

# Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

## Monthly Performance Report December 2022

Performance <sup>1</sup>	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	0.47	-0.20	0.96	0.18	2.02	3.52	3.55
Benchmark <sup>2</sup>	0.53	1.30	7.23	5.35	3.83	3.02	2.48
Excess Return	-0.06	-1.50	-6.27	-5.17	-1.81	0.50	1.07

<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 December 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>	\$8.3bn
<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>	68%	<b>AAA</b>	60%	<b>AUD</b>	45%
<b>Government - State</b>	32%	<b>AA</b>	35%	<b>CAD</b>	15%
<b>Total</b>	100%	<b>A</b>	5%	<b>EUR</b>	14%
		<b>Total</b>	100%	<b>JPY</b>	1%
				<b>NZD</b>	1%
				<b>GBP</b>	7%
				<b>USD</b>	17%
				<b>Total</b>	100%

Source: Ardea Investment Management, S&P Ratings

## Portfolio Commentary

Performance for the month of December was +0.47% (after fees).

December was a challenging month to end one of the toughest years on record for markets. Equities fell and bond yields lifted sharply as central banks continued to tighten policy to fight high inflation. While the incremental pace of rate hikes slowed relative to prior months – 50bp hikes for large developed markets and 25bp for the RBA – central bank commentary and forecasts (especially from the ECB) still pointed to significantly tighter policy in 2023. European, UK and Australian markets underperformed US Treasuries.

The bond sell-off gathered momentum after the BoJ surprised markets by widening their target range for 10y JGB yield moves from 0.25% to 0.5%. While the BoJ cited operational reasons for the change, markets are speculating about further policy shifts. Also, the higher upper band for the target further disincentivises offshore sovereign bond allocations from Japanese investors in an environment where FX-hedge costs are already prohibitively high.

The Fund is positioned to target relative value opportunities across global interest rate markets, while minimising exposure to duration (for a discussion on key rates market themes and the implications for RV, see our [2023 key themes](#) note). Since there are a large number of small sized trades in the portfolio, we summarise our performance attribution with reference to broad risk factor exposures. Over the month, exposure to RV yield curve and option risk factors were flat to positive contributors, while bond vs derivative exposures were a detraction.

RV curve (+0.5%) gains were spread across markets. For example, within the EUR market, the Fund benefited from a net flattening exposure in less than 10y maturities, which offset a detraction from net steepening exposure between 10y and 20y. In GBP, a net steepening exposure between 3y and 7y added to performance. The net curve positions in EUR, GBP and other markets reflect a wider range of underlying RV trades with varying rationales. Given the diversification of curve risk across markets and sectors of yield curves, over short periods of time it is normal for some positions to add value and others to detract.

Options exposures were flat in the month. After the historically large correction lower in November, movements in implied volatility were more stable in December. Movements in the very short end of the curve are more restrained than earlier in 2022, as markets perceive the peak in policy rates to be nearer and the pace of future tightening to be more measured. From a longer-term perspective, the level of implied volatility across global rates markets is still elevated. Markets are contending with significant two-sided tail risks of a prolonged higher rates cycle and the possibility of a deep enough recession to prompt a quicker move to rate cuts. In choosing the size, expiry and underlying tenor of option positions, we consider the risk balance offered by options for other RV positions, as well as the RV analysis within option markets.

Bond vs derivative (-0.1%) exposures detracted from performance overall. The AUD, USD and GBP positions offset gains in EUR and JPY markets. For example, in the AUD market, long positions in government bonds in the 5y and 15y parts of the curve relative to short positions in interest rate swaps detracted. Movements in these spreads reflect a range of supply/demand dynamics in bonds and temporary flows within the swap market. The Fund actually benefited from a small exposure in the JPY market, driven by moves in cross-currency basis spreads. Movements in these spreads mostly reflect actual and anticipated hedging activity. In December, the market anticipated less offshore bond asset hedging from Japanese investors following the BoJ policy shift (as described above).

AUD inflation beta (-0.1%) exposures were a modest detractor in December. The Fund is structurally long across the inflation curve and does not seek to position based on macro views. Over the month, losses from shorter term inflation positions slightly offset gains from longer term positions, as the inflation curve steepened. There was no official Australian CPI data in the month (Q4 data is released in January), but markets speculated that inflation over the next few years might not be as high as earlier thought, following signs of easing inflation offshore. Conversely, longer term inflation expectations increased slightly.

## 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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The Morningstar Analyst Rating™ for  
Ardea Real Outcome Fund is  
'Bronze' as of 7/9/2022



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