

Altius Sustainable Bond Fund

Fund Update
31 July 2021

Altius Asset Management employs a diversified strategy to fixed interest funds management that aims to take advantage of the mispricing of bonds in all market conditions. The Altius Sustainable Bond Fund is an Australian fixed interest fund that invests in companies which conduct their business and apply capital responsibly, giving full consideration to a range of environmental, social and governance (ESG) issues.

Performance as at 31 July 2021

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Since inception % p.a.
Total return	0.67	0.52	(0.45)	1.59	1.58	2.33
Benchmark	0.88	1.37	0.36	2.75	2.22	2.75
Excess to benchmark	(0.21)	(0.85)	(0.81)	(1.16)	(0.64)	(0.42)

Inception date for performance calculations is 21 November 2014.

Total returns are calculated after fees and expenses and assume the reinvestment of distributions. Past performance is not a reliable indicator of future performance. Effective 1 July 2016, Benchmark is 50% Reserve Bank of Australia Cash Rate and 50% Bloomberg AusBond Composite 0+Yr Index and applied retrospectively for all periods. Excess to benchmark is calculated on Total return.

Portfolio Performance and Activity

Bonds rallied from the beginning of July, with the increasing spread of the Delta variant weighing heavily on global sentiment. Domestic yields outperformed movements in the US with the 10-year falling 0.36% to finish the month at 1.175% while the US 10-year fell 0.25% to 1.22%. After starting the month with 1.88 years, the short duration was neutralized early in the month to finish at 3.10 years.

The lockdowns in Australia drove the outperformance of the domestic market and had many market participants speculating whether the RBA would delay the taper of the QE program that was announced at their July meeting. This speculation saw 3-year yields drop 0.17% to 0.24%. As the Sydney lockdown continued through the month strong domestic data was largely ignored as little of it reflects activity in Sydney after the lockdown.

The two key economic releases in July were unemployment and CPI. Unemployment dropped to 4.9%, a post-pandemic low with 29,000 new jobs being generated. Next month's employment release will be of great interest to markets as it will capture the restrictions of the current Sydney lockdown. It is expected that employment will be affected but the broad recovery should remain intact. CPI printed 0.8% over the quarter, which resulted in an annual number of 3.8%. While inflation printed outside the RBA's band it was largely driven by base effects, with supply chain pressures being alleviated by the deflationary impact of numerous government schemes such as HomeBuilder.

The much-anticipated RBA board meeting passed with little impact on markets, however a series of adjustments were made to their QE and yield curve control (YCC) programs. As widely expected, the yield target of 0.10% remained fixed on April 2024, signalling cash rates are unlikely to be increased prior to 2024. The key surprise was the announcement of a tapering of weekly purchases from \$5bn to \$4bn from September with a further review in November 2021. Overall, the market read the

announcements as a mildly hawkish.

While US economic data weakened over July, it remained very strong. Non-farm payrolls rose 850,000 in June, the most in 10 months, but the unemployment rate rose to 5.9% from 5.8%. Manufacturing data, across the board, remained strong with the Manufacturing and Services ISM sitting at 60.6 and 60.1, respectively (a number above 50 indicates an economy is expanding). Inflation printed well above expectations with the year on year number at 5.4%. While the Federal Reserve continues to point to inflation as being "transitory", the University of Michigan's survey indicated consumers have growing concerns about the rising prices of home, car, and household goods. To round out the month in the US, the Federal Reserve handed down the monetary policy decision on July 28, but with no surprises. Chairman Powell said "some ground needs to be covered" on the jobs front before tapering would be considered, but views being voiced by other Federal Reserve members were more hawkish over the month.

Domestic credit tightened over July overcoming mid-month volatility generated by US growth concerns. A lack of primary supply helped provide the foundation for the positive month. Financial spreads, in particular the major banks, saw spreads contract 0.04% with 3 and 5-year spreads finishing at 0.20% and 0.40%, respectively. This places them only 0.05% from recent tights. On the whole industrial spreads tightened in July, however sectors affected more directly by the lockdowns did experience a mild underperformance. These sectors included aviation, airports, and some property trusts. One name was Brisbane Airport which saw spreads widen by around 0.10%.

Only \$1.1bn of corporate bonds were issued in July, well down on the long-term average of \$6.4bn. Edith Cowan University issued 12 and 20-year deals at a yield of 2.50% and 3.50%, respectively, with \$250m across both maturities. Dexu Wholesale Property issued \$600m across 7-year and 11-year at risk margins of 0.95% and 1.25%. The Fund did not participate in either of the transactions. While we remain cautiously optimistic about credit, we did take

the opportunity to reduce credit risk across the portfolio as spreads push toward recent lows.

The asset-backed security (ABS) market, in particular the residential mortgage sector, continues to see high issuance volumes with very solid investor support. Deals of note include Puma 2021 RMBS (Macquarie Bank), which was the largest ever non-major bank transaction at \$3.8bn. The AAA tranche priced at 0.55% which was the tightest spread of any RMBS transaction since the GFC. While spreads have tightened significantly in this sector, we still see value compared to other sectors of the market. Metro Finance also bought the largest ever auto and equipment ABS transaction at \$750m with the AAA pricing at 0.75%. The Fund participated in both transactions.

Sustainable debt issuance was very quiet in July with only the European Investment Bank (EIB) and KFW (German government agency) returning with taps of existing bonds. The EIB increased its 2024 climate awareness bond by \$400m while KFW increased its green 2024 bond by \$350m.

Socially Responsible Investments in Focus

Climate change has always been talked about as a future threat until the past month. The northern hemisphere's extreme weather events, including flooded subway tunnels in China, submerged villages in Europe and raging fire superstorms in the American northwest, are alarming climate scientists with concerns that climate models are underestimating the magnitude of the impact of climate change on extreme weather events.

UNESCO has kept the Great Barrier Reef (GBR) off the "in danger" list after the Australian government's lobbying of the World Heritage committee. The reef's status will be examined again at the committee's mid-2022 session. Coral reefs are one of the world's most visible and sensitive barometers of climate change. Most sections of the GBR were affected by three mass bleaching events since 2015. The Intergovernmental Panel on Climate Change warns that if average global temperatures rise 1.5° C then 70% to 90% of the world's coral reef will suffer, at 2° C warming, virtually all (greater than 99%) would be lost. The Australian government may have succeeded this time in keeping the GBR off the endangered list but unless we step up our efforts to combat climate change, keeping GBR off the endangered list may just be first loss in that battle.

Outlook

Virus outbreaks and related restrictions are definitionally unpredictable. The role of bonds as part of a balanced portfolio is important. In a backdrop of elevated economic and market volatility, sovereign bonds assets have low or inverse correlations with income and growth assets assists. Indeed, this has been a factor driving the rally in bond markets, as investor appetite has lifted in many international markets.

Central banks are universally supportive, but also keen to ensure a recovery lifts inflation to target levels not seen over the last decade. This biases cash rates to remain low until inflation actually occurs. Markets will be more forward-looking, meaning longer dated interest rates can drift higher, albeit dampened by the ongoing central bank bond buying programs.

Despite the lift in underlying inflation expected to be temporary, the US has seen a larger lift than was expected. The narrative of the Federal Reserve has evolved to suggest the lift may be a little more persistent. The US economy continues to reopen. The high vaccination rate and political landscape means lockdowns are unlikely. Employment conditions are improving, and the Fed is

likely to reduce the volume and rate of government bond purchases.

The lockdown in NSW will see economic contraction during the third quarter. The experience to date has been that once virus outbreaks are contained; the economy bounces back quickly. Victoria's economic reopening continues.

The RBA notes that considerable momentum had built in the economy, it is embarking on the slow process of unwinding it's emergency settings, whilst hoping to spark a healthy measure of inflation.

So as not to allow an unhelpfully high Australian dollar, official cash rates are unlikely to lift ahead of the US increasing cash rates. However, reflecting the improved backdrop, albeit interrupted "temporarily" by the NSW lockdown, the RBA has decided to not extend its YCC point (April 2024 Government Bond) at 0.1%. Perhaps more significantly, the RBA will persist with the previously announced trimming of the volume of its weekly bond purchases.

Although we expect some upward recalibration to interest rates, with 10-year yields moving higher to around 1.9% by year end, we hold a duration position slightly longer than the benchmark while the lockdown volatility persists.

Intermediate maturity semi-government and corporate bonds continue to have attraction given the "roll down" of their very steep yield curves. The global "hunt for yield" born of ultra-low cash rates continues to support the high grade corporate and semi sectors.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	4.78	28.83
Semi-Government	17.66	12.90
Supranationals	14.21	4.63
Industrials	15.52	2.06
Financials	22.98	1.45
Asset Backed	10.78	0.00
Money Market	0.00	0.00
Agencies	11.26	0.13
11am	0.98	0.00
Cash at Bank	1.83	0.00
RBA Cash	0.00	50.00

Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	43.87	33.36
AA+ to AA-	34.04	14.09
A+ to A-	12.59	1.39
BBB+ to BBB-	9.50	1.16
RBA Cash	0.00	50.00

Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Nationl Housing Fin Invt	11.30	0.06
New S Wales Treasury Crp	9.19	3.18
Australian Government	4.80	28.41
Commonwealth Bank Aust	4.49	0.12
Queensland Treasury Corp	3.39	3.04
Inter-American Devel Bk	3.12	0.33
National Australia Bank	2.96	0.16
European Investment Bank	2.88	0.44
Aust & Nz Banking Group	2.79	0.15
Treasury Corp Victoria	2.73	2.81
Asian Development Bank	1.98	0.40
Woolworths Group Ltd	1.86	0.05
Wesfarmers Ltd	1.64	0.02
Bank Of Montreal	1.59	0.04
Kfw	1.53	0.53
Aust Capital Territory	1.52	0.26
Intl Bk Recon & Develop	1.40	0.34
Royal Bank Of Canada/Syd	1.36	0.01
Kommunalbanken As	1.35	0.25
Mirvac Group Finance Ltd	1.28	0.02



Ratings / Awards



Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	1.06	0.47
Modified duration (years)	3.10	3.04

Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$224.36m
Management fee*	0.57% p.a. Note: from 1 July 2021 this will reduce to 0.37% p.a.
Buy/Sell spread	0.00%/0.10%
Advice fee	Available

*Refer to the Fund's Product Disclosure Statement for more details on the Fund's management costs which also include recoverable expenses and indirect costs. Total management costs may vary.

RIAA - Certified Responsible Investment

The Altius Sustainable Bond Fund has been certified by RIAA. According to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See www.responsibleinvestment.org for details.

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