

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report December 2021

Performance ¹	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	0.42%	-0.19%	-0.60%	2.56%	4.47%	4.26%	3.83%
Benchmark ²	0.23%	0.67%	2.82%	1.83%	1.84%	1.84%	1.92%
Excess Return	0.19%	-0.86%	-3.42%	0.72%	2.63%	2.42%	1.91%

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 December 2021.

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	\$11bn
Management Fee	0.50% p.a.
Buy/Sell Spread	+0.05% / -0.05%
Distribution Frequency	Quarterly

Sector Exposure	
Government – National	77%
Government - State	23%
Total	100%

Rating Exposure	
AAA	48%
AA	34%
A	18%
Total	100%

Region Exposure*	
Australasia	39%
Europe	15%
N. America	45%
Total	100%

Interest Rate Duration (years)	
12 month average	0.0
Since inception average	0.2

* Australasia = Australia, New Zealand, Japan; Europe = France, Germany, UK ; N. America = USA, Canada

*Physical weights for sector and rating exposure

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Performance for the month of December was +0.42% (net of fees), which is within the range of expected performance variability (see the *Understanding Performance* section below for details).

The performance attribution figures refer to risk-factor level exposure for the Fund overall, rather than individual trades. The following themes impacting risk factor exposures were notable in December:

- The Fund benefited from **Relative Value (RV) Bond vs Derivative** exposures, particularly across long bond positions in the USD market, hedged with futures and swaps.
- **Options** exposures were a modest drag on performance, which was mostly a reflection of USD implied rates volatility easing from the elevated levels reached at the end of November.
- The **Inflation Beta** component of the portfolio – implemented in AUD inflation-linked bonds - also made a positive contribution, as market inflation expectations lifted over the month amid stronger than expected global CPI data and persistent supply chain pressures.

The Fund's performance is not driven by a few key trades or broader macro themes, so we focus the commentary below on examples of RV-specific themes that the Fund is positioning around. The performance of many individual trades underlying these themes and a large number of other themes, has contributed to the Fund's performance this month.

RV Theme – USD bonds vs derivatives

These trades contributed to the bond vs. derivative and curve attribution categories.

USD government bonds around the 20Y segment are priced cheap relative to closely related derivatives. This RV opportunity is driven by temporary demand / supply imbalances caused by elevated bond issuance to fund fiscal stimulus vs lack of natural bond demand around the 20Y point due to market segmentation (macro oriented market participants focus more on the 10Y point, while structural demand for bond duration from liability managers is more focused on the 30Y point).

The Fund is exploiting this via RV trades involving buying the 20Y bonds vs shorting 20Y and 30Y futures contracts to neutralise duration exposure. These trades aim to profit as the pricing of these bonds eventually converges towards that of the derivatives.

These trades were positive performance contributors for the month, as market participants are starting to anticipate less supply in this sector in the future.

RV Theme – USD Swaptions

These trades contributed to the options attribution category.

The Fund embeds option positions into RV strategies. These are RV trades in-of-themselves but also improve the risk balance of the portfolio. Over prior months, the Fund targeted long swaption 'straddle' positions in USD short end rates. This strategy involves buying a receiver and a payer swaption at the same strike level, such that the Fund is net positioned for higher volatility without needing to pick whether it is an up or down directional move in rates. The RV rationale at the time of implementation reflected lower option implied volatility relative to realised volatility.

The position underperformed in December, as volatility in this part of the curve eased from the elevated levels seen over the prior months (which had previously added to portfolio performance).

Market Commentary

Please see the Ardea website for our detailed thoughts on markets and investment themes. Our latest article on key themes for 2022 is available [here](#).

Understanding Performance

Performance is evaluated over rolling 2 year periods for consistency with the recommend 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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