



December 2020

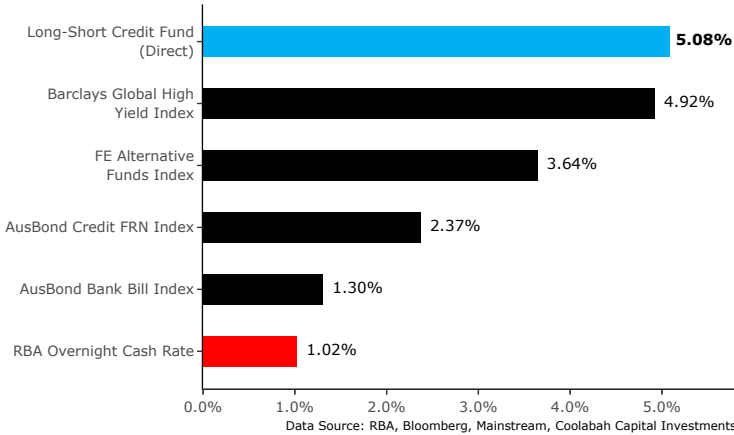
**Objective:** An absolute return fixed-income strategy focused on exploiting long and short mispricings in credit markets that targets high-yield like returns above the Reserve Bank of Australia (RBA) cash rate plus 4% to 6% p.a. over rolling 3 year periods with volatility of less than 5% p.a. after Management Fees, Administration Fees and Performance Fees.

**Strategy:** We add value via active asset-selection using a range of valuation models with the aim of delivering superior risk-adjusted returns, or alpha, to traditional hedge funds. We primarily invest in senior and subordinated debt securities, hybrids and derivatives issued by Australian entities domestically, although we can invest in these securities when they are issued overseas, or by overseas entities (into Australia or offshore). The Fund can use gearing and targets holding the majority of its portfolio in investment-grade securities. It is managed by Coolabah Capital Investments.

Period Ending	Gross Return (Direct)	Net Return (Direct) <sup>†</sup>	RBA Cash Rate	Gross Excess Return <sup>‡</sup>	Net Excess Return (Direct) <sup>†‡</sup>
2020-12-31					
1 month	1.74%	1.33%	0.00%	1.74%	1.33%
3 months	4.69%	3.54%	0.02%	4.67%	3.53%
6 months	7.53%	5.57%	0.05%	7.47%	5.52%
<b>1 year</b>	<b>9.10%</b>	<b>6.31%</b>	<b>0.25%</b>	<b>8.85%</b>	<b>6.07%</b>
2 years pa	9.38%	6.59%	0.71%	8.68%	5.89%
3 years pa	7.20%	4.97%	0.97%	6.23%	4.00%
<b>Inception pa Aug. 2017</b>	<b>7.32%</b>	<b>5.08%</b>	<b>1.02%</b>	<b>6.29%</b>	<b>4.06%</b>

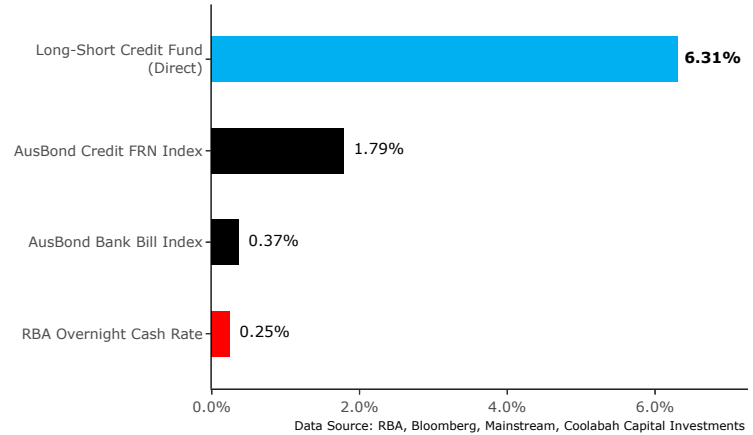
**Long Short Credit Fund Returns (Net) vs Benchmark (pa)**

Annualised Returns Since Inception in August 2017 to 31 December 2020



**Long Short Credit Fund Returns (Net) vs Benchmark**

12 Month Return to December 2020



<sup>†</sup> Net returns are calculated from the historic gross returns using the current fee structure as displayed in the Product Disclosure Statement. <sup>‡</sup> The Excess Return columns represent the gross and net return above the RBA cash rate.

**Disclaimer:** Past performance does not assure future returns. Returns are shown net of all Management and Performance fees unless otherwise stated. All investments carry risks, including that the value of investments may vary, future returns may differ from past returns, and that your capital is not guaranteed. To understand Fund's risks better, please refer to the Product Disclosure Statement available at Coolabah Capital Investments' website.

Net Monthly Returns > RBA Cash Rate	80%	Permitted Gearing	Yes
Gross Portfolio Weight to Cash Securities	2.8%	1 Year Av. Gross Portfolio Weight to Cash	1.6%
Gross Portfolio Weight to Bonds	97.0%	Gross Portfolio Weight to AT1 Hybrids	10.9%
Av. Portfolio Credit Rating	AA-	Gross Cash Securities + RBA Repo-Eligible Debt	62.1%
No. Cash Securities	4	Gross Portfolio Weight to ABS/RMBS	0.8%
No. Notes and Bonds	70	Net Credit Spread Duration Ex Govt	3.98 years
Av. Interest Rate (Gross Running Yield)	6.05%	Net Annual Volatility (since incep.)	3.27% pa
Modified Interest Rate Duration	0.17 years	Gross/Net Sharpe Ratio (since incep.)	1.88x/1.24x
		<b>Awards:</b> FE Alpha Manager 2019: Christopher Joye; <b>Qual Ratings:</b> Lonsec available to clients; Recommended (Atchison); "Very Strong" (Aust. Ratings)	



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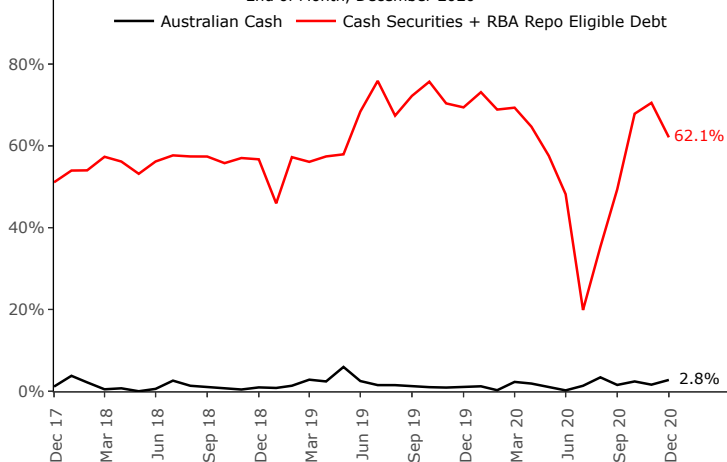


**ALPHA MANAGER 2019**  
Christopher Joye



**Portfolio Weights: Cash + RBA Repo Eligible Debt**

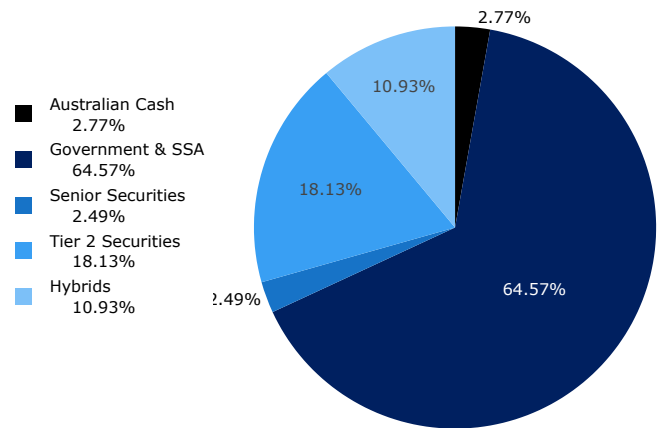
End of Month, December 2020



Data Source: Coolabah Capital Investments

**Long Short Credit Fund Portfolio Composition (Gross NAV)**

(Gross Levered Statistics) - 31 December 2020

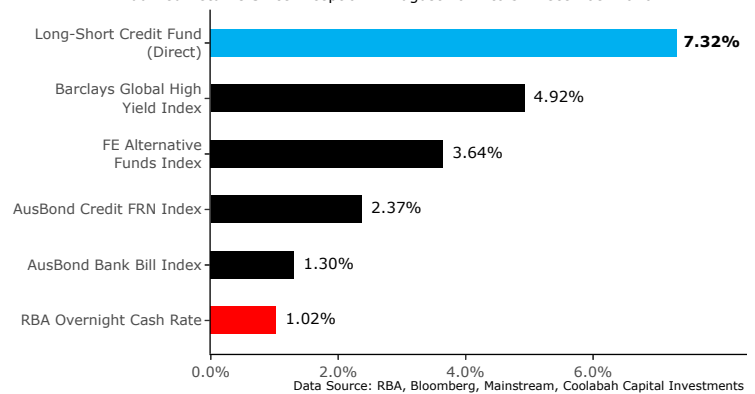


Data Source: Coolabah Capital Investments



**Long Short Credit Fund Returns (Gross) vs Benchmark (pa)**

Annualized Returns Since Inception in August 2017 to 31 December 2020



Data Source: RBA, Bloomberg, Mainstream, Coolabah Capital Investments

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The since inception gross (net) return of **7.32% pa gross (5.08% pa net)** is the total annual return earned by the fund since Aug. 2017, including interest income and movements in the price of the bond portfolio after all fund fees (assuming net returns are calculated from the historic gross returns using the current fee structure as displayed in the Product Disclosure Statement). The net return quoted applies to the Smarter Money Long-Short Credit Fund - Direct Investor Class, with quarterly distributions reinvested. Each investor's return will vary depending upon their own investment date and any top-ups and withdrawals they make. The **annualised volatility estimate of 3.27% pa** is based on the standard deviation of net daily returns since inception, which are then annualised, attributable to the Smarter Money Long-Short Credit Fund - Direct Investor Class.

Portfolio Managers	Christopher Joye, Ashley Kabel, Dr Stephen Parker, Dr Nick Campregher (Coolabah Capital Investments)		
APIR Code	SLT2562AU	Fund Inception	31-Aug-17
ISIN	AU60SLT25623	Distributions	Quarterly
Morningstar Ticker	41597	Unit Pricing	Daily (earnings accrue daily)
Asset-Class	Alternatives/Hedge Funds	Min. Investment	\$1,000
Target Return	Net 4.0%-6.0% pa over RBA cash rate	Withdrawals	Daily Requests (funds normally in 3 days)
Investment Manager	Coolabah Capital Investments	Buy/Sell Spread	0.00%/0.05%
Responsible Entity	Equity Trustees	Mgt. & Admin Fee	1.00% pa
Custodian	Mainstream Fund Services	Perf. Fee	20.5% of returns over RBA cash rate + 1.00% pa



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**Portfolio commentary:** The zero-duration and daily liquidity Long Short Credit Fund (LSCF) strategy returned 1.74% gross (1.33% net) in December, outperforming the AusBond Credit FRN Index (0.00%), the AusBond Bank Bill Index (0.00%), the RBA Overnight Cash Rate (0.00%), and the FE Alternative Funds Index (1.63%). LSCF ended December with a weighted-average credit rating of AA- and a running yield of approximately 6.05%. Over the December quarter, LSCF returned 4.69% gross (3.54% net), outperforming the RBA Overnight Cash Rate (0.02%), the AusBond Bank Bill Index (0.02%), the AusBond Credit FRN Index (0.53%), and the FE Alternative Funds Index (4.36%). Over the previous 12 months, LSCF returned 9.10% gross (6.31% net), outperforming the RBA Overnight Cash Rate (0.25%), the AusBond Bank Bill Index (0.37%), the AusBond Credit FRN Index (1.79%), and the FE Alternative Funds Index (4.54%).

Since LSCF's inception 3.3 years ago in August 2017, it has returned 7.32% pa gross (5.08% pa net), outperforming the RBA Overnight Cash Rate (1.02% pa), the AusBond Bank Bill Index (1.30% pa), the AusBond Credit FRN Index (2.37% pa), and the FE Alternative Funds Index (3.64% pa). LSCF's since inception Sharpe Ratio, which measures risk-adjusted returns, has been 1.88x (1.24x) gross (net). While LSCF's return volatility since inception has been low at around 3.27% pa (measured using daily returns), as a daily liquidity product with assets that are marked-to-market using executable prices, volatility does exist. This contrasts with illiquid credit (eg, loans and high yield bonds) wherein assets that have very high risk can appear to have remarkably low volatility, which is, in fact, just a mirage explained by the inability to properly value these assets using executable prices.

**Strategy commentary:** While we take it as given that uncertainty is the one true constant, 2020 presented an extraordinary array of “known-unknowns” and “unknown-unknowns” to borrow from the Rumsfeldian lexicon.

Australia started 2020 in flames as the world faced the spectre of US and Iranian military conflict that risked spiralling into a wider major power war.

The first global pandemic in 100 years began propagating in earnest at the same juncture, which triggered the worst economic shock since the Great Depression coupled with savage illiquidity and steep losses across all asset-classes in February and March.

Much more predictably, this then necessitated the mother-of-all liquidity and quantitative easing injections from the global central banking community, including the RBA, which would then embark on outright asset purchases rather belatedly in November.

By June, Australia had experienced its first recession in almost three decades with negative GDP growth prints over the first and second quarters.

This convinced almost all analysts, economists and fund managers to predict an Aussie housing Armageddon, partly fuelled by consensus forecasts for the unemployment rate to soar to between 10% and 12%. Even the RBA and Treasury were drinking from the same Kool-Aid on this doomsday front.

And yet in March and April, Coolabah Capital Investments (CCI) advised clients that Aussie dwelling values would only correct 0% to 5% over a brief six month interval following which they would commence climbing again.

We concurrently projected that Australia's jobless rate would rapidly settle at 6% to 7%, miles below the double-digit numbers expected by the consensus.

As it transpired, national home values declined by just 2.1% on a peak-to-trough basis over the circa six month horizon that had been anticipated (officially troughing in September). Over the 2020 calendar year Aussie dwelling values actually managed to climb 3% (see more on this below).

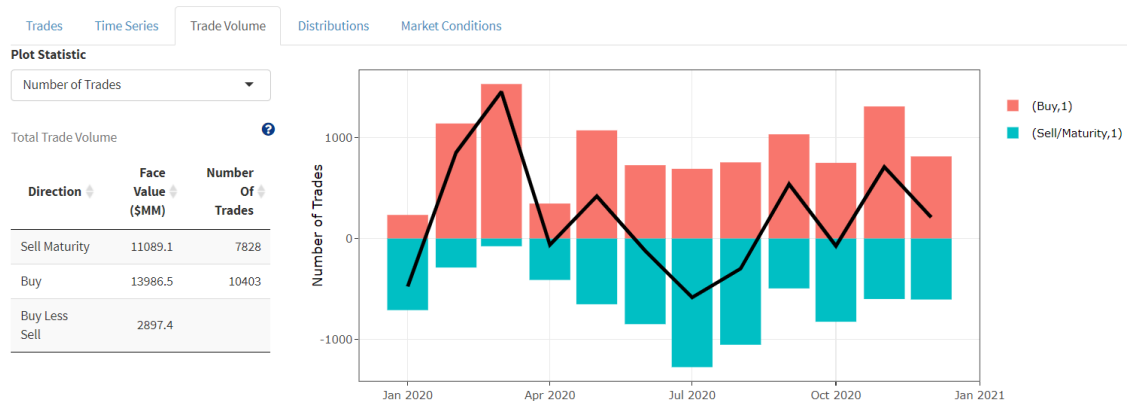
The jobless rate likewise surprised the analyst community, only increasing to 7.0% (it has currently settled at 6.8%), care of a faster-than-assumed recovery across the economy buoyed by huge fiscal and monetary support.

**Strategy commentary cont'd:** This extraordinary year also bequeathed us a new Cold War between China and the West, the belated consummation of Brexit, Megxit for British royal family fans, a tumultuous, single-term Trump presidency (perhaps a blessing for some), and, of course, the best investment opportunities we have seen in some time. ([Click here to read our analysis of Annus Horribilis](#) in more detail.)

Crucially, the smart money was buying, not selling, in March 2020 on the presumption that unprecedented fiscal and monetary policy stimulus would compel aggressive mean-reversion in liquid, high-grade and yet extremely oversold assets. While nobody on the planet predicted a global pandemic in December 2019, it was obvious to us that the key consequence of this shock would be the mother-of-all asset pricing recoveries. This is why we traded about \$1 billion in the month of March alone, with roughly 90% of our activity skewed to buying.

For CCI's clients, December was another healthy month of alpha generation across our portfolios as valuations continued to ineluctably mean-revert towards our proprietary fair-value targets, capping off what was, in the final analysis, a very rewarding 12 month period.

Over the year, we bought and sold \$25.1 billion of bonds, approximately \$15 billion of which was credit with another \$10 billion in government and semi-government bond trades. This involved a total 18,231 buys and sells. Our win ratio on these transactions was 98.2% with capital gains generated 93.3% of the time. The chart below shows our month-by-month buys (pink bars) versus sells (aqua bars), which highlights our de-risking in January, aggressive buying in March, and then profit-taking between April and August inclusive.



While we will return to valuation relativities in a moment, please permit a brief digression on performance. CCI's Long Short Credit Fund returned 1.74% gross (1.33% to 1.35% net retail) in the month of December compared to the RBA cash rate (0.00%), the AusBond Floating Rate Note (FRN) Index (0.00%), and the ASX Hybrids Index (0.92% unfranked). This daily liquidity, long-short credit strategy has an average AA- rating and only 0.17 years interest rate duration risk.

Over the 2020 calendar year, CCI's Long Short Credit Fund returned 9.12% gross (6.33 to 6.54% net retail) relative to the RBA cash rate (0.25%), the AusBond FRN Index (1.79%), the ASX Hybrids Index (2.49% unfranked), and the Aussie sharemarket (3.64% including dividends) as represented by the All Ordinaries Accumulation Index. The Long Short Credit Fund finished 2020 as the No.1 ranked strategy in Mercer's short duration credit universe over 1 year, 2 years, and 3 years.

For institutional clients, CCI runs a number of other long-short active credit solutions. Over the last 12 months these strategies returned between 9.22% and 11.57% on a gross basis. (Since these are insto-only products with confidential fee terms, fees are quoted on a gross not net basis.)

CCI is the investment manager of BetaShares' HBRD active ETF product, which is a full capital structure solution that focusses on investment-grade hybrids issued by Australian banks. In December HBRD returned 1.10% unfranked (estimated 1.28% franked), outperforming the Solactive ASX Hybrids Index (0.92% unfranked and 1.14% franked).



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**Strategy commentary cont'd:** In 2020, HBRD beat the Solactive ASX Hybrids Index on an unfranked basis by 0.58% after all HBRD's retail fees even though it was only about 90% invested in hybrids over this period (the index is fully invested). While final franking numbers have yet to be determined, we estimate that in the 2020 year HBRD returned approximately 4.11% franked after all retail fees compared to the Solactive ASX Hybrids Index's 3.71% return. HBRD finished 2020 with an average BBB- credit rating and 0.18 years of interest rate duration risk.

CCI's daily liquidity solutions that are classified in FE Fundinfo's "cash enhanced" universe, namely the Smarter Money Higher Income Fund and the Smarter Money Fund, returned 0.51% gross (0.39% to 0.40% net retail) and 0.38% gross (0.28% to 0.29% net retail) in the month of December, outperforming very poor returns from the RBA cash rate (0.00%), the AusBond Bank Bill Index (0.00%) and the AusBond FRN Index (0.00%).

Over the 12 months to 31 December 2020, the Smarter Money Higher Income Fund and the Smarter Money Fund, returned 3.97% gross (2.78% to 2.95% net) and 2.99% gross (1.98% to 2.10% net), once again exceeding the RBA cash rate (0.25%), the AusBond Bank Bill Index (0.37%), and the AusBond FRN Index (1.79%). These strategies finished the year with average A+ credit ratings and less than 0.1 years interest rate duration risk. Smarter Money Higher Income ranks No.1 in FE fundinfo's cash enhanced universe over 1 year, 3 years and 5 years.

CCI's much longer duration Active Composite Bond Strategy beat the AusBond Composite Bond Index by 0.46% (gross of fees) in the month of December (where the index suffered a 0.27% loss). Over the 2020 year, CCI's Active Composite Bond Strategy returned a robust 8.39% gross of fees relative to the Composite Bond Index's 4.48%, outperforming by 3.91%. It ranks in the top 2 products in Mercer's Australian fixed-income universe over the last 3 years. The Active Composite Bond Strategy ended 2020 with an average AA- rating and 6.23 years of interest rate duration risk. (Since this strategy is an insto-only product with confidential fee terms, returns are quoted on a gross not net basis.)

The RBA's target cash rate started 2020 at 0.75% and finished at an all-time record low of just 0.10%. In January 2020, the average term deposit rate was 1.05%—by December it had slumped to just 0.35%. Along similar lines, the yield on a 3 year Australian government bond began 2020 at 0.90%: it would finish at just 0.10% where it is set to remain for several years if the RBA's explicit forward guidance proves correct.

In a year of numerous contrarian calls, one of CCI's best was the projection that effective COVID-19 vaccines would be developed, approved and distributed in 2020. While this was based on our internal analysis and the advice of one of the world's most respected immunologists, it conflicted with the opinions of almost all other experts until very recently. As it happened, Moderna and Pfizer did indeed deliver immensely potent vaccines with circa 95% efficacy, which they began deploying in December.

Although 2021 is bound to be bumpy, this does lay the foundations for a secular rebound in global growth, which is CCI's central case. We believe that the dominant narrative in 2021 will be the newly intensified search-for-yield dynamic, which is particularly acute locally. ([Click here to read our 2021 forecasts](#) in more detail.)

Australian savers have never had to confront term deposit rates below 0.5 per cent or at-call rates and three-year government bond yields that are sitting near the zero lower-bound. For many this will undermine the value of cash and government bonds as an asset-class, forcing them to look for superior yields elsewhere. We have already observed the inception of this process, which is compressing spreads on high-yielding asset-classes.

At the start of 2020, 5-year major bank senior bond spreads were at 0.71% above the quarterly bank bill swap rate. As a result of the abovementioned influences and the arrival of the RBA's \$200 billion Term Funding Facility, which has obviated the need for most banks to issue senior bonds, these spreads have contracted to just 0.31%. This is well inside the post-GFC tights of around 0.60%.

We don't see much upside left in senior bank paper, and as a result have taken profits on about \$2.25 billion of holdings that we added to materially during the March shock when 5-year major bank senior spreads blew as wide as 1.71%.

**Strategy commentary cont'd:** In 2020, 5-year major bank Tier 2 bond spreads declined modestly from 1.75% to 1.57% above the quarterly bank bill swap rate on a point-to-point basis (punctuated by a record blow-out in Tier 2 spreads to around 4.0% in March).

The post-GFC tightens are around 1.35%, and, subject to the prevailing supply-side technicals, we think that major bank paper could test this level before too long. In the pre-GFC period, major bank Tier 2 traded at circa 0.35%, and it could continue to compress significantly yet.

Here we note the differences in the contractual terms of Tier 2 today compared with Tier 2 in 2007 juxtaposed against a very large deleveraging of major bank balance-sheets. In combination with the emergence of explicit government guarantees of both banks and their liquidity for the first time, this directly reduces default risks which is credit positive for these securities.

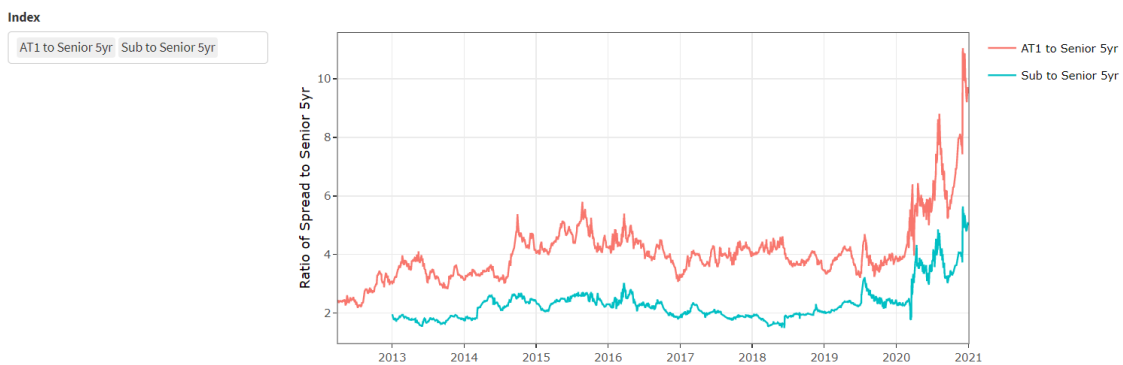
Perhaps the best value in the banks' capital structure is in the AT1 hybrid space where 5-year major bank spreads remain today wide of where they were at the start of the year. In January 5-year major bank hybrid spreads were sitting at 2.81% above the quarterly bank bill swap rate. Today they are at about 2.98%. Of course, they blew-out to around 8.4% in March (we picked up over \$300 million in that month alone). And yet the post-GFC tightens are much lower at around 2.35% with pre-GFC levels sitting tighter again at 1.25%. (The same comments above regarding pre- and post-GFC contractual differences apply to AT1 hybrids balanced against lower bank leverage and the advent of government-guarantees).

Another way to think about Tier 2 and AT1 hybrid valuations is through the multiple of their spreads over equivalent-tenor senior paper that sits higher up the capital structure, which is a heuristic commonly employed by institutional investors.

Since the application of the new Basel 3 banking rules in January 2013, 5-year major bank Tier 2 bonds have typically traded on a spread that is 2.15 times 5-year major bank senior bond spreads. Today that Tier 2/senior multiple has expanded to an unprecedented 5.04 times.

Five-year major bank AT1 spreads have historically traded at about 4 times 5-year major bank senior bond spreads. That multiple has likewise jumped to a never-before-seen 9.56 times (see the chart below, which is a screenshot from CCI's proprietary internal systems).

Major Bank Multiples: 5yr Spreads to BBSW3M vs Senior



Another tailwind for the hybrids sector is APRA's proposal to adjust the way banks calculate and report their first-loss common equity tier 1 (CET1) capital ratios ([click here to read our research on this development](#)). This will result in the big banks' capital ratios rising by about 1 to 1.5 percentage points. Whereas CBA currently reports an 11.8% CET1 ratio, this could be expected to increase to 12.8% to 13.3%.

Aussie bank hybrids contain a clause that stipulates they must automatically convert into bank equity if the CET1 ratio declines to 5.125%. The current distance to default in the case of CBA would require its 11.8% CET1 ratio to shrink by 56.6% for its hybrids to be converted into equity. Under APRA's proposal, CBA would have to suffer greater losses that reduce its new 12.8-13.3% CET1 ratio by about 60% to get down to the conversion trigger.



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**Strategy commentary cont'd:** (Click here to read our analysis of APRA’s aggressive stress-tests of the Aussie banking system, which showed that they were able to comfortably withstand two recessions over 2020 and 2021 encompassing a 30% drop in house prices, a 40% decline commercial property values, and an increase in the jobless rate to 14% that resulted in cumulative credit losses of \$163 billion.)

A final point of interest in respect of the local hybrid market is that NAB has recently obtained shareholder approval to be able to call (or repay) its long-neglected NABHA security.

The first available opportunity is likely to be in February, which is CCI’s central case. This would put \$2 billion into the hands of NABHA holders, who will have to search for income elsewhere. The supply outlook for bank hybrids otherwise appears relatively benign in the first half of 2020 with only a handful of new deals expected, which could provide for a positive bid-side technical.

We conclude our 2020 reflections with some more granularity on recent housing market innovations. According to CoreLogic’s market-leading hedonic index suite, Australian house prices continued their gradual rebound from the COVID-19 induced correction in December with dwelling values across both capital cities and regional markets appreciating by a strong 1.0% over the month.

The outperformance of non-metro regional markets remained robust with a 1.6% capital gain in December compared to a still-very-healthy 0.9% price rise for dwellings located in the 8 capital cities.

Over the 12 months of 2020, Australian dwelling values officially increased by about 3.0%. This concealed divergent performance across regional and metro markets: whereas homes in the 8 capital cities could only grind-out a soft 2.0% capital gain, regional dwellings increased in value by a solid 6.9%.

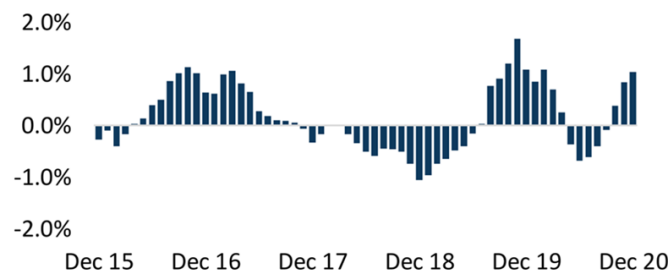
The price rises in December were remarkably consistent across the capital cities at around 1% for the month, which is impressive considering that this tends to be a seasonally weak month wherein activity dramatically decelerates.

Over 2020, the top performing housing market was Darwin (+9.0%) followed by Canberra (+7.5%), Hobart (+6.1%), Adelaide (+5.9%), Brisbane (+3.6%), and Sydney (+2.7%).

**Index results as at December 31, 2020**

	Change in dwelling values				
	Month	Quarter	Annual	Total return	Median value
Sydney	0.7%	1.3%	2.7%	5.3%	\$871,749
Melbourne	1.0%	1.5%	-1.3%	1.9%	\$682,197
Brisbane	1.1%	2.1%	3.6%	7.6%	\$521,686
Adelaide	1.1%	3.6%	5.9%	10.1%	\$468,544
Perth	1.1%	2.8%	1.9%	6.4%	\$471,310
Hobart	0.7%	3.2%	6.1%	11.4%	\$513,552
Darwin	2.3%	5.5%	9.0%	15.0%	\$416,183
Canberra	0.6%	3.5%	7.5%	12.5%	\$678,765
Combined capitals	0.9%	1.8%	2.0%	5.3%	\$651,983
Combined regional	1.6%	4.0%	6.9%	11.8%	\$420,502
National	1.0%	2.3%	3.0%	6.6%	\$574,872

**Month-on-month change in national dwelling values**



Notwithstanding all the forecasters predicting large 10%, 15%, 20% or even 30% house price falls post COVID-19, Melbourne (-1.3%) was the only city to suffer a capital loss last year.



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**ALPHA MANAGER 2019**  
Christopher Joye



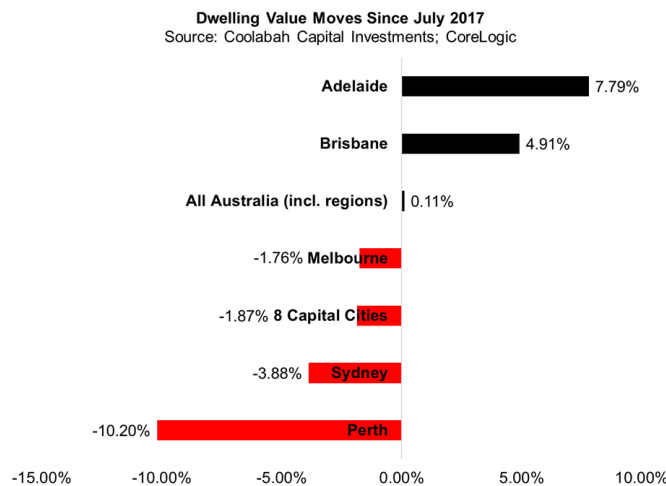
**Strategy commentary cont'd:** The truly abysmal forecasting performance of analysts in respect of the \$7.3 trillion Aussie housing market in 2020 was arguably one of the biggest misses of the year, which extends a long-running trend of private and public sector economists getting the nation's largest asset-class wildly wrong, especially around key turning points (eg, 2008, 2009, 2012-2013, 2017, 2019, and 2020 to name a few recent inflexions).

Clients might recall that CCI had a highly contrarian position in March 2020, projecting only a modest 0% to 5% decline in national dwelling values, which we argued would be superseded by capital gains of at least 10% to 20% commencing in or around September 2020.

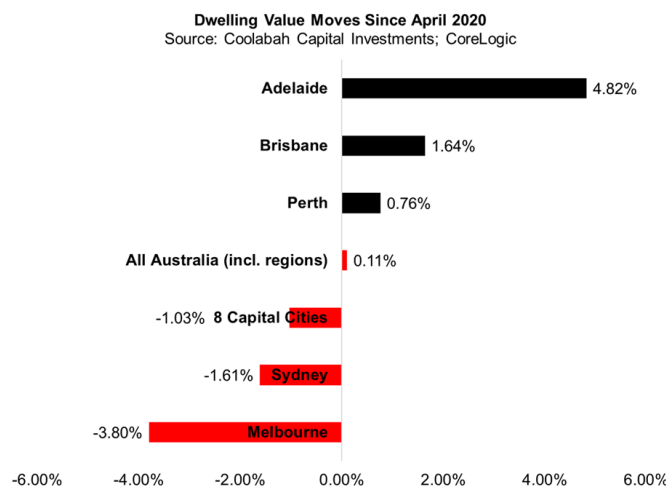
Across Australia, the peak-to-trough loss was just 2.1% according to the latest CoreLogic hedonic index data (capital city homes fell by 2.8%) with the correction coming to an end in September 2020.

CCI is forecasting house price growth of 10% to 15% in 2021, a view that many other analysts have slowly come to embrace.

What is not widely understood is just how little net aggregate house price growth there has been since 2017. The enclosed chart highlights the change in dwelling values across different markets since July 2017. Home values in Sydney (-3.88%) and Melbourne (-1.76%) are actually lower today than they were three years ago. This is also generally true across the 8 capital cities (-1.87%) with the biggest laggard being Perth property (-10.2%), which is substantially cheaper than it was in mid 2017. The flip side of that coin is property in Adelaide (7.79%) and Brisbane (4.91%), which have net increased in value over this period.



It's also interesting to consider the changes in home values since the peak in the market in April 2020. As the chart below shows, dwelling prices across the 8 capital cities are still 1.03% below their high watermark last year. This is driven by Melbourne (-3.80%) and Sydney (-1.61%), which have some reasonable ground to recover just to get parity with their pre-COVID marks.



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**Strategy commentary cont'd:** The next phase of the current housing cycle will likely see the return of investors seeking to capitalise on the unprecedented emergence of "positive gearing" whereby gross rental yields are way above the cost of servicing residential mortgage debt.

Understanding the housing market--and accurately predicting its future trajectory--is hugely important if one wants to have any hope of divining wider economic and hence financial market outcomes. Beyond being the single most valuable household asset, housing is also the banking system's largest exposure. My experience has been that those who get the housing market wrong tend to also misfire when it comes to hitting other macro targets...



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Christopher Joye

