

# Altius Sustainable Bond Fund

## Fund Update 31 October 2020

Altius Asset Management employs a diversified strategy to fixed interest funds management that aims to take advantage of the mispricing of bonds in all market conditions. The Altius Sustainable Bond Fund is an Australian fixed interest fund that invests in companies which conduct their business and apply capital responsibly, giving full consideration to a range of environmental, social and governance (ESG) issues.

### Performance as at 31 October 2020

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Since inception % p.a.
Total return	0.25	0.67	1.81	2.37	2.60	2.82
Benchmark	0.15	0.50	2.22	3.36	2.91	3.12
Excess to benchmark	0.10	0.17	(0.41)	(0.99)	(0.31)	(0.30)

Inception date for performance calculations is 21 November 2014.

Total returns are calculated after fees and expenses and assume the reinvestment of distributions. Past performance is not a reliable indicator of future performance. Effective 1 July 2016, Benchmark is 50% Reserve Bank of Australia Cash Rate and 50% Bloomberg AusBond Composite 0+Yr Index and applied retrospectively for all periods. Excess to benchmark is calculated on Total return.

### Portfolio Performance and Activity

Front end yields fell over the course of the month with 3-year bonds touching a low of 0.09%. The increased talk of the Reserve Bank of Australia (RBA) introducing a quantitative easing (QE) program was the key driver of this move. 10-year yields initially followed the move lower with the yield curve flattening to 56.5bpts, its lowest level in months. 10-year yields were unable to hold onto their gains, finishing 0.04bpts higher at 0.83%. While Australian 10-year yields rose over the month they outperformed those in the US with the spread differential going negative during the month before closing out the month at zero. Over the month we progressively added around 1.25 years of duration to our fund to finish the month at 5.24 years

A speech by RBA Governor Dr Philip Lowe presented at the Citi Australian/NZ investment conference in mid-October gave a very clear signal that the RBA would deliver additional policy response at their November meeting. In particular the Governor provided a strong indication that a traditional bond buying (QE) program could be introduced. This was subsequently delivered upon, including additional policy changes at their November meeting.

US yields moved higher over the month as risk sentiment improved supported by expectation of a US Fiscal stimulus agreement and a Biden Presidential win. Lack of progress on the fiscal front resulted in bond volatility through the month. Markets ignored equity weakness and rising Northern Hemisphere COVID-19 cases which heightened concerns that lockdowns would delay the global recovery with US 10-year treasury yields finishing 0.19% higher over the month at 0.875%, a level not seen since March.

Australian credit markets continued to perform well in October with spreads compressing between 10-15bpts depending on the sector. The RBA's Term Funding Facility (TFF) has meant local banks issuance has largely stopped resulting in a supply/demand imbalance which has seen a strong compression of spreads. This lack of bank supply has created slipover effects into the broader

credit markets as investors look for alternative investment grade options. A few sectors, including REIT's, airports, universities, auto and airline continue to trade wide relative to pre-COVID-19 levels, but should see continued improvement with the opening of Victoria. To date the market has seen \$40bn of issuance, down 30% on last year, driven by the large decline in major bank issuance. The fund continued to hold a large weighting in Green (31%) and Social linked bonds (10%), with Corporate holdings largely unchanged over the month. Primary investments were made in the inaugural Lendlease 7-year green bond (see sustainability in focus) at a spread of 3% and the NSWTC 2030 green bond, their third transaction since they commenced issuing green and sustainable bonds.

### Socially Responsible Investments in Focus

Banks are increasingly targeting net zero financed emissions with both HSBC and JPMorgan announcing they will work toward net zero emissions by 2050. HSBC has committed to reach net zero emissions across its supply chain and operations by 2030, before reaching net zero across its customer portfolio 20 years later by 2050. The bank will increasingly prioritise financing and investment that contributes to the low carbon transition and will apply a climate lens to financing decisions. HSBC's pledge follows similar moves by Barclays and Lloyds. JPMorgan has been under increasing pressure from environmental activists to divest from the fossil fuel industry. The bank's net zero pledge has also come under fire with the Rainforest Action Network saying the bank's new policy is a welcome step forward but falls short and that if they are serious about aligning with the Paris Agreement, they must immediately stop financing expansion of fossil fuels and deforestation.

There were two new green bond issuances in the domestic market, Lend Lease raised \$500m in a debut green bond and NSW government also issued a \$1.3bn green bond. NSW was able to issue their new bond against the existing pool of eligible assets which focuses heavily on low carbon transportation with the key project

being Sydney Metro Northwest. The issue saw very strong investor demand with the bond being 4 times oversubscribed. Lendlease green bond proceeds will focus on the finance and refinance of existing buildings and development, with all buildings holding or designed to hold high industry certification levels. While the program didn't include a second party opinion (committed to post transaction launch) or detail how the proceeds would be allocated between projects, we gain comfort that with the Groups overall sustainable strategy that commits to be a 1.5 degree aligned company including absolute zero scope 1, 2 and 3 emission by 2040. Lend Lease's deal also received strong support with the deal being 2 times oversubscribed.

Australia's key trading partners, China, Japan and South Korea have announced net zero ambitions. Japan and South Korea have announced they will cut emissions to net zero by 2050, and the Philippines have declared a moratorium on new coal fired power plants. Last month, China promised to aim for carbon neutrality by 2060. It is a shift away from coal in three of Australia's four biggest export markets. Every Australian state and territory has set a 2050 net zero target with public opinion swinging in favour of a national target to match. If climate change is not addressed, Australia will lose more than \$3 trillion and 880,000 jobs over the next 50 years, according to a new report by Deloitte Access Economics.

## Outlook

The risk of wider economic "lockdown" due to the surge in northern hemisphere COVID-19 infections, is significant and growing. More fiscal and monetary policy measures are needed. With cash rates at or near their lower bound, most major economies continue to increase or adjust their bond purchase programs.

The RBA has commenced its weekly purchases of \$5 billion worth of five to 10-year Government and Semi Government bonds. This is added to the bonds its was already purchasing to target the 3-year government bonds at 0.1%.

Australia's relative success in COVID-19 constraint will likely lift economic activity more quickly than other nations. This, combined with China's demand for Australia's iron ore, places upward pressure on the Australian dollar. Tighter financial conditions from a higher currency will increase pressure on the RBA to ease policy to maintain their goal of low bond yields.

There are three key strategies being employed currently to take advantage of the current backdrop.

First, the spillover effect of many major markets with negative bond yields drives investor demand to seek income in higher yielding bond markets, such as Australia and the US. Additionally, the RBA's announced long dated bond purchases are designed to add to demand and drive yields lower. Our overweight in these securities is designed to achieve the consequent capital gains.

Second, Commonwealth Government bond curves are attractively steep, but state government and corporate curves are even more attractive. Gains are also achieved through being overweight bonds with maturities that fall in yield most swiftly toward the 0.1% 3-year rate, which the RBA has anchored at the same yield as cash.

Government bond issuance is large and lumpy. Central Bank buying is rather more persistent. The timing mismatch provide opportunities to take advantage of the relatively confined range in long dated securities; selling when bond prices have been driven higher, due to the spillover effects of "Global QE", and buying when bond prices have weakened due to large issuance lumps.

## Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	7.89	28.32
Semi-Government	23.17	12.63
Supranationals	8.11	5.02
Industrials	11.20	2.22
Financials	28.59	1.64
Asset Backed	9.38	0.00
Agencies	9.40	0.17
11am	1.01	0.00
Cash at Bank	1.25	0.00
RBA Cash	0.00	50.00

## Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	56.65	38.89
AA+ to AA-	19.27	8.53
A+ to A-	11.07	1.58
BBB+ to BBB-	13.01	1.00
RBA Cash	0.00	50.00

## Top 20 Issuers

Issuer	Portfolio %	Benchmark %
New South Wales Treasury Crp	12.99	2.97
Nationl Housing Fin Invt	9.19	0.05
Australian Government	7.92	27.72
Treasury Corp Victoria	5.90	2.35
Queensland Treasury Corp	3.60	3.58
Commonwealth Bank Aust	3.01	0.15
National Australia Bank	2.42	0.20
ANZ Banking Group	2.34	0.19
Bank Of Montreal	2.10	0.04
Royal Bank Of Canada (Sydney)	1.87	0.01
Kommunalbanken AS	1.82	0.29
Inter-American Development Bank	1.70	0.35
Asian Development Bank	1.54	0.37
Teachers Mutual Bank Ltd	1.52	0.00
Westpac Banking Corp	1.44	0.17
UBS AG Australia	1.38	0.03
European Investment Bank	1.29	0.42
Heritage Bank Ltd	1.27	0.00
Bank Of Queensland Ltd	1.26	0.01
National RMBS Trust 2018-1	1.23	0.00

### Portfolio Summary Statistics

	Portfolio	Benchmark
Running yield (%)	0.83	0.36
Modified duration (years)	5.26	3.03

### Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$217.90m
Management fee*	0.57% p.a.
Buy/Sell spread	0.00%/0.15%
Advice fee	Available

\*Refer to the Fund's Product Disclosure Statement for more details on the Fund's management costs which also include recoverable expenses and indirect costs. Total management costs may vary.

### RIAA - Certified Responsible Investment

The Altius Sustainable Bond Fund has been certified by RIAA. According to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See [www.responsibleinvestment.org](http://www.responsibleinvestment.org) for details.



### Ratings / Awards



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The Altius Sustainable Bond Fund won the Lonsec Innovation Award 2016, which recognises the major innovators and industry leaders who are shaping the future of Australia's wealth creation sector. The Lonsec Awards go beyond the pure quantitative, looking at the people behind the investment decisions, the rigour of the investment process and philosophy, and the new thought and innovations that create real value for investors.

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