

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report August 2022

Performance ¹	1 month	3 months	1 year	2 year	3 year	5 year	Inception
Fund	0.63%	-0.64%	-1.35%	0.07%	1.75%	3.49%	3.50%
Benchmark ²	0.33%	1.79%	6.88%	5.07%	3.47%	2.80%	2.37%
Excess Return	0.30%	-2.44%	-8.23%	-5.01%	-1.72%	0.69%	1.13%

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 August 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	\$8.8bn
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	53%	AUD	30%
Government - State	28%	AA	39%	CAD	15%
Total	100%	A	9%	EUR	10%
		Total	100%	JPY	0%
				NZD	1%
				GBP	3%
				USD	40%
				Total	100%

Source: Ardea Investment Management, S&P Ratings

Portfolio Commentary

Performance for the month of August was +0.63% (after fees).

Major global equity, sovereign bond and credit benchmarks ended August in the red. The broad recovery in markets from July initially carried over into August - boosted by a lower-than-expected US CPI report. However, sentiment reversed sharply around the middle of the month. This turn in fortunes was accelerated by hawkish remarks from Fed Chair Powell in his annual Jackson Hole speech. The Fed is telling markets to expect higher rates for longer. They were quickly joined by ECB officials in talking up a more aggressive path for rate hikes, amid record high inflation of 9.1% y/y for the Euro Area and a 25% monthly rise in natural gas futures driving further stagflation concerns.

Against this turbulent global market backdrop, the Fund's RV strategy delivered positive returns in August. Performance remains uncorrelated with conventional duration and credit heavy fixed income benchmarks. The Bloomberg Global Aggregate Bond Index fell 4% over the month to be down 16% year-to-date.

The Fund is benefiting directly from higher interest rate market volatility through option strategies (+0.4%). Interest rate option markets offer RV opportunities as well as providing risk balance for other parts of the portfolio. A common 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 EUR and GBP option markets were contributors to performance through August, as these markets were buffeted by especially hawkish central bank policy expectations amid steep rises in inflation and energy prices.

In August, RV curve (-0.1%) exposures were a slight detractor overall, but within the portfolio reflected significant variation in performance across RV themes targeted by the Fund. For example, performance benefited from a net flattening position in the 0-5y sector of the GBP curve. In contrast, in the CAD market there was a small deduction from RV positions net long in 1-2y and 5-7y compared with short in 3-4y maturities.

In both cases, the Fund is targeting pricing differences in bonds, futures and interest rate swaps of similar maturities, while hedging against duration and macro yield curve movements. The drivers of these mispricings mostly reflect market flow dynamics.

The current high volatility environment is stretching global RV yield curve relationships to extreme levels, of a magnitude unseen since the 2008 crisis on some measures. This environment is ultimately an attractive future opportunity for RV, as many of these curve pricing relationships are likely to revert to more normal levels at some point. Normalisation is expected at different paces for the large number of positions held by the Fund.

The Fund is positioned long and short across a range of global government bonds and interest rate swaps and futures. The overall impact of bond vs derivative exposures was flat over the month. However, in many markets there is considerable movement in this normally constrained basis relationship as a spill-over from the large rise in outright yield levels. For example, the spread between EUR interest rate swaps and bonds reached record wide levels - at over 100bp for shorter dated maturities. The Fund also positioned for shifts in the RV between futures and physical bonds, brought about by changes in the deliverability characteristics heading into expiry in some markets and hedging flows in futures contracts.

The inflation beta (+0.3%) positions added to performance. These are implemented through modest-sized positions in AUD inflation-linked securities with the duration risk hedged. AUD market inflation expectations recovered from the correction in July, which is mostly a function of the rise in global inflation expectations and higher energy prices. Even after the rise in July, market inflation expectations are low compared with recent actual inflation outcomes. The AUD market is implying 2-3%pa inflation across most of the curve, compared with headline CPI of over 6%pa. The market is currently priced for inflation to quickly decline from the highest level in decades towards the RBA's target band.

Market Commentary

Please see the Insights section of the [Ardea website](#) for our latest thoughts on markets and investment themes.

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 7/9/2022



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