# Antares Income Fund

## Monthly Investment Report
## July 2022

### Fund Performance

| Period Ended 31/07/2022 | 1 Mth % | 3 Mths % | 1 Yr % | 3 Yrs % | 5 Yrs % | 7 Yrs % | Since Inception %pa[1] |
|---|---|---|---|---|---|---|---|
| Antares Income Fund | -0.12 | -0.43 | -1.34 | 0.53 | 1.31 | 1.73 | 1.98 |
| Bloomberg AusBond Bank Bill Index | 0.12 | 0.21 | 0.22 | 0.33 | 0.94 | 1.25 | 1.52 |
| Difference | -0.24 | -0.64 | -1.55 | 0.19 | 0.37 | 0.48 | 0.46 |

Valuation at month end was $193,675,782.30
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 31/07/2022

| | Fund | Benchmark |
|---|---|---|
| Interest Rate Duration (yrs) | 0.00 | 0.12 |
| Running Yield + Rolldown (%) | 3.07 | 1.70 |
| Credit Spread Duration (yrs) | 1.80 | - |
| Average Credit Rating | A | - |
| Liquidity* | 73% | 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.

### 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 |

### Rating Exposure (by market value %)

| Asset Type | MV % |
|---|---|
| AAA | 12.69% |
| AA+ | 1.07% |
| AA | 9.71% |
| AA- | 16.67% |
| A+ | 4.76% |
| A | 0.97% |
| A- | 17.28% |
| BBB+ | 17.95% |
| BBB | 18.90% |
| BBB- | 0.00% |

### Portfolio Review

**Key Drivers of Portfolio Performance:**

- The 25bp flattening of the 3-10yr curve detracted 11.5bps
- Corporate spreads widened 5-15bps detracting 16.5bps
- Yield enhancement and rolldown of quality investment grade bond holdings added 11.4bps
- Bank senior fixed tightened 10-18bps adding 4 bps.

### 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 potential bear steepening of yield curves. However aggressive tightening by central banks to contain inflation may curb economic growth quickly, creating a "stagflation" environment. | • Both the Fed and RBA appear committed to aggressively get on top of inflation. Accordingly, markets are pricing December 2022 cash rates of 3.40% for the Fed and 3.30% for the RBA.<br>• With central bank tightening now very data dependent, with no forward guidance, we believe current market pricing of short rates has risks both sides.<br>• But what surprises us is the market's strong assumption that inflation will return to target and hence the pricing of longer bonds at real yields of 1% based on central bank targets. Accordingly, we think shorter bonds are more sensibly priced than longer bonds and continue to favour a curve steepening strategy. |
| **Optimising yield through carry and rolldown**, focusing on the inflection points on steep curves. With curves in 1-2yrs still very steep (rolls down 20-50bp pa) and curves 3-15yrs rolling down at 6-12bp 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 2024-2025 maturities and major banks in the 2024-2025 maturities are the most attractive. |
| **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 tightened 45bps from its recent wides of 144 and we are considering adding to credit protection at iTraxx levels below 100. 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

Concerns over a slowdown in global growth and increased recession risks saw bond markets rally in July. This was driven by continued hawkish tones by central banks and aggressive rate hikes which saw yield curves bear flatten and the US yield curve invert. Globally, central banks showed their commitment to do what is needed to bring inflation down by delivering large hikes in July, with a surprise 50 basis point hike by the ECB, its first hike in eleven years. The Bank of Canada also surprised by hiking 100 basis points and the Fed hiked 75 basis points.

The US economy saw a mixed range of economic data and corporate earnings with falling home sales, mortgage applications at their lowest levels since 2000, and Walmart providing the market with an inter-reporting season profit warning. Higher than expected CPI came in at 9.1% vs 8.8% and economic growth data delivered a technical recession with two consecutive quarters of negative growth. The IMF cut the global growth outlook for 2022 to 3.2% from 3.6% in April.

For Europe, geopolitical instability and stagflation risks increased with the resignation of Italian president Draghi, and the ECB attempting to provide Italy some protection from future rate hikes by announcing its anti-fragmentation tool to buy Italian bonds to contain German / Italian sovereign spreads from widening excessively. German inflation surprised to the upside at 8.7% while German business confidence fell to two-year lows. In the absence of any forward rate guidance by the ECB, Europe remains fragile.

Russia's weaponising of gas continues to leave Europe in a vulnerable economic and social position. Towards the end of the month, Russia restarted gas exports to Europe via the Nord Stream 1 pipeline but quickly halved flow capacity from 40% to 20%, hindering Europe's ability to store gas for the winter months and increasing the case for rationing into the winter months. Ukraine grain exports were set to resume from the port of Odessa.

Australia's economy remains robust with 50-year low unemployment, and corporate margins remaining strong. However, confidence is falling amid strong headwinds around maintaining corporate margins amid increasing input costs including wage growth pressure. The RBA raised rates by 50 basis points to 1.35% in July and a further 50 basis points to 1.85% in August.

China's economy was characterised by poor sentiment, driven by a property market slump, with an increasing number of Chinese homebuyers suspending mortgage payments on stalled housing projects. This, together with recent COVID outbreaks have contributed to a deterioration in the growth outlook for China.

Global credit outperformed in July with corporate bonds outperforming government bonds, however, domestically investment grade credit underperformed swap spread movements which narrowed. Credit market sentiment also improved domestically as credit markets saw increased liquidity and a number of new deals came to market. That said the primary deal flow continued to be from bank and financial issuers. Aussie iTraxx CDS fell 20 basis points and US investment grade spreads fell 14 basis points.

### Macro Outlook

There have been some notable shifts in the macro outlook over the past month:

**Positives:**

**Biden managing to implement his "Inflation Reduction Act" IRA, has restored some confidence to his administration.** Granted, this US$433 billion bill is a watered-down version of the original "Build Back Better" bill of US$2 trillion, but it still amounts to the USA's largest commitment to addressing climate change. The package includes US$387 billion over 10 years in energy and climate-related incentives, along with a three-year extension of the Affordable Care Act's health insurance subsidies. This is funded by a 15% minimum tax on corporate profits for large companies (US$222 billion), savings from Medicare drug pricing negotiations and other healthcare changes (US$322 billion) and a 1% tax on share buybacks. Furthermore, Biden signed a landmark bill to provide US$52.7 billion in subsidies for US semiconductor production and research and to boost efforts to make the US more competitive with China's science and technology efforts. These measures should stimulate more advanced manufacturing in the US and are concrete evidence of the trend to "onshoring".

**Russia and Ukraine - Surging global inflation, primarily from energy and food prices, appears to be abating somewhat.** Putin's agreement to allow some exports from Ukraine's grain terminals is in response to intense global pressure and has contributed to some easing of key food prices. Increased oil and gas production outside Russia, and weakening fuel demand from inflation-impacted consumers, has contributed to a 20%+ fall in oil prices. US gasoline prices have fallen from US$5 to under US$4 per gallon.

**Negatives:**

**Nancy Pelosi's visit to Taiwan and the ensuing aggressive military exercise response from China, appears to have set back the thawing of relations between the USA and China.** Furthermore, if the intention of China's "simulated" invasion of Taiwan and the incursions into the Taiwan Strait were to unsettle and destabilise the maritime traffic that uses the Strait, it definitely succeeded. In 2021-22 nearly half of the global container fleet passed through this waterway. On a daily basis 250 ships pass through. That has dropped by 90% since Pelosi's visit.

**Impacts on Markets**

The Biden IRA and the fall in energy and food prices are a positive for falling inflation. In contrast, an extension of supply chain pressures around Taiwan will unsettle markets that have been looking for a normalisation of these pressures and an ensuing fall in inflation. The inflation bears will also note Biden's domestic manufacturing measures which support the trend to deglobalisation which, by definition, is more inflationary than offshoring.

**Australia**

The positive "honeymoon" period of the new Albanese government continues, with no obvious mistakes so far. This has surprised many commentators and could lead to more ambitious policy measures. Worker strikes are increasing, mostly from essential services that gained wide community support during the COVID lockdowns. This broad community support for higher wages for key workers is providing cover for the Albanese government on this politically sensitive subject, for the time being.

### 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% | 4.25% | 4.50% | 4.75% | 5.25% | 5.75% | 5.00% | 150 |
| Above Trend | 4.00% | 3.50% | 4.25% | 4.50% | 4.25% | 4.00% | 4.25% | 3.75% | 110 |
| Trend | 3.00% | 2.50% | 2.75% | 3.00% | 3.25% | 3.50% | 4.00% | 3.00% | 75 |
| Below Trend | 1.50% | 1.50% | 1.50% | 1.75% | 2.00% | 2.50% | 2.75% | 2.00% | 100 |
| Recession | -2.00% | 0.50% | 0.25% | 0.50% | 1.00% | 1.50% | 2.25% | 1.25% | 250 |
| Stagflation | 1.50% | 4.00% | 3.00% | 3.50% | 3.75% | 4.25% | 5.00% | 4.00% | 150 |
| Antares Latest Fair Value (FV) | 1.65% | 2.70% | 2.43% | 2.77% | 3.01% | 3.38% | 3.93% | 3.00% | 133 |
| Market Yield Latest | | | 2.89% | 3.10% | 3.10% | 3.44% | 3.82% | 2.90% | 109 |
| FV - Market (+ exp / - cheap) | | | -0.46% | -0.33% | -0.09% | -0.06% | 0.11% | 0.10% | 24 |

Antares' scenario analysis continues to shift to high inflation outcomes; 36% probability of the stagflation scenario of higher inflation with weak/negative growth (Scen 6); 10% probability of higher inflation with strong growth (Scen 2). After the sell-off in early August the fair values (FVs) for 3yr maturities are still 30bps below market yields while 10yr and 30yr bond FVs are very close to market yields. The wider FV differential on shorter bonds still supports Antares' yield curve steepening strategy.

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### Interest Rate & Inflation Outlook

Concerns over elevated inflation were further validated in July with the release of the Q2 CPI. While realised inflation came in slightly below consensus (1.7% vs 1.9%) it was nevertheless a strong print on the back of a series of elevated quarter on quarter results.

The current CPI profile keeps the annual inflation rate well above the RBA's target band with peak inflation now expected by the RBA to be near 8% by year-end. According to the August Statement of Monetary Policy (SOMP), the RBA projects that inflation will converge slowly towards its 2-3% band with a forecast of headline inflation of 3% by December 2024.

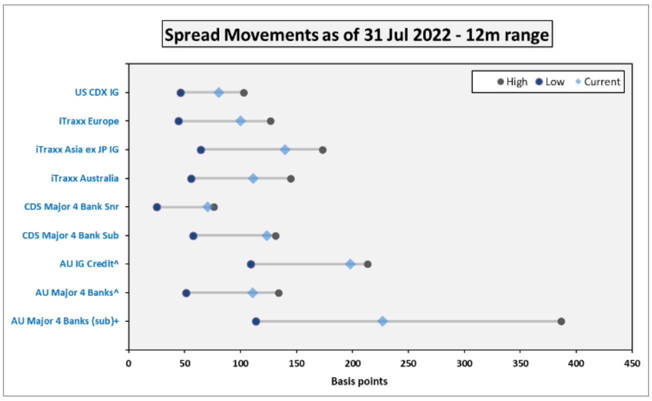
While these forecasts carry with them significant risks what is particularly noteworthy is the breadth of inflation we are currently seeing. The Q2 CPI print revealed one of the highest positive distributions of price inflation seen since the RBA began inflation targeting. The trimmed mean reflects the breadth of rising inflation across the basket of goods and services and points to the potential difficulty the RBA might have in bringing CPI back towards its mandated objective of 2-3%.

The latest SOMP projects an unemployment rate that troughs at 3.25%, only to rise incrementally to 3.5% in 2023 and peaking at a still respectable 4% by the end of 2024. This is expected to combine with rising wage inflation and growth moderating to sub-trend levels. The underlying projections assume a cash rate of 3% by year-end 2022. Key risks to the persistent inflation/higher rates view are if supply related inflation begins to materially fall, and/or growth slows quicker than initially anticipated.

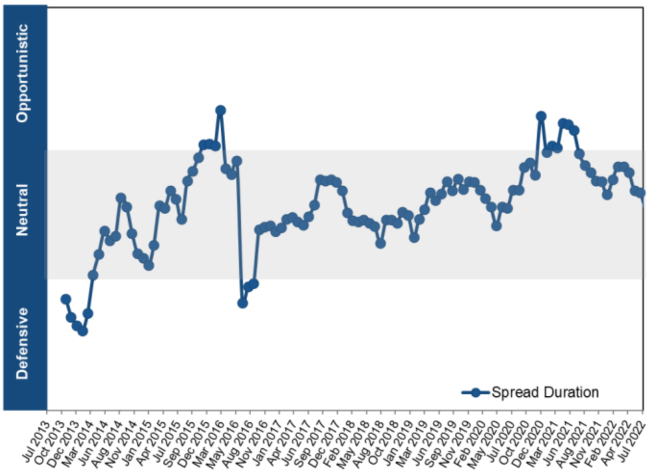
### Credit Outlook

Credit ended July on a firmer footing. Aussie iTraxx was a strong performer finishing notably tighter for the month. However, previous potential headwinds persist, not least expectations of central bank tightening amongst a still inflationary backdrop.

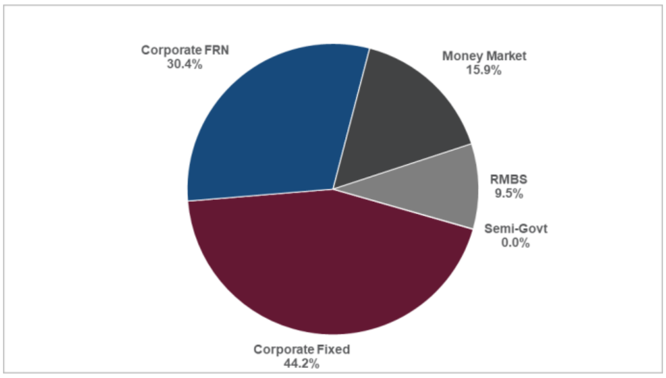
We also note weakening of some growth leading indicators globally and are on watch for a further slowing in some sectors of the economy. On the transaction front, NAB completed its Tier 2 deal, issuing to solid investor demand. The successful completion of this deal has perhaps restored some confidence for issuers and investors for the time being.




### 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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### 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

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