Investment Management

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report February 2022

Performance[1]	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	-0.97%	-0.79%	-2.06%	0.95%	3.61%	3.93%	3.63%
Benchmark[2]	0.37%	1.11%	3.78%	2.40%	2.29%	2.05%	2.03%
Excess Return	-1.34%	-1.91%	-5.84%	-1.44%	1.32%	1.88%	1.60%

[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, 28 February 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	
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	78%
Government - State	22%
Total	100%

Rating Exposure	
AAA	54%
AA	31%
A	15%
Total	100%

Region Exposure*	
Australasia	23%
Europe	19%
N. America	58%
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 February was -0.97% (after fees).

For context, a negative single month return of this magnitude is within the range of expected – but infrequent – return outcomes, based on the portfolio's 2% volatility target. We expect monthly performance to fluctuate in a range of -0.4% to +0.7% most of the time (around 68% of months), and in a wider band out to -1.0% to +1.3% some of the time (around 27% of months). A negative return in the range of -0.4% to -1.0% is expected around 13% of the time.

The largest impact on performance over the last month was a detraction from RV curve exposures (-0.9%). This attribution category reflects the cumulative impact of a large number of positions implemented to capture changes in the shapes of yield curves. As our investment approach is duration neutral, the level shift in rates / bond yields is not a driver of performance. Rather, the large shift in the relative volatilities of different parts of interest rate curves in February led to dramatic changes in curve shape.

These positions are spread across global rates markets and over the last month, the largest source of detraction came from curve exposures in the EUR market (-0.5%). Of particular relevance in February were positions in EUR targeting a steepening between the 10y and 30y sectors of the curve through forward swaps and for relative performance in 1-2y rates vs nearby maturities.

It has been a particularly challenging period for RV investing in the EUR market, which experienced an historically large regime shift and market conditions that were unusually dislocated. The backdrop is one of extreme macro uncertainty following a substantial repricing of European Central Bank (ECB) policy expectations, which was quickly followed by Russia's invasion of Ukraine, which in turn led to large changes in relativities between various parts of EUR yield curves.

Other measures of stress within the EUR rates market reached historical extremes unseen outside of COVID, the European sovereign crisis and 2008 global financial crisis. Beyond the large curve shifts, another example is the very sharp jump in the spread between bonds and swaps to extreme levels.

These moves adversely impacted the RV bond vs derivative exposures (-0.3%), where the EUR market was again the largest detractor, while other markets saw less significant moves.

While we expect these types of macro regime shifts to sometimes impose losses on individual RV strategies, we rely on our portfolio construction approach – prioritising risk diversification and risk balance – to keep total portfolio level performance neutral to macro factors. This approach works reliably over the longer term, but sometimes experiences shorter periods where it is less effective.

Part of our risk balance approach is holding long positions in options (+0.3%), which were a contributor to performance in February amid elevated global interest rate volatility. However, these gains were insufficient to offset the detraction from the changes in yield curve shape and bond vs derivative spreads over the last month.

The Fund also maintains a structural beta exposure to AUD inflation markets (+0.05%). The size of these exposures is maintained at consistent, moderately sized levels (the choice of particular bonds and swaps reflects RV considerations). Market-based AUD inflation expectations in February were mixed, depending on parts of the curve. Shorter dated inflation lifted sharply amid ongoing supply pressures and global price developments, including expectations for higher petrol prices. However, longer dated inflation expectations finished the month near flat, as these were more comparatively constrained by swings in risk appetite and expectations for central bank tightening.

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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Ardea Real Outcome Fund received a Morningstar Analyst Rating™ of 'Bronze' on 17 July 2021

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