Altius Sustainable Bond Fund

Fund Update
31 October 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 October 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	(0.83)	(0.95)	3.25	(1.01)	0.76	1.23	2.00
Net total return	(0.87)	(1.07)	2.75	(1.54)	0.15	0.60	1.35
Benchmark	(0.75)	(0.81)	1.25	(1.55)	0.59	0.97	1.53
Excess to benchmark	(0.12)	(0.26)	1.50	0.01	(0.44)	(0.37)	(0.18)

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.
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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

October saw a continuation of the steep bond sell-off from September, with Australian 10-year bond yields 0.44% higher and US 10-year bond yields 0.36% higher to both finish the month at 4.93%. Australian 3-year bond yields were also 0.32% higher with the yield curves steepening as investors priced in more term premiums to compensate for heightened risk as well as expected additional Treasury bond supply from the US. In light of these yield moves, the Bloomberg AusBond Treasury 0+ index generated a negative 1.85% return over the month. Credit markets also underperformed, with the Bloomberg AusBond Credit 0+ index generating a negative 0.78%. The fund underperformed over the month by 0.12%, driven by the overweight duration position held in the fund. At the end of October, the portfolio duration was 3.09 years, which was 0.67 years above benchmark.

The beginning of October was marred by geopolitical events in the Middle East with the Hamas invasion of Israel, which led to a risk-off move in markets, and as a result, investors sought safety in bonds. Australian 10-year bond yields initially fell 0.20% off the back of the risk-off move, however, this faded relatively quickly with market participants embracing the higher for the longer regime and revising the neutral rate higher which led to longer-dated yields increasing more than shorter-dated yields. The Reserve Bank of Australia (RBA) again left cash rates unchanged at 4.10% for the fourth month in a row, with the accompanying statement largely unchanged from the September release, despite a change in Governor, which reiterated a watch and see approach. The bank retained a slightly hawkish bias with "some further tightening of monetary policy may be required" to bring inflation back to the target within a reasonable timeframe with any future change to policy being driven by incoming data and global developments.

Locally, economic data printed on the stronger side in October. The unemployment rate ticked back down to 3.6%, close to the lows of the cycle, despite the underlying employment change and split of full-time to part-time jobs added being weaker than expected, which was driven by a fall in the participation rate. House prices also continued its march higher and is now close to regaining the highs seen in late 2022. Retail sales printed much stronger than expected at 0.9% Month on Month (MoM) against a 0.3% expected and 0.2% last month, and the eagerly awaited Q3 Consumer Price Index (CPI) showed a reacceleration of inflationary pressures, with the trimmed mean Quarter on Quarter (QoQ) at 1.2% vs. 1% expected. The trimmed mean QoQ was also substantially higher than the RBA's forecast of 0.9% and last quarter's print of 0.9% which was revised up to 1.0%, leading to the market pricing in a much higher probability of a rate rise in November and a higher terminal cash rate of 4.54%.

The domestic credit market was resilient over the month, outperforming equity markets where the ASX 200 fell by 3.80%. Financials and industrial credit spreads were relatively stable throughout the month, in contrast to global credit spreads which widened both in the US and Europe, in particular US High Yield, where spreads widened by 0.43%. Riskier 10NC5 subordinated debt in Australia widened by 0.25%. Issuance into the domestic credit market during October was lower than in prior months, with only a handful of issuers coming to market. Commonwealth Bank, QBE and Bendigo and Adelaide Bank issued subordinated T2 paper at spreads of 2.05%, 2.55% and 2.60% respectively. A few international banks also came to market, including Sumitomo, BPCE and notably Bank of America, who issued a total of $1.85bn across 3-year and 5-year fixed and floating tranches. Corporate issuance was also limited, with Woolworths, Scentre Group, QPH Finance and Transurban Qld Finance being the only issuers. Transactions were all largely well supported with deals being oversubscribed and pricing being lowered during the bookbuilding process.

Socially Responsible Investments in Focus

The Australian Energy Market Operator reported this month that wholesale electricity prices were negative a record 19% of the time in the September 23 quarter, helped by a record 11.9 GW of rooftop solar output or the equivalent supply of 44% of total electricity generated. Total emissions were also 11% lower and demand hit a new low. This highlights the growing impact of wind and solar and progress in replacing aging coal power plants, subject to sufficient support from firming generation like batteries are built to smooth out the prices.

https://www.afr.com/companies/energy/solar-boom-unleashes-surge-of-below-zero-power-prices-20231020-p5edqz

UN's climate body said chances of limiting global warming to 1.5C since pre-industrial times is now less than one-third to one-half predicted 2 years ago. Temperatures have already risen by at least 1.1C and carbon dioxide emissions from energy has continued to rise to an all-time high and are expected to rise further. If GHG emissions do not fall by half by 2030, the window to curb global warming to 1.5C will close.

UN science body head fears lower chance of keeping global warming to 1.5C (ft.com)

The Australian Accounting Standards Board (AASB) has published draft climate disclosure standards for public consultation. The draft is based on the International Sustainability Standards Board's (ISSB) sustainability disclosure standards and will apply to both companies and financial institutions. Reporting requirements are expected to apply from 1 July 2024 for large businesses and smaller entities will be phased in over the following 3 years. Many superannuation funds and asset managers will begin reporting from 1 July 2026.

The AASB draft proposes some modifications from the ISSB standards, including:

- Climate-related disclosures are limited to climate-related risks and opportunities and exclude non-GHG emissions.

- Scope 3 emissions disclosures will be encouraged not mandatory and prior period data will be allowed where current period reporting data is unavailable.

The proposed standards are welcome development as the disclosure of consistent and comparable information will be critical for investors to make fully informed decisions as such disclosures will reset risk profiles for businesses.

https://www.esgtoday.com/australia-releases-proposed-ifrs-based-climate-related-reporting-standards/

Trials for low carbon solutions for mine trucks are dealing with some challenges such as battery charging times that reduce the availability of a typical mine truck by 12.5%, and an overall reduction in productivity of 19%. BHP will trial electric trucks made by Caterpillar and Komatsu at while Fortescue is already trialing a battery-powered haul truck in WA.

https://www.afr.com/companies/mining/miners-may-suffer-big-productivity-hit-from-electric-truck-shift-20231002-p5e91q#:~:text=Battery%2Dpowered%20mine%20trucks%20would,to%20Australia's%20biggest%20export%20industry.

Outlook

Australian inflation is expected to recede, but at a gradual pace. Labour market conditions remain tight, providing the conditions for wage rises in response to the extended lift in the cost of living. Three years of negative real wages likely ensure an elongated but not acute wage response.

Australian growth has remained resilient when compared to market expectations. Although the Federal government budget is consolidating, State government infrastructure and general budget settings are expansionary, adding to aggregate demand.

Australia's significant population increase is pressuring housing supply. With some "crowding out" in the construction sector from state infrastructure, already high costs are leading to an ongoing shortage of housing. We expect this to underpin the rise in rental costs and housing prices generally.

Interest rate rises and falls in spending power are dampening discretionary spending, and tightening financial conditions appreciably, though unevenly. Mortgage and rental stress is present, though in aggregate have been somewhat offset by high levels of employment and hours worked.

Recent labour market data and higher than expected inflation point to a danger the path to the RBA's target inflation would be longer than preferred. Recent lifts in global oil prices account for some of the headline inflation lift.

Although the RBA preference is to cool inflation without disrupting labour market gains, it will act to ensure the return to target inflation is not excessively long. For this reason, cash rates are expected to be lifted at the November RBA meeting to 4.35%

Better global activity is related to resilient US consumers. 30-year fixed rate mortgages ensure existing borrowers have barely been impacted by the lift in US rates. Where interest rates have greater efficacy currently is with new mortgages, and business loans (much shorter). The recent large rise in term US rates likely tightens financial conditions more acutely, but the lag in effect is uneven.

The recalibration of US long term rates has driven Australian and most other major bond markets to higher yields. From a valuation perspective, Australian long dated bond yields now reflect real yields that are at decade highs and near the highest levels seen in the decade prior to the GFC.

Australia's cash rates are over 1% below many global peers. This essentially reflects a much higher efficacy of cash rate settings via variable mortgage preference. Long dated interest rates however, are higher than most.

10-year bond yields are between 0.15% higher than US Treasuries and 2% higher than German sovereign bonds. The impact of the global recalibration in long term rates suggests something of an overextension in Australia compared to peers.

Portfolio Strategy

In the context of a balanced fund, bond valuations, contextualized against historical real yields at decade highs determine there is value within the asset class. A further measure of value that we find in the high grade corporate market is related to the yield on the Australian Corporate Index being higher than the dividend yield of Australian stocks as defined by the ASX 200.

Shorter dated Australian Government Bond yields are only at or slightly above the expected cash rate. The portfolio has a strong preference for the superior income generated by higher yielding high grade credit. Non-cyclical consumer and regional bank securities in particular.

Largely driven by offshore markets, the range on Australian long dated bonds has shifted higher, with an approximate midpoint in

10 year Australian sovereign bonds around 4.75%. The portfolio strategy is to actively manage duration settings; increasing or decreasing duration accordingly, but with the benefit of attractive accrual.

Over time, there is likely an increasing importance of duration as an insurance policy.

The tightening of financial conditions offshore does two things. They place more pressure on banking systems and corporates. Adverse event risk is more likely where safe-haven assets increase in value.

Demand for and supply of credit is falling and softening private sector economic conditions gradually, contributing to less credit, softer economic conditions and falling inflation.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Supranationals	8.57	4.16
Industrials	12.86	2.22
Financials	26.10	2.17
Asset Backed	10.08	0.00
Agencies	10.39	0.53
11AM	1.79	0.00
Cash at Bank	1.80	0.00
RBA Cash	0.00	50.00
Semi Government	18.56	14.67
Sovereigns	9.85	26.26

Ratings Exposure

Rating	Portfolio %	Benchmark %
A	13.74	1.24
AA	30.33	14.93
AAA	39.24	32.36
BBB	16.70	1.48
RBA Cash	0.00	50.00

Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Government of Australia	9.25	26.26
New South Wales Treasury Corp.	8.72	3.99
National Housing Finance & Investment Corp.	6.76	0.06
Treasury Corporation of Victoria	4.63	4.13
Australia and New Zealand Banking Group Limited	4.36	0.21
Commonwealth Bank of Australia	4.18	0.23
Queensland Treasury Corp.	2.88	3.25
NBN Co Limited	2.55	0.16
BPCE	2.15	0.06
NAB 11AM A/C - Deposit Accounts	1.79	0.00
Woolworths Group Limited	1.73	0.07
Airservices Australia	1.67	0.04
Suncorp-Metway Ltd.	1.62	0.08
Wesfarmers Limited	1.60	0.03
National Australia Bank Limited	1.59	0.24
KfW	1.57	0.63
Kommunalbanken AS (Norway)	1.49	0.23
Asian Development Bank	1.47	0.41
APOLLO Series 2023-1 Trust	1.38	0.00
GAIF Bond Issuer Pty Limited	1.20	0.02

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	5.12	4.52
Modified duration (years)	3.09	2.42

Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	$5,000
Fund size (net asset value)	$188.44m
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.

Ratings / Awards

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