

# Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

## Monthly Performance Report August 2023

Performance <sup>1</sup>	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	0.46	1.49	5.64	2.09	1.89	3.99	3.69
Benchmark <sup>2</sup>	0.37	1.25	5.77	6.33	5.31	3.56	2.67
Excess Return	0.09	0.25	-0.13	-4.25	-3.42	0.43	1.02

<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 August 2023.

### 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>	\$6.6bn
<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>	61%	<b>AAA</b>	60%	<b>AUD</b>	27%
<b>Government - State</b>	39%	<b>AA</b>	35%	<b>CAD</b>	5%
<b>Total</b>	100%	<b>A</b>	4%	<b>EUR</b>	16%
		<b>Total</b>	100%	<b>JPY</b>	1%
				<b>NZD</b>	0%
				<b>GBP</b>	14%
				<b>USD</b>	37%
				<b>Total</b>	100%

Source: Ardea Investment Management, S&P Ratings

## Portfolio Commentary

Fund performance for the month of August was +0.5% (after fees).

The Fund's relative value (RV) strategies delivered positive returns, with positions in bonds versus derivatives, particularly in the US market, and options positions in the EUR market where volatility increased contributing to returns. The performance outcome is within the expected monthly performance range for the Fund's 2% volatility target and the Fund continues to deliver on its role as a long-term strategic portfolio defensive risk diversifier with low correlation to both the fixed income and equity market performance. From a total return perspective performance is also benefitting from the higher cash rates which is at a 10-year high. Performance attribution summarises returns into key risk factors: RV micro curve, capturing performance related to interest rate curve movements; Bond versus derivative, reflecting risk factors tied to government bond pricing versus interest rate derivatives; and RV option positions, utilised for both RV and portfolio risk management through long volatility exposures.

Bond yields in core markets continue to move higher reaching decade plus highs, while equity markets declined. In the US, 30-year government bond yields hit a 15-year high, and 2-year and 5-year note auctions saw yields at pre-financial crisis levels. The UK experienced a similar trend, with 2-year and 10-year yields also reaching 15-year highs, in part reflecting market expectations of further interest rate hikes. In Australia, the yield to maturity on the Ausbond composite bond index reached levels not seen since 2012, peaking at 4.4% mid-month. Factors contributing to higher yields include increasing government and corporate bond supply, sticky core inflation, resilient economic growth, and a shift in Japanese investor preferences towards domestic bonds due to the relaxation of yield curve controls in Japan. This has made the buying of domestic bonds more attractive to Japanese investors and resulted in funds being repatriated back to Japan (e.g., selling UST buying JGBs). This is creating a large opportunity set for the Fund to invest in from the RV perspective.

The theme from most central banks is a similar one – allow more time to pass to determine the impacts on economies of the significant rate rises already delivered.

Elevated inflation remains a concern, and the possibility of further rate hikes cannot be ruled out. It was a quiet month for central bank meetings with the Bank of England the only major central bank to tighten rates. The outlook for the Chinese economy remains uncertain due to ongoing stress in the property market.

In Australia, inflation and wage data will likely be the key economic releases closely watched with the cash rate expected to remain high for some time as inflation is only expected to back at top of the target band by the end of 2025. The RBA left rates unchanged at its August and early September meetings. The market is pricing a relatively steady cash rate for the next 12 months.

We anticipate higher volatility levels due to unanchored interest rate curves, which are no longer constrained by zero rates or quantitative easing. Central banks, previously suppressors of volatility, now contribute to its amplification through quantitative tightening. Increased government bond issuance, particularly in Europe and the UK, adds to price volatility. Under this regime fixed interest is likely to have a more variable correlation to equities with the composition of fixed interest allocations becoming important. In this environment, we expect fertile relative value (RV) opportunities, with Bond RV in Europe and the UK showing promise. Micro curve positions across various markets are also positive as yield curve shapes adjust and flows create anomalies. The Fund's structurally long volatility positions with the favourable asymmetric payoff profile should also provide significant upside potential against modest downside risk in this environment.

## 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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