Altius Bond Fund

Fund Update
31 October 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.

Performance as at 31 October 2021

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	10 yrs % p.a.	Since inception % p.a.
Total return	(1.98)	(2.46)	(3.52)	0.68	1.16	1.84	3.02	3.25
Benchmark	(1.77)	(2.46)	(2.60)	1.68	1.79	2.29	3.00	3.19
Excess to benchmark	(0.21)	0.00	(0.92)	(1.00)	(0.63)	(0.45)	0.02	0.06

Inception date for performance calculations is 14 June 2011.
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

Bond markets experienced one of the most significant selloffs in recent memory. Locally, most of the damage occurred in the 3 and 5-years part of the curve with rates lifting by 0.90%, and 3-year yields finishing at 1.40%. Overnight indexed swaps moved rapidly to price a tightening of cash rates with the market pricing the first tightening for April 2022, some two years ahead of RBA guidance. Further to this the market had priced four tightening's of cash rates by the end of 2022. The long end of the curve was not immune to these moves with the 10-year rate rising 0.61% to finish at 2.115%. We entered the month with a short duration exposure and gradually reduced this position throughout the month. With the aggressive pricing of rate hikes in the final week we added front end duration, finishing the month at 3.70 years.

Inflation was the talking point of markets during October. In the US, monthly data added to the story that inflation may not be transitory. Rising business activity and new orders rose while supply chain pressures remained high. Headline inflation and retail sale printed on the higher side of expectations. Markets responded by pushing 10-year US breakeven inflation levels to a record high of 2.70%. Locally, inflation surprised on the high side with the trimmed mean CPI, the RBA's preferred measure, printing at 0.70% for Q32021 leading to an annual rate of 2.10%. This was the first time in several years' inflation had moved into the RBA target band. The release drove front end rates higher and had many in the market questioning whether the RBA would stand by its Yield Curve Control strategy, with the April 2024 bond moving from 0.175%, RBA target rate of 0.10%, to over 0.70%. By October 28 the yield curve had flattened 0.50% over the month, a move only exceeded in June 2009.

Rising energy prices placed pressures on the market view of transitory inflation. Crude oil extended its YTD gains to 72%, with the October rise coming from a surge in natural gases prices. In Europe and Asia, gas prices are at record highs and coal prices are surging on the back of energy shortages in China, India and Germany. The surge in demand has been driven mostly by the recovery of the global economy and an anticipated extreme winter weather across Europe.

The final week of October was dominated by volatility and illiquidity. While inflation data was a large driver of markets there were a combination of factors that contributed to moves. Globally, pricing for central bank's policy was extremely hawkish over the month. The Bank of England signalled they would increase rates to prevent an upward rise in inflation expectations, the Bank of Canada ended QE and signalled a lift in rates could begin by Mid-2022 and RBNZ tightened rates by 0.25% following on from the Norges Bank (Norway) 0.25% rise in late September.

The rapid move higher in rates contributed to the underperformance of credit in October. Local bank risk pushed 0.12% wider with 5-year senior closing at a spread of 0.60%. Markets have become concerned about bank funding requirements, with the refinancing of the first tranche of Term Funding Facilities due in 15 months and the changes to APRA's Committed Liquidity Facility. Both added to investors' concerns about increased bank issuance. The move in senior risk spreads impacted subordinated debt with spreads widening 0.10%. Industrial risk performed better with spreads on BBB issuers widening by 0.05%. Local issuance remained light in October. Bank of Queensland issued $800m five years at a margin of 0.80%, issued with a decent concession to secondary market levels.

Issuance in sustainable finance format remained strong. GPT Wholesale Office Fund (GWOF) issued a 10-year green use of proceed bond. The bond is certified by the Climate Bond Initiative (CBI) with the eligible assets aligning with the CBI's Low Carbon Building Criteria. Key sustainable highlights for the GWOF business include 100% of the operational buildings are carbon neutral, the first Australian property portfolio to be recognized by the Green Building Council of Australia and the portfolio averaging a 6-star NABERS energy rating. APPF issued a 2031 Sustainable Linked Bond, the market's 3rd. The key sustainability metric (KPI) focusses on a reduction of scope 1 and 2 emissions aligned with the groups 1.5-degree trajectory to achieve net zero by 2040. Progress on meeting this objective will be measured in 2028. If APPF has not meet their objective the coupon of the bond will increase by 0.20%. The fund participated in both issues.

Outlook

The rise in oil prices, the global bottleneck in goods production, and the sharp lift in New Zealand inflation lead global investors to cut positions held in short dated Australian interest rate strategies. The liquidation of these positions was too large for the market to absorb quickly. The RBA's Yield Curve Control policy has usually addressed this. However, during the last two days of the month, the RBA abandoned this tool, deciding not to purchase short dated bonds, though, did not announce any policy shift directly. Consequently, the market quickly priced in six interest rate rises by the end of 2023, and the immediate cessation of Yield Curve Control (The April 2024 Commonwealth Bond at 0.10%)

The rise in New Zealand inflation was seen to be an early indication of regional inflation pressures, and a key input into the lift in Australian interest rates, given the RBNZ have embarked on a tightening cycle. New Zealand short term rates are 1% higher than the comparative Australian rate. Outside of energy prices, the extrapolation of the New Zealand experience is inappropriate given the inflation drivers are quite different.

The second element behind the rise in shorter dated Australian rates was the marginally higher than expected core inflation reading. The core inflation rate surprise added to the interpretation the RBA would be forced to increase cash rates. On the basis that realised headline inflation is likely to be above the 2% break even yield (at the time of writing) we have increased our exposure to inflation linked bonds. Importantly, we expect the rise in energy costs to further lift headline inflation. Oil is 29% higher than the August lows. Other supply chain disruptions are lingering longer than had been anticipated.

The Reserve Bank Governor, at the November RBA media conference, was strident in expressing was an unlikely prospect of a lift in wages of any significance before end 2023, and consequently the unlikely need to adjust cash rates higher.

Governor Lowe reiterated that the complete overreaction to the inflation data and that bond market pricing was difficult to reconcile." I'm not sure what state would lead us to raise rates next year". Moreover, raising rates at that speed is "not consistent with our reaction function. The factors that have kept wages low in Australia for a decade are still in place." We believe the case will build for the first cash rate increase in mid-2023, should wages pick up quicker than expected. We find value in the current pricing of short dated yields, with the first-rate increase priced for July 2022, and have increased our position to overweight.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	7.65	28.48
Supranationals	14.78	4.71
Industrials	12.43	2.23
Financials	14.97	1.37
Asset Backed	12.24	0.00
Agencies	12.27	0.15
11am	1.19	0.00
Cash at Bank	0.91	0.00
RBA Cash	0.00	50.00
Semi Government	23.57	13.06

Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	50.45	33.20
AA+ to AA-	29.80	14.22
A+ to A-	8.40	1.40
BBB+ to BBB-	11.35	1.18
RBA Cash	0.00	50.00

Maturity Profile

Term	Portfolio %	Benchmark %
0 - 1 year	5.09	54.30
1 - 3 years	23.43	8.72
3 - 5 years	23.10	11.60
5 - 7 years	20.12	9.09
7+ years	28.25	16.29

Top 10 Issuers

Issuer	Portfolio %	Benchmark %
New South Wales Treasury Corp	12.82	3.32
Nationl Housing Fin Invt	11.82	0.06
Australian Government	7.72	27.08
Treasury Corp Victoria	4.85	2.87
Asian Development Bank	3.76	0.40
Queensland Treasury Corp	3.65	3.09
Inter-American Development Bank	3.56	0.32
Intl Bk Recon & Develop	2.47	0.34
ANZ Banking Group	2.02	0.13
Aust Capital Territory	1.65	0.25

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	1.83	0.90
Modified duration (years)	3.70	2.89

Fund snapshot

APIR code	WFS0486AU
Inception date	14 Jun 2011
Distribution frequency	Quarterly
Minimum initial investment	$5,000
Fund size (net asset value)	$116.77m
Management fee*	0.46% 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.

Ratings / Awards

Contact us

australianunity.com.au/wealth

australianunitywealth@unitregistry.com.au

Investor Services

T 1300 997 774 F 1300 856 685

Adviser Services

T 1300 997 774 F 1300 856 685