

# Altius Sustainable Bond Fund

## Fund Update 31 March 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 31 March 2022

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Since inception % p.a.
Gross Return	(1.85)	(2.71)	(2.33)	0.31	1.44	1.86	2.27
Benchmark	(1.87)	(2.95)	(2.72)	0.08	1.37	1.53	1.88
Excess to benchmark	0.02	0.24	0.39	0.23	0.07	0.33	0.39

Inception date for performance calculations is 21 November 2014.

Gross Returns are calculated before 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 Gross Return.

### Portfolio performance and activity

Bond yields rose aggressively throughout March as inflationary pressure gathered momentum and fears grew that inflation would become embedded in expectations. The ongoing war and broadening sanctions on Russia left commodity prices under pressure, while globally, central banks' communication was increasingly hawkish. Three- and 10-year yields rose 0.87% and 0.94% respectively to finish at 2.56% and 2.85%. The 10-year point significantly underperformed the US markets with US 10yrs rising 0.42% to close the month at 2.33%. Duration ended the month at 2.02 years after starting the month at 2.46 years.

The US Federal Reserve commenced its tightening cycle by rising rates by 0.25%, but it was the hawkish commentary that followed that caught the markets attention. At the press conference post the increase, Chairman Powell noted that "ongoing increases in the federal funds rate will be appropriate"... "every meeting is live" and would move more quickly if required. As we moved through the month, the rhetoric from Federal Reserve members reflected growing inflationary concerns. A speech by Chairman Powell on March 21 highlighted these inflationary concerns. Powell noted that "the upward pressure from the invasion of Ukraine on inflation from energy, food and other commodities comes at a time of already too high inflation" and "the risk is rising that an extended period of high inflation could push longer term expectations uncomfortably higher, which underscores the need for the committee to move expeditiously". This was followed up by Federal Reserve member Bullard stating, "he wanted the Fed to move aggressively on rates and a 50-basis point move should be in the mix".

The tone coming from the RBA contrasted with that of global peers. The RBA continued to err on the side of caution in March. The March RBA policy minutes noted that the local economy remained resilient, and spending was expected to pick up further after the Omicron outbreak, labour markets remained strong with wages growth and broader wages measures continuing to tighten,

however, inflation remained lower than in other countries. The Board agreed it was "too early to conclude" that inflation was sustainably within the target band. This view was further reinforced by Governor Phil Lowe at a speech on March 9th, saying the rate hikes were plausible in late 2022 but repeating that Australian inflation was not yet at a point sustainably within their target, although recent lifts did bring that closer. Markets largely discounted the RBA commentary, instead believing the RBA would need to commence the tightening cycle sooner than they expected. By the end of March the market had priced a 0.25% tightening by June 2022 and had a full 2.35% of tightening priced to April 2023.

Credit markets were affected by increased volatility and reduced liquidity in March as the war in Ukraine added to global inflationary concerns and hawkish central bank commentary grew. Locally, spreads were significantly wider over the month with this occurring in the first half of the month. On the corporate front the BBB sector led the underperformance with spreads 0.15% to 0.25% wider. Senior and subordinated bank spreads also came under pressure following the launch of a CBA senior USD transaction. The deal was priced into weak market conditions which resulted in a large new issue premium being offered. This had a flow on effect of repricing the local market with 3yr and 5yr spreads moving from 0.50% and 0.75% to 0.66% and 0.90% respectively. Bank subordinated debt widened between 0.30% - 0.35% in the first few weeks of March. While issuance in this space has been extremely quiet the market took it's lead from the softer US market. With bank reporting due to kick off during April we are unlikely to see any meaningful supply until after the blackout periods which is around mid-May.

Locally, new issuance markets improved in the second half of March as spreads stabilised. Westpac was first to return to the market issuing \$2.5bn of three years at a margin of 0.69%. This was followed by a Bendigo Bank three year at 0.98% and a Suncorp 10.3NC5.2 subordinated deal at 2.30%. A number of corporate deals were printed with Monash University issuing six years at a margin of 0.90%. University of Tasmania issue a dual tranche 10- and 20-

year green bond with the eligible project category being green buildings. The focus of the bond is on reducing upfront embedded carbon emission by 20%. According to the Green Building Council "embodied carbon accounts for around 20% - 25% of a typical building's total carbon footprint over its lifetime".

### Socially Responsible Investments in focus

The most significant sustainability event for the quarter was the release by the Intergovernmental Panel on Climate Change (IPCC) of the Working Group III report providing an updated global assessment of climate change mitigation progress and pledges, and examination of the sources of global emissions. It also noted developments in emission reduction and mitigation efforts, assessing national climate pledges in relation to long-term emissions goals.

The report affirmed the growing role and price competitiveness of renewable energy as the path to lower global emissions but warned that vested interests were working against this transition.

The report notes "Drawing upon wider networks, campaigns by oil and coal companies against climate action in the US and Australia are perhaps the most well-known and largely successful of these".

Meanwhile the head of the United Nations Antonio Guterres observed that "Investing in new fossil fuels infrastructure is moral and economic madness. Such investments will soon be stranded assets — a blot on the landscape and a blight on investment portfolios."

Corporate sustainability efforts continue to attract criticism of greenwashing, as analysts and investors dive deeper into plans and assess consistency with announced targets. In a study of 25 of our largest global companies, New Climate Institute and Carbon Market Watch has noted that companies that provide specific detailed net zero pledges, commit to reduce their full value chain emissions from 2019 by only 40% on average. Collectively, the 25 companies specifically commit to reducing only less than 20% of their 2.7 GtCO<sub>2</sub>e emission footprint, by their respective headline target years.

CoreLogic has calculated climate risk rating for 98% of Australian residential properties using 30 years of tidal and shoreline retreat data. CoreLogic estimates that \$5.3bn worth of properties are at very high risk from climate change and another \$19.5bn are at high risk. This increases credit risk for banks, especially with regards to long-term loans if values of those properties decline.

Not surprisingly given the risk of climate on the financial system, regulators are increasing scrutiny on companies and banks and their Scope 3 emissions. The US SEC just released proposed rules to standardize climate-related disclosures, which will require US public companies to report on Scope 1, Scope 2 and Scope 3 emissions if they were significant. The rules if enacted in current form, would also apply to Australian banks and companies that issue debt or have securities listed in the US (with some exemptions).

In Canada, the Climate Aligned Finance Act proposes to impose the highest possible risk weightings for capital requirements on Canadian banks for their exposure to new fossil fuel infrastructure and extraction. Banks would also face a 'systemic climate risk-contribution capital surcharge' based on their 'facilitated emissions'. The proposed legislation could also force financial institutions and corporations to report on board members who work for, provide services for, have lobbied for, or actively control stock in an organisation "not in alignment with climate commitments".

### Outlook

The global economy continues to expand with tight product markets lifting goods inflation. Services inflation has been slower to rise but the strengthening labour market is placing upward pressure on core inflation. Led by oil, energy prices have continued to rise over the last fourteen months. To a large extent, the surge in energy prices and supply chain bottle necks have masked the underlying inflation that has built in major economies. An extended period of "emergency" monetary policy settings coupled with enormous fiscal expansion largely in the form of income support has generated excess demand output. As inflation has been more persistent, the clarity of the inflation picture has evolved.

Central banks experience and efficacy at dealing with inflation cycles is well informed by the inflation "shocks" of the 1970s and early 80s. The US Federal Reserve has shifted focus toward dampening inflation towards its target. By pivoting slightly away from the full employment target, monetary policy normalisation is being characterised as needing to be achieved quickly enough, to engineer a soft landing.

Significantly for asset markets, bond purchase programs have largely ceased. The US and New Zealand central banks have commenced or announced an intent to reduce their bond holdings. In the case of New Zealand, these will include sale of holdings, not just allowing maturities to roll off.

Most government funding requirements are significant. This requires a substantial increase in the amount of buying from the price sensitive private sector, where in previous years price, insensitive central banks have been the buyer. This places upward pressure on interest rates as well as a recalibration of the yields (higher) on other assets.

The Australian Reserve Bank had observed a lower starting point and slower uplift in inflation pressures, in comparison to many developed economies. The RBA narrative has evolved to signify cash rate rises can be expected as early as June. Given significant liquidity gaps, in part caused by the global shift from "QE" to "QT" coupled with central banks lifting cash rates, the Australian market has priced in an unprecedented cash rate uplift. The amount priced in is more than the US market – a market that has commenced its cash rate tightening ambitions.

We are underweight longer dated bonds as net bond supply (the amount of bonds issued by the government less bought by the RBA) is rising and inflation pressures continue to expand. As cash rate rises continue to be factored into the market, we remain underweight short dated bonds, but are mindful that the pace and size of rate rises looks excessive.

We remain significantly overweight in our exposure to an inflation linked strategy; a strategy sharply focused on headline inflation. The Ukraine invasion adds to the position imperative, given further rises to energy prices, but with the disruption to Asia – Europe trade lines adding to transport costs and similar. The current implied inflation rate is approximately 2.45%. 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 further in 2022.

### Sector profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	12.86	28.73
Semi-Government	18.26	13.17
Supranationals	11.41	4.56
Industrials	13.46	2.17
Financials	16.30	1.22
Asset Backed	11.17	0.00
Money Market	0.00	0.00
Agencies	10.92	0.15
11am	1.00	0.00
Cash at Bank	4.63	0.00
RBA Cash	0.00	50.00

### Ratings exposure

Rating	Portfolio %	Benchmark %
AAA	47.74	33.20
AA+ to AA-	27.57	14.27
A+ to A-	13.16	1.40
BBB+ to BBB-	11.54	1.13
RBA Cash	0.00	50.00

### Maturity profile

Term	Portfolio %	Benchmark %
0 - 1 year	12.05	54.73
1 - 3 years	22.89	10.65
3 - 5 years	15.91	9.53
5 - 7 years	13.19	10.27
7+ years	35.96	35.96

### Ratings / Awards



### Top 20 issuers

Issuer	Portfolio %	Benchmark %
Australian Government	12.83	27.09
National Housing Finance & Investment Corp	10.29	0.06
New South Wales Treasury Corp	8.18	3.18
Queensland Treasury Corp	3.51	3.11
Treasury Corporation of Victoria	3.31	3.06
Suncorp-Metway Ltd	2.77	0.05
Australia and New Zealand Banking Group Limited	2.21	0.11
Commonwealth Bank of Australia	1.85	0.05
European Investment Bank	1.64	0.44
Woolworths Group Ltd	1.62	0.06
BNG Bank N.V.	1.60	0.32
Inter-American Invest Co	1.59	0.02
Aust Capital Territory	1.42	0.25
Wesfarmers Ltd	1.35	0.02
South Australian Government Financing Authority	1.34	0.85
Kommunalbanken AS (Norway)	1.24	0.27
Royal Bank of Canada (Sydney Branch)	1.20	0.01
Citibank	1.19	0.00
International Bank Reconciliation & Development	1.19	0.30
Redse 2021-1 A	1.17	0.00

### Portfolio summary statistics

	Portfolio	Benchmark
Yield to maturity (%)	2.29	1.32
Modified duration (years)	2.02	2.78

### 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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