

# Antares Income Fund

## Monthly Investment Report

### October 2021



#### Fund Performance

Period Ended 31/10/2021	1 Mth %	3 Mths %	1 Yr %	2 Yrs %	3 Yrs %	Since Inception %pa <sup>1</sup>
Antares Income Fund	-0.16	-0.11	1.38	1.33	1.62	2.32
Bloomberg Bank Bill Index	0.00	0.00	0.03	0.27	0.73	1.63
Difference	-0.16	-0.11	1.35	1.06	0.89	0.69

Valuation at month end was \$165,077,567.84

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 31/10/2021

	Fund	Benchmark
Interest Rate Duration (yrs)	0.03	0.12
Running Yield + Rolldown (%)	1.60	0.05
Credit Spread Duration (yrs)	2.14	-
Average Credit Rating	A	-
Liquidity*	67%	100%
Fund Size (millions)	\$165.08	-

\* 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	15.62%
AA+	2.61%
AA	10.48%
AA-	11.24%
A+	6.77%
A	1.73%
A-	16.29%
BBB+	19.33%
BBB	15.93%
BBB-	0.00%

#### 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-Sep-21
Distribution Amount	0 Cents Per Unit
Next Distribution Date	31-Dec-21

#### Portfolio Review

##### Key Drivers of Portfolio Performance:

- The 0.06yr short duration position added 2bps as yields rose 45-75bps
- The 12bp flattening of the 10-3yr yield curve detracted 8bps
- Financial and corporate spreads widened 5-10bps detracting 17bps
- Yield enhancement and rolldown of quality investment grade bond holdings added 10bps.

#### Portfolio Activity and Positioning

- Bought Aircservices 5/30 and BOQ 5/25 FRN
- Maintained the strategic short position through the October sell-off
- We have maintained the liquid structure of the Fund.

#### Portfolio Strategy

Strategy	Implementation
<b>Duration and Yield Curve:</b> Our Scenario analysis points to an increasing probability of global inflation with a bearish move in bond yields	<ul style="list-style-type: none"> <li>• We have been playing duration strategically from the short side at an aggregate portfolio level. The recent 40-70bps sell-off in bond yields has brought market yields closer to our fair values.</li> <li>• The removal of YCC has "normalised" the government curve out to 3 years</li> <li>• Faster RBA rate hikes could lead to a bear flattening with 2-3yr bonds performing worst and 7yrs and longer bear flattening.</li> <li>• In contrast, a slower RBA, in line with Governor Phil Lowe's patient approach, could see support for 2-3yrs but a bear steepening from 7yrs out.</li> </ul>
<b>Optimising yield through carry and rolldown</b> , focusing on the inflection points on steep curves. With yields so low and curves still steep, <b>in many cases the expected annual rolldown exceeds the running yield</b>	<ul style="list-style-type: none"> <li>• We are using our proprietary analytics to find attractive rolldown maximisation opportunities per units of risk; currently NSW 26-28 and Commonwealth 4/25 to 4/27 are the most attractive, hedging with 3yr 5yr or 10yr futures.</li> </ul>
<b>Control credit risk</b>	<ul style="list-style-type: none"> <li>• Semis, led by NSW &amp; TCV, have recouped 50% of their August/September widening and still present attractive relative value, especially in the 4-6yr maturities, and we maintain overweight positions.</li> <li>• Credit spreads are near their tightest for 15 months, including iTraxx. We will selectively lighten some physical credit exposures and monitor iTraxx levels for further credit protection.</li> <li>• We are targeting credits with strong balance sheets and those issuers that are expected to show more resilience through the rolling pandemic and the recovery.</li> </ul>
<b>A strong level of liquidity that could be realised in stressed conditions</b>	<ul style="list-style-type: none"> <li>• Selective semis and government bonds provide both liquidity and attractive carry and rolldown, which is so important in this current low rate environment.</li> </ul>

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#### Market Review

The tumult in bond markets seen through September reached its crescendo in October, with a significant sell-off in local front-end rates towards the end of the month. Both risk appetite and the functionality of the domestic bond market deteriorated rapidly following the release of the Q3 Australian CPI report. While the headline CPI was broadly in line with consensus at 0.8% qoq, the trimmed mean surprised to the upside, returning core inflation inside the 2-3% target band for the first time since 2015.

Long standing received positioning in front-end swaps and longs in short tenor bonds, which had been underpinned by the RBA's commitment to yield curve control (YCC), gave way to significant liquidations with investors unwinding positions en masse. This had the effect of flattening the 3s10s curve to 50bps at one stage while rate hike expectations were brought forward to 2022. Once it became obvious the RBA would not return to the market to support the YCC bonds, the April 2024 bonds pushed out to 0.75%, exacerbating the sell-off in 2-5yr rates while the overnight index swap (OIS) market priced in an incredulous four rate hikes for 2022.

As a result of the sell-off and bear flattening, domestic bonds underperformed materially for the month, with yields across the curve pushing wide relative to most offshore markets. The Aussie-US 10yr spread widened to 50bps into month end, after having been negative only a few weeks earlier.

Credit markets saw some underperformance with some sectors experiencing spread widening including major bank senior paper. Widening swap spreads helped push spreads out across several sectors including most notably the supranationals and agencies where credit and swap spreads correlate highly. Over the month, the 5yr iTraxx became a little more volatile pushing out to 74bps only to close the month broadly unchanged at 65bps.

The dislocation in markets also spilt over to the inflation bond market, after a stellar rise in break-evens (BEIs) through the month leading up to and including the Q3 CPI day. Subsequent to the report, market concerns over inflation acting as a catalyst for earlier rate hikes saw BEIs completely reverse their month-to-date performance as bid-offers widened and market liquidity collapsed.

#### Macro Outlook

##### Global

The RBA's November Statement of Monetary Policy summarises global growth conditions very well: **"Conditions are in place for a sustained global recovery.** The spread of the Delta variant of COVID-19 through the middle of the year had set this recovery back in some countries, but only temporarily. Rapid increases in vaccination coverage in many countries has allowed restrictions to be eased, and economic activity has bounced back strongly. Alongside these better health outcomes, expansionary fiscal and monetary policy have assisted the recovery and continue to support the outlook. Most advanced economies are expected to return to their pre-pandemic paths for output next year, but a number of emerging market economies are likely to still be short of pre-pandemic trends. Health-related risks remain an uncertainty for the period ahead.

Higher upstream prices have also pushed up consumer price inflation in several economies to well above inflation targets. Central banks generally expect these pressures to subside and inflation to moderate over the year ahead. Market-implied inflation expectations and private sector inflation forecasts have risen, but for the longer term they are in line with central banks' targets."

Central banks are in the process of withdrawing QE at a measured pace (FED, RBNZ, RBA, BOE, ECB). However, the Bank of Canada decided to go "cold turkey" and immediately withdrew all QE. The next step in the removal of stimulus is raising interest rates. The Fed and RBA have spelt out that cutting back QE does not imply an immediate rise in interest rates. Bond markets have tended to ignore this advice and are pricing rate rises through 2022.

The key challenge for investors remains inflation. Central banks maintain that inflation is transitory and will revert back to target levels when supply chain blockages have been resolved. However, the narrative from central banks has shifted to "inflation is remaining elevated for longer than expected." Some strategists, such as Bridgewater Associates, see a structural shift to higher inflation and believe current inflation pressures are demand driven, fueled by the twin stimulus of fiscal and monetary policy.

#### Australia

The RBA's November Statement of Monetary Policy provides a bullish forecast for Australia's near-term growth: **"Now that vaccination rates are rising quickly to very high levels, and restrictions on activity have been eased significantly, the economy is recovering rapidly.** The speed of this recovery is consistent with the strong underlying momentum in the economy prior to the outbreak. GDP is expected to grow by around 3 per cent over 2021. Growth is expected to be around 5½ per cent over 2022, before returning to around 2½ per cent over 2023."

Given this bullish forecast, the RBA persists in being date-specific on its forecasts for changes in cash rates, unlike all other major central banks who maintain maximum flexibility, depending on the data.

"In some other plausible scenarios, wages growth and inflation could be higher than implied by the central scenario. If this were to eventuate, an increase in the cash rate in 2023 could be warranted. However, in the Board's view, the latest data and forecasts do not warrant an increase in the cash rate in 2022."

Bond investors have two ways to play the Australian yield curve:

1. Slow RBA (slow Lowe)  
The yield curve out to 2-3yrs will be well supported for carry and rolldown, but longer maturities will bear steeper, building in a risk premium that the RBA is "behind the curve".
2. Proactive RBA  
The yield curve out to 2-3yrs will rise quite quickly but longer maturities will bear flatten, as investors take confidence that the RBA is "ahead of the curve".

If one follows the RBA's rhetoric closely, you would favor option #1.

#### 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.

Scenarios	AU GDP	AU Inflation	AU 3YR Bond	AU 5YR Bond	AU 10YR Bond	AU 30YR Bond	US 10YR Bond
SC 1	4.00%	4.50%	5.00%	5.00%	4.50%	4.50%	4.00%
SC 2	4.00%	3.00%	2.50%	3.25%	4.25%	5.50%	4.50%
SC 3	3.00%	2.25%	1.25%	1.75%	2.50%	3.00%	2.50%
SC 4	1.50%	1.50%	0.30%	0.50%	1.00%	1.75%	0.75%
SC 5	-2.00%	1.00%	0.10%	0.30%	0.50%	1.40%	0.50%
SC 6	1.00%	3.00%	1.50%	2.25%	3.00%	4.25%	3.00%
Antares Latest Fair Value (FV)	2.14%	2.15%	1.00%	1.40%	2.05%	2.80%	2.05%

The broad-based increase in global inflation including Australia's core inflation breaking above 2%, has led the Antares team to make a shift to the "stagflation" Scenario 6 (1% growth and 3% inflation).

The removal of YCC by the RBA and the expectation that rate increases will come sooner than the RBA's timeline, has produced higher expected yields for 3 to 5yrs bonds in the rising inflation environment.

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After the major sell-off in bonds through September and October, Antares longer bond FVs are still 20-40bps higher than current market yields. However bonds of terms 3 to 5yrs are looking 10-20bps cheaper. This suggests positioning Antares' portfolios for a bear steepening.

The table below provides a summary of the respective FVs and comparisons to current market pricing.

Instrument	FV*	FV Range^	Market Price	FV – Market Price**
Cash (6mth forward)	0.40%	0.30-0.50%	0.30%	-0.10%
3YB	1.00%	0.75–1.25%	1.20%	+0.20%
5YB	1.40%	1.15–1.65%	1.50%	+0.10%
10YB	2.05%	1.70–2.40%	1.85%	-0.20%
30YB	2.80%	2.50–3.10%	2.55%	-0.25%
3/10 Spread	1.05%	0.75–1.35%	0.65%	-0.40%
iTraxx (forward contract*)	78	70-90	67+8	-3
US 10YR	2.05%	1.80-2.40%	1.55%	-0.50%

\*Antares current Fair Value (FV) based on current probability weighting.

^Antares assessment of the broad range of Fair Values across all of Antares' scenarios.

\*\*Antares current Fair Value (FV) – Market Price (+)cheap / (-)expensive

### Interest Rate Outlook

The sell-off in interest rates experienced in August and September that was driven by the move higher in domestic real yields continued in October although not as much from the real yields side in the early stages of the month. The near term outlook for nominal yields will continue to be driven primarily by the stance of central banks and the direction of real yields. Real yields are being underpinned by ongoing supply-side inflation pressures and increasing tightness in labour markets, as well as very patient central banks when it comes to rate hikes.

Complicating the outlook further, there are at least three other developments:

- i) The commencement of the Fed's QE tapering, which could accelerate from its current US\$15bn month pace. An acceleration in tapering would see potentially higher long bond yields in the US and elsewhere.
- ii) The US government's ongoing fiscal stimulus including its most recent round of infrastructure spending bills. Much of this however was already priced.
- iii) The slowdown in the Chinese property market and possible knock-on effects of a weaker credit impulse for global growth. If the authorities do not counteract this impact with additional liquidity injections and stimulus, further spill-over is likely for certain commodity prices and Australia's terms of trade.

The major driver of the shape of yields however will be the responsiveness (or otherwise) of central banks to the inflation concerns currently facing many economies. With much of the headline CPI coming through being supply-related in nature, it should not be surprising that yield curves remain very flat for this point in the economic cycle. Core inflation risks are gradually trending higher in Australia, although the domestic inflation performance to date has lagged materially other jurisdictions, including the US, UK and New Zealand. Much of this relates to a lack of synchronicity of cycles and the fact that many other labour markets are much tighter with higher wages and lower participation rates.

Following the RBA's November meeting and push back from Dr Lowe completely discounting the possibility of hikes in 2022, the market has

partially unwound the four rate hikes it priced in towards the end of October. We posed the question in last month's report on how the domestic interest rate market would reconcile global inflationary forces with the opposing and equally strident RBA view that inflation is not a near-term concern locally. It appears for now that the RBA's view should mostly prevail, although a hike in late 2022 cannot be ruled out.

### Inflation Outlook

Breakeven inflation (BEI) measures in Australia and US diverged once again in October, with a material underperformance of local BEIs into month end, following a significant sell-off across all rates. With Australian 10yr BEIs nearer to 2%, inflation expectations were momentarily impacted by strained market liquidity and the prospect of RBA rate hikes being brought forward. With liquidity once again restored and rate expectations moderating, there is a reasonable prospect for higher BEIs into year end.

As per the RBA's November Statement of Monetary Policy (SOMP) the RBA expects core inflation to rise 2.5% by the end of 2023, leaving 2024 for rate lift-off as its baseline view. A pre-condition for sustainable inflation at the middle of the band will be higher wages, which is likely to take some time as the national economy continues to open up post-pandemic.

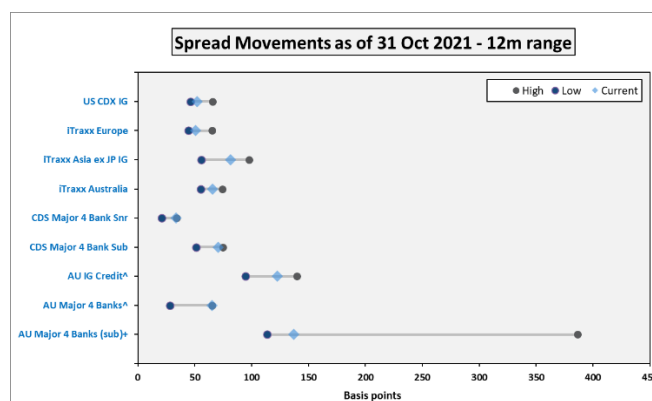
Supporting a more constructive view on the domestic inflation outlook, are some of the rising components evident in the Q3 CPI report released in October. While supply-related factors continue to seep into core measures of inflation, more encouraging for sustained inflation are developments in the housing inflation component. Strong rises in purchase dwellings, and the dissipating effects of government subsidies should see the very large housing component continue to support rising inflation numbers.

Also key to the inflation outlook will be how the economy transitions away from durable goods spending and back to services as the economy opens up. With the strong pace of goods spending through the pandemic helping to contribute to stock-outs and supply bottlenecks, it remains to be seen to what extent inflation rises as a result of the substitution of services for goods spending through 2022.

### Credit Outlook

October capped a month of widening in credit. In the wake of APRA's Commitment Liquidity Facility announcement, bank primary issuance served to re-price secondary funding curves wider. Additionally, the RBA's month-end capitulation on Yield Curve Control also resulted in broad based re-pricing of credit. However, this repricing was mainly via volatility in risk-free and swaps curves, with moves on a spread basis more muted in nature.

On the corporate side, there were a number of predominately smaller, longer-dated primary market transactions. We again declined to participate in these deals. Conversely, we have retained the view that with central banks leaning toward tighter monetary policy, that risks to longer-dated credit are asymmetrically skewed to the downside.



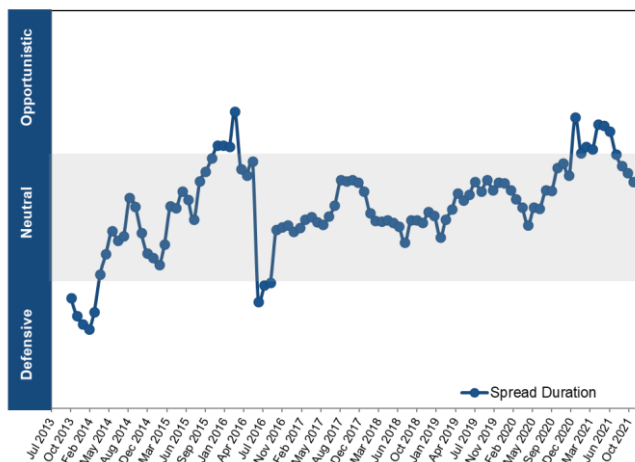
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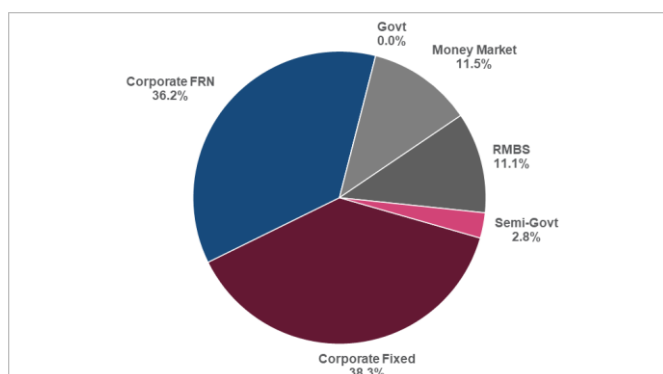
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#### Defensive to Opportunistic



#### Sector Breakdown (Market Value %)



#### ESG

The steady stream of green and sustainability-linked issuance continued apace in October. GPT Wholesale Office Fund completed the issuance of A\$250 million of 10-year green bonds. This transaction priced at a margin of 132bps, tightening from the initially guided 140bps. Funds from this green bond issuance will be used to finance offices which perform in the top 15% of its respective city location, measured by its carbon intensity.

Antares did not participate in the GPT Wholesale Office Fund due to concerns about the office sector and insufficient credit spread for such a long tenor bond. Antares is currently undertaking a broad review of its' ESG policy and engagement levels with the intention to increase the clarity and focus of ESG consideration in all investment decisions.

#### Market Movements

- Equity markets were mixed in October with the ASX200 down 0.1%, while the S&P500 jumped 6.9% for the month.
- Aus bonds yields rose sharply in October as the market brought forward rate hikes. Aus 3yr yields rose 93bps to 1.40% and 10yr yields rose 60bps to 2.12%. The 3-10yr curve flattened 33ps closing at 0.72%. US 10yr treasury yields rose a modest 6bps to 1.55%.
- BBSW rates rose sharply in October as the market brought forward rate hikes as early as 2022. BBSW3m rose 5bps to 0.07%, while BBSW6m rose 15bps to close the month at 0.204%.
- Credit spread volatility remains low, however Aussie bank FRN moved wider in October in response to rising market volatility. Aus iTraxx was 1.3bps tighter closing the month at 65.4bps.

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Australian Rates	October 2021	Month Change	1 Yr Change
RBA Cash Rate	0.10	0.00	-0.15
90 Day Bank Bill	0.07	0.05	0.01
3 Yr Futures	98.60	-0.93	-1.24
10 Yr Futures	97.89	-0.60	-1.29
3/10 Spread (bps)	71.50	-32.50	5.00
iTraxx Australia 5Y	65.44	-1.31	-5.34
10Yr BEI	2.15	0.18	0.76

Global Sovereign Rates	October 2021	Month Change	1 Yr Change
Fed Fund Rates	0.07	0.01	-0.02
ECB Main Refi Rate	0.00	0.00	0.00
US Sovereign 2 Yr	0.50	0.22	0.34
US Sovereign 10 Yr	1.55	0.06	0.68
Japan Sovereign 10 Yr	0.10	0.03	0.06
German Sovereign 10 Yr	-0.11	0.09	0.52

Currencies	October 2021	Month Change	1 Yr Change
AUD/USD	0.75	0.03	0.05
EUR/USD	1.16	0.00	-0.01
USD/JPY	113.95	2.66	9.29

Equities	October 2021	Month Change	1 Yr Change
ASX200	7324	-0.1%	23.6%
S&P500	4605	6.9%	40.8%

Commodities	October 2021	Month Change	1 Yr Change
WTI Crude	83.6	8.9	44.3
Gold	1783.4	26.4	-95.4

Australian Economic Data	Latest Monthly Print	Month Change	1 Yr Change
Employment Change (k)	-138.0	8.3	-297.9
Unemployment Rate (%)	4.6%	0.1%	-2.3%
Retail Sales (MoM%)	1.3%	3.0%	-0.2%
Trade Balance Value (m)	12243	-2496	5550
Building Approvals (MoM%)	-4.3%	-11.9%	-12.1%
Consumer Confidence (Westpac)	104.6	-1.6	-0.4
Business Confidence (NAB)	13.0	18.5	7.2
Business Conditions (NAB)	4.7	-9.8	-2.1

Australian Economic Data	Latest Quarterly (Q2)	Quarterly Change	1 Yr Change
Private Capital Expenditure (QoQ%)	4.4%	-1.6%	6.7%
GDP (YoY%)	9.6%	8.3%	13.2%
Inflation (YoY%)	3.00%	-0.8%	2.3%

Global Economic Data	Latest Monthly Print	Month Change	1 Yr Change
US Non-Farm Payrolls (k)	531	219	-149
US Unemployment Rate (%)	4.6%	-0.2%	-2.3%
US Manufacturing ISM	60.8	-0.3	2.0
US Non-manufacturing ISM	66.7	4.8	10.5
China Manufacturing PMI	49.2	-0.4	-2.2
China Non-Manufacturing PMI	52.4	-0.8	-3.8
German Factory Orders (MoM%)	1.3%	10.1%	-2.3%
German Industrial Production (MoM%)	-1.1%	2.4%	-4.2%

Semis * vs Gov Bonds	October 2021	Month Change	1 Yr Change
3yr (bps)	27.5	18.3	17.4
7yr (bps)	24.45	6.90	7.11

\* Semi calculation comprises an equal weighting of NSWTC and WATC

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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\$27.91 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 2021

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#### Important information

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