

Ardea Real Outcome Fund

ARSN 158 996 699 APIR Code HOW0098AU

Monthly Performance Report July 2021

Performance ¹	1 month	3 months	FYTD	1 year	3 year	5 year	7 year	Inception
Fund	0.00%	-0.41%	0.00%	1.85%	5.34%	4.98%	4.04%	4.12%
Benchmark ²	0.23%	0.74%	0.23%	3.55%	1.71%	1.81%	1.67%	1.87%
Excess Return	-0.23%	-1.15%	-0.23%	-1.69%	3.63%	3.17%	2.37%	2.25%

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 July 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.
Inception Date	20 July 2012
Fund Size	\$9.2bn
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	58%
AA	42%
Total	100%

Region Exposure*	
Australasia	62%
Europe	0%
N. America	38%
Total	100%

Interest Rate Duration (years)	
12 month average	0.5
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

How are we positioned?

The portfolio return in July was flat.

Performance is driven by strategies that target specific ‘relative value’ (RV) mispricing between closely related fixed income securities. These strategies are implemented in a way that isolates the RV mispricing from broader market movements, maintaining minimal interest rate duration exposure and excluding all credit investments. For this reason, the performance of RV portfolios, over time, has a low correlation to broader bond market and macro themes.

The portfolio is constructed with many modestly sized and diverse RV strategies that collectively contribute to overall performance. We outline performance based on our broad attribution categories. As there are a large number of individual positions, the commentary below focuses on a small subset of noteworthy RV themes and examples of positions.

The strategy suggested investment horizon is two years. Over short periods of time, like one month, performance variability commensurate with the portfolio’s volatility budget is to be expected.

Drivers

- **RV micro curve.** These RV strategies exploit pricing inconsistencies between different points on interest rate curves by taking a ‘long’ position in one point vs. a ‘short’ position in another, such that the overall trade is duration neutral. For example, groups of micro curve positions with net long exposure in AUD, USD and CAD markets in 10-15y bonds and swaps outperformed offsetting net short exposure in 5-7y sectors. These positions benefited from a flattening of these curve segments in July. There are a large number of other micro curve exposures that also contributed to and detracted from performance over the month. For example, micro curve steepening positions in USD inflation swaps were a modest drag on performance in July. Overall, the portfolio is constructed to exhibit limited relationship with macro curve swings over time.

Detractors

- **RV bond vs derivative.** These strategies exploit pricing inconsistencies between government bonds and closely related interest rate derivatives by taking a 'long' position in one vs. a 'short' position in the other, such that the overall trade is duration neutral. The net result of a large number of long bond vs short futures and swap positions was a small drag over the last month in the AUD market, which offset small gains in EUR bond vs derivative positions.

Portfolio Commentary

Notable events for the month are summarised below and more detailed discussions of topical themes are available in the [Research](#) section of the Ardea website.

What Happened?

Bond rally extends, real yields hit new lows

The performance of major asset classes was mixed in July. Investor focus was split between still strong data in major economies, solid US earnings, supportive central banks, versus concerns over a peak in growth momentum alongside a rise in Covid cases. Despite a few hiccups intramonth, US and European equities still posted new highs and a sixth consecutive monthly gain (S&P 500 +2.3% and Stoxx 600 +2.1%). In contrast, it was a weak month for many Asian markets - the Hang Seng (-9.9%) and Nikkei (-5.2%) finished July significantly lower. Investor sentiment in Asia centred on regulation, softening Chinese data and increasing Covid cases. Commodity prices still managed a broad rally – the Bloomberg Commodity Index adding 1.8% to reach a six year high.

The increasing uncertainty over global growth, the path for Covid and other forces supported sovereign bonds in July (see below for more detail). The Global Aggregate and US Treasury indices added 1.3-1.4%. Major developed market 10y yields fell 15-35bp. The US 10y yield finished the month at 1.22% - the lowest level since February, marking a full reversal of the “reflation” theme that had gripped markets earlier in the year. Australian bonds outperformed as major cities entered Covid-driven lockdowns. Two other themes within interest rate markets in July are worth noting:

- **Real yields hit new lows.** The rally is led by real yields, which hit record lows in the month, leaving inflation pricing comparatively range-bound (although still lower than the highs reached in May). Lower real yields are consistent with growth concerns being priced by the bond market, rather than expectations for lower inflation.
- **Front end policy rate pricing.** Markets pared pricing for rate hikes in the next 2-3 years – reversing much of the pressure in this part of the curve seen in June (an exception to the rule is in NZ, where the market prices 50bp of hikes this year).

Why is it relevant?

This is a summary of a more detailed research article on the Ardea website in July: ***What's driving the bond rally?*** (see [here](#) for full note)

- Bond yields hit five-month lows in July, reversing much of the Q1 sell-off and confounding consensus.
- Lower yields partly reflect concerns over a rise in global Covid case numbers.
- There are, however, many other factors at play, including positioning technicals, a sense of data “peaking” in large economies and a perception that central banks will cap upside inflation risks.
- Long term forward rates at current low levels imply a pessimistic outlook for growth or a view that structural headwinds have significantly lowered the neutral policy rate.
- Market narratives can change quickly – the path for growth, inflation and quantitative easing (QE) tapering over coming months can challenge current low rate pricing.

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

Senior Institutional Business Development Manager

Fidante Partners

P: 02 9994 7189

E: jgordon@fidante.com.au

www.ardea.com.au



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