

BMO Pyrford Global Absolute Return Fund (AU\$)

ARSN 168 994 205

For wholesale investors only

Q1 2022 Commentary

Performance

The fund returned 0.31% over the quarter. Since inception in June 2014, the fund has delivered 4.72% 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

Increasingly stringent economic sanctions and the subsequent shockwaves has created a difficult environment for investors to navigate given the complex interchange between the financial sanctions imposed on Russia, rising commodity prices, more fragile global economic growth from heightened geopolitical uncertainty, and any response that central banks may take.

Inflation is one of the most direct and obvious ramifications of the conflict. Petrol prices have leapt and with them everything that has a fuel input into its cost structure. Prior to the Russian invasion inflation was already high, and rising thanks mainly to the supply chain disruptions and shortages caused by the Covid pandemic. We have previously advised, with wavering confidence, that the current inflationary spurt is likely to be transitory. Recent geo-political events have further shaken our confidence. We, nor any central bank, knows quite where this is headed but one thing of which we are certain is that interest rates are simply too low. The UK, US and Canada have commenced their hikes. Get ready for more.

The quarter saw notable moves in bond markets with key 10-year government bonds in the US, UK, Canada, Australia and Japan all widen. Indeed, the German 10-year yield moved into positive territory. Such moves represent a significant diminution in capital value. Fundamentals are starting to reassert themselves in bond markets, perhaps other markets may soon follow.

Key Drivers & Detractors

Positive returns were led by both our domestic equity allocation with our overseas bonds the notable detractor over the quarter. Domestic equities contributed 2.13% with our overseas equities detracting -0.67%. Whilst the Australian bonds contribution was broadly flat, overseas bonds generated a negative contribution of -1.51%.

Within the domestic equity allocation Woodside Petroleum performed strongly assisted by a higher oil price, improved efficiency and cost savings. Woodside's production is linked to the oil price, whether through direct sales of liquid products or liquified natural gas contract prices based on the oil price. In addition, shortages in Europe and Asia have highlighted that demand for gas will be robust for many years to come, despite the energy transition, and that is not currently reflected in the levels of investment in an industry whose assets deplete through natural operations. Computershare added following strong performance last year. Earnings will benefit from interest rate rises globally. Computershare earns "margin" income on the flow of funds between its clients and their various counterparties. This income has been suppressed in recent years but now looks set to recover. Rio Tinto also added due to a strong recovery in the iron ore price and as progress has been made in negotiations with the Mongolian government on a copper mine.

Overseas equities detracted led by SAP and Essity. SAP reported clear momentum in cloud but is also facing increased costs to attract talent, an issue consistent across the technology industry. We remain positive on SAP given the acceleration in cloud momentum as well as a high and sustainable return on equity. Essity, the hygiene and health company, detracted as they missed consensus earnings due to an increase in energy and raw material costs. Management announced price increases to help alleviate these pressures. Reckitt Benckiser also weighed on returns due to an increase cost pressures. That said, management expect to grow margins through focusing on cutting overhead costs.

The Australian yield curve flattened as did most major overseas yield curves in reaction to central bank tightening. The short end widened more than the long end with the Australian 2-year widening by around 1.2% compare to 0.98% at the 10-year point of the curve. We are positioned at the short end, meaning that whilst the return from our domestic bond allocation was marginally negative, it was less negative than being positioned further out on the yield curve. We are also positioned at the short end within our overseas bond allocation. Both the UK yield curve and the US yield curve flattened over the quarter, meaning our position at the short end detracted. The British Pound, the Euro and the Canadian Dollar weakened against the Australian Dollar, generating a negative contribution from the overseas bond allocation.

Enquiries

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Pyrford



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Our US Dollar exposure remains hedged, meaning we benefitted from a weakening US Dollar.

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.

Within the fixed income allocation, Pyrford adopts a very defensive stance by only owning short duration securities in order to minimize the impact on the portfolio from interest rate rises. At the end of the period the modified duration of the fixed income portfolio stood at just 1 year. Whilst these very short duration bonds are unlikely to yield high returns, they will provide significant capital protection for the portfolio and importantly they are highly liquid. In the quarter there were no further changes to the overseas bond portfolio. 45% of the portfolio is invested in overseas bonds, with 17% in Canada, 16% in the UK and 12% in Australia. 32% of the portfolio is invested in US government debt.

Within the equity portfolio the companies we hold are defensive names, which we would expect to perform well during volatile periods. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. Within Europe there are no holdings in the peripheral Eurozone countries where sovereign debt concerns remain. The European portfolio is concentrated in Switzerland and the relatively healthy economies of core Europe and the UK. In Asia, we prefer the Southeast Asian markets over Japan. The potential growth rate in Japan remains low given the poor demographics and low productivity growth. Economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations.

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 230 proposals in 13 company meetings in the quarter. We voted against management on 16 proposals in 9 of these meetings. We also engaged with 53 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.

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You should consider the Product Disclosure Statement (PDS) before deciding whether to acquire or, to continue to hold, units in the fund. Copies of the PDS for the fund dated 15 October 2020 are available from Perpetual Trust Services Limited ABN 48 000 142 049, AFSL 236648 as the issuer of the PDS.

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Ref. 2022-110



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