Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report June 2023

Performance[1]	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	0.15	-0.48	2.70	1.27	1.85	3.71	3.62
Benchmark[2]	0.40	1.17	6.39	6.27	5.46	3.49	2.66
Excess Return	-0.25	-1.65	-3.68	-5.00	-3.60	0.22	0.97

[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, 30 June 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	$7.0bn
Management Fee	0.50% p.a.
Buy/Sell Spread	+0.05% / -0.05%
Distribution Frequency	Quarterly

Sector Exposure	
Government – National	60%
Government - State	40%
Total	100%

Rating Exposure	
AAA	59%
AA	39%
A	2%
Total	100%

Risk Contribution by Currency	
AUD	39%
CAD	5%
EUR	14%
JPY	0%
NZD	1%
GBP	18%
USD	22%
Total	100%

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Fund performance for the month of June was +0.15% (after fees).

In a short span of time, markets have made significant progress. Risk assets performed well in June, with the ASX200 index gaining 1.6%. This surge led many equity indices to reach their highest levels in over a year, with the ASX200 up 9.7%. Volatility measures continued to decrease, reaching levels similar to those before the COVID-19 pandemic. This recovery is remarkable, especially considering the pessimism experienced in Q1 when concerns about US bank failures and an impending recession in major economies prevailed. The recent optimism is backed by the resilience shown in economic data during Q2, particularly in the US.

Meanwhile, the aggressive rate hike cycle is set to stay higher for longer as inflation continues to remain stubbornly high. Apart from the Bank of Japan, all major central banks either increased rates in June or strongly indicated their intention to do so in the coming months. The US Federal Reserve decided to pause its tightening cycle after implementing a cumulative 500 basis points of rate increases. Federal Reserve Chair Powell acknowledged the extensive ground covered so far but pointed out that the full impact of these tightening measures is yet to be fully realised. He also projected two more quarter percentage point increases may be required before the end of the year. The minutes from the Federal Open Market Committee (FOMC) stressed that inflation levels remain elevated. In contrast, the Reserve Bank of New Zealand (RBNZ) signalled that it is likely to have completed its tightening cycle after raising the cash rate to its highest level in 14 years, reaching 5.5%.

In Australia, the labour market showed strength with a decrease in unemployment rate, robust employment growth, and record-high participation rates. The RBA surprised the market with a rate hike, acknowledging the increase in upside risks to the inflation outlook. The RBA emphasised the importance of improved productivity to prevent wages from becoming inflationary. It also hinted at the possibility of further monetary policy tightening to ensure inflation returns to the target range within a reasonable timeframe. Market economists are predicting an additional 2 to 3 rate hikes, which would bring the terminal rate to a range of 4.60% to 4.85%.

Globally, terminal rate cycle pricing forecasts are mostly trending higher, with the UK expected to reach over 6%. The shift to rate cuts has been pushed further into 2024, resulting in higher bond yields. Australian 3yr yields increased 67bpts to 4.04% and 10yr +40bpts to 4.01% which is the highest level since 2011. Bond indices underperformed during the month, such as the AusBond Composite which decreased by -2% (-3% for the quarter) and the Global Aggregate in AUD which declined by -0.2% (-0.3% for the quarter).

The sell-off in bonds has impacted shorter maturities to a great extent, leading to further inversion of the yield curve. The US 2-year yield is nearing 5.0%, reaching its cycle highs and marking a more than 1% turnaround from the lows experienced in March. This highlights the need for caution when making assumptions about volatility in short-duration bonds, as option markets are pricing high volatility in shorter maturities despite the recent decline in broader market measures of volatility such as the Merrill Lynch Option Volatility Estimate (MOVE) index.

The tightening of financial conditions has made the macro environment even more challenging to assess, emphasizing the value of strategies like interest rate relative value. These strategies are independent of conventional asset class movements and do not rely on subjective macro calls on inflation and central bank policy.

The performance of the Fund's RV strategies was positive across the various RV strategies except for option exposures. Options exposures gave back some of the outsized gains from previous months and particularly in the USD and EUR markets as the volatility levels declined. The benefit of the option return is best viewed on a cumulative basis, overall, the option exposure has performed as intended YTD. RV exposures that added to performance were various curve and rates strategies predominantly in the AUD and EUR markets which benefited from general curve shape flattening over the month. These were offset by some minor detractions from USD curve and GBP rates positions. The Fund’s beta exposure to cash continued to add to returns in the rising rates environment with inflation expectations remaining broadly unchanged over the month.

The options positions play a crucial role for RV opportunities; however, the options also provide Risk Balance in the portfolio as part of the portfolio construction process. This provides performance resilience during periods of market stress providing upside potential to balance the downside risk in other RV exposures. Conversely, when markets transition to lower volatility periods, it is anticipated that options may experience negative performance, however, this negative performance is counterbalanced by the greater upside potential exhibited by other RV exposures within the portfolio. This balancing effect, though not necessarily matching on a month-to-month basis, generally delivers over the longer term and is expected to provide a more stable performance profile over extended periods of time. Through this strategy, we aim to optimise risk-adjusted returns and position the portfolio to navigate varying market conditions effectively. Overall, the outlook RV strategies is positive for the coming periods.

Overall, the outlook RV strategies is positive for the coming period for example from yield curve distortions caused by uncertainty over the interest rate outlook which has given rise to changes in hedging flows and positioning from macro-focused market participants. This theme is common to most markets the Fund is active in. We continue to see new opportunities in Europe and the UK amid rising issuance relative to active bond selling from central banks as quantitative easing (QE) holdings are wound down. While the broad supply/demand balance in US Treasuries is less obviously unbalanced overall relative to the UK and Europe, the higher levels of liquidity in the US and flows from a wider range of market participants are giving rise to new RV trading opportunities.

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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Analyst-Driven %
100
Data Coverage %
100

The Morningstar Medalist Rating™ for the Ardea Real Outcome Fund is 'Bronze' as of 07/09/2022

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