

# Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

## Monthly Performance Report July 2022

Performance <sup>1</sup>	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	-2.09%	-1.51%	-2.24%	-0.21%	1.94%	3.41%	3.47%
Benchmark <sup>2</sup>	0.87%	2.05%	6.80%	5.17%	3.42%	2.77%	2.36%
Excess Return	-2.95%	-3.57%	-9.03%	-3.58%	-1.48%	0.64%	1.11%

<sup>1</sup> 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.

<sup>2</sup> The Fund benchmark is the Australian Consumer Price Index.

Source: Fidante Partners Limited, 31 July 2022.

### 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

<b>Portfolio Manager</b>	Ardea Investment Management
<b>Investment Objective</b>	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.
<b>Investment Horizon</b>	Recommended min. 2 years
<b>Inception Date</b>	20 July 2012
<b>Fund Size</b>	\$8.8bn
<b>Management Fee</b>	0.50% p.a.
<b>Buy/Sell Spread</b>	+0.05% / -0.05%
<b>Distribution Frequency</b>	Quarterly

Sector Exposure		Rating Exposure		Risk Contribution by Currency	
<b>Government – National</b>	69%	<b>AAA</b>	47%	<b>AUD</b>	50%
<b>Government - State</b>	31%	<b>AA</b>	46%	<b>CAD</b>	4%
<b>Total</b>	100%	<b>A</b>	6%	<b>EUR</b>	9%
		<b>Total</b>	100%	<b>JPY</b>	1%
				<b>NZD</b>	0%
				<b>GBP</b>	8%
				<b>USD</b>	28%
				<b>Total</b>	100%

Source: Ardea Investment Management, S&P Ratings

## Portfolio Commentary

Performance for the month of July was -2.1% (after fees).

The July monthly return is outside the range of normal expected performance variability for this Fund, which targets 2% annual performance volatility. The outsized magnitude of the negative return was driven by timing effects on some trades, which subsequently reversed in early August (further detail below). We are confident that both the structural nature of RV and the Fund's approach to portfolio construction will deliver strong risk-adjusted returns over the medium term. For the last decade this Fund has a track record of delivering returns consistent with its objectives over a recommended horizon of at least two years.

The market backdrop was one of abrupt reversal. At the headline asset level, markets rebounded in July after an historically poor first half of the year. Global government bonds posted their first decent monthly gain for 2022. Equity markets and credit spreads similarly outperformed. Underlying this reversal is the expectation that central banks will pivot from aggressive monetary policy tightening because of greater concern over softening growth, and a belief that the highest rate of inflation in decades is close to peaking.

Despite the speed of the narrative shift in markets and still high degree of underlying macro uncertainty, market pricing for central bank policy shifted to a more constrained forward rate path, compressing the perceived distribution of future rate outcomes. Measures of implied volatility from interest rate options fell sharply from the multi-year high levels reached in June. As a result, the Fund's structural long exposure to interest rate volatility through options (-0.7%) incurred losses, after material outperformance through Q2.

It is not unusual for interest rate volatility to abruptly reverse course as macro narratives shift. It is less typical for volatility to fall sharply at the same time as other relative value pricing relationships remain stressed. The combination of these developments led to negative performance in July.

The Fund is exposed to changes in the shapes of yield curves, which arise through long and short positions at different maturities, called RV Curve (-1.0%) in our portfolio attribution. Constructing these trades is a dynamic process, involving numerous offsetting long and short positions. Due to varying market conventions for the trading of different security types across different markets, it is normal to see modest timing differences in terms of matching the performance offset between the long and short legs of trade structures. (e.g. a timing mismatch where the loss on a 'short' leg of a trade is offset by a corresponding gain on the 'long' leg as expected, but with a delay). Such timing differences do not usually impact total portfolio level performance materially. However, in times of extreme market movements they can sometimes be material, but as they are purely timing related effects the impact tends to be short-lived. For the month of July, these timing effects resulted in a larger than normal negative performance impact in the final days of the month and has subsequently reversed through early August as expected.

Notwithstanding this effect, RV curve exposures came under pressure in July, after outperforming in the prior two months. For example, in AUD the detraction partly reflected an underweight position in the 3y part of the curve relative to nearby maturities. The 3y point outperformed as market participants revised lower the longer-term forward rate path for the RBA, and 3y futures are a preferred liquidity point for expressing long positions at the front end of the curve. Longer term curve exposures in the USD market were also adversely impacted by a combination of supply/demand pressures and a spill-over from the sharp turn lower in bond yields.

Bond vs derivative (-0.4%) exposures were adversely impacted by underperformance in various AUD, EUR and USD government bonds relative to the interest rate swap curve. There is not a consistent macro-level theme across these positions. Variability in these swap-bond spreads is within the confines of normal market volatility.

Inflation beta (-0.1%) exposures were a slight detractor. These are implemented through AUD inflation-linked bonds and swaps (with the interest rate risk hedged). Market based measures for inflation fell through July. Actual CPI remains at the highest level since the early 1990s in Australia – confirmed at +6.1% y/y for Q2 based on the official release in July. This turned out to be slightly under market expectations. However, the bigger impact weighing on inflation pricing came from global inflation expectations falling as markets reacted to signs of weaker global growth.

## Market Commentary

Please see the Ardea website for our thoughts on markets and investment themes. Our latest article is available [here](#).

## 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 17/07/2021



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