

Antares Income Fund

Monthly Investment Report

August 2022



Fund Performance

Period Ended 31/08/2022	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %	Since Inception %pa ¹
Antares Income Fund	0.39	0.12	-0.86	0.70	1.34	1.76	2.00
Bloomberg AusBond Bank Bill Index	0.15	0.33	0.37	0.36	0.95	1.24	1.52
Difference	0.23	-0.20	-1.23	0.34	0.40	0.52	0.49

Valuation at month end was \$196,544,308.48

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 31/08/2022

	Fund	Benchmark
Interest Rate Duration (yrs)	0.09	0.13
Running Yield + Rolldown (%)	3.63	2.17
Credit Spread Duration (yrs)	2.04	-
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.

Rating Exposure (by market value %)

Asset Type	MV %
AAA	13.81%
AA+	1.05%
AA	7.46%
AA-	14.86%
A+	4.89%
A	1.04%
A-	18.27%
BBB+	18.75%
BBB	19.87%
BBB-	0.00%

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 if central banks lose their creditability to contain inflation. However aggressive tightening by central banks to contain inflation may curb economic growth quickly, creating a "stagflation" environment.	<ul style="list-style-type: none"> Both the Fed and RBA appear committed to get on top of inflation, but the Fed is forging a more aggressive path. Accordingly, markets are pricing December 2022 cash rates of 3.80% for the Fed and 3.20% for the RBA. With central banks having tightened aggressively and committed to continue into 2023 the market has faith in inflation retracing (for now) and is focussing on the rising recession risk plus the terminal cash rate required to contain inflation. What surprises us is the market's strong assumption that inflation will return to target levels as experienced pre Covid. Many of the structural drivers keeping inflation low during the post GFC (pre Covid) period have potentially moved into reverse supporting a case that the longer-term structural level of inflation is higher. Accordingly, we think shorter bonds are more sensibly priced than longer bonds and continue to favour a curve steepening strategy. With the 3-10 curve having steepened above 40bps in September we have reduced curve positioning for some funds that were more aggressively positioned.
Optimising yield through carry and rolldown, focusing on the inflection points on curves. With curves in 1-2yrs still very steep (rolls down 25-50bp pa) and curves 3-15yrs rolling down at 8-15bp pa, there are improving roll down opportunities.	<ul style="list-style-type: none"> 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. More recently, the steepening of the 3-10yr curve has improved the rolldown of some longer maturities. We still like the steepness of semis in 10-15yrs versus Commonwealth government bonds. NSW and TCV 2037s are our preferences. Major banks in the 2024-2025 maturities are attractive.
Control credit risk	<ul style="list-style-type: none"> 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. iTraxx has tightened 45bps from its recent highs 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	<ul style="list-style-type: none"> Selective semis and government bonds provide both liquidity and attractive carry and rolldown.

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:

- The 40-60bps sell-off in interest rates added 3bps due to short duration positioning
- Corporate and bank spreads narrowed 5-10bps adding 7bps
- Sub debt narrowed 10-30bps adding 6bps
- CDS hedges detracted 4bps
- The flattening of the 3-10yr curve detracted 3bps but this was offset by the steepening of the 3-5yr curve which added 2bps
- Yield enhancement and rolldown of quality investment grade bond holdings added 12bps.

Portfolio Activity and Positioning

- We have maintained the liquid structure of the Fund.

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Market Review

Bond yields rose and yield curves bear flattened in August in response to persistent hawkish Fed speak, culminating in Chairman Powell's Jackson Hole speech which sent a very clear message that the Fed is prepared to do whatever it takes to address inflation despite the risk of recession.

Almost daily hawkish comments from the Fed dominated markets with Fed members reiterating that the greatest risk they see is inflation expectations becoming unanchored and acknowledging that the Fed will need to reach a terminal rate far beyond neutral into restrictive territory and risk an economic recession in order to keep inflation expectations anchored. Mixed economic and corporate data continues to come out of the US with no broad-based evidence of economic slowdown to date. Terminal cash rates rose substantially in the US from 3.25% to 3.85%.

There was also a strong hawkish pivot from the ECB as EU CPI hit another record high of +9.1% with an acknowledgement that policy makers have little choice to continue on a strong path to normalisation even if recession is the result.

Geopolitical risks remain elevated with US House Speaker Nancy Pelosi visiting Taiwan, prompting a military response from China. In Russia, gas supplies to Europe via the Nord Stream 1 pipeline were turned off towards the end of August and Putin announced they will not resume until western economic sanctions are lifted against Russia.

China's economy continues to soften with over 65 million people back in lockdown as part of China's zero-COVID policy. The stimulus policy response to date has not been enough to boost the domestic economy.

Domestically, the RBA continued on its rapid path to policy normalisation with another 50 basis points increase in August. There has been little evidence of demand destruction across the economy with household consumption remaining resilient. In addition, household savings remain higher than the historical average despite recent falls from pandemic highs and the labour market remains very tight, both providing buffers to the impact of the RBA's rate hikes to date. However, there is a clear acknowledgement of the lagging nature of these metrics with consumer confidence at near lows since the onset of the pandemic. Terminal cash rates rose in Australia from 3.25% to around 4.00% at the end of the month.

In credit markets, there was a positive credit premium with global investment grade corporate bonds outperforming treasuries. This was mirrored domestically with non-government bonds outperforming government bonds. Aussie iTraxx CDS spreads narrowed, ending the month at 107.8.

Macro Outlook

The macro outlook continues to be one of uncertainty and volatility as markets struggle to price in the expected timing and magnitude of the economic impact from central bank aggressive rate hikes.

To date there have been mixed economic and corporate data showing no clear broad-based deterioration in economic conditions as a result of the Fed and other central banks large and fast paced hikes in 2022. Considerable downside risks remain to the global and domestic economic outlooks as central banks become more committed to restoring price stability at the potential expense of an economic recession.

In addition, there is also the risk that despite central bank aggressive rate hikes, inflation will not be able to be contained and will become entrenched in the broader economy, leading to a price spiral situation where economic participants change their consumption behaviour in anticipation of higher future inflation. Currently markets remain confident in the ability of central banks to bring inflation back to the 2-3% band but if this cannot be achieved, it could present significant risks for the back end of yield curves.

Another area of uncertainty is the impact on market volatility of ongoing geopolitical factors. With Russia weaponising energy, the risks of stagflation in the Eurozone remain elevated. In addition, with China's continued commitment to a zero-COVID policy and a slowing global economic backdrop, this presents significant downside risks to the global growth outlook.

The risk of economic recession over the next year remains high with the current weak economic outlook in China and Europe and the economic impacts of rate hikes yet to be fully felt. The timing of such impacts will depend on how quickly the labour market will soften, if workers continue to come back into the workforce, and how long household savings continue to provide a buffer against tighter financial conditions. We expect markets will continue to pivot their focus between the risks of hawkish central bank action and recession.

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)	1.68%	2.70%	2.43%	2.79%	3.01%	3.38%	3.92%	3.01%	132
Market Yield Latest			2.77%	3.21%	3.32%	3.60%	3.82%	3.19%	108
FV - Market (+ exp - cheap)			-0.34%	-0.42%	-0.30%	-0.21%	0.10%	-0.18%	25

Antares' continues to have a decent probability weighting to structurally higher inflation outcomes; 35% probability being assigned to the stagflation scenario of higher inflation with weak/negative growth (Scen 6); and 11% probability of higher inflation with strong growth (Scen 2). After the aggressive yield sell-off in August, Antares' fair values (FVs) for 3yr bonds are around 40bps below market yields while Antares' FVs for 10yr bonds are around 20bps below market yields. The aforementioned are weighted average FVs and it should be noted that there is a wide dispersion of potential yield levels under the various potential scenarios.

Interest Rate & Inflation Outlook

Markets continue to price in more rate hikes with the terminal rate lifting to cycle highs of 3.8% in the US. Fed communication from the Jackson Hole Symposium help to reinforce rate hawkishness with Chair Powell reaffirming the need to reduce inflation even at the expense of economic growth.

While there are growing concerns about the state of the Australian housing market, there appears little evidence that RBA hikes are biting so far. Australian household consumption has remained resilient with the release of 2Q GDP further validating this strength. Capturing only the early rate hikes, the GDP report revealed few signs of tighter financial conditions. Household consumption rose 1.1% for the quarter with GDP up 0.9%.

The other key factor underpinning current economic resiliency has been the labour market, which saw the unemployment rate dip down to 3.4% in August. Notwithstanding a drop in the participation rate, the labour market remains very tight, leading to further upward pressure on wages and inflation. With the unemployment rate well through traditional levels of full employment, pressure remains on the RBA to take rates rapidly to neutral, with a strong case to move to restrictive shortly after.

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Despite ongoing volatility in key commodity prices, inflation markets have been mostly on the backfoot with respect to inflation expectations. This has largely resulted from high policy rates expectations feeding into higher real rates and therefore lower BEIs.

Medium term inflation risks remain elevated, with the CPI likely to come in higher than what the market is currently discounting. 1yr US inflation swaps are levelling at 2.7% - a very marked slowdown from realised US inflation currently running at 8.5%.

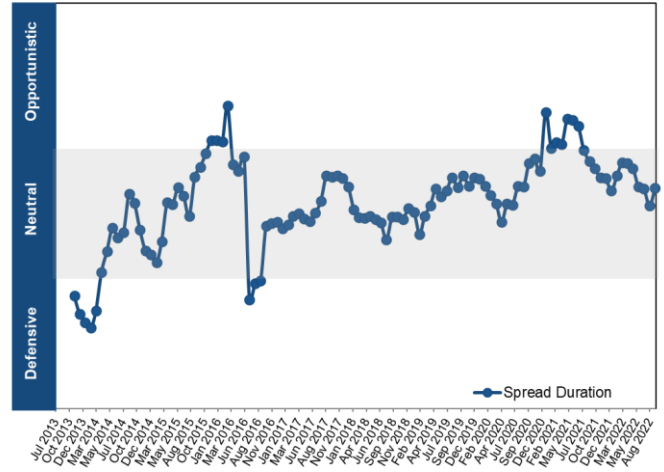
Credit Outlook

Credit markets began the month of August strongly, following on from the late July risk-on rally. Momentum softened post the Jackson Hole Symposium with markets starting to price in more rate hikes resulting in risk-assets selling off. Aussie credit ended the month resiliently with both iTraxx and cash bonds a touch tighter than at the beginning of the month.

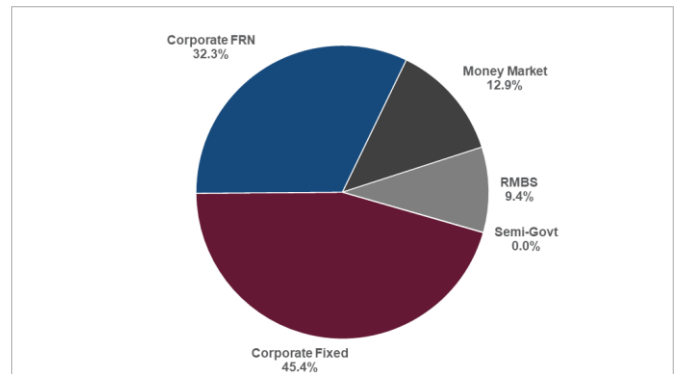
August reporting season showed Australian corporates remain in good financial health, with most companies continuing to experience top line growth, decent profit margins and strong balance sheets. Amongst them, hospitality and travel segments saw a strong rebound in earnings; retail REITs, toll roads and infrastructure companies have benefited from CPI-linked revenue escalation; insurers, supermarkets and retailers have also seen resilient consumer demand and were able to fully or partially pass on rising costs to end-consumers. There continues to be pockets of weakness in construction, building materials and manufacturing segments where some companies have been hurt by significantly higher raw material and energy costs, and either unable to or yet to pass on cost inflation to their customers.

Corporate management teams appear cautiously optimistic about the economic outlook but remain disciplined on capital expenditure. This is credit positive as we would like to see management being prudent and position themselves for a less rosy period ahead. We also note that many companies commented that they will be increasing prices further or exercise cost pass-through mechanisms in their contracts to pass on elevated energy costs, raw material costs and wages, without being concerned about demand destruction at this juncture. Whilst a credit positive, the aforementioned is suggestive of high inflation persisting with the risk of inflation being embedded in the economy rising.

Defensive to Opportunistic



Sector Breakdown (Market Value %)



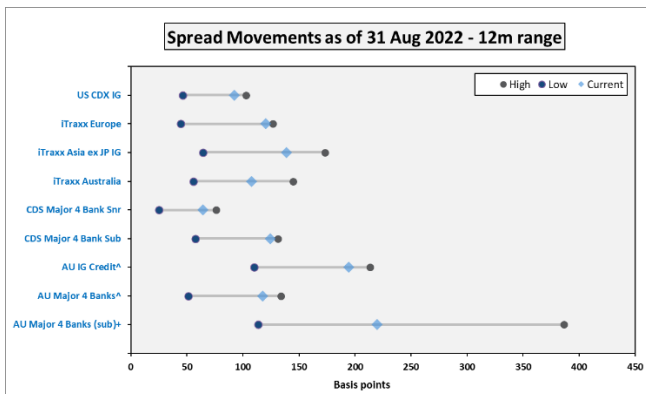
ESG

We are pleased to introduce a new Antares ESG Credit Impact Score framework, with a primary objective to extend our existing ESG risk analysis from bottom-up credit research to portfolio risk management. The new framework works as a traffic light system and provides grades of warnings on individual issuer's ESG risk exposure as well as portfolio risk exposure as a whole.

The key benefits of this system are:

1. To explicitly articulate how we think ESG risks are likely to impact a company's credit profile in a consistent and concise manner
2. To systematically measure and monitor each portfolio's credit risk exposure to ESG risks
3. To effect investment decisions and portfolio actions according to different levels of ESG risks.

We will be providing more details about proprietary Antares' ESG Credit Impact Score framework in upcoming communications.





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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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