YARRA CAPITAL MANAGEMENT

**Investment Commentary**
Month to 30 April 2024

# Yarra Emerging Leaders Fund

## Gross returns as at 30 April 2024

| | 1 month % | 3 months % | 1 year % | 3 years % p.a. | 5 years % p.a. | 10 years % p.a. | Since inception* % p.a. |
|---|---|---|---|---|---|---|---|
| Yarra Emerging Leaders Fund | -3.47 | 4.10 | 5.95 | 6.26 | 9.34 | 9.95 | 11.02 |
| Emerging Leaders Combined Benchmark† | -2.59 | 5.00 | 8.05 | 3.21 | 6.90 | 8.82 | 7.11 |
| Excess return (before fees)‡ | -0.88 | -0.89 | -2.10 | 3.06 | 2.44 | 1.13 | 3.91 |

**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 management costs, meaning they do not reflect the deduction of any investment management fees and expenses 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 30 April 2024

| | 1 month % | 3 months % | 1 year % | 3 years % p.a. | 5 years % p.a. | 10 years % p.a. | Since inception* % p.a. |
|---|---|---|---|---|---|---|---|
| Yarra Emerging Leaders Fund | -3.57 | 3.79 | 4.64 | 4.95 | 7.99 | 8.59 | 9.72 |
| Emerging Leaders Combined Benchmark† | -2.59 | 5.00 | 8.05 | 3.21 | 6.90 | 8.82 | 7.11 |
| Excess return (after fees)‡ | -0.98 | -1.21 | -3.41 | 1.75 | 1.09 | -0.23 | 2.60 |

**Past performance is not a reliable indicator of future performance. Taxes payable by investors have not been taken into account.** The figures shown have been provided for illustrative purposes – they are unaudited and subject to change. The total returns shown are prepared on an exit to exit basis – they include all ongoing fees and expenses and assume reinvestment of all distributions.

* Inception date Yarra Emerging Leaders Fund: September 1997

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

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

### Market review

The Australian mid and small cap market was negative for the month of April.

The Emerging Leaders Benchmark returned -2.6% for the month, taking its 12-month return to +8.0%. By comparison, the broader S&P/ASX 300 Accumulation Index fell 2.9% for the period. Globally, the MSCI World Index also recorded a -3.9% return.

Materials (+3.4%) was the largest contributor for the month, led by Evolution Mining (EVN, +13.4%). The gold and copper miner was a positive contributor as both gold and copper prices increased over the period. Other notable contributors were Lynas Rare Earths (LYC, +15.3%) and Alumina (AWC, +14.4%).

Health Care (+4.6%) was also a positive performing sector with Telix Pharmaceuticals (TLX, +16.8%) as the main driver of outperformance. The biotechnology firm saw its share price increase during the period following strong Q1 results, with revenue figures beating market expectations.

In contrast, Consumer Discretionary (-8.2%) was the worst performing sector during the month with Star Entertainment (SGR, -29.6%) as the main detractor following poor quarterly results. Other negative contributors included Light and Wonder (LNW, -11.2%), JB Hi-Fi (JBH, -5.0%) and Premier Investments (PMV, -8.0%).

Real Estate (-8.2%) also underperformed during the period with the prospect of interest rates remaining higher for longer with Charter Hall Group (CHG, -12.8%), Vicinity Centres (VCX, -9.6%) and Lifestyle Communities (LIC, -23.2%) all contributing to underperformance.

### Portfolio review

**Key Contributors**

Evolution Mining (EVN, overweight) – our overweight position in the gold and copper miner contributed to performance during April. Gold prices increased by 4.2% to close the month at US$2,336/oz, while copper prices increased by 14.6%. We remain attracted to EVN's long-life assets, and meaningful leverage to copper production at the Ernest Henry and Northparkes mines.

Sandfire Resources (SFR, overweight) – our overweight position in copper producer Sandfire was a source of outperformance during April as copper prices rose 14.6% to close at US$4.56/lb. We favour SFR as the best exposure to copper on the ASX, a commodity we like given declining supply and its leverage to electrification as a key material in batteries and electric motors. We believe the recent rally in copper prices to >US$4.50/lb is sustainable given improving demand, low inventories, and disappointing mine production globally.

Iluka Resources (ILU, overweight) – the mineral sands producer outperformed during the month following the release of its MarQ update. While quarterly production was below consensus expectations, the outlook for mineral sands demand is clearly improving with ILU expecting both price and volume improvements in JunQ24. We continue to like mineral sands markets long-term and favour ILU 's leverage as the world's largest Zircon producer and fifth largest producer of titanium feedstocks. Iluka is moving into Rare Earths production through the Eneabba refinery and would be a critical component producer for the EV industry.

**Key Detractors**

Reliance Worldwide (RWC, overweight) – the plumbing supplies company gave back some of its strong CYTD returns through April as the combination of higher interest rates in the USA and rising copper prices weighed on the share price. A push back in expectations of rate cuts in the USA has the market applying a lower probability to a US housing market recovery in CY25, while a rising copper price creates an input cost headwind that RWC will need to address through active price increases into FY25. Nonetheless, at current levels, we believe the stock valuation doesn't give appropriate credit to the mid-cycle earnings power of the group considering the resilience of its end markets, the majority of which relates to more non-discretionary, repair type housing activity.

Worley (WOR, overweight) – the leading provider of global engineering services underperformed over the month as substantial shareholder, Dar Al-Handasah Shair and Partners Holdings, sold down its 23.5% stake in the company. We remain overweight WOR given the strong pipeline of work ahead (Factored Sales Pipeline +35%, Backlog +11%), and a strong outlook for work driven by both the need to decarbonize, and to build and maintain energy infrastructure to meet future needs. Margins are also set to increase over the coming years as WOR benefits from a more consolidated industry structure, operating leverage, and active mix management towards higher margin sustainability work.

Lifestyle Communities (LIC, overweight) – our position in one of Australia's leading and highest-quality land lease owning and developing business, LIC, detracted value over the period following the company downgrading settlement expectations for the current financial year. The impact of lower settlements in FY24 (delayed, not lost) has the effect of reducing balance sheet flexibility, and lowering earnings in the short-term. Importantly, the company has retained its medium-term settlement expectation, underpinned by a view that the Victorian residential market will normalise on a multi-year view.

**Key Purchases**

Ansell (ANN) – we initiated a position in the global manufacturer and distributor of PPE as part of the company's $400m placement at a 6% discount to the last price ($23.89) to acquire Kimberley Clarke's PPE business. The acquisition is strategically important and was 12% accretive to group EPS. We are also attracted to the cyclical rebound in the business (prior to the acquisition) coming out of the February result. Both EM and DM industrial production is accelerating which should deliver stronger top-line performance for ANN's Industrial division. De-stocking in Life Sciences and Surgical should also ease over the coming months which bodes well for ANN's Healthcare division.

Chorus (CNU) – The portfolio initiated a position in CNU during the period. Through its ownership of New Zealand's largest fibre broadband network, CNU offers attractive regulated utility type exposure to investors. We believe CNU's current 7.0% FY25 dividend yield under appreciates the growth potential through the upcoming regulatory period and long term distribution sustainability.

NEXTDC (NXT) – The portfolio added to its position in leading Australian data centre owner and developer NXT during the period following an equity raising to support funding for its development pipeline. The company has the unique combination of a structural long term earnings growth profile combined with infrastructure like characteristics, solid returns on capital and is backed by a tangible asset base.

**Key Sales**

Sandfire Resources (SFR) – We elected to trim some of our overweight position in copper producer Sandfire following a period of share price outperformance. We remain overweight and continue to favour SFR as the best exposure to copper on the ASX, a commodity we like given declining supply and its leverage to electrification as a key material in batteries and electric motors. We believe the recent rally in copper prices to >US$4.50/lb is sustainable given improving demand, low inventories, and disappointing mine production globally.

**Key Active Overweights**

NEXTDC (NXT) – the portfolio maintains an overweight position in the leading Australian data centre owner and developer, NXT. The company has a unique combination of a 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 is backed by a tangible asset base.

CAR Group (CAR) – we are overweight the online vehicle classifieds company which has strong growth potential across Australia (42% revenue), Trader Interactive (25% revenue), and Webmotors (16% revenue). CAR Group has materially stepped up investment into product development recently which should permit for further yield growth across all geographies. In Australia, CAR's market position has strengthened in the private segment, in particular. The offshore businesses are less mature and have further runway for growth as key learnings (dynamic pricing) from the Australian business are applied offshore. The visibility on CAR's medium term revenue growth has improved, meaning the 33.4-times FY25 earnings trading multiple is relatively undemanding given these tailwinds.

Reliance Worldwide (RWC) – we view the plumbing supplies company as a compelling cyclical industrial opportunity, with cyclical upside as end-markets recover over the periods ahead and an improved, higher value product mix rolls out. We believe the current valuation doesn't give appropriate credit to the mid-cycle earnings power of the group considering the resilience of its end markets, the majority of which relates to more non-discretionary, repair type housing activity.

**Key Active Underweights**

WiseTech Global (WTC) – we remain underweight the leading developer of software solutions for the logistics industry with a preference for other names in the technology sector given WTC's demanding valuation of 84.6-times FY24 forward P/E. We believe WTC have and are continuing to build an exceptional product in CargoWise which should continue to attract and retain large freight forwarders.

REA Group (REA) – we hold an underweight position in Australia's largest online residential real estate platform business, and instead gain indirect exposure to the online real estate segment via Domain Holdings (DHG) through the portfolio's position in Nine Entertainment (NEC) (which owns 60% of DHG). REA trades on a multiple of 44.2-times FY24 P/E and we see superior risk adjusted returns in other high-growth online businesses such as Carsales.com (CAR) which trades on 33.4-times FY24 P/E.

Ampol (ALD) – we retain an underweight position in ALD, reflecting our view that F&I and Lytton are overearning vs long-run averages while Future Energy remains a drag. While ALD appear to be navigating the structural issues in Convenience (tobacco, declining fuel volumes), the long-term nature of the format remains uncertain even amid a long-dated energy transition with limited impact to date. With the company trading on a FY25 earnings multiple of 12.2-times and a 6.2% dividend yield we believe better opportunities can be found elsewhere.

## Market outlook

Global equity markets have clearly had a very strong six months into the conclusion of the March quarter, retuning 14%. Yet the month of April saw a major reappraisal of risk, with Australian equities declining 3% in the month, in part prompted by geo-political events and in part some evidence that inflation in the US in Q1 printed higher than expected which led a sharp reduction in the number of interest rate reductions expected by financial markets in 2024.

As we enter May the flashpoint of conflict in Gaza that threatened to spill over into a much larger regional conflict appears to have eased somewhat, and the prospect of a ceasefire has risen modestly.

In a similar vein, after the stronger inflation data in Q1 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 Personal Consumption Expenditures Price Index 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.

As such, some of the equity market declines in April have been reversed in early May and we continue to expect the combination of better news on global economic activity to be met with moderation in inflationary pressures to provide a positive backdrop for equity markets.

Turning to Australia's prospects, despite a weak finish for economic growth in 2023 – expanding just 0.2% qoq and 1.5% yoy – we continue to suggest that not only will Australia avoid a recession it will likely accelerate sequentially through 2024 with the improving global backdrop acting as a tailwind. No one should be disputing that 2023 likely felt like a recession for many Australians. A per capita recession and a negative income shock for those with high debt and young families has cascaded into weak discretionary spending as high interest rates coalesced with surging insurance, utilities, rates, education and food prices. Indeed, 1Q2024 has continued to be a subdued operating environment with retail sales, building approvals consumer confidence and housing finance all printing below market expectations. With the employment data remaining robust the RBA is caught between a relatively weak economy and persistent wage growth and consumer inflation.

Australia 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 that the RBA will commence a modest easing cycle for interest rates in 4Q 2024.

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

As a consequence, we are relatively optimistic on the outlook for the Australian economy and constructive on the equity market outlook for 2024. We expect economic growth to average 2.0% v a consensus forecast of 1.4%, bond yields to finish the year at 4.5%, the $A/$US to reach 72c, and Australian equities to return 10% in in large caps and 15% in small caps.

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

## Sector allocation

| | Portfolio % | Benchmark % | Active % |
|---|---|---|---|
| Communication Services | 10.62 | 6.41 | 4.21 |
| Consumer Discretionary | 8.31 | 10.92 | -2.61 |
| Consumer Staples | 0.53 | 2.78 | -2.25 |
| Energy | 0.00 | 6.63 | -6.63 |
| Financials | 14.02 | 12.28 | 1.74 |
| Health Care | 7.82 | 5.63 | 2.19 |
| Industrials | 14.19 | 13.54 | 0.65 |
| Information Technology | 10.14 | 10.34 | -0.20 |
| Materials | 21.06 | 21.09 | -0.04 |
| Real Estate | 12.71 | 9.37 | 3.33 |
| Utilities | 0.00 | 1.00 | -1.00 |

## Top 5 holdings

| | Portfolio % | Benchmark % | Active % |
|---|---|---|---|
| NEXTDC | 6.39 | 1.75 | 4.65 |
| CAR Group | 6.39 | 2.22 | 4.17 |
| Evolution Mining | 4.93 | 1.40 | 3.53 |
| Reliance Worldwide | 4.77 | 0.71 | 4.06 |
| Worley | 4.73 | 0.97 | 3.76 |

## Key active positions

| Overweights | Portfolio % | Benchmark % | Active % |
|---|---|---|---|
| NEXTDC | 6.39 | 1.75 | 4.65 |
| CAR Group | 6.39 | 2.22 | 4.17 |
| Reliance Worldwide | 4.77 | 0.71 | 4.06 |
| **Underweights** | | | |
| WiseTech Global | 0.00 | 2.96 | -2.96 |
| REA Group | 0.00 | 1.61 | -1.61 |
| Ampol | 0.00 | 1.53 | -1.53 |

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 | -1.53 | -2.28 | 2.85 | 4.95 |
| Distribution return | 6.17 | 7.23 | 5.14 | 3.63 |

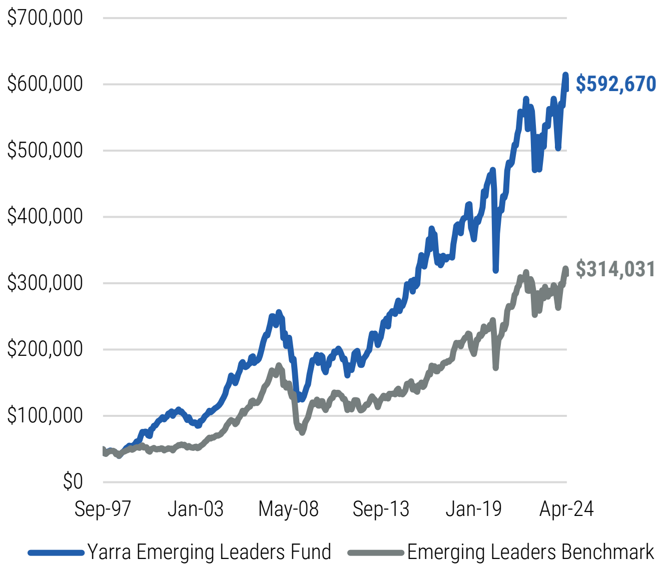
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders by way of income distribution in a 12-month period. It does not include capital distributions.

## Features

| | | |
|---|---|---|
| Investment objective | To achieve medium-to-long term capital growth through exposure to small and medium sized Australian companies that are considered to possess strong capital growth potential. In doing so, the aim is to outperform the benchmark over rolling 3-year periods. | |
| Recommended investment time frame | 5 - 7 + years | |
| Fund inception | September 1997 | |
| Fund size | A$93.2 mn as at 30 April 2024 | |
| APIR codes | JBW0010AU | |
| Estimated management cost | 1.25% p.a. | |
| Buy/sell spread | +/- 0.20% | |
| Platform availability | Asgard<br>Ausmaq<br>BT Panorama<br>BT SuperWrap<br>Financial Index | Hub24<br>Macquarie Wrap<br>Mason Stevens<br>MLC Wrap<br>OneVue |

## Investment performance comparison of $50,000

After fees, since inception of the Yarra Emerging Leaders Fund, September 1997 to April 2024.




For illustrative purposes only. Past performance does not guarantee future results, which may vary. The total net fund returns shown are prepared on an exit to exit basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the benchmark (comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index) is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.

## Applications and contacts

Investment into the Yarra Emerging Leaders Fund can be made by Australian resident investors only.

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