

# Altius Sustainable Bond Fund

Fund Update  
30 April 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 30 April 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	(0.81)	(3.05)	(4.15)	(0.80)	0.52	1.12	1.44
Benchmark	(0.74)	(3.18)	(3.71)	(0.24)	1.14	1.49	1.76
Excess to benchmark	(0.07)	0.13	(0.44)	(0.56)	(0.62)	(0.37)	(0.32)

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

There was little reprieve for asset markets in April as concerns about global growth gave way to the continuous repricing of Central Bank expectations, and inflation numbers printing well above expectation. For only the second time in the 21st century markets experienced a negative return in both global equity and bond markets. In the US the S&P fell more than 5% and US Treasuries lost more than 2% while locally the ASX200 was down around -1% and treasuries -1.50%. The losses were driven by multiple factors including the ongoing Russian invasion of Ukraine and the risk of further escalation, the China COVID-19 lockdowns and growing concerns that central banks won't be able to deliver a soft landing as they battle heightened inflation. By the end of the month domestic three- and 10-year yields had risen 0.38% to 2.715% and 0.30% to 3.17% respectively. Portfolio duration finished the month at 3.32 years after starting the month at 2.02 years.

The growing inflationary pressure theme remained the dominant driver of rates throughout April as it has been for several months. In the Euro Area, CPI rose to a record high of 7.5%, the highest level since the single currency was formed. In the US, the March inflation reading rose to a forty year high of 8.5%, with core inflation rising 6.5%. It was the same outcome for Australia, with inflation printing at 5.1% y/y with the trimmed mean, the RBA's preferred measure, printing at 3.7% y/y. This continued inflation placed significant pressure on central banks, with the markets increasing their expectations for future monetary policy tightening throughout April. Locally the market brought forward the timing of the first tightening of monetary policy with 0.15% priced for May and increased 12-month cash expectation to 3.18% from 2.41%. Subsequently, the first tightening fell short with 0.25% delivered at the May meeting. This theme was replicated in the US and Euro markets with a further 0.47% and 0.32% of tightening added to expectations over the end of 2022. All in all, April moves added to 12-month treasury losses with the domestic

market now down close to 7.50%.

April was another difficult month for credit markets globally. The combination of geopolitical risk, COVID-19 concerns in China and the broader issue of supply change and wage pressures, inflation and central bank expectations resulted in spreads pushing back to the wides of early March. Locally, liquidity concerns grew with banks reporting most investors were focused on risk reduction with the recycling of inventory back into the market becoming more difficult. In the corporate sector BBB names were most affected with spreads widening between 0.10%-0.25%. Financials performed slightly better with senior paper from major and regional banks widening 0.06%-0.07% with five years major banks closing at 0.92%. Bank Tier 2 subordinated debt was the standout underperformer in April, following the lead of the US market. Tier 2 spreads widened between 0.28%-0.30% driven by expectation of renewed issuance after an eight month hiatus. This now leaves 5 years banks subordinated 0.71% wider than Jan 1 levels. Highlighting the weak environment for Tier 2 debt, CBA launched and priced a 5 years transaction with roughly a 0.15% new issue concession, but unlike previous deals where the spreads contracted after pricing the market just repriced the Tier 2 curve and continued to push wider. With very short-dated Tier 2 offering good investment returns we added to our Major bank and regional bank exposures.

Issuance remained subdued over April. Of note was the return of NBN Ltd with their inaugural green bond transactions. NBN issued \$800m for five years at a margin of 1.23%, offered around a 0.15%-0.20% new issue concession. The key initiatives targeted for the funding focus on energy efficiency and renewable energy. These include the upgrade of the technology mix for 1.7 million customers leading to a reduction in absolute energy use of 20% by 2030, a strengthening of their net zero commitment by signing up to RE100 initiative and SBTi, verified by year end. Under the RE100 initiative NBN has committed to purchasing 100% renewable energy by 2025 with the first PPA in NSW meeting 20% of networks needs by 2023. While outside the scope of this

transaction NBN has also developed an action plan to address scope 3 emissions. One initiative is the rollout of more energy efficient products to customers which will see consumed watts per customer fall to 2-3 watts from 10 watts. Our assessment was that the initiatives being targeted by NBN will lead to a meaningful reduction in GHG emissions. As such, an investment was made for the portfolio.

### Socially Responsible Investments in Focus

During the month, major US banks again showed a reluctance to commit to alignment of their fossil fuel financing policies with net-zero by 2050 targets. Despite the banks signing up to the Net-Zero Banking Alliance, which commits to decarbonising their portfolios by the middle of the century, motions were roundly defeated at Wells Fargo, Bank of America, and Citi. More constructively, CBA will offer customers who build 7-star energy efficient home with solar and no gas a 1.99% standard variable rate to speed up the energy transition in the most polluting part of its financing portfolio. This will help CBA reduce the financed emissions of mortgages (scope 3), an area that is becoming a growing focus in the US and Europe.

Coles announced last week it would become Australia's first major supermarket group to sell a carbon-neutral beef line after it worked with farmers to reduce their emissions and purchased carbon credits (ACCUs) to offset the significant proportion of the carbon that they could not directly abate.

Controversially, the ACCUs will be purchased from the Armoobilla Regeneration Project in south-west QLD where Andrew Macintosh, the former chairman of a key market oversight integrity committee, has noted a material reduction in tree cover between 2015 and 2022 during the period they were issued the credits due to an outdated model used to estimate tree growth. Coles maintains the offset units purchased for the program meet the requirements of the Australian Government's Climate Active Carbon Neutral Standard.

The Australian Federal Court has ordered Westpac to pay \$113m for widespread compliance failures across multiple businesses, including banking, superannuation, wealth management and insurance. The penalties relate to historical civil penalty proceedings filed by ASIC, where the Judge found that Westpac's systems and compliance failures were a common feature across all 6 matters, and the misconduct by Westpac was considered serious. In accordance with the principles of the Fund's Sustainable Policy, Westpac has not been included in the Altius Sustainable investment universe for the past three years because of these and certain other compliance shortcomings.

New Zealand's Transpower has launched a Green Finance Program, certified under the global Climate Bonds Standard. The Green bonds are intended to "align our funding strategy with our sustainability objectives, while maintaining the reliable and secure operation of the grid and market system."

This is the first Certification globally of a transmission grid under the newly published Electrical Grids and Storage criteria. Sean Kidney, CEO of the Climate Bonds Initiative says, "This is an exciting moment for power transmission and distribution companies around the world. New Zealand's Transpower is leading on global best practice in green financing while advancing on its goal of a net zero grid."

NSW has released a draft Natural Capital Statement of Intent for consultation. The Statement outlines the NSW Government's vision for valuing and investing in NSW natural resources and harnessing the power of NSW landholders to participate in natural capital markets. The government is consulting with key

stakeholders including investors, conservation groups, farmers and land managers.

### Outlook

Headline Australian inflation has accelerated to 5.1%. Peak inflation is expected during the third quarter 2022 as baseline effects from earlier contributions to inflation cease to rise as rapidly. Inflation pressures are likely to be elongated given bottlenecks have become more acute and protracted. The likelihood of further European sanctions related to Russian gas and oil supply is significant enough to pressure global energy prices higher. China's COVID-19 related lockdowns have particularly impacted major transport hubs.

Rising building material prices are a combination of global forces and a domestic construction boom. Energy price rises in Australia are likely to spread beyond automotive fuel to electricity. The cut to excise duty on fuel is temporary in its impact, but should detract from inflation in quarter 2, though not enough to offset the broadening of inflation pressures. Domestically, wage pressures are being observed to be increasing as the labour market tightens further.

A key strategy within the portfolio is to take advantage of higher realised and expected headline inflation. We hold inflation linked bonds with an overlay that takes advantage of the indexation to the rising CPI of the inflation linked bonds as well as the rising gap in yield between inflation linked and nominal government bonds. The current ten-year market implied inflation rate is 2.60%, only slightly above the RBA inflation target mid point, and significantly below forecast inflation.

Historically, once a tightening cycle commences in Australia, there has been an initial continuation higher in yields as markets overreact, as hedging against potential further rises in interest rates takes place. However, with a lag, the result in a tightening of financial conditions leads to bond market correction via a meaningful rally over time.

Australia's household indebtedness has risen to around 115% of GDP. A large proportion of fixed rate mortgages revert to floating during the next year, meaning RBA policy setting efficacy is increased. As a percentage of household income, the average mortgage repayment with a cash rate of 2.5% is equivalent to the final stages of the tightening cycle in 2008. The peak implied by the Australian bond markets is a cash rate of 3.75%. We believe this to be excessive.

Significant liquidity gaps, in part caused by the global shift from "QE" to "QT" coupled with central banks lifting cash rates, has contributed to the weakness in bond markets, and has begun to impact equity markets that in time will lend support to bonds.

Current portfolio strategic duration positioning is slightly short of benchmark. Inflation is yet to peak, but we are alert to an earlier peak in bond yields and will look for opportunities to increase our duration as signs of the peak are nearing over coming months.

## Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	12.93	28.56
Semi-Government	19.80	13.12
Supranationals	12.55	4.50
Industrials	15.48	2.19
Financials	15.78	1.48
Asset Backed	11.14	0.00
Money Market	0.00	0.00
Agencies	10.91	0.15
11am	0.33	0.00
Cash at Bank	1.08	0.00
RBA Cash	0.00	50.00

## Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	48.90	33.11
AA+ to AA-	29.58	14.35
A+ to A-	12.66	1.39
BBB+ to BBB-	8.86	1.15
RBA Cash	0.00	50.00

## Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Australian Government	12.96	27.05
Nationl Housing Fin Invt	10.31	0.06
NSW Treasury Corp	9.67	3.17
Queensland Treasury Corp	3.56	3.13
Treasury Corp Victoria	3.34	3.06
Commonwealth Bank Aust	2.85	0.05
ANZ Banking Group	2.69	0.11
European Investment Bank	2.61	0.44
NBN Co Ltd	1.91	0.05
Woolworths Group Ltd	1.64	0.06
Inter-American Invest Co	1.63	0.02
BNG Bank Nv	1.62	0.32
Societe Generale Sydney	1.54	0.00
Aust Capital Territory	1.44	0.23
Bank Of Queensland Ltd	1.43	0.01
Wesfarmers Ltd	1.38	0.02
South Aust Govt Fin Auth	1.37	0.84
Mirvac Group Finance Ltd	1.30	0.02
Kommunalbanken As	1.28	0.27
Dexus Finance Pty Ltd	1.22	0.04

## Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	3.02	1.66
Modified duration (years)	3.32	2.72

## Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$243.76m
Management fee*	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.



## Ratings / Awards



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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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