

Antares Income Fund

Monthly Investment Report

August 2023



Fund Performance

Period Ended 31/08/2023	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %	Since Inception %pa ¹
Antares Income Fund	0.85	2.03	5.46	2.05	1.95	2.14	2.35
Bloomberg AusBond Bank Bill Index	0.37	1.04	3.37	1.25	1.24	1.40	1.71
Difference	0.49	0.99	2.10	0.80	0.71	0.74	0.65

Valuation at month end was \$155.71M

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 31/08/2023

	Fund	Benchmark
Interest Rate Duration (yrs)	0.13	0.13
Yield to Maturity*	5.35	4.09
Credit Spread Duration (yrs)	2.12	-
Average Credit Rating	A	-
Liquidity**	59%	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	12.01%
AA+	1.47%
AA	9.08%
AA-	21.80%
A+	2.31%
A	0.00%
A-	11.01%
BBB+	18.41%
BBB	21.83%
BBB-	2.06%

Portfolio Strategy

Strategy	Implementation
<p>Duration and Yield Curve: Our scenario analysis points to a high probability of structurally higher inflation for longer, with a 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 has meant the impact of aggressive tightening by central banks has been less than expected. This has lowered recession risks, which have been pushed out into 2024. We see increasing risks of a "stagflation" scenario where there is low growth accompanied by inflation.</p>	<ul style="list-style-type: none"> Domestically, the RBA paused in August to assess the impact of the policy tightening undertaken to date and the ongoing impact on fixed rate mortgage holders rolling onto higher variable rates. There are still risks of inflation becoming structurally embedded given the ongoing strength in the labour market, higher energy prices, and ongoing signs of wage pressure while there is negative productivity. Globally, markets keep pushing out rate cut expectations as ongoing economic resilience has reduced near-term recession risks. 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, while the Fed's view is 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. 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. So far there are indications of a soft landing, but core inflation remains high, and if recent increases in the oil price are sustained, this will feed into headline inflation. Yield curve: In Australia, the yield curve has bear steepened, driven by increases in real yields. Market pricing of long-term inflation expectations remains relatively anchored for now due to the 400 basis points of rate hikes. If the market was to lose faith in the central bank's ability to continue to lower inflation back to target, then long term bond yields may be subject to a repricing of the inflation risk premium, which would see further steepening the yield curve. Duration: 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.
<p>Credit exposure: Our scenario analysis points to stagflation and/or recession risks as being heightened over the medium term, therefore, we are selective about credit issuer exposure within portfolios. We have more probability weighting towards soft growth outcomes rather than deeply negative outcomes.</p>	<ul style="list-style-type: none"> Valuations: 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 they remain attractive compared to pre covid levels. Although some sectors are looking more expensive, we continue to add credit exposure in corporate sectors and issuers where there has been value. High quality issuers: With our outlook for a slowdown 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. Synthetic credit: Synthetic credit (such as iTraxx CDS) is looking expensive and offers relatively attractive levels to buy protection. We will continue to monitor credit protection and potentially buy protection for those portfolios that can use CDS.
<p>Optimising yield through carry and rolldown: Focusing on high quality credits and inflection points on steep curves.</p>	<ul style="list-style-type: none"> Portfolio construction: We are using our proprietary analytics to harvest attractive rolldown while maximising opportunities per unit of risk. Rate and swap term premia: 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. Credit term premia: The increase in primary market issuance has kept credit term premiums steep, particularly in the 5-7yrs, offering attractive opportunities to lock in nominal yields.
<p>Liquidity: Where appropriate, we are maintaining liquidity that can be realised in stressed conditions.</p>	<ul style="list-style-type: none"> Portfolio construction: Selective semis, major banks, and government bonds are seen as core liquidity building blocks across portfolios. We have maintained the liquid structure of Funds where appropriate.

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:

- Tactically reducing short duration and curve steepening strategies added solidly to returns.
- The 11bps steepening of the 10-3 year yield curve added to returns.
- Tightening credit spreads added substantially to returns: Financials and sub debt tightened 5-10bps, corporates tightened 7-20bps.
- Yield enhancement and rolldown of quality investment grade bond holdings added to returns.

Portfolio Activity and Positioning

- Reduced short duration and curve steepening strategies.
- Sold NAB 26 sub debt.

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Market Review

Yield curves continued to bear steepen in August, led by higher real yields driven by the US Treasury's large program of bond issuance, the impact of Japan loosening its yield curve control policy, and Fitch's downgrade of the US from AAA to AA+, all of which increased term risk premia.

During the month, US ten-year bonds reached highs not seen since October last year, with the US ten-year yield peaking at 4.33% during the month. Expectations of rate cuts in the US pushed further out into next year as economic data showed overall continued resilience in the economy and labour market. Fed rhetoric maintained the higher rates for longer message, highlighting that inflation is still too high and that upside risks remain from ongoing services inflation and the energy sector with recent increases in oil prices.

The RBA paused in August, with softer wages and monthly CPI data allowing more time to assess the impact of the tightening cycle to date. Australian ten-year yields reached a high of 4.33% during the month, ending the month at 4.00%.

There are increased concerns over an economic slowdown in China, driven by the property sector and a muted policy response by the Chinese government. The potential risks for the Australian economy were reflected in market pricing, with Aussie iTraxx widening 19 basis points to an intra month high above 90 intra before falling back to 77 by the end of the month.

Weaker economic data coming out of Europe, in particular Germany and the UK, showed increased stagflation risks compared to the US economy, which remains strong.

Macro Outlook

As the end of the rate hiking cycle nears, markets and Central Banks are focused on how long higher rates are needed to bring inflation back to target. As was the case at the beginning of the year, there are divergent views between market pricing and Central Banks, with the market pricing in more aggressive cuts sooner than the hawkish messages from Central Banks. What has changed is the timing of rate cuts, which at the beginning of the year were priced in for 2023 and have now been pushed out well into 2024.

A key factor driving the change in the timing of expected rate cuts has been the surprising resilience of the economy in an aggressive rate hiking environment, making it hard to gauge the impact of monetary policy. In particular, the strength in the labour market has been a key differentiator in this cycle and has underpinned the strength seen in the broader economy.

There are expectations of a soft or no landing in the US economy but a deeper contraction in Europe as GDP and manufacturing fall. The Australian economy has seen inflation fall while the labour market has been resilient. Total GDP in Australia has been solid supported by the strong growth in immigration but technically this same immigration growth has seen Australia experience a GDP "per capita" recession.

The economic slowdown in China, driven by structural issues in their property sector, pose significant risks to the Australian economy. A fall in the demand for commodities will impact Australia's growth outlook but also present imported inflation risks due to a depreciating Australian dollar. Other inflation risks include Australia's negative productivity growth and recent increases in global oil prices. These factors add to the uncertainty around the ability of the RBA to bring inflation back to target within their timeframe.

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	AU 3YR Bond	AU 5YR Bond	AU 10YR Bond	AU 30YR Bond	US 10YR Bond	iTraxx	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 signalling	1.50%	4.00%	4.75%	4.50%	4.38%	4.25%	4.50%	4.00%	150	38%
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%	3.61%	3.99%	3.67%	3.85%	4.25%	3.50%	149	
Market Yield Latest	19/07/2023		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	

Since the inflation breakout in early 2022, Antares has assigned a decent probability of a structurally higher level of inflation. Antares has its highest weighting to its two "stagflation" scenarios, with a combined probability of 50%. These scenarios are akin to a weak (6a) or recessionary (6b) growth environment, but with inflation at 3-4% being higher than the RBA's target range.

Under Antares stagflation scenario 6a, we see the potential for further bear flattening as the RBA can continue to tighten policy uninhibited by growth and unemployment concerns.

Under Antares stagflation scenario 6b, we see the potential for a curve steepening as the RBA may find itself constrained in tightening given the deterioration in the economic/unemployment outlook. Under this scenario, the RBA may find itself losing the market's confidence in the ability of monetary policy settings to bring inflation back to target.

Interest Rate & Inflation Outlook

At its September meeting, the RBA held rates steady for the third consecutive month, offering a relatively balanced assessment of how the Australian economy was travelling. Markets are pricing out any further hikes, with some prospect that the next move by the RBA will be a cut in late 2024.

Key to the RBA's decision to hold rates steady has been the ongoing disinflation that has been evident globally. Inflation releases have surprised to the downside, including the local Q2 CPI print and the most recent July report. More importantly, headline inflation is now tracking comfortably inside the Bank's forecast profile, which extends out to December 2025. If this forecast were to be revised towards 2.5% in the next Statement of Monetary Policy, it would materially raise the bar on further rate hikes over the medium term.

The RBA expects headline inflation to fall to 2.75% by December 2025. With unemployment and growth remaining relatively strong, the Bank continues to navigate a 'narrow path' in bringing inflation back to target while holding onto employment gains. In doing so, the RBA faces several challenges, including persistently high services inflation, poor productivity, and monetary policy's blunt distributional effects, making the 'narrow path' far from even.

Also complicating the outlook for rates and inflation are several structural factors that are currently unfolding. These include the slow transition to green energy and current reliance on fossil energy, the ageing of the population, onshoring and deglobalization. These are all potentially very negative for the longer term structural inflation outlook.

For now, central banks remain committed to their inflation targets, which has helped keep yield curves flat and BEIs compressed. If larger forces like climate change and deglobalization were to usher in a period of more frequent inflation shocks, then potentially this would also mean greater uncertainty for interest rates, which would require higher term premia and inflation risk premia to be paid.

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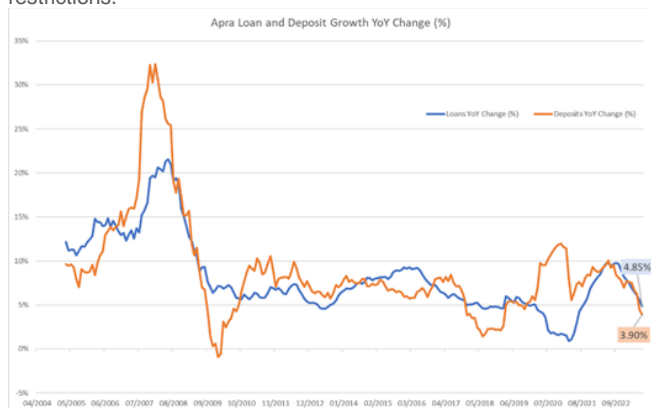


Credit Outlook

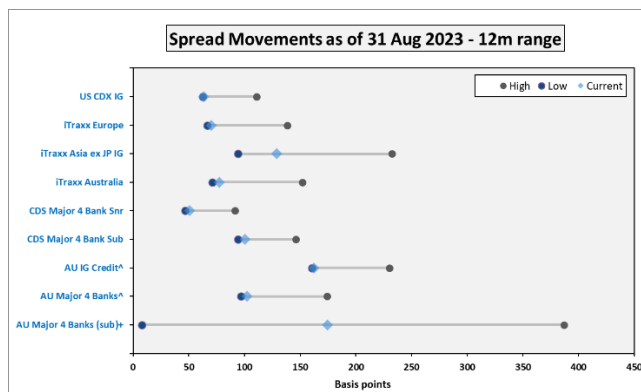
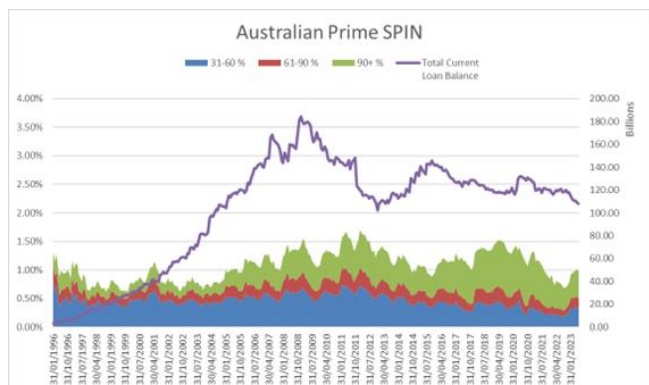
After several months of credit spread tightening, credit markets saw consolidation in the month of August and mostly moved sideways. However, synthetic credit spreads moved wider in the APAC region, driven by a further deterioration in China's property sector, which now starts to spill over to some parts of China's banking sector, albeit the impact is relatively contained so far.

August's reporting season shows that most Australian companies continue to grow their revenue positively, reflecting their built-in inflation pass-through mechanism and a resilient end-demand from consumers. However, several industries have started to experience large falls in their underlying profits as a result of margin squeeze and the pain of higher interest rates. Real estate, commodities, consumer staples, communications, and energy saw declines in their earnings per share, while industrial, technology, utilities, financial, and consumer discretionary saw positive trends in earnings growth.

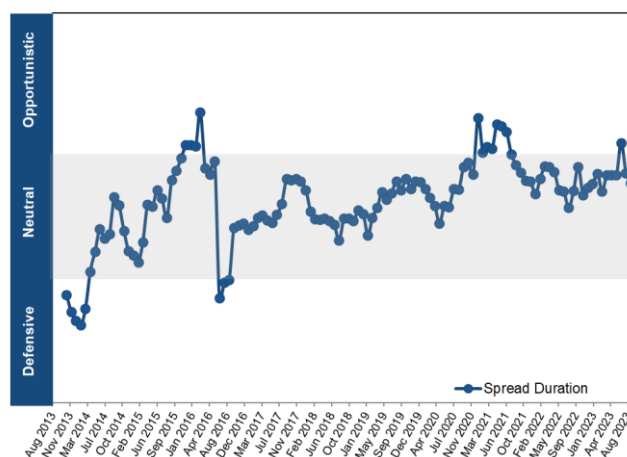
The latest APRA banking statistics show both deposit growth and loan growth continue to trend lower year on year, reflecting a weakening demand for credit in the economy and corporates digging into their cash balances, although household deposits are still holding up well. Despite the negative trend, the current loan and deposit growth trend is more normalised compared to the pre-pandemic period, whereas 2022 saw an abnormally high level of credit expansion as the economy rebounded sharply from exiting covid restrictions.



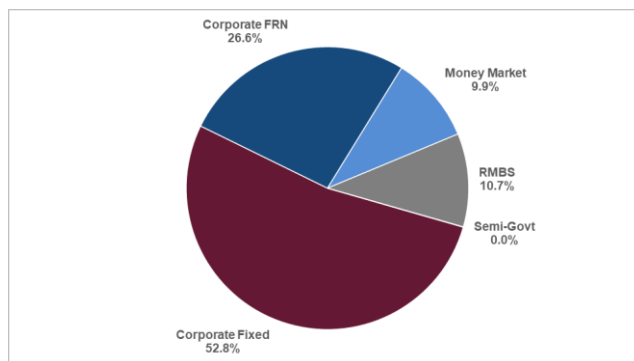
June saw another moderate decline in Australia's mortgage delinquency rate for both prime and non-prime mortgage loans. This is the second month of improvement since May after a few months of an increase in the delinquency rate and is consistent with the messages from major banks, which continue to see resilience in households balance sheets due to a high level of deposit built up and the strength of the housing market. Mortgage stress is not yet evident in current data; however, most banks sound cautious and have increased loan provisions for potential future losses.



Defensive to Opportunistic



Sector Breakdown (Market Value %)



ESG

During this reporting season, we have observed social risks related to workforce and customer relations starting to affect companies' operations to various degree. On the workforce side, trade unions and employees have been demanding sizable wage increases in response to high inflation. This has resulted in notable cost increases for companies with large workforces, such as Coles and Woolworths. In cases where satisfactory wage increases have not been provided, industrial action, as seen with Woodside and South32, has disrupted normal operations.

Finding the delicate balance between meeting employees' demands and maintaining operational efficiency has become crucial for companies. Moreover, navigating customer relations can be challenging as companies try to pass on cost increases to protect their margins. However, cost reduction measures, such as

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downsizing the workforce, can lead to negative impacts on customer service.

For instance, Qantas, while significantly reducing its cost base during the pandemic, has faced ongoing customer complaints in the past twelve months. Furthermore, retailers are experiencing increased theft and crime due to the rise in the cost of living, similar to other Western countries. This has resulted in rising stock losses, with financial repercussions and concerns regarding workforce safety. As a response, retailers and retail landlords are actively working on enhancing security measures within their store networks.

We will closely monitor how companies navigate these complex issues over the next 12 months.

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

Important information

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