

# Altius Sustainable Bond Fund

Fund Update  
31 July 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 July 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	2.15	(0.13)	(4.76)	(1.39)	0.34	1.03	1.38
Benchmark	1.73	0.58	(4.47)	(0.71)	1.16	1.51	1.78
Excess to benchmark	0.42	(0.71)	(0.29)	(0.68)	(0.82)	(0.48)	(0.40)

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

Concerns about growth slowing and some signs that inflation might have peaked saw markets begin to price less aggressive policy tightening by central banks in the second half of July. To demonstrate the extent of the move, US markets began to price rate cuts within the next six months while locally markets took the 12-month forward cash rate pricing from 3.70% to 3.17%. Across the board, bond rates fell dramatically with Australian three-year and ten-year bonds falling 0.46% and 0.60%, respectively to close the month at 2.66% and 3.06%. US and German 10-year rates fell 0.35% and 0.51% to finish the month at 2.65% and 0.81% respectively. After starting the month with duration of 2.80 years, we progressively added duration early in July before finishing the month with 3.34 years of duration. This meant the funds performance strongly benefited from the large rally in rates over July.

The RBA hiked cash rates by 0.50% in July for the second consecutive meeting to 1.35%. The move was fully priced by the market with little market reaction. The concluding paragraph-maintained guidance that "the board expects to take further steps of normalizing over the months ahead" and described the tightening as "a further step in the withdrawal of the extraordinary monetary support". High inflation and the historically low level of interest rates remained the motivation for the larger than standard interest rate hike. Late in the month saw the key release of the quarter two CPI. The headline CPI lifted by 1.8% over the quarter with cost pressures being broad based. On an annual basis inflation lifted to 6.1%, its highest level since 1990. Even the RBA's preferred measure of trimmed inflation pushed to 4.9% p.a. The release saw the CPI above the RBA's target band of 2%-3% for the fifth quarter. The increase added weight to a 0.50% hike at the August meeting, which was subsequently delivered on the 2nd of August.

The US Federal Reserve (Fed) delivered a further 0.75% tightening on July 27 taking the targeted rate to 2.25% to 2.50%. Chairman

Powell noted in the press conference that the Fed had moved the cash rate to neutral and will now assess policy on a meeting by meeting, data dependent basis. While noting the softening in the economic data, Powell reiterated that bringing inflation under control was the main goal of the FOMC, leaving open the possibility of a further 0.75% move at the September meeting. The last week of the month saw the advanced US GDP come in at -0.9% for quarter two, the second consecutive point in negative territory. While the media noted the US was in a technical recession, the NBER, who makes the call on US recessions, doesn't use GDP as one of their indicators. The variety of indicators used by NBER continues to look strong, in particular employment, however this didn't stop markets believing the Fed would respond to slowing activity.

At the ECB meeting mid-month, the central bank began their hiking cycle with a 0.50% move taking the deposit rate to zero. A week before the FOMC meeting the ECB announced they would discontinue forward guidance, saying the council would "make a transition to a meeting by meeting approach to interest rate decisions" providing increased flexibility. At the end of July, the market expected a terminal cash rate in Europe to reach 2%.

After closing June close to YTD wides, offshore credit markets staged a solid comeback in July while local markets were more mixed. As recessionary concerns grew, the expectation of less aggressive interest rate tightening provided a more positive backdrop for risk markets. Coupled with a supportive reporting season in the US, the S&P 500 closed up 7.5% and closer to home the ASX200 was up 5.75%. Globally, credit derivative indices led the market lower, with spreads contracting between 0.15% and 0.20%, with Australian itraxx finishing 0.20% tighter at 1.20%. Physical spreads performance was mixed with bank senior spreads tighter by 0.03% to 0.05% with five years spread closing at 1.03%. Bank subordinated debt continued to march wider with five years closing at 2.70%, 0.20% wider on the month. Corporate spreads also pushed wider across all sectors with the average move being 0.15%. Primary markets provided one bright spot for the bank

subordinated market with NAB returning with a 10NC5 AUD\$1.25bn deal at 2.80%. The deal was launched at 2.90% before being tightened by 0.10%. The deal was well oversubscribed and provided some support for secondary market pricing which had struggled for the last six months.

### Socially Responsible Investments in Focus

Long awaited action from legislators appears to be gaining momentum with breakthroughs clearing the path for climate bills in Australia and the US. The Climate Change Bill (2022) identifies two national greenhouse gas emissions targets: a 43% cut below 2005 levels by 2030 (a minimum or floor), and "net zero" by 2050. The legislation also resurrects the Climate Change Authority, charging it with the task of giving annual advice on progress towards meeting existing targets and advice on a new targets. The government will have to release the advice and publicly explain deviations from that advice. Government agencies must also consider the targets when making investment and the climate change minister must give an annual statement to parliament on progress towards the targets.

We are supportive of the Bill, but would like to see a more ambitious target (minimum 50% reduction) as supported by most of the state governments, the Business Council of Australia and the Australian Industry Group. The independent scientific consortium, Climate Action Tracker (which tracks and contrasts government climate action against the globally agreed Paris Agreement aim) notes that even with the new target, Australia still ranks amongst those governments rated "insufficient" in action, although previously the target was regarded as "highly-insufficient". In this regard, the ratchet mechanism that treats the current target as a floor is an important addition to the Act.

In the US bill (officially titled the Inflation Reduction Act), will see an unprecedented \$370bn invested in cutting United States emissions 40 percent by 2030, providing a launch pad for green investment and the transition towards renewable energy for the world's largest greenhouse gas emitter. The independent Rhodium Group think-tank assessed the measure would reduce US emissions by at least 31% by 2040, compared with 2005 levels, but noted that current favourable macroeconomic drivers such as increasingly high fossil fuel prices and cheap renewables could result in a 44% reduction.

In a welcome innovation for sustainable finance, the New South Wales government is proposing a series of energy auctions designed to overcome some of the obstacles to clean energy investment in the task of transforming the country's most coal dependent state grid. The auctions will provide a pricing floor to generation and storage projects to lower the cost of equity and finance and to attract more that were previously fearful of the market volatility and curtailment/connection risk. Access rights to the renewable energy zones will be auctioned to limit on the number of projects within a renewable zone and will award a maximum output capacity to each project.

APRA released an information paper on the Climate risk self-assessment survey conducted with medium-to-large financial institutions, with key findings including; 40% of institutions said climate-related events could have a material or moderate impact on their direct operations, 90% of institutions are overseeing climate risk and managing it in line with the recommendations of the TCFD. However, they noted 23% do not have any metrics to measure and monitor climate risks. Only a small portion have fully embedded climate risk across their risk management framework and integration of climate risk into strategic planning is work in progress. Advanced quantitative risk metrics such as scope 3 and

financed emissions, and forward-looking exposure to physical and transition risk, was not yet widespread with 50% of banks reporting they do not assess emissions arising from wholesale lending. Climate-related scenario analysis (including IPCC, NGFS, STEPS and SDS) is conducted by 72% of institutions and majority consider they have moderate vulnerability to both physical and transition risks under a high-risk scenario. 22% were unsure of their vulnerability to physical and transition risks.

Global investment in renewable energy increased 11% in the past year (H1 on H1), according to data published by Bloomberg NEF. Investment in solar projects hit US\$120 billion (an increase of 33%) and US\$84 billion for wind projects (an increase of 16%). However, accreditation body Bureau Veritas has warned of heightened pressure on renewables' supply chains due to a shortage of key materials, which risks slowing down the upscaling of solar and wind projects.

Global Green, Social, Sustainability, and Sustainability-Linked (GSSS) Bond issuance reached \$500 billion, notably lower than \$747 billion last year.

The reduced issuance can partly be attributed to volatile markets (geopolitical and macroeconomic backdrop). According to Environmental Finance data, total sustainable debt issuance has now surpassed \$3 trillion where more than 3/5th has been green bonds, while social and sustainability bond issuance have accounted for roughly 1/3rd of the issuance. Sustainability-linked bonds have been roughly 5%.

### Outlook

Australian bond yields have likely peaked but are expected to remain elevated within a reasonably broad range. Financial markets are oscillating between nascent inflation pressures driving central bank tighter monetary settings and a potential economic hard landing.

Inflation lifted to above 6% in year-on-year terms. Given the expiry of the fuel excise relief, ongoing building material shortages, weather impacted food prices and previous one-off government subsidy measures, headline inflation is likely higher next quarter.

Although some of the initial drivers of inflation are likely peaking over coming quarters, the second order sources of inflation that are emerging will dictate that inflation will remain elevated for a period longer than the market is currently pricing. This underpins our core inflation hedging strategy within the fund.

Governor Philip Lowe recently stated that the RBA now expects inflation to peak at ~7% by the end of the year. An upward revision relative to the RBA's inflation forecasts in the May Statement of Monetary Policy. This unusual upward revision has in large part been the basis for the RBA hiking rates in 50bp increments over the past two months.

Given 40-year lows in unemployment, the Reserve Bank's primary objective will continue to ensure there is no inflation spiral. It is worth noting that many indexation clauses in the economy are linked to headline CPI. And wage negotiations generally take place with the rate of headline inflation as a key input rather than the underlying rate.

We believe the RBA will lift cash rates by two further 50 basis point increments and a further two 25 basis point rate rises before year end with a terminal cash rate around 3.25%. This has largely been factored into shorter dated bonds, with current yields modestly below fair value.

Longer dated bonds rallied significantly in late July on the back of

weaker than expected European and US activity data. The portfolio held an overweight duration position, however, the persistent impact of the cessation of major central bank QE, tight labour markets and strong tightening rhetoric, likely imply ten-year sovereign bonds trade in a broad range. The portfolio can be expected to increase its' duration exposure as yields move to the higher end of the range.

Running yield on non-sovereign debt related to higher base rates and wider risk spreads continue to offer attractive pricing. This particularly the case for shorter dated subordinated bank debt which has struggled over 2022. We believe the risk margin now on these shorter dated securities offers an attractive break-even level, providing protection if further deterioration occurs. As such, we will look for opportunities to add to our current exposure in this sector.

### Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	12.57	28.07
Supranationals	11.37	3.89
Industrials	12.49	2.34
Financials	16.94	1.59
Asset Backed	11.36	0.00
Agencies	10.57	0.39
11AM	1.73	0.00
Cash at Bank	2.79	0.00
RBA Cash	0.00	50.00
Semi Government	20.17	13.71

### Ratings Exposure

Rating	Portfolio %	Benchmark %
A	15.35	1.39
AA	25.93	12.91
AAA	44.98	34.15
BBB	13.74	1.56
RBA Cash	0.00	50.00

### Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Government of Australia	12.57	28.07
National Housing Finance & Investment Corp.	9.02	0.06
New South Wales Treasury Corp.	8.50	3.29
Queensland Treasury Corp.	4.74	3.46
Treasury Corporation of Victoria	3.62	3.41
European Investment Bank	2.80	0.50
Australia and New Zealand Banking Group Limited	2.71	0.17
Commonwealth Bank of Australia	2.20	0.09
NBN Co. Ltd.	2.03	0.10
Societe Generale Sydney Branch	1.79	0.00
BNG Bank N.V.	1.73	0.30
Australian Capital Territory	1.66	0.29
Woolworths Group Limited	1.55	0.07
Kommunalbanken AS (Norway)	1.55	0.28
Wesfarmers Limited	1.46	0.03
REDS EHP Trust Series 2021-1	1.40	0.00
Inter-American Investment Corp.	1.31	0.01
Bank of Queensland Limited	1.29	0.02
International Bank for Reconstruction & Development	1.15	0.33
Asian Development Bank	1.12	0.37

### Portfolio Summary Statistics

	Portfolio	Benchmark
Modified duration (years)	3.39	2.71
Yield to maturity (%)	3.76	1.56

### Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$208.40m
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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