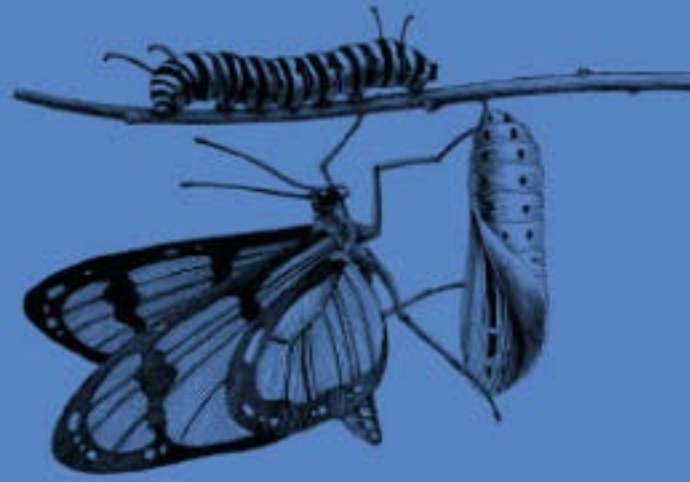


IT PAYS TO BE SMALL MINDED



Weak equity markets, falling interest rates, small cap stocks outperforming: these were just a few of the predictions from market watchers which proved wide of the mark in 2024. Add that to geopolitical uncertainty and the ability to reliably predict trends, and it is clear that investing in 2025 is clearly a high-risk game. Against that backdrop, we continue to focus on what we do know. Central to that is continuing to invest for the long term in companies with durable business models, cash flow generation and the ability to withstand uncertain times.

By Michael Steele, Co-Portfolio Manager, Small Caps



The ingredients for small cap outperformance are in place

While the Australian Small Cap sector (ex-ASX 100) had a year of solid absolute returns in 2024 the asset class recorded its third year in a row of underperforming the Large Cap sector (ASX 100), thanks to share price strength in the banking sector and strong momentum in high growth, high multiple industrials.

Looking forward, the pre-conditions for small cap outperformance are in place: a backdrop of falling interest rates (which tends to be supportive of small cap outperformance), with more compelling earnings growth and better relative valuation support.

Chart 1 – ASX 100 vs. Small Ords Total Return



Source: Bloomberg, Yarra Capital Management.

We are hunting market share winners

Within the small cap sector, we continue to be attracted to market share winners. Growing through product innovation, market and geographic expansion or through acquisition, these companies have the ability to take market share and grow faster than underlying economic growth.

We have found these companies in funds management, platforms, insurance broking, technology, infrastructure and even agricultural products such as olive oil.

Global shifts will be important to watch, even for small caps

In the aftermath of COVID, companies began actively diversifying their supply chains. Post the US election a new trend – “near-shoring” – is emerging. Companies are seeking to get closer to their customer base and shifting supply arrangements to ensure they are not locked (or priced) out of markets.

This trend has far-reaching implications for manufacturing, transport providers and supply chains as trade flows react to this shift. The value of incumbency in the US market is likely to increase with trade barriers, making it more challenging to compete.

We have a number of companies (such as Breville) in our portfolio with strong existing businesses in the US. For those companies who have successfully navigated the supply chain shifts there is a meaningful opportunity to win further market share.

The attraction of long duration assets in a falling interest rate environment

With a strong inverse correlation to interest rate movements, due to the value of long duration cashflows, the appeal of long duration assets is likely to improve as local rates fall in 2025.

Infrastructure companies like airports (such as Auckland Airport) with an ability to deploy capital at high rates of return and property asset owners (in particular, select industrial and retail assets) will see their cashflows revalued. These companies can be highly attractive, able to grow and compound earnings growth over time.

Momentum is important short term; cash flows and valuation should matter long term

Momentum, particularly revenue momentum, has been the key driver of equity performance in 2024. While revenue momentum is important, we also think about the durability of revenues, the ability to scale businesses to deliver attractive margins and free cash flow generation. We continue to invest against long-term timeframes and expect cashflows and valuations to be the key drivers of performance for the period ahead.



Contact us

Call : +61 2 8072 6300
Email : sales.au@yarracm.com
Level 19, 101 Collins Street
Melbourne VIC 3000



Revenue momentum has been the key driver of equity performance in 2024.

Yarra Funds Management Limited (ABN 63 005 885 567, AFSL 230 251) (‘YFM’) is the issuer and responsible entity of a range of registered managed investment schemes, which includes those named in this document (‘Funds’). YFM is not licensed to provide personal financial product advice to retail clients. The information provided contains general financial product advice only. The advice has been prepared without taking into account your personal objectives, financial situation or particular needs. Therefore, before acting on any advice, you should consider the appropriateness of the advice in light of your own or your client’s objectives, financial situation or needs. Prior to investing in any of the Funds, you should obtain and consider the product disclosure statement (‘PDS’) and target market determination (‘TMD’) for the relevant Fund by contacting our Investor Services team on 1800 034 494 or from our website at www.yarracm.com/pdsupdates/. The information set out has been prepared in good faith and while Yarra Funds Management Limited and its related bodies corporate (together, the “Yarra Capital Management Group”)

reasonably believe the information and opinions to be current, accurate, or reasonably held at the time of publication, to the maximum extent permitted by law, the Yarra Capital Management Group: (a) makes no warranty as to the content's accuracy or reliability; and (b) accepts no liability for any direct or indirect loss or damage arising from any errors, omissions, or information that is not up to date. No part of this material may, without the Yarra Capital Management Group's prior written consent be copied, photocopied, duplicated, adapted, linked to or used to create derivative works in any form by any means.

YFM manages the Fund and will receive fees as set out in the PDS. To the extent that any content set out in this document discusses market activity, macroeconomic views, industry or sector trends, such statements should be construed as general advice only. Any references to specific securities are not intended to be a recommendation to buy, sell, or hold such securities. Past performance is not an indication of, and does not guarantee, future performance. Information about the Fund, including the relevant PDS, should not be construed as an offer to any jurisdiction other than in Australia. With the exception of some Funds that may be offered in New Zealand from time to time (as disclosed in the relevant PDS), we will not accept applications from any person who is not resident in Australia or New Zealand. The Fund is not intended to be sold to any US Persons as defined in Regulation S of the US federal securities laws and has not been registered under the U.S. Securities Act of 1933, as amended.

References to indices, benchmarks or other measures of relative market performance over a specified period of time are provided for your information only and do not imply that the portfolio will achieve similar results. Holdings may change by the time you receive this report. Future portfolio holdings may not be profitable. The information should not be deemed representative of future characteristics for the strategy. There can be no assurance that any targets stated in this document can be achieved. Please be advised that any targets shown are subject to change at any time and are current as of the date of this document only. Targets are objectives and should not be construed as providing any assurance or guarantee as to the results that may be realized in the future from investments in any asset or asset class described herein. If any of the assumptions used do not prove to be true, results may vary substantially. These targets are being shown for informational purposes only.

© Yarra Capital Management, 2024.