

# Antares Income Fund

## Monthly Investment Report

### June 2023



#### Fund Performance

Period Ended 30/06/2023	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %	Since Inception %pa <sup>1</sup>
Antares Income Fund	0.52	1.52	4.19	1.80	1.74	2.00	2.23
Bloomberg AusBond Bank Bill Index	0.30	0.90	2.89	1.01	1.17	1.35	1.66
Difference	0.22	0.62	1.29	0.79	0.58	0.65	0.58

Valuation at month end was \$178.87M

Antares Income Fund returns are expressed after investment management fees and before taxes; The difference in returns between the Fund and the benchmark may be out due to rounding; 1. Since Inception 31/01/2013

#### Key Characteristics at 30/06/2023

	Fund	Benchmark
Interest Rate Duration (yrs)	0.06	0.13
Yield to Maturity*	5.56	4.22
Credit Spread Duration (yrs)	2.50	-
Average Credit Rating	A	-
Liquidity**	62%	N/A

\*Estimated return if held to maturity. Market yield for Fixed Rate Bonds whilst FRNs uses a swap assumption rate as an input.

\*\*Liquidity deemed available within 24 hours. Consisting of: (1) Cash and short-term securities, government & semi government bonds that are expected to be able to be liquidated at mid-market yields and thus no transaction costs, and; (2) Unit holdings of other Antares managed sub funds for which there is no buy/sell spread and next day redemption facility if notified by 2pm.

#### Rating Exposure (by market value %)

Asset Type	MV %
AAA	15.44%
AA+	1.40%
AA	7.76%
AA-	17.09%
A+	2.15%
A	0.00%
A-	11.45%
BBB+	20.36%
BBB	21.93%
BBB-	2.42%

#### Portfolio Strategy

Strategy	Implementation
<p><b>Duration and Yield Curve:</b> Our scenario analysis points to a high probability of structurally higher inflation for longer, with an eventual bear steepening of yield curves if central banks are unable to contain longer term inflation expectations.</p> <p>The continued resilience of the consumer, labour markets, and wages price pressure mean the impact of aggressive tightening by central banks may look to play out beyond 2023, where we see increasing risks of a "stagflation" scenario.</p>	<ul style="list-style-type: none"> <li>Domestically, the RBA is trying to determine if further rate hikes are required by pushing out potential additional hikes to allow more time to assess economic data over the coming months. With this longer timeframe, they also need to balance the risks of inflation becoming structurally embedded given the ongoing strength in the labour market and signs of growing wage pressure.</li> <li>Globally, markets are pushing out rate cut expectations as ongoing economic resilience has reduced the near-term recession risk. At the beginning of this year, US markets had aggressive rate cuts priced in for the second half of 2023. This has now been pushed out into 2024 and is more in line with the Fed's view that rate structures need to remain higher for longer to bring inflation back to 2%. This thematic is playing out in major developed global markets, especially in the UK, as sticky core inflation and a strong labour market have highlighted the need for further tightening.</li> <li>Overall, we continue to see risks around the ability of central banks to bring inflation back to target levels and see that outcome as difficult to achieve while also engineering a soft landing.</li> <li><b>Yield curve:</b> In Australia, the market pricing of long-term inflation expectations remains relatively anchored for now. This has been driven by the 400 basis points of rate hikes, which has produced a bear flattening and now inverted yield curve. Looking forward, Antares expects the transmission mechanism of rate hikes to be felt on economic activity and the labour market, which will see a turn in the cycle as central banks assess their impact against the inflation backdrop. In this scenario, long term bond yields may be subject to a repricing of the inflation risk premium and thus a steepening of the yield curve.</li> <li><b>Duration:</b> Given our outlook, we are positioned between neutral and short duration across mandates, depending upon mandate objectives. If bond yields continue to rise, we may look to reduce short duration positions opportunistically.</li> </ul>
<p><b>Credit exposure:</b> Our scenario analysis points to stagflation and/or recession risks as being heightened over the medium term, and thus we are selective about credit issuer exposure within portfolios.</p>	<ul style="list-style-type: none"> <li><b>Valuations:</b> Credit spreads have continued to narrow since the widening seen back in March following the financial stability issues in the US regional banking sector and the collapse of Credit Suisse, but still remain attractive compared to pre covid levels. We have added credit exposure in some corporate sectors and issuers where there has been value.</li> <li><b>High quality issuers:</b> With our outlook for a deterioration in economic growth, we remain focused on high quality credit issuers, which we assess as being more resilient to an economic downturn. We are targeting credits with low leverage, strong cashflows, some inflation protection/pricing power, and robust balance sheets, i.e., issuers that are less exposed to inflation and recession risks, such as regulated utilities.</li> <li><b>Synthetic credit:</b> Synthetic credit (such as iTraxx CDS) is looking expensive and is offering relatively attractive levels to buy protection. We will continue to monitor credit protection and potentially buy protection for those portfolios that can use CDS.</li> </ul>
<p><b>Optimising yield through carry and rolldown:</b> Focusing on high quality credits and inflection points on steep curves.</p>	<ul style="list-style-type: none"> <li><b>Portfolio construction:</b> We are using our proprietary analytics to harvest attractive rolldown while maximising opportunities per unit of risk.</li> <li><b>Rate and swap term premia:</b> For long maturity portfolios, we continue to see value in semi-government bonds in the 10 - 15yr part of the curve versus Commonwealth government bonds.</li> <li><b>Credit term premia:</b> The increase in primary market issuance has kept credit term premiums steep, particularly in the 5 to 7yrs, offering attractive opportunities to lock in nominal yields north of 6%.</li> </ul>
<p><b>Liquidity:</b> Where appropriate, we are maintaining liquidity that can be realised in stressed conditions.</p>	<ul style="list-style-type: none"> <li><b>Portfolio construction:</b> Selective semis, major banks, and government bonds are seen as core liquidity building blocks across portfolios.</li> <li>We have maintained the liquid structure of Funds where appropriate.</li> </ul>

#### Investment Return Objective

The Antares Income Fund aims to provide investors with a regular income and a return (after fees) that exceeds the Bloomberg AusBond Bank Bill Index over rolling three-year periods.

#### Distribution History

Distribution Information	Date
Distribution Date	30-Jun-23
Distribution Amount	2.37 Cents Per Unit
Next Distribution Date	30-Sep-23

#### Portfolio Review

##### Key Drivers of Portfolio Performance:

- Short duration contributed to returns as yields rose sharply.
- The yield curve from 3-30yrs flattened, detracting from returns.
- Financials and corporates tightened 5-15bps, contributing to returns.
- Yield enhancement and rolldown of quality investment grade bond holdings added to returns.

#### Portfolio Activity and Positioning

- Bought Network Finance 6/30.
- Used futures to reduce the short duration to target levels.

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#### Market Review

Markets continue to unwind their expectations around imminent recession risks with continued strong economic data and sticky core inflation, causing markets to push out rate cut expectations from 2023 into 2024.

Term premiums were negative in June as yields moved higher in response to most major central banks continuing to raise rates. Even the Fed's pause was deemed hawkish, as Powell acknowledged there is more work to do to ensure rates are restrictive enough for long enough to combat inflation. Major yield curves continued to invert.

Market pricing of the US terminal cash rate increased from 5.28% at the end of May to 5.41% at the end of June. Market timing of the terminal rate also pushed it out from July to November. Over the month, there was mixed US economic data, but overall, the data showed the economy remained strong, showing no clear slowdown trend. US housing starts and building permits beat market estimates, as did JOLTS Job openings, non-farm payrolls, ADP employment, and retail sales. GDP came in at 2.0% vs 1.4% expected, and US consumer sentiment was stronger than expected. On the inflation front, core inflation came in higher than expected at 5.3%, but other measures of inflation, including headline and the Fed's preferred core PCE deflator, came in lower than expected. Unit labour costs, ISM prices paid, and ISM services also came in lower than expected.

There was softer economic data in the Eurozone, with inflation printing lower than expected except for the UK where both headline and core inflation came in stronger than expected and the Bank of England raised rates by 50 basis points. Most European central banks also raised rates, with ECB's Lagarde providing forward guidance for further hikes. China's recovery continues to stall. Annual inflation came in at 0.2%, the PBOC cut rates by 10bps, retail sales disappointed, and plans were announced for more stimulus and support for the property sector.

Australian yields were higher in June as the RBA made a hawkish pivot, hiking 25bps as the economy and labour market remained strong. Headline inflation came in lower than expected, driven by sharp falls in energy and travel. However, excluding these categories, inflation increased 0.5% month on month, showing core inflation remains sticky. Credit securities outperformed over the month as spreads narrowed in response to markets pushing out the timing of monetary policy tightening on corporate earnings.

#### Q2 2023

Over the quarter, yield curves bear flattened as concerns over sticky core inflation, resilient labour markets, and wages pressure weighed on central banks.

At the beginning of the quarter, markets were pricing in 0.8 rate cuts in Australia and 2.5 cuts in the US by the end of the year. By the end of the quarter markets moved rate cut expectations out to 2024 and priced further hikes for the remainder of 2023 which is more consistent with central bank messaging, calling for higher rate structures for longer to get inflation back to target.

As a result, there was a strong negative term premium and positive credit premium over the March quarter as credit spreads narrowed back towards levels before the banking collapses in the US and Europe in early March.

#### Macro Outlook

Over the month of June and the quarter, markets pushed out their expectations of central bank rate cuts as economies and labour markets continued to show limited impact from the rapid tightening of monetary policy. As a result, the previous divergence seen between market pricing and central bank rhetoric about rates needing to be higher for longer narrowed. Recession risks have fallen but remain high for some economies.

At this point in the cycle, the key uncertainty is, what terminal rate is required and for how long is it needed to be maintained to create enough economic contraction to return inflation back to 2-3%. For now, market pricing suggests that there is still strong faith in the various central bank's ability to achieve this. However, while headline inflation has peaked and is heading lower, core inflation remains sticky.

In Australia, there are structural factors that may challenge that faith and the ability of the RBA to bring inflation back to target by mid-2025. Firstly, there has been significant wage growth outcomes across sectors in response to higher inflation, which are higher than the RBA's assumption of 4.0% wages growth. Secondly, productivity growth has also fallen short of the RBA's 1% assumption. Thirdly, Australia is pursuing an aggressive immigration policy, which will add to aggregate demand and put further pressure on the housing and rental markets but could provide some relief for labour markets over the next 12 months. Fourthly, there are significant increases in energy prices that take effect in July. These factors are yet to be incorporated into the CPI data.

In addition, the RBA's glidepath to get inflation back to target is already longer than that of its global central bank peers, who have a 2024 timeframe vs the RBA's mid-2025. The longer it takes to get inflation back to target, the higher the risk that inflation becomes embedded in consumer and business expectations. When compared with other major markets, Australia has one of the highest core inflation rates but currently has the lowest cash rate. Countries including the US, UK, Canada, and New Zealand have a cash rate of 5.0% or above vs Australia's 4.10%.

Looking forward and considering the RBA's dual mandate of full employment and price stability, the key questions will be: Is it possible to achieve a 2-3% inflation target without a hard recession by having to trade off the gains made in achieving record low unemployment? Will monetary policy have the required impact on the economy given the prior decade of wealth accumulation, making certain segments of the economy less sensitive to rate rises? And what will be the impact on Australia of a slower than expected economic recovery in China?

The lags seen in the transmission of rate rises on the economy, higher than expected wages growth, and the RBA being behind other major central banks suggest that the RBA has more work to do in 2023 to achieve a restrictive monetary policy level that is consistent with returning inflation back to target by mid-2025.

#### Antares Scenario Analysis

The Antares Scenarios table below reflects the interplay between growth, inflation, and bond yields, and how they will drive the level and shape of yield curves in the different scenarios.

Antares Scenarios - Growth & Inflation - Latest Market Yields										
Scenarios	AU GDP	AU Inflation	1YR Bond	AU 3YR Bond	AU 5YR Bond	AU 10YR Bond	AU 30YR Bond	US 10YR Bond	rTaxxx	Probability Weighting
1 Strong Growth	5.00%	4.50%	5.50%	5.75%	6.00%	6.50%	7.25%	6.50%	150	0%
2 Above Trend	4.00%	3.50%	4.75%	4.50%	4.25%	4.25%	4.50%	4.50%	110	7%
3 Trend	3.00%	2.50%	3.50%	3.50%	3.50%	3.75%	4.00%	3.75%	75	22%
4 Below Trend	1.50%	1.50%	2.50%	2.50%	2.50%	2.50%	2.75%	2.00%	100	10%
5 Recession	-2.00%	0.50%	0.25%	0.50%	1.00%	1.50%	2.25%	1.25%	250	7%
6a Stagflation...Growth & employment softens, inflation elevated, RBA continues tightening	1.50%	4.00%	4.75%	4.50%	4.35%	4.25%	4.50%	4.00%	150	30%
6b Stagflation...Growth & employment fall sharply, inflation elevated, RBA on hold or easing	-1.50%	3.50%	2.75%	3.25%	4.00%	4.75%	5.75%	4.75%	150	16%
Team Latest Fair Value (FV)	1.27%	3.05%	3.81%	3.59%	3.67%	3.85%	4.25%	3.50%	149	
Market Yield Latest	18/07/2023		4.15%	3.90%	3.86%	3.98%	4.27%	3.83%	77.5	
FV - Market (+ exp - cheap)			-0.54%	-0.30%	-0.19%	-0.13%	-0.02%	-0.33%	72	

Stubbornly high inflation and falling growth forecasts have seen Antares' scenario analysis shift from the better growth Scenarios 2 & 3 to the slower or negative growth "stagflation" Scenario 6. "Stagflation" is the highest probability at over 50%. Since the inflation breakout in early 2022, Antares has anticipated a structural rise in inflation (higher for longer), in contrast to the RBA's forecast of a return to the 2-3% range of the past decade.

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The RBA has recently shifted its stance to more aggressive tightening as it confronts what it now sees as “sticky” inflation. This shift has surprised markets and Antares, generating a significant bear steepening of the yield curve.

Antares have two stagflation scenarios;

1. 6a. Unemployment below 4%, inflation elevated with an aggressive RBA raising rates. This scenario produces a bear flattening.
2. 6b. In response to aggressive RBA tightening, unemployment rises above 4%, inflation falls a bit and markets assess the RBA on hold, potentially pricing in rate cuts in 2024. This scenario produces a bull steepening.

The key challenge for Antares is the timing between these two stagflation scenarios.

### Interest Rate & Inflation Outlook

The appointment of Michelle Bullock as governor of the RBA should do little to affect the ultimate trajectory of policy rates and the need for them to become sufficiently restrictive to contain inflation. Bullock’s appointment will become effective following Dr. Lowe’s departure on 17 September 2023. In the immediate term, however, markets may view her appointment as dovish for rates, given her previous comments and the deputy role she played to Dr. Lowe through much of the post pandemic period.

As recently as December 2022, Bullock was putting forward the case for a pause and was likely supportive of the RBA’s decision to move from 50bp to 25bp incremental hikes in November, which now appears to have been premature. With the official cash rate at 4.1%, markets have room to unwind front-end expectations further after reaching a terminal rate expectation of 4.6% at one point in June. If realised, a reduction in the terminal rate expectation would put some steepening pressure on the yield curve.

While markets may perceive Bullock to be a rates dove, there are three further considerations that are likely to have a bigger bearing on the future direction of policy rates through this cycle:

1. A greater symmetry between employment and inflation objectives, where recently realised inflation has overshot its objective and unemployment has undershot;
2. The establishment of a new RBA board and expert panel in June 2024, which will scrutinise the RBA’s decision-making process and ensure a greater balance between the above objectives;
3. The replacement of the Head of Economics and Forecasting (following the recent departure of Luci Ellis whom has taken up the chief economist role at WBC) and the review of processes likely with her replacement. This will hopefully lead to more accurate forecasting and potentially result in different growth and inflation forecast profiles, requiring further policy rate adjustments.

Combined, these factors are likely to shape monetary policy settings over the medium term. The need for more restrictive rates will be largely dictated by the underlying strength of the domestic and global economies, with both showing tremendous resiliency to the tightening seen so far.

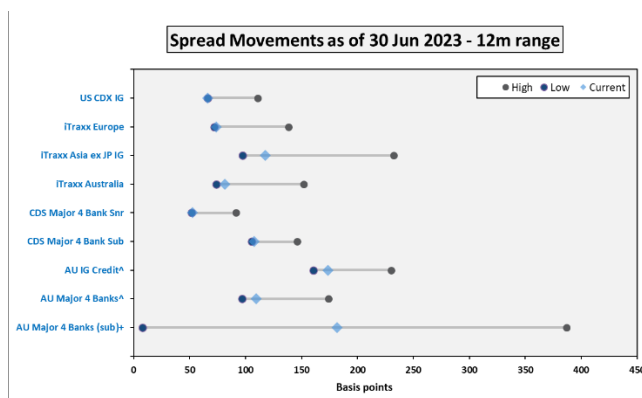
Domestic inflation continues to moderate, albeit at a very slow pace, with core measures of inflation remaining uncomfortably above target. The increasing incidence of 5%+ wage claims across the private sector, including notably high profile decisions like that of NAB, will do little to suppress inflation expectations or services inflation.

### Credit Outlook

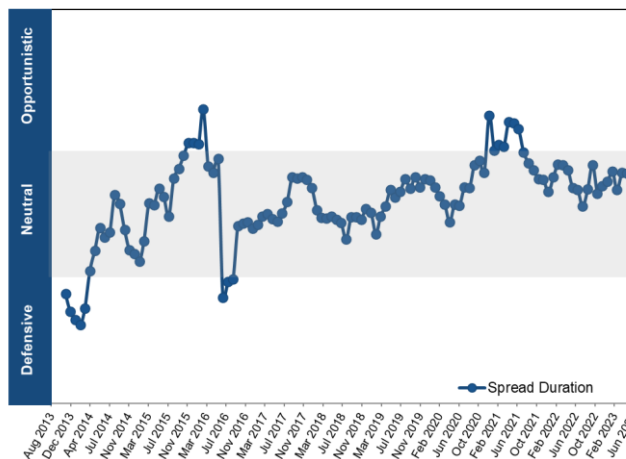
Credit spreads performed strongly across major markets in June. US IG spreads narrowed 15bps to 122bps, Australian IG spreads narrowed 7bps to 127bps, and European IG spreads narrowed 7bps to 164bps. US High Yield spreads narrowed 70bps to 390bps. Synthetic credit spreads underperformed cash bonds and mostly moved sideways.

June saw another month of robust primary issuance, with over \$14 bln of credit bonds issued into the Australian market. Corporate bond supply was easily absorbed by the market and we saw several regulated utilities successfully issue longer term 7 to 10 year bonds. Technicals continue to be very supportive for credit funds globally, with US IG bond funds attracting 14 consecutive months of inflows.

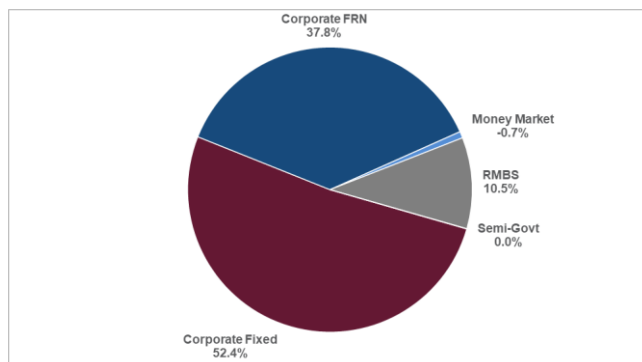
With inflation continuing to stay elevated and potential further rate hikes, we are mindful that credit spreads might be at risk of potentially widening with current valuations becoming more expensive. We continue to prefer defensive credit issuers with resilient cash flow profiles and whom have the ability to pass on inflation in a stagflation environment., such as regulated utilities.



### Defensive to Opportunistic



### Sector Breakdown (Market Value %)



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#### ESG

We participated in Network Finance Company's (also known as Endeavour Energy) primary issuance of a 7-year senior secured bond. Endeavour Energy is a major electricity distribution company in the state of NSW, with key infrastructure networks covering Western Sydney, the Blue Mountains, the Southern Highlands, the Illawarra, and the South Coast of NSW. The company is well-

positioned to benefit from Australia's climate transition and net zero goals, as they will be expanding their Regulated Asset Base by investing in their existing infrastructure to facilitate two-way flows and connections to rooftop PVs, which will support the energy transition process within Australia.

#### Market Movements

Australian Rates	June 2023	Quarterly Change	1 Yr Change
RBA Cash Rate	4.10	0.50	3.25
90 Day Bank Bill	4.35	0.64	2.54
3 Yr Futures	96.01	-1.08	-0.63
10 Yr Futures	95.98	-0.72	-0.30
3/10 Spread (bps)	3.00	-35.50	-32.50
iTraxx Australia 5Y	81.37	-8.63	-49.08
10Yr BEI	2.45	0.10	0.18

Global Sovereign Rates	June 2023	Quarterly Change	1 Yr Change
Fed Fund Rates	5.08	0.25	3.50
ECB Main Refi Rate	4.00	0.50	4.00
US Sovereign 2 Yr	4.90	0.87	1.94
US Sovereign 10 Yr	3.84	0.37	0.82
Japan Sovereign 10 Yr	0.40	0.05	0.17
German Sovereign 10 Yr	2.39	0.10	1.06

Currencies	June 2023	Quarterly Change	1 Yr Change
AUD/USD	0.67	0.00	-0.02
EUR/USD	1.09	0.01	0.04
USD/JPY	144.31	11.45	8.59

Equities	June 2023	Quarterly Change	1 Yr Change
ASX200	7203	0.4%	9.7%
S&P500	4450	8.3%	17.6%

Commodities	June 2023	Quarterly Change	1 Yr Change
WTI Crude	70.6	-4.8	-15.4
Gold	1919.4	-49.9	112.1

Australian Economic Data	Latest Print	Previous Quarter Print	June 2022 Print
Employment Change (k)	76	53	-34.3
Unemployment Rate (%)	3.6%	3.5%	5.2%
Retail Sales (MoM%)	0.7%	0.2%	4.6%
Trade Balance Value (m)	11791	13870	10302
Building Approvals (MoM%)	20.6%	4.0%	-16.5%
Consumer Confidence (Westpac)	79	78.5	104.6
Business Confidence (NAB)	-0.4	-1.0	21.7
Business Conditions (NAB)	9.5	15.8	12.6

Australian Economic Data	Latest Print	Previous Quarter Print	June 2022 Print
Private Capital Expenditure (QoQ%)	2.4%	2.2%	-1.1%
GDP (YoY%)	2.3%	2.7%	4.1%
Inflation (YoY%)	7.0%	7.8%	3.0%

Global Economic Data	Latest Print	Previous Quarter Print	June 2022 Print
US Non-Farm Payrolls (k)	209	236	677
US Unemployment Rate (%)	3.6%	3.5%	4.6%
US Manufacturing ISM	46.0	46.3	60.8
US Non-manufacturing ISM	53.9	51.2	66.7
China Manufacturing PMI	49.0	51.9	49.2
China Non-Manufacturing PMI	53.2	58.2	52.4
German Factory Orders (MoM%)	6.4%	4.8%	-5.9%
German Industrial Production (MoM%)	-0.2%	2.0%	2.7%

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#### About Antares Fixed Income

Antares Fixed Income (Antares) is a specialist fixed interest manager covering a range of domestic and international securities. Antares has managed fixed interest and cash portfolios for investors since 1990 and currently has over A\$25.67 billion\* in funds under management across a range of cash management, fixed income and liability driven investment strategies. Antares is focused on delivering performance objectives for its clients within a carefully managed and defined risk framework.

\*as at 30 June 2023

#### Contacts

##### Investor Relations

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#### Important information

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