

# Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

## Monthly Performance Report January 2022

Performance <sup>1</sup>	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	-0.24%	0.26%	-0.96%	2.08%	4.18%	4.19%	3.77%
Benchmark <sup>2</sup>	0.30%	1.19%	3.60%	2.26%	2.16%	2.01%	2.00%
Excess Return	-0.54%	-0.93%	-4.56%	-0.18%	2.02%	2.18%	1.76%

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

Sector Exposure	
Government – National	76%
Government - State	24%
<b>Total</b>	<b>100%</b>

Rating Exposure	
AAA	50%
AA	33%
A	17%
<b>Total</b>	<b>100%</b>

Region Exposure*	
Australasia	27%
Europe	23%
N. America	50%
<b>Total</b>	<b>100%</b>

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 January was -0.24% (net of fees), which is within the range of expected performance variability (see the *Understanding Performance* section below for details).

Returns are driven by the interaction between a large number of small sized relative value positions, rather than a few key trades or macro themes. The attribution of returns for this Fund reflects exposure to broad interest rate market RV risk factors. The following themes impacted these risk factor level exposures in January:

- **Curve** positions were a modest overall detractor from performance. The Fund holds a series of long and short positions across major interest rate markets, targeting constrained curve relationships. A notable source of detraction were curve positions in the EUR market - mostly in short end and ultra-long maturities - which were not completely offset by gains in intermediate sectors. Positions in other markets were mixed.
- **RV Bond vs Derivative** exposures added value in January. These positions target relative pricing differences between bonds and derivatives and are mostly driven by market-specific changes in the balance of supply and demand. For example, some of the Fund's EUR and AUD bonds outperformed offsetting duration hedges in swaps and futures.
- **Options** exposures added to performance, reflecting the increase in rates market volatility over the month, with USD positions benefiting the most. These positions reflect RV considerations and are intended to provide the portfolio with risk balance.
- The **Inflation Beta** component of the portfolio was a small positive contributor but experienced significant intra-month volatility. The prospect of more aggressive global central bank tightening initially weighed on global breakeven rates. However, late in the month, Australian breakeven rates outperformed following a higher than expected Q4 CPI report and month-end index extension demand.

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.

### **RV Theme – EUR Curve**

These trades contributed to the curve attribution category.

The Fund holds a series of long and short positions across the EUR swap curve, targeting various relative value opportunities. One such example is in ultra-long maturities, between 10y and 30y, where the curve is inverted and the fund is positioned for steepening. The sharp inversion in this part of the curve reflects increased demand for receiving swap in 20-30y (for example from long duration investors such as insurance funds), compared with increased paying flows from investors in 10y and shorter maturities. Risk from these positions is balanced in the portfolio with other trades, such as offsetting exposure in other EUR swap maturities, long-dated EUR bonds, options and long-dated curve positions in other swap markets.

The exposure in the long end of the EUR swap curve was a detractor this month, but the Fund continues to see value in these positions.

### **RV Theme – USD Swaptions**

These trades contributed to the options attribution category.

These swaption positions 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 outperformed in January, as volatility in this part of the curve increased substantially.

## **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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