Altius Bond Fund

Fund Update
30 November 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 30 November 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	0.67	(1.55)	(2.93)	0.86	1.42	1.88	2.97	3.29
Benchmark	1.04	(1.49)	(1.53)	1.97	2.13	2.33	3.00	3.26
Excess to benchmark	(0.37)	(0.06)	(1.40)	(1.11)	(0.71)	(0.45)	(0.03)	0.03

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

Another volatile month for bond markets as investors worked though changing central bank commentaries, economic data and the appearance of the new COVID-19 variant "Omicron". Locally, three-year bonds traded in a range of 0.99% to 1.33% before finishing at 1.01%, 0.39% lower over the month. 10-year bonds closed at 1.70%, 0.415% lower, after trading between 1.66% and 2.02%. Australian rates outperformed US markets with US 10-years only closing 0.10% lower at 1.45%. The Fund maintained a long duration position over November, however the large deterioration in the swap and credit spreads swamped the overall Fund performance. At the end of the month the Fund duration was 3.57 years.

After much speculation in the second half of October, the RBA confirmed the end of its Yield Curve Control (YCC) program at its November meeting. This was the next step in the normalization of monetary policy which began with the ending of the Term Fund Facility (TFF) on June 30. The RBA however remained resolute that interest rates would not be increased before late 2023, in stark contrast to market pricing which had close to four tightening's priced before the end of December 2022. This disconnect between the RBA view and the market is adding to the increased volatility experienced over the past six weeks.

Outside of Australia, central bank commentary and action dominated market thinking. The Bank of England surprised markets early by leaving cash rates unchanged after being considered a leading candidate to increase rates due to the sharp jump in inflation. The US Federal Reserve become more hawkish, suggesting a faster pace of tapering with Powell noting that it may be a good time for the Fed to retire the "transitory" word and in his view the taper should accelerate to finish a "few months sooner". Finally, the Bank of New Zealand delivered its second 0.25% tightening of the cash rate. While central bank commentary weighed heavily on market sentiment, it was again COVID-19 that had the last word. The headlines of the new strain on November 25th saw local yields rally 0.18% into the month end close.

One of the big stories of the month was the large underperformance of swap spreads. Multiple factors drove the moves. Significant payside pressure from corporates and bank mortgage books, the ceasing of the RBA's YCC program meant "carry" strategies began to be questioned and the improving fiscal position of the Government meant lower bond supply going forward. These factors saw the 3-year and 10-year spreads widen by 0.14% and 0.15%, respectively. This large move meant that all fixed rate sectors (Semis, Supranational and Credit) underperformed the Government market.

Credit spread volatility increased in November. Concerns about the new COVID-19 variant, rising inflation, faster global central bank tapering and heavy issuance in offshore markets weighed on spreads. This was particularly the case in the US market that saw senior financial spreads widen 0.23% to 0.91%, financial subordinated spreads widen 0.29% to 1.31% and US high yield widen 0.70% to 3.75%. Domestically, spreads performed extremely well relative to their US peers. Locally, BBB credit and senior financial spreads widened 0.07% to average 1.23% and 0.66%, respectively. While the November move was small, financial spreads have been widening since July with spreads now 0.22% higher year to date.

Issuance was light in November. The Bank of Queensland issued $400m of 10NC5 subordinated debt at a margin of 1.75% and Melbourne Airport issued 10 years at a spread of 1.67% with the book 1.7 times oversubscribed. Goodman Australian Industrial priced $400m for 6 years at 0.83%, 0.12% tighter than the announced levels. Two additional corporates issued under a sustainable framework in November. Optus issued $300m of a seven-year sustainable linked bond (SLB), the fourth SLB in the local market. The key performance indicator of the bond related to absolute GHG emissions reduction for scope one and two with the performance target being a 25% reduction in absolute emission by 25% by 2025 from 2015 baseline. Optus uses a Science Based Targets initiative (SBTi) to guide their emissions reduction pathway which we believe is essential for emissions targets in SLB structures. However, given emissions have continued to rise since 2017 due to ongoing expansion, no inclusion of scope three targets and a weak credit view we decided not to invest. We participated in the Mercury NZ 7-year green bond certified by the Climate Bond Initiative. Mercury is one of four integrated electricity companies in New Zealand with 100% of generation from renewables and 51% owned by the New Zealand Government. The bond refinances a mix of geothermal and wind assets. The certification seeks to filter out geothermal plants that are deemed high emitters. All five geothermal plants fall into the low emitting category generating less the 100gCO2/kWh.

Outlook

The global economy continues to recover, albeit somewhat unevenly. High energy prices and tight product markets have lifted inflation. Tight labour markets and more persistent core inflationary pressures have built in North America, UK and New Zealand. US inflation lift has been persistent enough for the Federal Reserve Chair to abandon the inflation description as being transitory. Australian, European and Chinese inflation pressures have largely been energy related.

Major central banks have commenced the path to removing the COVID-19 emergency monetary policy settings. The velocity of bond purchase programs has reduced. Expectations of interest rate rises has been brought forward. This has induced a liquidity vacuum that has contributed to higher yields, and a disruption to leveraged "carry trades" utilized by hedge funds and similar operators.

The emergence of the Omicron strain has introduced a new source of uncertainty. The associated fall in oil prices, and thus headline inflation pressures have led long dated bond yields to fall modestly to around 1.70%. Wholesale lockdowns are unlikely, given the political will has evaporated. With the recovery unlikely to be derailed and quantitative easing to cease in Australia and overseas in early 2022, the trend for slightly higher bond rates is likely to reassert. Indeed, there is a chance for a prolonging in pipeline pressures from more production delays given the recent increase in border restrictions.

We believe there may be a case for the first cash rate increase in mid-2023, should wages pick up quicker than expected. Considerably more has been factored in (the implied first-rate increase in February 2022). Accordingly, we find significant value in the current pricing short dated yields, remain overweight. The abandoning of YCC at the November RBA meeting has little long-term implications.

We have increased our exposure to inflation linked bonds, on the basis that realized headline inflation is likely to be above the 2% break even yield (at the time of writing). Importantly, we expect the rise in energy costs to further lift headline inflation. As discussed, other supply chain disruptions are lingering longer than had been anticipated with the lower Australian dollar adding to imported inflation pressures. We are monitoring is the lift in domestic industrial action. Any broad-based wage pressures are supportive of the inflation linked strategy.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Australian Commonwealth Government	9.32	28.62
Supranationals	12.90	4.67
Industrials	18.27	2.17
Financials	14.70	1.31
Asset Backed	12.66	0.00
Agencies	9.52	0.15
11am	4.61	0.00
Cash at Bank	1.95	0.00
RBA Cash	0.00	50.00
Semi Government	16.07	13.07

Ratings Exposure

Rating	Portfolio %	Benchmark %
AAA	47.66	33.28
AA+ to AA-	31.64	14.19
A+ to A-	9.83	1.38
BBB+ to BBB-	10.87	1.15
RBA Cash	0.00	50.00

Maturity Profile

Term	Portfolio %	Benchmark %
0 - 1 year	13.05	55.10
1 - 3 years	25.77	8.82
3 - 5 years	13.16	10.36
5 - 7 years	23.05	9.36
7+ years	24.97	16.36

Top 10 Issuers

Issuer	Portfolio %	Benchmark %
Australian Government	9.40	27.22
Nationl Housing Fin Invt	7.88	0.06
New South Wales Treasury Corp	6.24	3.34
Treasury Corp Victoria	4.22	2.87
Queensland Treasury Corp	3.36	3.12
Macquarie University	2.64	0.01
Toronto-Dominion Bank	2.62	0.04
Etsa Utilities Finance	2.59	0.01
Australian Catholic Uni	2.45	0.01
ANZ Banking Group	2.10	0.13

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	1.50	0.76
Modified duration (years)	3.57	2.92

Fund snapshot

APIR code	WFS0486AU
Inception date	14 Jun 2011
Distribution frequency	Quarterly
Minimum initial investment	$5,000
Fund size (net asset value)	$38.76m
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.

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