

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report June 2022

Performance ¹	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	0.84%	1.59%	-0.15%	1.43%	2.84%	3.87%	3.72%
Benchmark ²	0.43%	1.44%	5.79%	4.82%	3.06%	2.57%	2.25%
Excess Return	0.40%	0.15%	-5.95%	-3.39%	-0.22%	1.30%	1.46%

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 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	\$9.4bn
Management Fee	0.50% p.a.
Buy/Sell Spread	+0.05% / -0.05%
Distribution Frequency	Quarterly

Sector Exposure		Rating Exposure		Risk Contribution by Currency	
Government – National	72%	AAA	54%	AUD	43%
Government - State	28%	AA	40%	CAD	19%
Total	100%	A	6%	EUR	8%
		Total	100%	JPY	1%
				NZD	0%
				GBP	9%
				USD	19%
				Total	100%

Interest Rate Duration (years)	
12 month average	-0.2
Since inception average	0.1

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Performance for the month of June was +0.84% (after fees).

Global bond markets remain under pressure and in June experienced large intra-month volatility. Early in the month, inflation data continued to exceed expectations, prompting central banks to step up aggressive monetary policy tightening. The Fed hiked 75bp and the Reserve Bank of Australia (RBA) hiked 50bp, while the European Central Bank (ECB) flagged rate hikes at upcoming meetings. Bond yields surged to new multi-year highs into the middle of the month, while risk assets fell sharply. That theme quickly gave way to recession fears and bonds subsequently rallied strongly, albeit still leaving yields higher than end of May levels and major bond indices with negative monthly returns.

Against this turbulent global market backdrop, the Fund's RV strategy delivered positive returns. Performance remains uncorrelated with conventional duration and credit heavy fixed income benchmarks.

In June, the Fund benefited directly from high volatility in global bond markets through exposure to interest rate options (+0.7%) and associated hedging activity, reflected in the RV rates (+0.2%) component of performance attribution. Options positions are primarily held across USD, AUD, EUR and GBP markets. Interest rate option markets offer RV opportunities as well as providing risk balance for other parts of the portfolio. A common option strategy implemented by the Fund is a long interest rate swaption straddle - holding a receiver and payer swaption at the same strike. In effect, the Fund is able to benefit from large interest rate movements, irrespective of direction. These positions have limited downside risk and larger upside potential.

The Fund also benefited from exposure to yield curve (+0.3%) risk through June. This risk factor is common to a large subset of individual RV trades, such that no one theme explains performance. Some notable gains came from USD and EUR markets in June. For example, in USD the Fund held various RV micro curve positions across the 3m futures curve, which outperformed due to a flattening of the 6m-1y vs 2-3y curve segments. At the long end between 10y and 30y, net steepening of the USD and EUR curves supported performance late in the month.

Bond vs derivative (-0.2%) exposures were a slight detractor overall. Outperformance of AUD bonds relative to swaps supported performance but was offset by a mixture of underperformance in similar positions in other markets and some cross-currency basis exposures (this type of basis also falls into this attribution category). AUD bond vs swap spreads are widening on the back of significant swap paying from borrowers hedging against rising interest rates, asset swapping from investors and other flows. The fund was positioned for a higher JPY vs USD cross-currency basis spread in the 2y part of the curve. Over the month, hedging flows in the market were still biased towards receiving 2y. These positions are typically low volatility and a small contribution to overall portfolio risk.

Inflation beta (-0.1%) exposures were a small net detractor. These positions are implemented through AUD inflation-linked bonds and swaps (with the interest rate risk hedged) and are maintained at a fairly steady and modest size. Despite continued overall investor fear of high inflation, market-based measures of inflation expectations experienced sharply divergent paths through June (a similar pattern to May). There was no official Australian CPI released in June, but shorter dated AUD inflation expectations lifted as markets priced continued high inflation over the coming years based on global developments, RBA commentary on higher near-term inflation forecasts and indications of higher wage growth. However, longer-dated AUD inflation expectations fell sharply late in the month as the market narrative shifted towards tighter financial conditions ultimately tipping major economies into recession. Since the Fund holds balanced positions across the inflation curve, the net effect of the two themes resulted in slightly negative overall inflation beta performance.

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.

Contact

For further information, please contact:

Fidante Partners Investor Services

P: 13 51 53

E: info@fidante.com.au

W: www.fidante.com.au

For Financial planner enquiries, please contact:

Your local **Business Development Manager** or

E: bdm@fidante.com.au

For institutional enquiries, please contact:

Jeremy Gordon

Head of Client Management

Ardea Investment Management

E: Jeremy.gordon@ardea.com.au

www.ardea.com.au



The Morningstar Analyst Rating™ for
Ardea Real Outcome Fund is
'Bronze' as of 17/07/2021



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