

Antares Income Fund

Monthly Investment Report

October 2022



Fund Performance

Period Ended 31/10/2022	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %	Since Inception %pa ¹
Antares Income Fund	-0.04	0.66	-0.58	0.69	1.29	1.75	2.00
Bloomberg AusBond Bank Bill Index	0.24	0.54	0.76	0.43	0.97	1.25	1.53
Difference	-0.28	0.11	-1.34	0.26	0.32	0.50	0.46

Valuation at month end was \$204,199,260.72

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 31/10/2022

	Fund	Benchmark
Interest Rate Duration (yrs)	0.16	0.12
Running Yield + Roll-down (%)	4.18	2.91
Credit Spread Duration (yrs)	2.00	-
Average Credit Rating	A	-
Liquidity*	72%	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	19.51%
AA+	9.65%
AA	10.83%
AA-	29.95%
A+	4.26%
A	2.01%
A-	5.01%
BBB+	12.47%
BBB	6.31%
BBB-	0.00%

Portfolio Strategy

Strategy	Implementation
<p>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.</p> <p>However, aggressive tightening by central banks to contain inflation may curb economic growth quickly, creating a "stagflation" environment.</p>	<ul style="list-style-type: none"> 1. With the sustained rise in bond yields from January to mid-June, we steadily reduced our short duration positions as market yields moved closer to our fair value levels. 2. The strong bond rally from late June to late July provided an opportunity to reset some short positions. 3. The sell-off in bonds through August to October has allowed us to steadily trim our short positions as market yields move closer to, and through, our fair value levels (refer to scenario analysis below). Both the Fed and RBA have been taking an aggressive path to get on top of inflation; but the RBA "blinked first", tightening by a reduced 25bps at both its October and November meetings. Possibly the very high exposure of Australian households to floating rate mortgages was the key driver of the RBA's decisions. In contrast, US homeowners are largely exposed to 30yr fixed mortgages. As a result, the market is pricing RBA March 23 cash rates of 3.35% versus the Fed at 4.75%, a 1.40% difference. What keeps surprising 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 the case that the longer-term structural level of inflation is higher. Accordingly, we think shorter bonds are still more sensibly priced than longer bonds and continue to favour a curve steepening strategy. With the 3-10yr curve trading in a 35/55 range, we may tactically reduce some steepening positions at levels above 50.
<p>Optimising yield through carry and roll-down, focusing on the inflection points on steep curves. With steep curves from 2-15yrs (rolls down 8-30bp pa), there are improving roll down opportunities.</p>	<ul style="list-style-type: none"> We are using our proprietary analytics to find attractive roll-down maximisation opportunities per unit of risk; currently, Semi and Commonwealth government bonds from 2024 out to 2037 are as steep as we've seen for the past 5 years (rolling down 13bp pa). Recent major bank issuance in the 5yr area has markedly steepened the bank curve and created attractive switch opportunities between 2yrs and 5yrs. We still like the steepness of semis in 10-15yrs versus Commonwealth government bonds. NSW and TCV 2037s and the new TCV 36 are our preferences.
<p>Control credit risk</p>	<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 is back trading at close to its lows of the recent 100-150 range. We may add some credit protection at iTraxx levels close to 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.
<p>A strong level of liquidity that could be realised in stressed conditions</p>	<ul style="list-style-type: none"> Selective semis and government bonds provide both liquidity and attractive carry and roll-down.

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-22
Distribution Amount	0.40 Cents Per Unit
Next Distribution Date	31-Dec-22

Portfolio Review

Key Drivers of Portfolio Performance:

- The 5-10 yield curve steepened 9bps adding 6bps
- Corporate spreads widened 10-20bps detracting 21.3bps
- Senior banks widened 5-30bps detracting 10bps
- Bank sub debt widened 10-25bps detracting 6.5bps
- CDS protection detracted 8bps as iTraxx tightened 17bps
- Yield enhancement and roll-down of quality investment grade bond holdings added 11.3bps.

Portfolio Activity and Positioning

- Bought ANZ 11/27 hedged with 3yr futures
- Bought NAB 11/26 sub debt
- We have maintained the liquid structure of the Fund.

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Market Review

October

Outsized central bank hikes and higher than expected inflation data continued in October. However, the RBA and Bank of Canada's smaller than expected rate rises saw markets eager to call a pivot on monetary policy tightening.

Rather than a pivot, these more dovish hikes represent a slowdown in the pace of tightening, with the RBA and BOC considering their dual mandates of price stability and full employment and rate hikes to date will impact their economies given their high household debt levels. With central banks globally moving closer to terminal rates, there was talk of the need to slow the pace of rate hikes at some point. Fed Daly stated that a 75bp hike in November should not be taken as 75 forever. But for now, the Fed has reiterated it still needs to see clear evidence of falling inflation and a softening labour market before they change their trajectory.

Hawkish Fed rhetoric continued throughout the month, with Fed Daly referring to inflation as a corrosive disease and other Fed members saying there is more work to do to bring inflation down. But there was also increasing talk of the cost of a policy tightening error in increasing recession risks and the importance of calibrating the pace of future rate hikes to mitigate recession risks. Markets are assessing if an inflection point has been reached in the rate tightening cycle.

The US economy remains robust with higher than expected retail sales, consumer sentiment, and lower unemployment. US CPI surprised to the upside with core CPI at 6.6% vs 6.5% expected. These factors resulted in the Fed delivering its fourth consecutive 75bp hike in October. Some weakness was evident in the US housing sector with house prices falling.

UK bond markets were the best performer of the month after the UK government scrapped proposed unfunded tax cuts which sent markets reeling in September. Political and market stability returned in the UK with the appointment of Rishi Sunak as the new UK Prime Minister.

Globally, CPI data also surprised to the upside with the UK, Germany, Europe, and Canada all printing higher than expected inflation.

Australian core and headline CPI data was also higher than expected at 6.1% vs 5.5% with inflation being very broad based across the CPI basket. RBA governor Lowe again reiterated his objective of keeping the economy on an "even keel" as the RBA navigates its way to a more restrictive policy setting, delivering a 25bp hike in October to a cash rate of 2.60%. Lowe has also made constant reference to Australia's economy being different from the rest of the world as justification for policy path differences. Given the similar levels of unemployment and inflation in the US, this argument is getting harder to justify. One key difference, however, is the higher levels of household debt in Australia compared to the US, which may explain the current 1% difference in terminal rates between Australia and the US.

The month ended with a rate higher for longer thematic in recognition that policy responses to date have not had the intended impact on inflation. Markets now expect that monetary policy will need to be restrictive for longer to bring inflation back to the central bank's target band of 2-3%. The Antares team view is that inflation may be structurally higher going forward and that there are risks around central banks being able to bring inflation from 8% levels back to 2-3% over the medium term. One potential source of uncertainty in that scenario is the slowing economic situation in China. With deflation risks in China's domestic economy, this increases the likelihood that China could export deflation to the global economy in the future.

Macro Outlook

The outlook for global growth continues to be negative as central banks move closer to terminal rates, increasing the risk of recession. In addition, the impact of a China economic slowdown is yet to be felt through the global economy.

Markets are concerned about a potential policy error by the Fed as they continue to deliver outsized rate hikes until there is clear evidence of inflation moving back towards the 2-3% target band.

While to date the US economy has remained resilient to the Fed's rapid and aggressive rate hikes, the US housing market is starting to show some weakness and there has been some softening in ISM prices paid for both goods and services, which may be an early sign that rate hikes are starting to impact demand. The tightening cycle may reach an inflection point in coming months.

However, the Fed has made it clear all along that they will need to see evidence of falling prices before adjusting the pace and magnitude of hikes or consider pausing. Markets will be anticipating next month's inflation print and looking for a softening in the labour market before expecting a change in pace from the Fed.

With the RBA now taking a different path to the Fed by adjusting its policy pace in October, Lowe's rationale is to account for the lagged effects of rate hikes on the economy and the potential impacts of a weaker global growth outlook on the Australian economy. By pulling back on the pace of hikes before clear evidence of falling inflation, markets are anticipating that rates will need to stay higher for longer to bring down the highest inflation in over 30 years. Inflation is also expected to stay elevated over the coming months with the impact of the east coast floods yet to be captured in the inflation data.

Part of the negative global growth outlook is due to China's weak domestic economy, largely driven by China's zero covid policy. With China running a large trade surplus and factory prices expected to fall this could have a dampening impact on global inflation as China could export disinflation to the global economy. This outlook is not expected to change until China softens its zero covid policy, which is not expected until well into 2023.

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	5.00%	4.50%	5.00%	5.50%	6.00%	6.50%	7.25%	6.50%	150
Above Trend	4.00%	3.50%	4.50%	4.50%	4.25%	4.00%	4.25%	4.25%	110
Trend	3.00%	2.50%	3.25%	3.50%	3.75%	4.00%	4.50%	4.00%	75
Below Trend	1.50%	1.50%	2.50%	2.50%	2.50%	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	0.50%	4.00%	3.00%	3.50%	3.75%	4.25%	5.00%	4.00%	150
Antares Latest Fair Value (FV)	1.65%	3.25%	2.95%	3.35%	3.50%	3.80%	4.30%	4.10%	130
Market Yield Latest			3.05%	3.15%	3.30%	3.65%	4.10%	3.85%	115
FV - Market (+ exp / - cheap)			-0.10%	0.20%	0.20%	0.15%	0.20%	0.25%	15

Antares' continues to have a greater than 60% probability weighting to structurally higher inflation outcomes; 45% probability being assigned to the stagflation scenario of higher inflation with weak/negative growth (Scen 6); and 20% probability of higher inflation with strong growth (Scen 2). After the better than expected October US inflation print, and subsequent bond rally, bond yields look expensive with Antares' fair values (FVs) 15-25bps above 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.

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Interest Rate & Inflation Outlook

Over the month the market witnessed a dovish turn from the RBA, shifting its policy stance from one of automatic 50bp hikes to being more data dependent. The RBA hiked 25bps in October, surprising many in the market expecting another 50bps hike. The RBA outlined its concerns around financial stability and the lagged effects of monetary policy, with much of this to play out in early to mid-2023 as fixed rate mortgages roll into variable rates.

Consequently, the market dialed back its expectations around RBA rate hikes, anticipating now a series of 25bp hikes with the terminal rate pushing out towards mid-2023. As a result, the November meeting was a fait accompli, with the RBA hiking only 25bps despite a higher than expected Q3 CPI print.

The RBA's policy actions, whilst contentious, place the RBA as one of the most dovish central banks globally, with its objective of targeting inflation between 2-3% coming under increasing scrutiny. The RBA faces the twin objectives of moderating inflation through higher rates while maintaining financial stability. The difficulty with this policy stance is that annual inflation is currently running at 7.3% and forecast to lift to 8% by year end. More concerning for nominal bond investors is the unlikely prospect that inflation will return to its 2-3% band before 2025.

Tight capacity constraints, full employment and ongoing strength in household demand, coupled with ongoing price pressures including an energy price shock underpins significant inflation risks for the next 12 months. Weighing against this are ominous signs around consumer sentiment given the tightening in rates already seen. While historically this has translated to weaker household consumption, a large build-up in savings and ongoing wage growth may be growth-supportive factors.

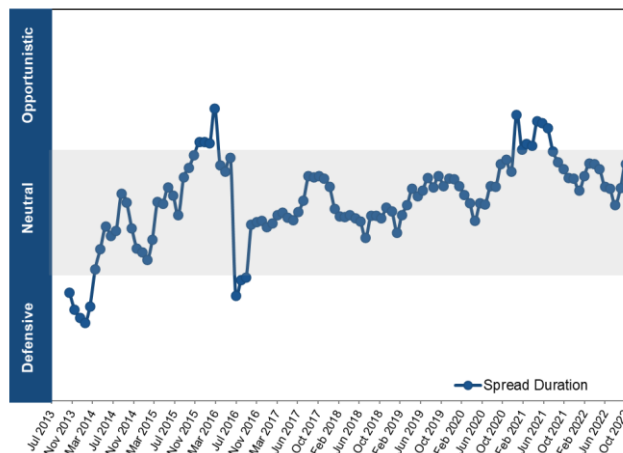
If weakness transpires in the growth outlook, it is likely to be amplified by a global growth slowdown, given tighter financial conditions and weakening merchandise trade. This is anticipated to play out in 2023, with the RBA already revising down its growth expectations while projecting persistent and elevated inflation for the medium term.

Credit Outlook

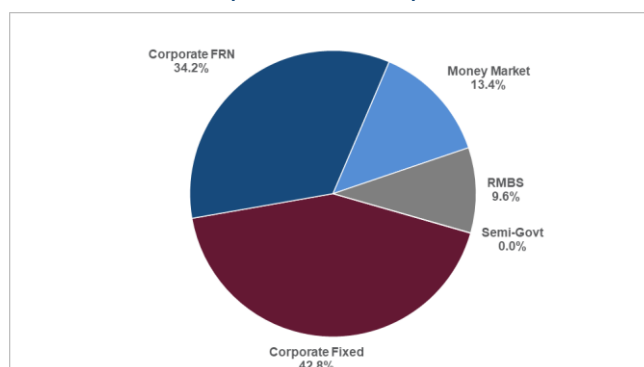
Credit spreads moved wider in October, with financial issuers the notable laggards. ANZ printed A\$4.75bn in senior paper across 3 and 5-year tranches with this transaction seeing the major bank curve reprice ~7-8bps wider on the month.

Similarly to last month, we continued to trim exposure to European financials due to concerns around the region's economic outlook and knock-on effects for bank asset quality. These moves were perhaps vindicated with this sector continuing to underperform their Australian counterparts in A\$ secondary. In terms of outlook, we are wary of continued tightening in financial conditions and their potential impact on economic activity and corporate earnings. As such, we remain cautious on credit and mindful of portfolio liquidity in these uncertain times.

Defensive to Opportunistic

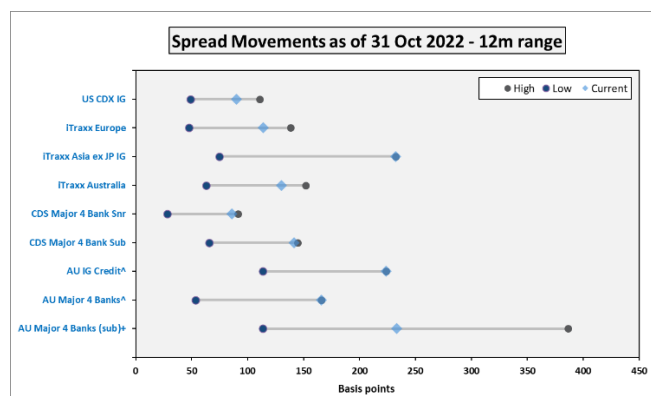


Sector Breakdown (Market Value %)



ESG

ESG analysis is reviewed regularly for material changes to the issuer's credit profile, as well as the effectiveness of the risk mitigants in place to manage such risk. For the month of October, our fundamental credit assessment process did not uncover any concerns around an individual issuer's ESG risk. Therefore, no action was required.





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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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