COOLABAH CAPITAL INVESTMENTS™
THE INTELLECTUAL EDGE: MAKING EVERY BASIS POINT COUNT

Fund: **Smarter Money Higher Income Fund - Assisted Investor Class**

Strategy: **Higher Income/Short-Term Fixed-Interest**

Return (since Oct. 2014): **3.42% pa gross (2.46% pa net)**

Net return volatility (since Oct. 2014): **0.86% pa**

Atchison/Australia Ratings: **Highly Recommended/Superior**

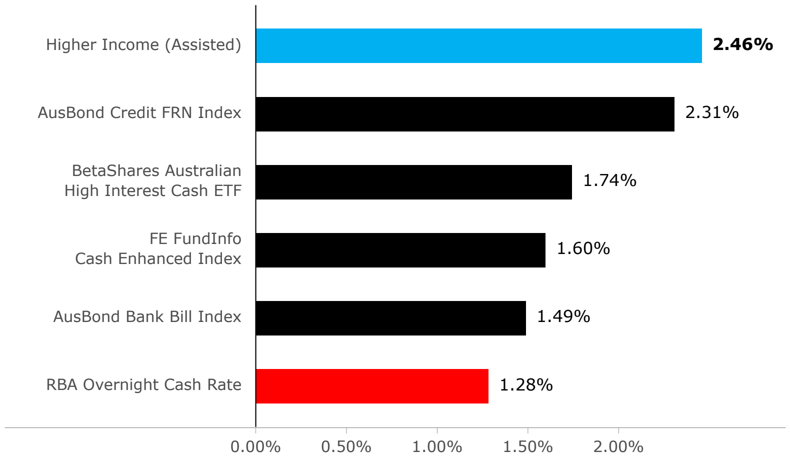
March 2023

Objective: An independently-rated/recommended strategy targeting low-risk cash and fixed-income returns that exceed the RBA's cash rate by 1.5%-3.0% pa after fees, over rolling 12 month periods.

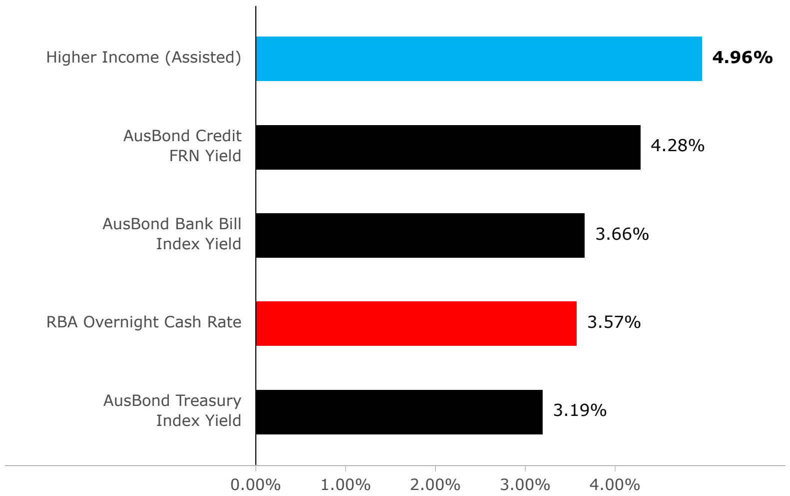
Strategy: We actively invest in a diversified portfolio of Australian deposits, investment grade floating-rate notes and hybrid securities with a weighted-average "A" credit rating. We do not invest in fixed-rate bonds (unless interest rate risk is hedged), direct loans, use leverage, or take currency risk. We add value via active asset-selection using a range of valuation models with the aim of (1) delivering lower portfolio volatility than traditional bond funds and (2) providing superior risk-adjusted returns, or alpha, without explicitly seeking interest rate risk, credit risk or liquidity risk. The strategy is managed by Coolabah Capital Investments, which is a specialist active credit manager.

***Period Ending 2023-04-13**	**Gross Return (Assist.)**	**Net Return (Assist.)†**	**RBA Cash Rate**	**Gross Excess Return‡**	**Net Excess Return (Assist.)†‡**
MTD*	0.33%	0.27%	0.13%	0.20%	0.14%
March 2023	0.09%	0.03%	0.29%	-0.20%	-0.26%
1 month*	0.37%	0.28%	0.30%	0.07%	-0.02%
3 months*	1.49%	1.20%	0.82%	0.68%	0.39%
6 months*	2.43%	1.96%	1.54%	0.89%	0.42%
1 year*	2.53%	1.70%	2.15%	0.38%	-0.45%
3 years pa*	2.96%	2.02%	0.76%	2.20%	1.27%
5 years pa*	2.78%	1.86%	0.93%	1.85%	0.92%
Inception pa to 31-Mar	**3.42%**	**2.46%**	**1.28%**	**2.14%**	**1.18%**

Smarter Money Higher Income Fund Returns (Net) vs Comparisons
Annualized Total Returns Since Inception in October 2014 to March 2023



Annualised Yield to Call/Maturity
31 March 2023



Data Source: RBA, Bloomberg, Mainstream, Coolabah Capital Investments

Data Source: RBA, Bloomberg, Coolabah Capital Investments

† Net returns are calculated from the historic gross returns using the current fee structure as displayed in the Product Disclosure Statement. ‡ The Excess Return columns represent the gross and net return above the RBA cash rate.

Net Monthly Returns > RBA Overnight Cash Rate	76%	Modified Interest Rate Duration	0.10 years
Portfolio Weight to Cash Securities	3.3%	Gearing Permitted?	No
Portfolio Weight to Bonds	97.4%	1 Year Av. Portfolio Weight to Cash	5.2%
Av. Portfolio Credit Rating	A	Portfolio Weight to AT1 Hybrids	0.4%
Portfolio MSCI ESG Rating	A	Cash Securities + RBA Repo-Eligible Debt	44.6%
No. Cash Securities	11	Net Annual Volatility (since incep.)	0.86%
No. Notes and Bonds	92	Net Sharpe Ratio (since incep.)	1.36x
Av. Interest Rate (Gross Running Yield)	4.73%		

Awards: FE Alpha Manager 2019: Christopher Joye; **Ratings:** Lonsec available to advisers; Highly Recommended (Atchison); 'Superior Relatively Simple' (Foresight Analytics)

Signatory of: PRI Principles for Responsible Investment

HIGHLY RECOMMENDED ATCHISON CONSULTANTS

ALPHA MANAGER 2019 Christopher Joye

SUPERIOR RELATIVELY SIMPLE Foresight Analytics

MSCI ESG RATINGS A — CCC B BB BBB A AA AAA — Asset weighted average rating

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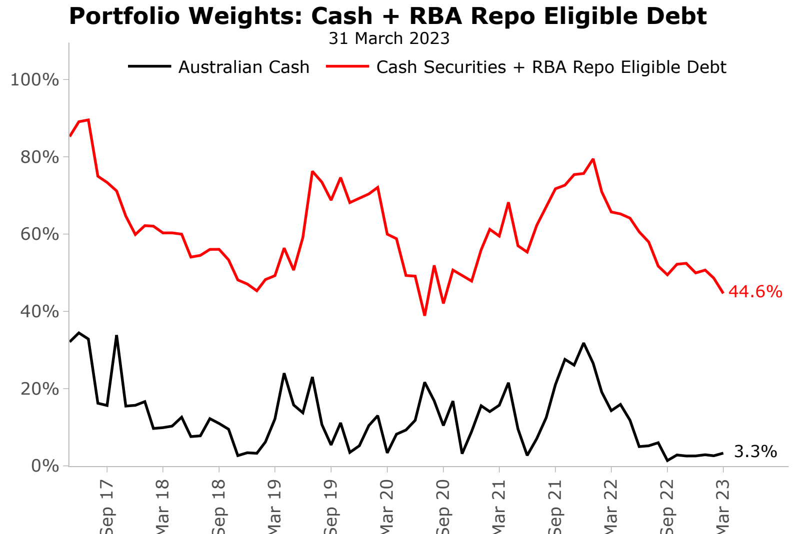
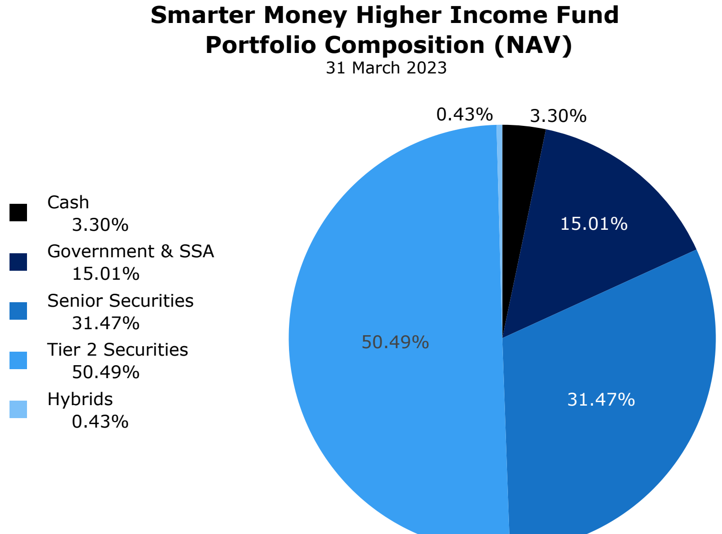
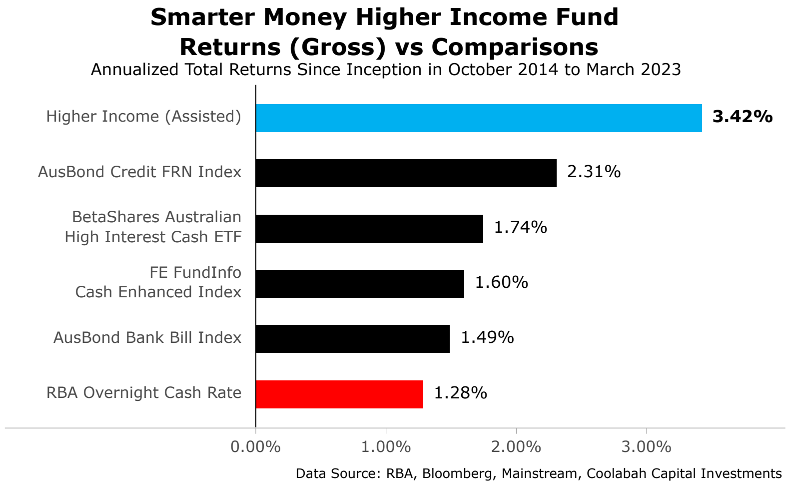




Data Source: Coolabah Capital Investments



Disclaimer: Past performance does not assure future returns. Returns are shown net of all Management and Performance fees unless otherwise stated. All investments carry risks, including that the value of investments may vary, future returns may differ from past returns, and that your capital is not guaranteed. To understand Fund's risks better, please refer to the Product Disclosure Statement available at Coolabah Capital Investments' website.

The since inception gross (net) return of 3.42% pa gross (2.46% pa net) is the total annual return earned by the fund since Oct. 2014, including interest income and movements in the price of the bond portfolio after all fund fees (assuming net returns are calculated from the historic gross returns using the current fee structure as displayed in the Product Disclosure Statement). The net return quoted applies to the Smarter Money Higher Income Fund - Assisted Investor Class, with quarterly distributions reinvested. Each investor's return will vary depending upon their own investment date and any top-ups and withdrawals they make. **The annualised volatility estimate of 0.86% pa** is based on the standard deviation of net daily returns since inception, which are then annualised, attributable to the Smarter Money Higher Income Fund - Assisted Investor Class.

Portfolio Managers	Christopher Joye, Ashley Kabel, Roger Douglas, Dr Nick Campregher (Coolabah Capital Investments)		
APIR Code	SLT0052AU	Fund Inception	30-Sep-14
mFund Code	SMF02	Distributions	Quarterly
Morningstar Ticker	40536	Unit Pricing	Daily (earnings accrue daily)
Asset-Class	Short-Term Fixed-Interest	Min. Investment	$1,000
Target Return	Net 1.5%-3.0% pa over RBA cash rate	Withdrawals	Daily Requests (funds normally in 3 days)
Investment Manager	Coolabah Capital Investments (Retail)	Buy/Sell Spread	0.00%/0.025%
Responsible Entity	Equity Trustees	Mgt. & Admin Fee	0.69% pa
Custodian	APEX Fund Services	Perf. Fee	22.5% of returns over RBA cash + 2.19% pa

Portfolio commentary: The zero-duration daily liquidity Smarter Money Higher Income Fund (SMHI) returned 0.33% gross (0.27% net) month to date as of 13-April. In March, SMHI returned 0.09% gross (0.03% net), compared to the AusBond Bank Bill Index (0.28%), the RBA Overnight Cash Rate (0.29%), and the BetaShares High Interest Cash (AAA) ETF (0.31%). SMHI ended March with an annualised yield to call/maturity of 4.96% pa, a weighted-average credit rating of A, and a portfolio weighted average MSCI ESG rating of A. Over the 3 months to 13-April, SMHI returned 1.49% gross (1.20% net), outperforming the RBA Overnight Cash Rate (0.82%), the AusBond Bank Bill Index (0.82%), and the BetaShares High Interest Cash (AAA) ETF (0.85%).

Since the inception of SMHI 8.5 years ago in October 2014, it has returned 3.42% pa gross (2.46% pa net), outperforming the RBA Overnight Cash Rate (1.28% pa), the AusBond Bank Bill Index (1.49% pa), and the BetaShares High Interest Cash (AAA) ETF (1.74% pa). Since inception, SMHI's Sharpe Ratio, which measures risk-adjusted returns, has been 2.42x gross (1.36x net). While SMHI's return volatility since inception has been low at around 0.86% pa (measured using daily returns), as a daily liquidity product with assets that are marked-to-market using executable prices, volatility does exist. This contrasts with illiquid credit (eg, loans and high yield bonds) wherein assets that have very high risk can appear to have remarkably low volatility, which is, in fact, just a mirage explained by the inability to properly value these assets using executable prices.

Strategy commentary: March madness struck with gusto. The month began as an extension of the robust conditions evidenced since October 2021, with performance across most parts of the capital structure, including senior-ranking bank bonds, Tier 2 bonds, and State government debt. But markets took a sudden turn on Friday, 10 March 2023 with the collapse of Silicon Valley Bank (SIVB) - an institution few, if any, participants had ever heard of.

The sense of subsequent contagion across US regional banks and through to Credit Suisse pushed global credit spreads wider through March, although this price action has since started to reverse as the hysteria has been replaced with the cold hard reality that credit risks relating to big global banks are now actually much lower than they were in the past. And the actions of many governments to explicitly guarantee their banks following the questions posed during March has only served to further reduce latent creditor concerns, as we explain in much more detail below.

In bond markets, we saw 5-year major bank senior bond spreads compress from 96bps (0.96%) over the quarterly bank bill swap rate (BBSW), which is currently sitting at about 3.65% (so a total running yield of 4.61%) to 88bps on 9 March only to jump to 101bps on 20 March and then compress down to 95bps at the time of writing.

One step down the capital stack, 5-year major bank Tier 2 bond spreads compressed from 220bps over BBSW (5.85% running yield) down to 207 bps on 7 March following which they jumped to 230bps and have since corrected back to 224bps currently (5.9% running yield).

While Credit Suisse hybrid holders were wiped-out in March (and some Aussie investors remarkably thought these were sensible assets to own!), Aussie bank and insurer hybrids were characteristically very resilient, because (1) they are issued by the strongest and most liquid banks in the world and (2) they cannot be simply written-off—as unusually occurred with the Credit Suisse securities —and must be converted into equity in a scenario where a bank is blowing-up, thereby diluting-down shareholders. We go into much more detail about this below.

In March, 5-year major bank hybrid spreads climbed from 252bps above BBSW (6.17% running yield) to a peak of 316bps above BBSW and have since started mean-reverting back to 290bps (6.55% running yield).

Coolabah is the underlying investment manager for BetaShares' active hybrids ETF (ASX: HBRD), which in March materially outperformed the Solactive Major Bank Hybrids Index. This outperformance was driven by HBRD de-risking its exposure to ASX hybrids from 99% in 2022 to circa 74% in 2023 and increasing its holdings of bank-issued senior and Tier 2 bonds.

Since its inception in 2017, HBRD has outperformed the Solactive Major Bank Hybrid Index after all fees despite only being about 89% invested in hybrids, on average, with the additional benefit of lower return volatility.

Strategy commentary cont'd: In the State government bond market 10-year spreads also shifted wider in March from 68bps above 10-year Commonwealth bonds to a maximum of 81bps during the month, but have since gapped back down to 69bps. The driver was wider swap spreads, which are now normalising.

Digital Deposit Runs

While we provided a very detailed real-time dissection of SIVB's collapse over at Livewire on the weekend that it was placed into administration, one key insight was the advent of historically unprecedented, high-velocity digital deposit runs.

In the global financial crisis, digital banking had yet to be fully implemented. When the UK bank Northern Rock collapsed, depositors queued up for days outside branches. In contrast, SIVB lost US$42 billion of deposits on a single day, which shocked both bankers and regulators. Credit Suisse suffered a similar fate. Crucially for bond markets, the response of governments and regulators was fast and furious, reinforcing the too-big-to-fail nature of the largest institutions.

A combination of the US Federal Reserve, Treasury and FDIC moved swiftly to guarantee all SIVB deposits, including, importantly, those wholesale investors that were above the US deposit guarantee cap of US$250,000. The US president and Fed chair subsequently declared that all US deposits were safe.

The advent of broader and seemingly unconditional government guarantees of bank deposits is of profound significance for investors in bank bonds. The main way a bank goes bust is via a deposit run. Widespread government guarantees of deposits were introduced during the 2008 GFC, generally in an unlimited fashion (in Australia, the guarantee was up to $1m beyond which you could pay the government a premium to guarantee 100% of any deposit).

After the GFC, deposit guarantees were pared back—in Australia's case, to $250,000. But the experience of SIVB and then Credit Suisse is a game-changer for bank credit risk.

Neither bank had large loan losses or credit risks that were of fundamental concern for depositors. SIVB's problems were reminiscent of many US regional banks. As we explained on the weekend of SIVB's collapse, around 25 US regional banks have died, on average, each year since 2001. Since 2012, that number has been about 7 US bank deaths a year.

Business Model Flaws

US regional banks tend to be highly geographic focussed, which makes them vulnerable to local economic shocks. SIVB was both geographically focussed on Silicon Valley and also had a huge industry concentration risk with its dependency on tech.

As the Fed's savage and unprecedented interest rate increases crushed the tech sector, SIVB lost some US$30bn of deposits between January 2022 and March 2023 as VC funds failed to raise new capital and start-ups burnt through cash.

At the same time, SIVB's management severely exacerbated these business model risks by not hedging any interest rate risks on its balance-sheet, which is normally a core focus for banks that borrow short-term money via deposits and lend that capital out via long-term loans. (Interestingly, Australia is the only jurisdiction in the world that makes holding capital against interest rate risk a Pillar 1 requirement.)

Ironically, SIVB did not do much lending: only 43% of its deposits were used to fund loans. The remaining money was invested in superficially safe long-term bonds. But SIVB clearly wanted to run a big carry trade: it wanted to pay depositors a very low short-term interest rate and then earn a much higher yield on its long-term bonds.

If it had hedged out the interest rate risk on these bonds back to a short-term, floating-rate risk profile, as all large banks do, it would have destroyed the economics of this carry trade. And so, it did not. This mean that its circa US$117 billion in bond holdings were exposed to huge valuation risks if the Fed ever raised interest rates, which of course it did in a never-before-seen way in 2022.

Strategy commentary cont'd: Analysts estimated that the losses on SIVB's bond holdings would have completely wiped out its shareholder equity base. Again, big banks normally have to report any bond losses due to interest rate and/or credit spread changes through either their P&L or their reported capital ratios.

SIVB successfully lobbied the Trump administration to have itself exempted from the liquidity and capital rules that large global banks have to comply with. SIVB's bond losses were, therefore, hidden until SIVB had to sell US$21bn of bonds to pay for deposit outflows, and then reported losses of US$1.8bn that necessitated a $2.25bn fresh equity capital raising. When depositors discovered these losses, they wanted to run for the hills, understandably.

Government Guarantees

But there were no big credit losses, or loan defaults, on SIVB's balance-sheet, which are the normal vector for bank blow-ups. It was really all about structural flaws in its business model that meant it deserved to die. And these flaws were highlighted by the emergence of digital banking enabling enormously rapid deposit runs.

Of course, once you slap a government guarantee on a bank's deposits, there will never be a run—because depositors face zero risks. This in turn means it is very hard for a bank to default on its bonds: deposit guarantees very materially reduce credit risks on bank bonds.

The key regulatory reaction to the US regional bank dramas and Credit Suisse has been greater government guarantees of all banks, which will mean even tougher regulations on liquidity, funding, and capital. This is, once again, positive for depositors and bond holders, but negative for bank shareholders. It means lower bank credit risks, but also lower returns on equity. So it is a net transfer of wealth from equity to debt. As creditors, we welcome it.

SIVB demonstrated that even the failure of a small bank can metastasise into a systematic crisis for all banks, if only because it demonstrated the fickle and flighty nature of digital deposits. This was reinforced via Credit Suisse, a poorly performing investment bank that we had been negative on since early 2021, when we repeatedly advised clients to exit their private banking exposures to the Swiss bank. We had an internal credit research ban on long exposures to Credit Suisse in 2021, and we were actively short-selling Credit Suisse's senior bonds in 2022 on the basis we thought its credit spreads needed to widen materially.

Reaching for Risk

We have generally never been willing to invest down the capital structure of riskier investment banks and foreign banks, precisely because:

1. these securities tend to be quite illiquid,

2. it is very hard to unravel all the latent tail risks embedded in investment banking business models, and

3. foreign regulators can be very difficult to predict.

We have seen these hazards come to the fore with repeated write-downs of hybrids/bonds in jurisdictions such as Austria, Denmark, Spain, Holland, Cyprus, Portugal and now Switzerland.

In the past, some have criticised us for not chasing easy returns via "illiquidity risk premia". They have encouraged us to allocate capital to private debt, warehouse loans, illiquid corporate bonds, subordinated ABS and RMBS, and higher yielding securities, like Virgin's senior bonds, and European bank hybrids.

But this is not compatible with our philosophy of building portfolios comprised of bonds issued by government-guaranteed businesses and government agencies with negligible-to-no default risk and extremely high liquidity in all market conditions.

Any monkey can chase risk to get higher returns: it is much harder to actively generate strong returns from very low risk assets.

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Strategy commentary cont'd: Hedge Fund Attacks

Credit Suisse's sale to UBS was triggered by a speculative hedge fund attack—aside from being a sub-par investment bank, there was nothing fundamentally wrong with the business. After SIVB's failure, we predicted that Credit Suisse would be the next target pursued by speculative short-sellers, followed thereafter by Deutsche Bank.

The hedge funds started by seeded sensationalist media stories about Credit Suisse's pending demise. With only modest amounts of money deployed, they were then able to push Credit Suisse's credit default swaps and bond spreads materially wider. This signalled that there was something awry. At about the same time, the bank's equity was hammered, the trigger for which was an old, recycled story about the Saudi National Bank not being able to increase its exposure to Credit Suisse beyond 9.9%. There was no news in this story, but it still managed to smash Credit Suisse's stock down some 20-30% on the day it was reported.

Had the Swiss authorities made it clear that all Credit Suisse deposits were government guaranteed, there would never have been a deposit run. The Swiss would not have needed to give UBS and Credit Suisse CHF150 billion of cheap loans nor furnish UBS with an indemnity for at least CHF9 billion of potential future losses. Credit Suisse shareholders would not have lost 90% of their money, and the Swiss would not have had to forever tarnish their regulatory reputation by zeroing hybrid holders ahead of equity. (Credit Suisse's depositors and senior and Tier 2 bondholders did not suffer losses.)

Consider the counter-factual, which was Deutsche Bank. After its equity started to get hammered, the German Chancellor came out and signalled that Germany would protect its national champion. Concurrently, European regulators announced they would be investigating questionable price action in Credit Suisse and Deutsche Bank securities for market-manipulation.

Short-sellers knew that Europe had already banned naked shorts on their government bonds. They could easily do exactly the same thing on bank securities, as they had done during the 2008 crisis. So, the hedgies ran for the hills; Deutsche's stock soared; hyperbolic media were scorned; and the notion that speculators could precipitate high-velocity deposit runs was buried by explicit government guarantees.

Pricing Guarantees

There are two issues with guarantees. The first is they should be priced. In many countries, banks pay a premium for public deposit insurance. In Australia, we have the so-called big bank tax, which is an 0.06% annual price larger banks pay the Commonwealth for the implicit guarantee of their bonds and wholesale deposits (above the capped $250,000 guarantee). This column has always argued that banks should pay for the explicit deposit guarantee and that logic remains robust (the implicit guarantee is already priced).

A second concern is moral hazard. Yet the practical reality is that bank executives are so aggressively regulated nowadays, it is all but impossible for them to behave in a systematically reckless fashion.

In a Q&A session following a speech, the RBA's governor Phil Lowe recently touched on many of these points, including the importance of ensuring that shareholders wear losses before creditors situated higher up the capital stack. And he noted that Australia was recognised as a global leader in terms of the unquestionably strong capital banks are forced to hold, the exceptional liquidity they need to maintain as a buffer against deposit runs, and the way they are required to actively hedge-out interest rate risks.

Activist Reforms

Strategy commentary cont'd: For a decade we claimed—in the face of much opposition—that the big banks should be forced to massively de-lever their balance-sheets. The 2014 financial system inquiry agreed, and the major banks were compelled to raise $150 billion of fresh equity capital. For years we asserted that banks should only hold government bonds as a regulatory liquidity buffer, calling for the closure of the Committed Liquidity Facility, which was full of riskier and less liquid assets that overseas banks are still allowed to hold. The APRA finally wound the CLF down in 2022 in the face of resistance from bankers hoping to pick-up more yield in illiquid assets issued by them and their peers, such as internal loans, senior-ranking bank bonds, and RMBS.

In 2021 and 2022, ANZ, CBA and UBS' analysts argued that Aussie banks should be permitted to run lower Liquidity Coverage Ratios of 120 or 125% as a result of the CLF being closed and the fact our banks were above the 100% regulatory minimum. We brought this to APRA's attention and countered that it would be irresponsible to allow local banks to drop their LCRs to levels that would have been below European standards. To its immense credit, ARPA hammered this same point home, reminding banks that investors expected them to report LCRs over 130%.

More recently, banks have lobbied APRA to allow them to include relatively illiquid covered bank bonds and RMBS as a liquidity buffer instead of holding government bonds. Last year we engaged with APRA to explain why this was a terrible idea, and the regulator has since made it clear it concurred.

Finally, in 2017 we warned APRA that it should not allow banks or insurers to issue hybrids that are written-off in a crisis ahead of equity given that this inverts the capital structure hierarchy and provides controlling shareholders with a conflicted incentive to manipulate this outcome to protect themselves, which is exactly what happened with Credit Suisse. Almost all Aussie bank hybrids automatically convert into equity in these scenarios, and cannot, therefore, suffer the fate of Credit Suisse's securities. But APRA did approve one bond from Genworth and a hybrid issued by ME Bank that could have been automatically written-off ahead of equity simply because shareholders in these businesses wanted to design these securities to minimise their own losses. The Swiss debacle has demonstrated just how dangerous this can be.

The bottom line is that "market discipline" via activist creditors is an important form of shadow regulation that can support government agencies. It is, of course, much easier to blindly reach for risk in the search for yield. Some Aussie investors have been badly burned by buying Credit Suisse hybrids in the name of capturing higher illiquidity premiums. We saw a similar theme play-out during the pandemic with Virgin's popular senior bonds, which were wiped-out when Virgin went under. History has a habit of rhyming if you do not study it.

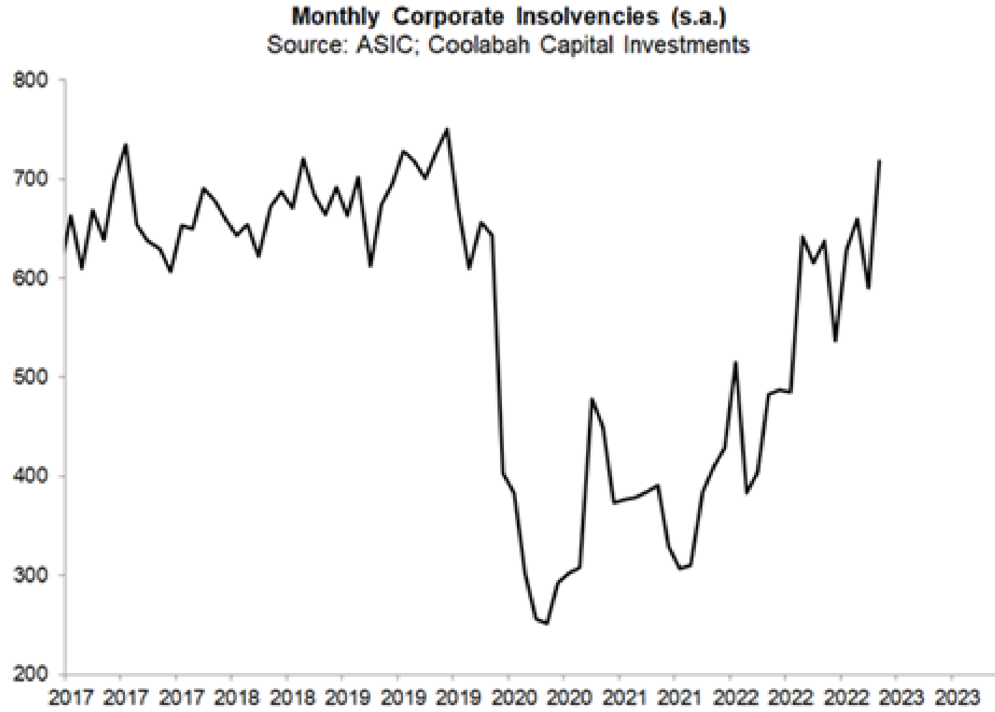
Emerging Default Cycle

Many assumed the search for yield came with no risk in a low-rate world. But we are now watching the downside risk materialise. Global corporate defaults are running at their highest level since 2009. US corporate insolvencies are the loftiest they've been since 2010. In Australia, the RBA reports that 15% of all borrowers could have negative cash-flows while 16% may not be able to refinance existing loans. S&P comment that 2023 is shaping up as the worst default cycle since the GFC:

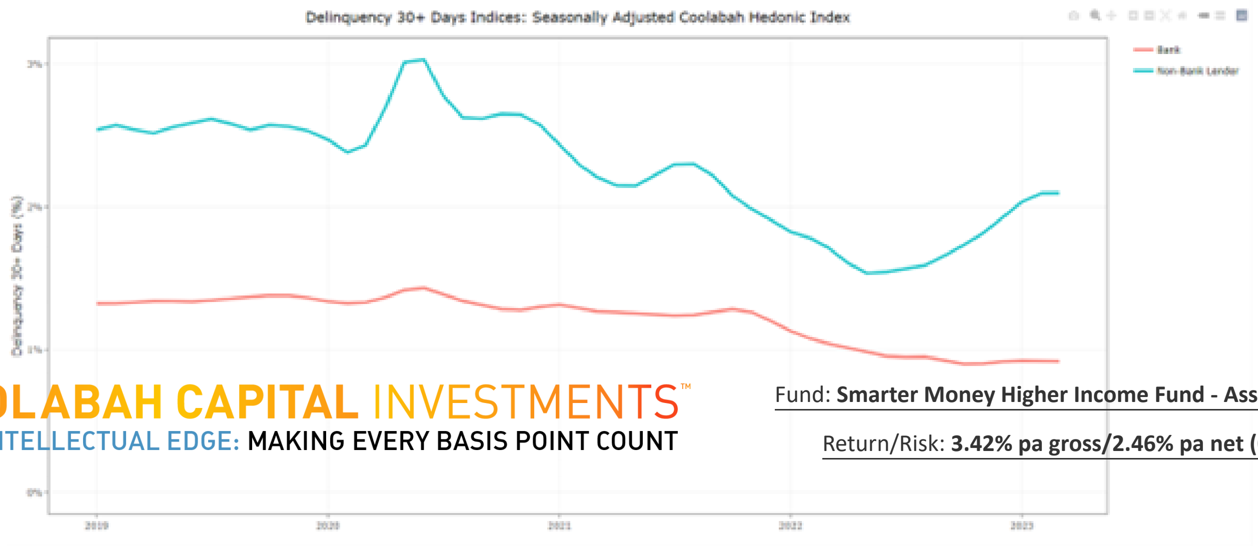
> *This year's global corporate default tally rose to 23 as of Feb. 28 - the highest year-to-date tally since 2009 - with 15 defaults in February alone, marking the highest monthly total since November 2020. Nearly three-quarters of February defaults came from U.S.-based issuers, and U.S. corporate defaults this year are already over 2.5x higher than the year-to-date 2022 total. U.S.-based media and entertainment issuers led February defaults, but the retail sector leads defaults year to date with seven (over 30% of the global tally). - We forecast the U.S. and European trailing-12-month speculative-grade corporate default rates could rise to 4% and 3.25%, respectively, by December 2023.*

Every day we are reading about builders, developers, breweries and other businesses going bust. This gels with the data. We seasonally-adjust ASIC's corporate insolvency data, which climbed to more than 700 insolvencies in February alone relative to the pandemic lows around 200 per month. The concern would be if this trend continued.

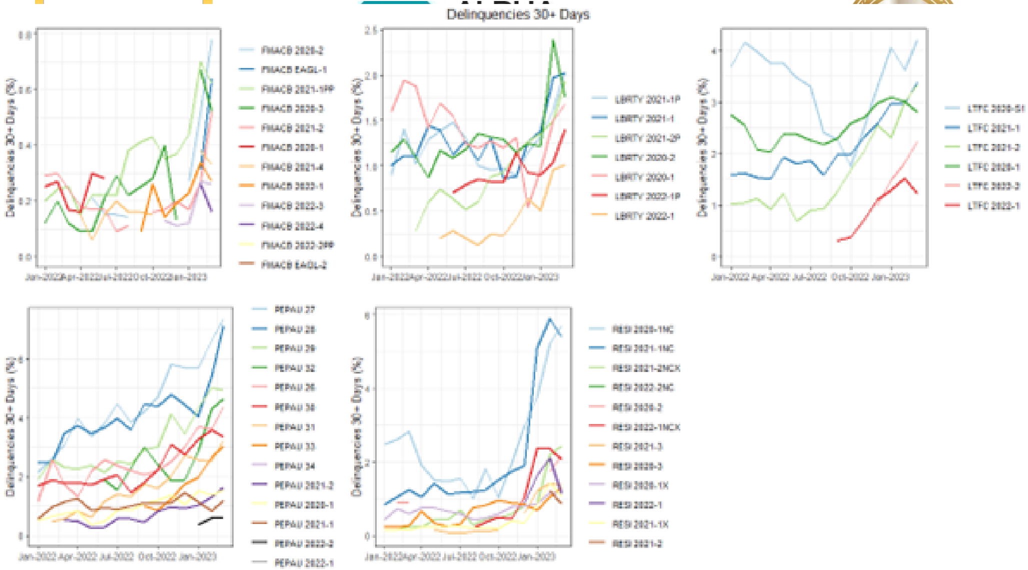
Strategy commentary cont'd:



While the arrears reported by banks remain historically very low, and have yet to materially tick-up, non-bank arrears rates are starting to soar. This is borne-out in the arrears statistics reported on RMBS deals, which for the sub-prime or non-conforming—lenders have begun to spike. Since 2008 regulators have prevented banks from lending to higher-risk borrowers, who have been forced to seek liquidity from unregulated non-bank lenders. The worry is that none of these non-banks existed the last time Australia had a real default cycle, which was during the 1991 recession. The first chart below shows 30 plus days arrears on non-bank (blue line) and bank (red line) issued RMBS. You can see that non-banks generally have much higher arrears, and those are trending higher. In the second chart we plot arrears rates on specific non-bank RMBS deals issued by FirstMac, Liberty, LaTrobe, Pepper, and Resimac. It tells a pretty ugly story, which is only likely to get worse.



Strategy commentary cont'd:



More Detail on the Unusual Credit Suisse Hybrids

The Credit Suisse hybrids, which were rated junk or “B” by S&P, were radically different to Aussie bank/insurer hybrids in many respects (major bank hybrids are rated an investment-grade “BBB-“). First, they did not convert into equity, or bank shares, in a “non-viability” (blow-up) event, as Aussie hybrids automatically do. Instead, they had to be written off.

Second, the Credit Suisse write-down had to be 100%: the securities did not allow for a partial write-down. In the case of Aussie hybrids, they are only converted into stock, diluting shareholders to the extent the bank needs additional equity.

Third, most Credit Suisse hybrids had to be wiped out at an equity capital ratio trigger of 7%, which is much higher than the 5.125% equity threshold at which Aussie hybrids convert into shares. The current average major bank equity ratio is about 12%. In the case of CBA, it would have to suffer unprecedented losses of $31.5 billion (and not raise compensating equity in the process), for its equity ratio to fall to 5.125%.

If UBS was government-guaranteed before the Credit Suisse saga, it has rolled-gold public backing today.

In its regular stress-testing, the Australian Prudential Regulation Authority runs a scenario where Aussie house prices fall 30%, commercial property values decline by 40%, the jobless rate jumps from 3.5% to more than 13%, and GDP contracts by 15%. In this extraordinarily severe recession, Australian banks' equity ratios decline to 6.6%, notably above the 5.125% threshold at which hybrids convert into shares.

A final important difference is the sacrosanct capital structure "hierarchy", the protection of which is an essential feature of the global Basel 3 banking regulations, the framework of the Australian Prudential Regulation Authority (APRA), the Corporations Act and Australian common law, and is embedded explicitly into Aussie hybrid prospectuses.

In short, this means shareholders need to bear losses first. The Swiss bizarrely inverted the capital structure hierarchy: Credit Suisse shareholders recovered modest value and hybrid investors lost everything.

This has led to widespread condemnation from global regulators, including the European Union, the Bank of England and others, which have confirmed that in their jurisdictions shareholders would lose 100% of their investments before higher-ranking creditors suffered losses.

APRA's regulations state that bank shares must be "the most subordinated claim in liquidation of the issuer" and "take the first and proportionately greatest share of any losses as they occur". They further declare that after equity suffers losses, hybrids must be converted into equity before any Tier 2 bonds are at risk.

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Return/Risk: **3.42% pa gross/2.46% pa net (0.86% pa volatility)**

Strategy commentary cont'd: Aussie hybrid prospectuses expressly state that they cannot be converted into shares until equity first bears losses. And the issuers pre-arrange all approvals for equity conversion before a hybrid is launched to ensure the process cannot be perturbed.

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Return/Risk: **3.42% pa gross/2.46% pa net (0.86% pa volatility)**

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