

# Altius Sustainable Bond Fund

Fund Update  
**28 February 2022**

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 28 February 2022

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Since inception % p.a.
Total return	(0.38)	(0.68)	(0.79)	0.44	1.21	1.53	1.86
Benchmark	(0.60)	(1.05)	(0.46)	1.03	1.82	1.88	2.17
Excess to benchmark	0.22	0.37	(0.33)	(0.59)	(0.61)	(0.35)	(0.31)

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

February was a tale of two halves. The first was dominated by strong economic data, higher inflation, and hawkish central bank commentary, prompting concerns of more aggressive tightening cycles. The increase in yield quickly halted in the second half as warnings and the eventual invasion of Ukraine resulted in a significant increase in market volatility and a safe haven bid for US treasuries which flowed through to domestic yields. By the end of the month, domestic three and ten-year yields were 0.21% and 0.40% higher, at 1.62% and 2.19% after reaching a high of 1.80% and 2.33% respectively prior to the conflict. Portfolio duration started the month at 1.62 years before finishing the month at 2.46 years.

The conflict's implications went beyond the direct impact on Russia. Numerous commodities surged on the invasion news. Oil was a notable example, with Brent Oil moving above \$100 a barrel, the first time since 2014. Numerous other commodities experienced double digit percentage increases with European gas up 16.4%, LNG up 13%, wheat up 21.9% and aluminum up 11%. The rise in commodity prices is set to make central bank lives more difficult as supply shocks lead to further inflation pressure and lower growth. The main concern for central banks is that inflation becomes entrenched resulting in a stronger policy response.

Central bank commentary was also a key driver of sentiment throughout February. While the FOMC did not rule out a 0.50% hike at their March meeting, the St. Louis President Bullard appeared to endorse a 0.50% move saying he would like to see the Fed Funds rate 1% higher by July. Even in Europe, the ECB appeared to change tact with President Lagarde offering little resistance to the suggestion that interest rates could be increased in 2022. The Bank of England tightened rates by 0.25%, but the market was surprised that four of the nine members voted for a 0.50% increase. Closer to home the RBNZ recommenced its tightening cycle following a COVID-19 driven pause by increasing rates by 0.25% to 1.00%. The RBA announced the end of its QE

program at the February meeting, although they took a more optimistic view towards inflation, noting the importance of inflation being "sustainably with the 2% to 3% target" before increasing cash rates. The more dovish view of the RBA didn't stop markets from factoring in multiple rate hikes over the coming 12 months. By April 2023 the market expected the cash rate to be 1.65% with the first move expected in August 2022.

Credit markets globally remained under pressure throughout February. Heightened inflation fears and geopolitical concerns weighed heavily on all sectors. European credit was most impacted over the month. Concerns about the potential impact of any Russian defaults on the European banking system saw European credit widened as much as 0.40% while US credit spreads widened roughly 0.20%. Domestically credit markets performed substantially better than global peers widening by around 0.07%. Financial spreads were a clear under performer with major bank five-year senior spreads widening 0.09%, subordinated debt increased by 0.15% and bank RMBS widened 0.08%. Issuance was strong leading into the Ukraine conflict but the eased significantly. Transactions of note included the \$4bn multi tranche NAB three and five-year deal at a spread of 0.47% and 0.72% respectively, and Newcastle Permanent Building Society five-year at a spread of 1.00%.

NSWTC returned to the sustainable finance market with a new 2022 sustainability bond. This is the fourth sustainable transaction NSW has bought to the market and remains the standout semi government issuer. As with previous transactions, most assets are a green focus, mainly rail infrastructure while public school infrastructure is a key social asset. Our fund participated in this transaction. NWB Bank (Dutch promotional bank) issued a 3.5-year social bond with the proceeds used to finance affordable housing and IDB Invest issued a green 2027 bond.

The reporting season wrapped up in February with the majority of companies reporting credit neutral results. In general, balance sheets remained in good health with most companies within their credit metrics. Sectors of note for our portfolios included

Australian Banks and domestic REIT's. In general, capital levels for banks remained high however share buybacks have started to erode these levels, competition is strong for home and business lending, net interest margins have fallen as banks chase growth and cost of funds increase and asset quality is strong. There were differing fortunes across the REIT sector. Retail REITs remained weak due to COVID-19 impacts with the CBD still underperforming the suburbs. Office was mixed with high demand for premium space, but incentives remained high with vacancy still above long-term averages. A strong performance from the Industrial REITs while Residential REITs struggled with supply chain constraints, labour shortages and lower demand due to slow population growth.

### Socially Responsible Investments in Focus

The impacts of climate change are increasingly impossible to ignore and arriving faster than scientists predicted even a decade ago as underlined by the latest climate assessment from the UN Intergovernmental Panel on Climate Change (IPCC). A note by the journal Nature, "many impacts are unavoidable and will hit the world's most vulnerable populations hardest, it warns — but collective action from governments to both curb greenhouse-gas emissions and prepare communities to live with global warming could yet avert the worst outcomes". In this regard the impact of climate risk may echo the pandemic in undermining the winning strategies of just-in-time inventory management, long supply chains and blithe assumptions about conflict-free operation of capital markets, export markets and the movement of labour.

Dealing with the "in your face" symptoms of climate change may be inflationary enough, dealing with the cause (our reliance on fossil fuels) increasingly threatens to degenerate into the "disorderly transition" financial regulators have been warning against. According to International Energy Agency (IEA) data, investment in oil and gas exploration and production has plummeted of recent years as sustainability metrics were run over unsustainable businesses and patient fossil fuel investors were punished with dismal returns. Clean energy investment has nowhere near kept pace to compensate and the war in Ukraine dramatically illustrates the fragility and unpreparedness of those countries in Europe, previously considered to be in the vanguard of decarbonisation.

### Outlook

The global economy continues to recover from the pandemic. Tight product markets have lifted goods inflation. Services inflation has been slower to rise but strengthening labour markets are placing upward pressure on core inflation. Lead by oil, energy prices have continued to rise over the last fourteen months.

Financial system liquidity and expansionary monetary policy, with wages reasonably contained until recently, have led to an output boom that has driven industrial metals and other construction commodities. The breadth of inflation sources had been somewhat masked by the energy price surge, and the trade flow bottleneck narrative.

The Federal Reserve commented that (they) would have engaged (their) tools earlier if the picture had been better understood, indicating, that they are behind in their addressing of inflation pressures. The cash rate will be lifted in March and carefully raised over the course of the year, but by more than 0.25% increments if necessary. An earlier commencement of balance sheet reduction largely via maturities can be expected.

We remain significantly overweight in our exposure to an inflation linked strategy. The current implied inflation rate is approximately

2.3%. Core inflation is currently tracking at 2.6% and headline 3.5% with pressure to rise further as food, energy and building costs have lifted. The inflation strategy involves holding real yield sovereign bonds with an sold overlay that generates alpha as the implied inflation rate rises.

Similar to most central banks, the Reserve Bank of Australia have ceased asset purchases. The lift off for cash rates will be later, as the RBA waits for wages data to point to rising inflation that is more persistent and not attached to commodity price rises. International inflationary forces are likely to become imported via the lower Australian Dollar.

We tactically increased our weighting of short dated sovereign bonds as the safe haven capital flow out of equity and emerging markets is supportive of bond markets. There may be a small delay in European cash rate rises that could add to appetite for short dated securities.

We are underweight longer dated bonds as net bond supply (the amount of bonds issued by the government less bought by the RBA) is set to rise. Over the course of the second half of 2021, AOFM have issued on behalf of the government, \$45billion of their full year target of \$105bn. There remains \$60bn of sovereign issuance for the current financial year to do. With the RBA ceasing all bond purchases in early February, there is an increased burden on private sector purchasers.

### Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	10.48	28.56
Semi-Government	18.63	13.23
Supranationals	11.54	4.61
Industrials	13.33	2.19
Financials	18.01	1.26
Asset Backed	10.37	0.00
Money Market	0.00	0.00
Agencies	11.22	0.15
11am	3.65	0.00
Cash at Bank	2.77	0.00
RBA Cash	0.00	50.00

### Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	44.99	33.10
AA+ to AA-	33.10	14.36
A+ to A-	11.54	1.39
BBB+ to BBB-	10.37	1.15
RBA Cash	0.00	50.00

## Top 20 Issuers

Issuer	Portfolio %	Benchmark %
National Housing Fin Invnt	10.61	0.06
Australian Government	10.50	27.00
NSW Treasury Corp	8.33	3.29
Commonwealth Bank Aust	4.42	0.07
Queensland Treasury Corp	3.60	3.11
Treasury Corp Victoria	3.43	3.01
Suncorp-Metway Ltd	2.34	0.05
ANZ Banking Group	2.18	0.13
European Investment Bank	1.67	0.44
BNG Bank Nv	1.66	0.32
Woolworths Group Ltd	1.62	0.06
Inter-American Invest Co	1.61	0.01
Aust Capital Territory	1.45	0.25
Wesfarmers Ltd	1.40	0.02
South Aust Govt Fin Auth	1.37	0.83
Kommunalbanken AS	1.25	0.27
Intl Bk Recon & Develop	1.20	0.31
Asian Development Bank	1.18	0.38
Royal Bank Of Canada (Syd)	1.18	0.01
Citibank	1.17	0.00



## Ratings / Awards



## Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	1.75	0.99
Modified duration (years)	2.46	2.84

## Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$257.59m
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](http://www.responsibleinvestment.org) for details.

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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.

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