Altius Bond Fund

Fund Update
31 December 2020

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.

Performance as at 31 December 2020

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Since inception % p.a.
Total return	(0.24)	0.08	2.37	2.49	2.68	3.03	3.91
Benchmark	(0.13)	(0.03)	2.39	3.19	2.90	3.27	3.73
Excess to benchmark	(0.11)	0.11	(0.02)	(0.70)	(0.22)	(0.24)	0.18

Inception date for performance calculations is 14 June 2011.
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

Front end yields remained unchanged over December with 3-year bonds closing the year at 0.10%. Ten-year yields moved higher, finishing 7 basis points higher 0.97%. While COVID-19 infection numbers weighed heavily on global growth expectations on the rollout of the vaccine, an additional US stimulus package and positive domestic data all placed upward pressure on long dated yields. Over December the fund returned -0.24% while over 12 months it returned 2.37%.

As expected, the RBA's December board meeting was uneventful. The statement suggested the Bank remains open to further quantitative easing (QE) while negative rates and further Yield Curve Control seem unlikely. The RBA made it clear that their balance sheet wouldn't drift too far from global peer action, meaning any further global QE action could result in further domestic QE. The December RBA board minutes contained few surprises. Of note was the boards comment that they would closely monitor the effect of the QE program on the economy and the functioning of the market and were prepared to do more if required and the size of the QE program remains "under review".

The Australian government released its mid-year budget update. Australia's deficit for FY2021 was revised lower to $197bn from $214bn. The improvement is owed mostly to the JobKeeper program, with strong economic growth and fewer recipients. On the economic front, Q3 GDP came in on the stronger side with a quarter on quarter jump of 3.3%. With Victoria coming out of lockdown during this period it leaves more pickup ahead in the coming quarters. November employment was strong at 90k, well above expectation. Victoria again drove much of the improvement. Finally, unsurprisingly retail sales jumped a remarkable 7% month on month, again reflecting Victoria. Excluding Victoria, the number was still a solid 2.7% gain.

Turning to the offshore markets, US ten-year bonds moved higher finishing the year at 0.92% from 0.84%. The US Federal reserve (Fed) did little to change its monetary policy stance in December. The most notable development was how they described the outlook for their asset purchase program. Noting they would continue until there had been "substantial further progress" on the inflation and employment front. Congress also passed a $900bn stimulus package which the market expected, and the UK finally struck a Brexit deal with Europe.

December was a mixed month for local credit markets with strong support for high yielding BBB rated corporates and widening pressure on local bank spreads. The strong theme from previous months continued with investors searching for yielding product, driving BBB spreads 7 basis points tighter to finish the year at 1.07%. While three- and five-year domestic bank paper struggled to hold onto recent lows, with spreads widening 3 basis points respectively to 0.20% and 0.36%. Issuance was extremely light in December with only three notable transactions. Goodman Industrial Partnership issued an 8-year bond at credit margin of 1.15%. Like the majority of transaction in the second half of 2020 the deal was well oversubscribed and priced 15 basis points tighter than the announced price. Macquarie Bank issued a five-year bond at a margin of 0.48%. Finally, SHML launched its first RMBS transaction for 2020. As a premium issuer, interest was extremely high with the transaction 3.5 times oversubscribed. The fund participated in the Macquarie and SMHL transactions.

Outlook

The health crisis became an economic crisis as governments closed parts of the economy. In that context, financial markets have largely factored in a successful implementation of COVID-19 vaccinations across most developed economies, and thus implying a significant reopening of the global economy over the course of 2021. However, COVID-19 infection numbers continue to climb - particularly in the northern hemisphere. Restrictions are being reimplemented and healthcare facilities overwhelmed. Logistical delays to the deployment of vaccines are unlikely to allow economies to reopen as currently thought.

It is acknowledged by policy makers that more fiscal stimulus is required to transition away from a hibernation toward productive growth. The financing of these large deficits increases supply of government bonds, placing upward pressure on bond yields. This is particularly the case in the US.

The combination of these elements has led US bond markets to factor in an implied inflation rate a little over 2%, this has contributed to Australian longer dated bonds moving a little higher in yield. This is an overly optimistic outlook, as the implied US inflation is now 0.20% above the average of the five years before COVID-19, and equal to the period where the Fed was lifting cash rates due to actual inflation pressures. Also, there remains significant labour market slack as many service sectors remain impaired. Wage pressures, the key driver of consumer price inflation will remain muted, ensuring Central Banks retain ultra-easy monetary settings. With cash rates at or near their lower bound, most major economies continue to increase or adjust their bond purchase programs.

As part of their QE program the Reserve Bank of Australia will continue to add weekly purchases of $5billion worth of five to ten-year Government and Semi Government bonds. Adding to the bonds its was already purchasing while targeting three-year government bonds at 0.1%.

China's demand for Australia's iron ore, coupled with relative success in COVID-19 constraint, has placed upward pressure on the Australian dollar. At 0.78 vs the USD, currency pressure will likely increase pressure on the Reserve Bank to increase longer dated bond purchases, pushing Australian bond yields lower.

There are three key strategies being employed currently to take advantage of the current backdrop.

First, Commonwealth Government bond curves are attractively steep, but state government and corporate curves are even more attractive. Capital gains are also achieved through being overweight bonds with maturities that fall in yield most swiftly toward the 0.1% 3-year rate, which the RBA has anchored at the same yield as cash.

Second, the spill over effect of many major markets with negative bond yields drives investor demand to seek income in higher yielding bond markets, such as Australia. Additionally, the RBA's announced long dated bond purchases are designed to add to demand and drive yields lower. Our overweight in these securities is designed to achieve the consequent capital gains.

Government bond issuance is large and lumpy. Central Bank buying is rather more persistent. The timing mismatch provide opportunities to take advantage of the relatively confined range in long dated securities; selling when bond prices have been driven higher, due to the spill over effects of "Global QE", and buying when bond prices have weakened due to large issuance lumps.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	11.09	28.03
Supranationals	8.47	5.03
Industrials	16.40	2.24
Financials	20.94	1.62
Asset Backed	8.98	0.00
Agencies	9.67	0.13
11am	0.90	0.00
Cash at Bank	0.31	0.00
Semi Government	23.25	12.95
Transurban Queensland Finance Pty Ltd.	0.83	0.02

Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	57.38	38.94
AA+ to AA-	14.00	8.51
A+ to A-	13.00	1.47
BBB+ to BBB-	15.62	1.08
RBA Cash	0.00	50.00

Maturity Profile

Term	Portfolio %	Benchmark %
0 - 1 year	7.96	54.52
1 - 3 years	30.85	8.23
3 - 5 years	15.86	10.74
5 - 7 years	14.50	8.49
7+ years	30.83	18.03

Top 10 Issuers

Issuer	Portfolio %	Benchmark %
New South Wales Treasury Corp.	12.78	3.02
Government of Australia	11.20	28.36
National Housing Finance & Investment Corp.	9.30	0.04
Queensland Treasury Corp.	5.21	3.91
Treasury Corporation of Victoria	4.68	2.57
Asian Development Bank	3.67	0.39
Royal Bank of Canada (Sydney Branch)	1.97	0.01
International Bank for Reconstruction & Development	1.95	0.46
Bank of Queensland Limited	1.65	0.01
McDonald's Corporation	1.64	0.04

Portfolio Summary Statistics

	Portfolio	Benchmark
Running yield (%)	0.93	0.40
Modified duration (years)	4.45	3.06

Fund snapshot

APIR code	WFS0486AU
Inception date	14 Jun 2011
Distribution frequency	Quarterly
Minimum initial investment	$5,000
Fund size (net asset value)	$153.92m
Management fee*	0.46% 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.

Ratings / Awards

Contact us

australianunity.com.au/wealth

investments@australianunity.com.au

Investor Services

T 13 29 39 F 1300 856 685

Adviser Services

T 1800 649 033 F 1300 856 685

Important Information