

# Altius Sustainable Bond Fund

Fund Update  
**31 May 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 May 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	(1.12)	(3.77)	(5.19)	(1.26)	0.21	0.93	1.27
Benchmark	(0.43)	(3.01)	(4.25)	(0.68)	0.92	1.42	1.68
Excess to benchmark	(0.69)	(0.76)	(0.94)	(0.58)	(0.71)	(0.49)	(0.41)

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

Despite the markets rallying the majority of May, the sharp selloff in the first week meant local markets ended in negative territory. The biggest market shift in May was the changing narrative from inflation risk to growth risk, as investors grappled with the monetary policy tightening and the impact on the growth outlook. The zero Covid-19 strategy in China, war in Ukraine and a string of weak US data, in particular softer housing data, added to global growth fears. Over May, three-year yields and 10-year yields rose 0.13% and 0.23% to close at 2.84% and 3.35% respectively. This was a significant underperformance to the US markets which saw bond yields eke out a small rally over the month, with two-year yields and 10-year yields falling 0.08% and 0.03% to finish at 2.55% and 2.84%. Portfolio interest rate duration was reduced over the month to 2.41 years after starting the month at 3.32 years.

Locally, pricing of monetary policy expectation started to drift away from the global peers with the market increasing the 12-month forward expectation of cash rates to 3.35% from 3.18%. This contrasted with US pricing with May being the first time in 10 months that the Fed fund futures had downgraded the implied rate by the December 2022 meeting to 2.74%, 0.12% lower. Furthermore, speculation about a potential 0.75% rate hike in the US cash rate was removed following the Fed Chair Powell strongly signaling two further 0.50% hikes at the June and July meetings.

Locally, the main news stories were the first RBA hike in rates for over a decade, with the cash rate moving to 0.35% from 0.10%. Noting that "inflation has picked up significantly and by more than expected, although it remains lower than in most other advanced economies." The release of the wages data on May 18 hinted at some wage pressures starting to emerge. The Q1 Wage Price Index rose 0.70%, slightly above consensus, with the private sector Q1 averaging 3.5%, the fastest pace since 2013. While this was driven by a small segment of the market it would be expected to broaden as the market test full employment. The following day was the release of the employment numbers, with unemployment

staying steady at a low of 3.9%. While only 4k new jobs were created in April it was the large shift from part-time to full-time, with a 92.4k increase in full-time employment. The ongoing strength of the labour market highlights the risks of future wages pressures.

Semi government spreads performed poorly over May with 10-year risk widening 0.10% to the Treasury curve. Victoria, Tasmania and WA released their budgets. While WA continued to benefit from strong commodity prices, Victoria and Tasmania were more reflective of the broader market concerns of growing budget deficits and increasing future supply.

Credit markets globally were again under pressure with the monetary policy outlook weighing on risk assets. In the US the Lipper funds flow data posted its 9th consecutive week of investment grade credit outflows, the worst since 2015. Domestically industrial risk fared better than financials with limited primary issuance helping support the technical backdrop. The BBB sector closed the month between 0.05% to 0.15% wider after pushing as high as 0.30% wider earlier in the month. Financials spreads remained challenged with ongoing and future supply pushing major bank senior debt 0.10% wider to 1.05%. But it was the bank subordinated spread that bore the brunt of the widening in May. For the 3rd month in a row spreads widened 0.25% taking 5 years to 2.35%. Over the course of 2022 bank subordinated spreads have moved from 1.33% to 2.35%.

Primary supply came mainly from the financial sector in May, with \$13.35bn of new issuance. With liquidity poor in the secondary market new deals placed considerable pressure on spreads, with most deals offering a decent new issue concession. Post earnings NAB, ANZ and Westpac all issued senior transactions. To highlight the pressure on the secondary market, NAB launched and priced a 3-year transaction at a spread of 0.90% when the secondary market was trading at 0.83%. Instead of the new issue premium being removed when trading commenced the secondary curve just repriced.

## Socially Responsible Investments in Focus

Momentum in the sustainable finance market continues to grow, however inflation and geopolitical risks led to a slowdown of issuance year on year. Sustainable debt issuance was 17% lower in Q122 with a total of US\$348bn issued in labelled bonds and loans. Green bonds remain the dominate issuance format representing 41% of Q1 issuance. Despite the volatility Sustainability-Linked Bonds (SLB) grew 121% year on year and are fast becoming an important format of choice for the corporate sector.

One of the recent breakthroughs was the issuance of a Sustainability-Linked Bond by the Sovereign issuer, Chile. The transaction raised \$2bn and was the first sovereign to issue in the SLB format. The 20-year deal is linked to Chile reducing its GHG emissions to 95 million tonnes of CO<sub>2</sub>-e by 2030 (from 112 tonnes in 2018) and increasing the countries share of renewables to 50% by 2028 and 60% by 2032, compared to 27% in 2021.

The Taskforce on Nature-related Financial Disclosure (TNFD) released the first beta version of its nature-related risk-management and disclosure framework. The beta version included three core components: foundational concepts and definitions, disclosure recommendations aligned to TCFD; and practical guidance on nature related risks and opportunity analysis. The framework is designed to have global application across corporate and financial institutions. The framework will now go through an 18-month consultation process.

Regulators continue to increase their focus on green-washing in the finance industry. In May the US Securities and Exchange Commission released two new rules to enhance disclosure and standards for funds making environmental, social and governance claims. The driver being heightened fears of opaque ESG-labelled financial products. The first rule will set minimum requirements for a fund with an ESG title and the second requires enhanced disclosure of ESG attributes. Closer to home, in his final public appearance in March, ACCC Commission Rod Sims talked to the regulators priorities in 2022-23 and warned "falsely promoting environmental or green credentials: would face an enforcement crackdown" The stepping up of environmental reporting sees ACCC join other local regulators acting on green-washing.

## Outlook

Although pace of inflation is likely peaking, we believe it will remain elevated for a period longer than the market is currently pricing. Second order inflationary pressures are present, as the broader economy responds to the persistently high inflation in energy and food prices.

In the recent stronger than expected GDP data, the household consumption (inflation) deflator rose a strong 1.5%; the second highest quarterly gain since 1990. This likely brings forward the RBA rate rise trajectory, though not doesn't necessarily increase the quantum.

A key strategy within the portfolio relates to inflation. We hold inflation linked bonds with an overlay that takes advantage of the indexation to the rising CPI. Currently, the running yield of the inflation linked bonds, given the high CPI outcomes, is more than 4% higher than the equivalent nominal bond. The current implied market implied inflation rate is 2.40%. If, as we believe, the gap between the yield of the inflation linked and nominal government bond is maintained, the excess accrual is realised. Capital gains accrue if the inflation rate expected by the market rises.

The RBA and notably the US Federal Reserve have recently commenced Quantitative Tightening. The effect of this is an

upward bias to sovereign yields as large price insensitive buyers (central bank asset purchase programs) are replaced with private sector price sensitive buying.

The portfolio is positioned short of its bond benchmark, though increasingly we see the prospect of much higher yields becoming somewhat limited. Historically, once a tightening cycle commences in Australia, there is an initial continuation higher in yields as markets overreact, driven by hedging against potential further interest rate rises.

Although we expect higher yields over the short term, bond yields have factored in a considerable rate rise environment and are increasingly becoming value. We are alert to the inputs that indicate financial conditions are tighten sufficiently to indicate increased probability of a bond market rally. Ultimately, we believe the resulting implied terminal cash rate, currently 3.75%, is unlikely to be delivered.

A large proportion of the surge in fixed rate mortgages revert to floating during this calendar year. With Australia's interest rate structure predominantly floating, any changes in Australian official interest rates are extremely effective; far more than the fixed rate regimes internationally. This naturally inclines the RBA to a degree of caution in moving interest rates higher.

Significant liquidity gaps, in part caused by the global shift from "QE" to "QT" coupled with central banks lifting cash rates, and higher rates generally has contributed an impact on equity markets. The correlation between stocks and bonds had been positive, but as financial conditions tighten sufficiently, we expect the correlation to break down which will be supportive of bonds over the longer term.

## Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	10.50	28.24
Supranationals	11.23	4.00
Industrials	13.36	2.36
Financials	17.46	1.47
Asset Backed	10.76	0.00
Agencies	12.35	0.41
11AM	0.05	0.00
Cash at Bank	6.91	0.00
RBA Cash	0.00	50.00
Semi Government	17.37	13.51

## Ratings Exposure

Rating	Portfolio %	Benchmark %
A	19.43	1.45
AA	22.54	14.06
AAA	44.30	32.87
BBB	13.73	1.62
RBA Cash	0.00	50.00

## Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Government of Australia	10.50	28.24
National Housing Finance & Investment Corp.	10.12	0.06
New South Wales Treasury Corp.	7.42	3.12
Queensland Treasury Corp.	3.47	3.75
Treasury Corporation of Victoria	3.26	3.19
Commonwealth Bank of Australia	2.83	0.10
Australia and New Zealand Banking Group Limited	2.66	0.13
European Investment Bank	2.21	0.50
NBN Co. Ltd.	1.90	0.10
Woolworths Group Limited	1.62	0.07
Kommunalbanken AS (Norway)	1.62	0.30
BNG Bank N.V.	1.59	0.30
Societe Generale Sydney Branch	1.55	0.00
Bank of Queensland Limited	1.43	0.02
Australian Capital Territory	1.41	0.26
Wesfarmers Limited	1.36	0.03
South Australian Government Financing Authority	1.35	0.87
Mirvac Group Finance Ltd.	1.29	0.02
REDS EHP TRUST SER 21 1 CLASS A 150229 FRM	1.22	0.00
Dexus Finance Pty Ltd.	1.21	0.04

## Portfolio Summary Statistics

	Portfolio	Benchmark
Modified duration (years)	2.39	2.66
Yield to maturity (%)	3.78	1.59

## Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$241.01m
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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