPECTED TO PRODUCE LESS VOLATILE RETURNS THAN ARE INHERENT IN EQUITY MARKETS, OVER THREE TO FIVE-YEAR PERIODS
TYPICAL NO. OF HOLDINGS	40-60
ANNUAL TURNOVER	20-25%
HOLDINGS IN EQUITY SECURITIES	UP TO 3%

The Fund typically holds at least 40 to 60 securities, with weights concentrated towards better credits and preferred relative value stocks. Specifically, position sizes are determined by an individual security's contribution to portfolio risk. That is, smaller (larger) positions are held in riskier (less risky) securities. Further, no single security, issuer, sector or industry is expected to have a material impact on the relative performance of the Fund.

Portfolio construction also takes into account the team's macro views and taxation considerations (e.g., franking credits).

Risk Management

Risk limits

CREDIT RATING (AGGREGATE) (BASED ON EXTERNAL OR INTERNAL RATINGS)	AAA TO AA- (100%); A+ TO A- (100%); BBB+ TO BBB- (85%); BB + TO BB- (50%); B+ TO B- (10%)
MIN. AVERAGE PORTFOLIO CREDIT RATING (BASED ON EXTERNAL OR INTERNAL RATINGS)	BBB- (SOFT LIMIT)
INTEREST RATE DURATION	-2.0 TO 3.5 YEARS (ABSOLUTE)
EQUITY	3%
CASH	N/A
SINGLE OBLIGOR (BASED ON EXTERNAL OR INTERNAL RATINGS)	AAA TO AA- (25%); A+ TO A- (20%); BBB+ TO BBB- (15%); BB + TO BB- (10%); B+ TO B- (2%) (SOFT LIMIT)
SECTOR	BANKING AND FINANCE (50%); INSURANCE (30%); ALL OTHER (20%)

The risk limits are sufficiently broad and the Fund is managed without reference to a hybrid benchmark. As such, risk management is largely the role of the Portfolio Manager.

The 50% soft limit on unlisted securities has been removed given the rapid change of hybrid market composition from listed to over-the-counter market as well as the improvement in liquidity monitoring.

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.

Currency management

The Fund invests predominately in AUD domiciled assets, but any non-AUD investments will be fully currency hedged.

Risks

An investment in the Fund carries a number of standard investment risks associated with domestic and international 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 risk

The movement in interest rates and bond yields directly impacts the market value of the Fund's assets. Market prices of fixed rate securities are typically inversely related with the movement of interest rates or bond yields.

Derivatives

Derivatives may be used to hedge risk in the Fund. Derivatives (e.g., interest rate futures and options, interest rate and credit default swaps, currency forwards) may be used to implement fixed income strategies. Derivative positions may result in notional exposures that are greater than the underlying value of assets in the Fund.

Counterparty risk

Where a Fund is exposed to the credit risk of a counterparty for the completion of a trade or investment (i.e. over-the-counter derivatives such as interest rate swaps). Yarra mitigates this risk by evaluating counterparties from a performance and risk perspective and conducts reviews at least annually.

Equity risk

The Fund invests in hybrid securities which exhibit both debt and equity characteristics. The equity components of the securities are exposed to systemic risk from equity markets in general.

Yarra Enhanced Income Fund

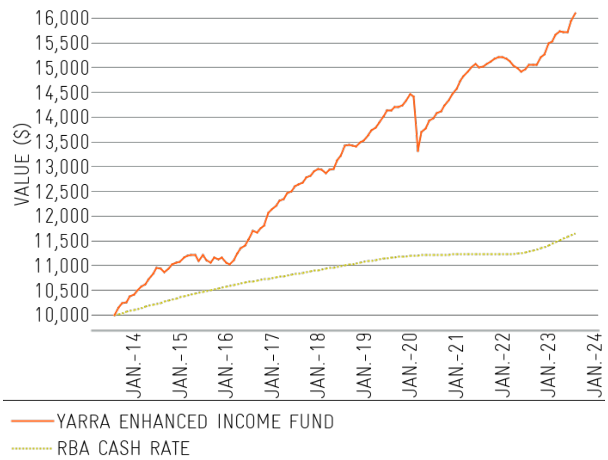
Quantitative Performance Analysis - annualised after-fee % returns (at 31-8-2023)

Performance metrics

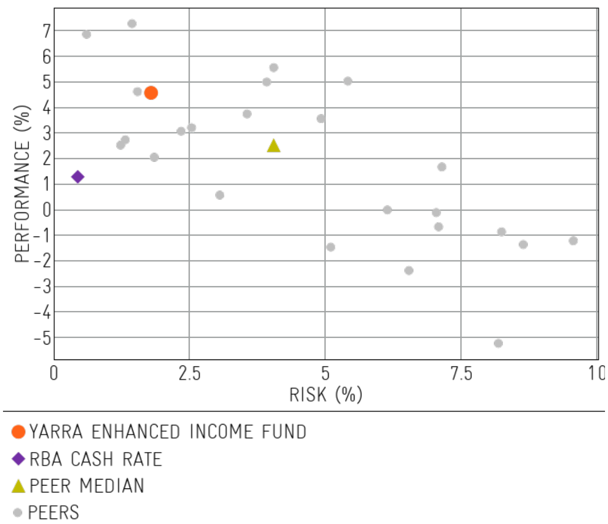
	1 YR		3 YR		5 YR		10 YR	
	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN
PERFORMANCE (% PA)	6.92	4.19	4.57	2.53	3.70	2.37	4.88	4.27
STANDARD DEVIATION (% PA)	1.99	7.00	1.79	4.05	4.10	6.22	3.30	4.93
EXCESS RETURN (% PA)	3.56	1.90	3.29	2.25	2.54	1.39	3.33	2.08
OUTPERFORMANCE RATIO (% PA)	58.33	58.33	66.67	66.67	70.00	65.00	71.67	65.00
WORST DRAWDOWN (%)	-0.21	-3.92	-1.92	-5.49	-7.96	-10.87	-7.96	-9.47
TIME TO RECOVERY (MTHS)	2	4	5	9	10	7	10	5
SHARPE RATIO	1.79	0.22	1.85	0.47	0.60	0.22	0.96	0.52
INFORMATION RATIO	1.83	0.47	1.91	0.95	0.63	0.28	1.02	0.42
TRACKING ERROR (% PA)	1.95	2.97	1.72	3.00	4.07	4.94	3.28	3.28

PRODUCT: YARRA ENHANCED INCOME FUND
LONSEC PEER GROUP: FIXED INTEREST - SPECIALISED HIGH INCOME
PRODUCT BENCHMARK: RBA CASH RATE
CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD
TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

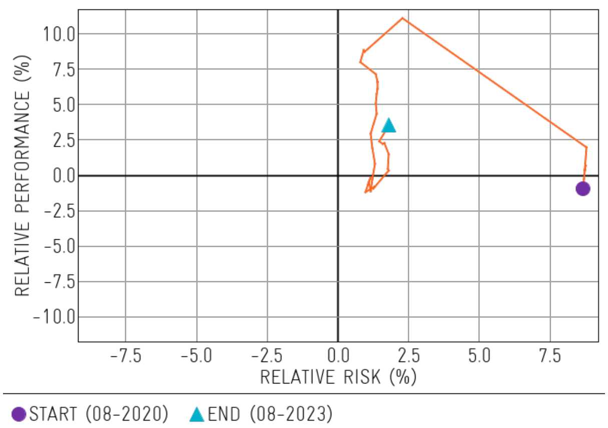
Growth of $10,000 over 10 years



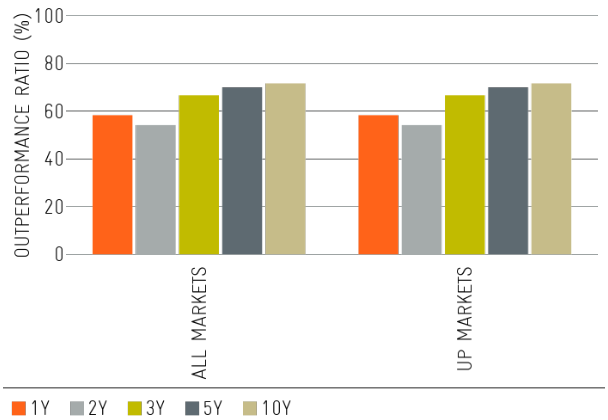
Risk-return chart over three years



Snail trail



Outperformance consistency



Yarra Enhanced Income 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

About Lonsec

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