

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report March 2023

Performance ¹	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	3.41	3.06	4.84	1.37	2.63	3.97	3.76
Benchmark ²	0.53	1.74	7.41	6.25	4.51	3.40	2.64
Excess Return	2.88	1.32	-2.57	-4.87	-1.88	0.57	1.12

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 March 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	64%	AAA	53%	AUD	30%
Government - State	36%	AA	42%	CAD	10%
Total	100%	A	5%	EUR	17%
		Total	100%	JPY	1%
				NZD	1%
				GBP	11%
				USD	31%
				Total	100%

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Performance for the month of March was +3.4% (after fees).

March was eventful in markets. The collapse of SVB, forced merger between Credit Suisse and UBS and pressure on other banks was a major shock for investors. Volatility surged – most notably in interest rate markets and US regional and some European bank assets. While some calm returned by month-end, markets remained priced for a significantly lower path for rates, reflecting expectations that credit tightening will serve as a substitute for further rate hikes and that something else will break following the relentless rate hikes delivered over the last year. This is a big change from early in the month, when investors feared a higher-for-longer rate scenario, as inflation remains well above central bank comfort levels. (See our latest [note](#) for more detail on recent rates volatility).

The moves have been especially violent at the front end of the US curve. Of note:

- Measures of short-dated US rates volatility eclipsed 2008 highs, as the market moved from pricing nearly 100bp of Fed rate hikes to as much as 80bp of rate cuts, despite a Fed hike in the month.
- The UST 2y yield tracked a 160bp range, registered one of the biggest ever 3 day moves and the UST 2s10s curve steepened the most in a single day since the early 1980s.
- The ECB and BoE also hiked rates in March, yet these markets, along with others such as AUD and CAD, saw big falls in forward interest rate pricing.

The Fund's RV strategy delivered outsized gains over the month, particularly in the USD market. The Fund is positioned across a large number of RV trades, a subset of which targets micro yield curve anomalies with futures contracts on short-dated US interest rates. The large movements in short-dated USD rates benefited these positions.

Gains were accelerated by the integration of options on US futures with less than one year to maturity, within yield curve RV strategies. The decision to buy options reflects a view on the RV attributes of the options themselves and the risk balancing benefits that come with blending options into RV strategies.

This approach is distinct from pure portfolio insurance strategies, which simply use options as a tail risk hedge without regard to RV and more granular risk balancing. The options most beneficial for the Fund's performance in March – on US futures with less than one year to maturity - were cheap because the volatility assumptions priced were favourably skewed by market flows and macro positioning biases.

These particular USD positions have comparatively less downside from a scenario where rates volatility falls sharply than alternative option strategies. That positive asymmetry reflects the fact that options with shorter expiries and underlying maturities are less exposed to sharp falls in implied volatility than longer expiry and maturity alternatives.

Other RV exposures also added to performance, such as various bond RV strategies in the EUR market and swap curve RV positions in the CAD market. These offset some minor detractions from the AUD market.

The Fund's beta exposure to cash continued to add to returns in the rising cash rate environment and this broadly offset a detraction from inflation beta positions. Inflation pricing fell as markets priced the negative global growth implications of bank stress and as higher liquidity nominal bonds tend to outperform inflation-linked bonds in periods of market dislocation (compressing breakeven inflation rates).

The Fund was active in adding new RV positions in March. We continue to take advantage of historically large pricing anomalies in government bond markets, driven by large shifts in the supply/demand balance due to high issuance volumes and central bank quantitative tightening. Core European and UK markets have been notable sources of new RV in recent months. The large moves in yield curve shapes have driven some shifts in positions across curves, especially in the USD market.

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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