

# Antares Income Fund

## Monthly Investment Report

### July 2023



#### Fund Performance

| Period Ended 31/07/2023           | 1 Mth % | 3 Mths % | 1 Yr % | 3 Yrs % | 5 Yrs % | 7 Yrs % | Since Inception %pa <sup>1</sup> |
|-----------------------------------|---------|----------|--------|---------|---------|---------|----------------------------------|
| Antares Income Fund               | 0.64    | 1.63     | 4.98   | 1.85    | 1.83    | 2.07    | 2.28                             |
| Bloomberg AusBond Bank Bill Index | 0.37    | 0.97     | 3.15   | 1.13    | 1.20    | 1.38    | 1.68                             |
| Difference                        | 0.27    | 0.66     | 1.83   | 0.72    | 0.62    | 0.69    | 0.60                             |

Valuation at month end was \$149.79M

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 31/07/2023

|                              | Fund | Benchmark |
|------------------------------|------|-----------|
| Interest Rate Duration (yrs) | 0.03 | 0.12      |
| Yield to Maturity*           | 5.46 | 4.16      |
| Credit Spread Duration (yrs) | 2.20 | -         |
| Average Credit Rating        | A    | -         |
| Liquidity**                  | 64%  | 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        | 13.08% |
| AA+        | 12.82% |
| AA         | 13.29% |
| AA-        | 25.07% |
| A+         | 7.35%  |
| A          | 2.30%  |
| A-         | 6.13%  |
| BBB+       | 13.65% |
| BBB        | 5.95%  |
| BBB-       | 0.35%  |

#### Portfolio Strategy

| Strategy   | Implementation  |
|--|---|
| <p><b>Duration and Yield Curve:</b><br/>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 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 paused in August to assess the impact of the policy tightening undertaken to date plus 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 and ongoing signs of wage pressure.</li> <li>Globally, markets have pushed 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. Since May we have seen longer term real yields rise while longer term inflation expectations have remained anchored. 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 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><br/>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> <p>We have more probability weighting towards soft growth outcomes rather than deeply negative outcomes.</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. Although some sectors are looking more expensive, we continue to add credit exposure in 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><br/>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 5-7yrs, 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:

- The 20bp steepening of the 3-10 yield curve was a big contributor to returns.
- Corporates tightened 4-15bps, contributing to returns.
- Yield enhancement and rolldown of quality investment grade bond holdings added to returns.

#### Portfolio Activity and Positioning

- Sold a range of corporates and financials to meet cashflows.

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#### Market Review

July saw a steepening in the back end of yield curves as Japan loosened its Yield Curve Control, allowing long term rates to trade in a wider range, and the US Treasury increased its borrowing estimates for the third quarter of 2023 to over one trillion dollars.

Market pricing reflected an increased probability of a soft landing as inflation eased amid a resilient US economy, overall strong US corporate earnings, and a perceived reduction in recession risk. In contrast, Europe and China are experiencing a more pronounced slowdown. China GDP was +6.3% in July vs +7.1% expected, and Eurozone GDP came in at +0.6%. There is uncertainty around the global impact of a slowing China but there is a growing consensus that it will continue to export disinflation in manufactured goods.

Central bank rhetoric over the month was that additional policy action may be required but that forward guidance would be data dependent from meeting to meeting given the uncertainty around the economic impact of the hiking cycle to date. Although headline inflation continues to fall, core inflation remains sticky, particularly around services, which was evident in the Australian July CPI data. Of particular concern is inflation from housing and rents, as strong demand is being met with supply shortages, reflecting a structural imbalance in the property and construction sectors.

#### Macro Outlook

Markets seem increasingly confident in the ability of central banks to bring inflation back to targets while engineering a “goldilocks” soft landing. Historically, central banks have not been able to achieve this outcome after aggressive tightening cycles. The key question is: will it be different this time?

Looking forward, there are two main areas of uncertainty: economic growth and the inflation impact from central banks policy tightening. While growth rates are slowing globally, it seems less likely that we will see a traditional recession with negative GDPs accompanied by high unemployment. While headline inflation continues to fall, labour markets have remained strong, increasing reflation risks. In addition, geopolitical risks are impacting the outlook for global food and energy prices. Globally, economies are still experiencing sticky services inflation.

Looking at the Australian landscape, inflation risk factors include wages growth, energy price rises, strong housing and rent demand, an aggressive immigration policy, and a strong labour market underpinned by a large pipeline of housing and infrastructure spending. Unlike a traditional downturn, asset valuations have so far remained relatively stable. We question if monetary policy is sufficiently restrictive to bring inflation back to target within a reasonable timeframe and remove the risk that a structurally higher level of inflation becomes embedded within the economy.

#### 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 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%  | 3.59%       | 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     |                       |

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 over 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

The release of the August Statement of Monetary Policy (SOMP) highlighted the competing forces currently buffeting the Australian economy. Global disinflation continues to play out, with China now exporting its deflation to the rest of the world. In conjunction with this, global supply chains continue to see relief from pandemic related shortages, resulting in the RBA projecting 3.6% CPI for the next 12 months, stepping down to below 3% by the end of 2025.

The domestic economy continues to experience additional tightening as the wave of fixed rate mortgages convert to variable rates. With approximately one million fixed rate loans having converted to date, and another million due over the coming year, it remains to be seen what the full impact of this will be.

For now, the Australian economy has weathered the tightening of rates admirably. Banks are reporting very low loan arrears and fixed to variable rate loan conversions have not resulted in observable repayment stress. Indeed, the SOMP clearly shows that borrowers have not fallen behind in mortgage repayments, and if anything, many still have ample buffers.

As with many other risks, concerns around the fixed rate mortgage cliff may have been overstated. This may be due to the well-telegraphed nature of upcoming rollovers, very strong labour market conditions that are supporting incomes, and the likelihood that many fixed rate borrowers were able to save early on.

While the cumulative impact of the tightenings continue to work through the economy, given the long and variable lags, it should be noted that the full impact has also been blunted by intense bank competition in the lending market. Over the hiking cycle, the RBA has lifted rates 400bps (to date) while the average loan rate has only gone up 340bps.

With household demand slowing and inflation projected to fall back into the 2-3% band by 2025, the RBA remains patient. Hence, a period of policy rate stability is expected as the RBA gathers more information on the economy. From there, it is likely to calibrate rates for the end of the cycle, although by how much remains uncertain. Markets are pricing a further 6-10bps of hikes, which may turn out to be complacent. A lot will depend on upcoming CPI prints, the outlook for the housing market, and employment conditions.

#### Credit Outlook

Credit spreads tightened in July, with the market contemplating a potential “soft landing” in contrast to earlier expectations of a deep recession being required to bring inflation back to targets.

After the solid issuance pipeline seen in May and June, there was a lack of primary issuance in July, and the spread performance was driven by strong secondary market demand. Brokers were able to lift corporate inventory quickly and sell well inside mid marks.

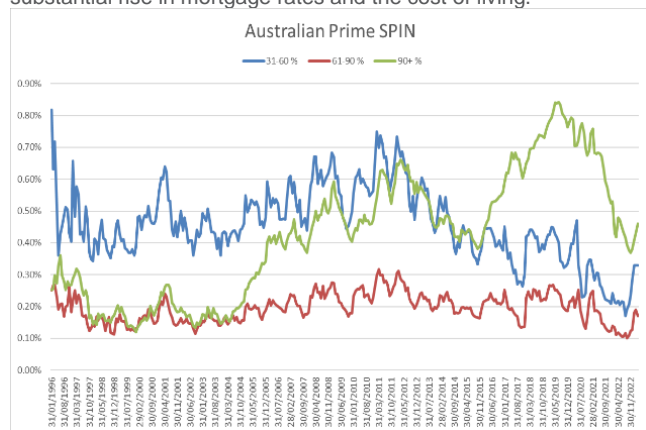
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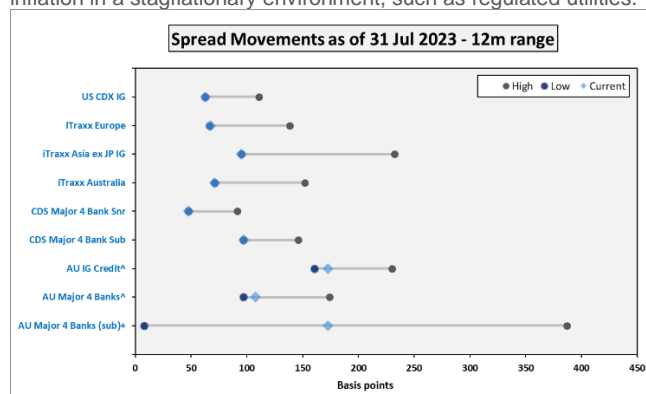


Australian mortgage delinquency rates have been rising, but the latest May data actually showed a small decline in delinquencies. Mortgage stress is not seen as material in Prime RMBS even though the borrower's finances have been materially impacted by the substantial rise in mortgage rates and the cost of living.



S&P, Antares Fixed Income

Globally, lending standards and covenants have tightened, but credit is still readily available. The latest June US Senior Loan Officer Survey shows an acceleration of tightening lending conditions by US banks, with 50.8% of lenders citing more tightening lending standards. We continue to prefer defensive credit issuers with resilient cash flow profiles and whom have the ability to pass on inflation in a stagflationary environment, such as regulated utilities.



### About Antares Fixed Income

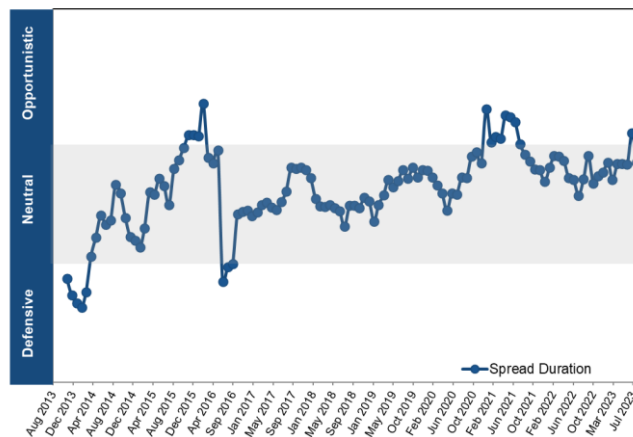
Antares Fixed Income (Antares) is a specialist fixed interest manager covering a range of domestic and international securities. Antares has managed fixed interest and cash portfolios for investors since 1990 and currently has over A\$25.67 billion\* in funds under management across a range of cash management, 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

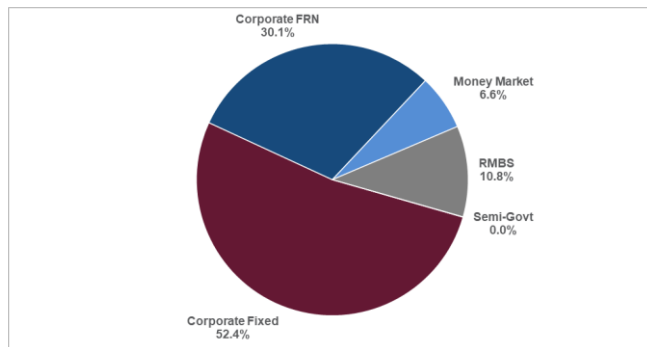
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### Defensive to Opportunistic



### Sector Breakdown (Market Value %)



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