

Altius Sustainable Bond Fund

Fund Update 30 September 2021

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 September 2021

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Since inception % p.a.
Total return	(0.26)	0.14	(1.38)	1.29	1.35	2.20
Benchmark	(0.75)	0.17	(0.69)	2.40	2.03	2.57
Excess to benchmark	0.49	(0.03)	(0.69)	(1.11)	(0.68)	(0.37)

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

Local bond markets started to look past the uncertainty of lockdown in September as vaccination numbers grew and markets began factoring in a more optimistic outlook. This was particularly the case in the final week as 10 year bonds rose 0.22% to finish at 1.49%; 0.33% higher over the month. The move higher was sparked by a more hawkish tilt to the US Federal Reserve's Federal Open Market Committee (FOMC) statement and Chairman Powell's press conference, resulting in US 10 year rates pushing 0.18% in the final week to finish at 1.49%. The Fund held a short interest rate position to benchmark over the month, driving the strong outperformance, with duration largely unchanged at 1.49 years.

As expected, the US Federal Reserve confirmed that a November taper announcement was likely, but it was the somewhat quicker timeline of the QE taper reduction, concluding around the middle of 2022 that surprised the market. A quicker timeline opened up the optionality for rate hikes by the end of 2022 should the conditions warrant. The other driver of the markets hawkish interpretation of the statement was that inflation was expected to remain elevated for a longer period, with Chairman Powell noting that "more persistent than expected bottlenecks relative to their forecast update in June". The combination of these three factors saw rates push higher, indirectly impacting local interest rate markets.

The RBA surprised the market at its September meeting by keeping to its July decision to reduce bond purchases in September from \$5bn per week to \$4bn, however they did push out the next review of the program to February 2022. The market had speculated this would be reversed, with some expecting an increase in QE purchases due to COVID-19 uncertainty, instead the RBA expects the economy to rebound strongly post lockdown. While the September meeting was mildly hawkish, the RBA noted it didn't expect to increase cash rates until 2024 when actual inflation was sustained within the 2-3% target range.

Semi-government spread performed strongly in September after several months being impacted by the economic uncertainty of COVID-19 and increasing budget pressure. Two separate events had a positive impact. Firstly, the regulator announced the phasing out of the Committed Liquidity Facility (CLF). This facility was used by banks as part of regulatory liquidity calculations. Banks are expected to replace this facility with semi-government holdings, leading to increased demand over the medium term. The other story was the sale announcement of Westconnex by the NSW Government for \$11bn which would be used to retire the equivalent amount of debt over the next two years. Overall performance was relatively uniform, but NSW did perform slightly better.

Local credit spread volatility remained low over September with financial spreads moving wider by 2 basis points. Financials' 3 and 5 year margins finished the month at 0.28% and 0.46%, respectively. Volatility in offshore markets did increase over the month due to inflationary concerns, QE taper announcements and fear of default by China's Evergrande Group, potentially impacting the Chinese banking and property sectors. Primary market issuance was \$3.7bn over September, with \$1bn and \$2.7bn of financial and corporate issuance, respectively. Key primary issues included \$500m of a 7 year yield at 3.25% from Qantas with the book 3.8 times oversubscribed and pricing 0.20% tighter than initial guidance, \$700m Toyota 3 year at a margin of 0.43%, \$250m from Shopping Centre Australasia for 8 years at a risk margin of 1.27% and the inaugural 7 year from Waypoint REIT at a margin of 1.37%, 0.18% tighter than initial indications.

A very strong month for sustainable debt issuance with multiple deals coming to the market. CBA surprised the market by not only issuing 5.5 year senior unsecured but in green format. This is the second green transaction bought by the bank. The portfolio of assets is predominately focused on renewable energy and green commercial buildings. After extensive restructuring of their sustainability program Treasury Corp of Victoria (TCV) returned to the market issuing \$2.5bn of a 2035 Sustainability bond. Unlike their small issue in 2016, TCV announced the bond would be

considered a benchmark line meaning additional issuance commitments. The asset pool was greatly expanded to \$9.2bn with around a 50/50 split between social and environmental projects. Key projects include Victoria's \$5bn Big Housing Build, with the Government building 2,900 affordable housing and 9,300 new social housing all meeting a 7 NatHers efficiency standard and \$540m for the development of Victoria's Renewable Energy Zones, which will strengthen the transmission network to enable the transition to renewable energy. Investa Commercial Property returned with a \$140m 9 year green bond. Investa remains one of our preferred sustainable issuers in the property sector with the group committing to a science-based target of zero net by 2040, reporting under the Task Force on Climate-Related Financial Disclosures requirement since 2019 and maintaining a 5-star GRESB rating since 2013. Finally, Woolworths issued a dual 6.5 and 10 year Sustainable Linked Bond, the second in the domestic market. The bond was 5 times oversubscribed with pricing reduced by 0.20% across both bonds from initial indications. The bond had one KPI, a reduction in absolute scope 1 and 2 emissions from its own business, expressed as a percentage, in line with 1.5 degrees Paris Agreement scenario as verified by the Science Based Target Initiative. The overall emission reduction target represents a 63% fall from 2015 (baseline) to 2030. While the targets were a positive, they only covered scope 1 & 2 with scope 3 emission excluded. Over the month, we participated in the 3 green/sustainability bonds while only a small investment was made in Woolworths, preferring the existing green bond.

Socially Responsible Investments in Focus

The European Central Bank (ECB) has released the results (<https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op281~05a7735b1c.en.pdf>) of an economy-wide stress test examining the impact of climate change on millions of firms and the associated exposure of eurozone banks. The study found that short-term costs of the transition pale in comparison to the costs of unfettered climate change in the medium to long-term. The ECB's study concludes that the potential impact of climate change worst-case, could knock 10% of European GDP and cause a 30% rise in defaults on corporate loans to the most exposed companies by 2050. Luis de Guindos, President of the ECB was quoted as saying "Without policies to transition to a greener economy, physical risks will increase over time." The physical risks were underlined with major floods in Germany, as well as wildfires in Turkey, Italy and Greece after Europe recorded its second-warmest July this year. The study also found that risk from the most polluting companies was heavily concentrated among a few large banks. Only 4% of lenders accounted for 20% of loans to the most polluting companies, which produced 45% of carbon emissions. The results will be used as basis for stress tests to assess exposure of individual eurozone banks to climate risks next year, which will feed into their capital requirements.

At the same time, the RBA has released a paper (<https://www.rba.gov.au/publications/bulletin/2021/sep/climate-change-risks-to-australian-banks.html>) outlining estimates of the possible climate impacts facing Australian banks. Mortgage exposure to climate physical risks could result in substantial credit losses and if left unmanaged climate change could pose substantial risks to the local financial system.

Outlook

The portfolio is positioned for further upward recalibration to interest rates. We are looking to profit from a lift in Australian 10 year government bond yields to around 1.9% by year end, and US 10 year yield to around 1.8% by retaining an underweight in longer

dated bond. The major tonic for the outlook is the high level of vaccination bringing a reopening of the Australian economy onto the immediate horizon. Additionally, as the world recovers, the major central banks have started to reduce the quantum of weekly bond purchases, flagging a cessation my mid-2022.

We have increased our exposure to inflation linked bonds, on the basis that realized headline inflation is likely to be above the 1.9% break even yield (at the time of writing). Importantly, we expect the rise in energy costs to lift headline inflation. Oil is 28% higher than the August lows. Other supply chain disruptions are lingering longer than had been anticipated.

Core inflation is being dampened by weak wages growth, as labour market slack is likely to persist. This biases cash rates to remain low until core inflation actually appears. With cash rates likely to remain at 0.1% for a number of years, we find little reward for ultra-short dated securities including bank bills and term deposits but with strong preference with higher yielding floating rate corporates.

Intermediate maturity semi-government and corporate bonds continue to have attraction given the "roll down" of their very steep yield curves. The global "hunt for yield" born of ultra-low cash rates continues to support the high grade corporate and semi sectors.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	5.84	28.68
Semi-Government	17.88	12.98
Supranationals	13.53	4.66
Industrials	15.41	2.14
Financials	21.55	1.37
Asset Backed	11.33	0.00
Money Market	0.00	0.00
Agencies	12.11	0.16
11am	1.28	0.00
Cash at Bank	1.08	0.00
RBA Cash	0.00	50.00

Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	45.68	33.33
AA+ to AA-	34.59	14.12
A+ to A-	10.23	1.40
BBB+ to BBB-	9.50	1.15
RBA Cash	0.00	50.00

Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Nationl Housing Fin Invt	11.58	0.07
NSW Treasury Corp	7.31	3.30
Australian Government	5.81	27.30
Commonwealth Bank Aust	4.34	0.11
Treasury Corp Victoria	3.97	2.84
Queensland Treasury Corp	3.95	3.02
Inter-American Devel Bk	3.00	0.32
ANZ Banking Group	2.74	0.13
European Investment Bank	1.99	0.45
Asian Development Bank	1.91	0.40
Woolworths Group Ltd	1.83	0.05
Landwirtsch. Rentenbank	1.73	0.39
National Australia Bank	1.68	0.16
Wesfarmers Ltd	1.58	0.02
Intl Bk Recon & Develop	1.58	0.34
Aust Capital Territory	1.47	0.26
Royal Bank Of Canada/Syd	1.33	0.01
OCBC Sydney	1.31	0.00
Kommunalbanken As	1.26	0.25
Mirvac Group Finance Ltd	1.23	0.02



Ratings / Awards



Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	1.30	0.57
Modified duration (years)	1.49	2.95

Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$228.44m
Management fee*	0.57% p.a. Note: from 1 July 2021 this will reduce to 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 for details.

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