

Altius Sustainable Bond Fund

Fund Update
31 July 2023

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 2023

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Since inception % p.a.
Gross total return	0.61	(0.20)	2.98	(0.42)	1.09	1.43	2.17
Net total return	0.57	(0.32)	2.48	(0.96)	0.48	0.79	1.51
Benchmark	0.43	(0.83)	0.84	(1.12)	0.88	1.04	1.67
Excess to benchmark	0.14	0.51	1.64	0.16	(0.40)	(0.25)	(0.16)

Inception date for performance calculations is 21 November 2014.

Gross total returns are calculated before fees and expenses and assume the reinvestment of distributions. Past performance is not a reliable indicator of future performance.

Net 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 Net total return.

Portfolio Performance and Activity

Fixed-income markets were mixed in July as Central banks continued to increase interest rates. Although markets largely believe central banks are close to the end of their tightening cycle, the risk remains to the upside, driven by persistent core inflation. Domestically, rates curves steepened as the three-year rates fell 0.12% to finish at 3.86% while 10-year rates increased by 0.035% to finish at 4.05%. Portfolio interest rate risk was largely unchanged over July, finishing at 3.43 years.

The Reserve Bank of Australia (RBA) held rates steady at 4.10% at the July meeting with guidance remaining unchanged while noting "some further tightening of monetary policy may be required". The Governor reprised the same language used at the April pause, "the decision to hold interest rates steady this month provides the board with more time to assess the state of the economy and the economic outlook and associated risks..." Overall the statement was balanced with the bank acknowledging that inflation had passed its peak but was still too high, labour markets were showing some signs of easing, particularly in the leading data such as vacancies and advertisements however unemployment is still at historical lows. Market reaction to the pause was muted with both three- and 10-years bonds rallying 0.04% while two further tightenings were priced over 12 months with September the preferred timing for the next move.

The most important domestic economic release occurred in the final week of the month. The quarterly inflation release surprised the market by falling further than expected and providing the RBA further reason to pause at the August meeting. The RBA's preferred measure of inflation (trimmed mean) increases by 0.9% q/q easing to 5.9% on an annual basis, down from 6.6% and below the RBA's forecast of 6%. Importantly, y/y non-tradeable inflation eased to 6.9% from 7.5%, reflecting a moderation of domestically

generated inflation. Post the release the market reduced the probability of an August tightening and only priced one further tightening for this cycle. Other notable economic releases include the ever-important employment numbers which saw 32,600 new jobs created and the unemployment rate at 3.5% and retail sales which fell 0.8% for June. The retail sales number is important as it highlights the significant impact rate increases and cost of living issues are having on household budgets.

As largely expected, the US Federal Reserve raised rates for the eleventh time this cycle, taking the cash rate to 5.375%, above the peak seen prior to the Global Financial Crisis (GFC). Overall, the statement was largely unchanged with the press conference highlighting the hawkish bias of the bank. As with all Central banks close to the end of their tightening cycle, the FED Chairman emphasized that any further tightening is totally data dependent and is not committed to every meeting tightening pace.

Bank of Japan (BOJ), the last central bank to hold out on ultra-low yields made some significant changes to monetary policy in the last days of the month. With inflation firmly above the BOJ's target for the 14th straight month, the bank altered its yield curve control policy. The BOJ kept its target for the 10-year rate at 0% but effectively widened the band to 1%. The change was seen as the first step towards policy normalization.

The risk on tone of the previous months remained the dominant theme for credit markets in July. Cooling inflation, an economy that appeared to be holding up better than anticipated, Central banks close to the end of the tightening cycle and a solid US reporting season all supported the risk on narrative. Financials experienced the biggest move with the financial index contracting around 0.08% while corporates lagged the move contracting 0.04%. Bank-subordinated debt was the big outperformer. For the past seven months subordinated bank spreads had remained in a tight 0.15% range but that was smashed in July with five-year

Major bank subordinate debt contracting 0.25% and taking them to a 12-month low of 1.90%. The outperformance was driven by strong private bank demand coupled with limited supply. Primary markets were quiet with only two corporate deal priced. CNH Industrial priced \$175 million of 3 years at 1.45% and LaTrobe University priced \$175 million of 7-year green bond at 1.07% after launching at a range of 1.10% to 1.15%. The bond included eligible project categories such as green buildings, renewable energy, energy efficiency and clean transportation.

Socially Responsible Investments in Focus

Australia's Minister for Climate Change and Energy, Chris Bowen announced that the Federal Government will develop sectoral decarbonisation pathways to support the country's net zero plan and inform on the 2035 emissions targets. The Climate Change Authority will be responsible for developing such plans, but specific sector targets will not be stipulated. Six key sectors were identified, including electricity and energy, industry (including waste), building, transport, resources, and land. The development of the plans is expected to take 18 months and will be important in providing certainty to investors and attracting capital for the clean energy transition and new low-carbon technology.

The International Maritime Organisation (IMO) has reached an agreement to reach net zero emissions from international shipping "by or around" 2050, a pricing mechanism for Greenhouse gasses (GHG) and to ensure the uptake of low GHG emissions fuels by 2030. Maritime shipping accounts for around 3% of global GHG emissions and are estimated to double by 2050 under most economic scenarios. The new agreements mark a significant increase over the International Maritime Organization's (IMO's) prior 2050 goal of a 50% emissions reduction from shipping.

The IMO confirmed new standards on marine fuels will be developed with a phased reduction in the GHG intensity of fuels and that the pricing mechanism will be enforced on maritime emissions. An interim guidance on biofuel use had also been approved and research will be done on how carbon capture technology will apply to its targets. The use of carbon credits is discouraged.

The global market for green bonds has staged a strong comeback this year as noted in the Financial Times (FT), after a plummet in issuance during the latter half of 2022, green bonds have defied expectations and made an impressive resurgence in the first quarter of 2023, with quarterly issuance reaching an all-time high of over \$150 billion. Sovereign green bonds are on track for record annual issuance in 2023, as governments increasingly look to fund their Paris Agreement and other environmental commitments and boost their climate and sustainability credentials. More broadly, year to date, Global Green, Social, Sustainability, and Sustainability-Linked (GSSS) Bond issuance has aggregated to \$574 billion which is slightly higher than issuance during the same time last year.

Outlook

International bond markets are increasingly idiosyncratic. This should continue as each economy exhibits a different pace of resolution to supply-demand imbalances and efficacy of cash rate rises.

US headline inflation has fallen by 6.1% to 3%. Core is more resilient, 1.7% off its peak but tracking at 4.9% in year-on-year terms. In contrast, UK core inflation has reaccelerated to 6.9%. Australian headline inflation is 1.8% off its peak, and core 1% off its peak at 5.9%, with the most recent quarterly data annualising

at 3.2%.

The central bank cash rate tightening cycle amongst dollar bloc countries is not yet but very close to complete. Central bankers have more recently acknowledged the lagged but cumulative effects of significant rate rises are being felt.

We believe cash rates will rise to 4.35%, though it is some possibility the Australian and New Zealand cycle is complete. A terminal cash rate of 4.35% is largely factored into markets. Any moves to price in rate cuts would in our view be premature.

The probability of a further rate rise lies with the current quarter's inflation outcome (due late October). Prevention of a wage/price spiral by dampening wage expectations is the overriding Reserve Bank of Australia (RBA) objective.

The recent decisions on award wage case and public sector wage claims (which had lagged private sector wages) take effect over the current quarter. Combined with the expected rise in energy prices and rental pressure, this would be the tonic for a November rate rise.

Australian bond yields are expected to oscillate in a reasonably wide range with the top end of that range currently observed. The range trading nature of bonds reflects variability in downward shifts in activity countered by an evolving but uneven effect of the tightening cycle on activity, inflation and policy measures.

The Bank of Japan's (BOJ) decision to modestly lift the 10-year Japanese Government Bond (JGB) Yield Curve Control cap to 1% may recalibrate global bond yields higher. That the BoJ is the last of the major central banks to adjust ultra-easy monetary settings likely dictates any related shift higher in bond yields to be temporary.

The magnitude of the Reserve Bank of Australia rate cycle has differed from other dollar bloc central banks for several factors, and so justifies a lower interest rate structure that likely results in a lower Australian dollar.

Interest rate rises impact a much greater part of the economy due to borrowers' preference for floating-rate mortgages. Higher cash rates have greater efficacy. Consumer demand is cooled at much lower interest rates. A more patient approach to returning inflation to the target has been the RBA's preference given the intent to retain much of the hard-fought employment gains.

With an approximate midpoint in 10-year Australian sovereign bonds at 3.8%, the portfolio strategy is to actively manage duration settings; increasing or decreasing duration accordingly, but with the benefit of attractive accrual.

Greater certainty surrounding peak central bank cash rates supported by lower inflation has increased the odds of a soft landing. Couple with investment grade technicals and fundamentals appearing strong provides a supportive backdrop for high-grade credit markets. The portfolio maintains an overweight in high-grade corporates with a focus on the short end of the yield curve given the higher yield compared to cash and short-dated sovereign assets.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Supranationals	9.13	4.18
Industrials	11.99	2.20
Financials	21.96	2.06
Asset Backed	10.61	0.00
Agencies	11.05	0.55
11AM	3.38	0.00
Cash at Bank	1.04	0.00
RBA Cash	0.00	50.00
Semi Government	21.06	14.49
Sovereigns	9.77	26.53

Ratings Exposure

Rating	Portfolio %	Benchmark %
A	12.71	1.26
AA	29.83	14.19
AAA	42.60	33.07
BBB	14.86	1.47
RBA Cash	0.00	50.00

Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Government of Australia	9.14	26.53
New South Wales Treasury Corp.	8.79	3.84
National Housing Finance & Investment Corp.	7.46	0.06
Treasury Corporation of Victoria	5.07	4.00
Queensland Treasury Corp.	3.95	3.25
Australia and New Zealand Banking Group Limited	3.46	0.20
NAB 11AM A/C - Deposit Accounts	3.38	0.00
Commonwealth Bank of Australia	3.28	0.19
KfW	3.15	0.61
NBN Co Limited	2.17	0.13
Australian Capital Territory	1.77	0.28
Woolworths Group Limited	1.69	0.07
Airservices Australia	1.67	0.04
Suncorp-Metway Ltd.	1.58	0.07
BPCE SA a conseil d'administration	1.58	0.06
Wesfarmers Limited	1.58	0.03
National Australia Bank Limited	1.55	0.25
Suncorp Group Limited	1.46	0.02
Kommunalbanken AS (Norway)	1.46	0.25
APOLLO Series 2023-1 Trust	1.32	0.00

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	4.43	4.20
Modified duration (years)	3.46	2.56

Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$194.30m
Management fee*	0.37% p.a.
Buy/Sell spread	0.05%/0.05%
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 for details.



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