Antares Income Fund

Monthly Investment Report
May 2023

Fund Performance

Period Ended 31/05/2023	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %	Since Inception %pa[1]
Antares Income Fund	0.46	1.09	3.49	1.75	1.67	1.94	2.20
Bloomberg AusBond Bank Bill Index	0.29	0.89	2.64	0.91	1.14	1.33	1.64
Difference	0.16	0.20	0.86	0.84	0.53	0.61	0.56

Valuation at month end was $233.7M
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 31/05/2023

	Fund	Benchmark
Interest Rate Duration (yrs)	0.12	0.13
Yield to Maturity*	5.05	3.90
Credit Spread Duration (yrs)	2.28	-
Average Credit Rating	A	-
Liquidity**	73%	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	13.25%
AA+	1.00%
AA	5.08%
AA-	30.78%
A+	4.24%
A	0.00%
A-	9.78%
BBB+	16.17%
BBB	17.97%
BBB-	1.73%

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	31-Mar-23
Distribution Amount	0.69 Cents Per Unit
Next Distribution Date	30-Jun-23

Portfolio Review

Key Drivers of Portfolio Performance:

- Short duration positioning contributed to returns as yields rose.
- The yield curve from 3-10yrs flattened detracting from returns.
- Financials and corporates tightened 3-10bps contributing to returns.
- Yield enhancement and rolldown of quality investment grade bond holdings added to returns.

Portfolio Activity and Positioning

- Switched ANZ 24/29 sub debt into ANZ 28/33 sub debt.
- Bought Transgrid 5/30.
- Used futures to reduce the short duration to target levels.

Portfolio Strategy

Strategy	Implementation
Duration and Yield Curve: Our scenario analysis points to an increasing 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. The 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.	• Domestically, the RBA appears to have shifted to a more aggressive stance in response to the risk of high inflation becoming more structural, given the ongoing strength in the employment data and signs of growing wage pressure. • Globally, ongoing economic resilience has seen some of the recession risk, and, hence cash rate easing expectations being priced out of forward yield curves. The US, being more advanced in the tightening cycle, had aggressive easing expectations priced for late 2023 and early 2024, but this has been partially unwound as the market has shifted to an expectation of "higher for longer". In the UK, EU and now Australia, markets have recently increased the magnitude of tightening expectations. • We continue to see risks around the ability of central banks to bring inflation back to target levels and certainly do not envision such an outcome being attainable while also engineering a soft landing. • **Yield curve:** In Australia, the market pricing of long-term inflation expectations remains relatively anchored for now. This has been supported by the recent more hawkish rhetoric from the RBA, which has driven the curve flatter. Looking forward, Antares expects economic activity to fall, unemployment rates to rise, and in time, this is expected to limit the ability of central banks (including the RBA) to maintain the aggressive tightening cycle. 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. • **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.
Credit exposure: Our scenario analysis points to rising risks of a growth recession and stagflation risks that make us more selective about credit exposure in portfolios.	• **Valuations:** Credit spreads have narrowed since the widening seen back in March following the financial stability issues in the US regional banking sector and the collapse of Credit Suisse. That said, we are still finding some attractive value in some corporate sectors and issuers given the recent uptick in supply. • **High quality issuers:** With our expectation of economic growth to deteriorate, we are focusing 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. • **Synthetic credit:** 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.
Optimising yield through carry and rolldown: Focusing on high quality credits and inflection points on steep curves.	• **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 recent 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%.
Liquidity: Where appropriate, we are maintaining liquidity that can be realised in stressed conditions.	• **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.

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Market Review

Risk sentiment increased in May, driven by uncertainty around ongoing US debt ceiling negotiations, which saw a resolution towards the end of the month. Despite the ten plus rate hikes delivered by central banks over the past year, there is still a lack of definitive evidence of their impact in the economic data. This, coupled with continued strong wage, labour market, and sticky services inflation saw most major central banks hike 25bps in May. Markets responded by pushing bond yields higher and pricing in a higher rate structure for the remainder of 2023 to be more in line with hawkish central bank rhetoric.

The RBA's 25bps hike in May was driven by mixed economic data and concerns over a wage price spiral without the productivity gains to match. The Fair Work Commission delivered a 5.75% increase to the minimum wage at the end of May. Rhetoric from the RBA throughout the month suggests the board is reviewing its stance on the tradeoff between preserving the gains made in employment vs their price stability mandate.

Macro Outlook

In light of sticky inflation, a resilient labour market, and a lack of clear evidence of an economic slowdown, markets are in the process of repricing their rate expectations more in line with central bank views that rate structures will need to be higher for longer to bring inflation back to target. Until recently, there has been a large divergence between central bank and market pricing, with markets pricing rate cuts towards the end of the year, reflecting recession risks associated with the aggressive rate hikes seen to date.

Terminal rates in the US increased 19.5bps in May, and expectations of rate cuts were reduced by 22bps. In Australia, terminal rates increased by 41bps, and rate cut expectations fell by 14bps.

This material repricing in Australia reflects that the RBA is behind the rate hiking cycle of its global peers. With the highest core inflation and lowest cash rate among the major central banks, the RBA is now reassessing the risk of structurally embedded inflation from a potential wage price spiral.

This suggests the RBA has more work to do in 2023 to achieve a restrictive monetary policy stance consistent with bringing 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	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 tightening	1.50%	4.00%	4.75%	4.50%	4.35%	4.25%	4.50%	4.00%	150	38%
6b	Stagflation...Growth & employment collapses, 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%	3.59%	3.67%	3.85%	4.25%	3.50%	149	
	Market Yield Latest	22/06/2023		4.31%	3.97%	3.89%	3.97%	4.21%	3.73%	79.0	
	FV - Market (+ exp - cheap)			-0.70%	-0.37%	-0.22%	-0.12%	0.04%	-0.23%	70	

High inflation and falling growth forecasts have seen Antares' scenario analysis continue to shift from the better growth Scenarios 2 & 3 to the slower or negative growth "stagflation" Scenario 6. **"Stagflation"** is the highest probability (54%).

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.**

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 RBA followed through on its tightening bias in its June meeting with its 12th interest rate hike for this cycle. This follows the 25bps hike in May and renewed hawkishness by the central bank. Both the May and June statements revealed some concern over the persistence of global services inflation, the dissipating effects of earlier rate rises, very tight labour market conditions, and poor productivity. These factors help raise some doubt over the efficacy of the RBA's 2025 timeline for returning inflation back to target.

Also adding to the RBA's dilemma has been the rebound in housing activity, with house prices stabilising sooner and at higher levels than initially anticipated. This is likely to be supportive to personal consumption and higher rents and household goods prices.

Higher rental inflation was evident in the May monthly CPI report, which came in higher than expected at 6.8% in annual terms. Also contributing to the higher than consensus outcome were higher discretionary items like travel and accommodation, which saw large rises. Interestingly, after many years of downplaying CPI swap pricing for the information it provides on the inflation outlook, the RBA referenced a potential unanchoring of inflation expectations in the June statement. The 5yr CPI swap is currently levelling at 2.85%, while the 10yr reached a high of 2.84% and has slightly moderated since.

With the OIS market now pricing in 4.50% as the terminal cash rate, there has been a material repricing of policy rates by the domestic market, pointing to at least a further rate hike by August. This compares with prior to the May meeting, when the cash rate was 3.85% and markets were expecting the next move to be a cut. Given concerns relating to the RBA's June 2025 timeline for inflation returning back to the 2-3% band, there continues to be upside risks to the market's rate call.

Credit Outlook

May was an uneventful month for the credit market. US IG spreads were unchanged at 137bps, European IG spreads widened 6bps to 171bps, Australian IG spreads tightened 7bps to 135bps. Synthetic credit spreads continued to compress 5-7bps in the APAC region and remain flat in the US and Europe. Our internal valuation model suggests cash bonds are in neutral territory compared to historical levels, whereas synthetic instruments are now looking expensive.

May saw a record level of credit issuance, with over $15bln of new issuances priced in Australia. Whilst the majority of the issuance remains bank paper, the return of corporate bonds was welcomed by the market, with several utilities successfully printing 7-10 year bonds. Technicals continues to be supportive for IG credits globally, which have seen 8 consecutive months of inflow.

US consumer credit card delinquency and auto loan delinquency have increased back to pre-pandemic levels, while corporate filings for chapter 11 bankruptcy have also picked up, albeit still below historical coverage. S&P reported another 13 new corporate defaults in the month of April, taking the total global corporate defaults to 50 cases year to date, which is 25% higher than the 10-year average.

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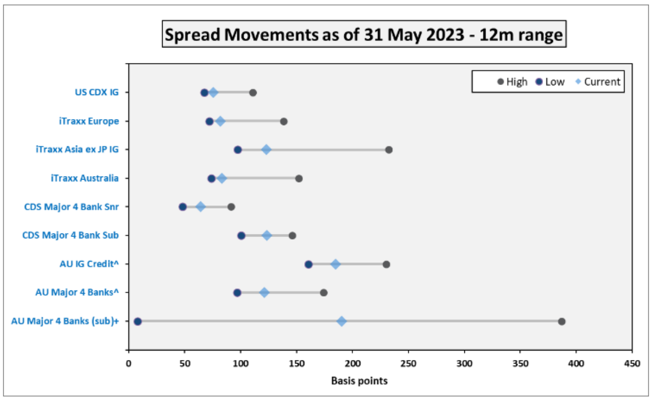
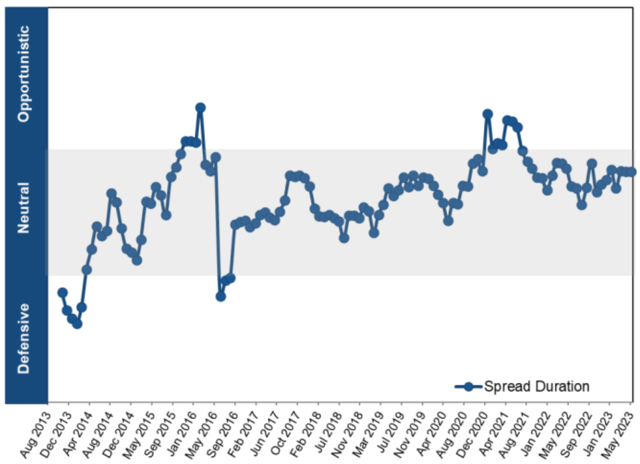
Looking ahead, we expect credit conditions and default cycle to deteriorate further as central banks continue to hike rates and commercial banks tighten their lending standards. The latest Fed data shows aggregate lending and deposits declined further in April sequentially, indicating a negative credit impulse and more pain ahead for the economy. Lending condition in Australia remains healthy, however credit impulse has slowed.



Defensive to Opportunistic

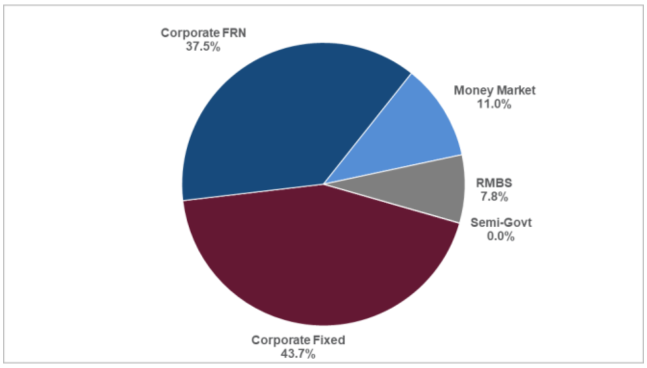


About Antares Fixed Income

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$25.41 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 2022

Sector Breakdown (Market Value %)



ESG

We participated in the primary issuance of the AUD 7 senior secured bond from NSW Electricity Network Finance (TRANSGRID). As a transmission operator, Transgrid plays an essential role in providing the infrastructure required for Australia's energy transition and net zero goals, which would ultimately benefit society over time by providing clean energy at a low cost.

In order to accommodate Australia's transition journey, Transgrid will carry out major capex work, including the construction of ultra-high voltage towers and lines across regional Australia, which may raise issues with locals and indigenous landowners and result in land disputes. We brought this up with management as a major risk for our ESG consideration. Based on our engagement, it appears that Transgrid's management is highly conscious of such risks and understands the importance of maintaining a social license. They are spending a lot of time on community engagements and managing a way forward with all parties, as they understand early and regular engagements are a key to success.

Concerns surrounding the management of the Bank of Queensland and the sizable gaps in its risk management framework dominated headlines in May. We want to once again emphasise that, due to our robust ESG integration process, we did not participate in recent bond issuance by this issuer as we had identified concerns about its risk culture and corporate governance practices back in 2022. As a result, we assigned a 'material' governance risk score to this name.

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