

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report February 2023

Performance ¹	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	1.22	0.14	1.85	-0.12	1.25	3.29	3.46
Benchmark ²	0.50	1.83	7.59	6.07	4.36	3.32	2.61
Excess Return	0.72	-1.69	-5.74	-6.19	-3.11	-0.03	0.85

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, 28 February 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	\$8.1bn
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	72%	AAA	56%	AUD	38%
Government - State	28%	AA	40%	CAD	15%
Total	100%	A	4%	EUR	15%
		Total	100%	JPY	1%
				NZD	1%
				GBP	9%
				USD	21%
				Total	100%

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Performance for the month of February was 1.22% (after fees).

After a strong start to the year for most asset classes, markets reversed course in February. Sovereign bonds, credit and equities delivered negative returns. The broad macro narrative abruptly shifted from disinflation and peak rates to a higher for longer view on rates following upside surprises to inflation, jobs and high frequency global growth data. Central banks have reinforced hawkish rhetoric. The subsequent sharp repricing higher of terminal policy rates has taken short term bond yields to new cycle highs, flattening yield curves.

Against this challenging market backdrop for conventional fixed income, the Fund's RV strategy delivered positive performance in February. Elevated macro uncertainty over the path for interest rates is creating new RV opportunities for the Fund to target through increased micro distortions in the shapes of yield curves. We have recently added positions in interest rate swaps in the USD and EUR markets to target these mispricings. Bond supply/demand dynamics are also presenting new opportunities as markets adjust to lower central bank bond holdings and high issuance levels, particularly in the EUR and GBP markets.

The drivers of performance for the Fund are summarised by broad risk factors in the attribution table. These risk factors capture a large number of underlying trades across global interest rate markets and as such, there is no single position that explains performance. We outline a few themes impacting the attribution.

Bond vs Derivative exposures added value, led by gains in the AUD market. The Fund holds government and semi-government bonds across the curve, hedged with swaps and futures. For example, within the AUD market, the Fund benefited from outperformance in shorter maturity inflation linked bonds and 15-30y nominal government bonds relative to swaps.. Positions in 12-14y semi-government bonds also outperformed swaps. These are a relatively cheap sector within semi yield curves. Positions in the GBP market also added value, as a short in relatively expensive 30y Gilts underperformed an offsetting long position in swaps (the Fund is also positioned long in shorter maturities to capture relatively cheap Gilts). A small detraction came from long and short curve positions in long-dated French government bonds.

There was a slight detractor from cross-currency basis swaps, which were a small offset to the overall positive bond vs derivative attribution. The Fund is positioned to receive AUD vs USD and JPY cross-currency basis spreads. These spreads move around based on current and anticipated future hedging needs of bond issuers and investors. Our positions are targeted to capture the relatively steep front end of the basis curve. The AUD-USD basis position underperformed slightly though February, reversing some of the gains seen over the prior month, as spreads widened amid short term hedging flows. USD-JPY basis positions were flat to slightly positive.

RV curve exposures were overall positive contributors to performance. The Fund is positioned for micro curve RV, which seeks to minimise exposure to macro yield curve shifts, such as the broad flattening of curves in February (driven by higher terminal policy rate pricing). Themes were mixed across markets. For example, there was some reversal of losses from the prior month from positions in the CAD swap curve. The Fund benefited from underperformance in 3-4y CAD swap rates relative to nearby maturities - a position that is fading excess swap receiving flows in this part of the curve. Gains from the EUR market reflected long positions in 2y and 4y rates relative to other nearby tenors and from a steepening position in 10-30y, among many other long/short exposures across the curve.

Options exposures were modest contributors to performance in February. These positions are implemented for portfolio risk balance – an important factor amid the turmoil in bond markets over the last year – and to target RV in option markets. Despite a re-emergence of higher for longer rate and inflation fears, the uplift in rates volatility was modest in some markets and non-existent in others (conditions also varied by expiry and underlying maturity). The link between higher short-term rates and the level of option-implied volatility has recently become less consistent given the higher absolute levels of rates compared with 2022. This shift in volatility reflects improved demand for bonds at higher yield levels and a perception among many market participants of a more constrained distribution of future rate outcomes late in a policy tightening cycle, in the context of data showing limited reasons to expect imminent rate cuts.

The inflation beta exposures (positions only in AUD) were small contributors to performance in February. Market pricing for inflation was mixed across the curve – short term inflation expectations lifted, while long term pricing was flat to lower. Global data suggested the period of exceptionally high inflation would linger for longer – a trend which the AUD market embraced. The higher carry profile from elevated CPI prints also supports demand for shorter maturity inflation-linked bonds. The portfolio is positioned across the whole curve to avoid excessive macro volatility from quarterly inflation.

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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