

Antares Income Fund

Monthly Investment Report

December 2022



Fund Performance

| Period Ended 31/12/2022 | 1 Mth % | 3 Mths % | 1 Yr % | 3 Yrs % | 5 Yrs % | 7 Yrs % | Since Inception %pa ¹ |
|-----------------------------------|---------|----------|--------|---------|---------|---------|----------------------------------|
| Antares Income Fund | 0.63 | 0.81 | 0.44 | 0.85 | 1.39 | 1.81 | 2.05 |
| Bloomberg AusBond Bank Bill Index | 0.25 | 0.74 | 1.25 | 0.55 | 1.01 | 1.27 | 1.56 |
| Difference | 0.38 | 0.06 | -0.81 | 0.30 | 0.38 | 0.55 | 0.49 |

Valuation at month end was \$206,751,357.09

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 31/12/2022

| | Fund | Benchmark |
|------------------------------|------|-----------|
| Interest Rate Duration (yrs) | 0.12 | 0.13 |
| Yield to Maturity* | 4.60 | 3.13 |
| Credit Spread Duration (yrs) | 2.09 | - |
| Average Credit Rating | A | - |
| Liquidity** | 72% | 100% |

*Estimated return if held to maturity. Market yield for Fixed Rate Bonds whilst FRNs uses a swap assumption rate as an input.

**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 | 16.55% |
| AA+ | 1.08% |
| AA | 6.62% |
| AA- | 16.09% |
| A+ | 3.96% |
| A | 1.36% |
| A- | 14.39% |
| BBB+ | 21.42% |
| BBB | 18.53% |
| BBB- | 0.00% |

Portfolio Strategy

| Strategy | Implementation |
|---|---|
| Duration and Yield Curve: Our scenario analysis points to an increasing probability of structurally higher inflation for longer with a potential bear steepening of yield curves if central banks are unable to contain longer term inflation expectations. The extent of the economic impact of aggressive tightening by central banks will play out in 2023 where we see increasing risks of a "stagflation" scenario. | <ul style="list-style-type: none"> 2022 saw an "unprecedented" and volatile sell-off in bond markets. The rise in bond yields from January to mid-June, saw us steadily reduce our short duration positions with market yields moving closer to our fair value levels. From late June through to July, a strong rally provided the opportunity to reset some short positions. Bonds then sold off again through August-October, once again allowing us to trim short positions as yields traded through our fair values. November through to mid-December saw another rally with a strong sell-off in the last two weeks of December. We continue to see risks around market assumptions that inflation will fall back within central bank's target band of 2-3% due to long term structural inflation drivers in the post covid era. Yield curve: With the sell-off in 2022 being driven by front end central bank rate rises and long-term inflation expectations remaining anchored for now, we continue to favour a curve steepening strategy based on our view of the potential risks of structurally higher long-term inflation. Duration: Given our outlook, we are positioned between neutral and short duration across mandates depending upon mandate objectives. |
| Credit exposure: Our scenario analysis points to rising risks of recession and stagflation risks that make us cautious about credit risk in portfolios. | <ul style="list-style-type: none"> Valuations: After widening sharply this year, credit spreads have been narrowing since November, reflecting the resilience seen to date in both the economy and the labour market, despite the most aggressive rate hiking cycle in four decades. We are focusing on high quality credit, targeting credits in the 3-5yr area. High quality issuers: 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. Synthetic credit: iTraxx is back trading below 80 after reaching highs of around 150 in October. We will continue to monitor credit protection and potentially buy protection opportunities for those portfolios that can use CDS. |
| Optimising yield through carry and rolldown: Focusing on high quality credits and inflection points on steep curves. | <ul style="list-style-type: none"> Portfolio construction: We are using our proprietary analytics to harvest attractive rolldown while maximising opportunities per unit of risk. Rate and swap term premia: For long maturity portfolios we still like the steepness of semi-government bonds in 10-15yrs versus Commonwealth government bonds. NSW and TCV 2036-7s are our preferences. Credit term premia: Recent major bank issuance in the 3-5yr area has markedly steepened the major bank curve and created attractive switch opportunities between shorter bonds and newly issued 5-year bonds. |
| Liquidity: Where appropriate, we are maintaining liquidity that can be realised in stressed conditions. | <ul style="list-style-type: none"> Portfolio construction: Selective semis, major banks and government bonds are seen as core liquidity building blocks across portfolios. We have maintained the liquid structure of Funds where appropriate. |

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 | 31-Dec-22 |
| Distribution Amount | 0.62 Cents Per Unit |
| Next Distribution Date | 31-Mar-23 |

Portfolio Review

Key Drivers of Portfolio Performance:

- The 3-10 yield curve steepened 19bps, adding 11bps to returns
- Corporate spreads narrowed 5-12bps contributing 12.5bps
- Sub debt tightened 10-25bps adding 6bps
- Yield enhancement and rolldown of quality investment grade bonds added to returns.

Portfolio Activity and Positioning

- We have maintained the liquid structure of the Fund.

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Market Review

December

The major thematic that played out in December was one of higher rate structures for longer. Australian and major global yield curves bear steepened as high inflation persisted, the Bank of Japan surprised by increasing its 10-year yield curve control rate, and China abruptly abandoned its zero-COVID policy. Central bank rhetoric remained hawkish, acknowledging there was a long way to go to bring inflation towards target despite the most aggressive rate hiking cycle in decades increasing the risk of recession.

Despite some dovish Fed commentary during the month stating it may soon be appropriate to slow the pace of rate hikes and not wanting to overtighten, the overall message remained hawkish as Fed members acknowledged that rate structures may need to be higher for longer and terminal rates will likely be higher than expected. The key risk highlighted by the Fed was their concern over inflation expectations becoming unanchored if there is a slow return to normal levels of inflation. Similarly, the ECB stated that significant rate rises at a steady pace were still to come. Over the month, the Fed, ECB, Bank of England, and Bank of Canada all raised rates by 50bps while the RBA hiked 25bps.

There was mixed economic data over the month with many indicators showing signs of slowing growth. Global manufacturing PMIs were in contractionary territory, driven by the continued shift from goods demand to services in the post pandemic environment. This has also been a factor in the continued resilience seen in the labour market. US jobs data out in December showed an unemployment rate of 3.7% and higher average hourly earnings. Australia's unemployment rate came in at 3.4%. However, there were some disappointing corporate earnings in the US and several large companies such as Amazon, Goldman Sachs and Salesforce announced plans to lay off workers. Stronger than expected US retail sales and earnings suggest that for now consumption remains strong.

On December 20, the Bank of Japan (BOJ) made a surprise announcement, increasing yield curve control on the 10-year part of the curve from 25 to 50bps. The market interpreted the announcement as the BOJ starting to make moves towards a potential first rate rise next year and adjusting to a higher global rate environment to make it easier to manage to the target.

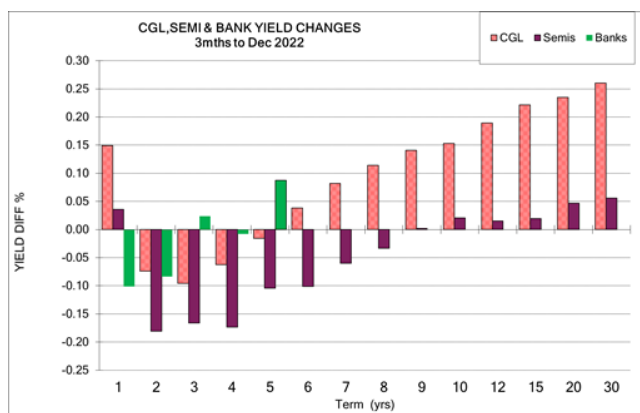
During the month, China spectacularly abandoned its strict zero-COVID policy stance, despite record high cases. Initial reaction from some countries was to introduce testing requirements for all arrivals from China on fears cases could rise globally as a result.

Q4 2022

The last quarter of 2022 saw central banks and markets grapple with reigning in persistent inflation against rising recession risks from aggressive rate hikes. Over the quarter, markets continued to be surprised by the resilience of the economy and the consumer in the face of decades high inflation. Key to this has been the resilience of the labour market, driven by strong demand for services.

Central banks continued with their hawkish rhetoric over the quarter to ensure longer term inflation expectations remained anchored. This resulted in a bear steepening of Australian yield curves as illustrated in the chart to the right.

While markets were keen to see any sign of a Fed pivot, it was acknowledged that the time was appropriate to consider slowing the pace of hikes going forward. Terminal rates remain around 5.0% for the US and 3.8% for Australia. The main takeout from the quarter was the realisation that rates may need to be higher for longer given the persistence of high inflation and the resilience of the labour market. This is inconsistent with current market pricing, with US rate cuts being priced in mid-2023.



Macro Outlook

The key question for 2023 will be whether central banks have done enough or gone too far in their policy tightening to bring inflation back to "normal" levels without causing a recession. Central bank reaction functions in 2022 were the most aggressive in decades to play catchup in tackling persistently high inflation which had been considered only transitory in nature at the back end of 2021.

Expect to see a deterioration in macro fundamentals throughout 2023 as the impact of rate hikes play out in the broader economy. Markets will be focused on anticipating the timing and magnitude of a slowdown in growth. There is much uncertainty around the timing of any pause/pivot in central bank hiking cycles. A key driver of this uncertainty has been the continued resilience of the consumer and labour market, which will be tested in 2023. Current market pricing has the Fed pivoting to rate cuts in mid 2023 but recent Fed commentary has reiterated the theme that rates may need to be higher for longer to deal with more persistent inflation than expected.

Markets are divided over the likelihood of a recession and if it will be short or more protracted. The current global outlook for growth has been revised down by economists and international bodies such as the World Bank and IMF from the 3% range to the 1% range. The IMF expects a third of the world economy to be in recession in 2023.

The outlook for the Australian economy is to soften but is currently expected to either avoid or experience a shallow recession. Australian households will be tested come mid-year as around 20% of all mortgages come off low fixed rates onto materially higher variable rate structures.

Inflation is expected to decline but not get back to pre pandemic levels in 2023. A continued strong labour market driven by strong demand for services has seen inflation remain sticky and this will be a key area to watch. We support recent market views that interest rates will need to remain higher for longer to deal with high inflation from tight labour markets and longer-term structural price pressures. With falling growth rates and inflation remaining elevated, the Antares team see a high risk of a stagflation scenario in 2023.

For credit markets, credit spreads are expected to widen. Current spreads are not pricing in recession risks and companies have only recently started to see some deterioration in corporate earnings and some have announced staff layoffs in anticipation of a slowdown in growth. Domestically, it is expected that there will be a large supply of issuance this year as the RBA winds down its Term Funding Facility and banks re enter the primary market to secure funding which will support elevated bank spreads for some time.

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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 5YR 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% | 4.00% | 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 low growth/high inflation | 1.50% | 4.00% | 3.75% | 4.25% | 4.75% | 5.25% | 5.75% | 5.50% | 150 |
| Stagflation -ve growth/high inflation | -1.50% | 4.00% | 2.00% | 2.50% | 3.50% | 4.75% | 5.75% | 4.75% | 150 |
| Antares Latest Fair Value (FV) | 1.63% | 3.02% | 3.14% | 3.42% | 3.75% | 4.12% | 4.59% | 4.06% | 127 |
| Market Yield Latest | | | 3.26% | 3.28% | 3.41% | 3.63% | 3.96% | 3.55% | 89 |
| FV - Market (+ exp / - cheap) | | | -0.12% | 0.15% | 0.34% | 0.48% | 0.63% | 0.51% | 38 |

Antares' continues to have a greater than 57% probability weighting to structurally higher inflation outcomes; 42% probability being assigned to the stagflation scenario of higher inflation with weak/negative growth (Scen 6); and 15% probability of higher inflation with strong growth (Scen 1 & 2). The selloff from mid-December took bond yields close to Antares' Fair Values, but after the 20-40bp rally in January, current market yields again look expensive versus Antares' Fair Values (FVs) (15-60bps). The aforementioned are weighted average FVs and it should be noted that there is a wide dispersion of potential yield levels under the various scenarios.

Interest Rate & Inflation Outlook

December saw mixed fortunes for bonds, with a large reversal in long bond yields taking place after posting a strong performance in the preceding two months. The Aussie 10yr yield rallied 90bps from its peak in late October down to 3.30% by early December, only to sharply sell-off into quarter-end.

The initial bond rally coincided with growing expectations of a policy pivot from major central banks around the world. Included amongst this group was the RBA who, notably, was one of the first to signal a potentially slower path of rate hikes. The RBA's more cautious approach ultimately resulted in consecutive 25bp hikes for its October, November and December meetings, marking a clear change in pace.

Given the rationale for slowing the rate tightening, including reasons relating to the lagged effects of policy on the mortgage market, the bar remains very high for a re-acceleration of rate hikes in 2023. This is notwithstanding a significant CPI print that stands between current market pricing and the next RBA meeting, in February.

Early indications point to another outsized CPI print due on 25 January with headline inflation potentially reaching above 1.5%, which would mark the fourth consecutive print to do so. If inflation is to gravitate back towards the RBA's 2-3% objective by 2025, the quarterly run-rate would need to slow to at least 1.25% in the coming quarters. Indeed, the RBA's own forecast for headline CPI by year end is 4.7%.

BEIs are currently showing inflation to average around 2.4% for the next 10 years, while shorter term BEIs remain elevated given the persistence of near term inflation and the carry associated with this.

Beyond 5 years, the inflation term structure remains very flat, reflecting that long term inflation expectations continue to remain very well anchored.

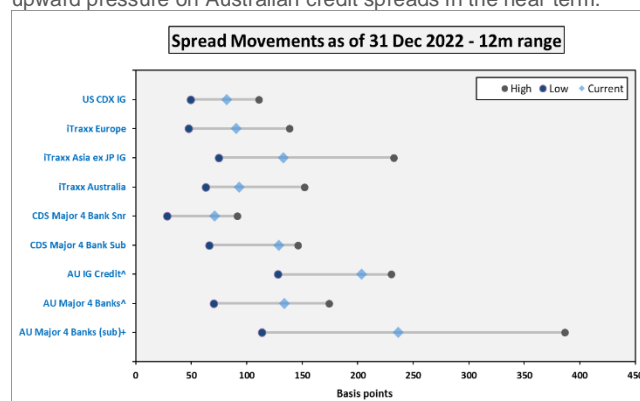
Forward rates suggest that domestic policy rates will peak around 3.75%- 3.9%, which implies the cycle has three more rate hikes left. While this seems a reasonable baseline view, the risks around it remain significant in both directions.

A similar distribution of risks confronts the US, which has led the global adjustment in rates since early 2022. With US cash rates expected to reach 5%, there is already a lot priced into US bonds, with the key caveat being that inflation continues to moderate in line with current market expectations. Any deviations from this, or more persistence in labour market strength would likely see front end rates rise further, putting enormous pressure on risk assets generally.

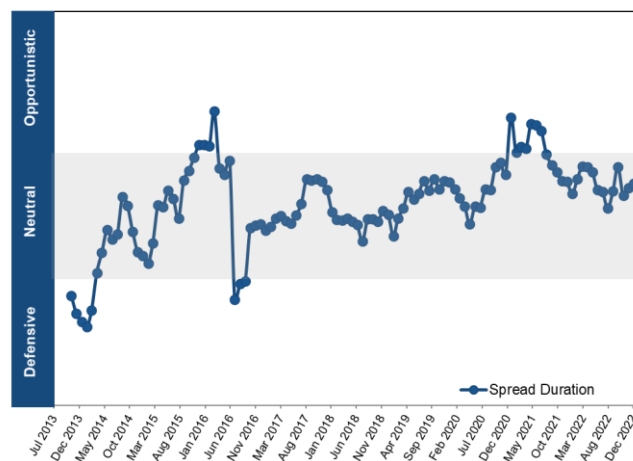
Credit Outlook

Credit spreads were resilient in December despite the sell-off in rate markets. US Investment Grade and High Yield credit spreads remained mostly unchanged, while European Investment Grade and High Yield credit spreads both narrowed 14bps. Australian credit tightened 3bps to 5bps across the curve, with notable performance in the Utility and Teleco segments. Synthetic credit spreads remained largely unchanged throughout the month but widened by 3-5bps towards the end of December.

Several Australian banks took advantage of the recent tightening in the USD credit market and issued a number of large Yankee transactions in December. The total amount of USD bond issuance by Australian banks and corporates reached a historical high of USD 250 bln in 2022, 2.5 times higher than in 2021 and 1.8 times higher than the previous high in 2019. We expect Australian banks will now turn their focus back on the domestic market and, as a result, we anticipate an increase in bank issuance in 2023. This may put some upward pressure on Australian credit spreads in the near term.



Defensive to Opportunistic



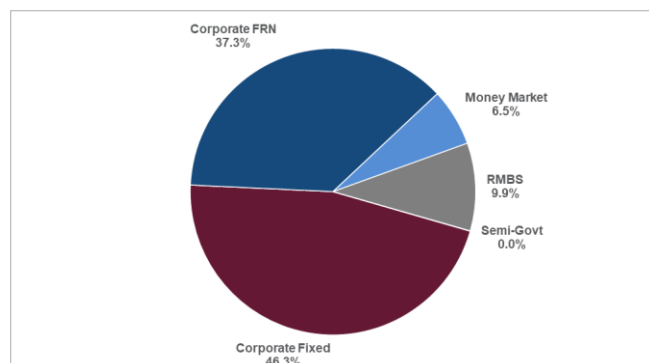
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Sector Breakdown (Market Value %)



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 December, our fundamental credit assessment process did not uncover any concerns around an individual issuer's ESG risk. Therefore, no action was required.

Market Movements

| Australian Rates | Dec 2022 | Quarterly Change | 1 Yr Change |
|---------------------|----------|------------------|-------------|
| RBA Cash Rate | 3.10 | 0.75 | 3.00 |
| 90 Day Bank Bill | 3.26 | 0.20 | 3.20 |
| 3 Yr Futures | 96.41 | 0.08 | -2.41 |
| 10 Yr Futures | 95.93 | -0.16 | -2.36 |
| 3/10 Spread (bps) | 48.50 | 24.00 | -5.00 |
| iTraxx Australia 5Y | 93.06 | -48.04 | 29.09 |
| 10Yr BEI | 2.46 | 0.30 | 0.19 |

| Global Sovereign Rates | Dec 2022 | Quarterly Change | 1 Yr Change |
|------------------------|----------|------------------|-------------|
| Fed Fund Rates | 4.33 | 1.25 | 4.26 |
| ECB Main Refi Rate | 2.50 | 1.25 | 2.50 |
| US Sovereign 2 Yr | 4.43 | 0.15 | 3.69 |
| US Sovereign 10 Yr | 3.87 | 0.05 | 2.36 |
| Japan Sovereign 10 Yr | 0.42 | 0.18 | 0.35 |
| German Sovereign 10 Yr | 2.57 | 0.46 | 2.75 |

| Currencies | Dec 2022 | Quarterly Change | 1 Yr Change |
|------------|----------|------------------|-------------|
| AUD/USD | 0.68 | 0.04 | -0.05 |
| EUR/USD | 1.07 | 0.09 | -0.07 |
| USD/JPY | 131.12 | -13.62 | 16.04 |

| Equities | Dec 2022 | Quarterly Change | 1 Yr Change |
|----------|----------|------------------|-------------|
| ASX200 | 7039 | 8.7% | -5.5% |
| S&P500 | 3840 | 7.1% | -19.4% |

| Commodities | Dec 2022 | Quarterly Change | 1 Yr Change |
|-------------|----------|------------------|-------------|
| WTI Crude | 80.3 | 0.8 | 5.1 |
| Gold | 1824.0 | 163.4 | -5.2 |

| Australian Economic Data | Latest Print | Previous Quarter Print | Dec 2021 Print |
|-------------------------------|--------------|------------------------|----------------|
| Employment Change (k) | 64.0 | 33.5 | -138.0 |
| Unemployment Rate (%) | 3.4% | 3.5% | 4.6% |
| Retail Sales (MoM%) | 1.4% | 0.6% | 1.3% |
| Trade Balance Value (m) | 13201 | 8324 | 12,243 |
| Building Approvals (MoM%) | -9.0% | 28.1% | -4.3% |
| Consumer Confidence (Westpac) | 80.3 | 84.5 | 104.6 |
| Business Confidence (NAB) | -4.4 | 10.2 | 13.0 |
| Business Conditions (NAB) | 20.3 | 19.9 | 4.7 |

| Australian Economic Data | Latest Print | Previous Quarter Print | Dec 2021 Print |
|------------------------------------|--------------|------------------------|----------------|
| Private Capital Expenditure (QoQ%) | -0.6% | -0.3% | 4.4% |
| GDP (YoY%) | 5.9% | 3.6% | 9.6% |
| Inflation (YoY%) | 7.3% | 6.1% | 3.0% |

| Global Economic Data | Latest Print | Previous Quarter Print | Dec 2021 Print |
|-------------------------------------|--------------|------------------------|----------------|
| US Non-Farm Payrolls (k) | 223 | 263 | 531 |
| US Unemployment Rate (%) | 3.5% | 3.5% | 4.6% |
| US Manufacturing ISM | 48.4 | 50.9 | 60.8 |
| US Non-manufacturing ISM | 49.6 | 56.7 | 66.7 |
| China Manufacturing PMI | 47.0 | 50.1 | 49.2 |
| China Non-Manufacturing PMI | 41.6 | 50.6 | 52.4 |
| German Factory Orders (MoM%) | -5.3% | -2.4% | 1.3% |
| German Industrial Production (MoM%) | 0.2% | -0.8% | -1.1% |



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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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Important information

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