

Altius Sustainable Bond Fund

Fund Update 30 June 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 June 2021

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Since inception % p.a.
Total return	(0.11)	0.39	(0.55)	1.42	1.53	2.26
Benchmark	0.35	0.77	(0.32)	2.49	2.13	2.65
Excess to benchmark	(0.46)	(0.38)	(0.23)	(1.07)	(0.60)	(0.39)

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

The key themes over June were the significant flattening of both the domestic and US curves and the reduced fear of market concerns about inflation risk. The domestic curve started the month at 1.43% and fell to 1.07%. Three year rates rose 0.25% to 0.465% following a significant change in the market's expectations that the Reserve Bank will commence tightening rates as early as 2022, while 10 year rates fell 0.11% to 1.47% driven by reduced inflationary fears in both the US and domestic economy. The flattening of the curve was a key driver for the Fund's underperformance with our expectations that inflationary pressures will grow with improved economic data and employment numbers. At the end of the month, the Fund maintained its short duration position of 1.77 years.

US inflation data and expectations continued to surprise on the upside but was offset by a poor employment report. While inflation data was high, markets become more comfortable with the Fed's view that inflationary pressures were only transitory. The US Federal Open Market Committee (FOMC) surprised markets with the Fed dots implying two rate hikes in 2023 while inflation forecasts were only 2.20%, well under market expectations. Immediately post this meeting, long end rates pushed lower while short rates rose.

Key data releases over the month were both the domestic and US employment numbers. While the US payrolls report disappointed with the 559,000 jobs created being well below expectations, it was the local employment numbers that surprised with 115,000 jobs versus expectation of 30,000, driving the unemployment rate to 5.1%, a pre-pandemic low. Following this report and coupled with the FOMC outcome, domestic banks began to change their RBA views, including the timing of the first-rate hike and the tapering of their QE program. The impact was the first leg of the significant curve flattening that occurred throughout June.

Credit spread tightened marginally over June with investor

sentiment remaining strong. Financial spreads fell roughly 0.03% while non-financials fell 0.01% to finish at 0.53% and 0.85% respectively. With many corporates taking the opportunity to issue several months ago, it meant primary markets were extremely quiet. REIT's and Financials dominated issuance with Charter Hall LWR returning to the market to issue \$267m of 8.5 years at a margin of 1.25% and LendLease International Towers Sydney issuing \$200m of 9 years at 1.40%. While on the financial side, Teachers Mutual issued \$100m for 5 years to refinance their July 2020 maturity at 0.68%. Teachers Mutual remains a preferred regional bank from our sustainability view, and as such we participated in the transaction. Bendigo Bank and Macquarie round out the month with a 5-year senior and 5-year subordinated deal at 0.65% and 1.55% respectively. Over the course of the month portfolio risk to corporates was largely unchanged.

Sustainable issuance continued to grow strongly through June. Of most interest was the inaugural Wesfarmers Sustainable Linked Bond (SLB), the first such transaction in the local market. Wesfarmers set two KPIs for the transaction. The first KPI focused on renewables and emission reductions with a commitment to source 100% of electricity requirements from renewables for its retail businesses by December 2025. The second KPI focused on nitrate production and limiting emission intensity to 0.25 tonnes of CO2 of ammonium nitrate produced, or lower. If Wesfarmers fails to meet either target, the coupon on the bond increases by 0.125% for each KPI. We believed both KPIs meet the objectivities of the SLB principles, and as such, an investment was made for the Fund. CPP Investment (Canadian Pension Fund) issued a 7-year green bond with a focus on renewables, sustainable water and green buildings. While IDB Invest, a member of the IADB Group which focuses on Latin America and the Caribbean, issued a 5-year social bond.

Socially Responsible Investments in Focus

The Queensland government has announced an increase of a further \$1.5 billion to their clean energy fund, on top of an existing

\$500 million renewable energy fund committed in last year's budget. The expanded Queensland Renewable Energy and Hydrogen Jobs Fund will be used to invest directly in new renewable electricity, hydrogen production and clean energy resources project.

It was a big month for zero emission transport with the NSW government announcing ambitious plans to electrify the state's train network within the next four years, and retrofit some harbour ferries with electric engines, as well as funding to speed up adoption of passenger electric vehicle (EV) use in the state. The government has also announced a new scheme to retrain motor mechanics so they can work on electric vehicles, as it ramps up the electrification of its bus network. Over the next decade, the NSW government plans to replace its entire network of 8,000 buses with zero emissions vehicles. The scheme to retrain mechanics on these new buses will be run as a partnership with Volvo Australia and TAFE NSW. NSW will waive stamp duty on new EVs under \$78,000, give cash rebate of \$3,000 for 25,000 new EV buyers and spend \$171 million on chargers throughout the state. The government is aiming to increase EV sales to more than 50% of new cars sold in NSW by 2030 and the vast majority of sales by 2035.

In another win for the environment, the NSW government has announced plans to cut single-use plastics by 2025. The move has been lauded by different environmental groups as NSW was the only state in Australia without a ban on plastic bags. Straws, stirrers, cotton buds and polystyrene cups will be phased out 12 months after legislation is passed, with a review on plastic cups, heavy bags and fruit stickers to be carried out within three years.

UNESCO has recommended that that Great Barrier Reef be placed on a list of world heritage sites that are "in danger" urging Australia to take accelerated action at all possible levels on climate change. The United Nations committee has also called on the Tasmanian government to halt tourism development in the Tasmanian Wilderness World Heritage Area (TWWHA) until a cultural assessment is completed (<https://www.abc.net.au/news/2021-06-23/unesco-tasmanian-wilderness-world-heritage-area/100236044>). The G7 summit in Cornwall in June saw G7 leaders make new pledges to combat climate change. Although the G7 leaders have agreed to stop financing coal projects by the end of 2021, their climate pledge were criticised for not going far enough.

A draft of the Intergovernmental Panel on Climate Change report said crushing climate impacts will hit sooner than feared. With 1.1°C warming clocked, the climate is already changing. Earlier models predicted we were not likely to see Earth-altering climate change before 2100 but dangerous thresholds are closer than once thought with the report outlining the danger of compound and cascading impacts, along with point-of-no-return thresholds in the climate system known as tipping points. Warming of 2°C could push the melting of ice sheets past a point of no return. Other tipping points could see Amazon basin morph from tropical forest to savannah and billions of tonnes of carbon leech from Siberia's permafrost, fueling further warming.

Outlook

Australia is well advanced in its recovery. Successful virus containment has allowed the economy to open more quickly than anticipated, but we expect virus mutations and the nature of the pandemic to be with us for some time. Virus outbreaks and related restrictions are definitionally unpredictable, thus providing a backdrop of some volatility.

Central banks are universally supportive, but keen to ensure a recovery lifts inflation to target levels not seen over the last

decade. This biases cash rates to remain low until inflation actually appears, but markets will be more forward-looking, meaning longer dated interest rates can drift higher, albeit dampened by the ongoing central bank bond buying programs.

Despite the rise in underlying inflation expected to be temporary, the US has seen a larger lift than expected. The narrative of the Federal Reserve has evolved to suggest the lift may be a little more persistent.

Australia's position is rather more idiosyncratic. Closed borders mean virtually no workers coming from overseas combined with the historically high participation rate, there are pockets of wage pressure emerging. Although no widespread wage lift has been seen in official data, anecdotal evidence suggests that the labour market is tightening a little quicker than the RBA has forecast. The RBA has significantly revised up expected growth rates for 2021 to 4.75%. Unemployment is expected to fall to 5% by year end.

The RBA is embarking on the slow process of unwinding its emergency settings, whilst hoping to spark a healthy measure of inflation. So as not to allow an unhelpfully high Australian dollar, official cash rates are unlikely to lift ahead of the US increasing cash rates. However, reflecting the improved backdrop, the RBA has decided to not extend its Yield Curve Control point beyond the current maturity (April 2024 Government Bond) at 0.1%. Given smaller government budget deficits, the RBA has been able to trim the volume of its bond purchases. Consequently, we expect some upward recalibration to interest rates, with 10-year yields moving higher to around 1.9% by year end.

The Fund's exposure to inflation-linked bonds caters to the likely lift in headline inflation from the rebasing effect of the depths of "COVID-19 shutdown" passing, and as a hedge against expectations of wage increases.

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	7.27	28.65
Semi-Government	17.24	13.00
Supranationals	12.90	4.63
Industrials	15.12	2.08
Financials	25.35	1.50
Asset Backed	9.68	0.00
Money Market	0.00	0.00
Agencies	10.31	0.14
11am	0.94	0.00
Cash at Bank	1.19	0.00
RBA Cash	0.00	50.00

Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	42.35	33.13
AA+ to AA-	32.94	14.31
A+ to A-	14.56	1.39
BBB+ to BBB-	10.15	1.17
RBA Cash	0.00	50.00

Top 20 Issuers

Issuer	Portfolio %	Benchmark %
Nationl Housing Fin Invnt	10.17	0.05
NSW Treasury Corp	7.62	3.09
Australian Government	7.17	28.25
Commonwealth Bank Aust	4.42	0.14
Treasury Corp Victoria	3.79	2.78
Queensland Treasury Corp	3.25	3.09
Inter-American Development Bank	3.02	0.33
National Australia Bank	2.92	0.16
ANZ Banking Group	2.75	0.17
UBS Ag Australia	2.16	0.04
European Investment Bank	2.12	0.43
Asian Development Bank	1.92	0.40
Woolworths Group	1.82	0.05
Royal Bank Of Canada (Syd)	1.79	0.01
Bank Of Montreal	1.57	0.04
Aust Capital Territory	1.46	0.26
Bank Of Queensland	1.43	0.01
Intl Bank Reconstruction & Development	1.37	0.35
Kommunalbanken As	1.33	0.26
Mirvac Group Finance	1.24	0.02

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	1.15	0.58
Modified duration (years)	1.77	3.02

Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$227.52m
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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