

Portfolio Description

The fund invests in a diversified portfolio of higher yielding Australian and international fixed interest investments.

Investment Strategy

The fund invests in a portfolio of predominantly global credit securities. The fund's strategy is to earn an income return from its investments, controlling risk through careful selection and monitoring, combined with broad diversification. The increased credit risk of credit securities means that these investments have the potential to deliver higher returns over the medium term compared to cash. Derivatives may be used for risk management or return enhancement. The fund aims to hedge currency exposure.

Investment Objective

To provide income-based returns and to outperform the Bloomberg AusBond Bank Bill Index over rolling three-year periods before fees and taxes by investing in a diversified portfolio of relatively higher yielding Australian and international fixed interest investments.

Key Investment Personnel and Experience (Industry / Firm)

Tony Togher	Head of Fixed Income, Short Term Investments & Global Credit	(1983 / 1988)
Craig Morabito	Senior Portfolio Manager	(2003 / 2005)

Product Overview

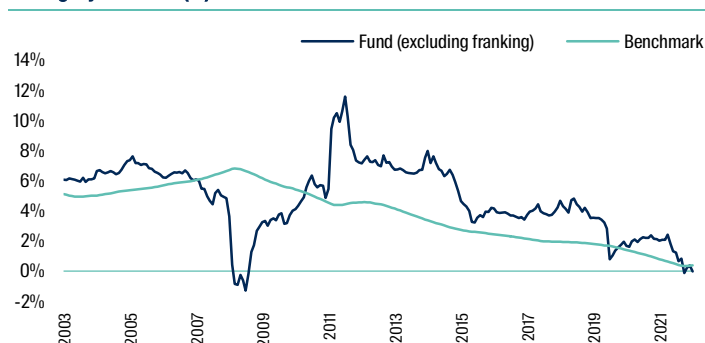
APIR code	FSF0084AU
Inception date	15 September 2000
Fund Size (A\$)	719 million
Benchmark	Bloomberg AusBond Bank Bill Index
Buy / Sell spread	0.15% / 0.15%
Minimum investment (A\$)	5,000
Management fees and costs (p.a.)*	0.62%

* Information on Management fees and costs (including estimated indirect costs) is set out in the Fund's PDS.

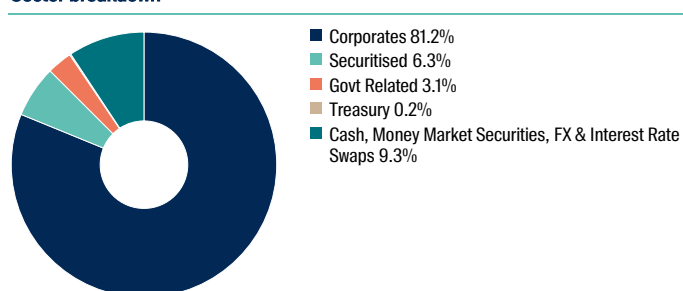
Performance Summary (%)

Period	3mth	1yr	3yr	5yr	7yr	10yr	SI
Net return	0.8	-3.6	0.0	1.0	2.3	3.0	4.5
Benchmark return	0.4	0.5	0.4	0.9	1.2	1.7	3.7
Excess net return	0.4	-4.2	-0.4	0.1	1.1	1.3	0.8
Income return	0.0	1.3	1.6	2.2	4.0	4.3	5.2
Growth return	0.8	-5.0	-1.6	-1.2	-1.7	-1.3	-0.7

Rolling 3 year return (%)



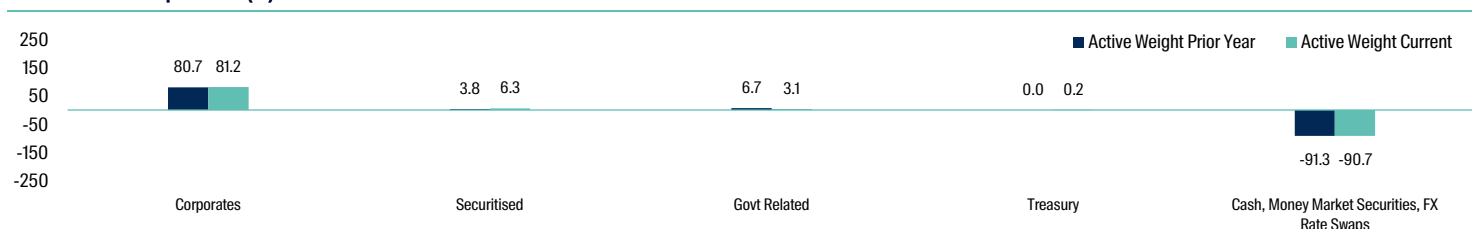
Sector breakdown

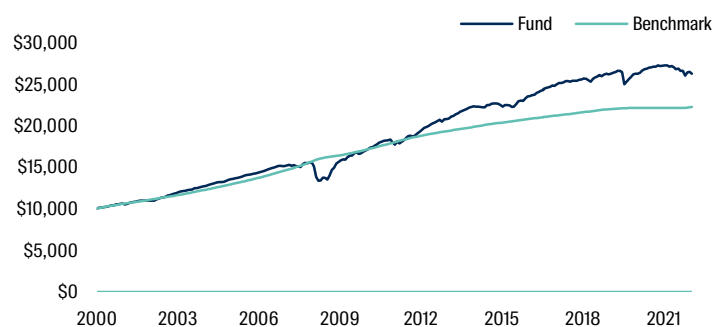
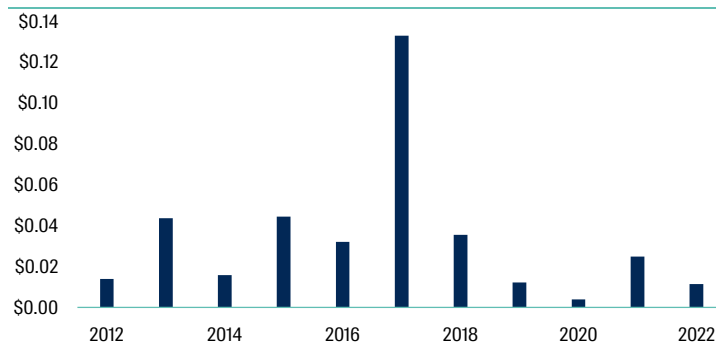


Risk Characteristics

Period	1yr	3yr	5yr	7yr	10yr	SI
Fund standard deviation (%)	2.9	4.0	3.3	3.0	2.8	3.6
Benchmark standard deviation (%)	0.2	0.2	0.2	0.2	0.3	0.6
Tracking error (%)	2.9	4.1	3.3	3.0	2.7	3.7
Fund Sharpe ratio	-1.4	-0.1	0.0	0.4	0.5	0.2
Information ratio	-1.4	-0.1	0.0	0.4	0.5	0.2

Fund active sector positions (%)



Growth of AUD 10,000 Investment Since Inception**Distributions**

Performance returns are calculated net of management fees and transaction costs. Performance returns for periods greater than one year are annualised. Past performance is not a reliable indicator of future performance.

Data source: First Sentier Investors 2022

Data as at: 30 September 2022

Fund Performance

Net of fees, the Fund appreciated by 0.8% over the quarter, which was well ahead of the 0.4% return from the bank bill benchmark. Performance continued to be supported by the regular receipt of coupon income – this more than offset the impact of slightly wider credit spreads over the period.

Returns remain in the red in the calendar year to date, owing to the impact of widening credit spreads. That said, much higher risk-free rates and wider spreads have improved the return outlook. 'All in' yields from US investment grade credit have risen above 5%, for example; the highest level for more than a decade. This augurs well for the generation of income in the period ahead, and should help the Fund achieve its performance objectives over the full market cycle.

Market Review

Credit spreads narrowed in July and early August, but started widening again later in the quarter and ended the period slightly above where they started. Investment grade spreads rose 0.05% in the period as a whole, to 1.80%; their highest level since May 2020 following the initial Covid shock. These moves hindered returns from corporate bonds and prevented the Fund from making more meaningful progress.

Like in equity markets, the increasing probability of recession in major economies in 2023 appeared to un-nerve investors and clouded the outlook. Default rates remain very low by historic standards, although it seems reasonable to assume that some companies will struggle if economic activity levels moderate and as higher borrowing costs start to bite.

European issuers underperformed their US counterparts, owing to concerns about energy supply disruptions in the northern hemisphere winter. The associated risk of factory closures threatens to erode GDP growth and corporate profitability, and could result in a recession in the region next year.

Fund Activity

We unwound the Fund's previously-held bought protection position in EUR-denominated credit, following weakness in the sector. The Fund's previous active position in the US high yield credit sub-sector was also closed out profitably in July, following a rally in this area of the market. Some of the Fund's individual credit exposures were modified a little too, as relative valuations shifted. Selected bonds were sold, for example, as the financial outlook for the issuing companies deteriorated. In spite of these sales the Fund remained well diversified, with exposure to nearly 430 issuers at quarter end. Maintaining such a high level of diversification mitigates risk, and should help ensure that any unexpected defaults do not have an out-sized influence on returns.

It is also worth remembering that the performance of this Fund is not directly affected by rising government bond yields. Some comparable fixed income products that do not hedge interest rate risk have performed very poorly this year as interest rates have risen. This is important to bear in mind, particularly given the possibility of even higher government bond yields if inflation remains elevated and if central banks respond by tightening policy settings further.

Market Outlook

In most cases firms remain well capitalised and comfortably able to service their debt repayment obligations, even though borrowing costs are rising. The most recent release of financial results showed that most firms continue to enjoy good levels of profitability.

Encouragingly, it appears that higher 'all in' yields are helping to attract income-oriented investors back into the asset class, many of which have been on the sidelines for the past year or two whilst prospective yields and income have been unusually low. We saw a strong flow of new issuance for much of the period, as companies responded to healthy investor demand for credit. Nearly US\$36 billion of new investment grade bonds were issued in the US in a single day in early September, for example; the largest single-day issuance volume this year and the second largest ever. We are expecting more companies to come to market before the end of the year, which might present some new investment opportunities.

Overall, we are mindful that volatility could pick up in the period ahead as central banks continue to raise interest rates to combat persistent inflationary pressures. The portfolio continues to be positioned slightly conservatively, with a reasonable amount of cash being held. Any material pull-back in valuations could provide a good opportunity to deploy this cash into the market and add risk to the portfolio. Capturing higher credit spreads would boost the Fund's income generation and help contribute to the achievement of long-term performance objectives.

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