

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report May 2023

| Performance ¹ | 1 month | 3 months | 1 year | 2 year | 3 year | 5 year | Inception |
|--------------------------|---------|----------|--------|--------|--------|--------|-----------|
| Fund | -0.17 | 2.76 | 3.41 | 0.92 | 2.10 | 3.68 | 3.64 |
| Benchmark ² | 0.47 | 1.23 | 6.58 | 6.19 | 5.09 | 3.43 | 2.64 |
| Excess Return | -0.64 | 1.53 | -3.17 | -5.28 | -2.99 | 0.25 | 1.00 |

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 May 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 | \$7.3bn |
| 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 | 66% | AAA | 60% | AUD | 34% |
| Government - State | 34% | AA | 36% | CAD | 7% |
| Total | 100% | A | 4% | EUR | 16% |
| | | Total | 100% | JPY | 0% |
| | | | | NZD | 1% |
| | | | | GBP | 11% |
| | | | | USD | 31% |
| | | | | Total | 100% |

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Performance for the month of May was -0.17%.

Market sentiment was influenced by ongoing negotiations regarding the US debt ceiling, which had a more pronounced impact in the latter half of the month. Consequently, global bond yields experienced an upward pressure throughout the month. By the end of the month, an initial agreement on the US debt ceiling was reached, although it still requires progression through the House rules committee, the House of Representatives, and the Senate for approval. This development brought about a slightly more positive outlook, resulting in longer-term yields declining marginally towards the end of the month with softer CPI data in Europe and weaker China PMI data also contributing. Once the debt ceiling is raised, it is anticipated that the US Treasury will issue a substantial amount of bills, totalling \$1.2+ trillion, by the end of the year to replenish its cash balance. European Central Bank (ECB), Bank of England (BOE), and Reserve Bank of New Zealand (RBNZ) all implemented 25 basis point rate hikes. The level of overall macro uncertainty remains high and bond markets continue to swing dramatically between divergent states of the world, from recession and rate cuts to high inflation and higher rates for longer. The move higher in yields has bond market indices delivering negative returns for the month.

Overall, bond yields exhibited a broader range of fluctuations in May compared to April, but remained within the boundaries observed in March (both US Treasury and Australian 10-year yields fluctuated within a 56 basis point range, while Australian 3-year yields experienced a wider 69 basis point range). Initially, yields moved lower during the month as concerns eased regarding the US regional bank sector. However, economic data releases from mid-month onwards did not support further decreases in rates, compounded by concerns surrounding the debt ceiling. Examples of yield moves include US Treasury 10-year yields increasing by 22 basis points, to close at 3.65%, and US Treasury 2-year yields concluding the month with a 39 basis point increase, settling at 4.40%. Australian 3-year yields increased by 37 basis points, closing at 3.37%, while Australian 10-year yields rose by 27 basis points, closing at 3.60%.

In terms of inflation, the UK and Europe experienced elevated CPI levels, and towards the end of the month, the US PCE deflator and the Australian monthly CPI indicator also exhibited stronger-than-anticipated results. Although the Australian wage price index for Q1 fell below expectations and the unemployment rate increased, the market continues to factor in further tightening measures due to persistently high inflation. A similar situation is observed in the US, where at month end the futures market indicates a 65% probability of another 25 basis point rate increase at the June meeting, driven by growing wage pressures and inflation remaining above the target, however a number of key data releases are due prior to the FOMC meeting which will likely determine the outcome. The RBA meets on 6 June, market economists are split as to whether rates will increase in June.

The Reserve Bank of Australia (RBA) surprised the market at the beginning of May with a 25 basis point increase. 12 months ago the RBA began aggressively raising rates, resulting in the yield on the Austbond bank bill index rising from 0.3% at the start of May 2022 to 3.9% currently (the rate had been a very low 0.1% since May 2020).

Inflation bond break-evens for 10-year maturities increased from 2.3% to 2.45%. The movement was even more significant for 30-year break-evens, although break-evens for 5-year and shorter maturities declined which reflects the declining pace of actual CPI outcomes. The move higher in longer dates maybe starting to reflect rising concerns about long-dated inflation becoming anchored.

The fund's inflation beta positions produced a positive outcome while the beta exposure to cash continues to add to total returns in the rising rates environment. Overall, the RV strategies detracted over the month with positions in EUR curve RV being the main driver while gains in AUD and GBP were offset by USD positions. The EUR curve positions were impacted by a steepening bias early in the month. Option positions across the markets delivered a flat outcome while bond verses derivative positions contributed with AUD and CAD positions performing. AUD swap-bond spreads have tightened benefitting the fund as did inflation bonds exposures. The swap spread exposure also has a slight steepening bias which benefited from swap spread curve steepening.

The stress levels observed in interest rate markets remain elevated, with certain markets positioned around the 80th percentile. This aligns with the significant macro uncertainty prevailing at this stage of the economic cycle. However, it also presents an improved opportunity for future relative value (RV) trades as these extreme pricing distortions begin to normalise. While curve anomalies in the front part of yield curves have started to stabilise to some extent, due to reduced expectations of higher rates, they still persist at historically high levels. Notably, the bond RV sector is currently experiencing its highest level of distortions in at least a decade, particularly evident in UK Gilts and European bonds. This phenomenon is driven by central bank quantitative tightening and substantial bond supply, which has disrupted the supply/demand balance and created historically favourable conditions for bond RV opportunities. The fund continues to be positioned to capitalise on the improved forward looking opportunity set for RV as the pricing distortions normalise.

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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