

BMO Pyrford Global Absolute Return Fund (AU\$)

ARSN 168 994 205

For wholesale investors only

Q3 2021 Commentary

Performance The fund returned 1.80% over the quarter. Since inception in June 2014, the fund has delivered 4.99% per annum.

The aim of the fund is to provide a stable stream of real total returns over the long term with low absolute volatility and significant downside protection.

Market Commentary Risks are accumulating on the horizon with the market having to digest various China risks, Washington DC policy risks, energy risks, a weakening of earnings as well as a shift to central bank tightening. Virus risks have long been the primary concern, but infection rates continue to improve, and positive developments continue with Merck announcing positive test results for a pill.

The US 10-year bottomed at 1.17% over the quarter, widening by over 30 basis points to end September at 1.49%. The selloff in the US 10-year is understandable given the Fed has flagged they are ready to reduce the \$120bn a month of asset purchases but will remain "patient" with regards to rate rises. The market has been debating the timeline for the withdrawal of asset purchases for many months and initially took the news in its stride. That said, winding down the program by mid-2022 implies a more aggressive rate of withdrawal than anticipated which woke the Treasury market. The move higher in Treasury yields was not limited to the US. From their respective lows, the yield on the UK 10-year increased by around 50 basis points to 1.02% and the German 10-year by 26 basis points to -0.23% over the quarter as a more hawkish sentiment descended on Treasury markets.

The current inflation surge is both cost-push and demand-pull. Demand-pull because the 'free' money handed out in one form or another pushed up savings rates and gave many people more liquidity than they had experienced in years – perhaps ever. Ultimately, the money started to chase goods and services. Cost-push because global supply chains were massively disrupted, ships and other forms of carriage were taken off-line, and many people left those industries.

On the question of transitory or permanent inflation, we come down on the side of the inflation scare being temporary – but 'temporary' may still be as long as several years. It means that central banks must navigate a journey through a confused economic narrative.

Key Drivers & Detractors Strong returns were dominated by both our overseas bond and equity allocations with our domestic equities adding further. Overseas equities contributed 1.02% with domestic equities contributing 0.51%. Whilst the Australian bonds contribution was flat, overseas bonds generated a positive contribution of 1.07%, helped by a strengthening of the British Pound, Euro and Canadian Dollar.

Overseas equities added led by Telkom Indonesia and Legal & General. Telkom Indonesia saw sequential growth across all segments in the second quarter with non-mobile growing faster than mobile. They continue to see strong traction in its fibre broadband business with steady increase in subscribers and higher revenues per subscriber as they take on dual or triple play services. Competition in mobile also eased too and is likely to remain so given the announced consolidation amongst the smaller operators. The company is also in advanced stage to list their tower subsidiary Mitratel by year end which will lead to a sizable valuation gain. Legal & General added as bond yields rose over the quarter which is seen as beneficial for insurers as investment income is enhanced.

Within the domestic equity allocation both Woodside and QBE Insurance were notable contributors. Woodside benefitted from the rebound in oil and gas prices as well as positive news on the merger with BHP's oil and gas division. As with Legal & General, QBE will benefit from higher rates. QBE reported an increase in premiums, although management remained cautious on capital distribution as catastrophe claims are elevated.

The Australian yield curve shifted lower in stark contrast to the shift higher seen in most overseas yield curves. The long end tightened with the Australian 10yr hitting 1.48%. We are positioned at the short end, meaning the return from our domestic bond allocation was broadly flat. We are also positioned at the short end within our overseas bond allocation. The UK yield curve widened across the curve whilst the US curve was slightly steeper. The long end of both yield curves widened meaning that our position at the short end marginally outperformed. The British Pound, the Euro and the Canadian Dollar appreciated, adding to the contribution from the overseas bond allocation.

Our US Dollar exposure remains hedged, meaning we did not benefit from the positive impact of a strengthening US Dollar.

Enquiries

BMO Global Asset Management

Level 29, 2 Chifley Square, Sydney, NSW 2000

Telephone: 02 9293 2804

Email: michael.angwin@bmo.com

harry.page@bmo.com

rhys.leitch@bmo.com

Asset Allocation & Positioning There were no portfolio changes made over the quarter.

We remain defensively positioned. Our current allocation is 52% government bonds, 45% equities and 3% cash. The equity portfolio remains positioned in defensive sectors such as utilities and telecommunications. These sectors offer predictable revenue streams and attractive valuations. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. In Asia, we prefer the Southeast Asian markets over Japan as the economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations.

In bonds, Pyrford continues to adopt a defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields. At the end of the period, the modified duration of the fixed income portfolio stood at around 1 year.

The US Dollar remains hedged to meet the portfolio target exposure of no more than 45% in non-AUD, unhedged currencies. Our hedging rule is to hedge currencies that are more than 25% overvalued relative to the base currency. Whilst the US Dollar is not more than 25% overvalued as per our hedging rule it is the most expensive currency relative to the Australian Dollar.

Quarterly ESG & Voting Summary As long-term shareholders of companies, we have the ability, and in our view the responsibility, to try and influence the business practices of companies.

Pyrford voted 238 ballots in 9 company meetings in the quarter. We voted against management in over 20% of meetings. We also engaged with 51 companies worldwide and ESG issues are a standing agenda item in every meeting we conduct.

For a detailed overview of ESG activity, please visit our website for all voting records and our latest annual ESG report.

N.B. Returns are quoted in AU\$ unless otherwise stated.

Risk disclosure

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In Q4 2021, subject to regulatory approval and customary closing conditions Pyrford International is to become part of Columbia Threadneedle Investments.

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