# Antares Income Fund

## Monthly Investment Report
## June 2022

### Fund Performance

| Period Ended 30/06/2022 | 1 Mth % | 3 Mths % | 1 Yr % | 3 Yrs % | 5 Yrs % | 7 Yrs % | Since Inception %pa[1] |
|---|---|---|---|---|---|---|---|
| Antares Income Fund | -0.15 | -0.43 | -1.23 | 0.69 | 1.39 | 1.78 | 2.01 |
| Bloomberg AusBond Bank Bill Index | 0.05 | 0.07 | 0.10 | 0.33 | 0.95 | 1.26 | 1.52 |
| Difference | -0.20 | -0.50 | -1.33 | 0.35 | 0.44 | 0.52 | 0.50 |

Valuation at month end was $190,977,328.70
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 30/06/2022

| | Fund | Benchmark |
|---|---|---|
| Interest Rate Duration (yrs) | 0.05 | 0.13 |
| Running Yield + Rolldown (%) | 3.01 | 1.36 |
| Credit Spread Duration (yrs) | 2.04 | - |
| Average Credit Rating | A | - |
| Liquidity* | 74% | 100% |

*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 | 13.99% |
| AA+ | 1.05% |
| AA | 6.06% |
| AA- | 20.56% |
| A+ | 5.47% |
| A | 0.86% |
| A- | 16.56% |
| BBB+ | 18.19% |
| BBB | 17.26% |
| 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-Jun-22 |
| Distribution Amount | 1.81 Cents Per Unit |
| Next Distribution Date | 30-Sep-22 |

### Portfolio Review

**Key Drivers of Portfolio Performance:**

- Corporate spreads widened 1-10bps detracting 29.5bps
- Bank senior and sub debt widened 0-25bps detracting 14.5bps
- iTraxx protection added 13.4bps as CDS widened 5-30bps
- Yield enhancement and rolldown of quality investment grade bond holdings added 12.5bps.

### Portfolio Activity and Positioning

- We have maintained the liquid structure of the Fund.

### Portfolio Strategy

| Strategy | Implementation |
|---|---|
| **Duration and Yield Curve:** Our Scenario analysis points to increasing probabilities of more sustained global inflation with a bear steepening of yield curves. However aggressive tightening by central banks to contain inflation may curb economic growth quickly, creating a “stagflation” environment | • Given the 150-200bps rise in bond yields since year-end we have steadily reduced our short duration positions as market yields moved closer to our fair value levels (refer scenario analysis below). However the strong bond rally in late June provided an opportunity to reset some short positions.<br>• Both the Fed and RBA appear committed to aggressively get on top of inflation. Accordingly markets are pricing December 2022 cash rates of 3.30% for the Fed and 3.10% for the RBA.<br>• The very aggressive front-loaded tightening from the Fed and RBA could well slow economic growth rapidly, with markets now pricing a 40% probability of a recession in mid-2023. Rapidly slowing economic data or very negative consumer responses to rising rates could see central banks holding back on the pace of tightening.<br>• We believe that close to the maximum tightening has been priced in and the risk is that the pace of tightening slows, creating a rally in short bonds and a steepening of the yield curve.<br>• To cover both the “fast” and “slower” RBA tightening scenarios, we are overweighting the 2-4yr segment of the yield curve versus the 10yr+ segment. |
| **Optimising yield through carry and rolldown**, focusing on the inflection points on steep curves. With curves in 1-3yrs still very steep (rolling down 20-50bps pa) and curves 4-10yrs rolling down at 7-15bps pa, there are still attractive roll down opportunities | • We are using our proprietary analytics to find attractive rolldown maximisation opportunities per units of risk; currently semi and Commonwealth government bonds in the 2024-2026 maturities and major banks in the 2024-2025 maturities are the most attractive. However, the recent steepening of the 5-10yr curve is presenting better rolldown value in longer maturities such as NSW 2028-2031. In 10yrs+ NSW or TCV 2037’s are our preferences. |
| **Control credit risk** | • Credit spreads have widened sharply this year driven by concerns for growth slowdowns or recessions, refinancing risk from rising bond yields and the partial unwind of the carry trade. We are still cautious on credit at these higher yields, targeting credits in the 2-4yr area.<br>• iTraxx has widened in line with cash bonds and is providing some protection against widening credit spreads.<br>• We are targeting credits with low leverage, strong cashflows, some pricing power and robust balance sheets, i.e., issuers that are less exposed to inflation and recession risks. |
| **A strong level of liquidity that could be realised in stressed conditions** | • Selective semis and government bonds provide both liquidity and attractive carry and rolldown, which is so important in this current low-rate environment. |

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## Market Review
**Q2 2022**
The second quarter of 2022 saw large rises in bond yields, credit spreads widen and increased global market volatility, as hawkish central banks aggressively raised rates with inflation reaching new decade highs. Towards the end of the quarter, bonds rallied as markets pivoted their focus from inflation to concerns over a slowdown in global growth with increasing risks of recession and stagflation scenarios.

Over the past three months, central banks globally have stepped up their commitment to reign in persistently high inflation. The Fed, RBA, Bank of England, Bank of Canada, and Reserve Bank of New Zealand, all raised rates between 25 and 50 basis points, with the Fed increasing rates by 75 basis points in June, its largest single rate hike since 1994. There was also a marked increase in aggressive hawkish Fed speak over the quarter with the Fed making it clear to the market that it is acutely focused on inflation, will act forcefully if necessary, and acknowledging that the worst outcome would be if inflation expectations were to become unmoored. Former Fed member Dudley stated that the central bank's employment mandate is now subservient to its inflation mandate and Fed Chair Powell reiterated that the Fed's commitment to bringing down inflation is unconditional.

With persistently high inflation prints and more hawkish Fed tones, markets pivoted their focus in mid-June to the increasing risks of a hard economic landing, increasing the risk of a recession or stagflation scenario. There was broad acknowledgment by central banks that they had underestimated inflation with the Bank of England forecasting inflation to reach 11% this year and the RBA forecasting inflation to peak at 7%. This also led to the Fed admitting that a soft economic landing was becoming significantly more challenging, recognising that there could be a couple of negative quarters. This, coupled with some weak economic data saw bonds rally toward the back end of June, reflecting the markets risk-off sentiment. As a result, the US yield curve inverted for the third time this year, reflecting increased recession risks.

These themes were mirrored domestically with the RBA commencing its path to policy normalisation in May with a 25 basis points increase and a subsequent 50 basis points increase in June. Australian households struggled with the impact of energy and food inflation, which saw consumer confidence fall, however, economic data such as retail sales and household spending remained strong over the quarter.

Further fueling concerns over a global growth slowdown was China's continued commitment to a zero-COVID policy with various cities enduring long lockdowns over the quarter. This coupled with recession fears impacted commodity markets in the second half of June with commodity prices falling from their peaks due to the ongoing war in Ukraine. Towards the end of June, the emergence of a new COVID omicron third wave was another cause for concern over the outlook for economic growth.

In global and domestic credit markets, credit spreads widened significantly over the quarter. Australian iTraxx CDS widened from 81 to 130 and the Bloomberg Barclays Agg Corporate Option Adjusted Spread widened from 1.24 to 1.75.

## Macro Outlook
**Update on the two dominant risks that are exacerbating global inflation pressures and destabilising global markets:**

**1. Russia and Ukraine**
Putin has established a military foothold in the Donbas region and is prepared to terrify the inhabitants with indiscriminate missile attacks on apartment buildings. Part of the motivation could be to force the non-Russian sympathising inhabitants of the region to flee, creating a more Russian-friendly Donbas region which could be annexed by Russia in due course.

**At the recent NATO summit, European leaders reinforced their staying power in confronting Putin, egged on by the USA and UK.** It will be more challenging for Europe to hold this line as it moves into winter, with a commitment to boycott Russian oil and gas. As the USA ramps up its diplomatic dialogue with China, its key demand is that China joins the free world community in condemning Russia. There's no doubt that Chairman Xi wields immense power in this regard; he needs to trade off his leverage over the West against growing reputational damage for China by supporting Putin.

The unresolved embargo on energy and food from Russia/Ukraine is sustaining record inflation rates in Europe and the US, but particularly in the poorer emerging markets. Given that most of these emerging markets are in China's orbit, the West through the IMF and World Bank is highly motivated to provide meaningful rescue packages. The West does not want to be outbid by China's rescue commitments. **Markets continue to price in increasing prospects of a recession in 2023, driven by high inflation which is producing aggressive central bank tightening. However, there remains a not insignificant prospect of a positive surprise in the Ukraine war and the energy and food disruptions, which would create some upside volatility for markets.**

**2. China's zero-COVID policy**
Chairman Xi is doggedly sticking to the zero-COVID policy, at least until the National People's Congress meet later this year. With China's growth rate and business confidence struggling to recover, the government is bringing forward significant infrastructure spending. Markets have responded positively to this stimulus, with China's equities rising 17% from their recent lows. **However, sluggish growth and continuing supply chain bottlenecks in China, will contribute to global "stagflation" pressures of slower growth with elevated inflation.**

**Australia**
It has been a busy period for the new Albanese government and the general public's reaction has been positive. It is too early to test bi-partisan support across the two major parties but there has been obvious bi-partisan coordination between the federal and NSW governments on flood relief measures. The new federal Treasurer appears to be aligned with the approach of the RBA which augurs well for the interaction of fiscal and monetary policy.

## 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 | 1YR | AU 3YR Bond | AU 5YR Bond | AU 10YR Bond | AU 30YR Bond | US 10YR Bond | iTraxx |
|---|---|---|---|---|---|---|---|---|---|
| Strong Growth | 4.00% | 4.50% | 3.50% | 4.50% | 4.75% | 5.25% | 5.50% | 4.75% | 150 |
| Above Trend | 4.00% | 3.50% | 2.75% | 3.50% | 3.75% | 4.25% | 4.75% | 4.25% | 110 |
| Trend | 3.00% | 2.50% | 1.75% | 3.00% | 3.25% | 3.50% | 4.00% | 3.00% | 75 |
| Below Trend | 1.50% | 1.50% | 0.75% | 1.75% | 2.00% | 2.50% | 2.75% | 2.00% | 100 |
| Recession | -2.00% | 0.50% | 0.10% | 0.50% | 1.00% | 1.50% | 2.25% | 1.25% | 250 |
| Stagflation | 1.50% | 4.00% | 1.50% | 3.00% | 3.75% | 4.50% | 5.25% | 4.00% | 150 |
| Antares Latest Fair Value (FV) | 2.20% | 2.80% | 2.07% | 2.46% | 2.91% | 3.45% | 4.01% | 3.03% | 131 |
| Market Yield Latest | | | 2.55% | 3.05% | 3.20% | 3.45% | 3.75% | 2.95% | 140 |
| FV - Market (+ exp / - cheap) | | | -0.48% | -0.59% | -0.29% | 0.00% | 0.26% | 0.08% | -9 |

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 (38%) with **"Trend"** (20%) and **"Below Trend"** (21%) still significant. Notwithstanding the strong rally in bonds since mid-June, the fair values (FV) for shorter bonds, particularly 3yr maturities, are still 40-60bps below market yields. 10yr bond FVs are 10-20bps above current market pricing. The wide FV differential on shorter bonds supports Antares' yield curve steepening strategy.

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### Interest Rate & Inflation Outlook

The RBA Board lifted the cash rate by 50 basis points in July taking the official rate to 1.35%. This follows a similar move in June and marks one of the fastest policy rate hiking cycles ever seen from the RBA. Still this does little to dissuade us that the next move in August, will be equally aggressive. Supporting this view is a labour market that enjoys the lowest unemployment rate in 40 years, and inflation that for now is stubbornly high.

With rising rates and deteriorating asset markets, financial conditions have tightened. The tightening has also resulted in moderating household demand, declining consumer and business sentiment and weakening credit growth. Asset markets have as a result declined precipitously. Offsetting these macro concerns are a highly resilient labour market currently experiencing skill shortages across industries leading to rising wages and potentially a self-reinforcing upward wage-price spiral.

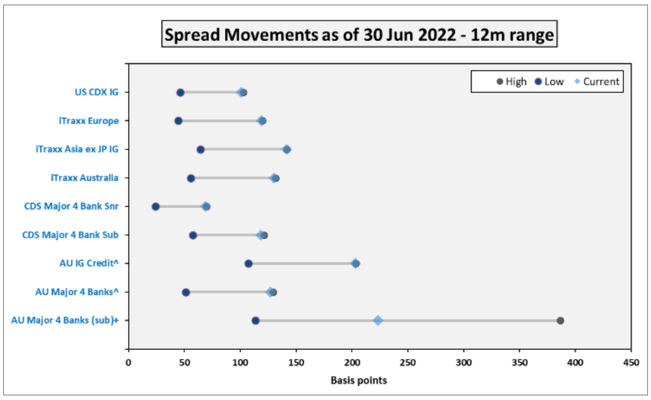
Further complicating the outlook are additional inflationary pressures emanating from higher energy prices (namely petrol, gas and electricity), ongoing supply constraints (albeit improving), rising food prices (worsened by the recent floods on the eastern seaboard) and pressure on insurance premiums and rents. These factors are likely to result in an elevated CPI print for Q2, with some forecasters looking for a print above 2%.

Solid back to back CPI prints keep the annual inflation rate well above the RBA's target band with the peak in inflation expected by year end to be 7%. For now the RBA projects that inflation will only converge slowly towards its 2-3% band in 2023 with significant risks around the RBA's modal outcome.

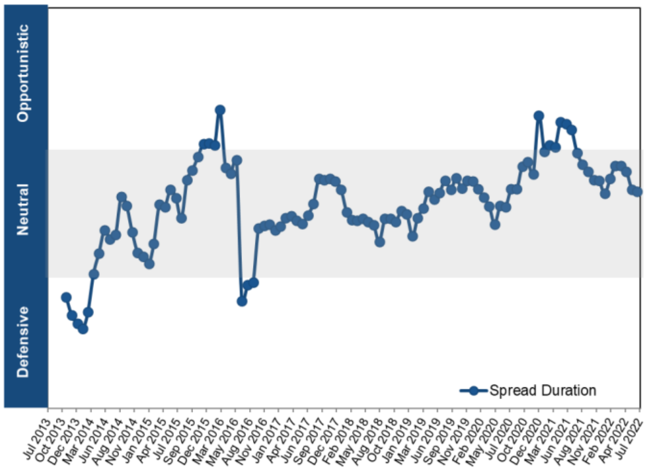
### Credit Outlook

Credit spreads pushed wider yet again in June, with persistently high inflation and correspondent central bank tightening the key overarching themes initially, but in the second half of June recession risks weighted on the market, impacting credit spreads further particularly on lower rated and high yield securities.

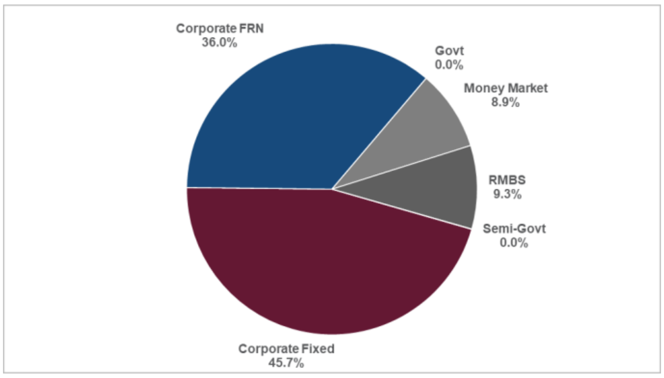
Aussie iTraxx was the notable underperformer, finishing the month +30bps wider from broad-based protection buying. Conversely, cash spreads were relative outperformers with banks seeing more muted issuance volumes in June. We continue to remain cautious on credit and have remained mindful of portfolio liquidity in these uncertain times.




### Defensive to Opportunistic




### Sector Breakdown (Market Value %)




### ESG

With additional resources on board, we are currently reassessing our ESG processes and looking to potentially introduce a new Credit ESG Risk Score system in the not-so-distant future. We have decided to pause on the commentary on ESG section temporarily to re-evaluate what content to include going forward. We would like to invite you to provide some feedback on the ESG content you would find useful or would like to see more of, so that we can improve our reporting on ESG going forward.

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### Market Movements

| Australian Rates | June 2022 | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| RBA Cash Rate | 0.85 | 0.75 | 0.75 |
| 90 Day Bank Bill | 1.81 | 1.58 | 1.78 |
| 3 Yr Futures | 96.64 | -0.81 | -2.91 |
| 10 Yr Futures | 96.28 | -0.82 | -2.18 |
| 3/10 Spread (bps) | 35.50 | 1.00 | -72.50 |
| iTraxx Australia 5Y | 130.45 | 49.22 | 72.66 |
| 10Yr BEI | 2.27 | -0.24 | 0.21 |

| Global Sovereign Rates | June 2022 | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| Fed Fund Rates | 1.58 | 1.25 | 1.50 |
| ECB Main Refi Rate | 0.00 | 0.00 | 0.00 |
| US Sovereign 2 Yr | 2.95 | 0.62 | 2.70 |
| US Sovereign 10 Yr | 3.01 | 0.67 | 1.54 |
| Japan Sovereign 10 Yr | 0.23 | 0.01 | 0.17 |
| German Sovereign 10 Yr | 1.34 | 0.79 | 1.54 |

| Currencies | June 2022 | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| AUD/USD | 0.69 | -0.06 | -0.06 |
| EUR/USD | 1.05 | -0.06 | -0.14 |
| USD/JPY | 135.72 | 14.02 | 24.61 |

| Equities | June 2022 | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| ASX200 | 6568 | -12.4% | -10.2% |
| S&P500 | 3785 | -16.4% | -11.9% |

| Commodities | June 2022 | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| WTI Crude | 105.8 | 10.7 | 40.3 |
| Gold | 1807.3 | -130.2 | 37.2 |

| Australian Economic Data | Latest Print | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| Employment Change (k) | -34.3 | 34.7 | -201.2 |
| Unemployment Rate (%) | 5.2% | 0.0% | -1.7% |
| Retail Sales (MoM%) | 4.6% | 0.0% | 3.3% |
| Trade Balance Value (m) | 10302 | -193 | 3770 |
| Building Approvals (MoM%) | -16.5% | -2.8% | -24.0% |
| Consumer Confidence (Westpac) | 104.6 | 0.0 | -0.4 |
| Business Confidence (NAB) | 21.7 | 1.1 | 15.3 |
| Business Conditions (NAB) | 12.6 | 2.2 | 5.9 |

| Australian Economic Data | Latest Quarterly (Q4) | 1 Yr Change |
|---|---|---|
| Private Capital Expenditure (QoQ%) | -1.1% | 1.7% |
| GDP (YoY%) | 4.1% | 7.5% |
| Inflation (YoY%) | 3.00% | 2.3% |

| Global Economic Data | Latest Print | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| US Non-Farm Payrolls (k) | 677 | 0 | 30 |
| US Unemployment Rate (%) | 4.6% | 0.0% | -2.3% |
| US Manufacturing ISM | 60.8 | 0.0 | 2.0 |
| US Non-manufacturing ISM | 66.7 | 0.0 | 10.6 |
| China Manufacturing PMI | 49.2 | 0.0 | -2.2 |
| China Non-Manufacturing PMI | 52.4 | 0.0 | -3.8 |
| German Factory Orders (MoM%) | -5.9% | 0.0% | -9.7% |
| German Industrial Production (MoM%) | 2.7% | -0.7% | -0.5% |

| Semis * vs Gov Bonds | June 2022 | Quarterly Change | 1 Yr Change |
|---|---|---|---|
| 3yr (bps) | 49.9 | 30.2 | 44.5 |
| 7yr (bps) | 49.85 | 20.84 | 34.45 |

* Semi calculation compromises 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$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

### Contacts


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### Important information