

Altius Sustainable Bond Fund

Fund Update 31 December 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 December 2021

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Since inception % p.a.
Total return	0.29	(0.55)	(1.97)	0.97	1.51	1.84	2.04
Benchmark	0.05	(0.70)	(1.35)	1.72	2.15	2.20	2.38
Excess to benchmark	0.24	0.15	(0.62)	(0.75)	(0.64)	(0.36)	(0.34)

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

A mixed month for global rates with domestic yields largely unchanged while the short end of the US curve continued to push higher as the market increased the likelihood and size of interest rate moves in 2022. Over the month the domestic 3-year yields drifted 0.04% higher to 0.91% while 10-year yields closed 0.02% lower at 1.67%, the US 2-year and 10-year rate increased 0.15% to 0.73% and 0.05% to 1.51% respectively. We started the month with duration of 3.67 years before unwinding this position around the middle of the month. We finished the month with 2.77 years of interest rate durations with a steepening curve bias.

No surprises from the RBA at its last board meeting for the year with settings unchanged and no hints at any possible shifts to quantitative easing (QE) or taper. Overall, comments were a bit more hawkish. GDP was forecast to remain strong as the Omicron variant was noted as a "new source of uncertainty" but "not expected to derail the recovery" and the economy was expected "to return to its pre-delta path in the first half of 2022. Adding to the more hawkish tone was the reference to "Leading indicators point to a strong recovery in labour markets" and a "further pick up in wages growth is expected as the labour market tightens". Wages have been noted previously by the RBA as a key for higher inflation. With its next meeting on 1 February, the RBA has the luxury of time to observe the economy, Omicron developments and the actions of other central banks in the next couple of months.

RBA Governor Lowe delivered a speech on December 16 which sets up an end of QE in February, absent a big hit to the economy from Omicron. Governor Lowe detailed three paths for the QE exit. The first option was to further taper in February from the current \$4 billion a week level, with the expectation that purchases would end around May. The second was to taper further but then review again in May with the third option being to end QE in February. Lowe detailed that the base case was option one but critically he highlighted the strong forecasts detailed in their November Statement of Monetary Policy which could prompt the RBA to end

QE in February. The same day we saw the release of a stellar employment number. Headline employment surged approximately 366,000 and hours worked jumped 4.5%. The participation rate jumped to 66.1% and the unemployment rate fell to 4.6% from 5.2%. Following the employment release speculation grew that February would see the end of QE in Australia.

In the US the Federal Reserve (FED) delivered the much-expected doubling of the taper to \$30bn per month at the December meeting, leaving the door open to rate hikes in early 2022. The updated median rate projection included three hikes by the end of 2022 and eight cumulative hikes through to 2024, a level which is still considered below the neutral rate. As expected, the statement no longer cited "transitory" inflation and in his remarks Chairman Powell noted the risks of rising inflation being more sustained, a rapid improvement in the labour market warranted a shift in policy guidance. Key economic releases included a further rise in annual inflation to 6.8% and a fall in the unemployment rate to 4.2% from 4.6% accompanied by a YoY rise in average hourly earnings by 4.8%.

After a negative start credit sentiment improved into month end with spreads closing tighter. Concerns around Omicrons impact on economic growth and growing inflationary concerns weighed heavily on risk markets before retracing into the Christmas break. Sentiment started to improve around 8 December as further evidence and statements of the variant's comparatively mild effects and claims from GlaxoSmithKline that it had an effective antibody to the new variant. The following day Pfizer-BioNTech provided a positive update on its vaccine efficacy and preliminary lab studies that demonstrated that three doses of its vaccine neutralized Omicron. While the Federal Reserve announced a faster bond taper and a higher chance of the first-rate hike in early 2022 credit markets largely ignored the FED announcement instead focusing on solid credit fundamentals and the upbeat economic outlook. Over the month bank senior 3 and 5-year debt finished 0.02% and 0.05% tighter at 0.44% and 0.63% respectively with the average industrial credit finishing 0.03% tighter at 0.70%.

With most issuers completing their 2021 funding requirements by November, December turned out to be a quiet month for primary transactions. The two deals of note were the inaugural deal by Centuria Industrial REIT and AMP Bank. Centuria issued \$350m for six years at a risk premium of 1.35% while AMP Bank issued \$125m for three years at a margin of 0.90%. No investment was made in either transaction as the issuer failed our ESG requirements.

Socially Responsible Investments in Focus

Adding to growing regulatory moves to address climate risk, this month APRA released its final guide (CPG 229) related to climate change financial risks stressing that "within the financial sector, a prudent institution will consider both the financial opportunities and the financial risks of climate change as it sets its strategy". The guide is designed to assist banks, insurers, and superannuation funds in managing climate-related risks and opportunities as part of their existing risk management and governance frameworks. The guide outlines best practice in line with the Task Force on Climate-related Financial Disclosures (TCFD). It contains five pillars.

1. Identifying and measuring risks to understand potential impacts on business model.
2. Monitoring risks through regulator updated metrics.
3. Considering scenario analysis to inform understanding of long-term risks and opportunities.
4. Evidencing plans to manage risks through mitigation plans, including through engaging customers and counterparties.
5. Reporting relevant information to board and senior management and considering external market disclosures.

Meanwhile the regulator for US government-sponsored mortgage market makers Fannie Mae and Freddie Mac, says these enterprises should take into account financial risks posed by climate change into their decision making and is expanding its monitoring and supervision of climate change issues as climate change "poses a serious threat to the U.S. housing finance system".

In relation to action on reducing emissions, the Australian Energy Market Operator (AEMO) now projects that coal closures may occur at three times the previously anticipated rate, with brown coal generators gone by 2032. The new assumptions are part of AEMO's updated "step change" scenario. Conceived in 2020 as an extreme scenario, energy market economics favouring renewables have developed so emphatically that it is now considered the most likely outcome for planning purposes. Under the new central scenario, the amount of electricity produced in the main grid is doubled to meet the demands of electric vehicles, the electrification of industry and households, and renewable hydrogen. Extensive work on the grid will be required to support this transition, with AEMO proposing a 30-year 'optimal development path' which includes 10,000 kilometres of new transmission infrastructure and/or "developments that reduce the need for new transmission, including batteries, gas-fired generation and offshore wind developments that connect to the existing network easements." As the extreme becomes mainstream, AEMO has introduced a new scenario compatible with the 1.5°C Paris climate goal. Under this scenario, Australia as a "Hydrogen Superpower" would decommission all coal generators in the main grid by 2032, which would rely largely on wind, solar and vast amounts of storage.

Outlook

The global economy continues to recover, albeit somewhat

unevenly. High energy prices and tight product markets have lifted inflation. Tight labour markets and more persistent core inflationary pressures have noticeably built in North America, UK, and New Zealand. The US inflation lift has been persistent enough for the Federal Reserve Chair to abandon the inflation description as being transitory. Australian, European and Chinese inflation pressures have largely been energy related.

A significant impact of the recent Omicron outbreak is the number of workers unable to work and therefore essential items such as food are in short supply. Woolworths are currently reporting over 20% of distribution staff are on sick leave. These supply chain issues place upward pressure on prices. Concurrently, energy shortages, particularly in the northern hemisphere are driving global energy prices. These are non-discretionary items and have a marked impact on lifting headline inflation. Further contributing to local inflation concerns is the improved labour market leading to broad based wages pressure and a weaker AUD feeding into goods inflation as the RBA lags a Fed tightening cycle. We remain significantly overweight in our exposure to an inflation linked strategy as we see this as the most effective way to take advantage of growing inflationary concerns.

The Australian market has factored in four rate rises over the coming year. The implied peak cash rate over the next few years is approximately 2.25%. We are of the view the market has factored in excessive cash rate hikes. This has largely been driven by the lift in fixed rate mortgage hedging and the global disruption of "carry" trades driven in part by the prospect of the Federal Reserve commencing a tightening cycle. Accordingly, we see value in shorter dated bonds and are modestly overweight.

Over the course of the second half of 2021, the AOFM has issued \$45bn of their full year target of \$105bn. With the RBA buying on average \$4 billion of sovereign bonds per week from their QE program, net negative issuance has occurred in the second half of 2021. This has provided a downward pressure on longer dated bond yields. With the RBA expected to taper its QE program by at least half from February 2022 and cease totally by May, we hold an underweight position in longer dated bonds, as the supportive backdrop provided by negative net issuance will reverse, albeit slowly.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	10.83	28.36
Semi-Government	17.97	13.28
Supranationals	13.17	4.70
Industrials	14.81	2.21
Financials	18.01	1.30
Asset Backed	10.73	0.00
Money Market	0.00	0.00
Agencies	11.47	0.15
11am	0.01	0.00
Cash at Bank	2.99	0.00
RBA Cash	0.00	50.00

Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	49.03	33.04
AA+ to AA-	30.56	14.38
A+ to A-	11.86	1.40
BBB+ to BBB-	8.55	1.18
RBA Cash	0.00	50.00

Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Australian Government	10.89	26.96
National Housing Fin Invt	10.87	0.06
NSW Treasury Corp	8.02	3.37
Commonwealth Bank Aust	3.77	0.08
Queensland Treasury Corp	3.76	3.16
Treasury Corp Victoria	3.44	2.97
Inter-American Devel Bank	2.72	0.32
ANZ Banking Group	2.63	0.13
European Investment Bank	2.05	0.44
Asian Development Bank	1.77	0.39
Landwirtsch. Rentenbank	1.71	0.40
Intl Bank Recon & Develop	1.48	0.35
Aust Capital Territory	1.48	0.25
Woolworths Group Ltd	1.47	0.06
Wesfarmers Ltd	1.38	0.02
Kommunalbanken As	1.32	0.25
Bank Of Queensland	1.29	0.01
Royal Bank Of Canada(Syd)	1.16	0.01
Redse 2021-1 A	1.14	0.00
Mirvac Group Finance Ltd	1.13	0.02

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	1.49	0.77
Modified duration (years)	2.77	2.92

Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$261.91m
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.



Ratings / Awards



Contact us

australianunity.com.au/wealth

australianunitywealth@unitregistry.com.au

Investor Services

T 1300 997 774 F 1300 856 685

Adviser Services

T 1300 997 774 F 1300 856 685

Important Information

Units in the Altius Sustainable Bond Fund are issued by Australian Unity Funds Management Limited ABN 60 071 497 115, AFS Licence No. 234454. Information provided here is general information only and current at the time of publication and does not take into account your objectives, financial situation or needs. In deciding whether to acquire, hold or dispose of the product you should obtain a copy of the Product Disclosure Statement (PDS) and seek professional financial and taxation advice. The PDS is available at australianunity.com.au/wealth or by calling our Investor Services team on 1300 997 774. Past performance is not a reliable indicator of future performance. This information is intended for recipients in Australia only. Not to be reproduced without permission.

Bloomberg Finance L.P. and its affiliates (collectively, "Bloomberg") do not approve or endorse this material and disclaim all liability for any loss or damage of any kind arising out of the use of all or any part of this material.

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. The Responsible Investment Certification program does not constitute financial product advice. Neither the Certification symbol nor RIAA recommends to any person any financial product is a suitable investment or that returns are guaranteed. RIAA does not hold an Australian Financial Service License.

The Altius Sustainable Bond Fund won the Lonsec Innovation Award 2016, which recognises the major innovators and industry leaders who are shaping the future of Australia's wealth creation sector. The Lonsec Awards go beyond the pure quantitative, looking at the people behind the investment decisions, the rigour of the investment process and philosophy, and the new thought and innovations that create real value for investors.

The Zenith Investment Partners ("Zenith") Australian Financial Services License No. 226872 rating (assigned June 2021) referred to in this document is limited to "General Advice" (s766B Corporations Act 2001) for Wholesale clients only. This advice has been prepared without taking into account the objectives, financial situation or needs of any individual and is subject to change at any time without prior notice. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Investors should seek independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation and needs. Investors should obtain a copy of and consider the PDS or offer document before making any decision and refer to the full Zenith Product Assessment available on the Zenith website. Past performance is not an indication of future performance. Zenith usually charges the product issuer, fund manager or related party to conduct Product Assessments. Full details regarding Zenith's methodology, ratings definitions and regulatory compliance are available on our Product Assessments and at: <http://www.zenithpartners.com.au/RegulatoryGuidelines>

The rating issued 08/2021 is published by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421 445 (Lonsec). Ratings are general advice only, and have been prepared without taking account of your objectives, financial situation or needs. Consider your personal circumstances, read the product disclosure statement and seek independent financial advice before investing. The rating is not a recommendation to purchase, sell or hold any product. Past performance information is not indicative of future performance. Ratings are subject to change without notice and Lonsec assumes no obligation to update. Lonsec uses objective criteria and receives a fee from the Fund Manager. Visit lonsec.com.au for ratings information and to access the full report. © 2021 Lonsec. All rights reserved.