

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report January 2023

Performance ¹	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	-1.54	-2.92	-0.36	-0.66	1.26	3.01	3.37
Benchmark ²	0.70	1.95	7.82	5.91	4.23	3.25	2.58
Excess Return	-2.24	-4.87	-8.18	-6.57	-2.96	-0.23	0.79

¹ 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.

² The Fund benchmark is the Australian Consumer Price Index.

Source: Fidante Partners Limited, 31 January 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

Portfolio Manager	Ardea Investment Management
Investment Objective	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.
Investment Horizon	Recommended min. 2 years
Inception Date	20 July 2012
Fund Size	\$8.2bn
Management Fee	0.50% p.a.
Buy/Sell Spread	+0.05% / -0.05%
Distribution Frequency	Quarterly

Sector Exposure		Rating Exposure		Risk Contribution by Currency	
Government – National	69%	AAA	53%	AUD	44%
Government - State	31%	AA	43%	CAD	17%
Total	100%	A	4%	EUR	14%
		Total	100%	JPY	1%
				NZD	1%
				GBP	6%
				USD	17%
				Total	100%

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Performance for the month of January was -1.5% (before fees).

The main drivers of the negative monthly return are interest rate option holdings amid falling volatility and shifts in yield curves, which adversely impacted other RV positions.

The Fund holds options across major interest rate markets, underlying maturities and expiries. The broad-based fall in volatility over the month, to still elevated levels from a long-term perspective, reflects a positive shift in sentiment supported by:

- signs of a peak in US and European inflation;
- a collapse in European gas prices from the very high levels reached in late 2022; and
- the continued reopening of China's economy.

Underlying the positive market narrative in January is significant two-sided uncertainty around the path for inflation and prospects of a recession in the coming year (indeed, market views on the longevity of the rate hike cycles have shifted again in early February). As such, interest rate volatility may not remain on a consistent downward path.

As RV investors, we do not seek to predict the macro drivers of volatility, but instead use options within our portfolio construction framework to balance risk over time. Options have played an especially important role in the portfolio through the extraordinary period of global market upheaval over the last year, adding to performance and reducing potential performance volatility. The last year has been a period of extraordinary stress in RV pricing relationships, which ultimately improves the future opportunity set and return potential for the strategy (RV pricing stress is discussed in more detail in this [note](#)).

Through our long-term experience of managing RV Funds, the approach of holding a diverse portfolio of RV trades alongside option positions has proven to be reliable over time.

In an environment of falling interest rate market volatility, non-option (linear) forms of RV tend to outperform, as RV pricing relationships stabilise. However, the trade-off between the decline in volatility and the stabilisation of RV pricing relationships does not work perfectly from one month to the next, as there can be time lags. January was one such example of this lag effect, as the performance of non-option RV was insufficient over the month to offset the drag from option positions.

The detraction from other interest rate RV in the month is shown within two broad risk factors in our performance attribution table, called RV curve and bond vs derivative. These risk factors summarise a large number of underlying trades across global interest rate markets and as such, there is no single position that explains performance.

A few examples of themes that have been notable detractors from performance within the RV curve attribution are long and short positions at shorter maturities within the CAD, EUR and GBP curves. In CAD, the Fund is positioned for underperformance in the 3-4y sector relative to nearby maturities. The 3-4y swap rates were trading expensive due to preferences to receive in this part of the curve and these flows continued over the month. In GBP a broader steepening of the forward curve adversely impacted a net flattening position in the 1-5y sector. The Fund holds a series of long and short positions across the EUR curve – the 10y and longer sector performed well over the month, but this was offset by RV positions at the 1-5y sector. There are numerous market themes underlying these curve exposures. A common feature is the high level of uncertainty over the future path of interest rates, which gives rise to many micro distortions in the shape of yield curves.

The basis between bonds and derivatives had a more limited impact and there was no single theme driving overall performance. A small detraction reflected positions in the EUR and GBP government bond curves vs swaps, mostly at longer dated maturities. We are seeing larger than normal opportunities in global government bond vs derivative RV in the wake of reduced central bank participation in bond markets. Also reflected in this attribution category are the Fund's positions in cross-currency and domestic swap basis spreads – types of hedging markets for interest rate market participants - these were also modest detractors.

The inflation beta component made a small contribution over the month. The release of stronger than expected Q4 Australian CPI data late in January supported a rise in market-based inflation expectations. Realised inflation as measured by CPI is running at 7.8% y/y – well above market expectations for future inflation, where most of the curve out to 30y is pricing inflation of 2-3% (within the RBA's target band).

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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