

# Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

## Monthly Performance Report October 2022

Performance <sup>1</sup>	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	1.23	3.73	2.90	1.02	2.57	3.89	3.75
Benchmark <sup>2</sup>	0.13	1.34	6.93	5.04	3.59	2.87	2.41
Excess Return	1.10	2.39	-4.03	-4.02	-1.02	1.03	1.35

<sup>1</sup> Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of future performance.

<sup>2</sup> The Fund benchmark is the Australian Consumer Price Index.

Source: Fidante Partners Limited, 31 October 2022.

### Fund Features

**Unique 'relative value' investment strategy:** The Fund adopts a relative value investment strategy to access a range of fixed income return sources that are independent of interest rates.

**Tight risk control:** The Fund specifically targets low volatility returns by using a range of risk management strategies.

**Diversification benefits:** The Fund offers significant diversification benefits when combined with conventional bond, credit and equity investments in an investment portfolio.

**Capital preservation:** The Fund prioritises capital preservation by only investing in high quality government bonds, related derivatives and cash like investments. However, the Fund is not guaranteed.

**Protect long term purchasing power:** The Fund explicitly targets a return exceeding Australian inflation rates to protect long term purchasing power.

**Daily liquidity:** The Fund only invests in the most liquid segments of global fixed income markets.

**Experienced and stable investment team:** Ardea's investment team has decades of experience across global fixed income markets. Majority employee ownership of the Ardea business fosters team stability.

### Fund Facts

<b>Portfolio Manager</b>	Ardea Investment Management
<b>Investment Objective</b>	The Fund targets low volatility returns exceeding cash rates and inflation, by investing in a global portfolio of high quality government bonds that prioritises capital preservation and liquidity.
<b>Investment Horizon</b>	Recommended min. 2 years
<b>Inception Date</b>	20 July 2012
<b>Fund Size</b>	\$8.7bn
<b>Management Fee</b>	0.50% p.a.
<b>Buy/Sell Spread</b>	+0.05% / -0.05%
<b>Distribution Frequency</b>	Quarterly

Sector Exposure		Rating Exposure		Risk Contribution by Currency	
<b>Government – National</b>	75%	<b>AAA</b>	49%	<b>AUD</b>	31%
<b>Government - State</b>	25%	<b>AA</b>	46%	<b>CAD</b>	17%
<b>Total</b>	100%	<b>A</b>	5%	<b>EUR</b>	17%
		<b>Total</b>	100%	<b>JPY</b>	1%
				<b>NZD</b>	1%
				<b>GBP</b>	6%
				<b>USD</b>	28%
				<b>Total</b>	100%

Source: Ardea Investment Management, S&P Ratings

## Portfolio Commentary

Performance for the month of October was +1.23% (after fees).

The market backdrop in October was one of continued underperformance in global fixed income. However, risk sentiment improved amid hopes central banks may soon pivot away from aggressive policy tightening, alongside falls in key European energy prices and a stabilisation in the UK market following a change of government. Equities bounced strongly but didn't fully recover the steep losses from September.

Global rates market hopes for a central bank pivot were supported early in the month by the RBA increasing the cash rate by only 25bp, later in the month by a more circumspect outlook from the BoC and media speculation of a change in Fed policy trajectory. However, these signals were broadly offset by US, UK and Euro Area inflation rates hitting new highs, the Fed and ECB still delivering 75bp hikes and talking up their inflation-fighting resolve. Consequently, for global fixed income markets, hopes of a policy pivot failed to translate into improved returns for most conventional long-only portfolios. The global aggregate and global government indices still finished the month in the red, leaving year-to-date losses in excess of 20%. Australian fixed income was a notable exception in delivering positive monthly returns at the index level following a moderation in the RBA's hawkish policy stance. Bond yields touched new highs for the cycle and in the case of the US 2y yield, a new high since 2007. However, October also saw some consolidation near these levels, marking a slowing in the pace of the broader trend higher in yield.

Ongoing high macro uncertainty saw USD and EUR volatility remain elevated, while GBP volatility declined sharply from the extreme highs of late September. The Fund's option (+0.2%) positions – held to capture RV and balance portfolio risk – still made a positive contribution.

Many relative value pricing relationships continue to experience heightened volatility, which gives rise to new opportunities for the Fund and impacts risk management of existing positions. We outline a few key themes impacting the bond vs derivative and curve risk factors shown in our attribution summary.

Bond vs derivative (+0.3%) gains were spread across multiple markets. For example, the Fund benefited from spreads between interest rate swaps and Australian government bonds, which widened sharply over the month. There are many influences on these spreads. Some of the recent moves are driven by temporary liquidity and positioning conditions, but the broader trend reflects supply/demand developments in bonds and a shift in the balance of swap flows. Relative bond performance has been supported by the still high stock of RBA bond holdings and falling issuance expectations. In swaps, there has been an imbalance of flows. Demand for receiving has eased relative to increased paying flow from investors hedging the duration risk of bond holdings and borrowers hedging against rising rates. The Fund's exposure to swap-bond spread risk is optimised to capture micro relative value differences between respective curves.

RV curve (+0.2%) exposures reflect a large number of underlying long and short positions across global interest rate markets. While RV trades target constrained shifts in curves, over short periods of time broader curve shape movements can influence the aggregate performance of these positions. For example, in October curve steepening exposures added value in the AUD market between 10y and 30y and in the USD market between 4y and 7y forward rates.

The inflation beta (+0.4%) positions – implemented in the AUD market – were also a driver of performance in October. This beta exposure rebounded from a large detraction in September, which stemmed from an aggressive global policy tightening outlook and negative risk sentiment. Market Inflation expectations abruptly reversed higher in October, as global markets reacted to higher realised inflation data. Locally, the Q3 CPI data (released in October) exceeded consensus expectations, taking headline inflation to the highest level since 1990 and contributing further to the outperformance of inflation beta positions. The AUD inflation curve – as with other markets – remains steeply inverted as the 30-year high in realised CPI is not expected to be sustained beyond the very near term.

## Market Commentary

Please see the Insights section of the [Ardea website](#) for our latest thoughts on markets and investment themes.

## Understanding Performance

Performance is evaluated over rolling 2 year periods for consistency with the recommended minimum investment horizon of 2 years. Over short-term horizons it is expected that portfolio performance will fluctuate in a range around the expected long-term investment outcome, including periods of negative returns. This is because the Fund's targeted return is not expected to materialise evenly over the investment horizon.

We use the concept of 'expected performance variability' to objectively define a range of short-term performance fluctuation that is consistent with the investment strategy operating as expected. This range is based on the Fund's volatility target of 2% p.a. and translates to an expectation for monthly performance to commonly fluctuate in a range of -0.4% to +0.7%.

The Fund's highly differentiated investment approach generates returns exclusively from capturing RV mispricing opportunities across global interest rate markets. This approach is intentionally independent of the level of bond yields, the direction of interest rates and broader bond market themes.

The Fund's portfolio construction process intentionally diversifies risk across many different types of independent and modestly sized RV trades. Therefore, performance is the cumulative result of interactions between hundreds of trades entered, exited, and held over the preceding months.

For these reasons, the Fund's performance is ordinarily not driven by a few key trades, nor can it be mapped to broader market fluctuations or macro themes. This is intentional, because the Fund aims to deliver volatility controlled returns that exhibit low correlation to the performance of government bond, credit, and equity markets. This is precisely why the Fund can offer compelling diversification benefits when combined with conventional investments.

Please note that monthly performance attribution is heavily influenced by short-term 'noise' and ordinarily offers little genuine information value.

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