



January 2023

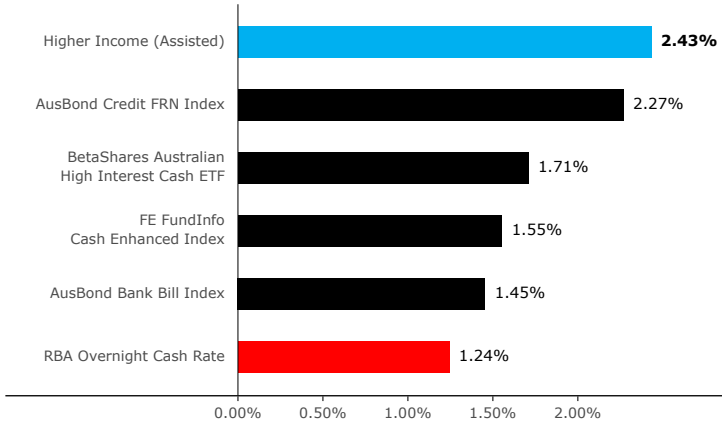
**Objective:** An independently-rated/recommended strategy targeting low-risk cash and fixed-income returns that exceed the RBA's cash rate by 1.5%-3.0% pa after fees, over rolling 12 month periods.

**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 2023-01-31	Gross Return (Assist.)	Net Return (Assist.) <sup>†</sup>	RBA Cash Rate	Gross Excess Return <sup>‡</sup>	Net Excess Return (Assist.) <sup>†‡</sup>
1 month	0.54%	0.46%	0.27%	0.27%	0.20%
3 months	2.01%	1.82%	0.74%	1.27%	1.08%
6 months	2.22%	1.84%	1.29%	0.92%	0.55%
1 year	1.55%	0.84%	1.49%	0.07%	-0.65%
2 years pa	1.05%	0.33%	0.76%	0.29%	-0.42%
3 years pa	2.06%	1.17%	0.57%	1.50%	0.61%
4 years pa	2.60%	1.67%	0.70%	1.90%	0.97%
5 years pa	2.58%	1.68%	0.86%	1.72%	0.82%
<b>Inception pa Oct. 2014</b>	<b>3.39%</b>	<b>2.43%</b>	<b>1.24%</b>	<b>2.15%</b>	<b>1.19%</b>

**Smarter Money Higher Income Fund Returns (Net) vs Comparisons**

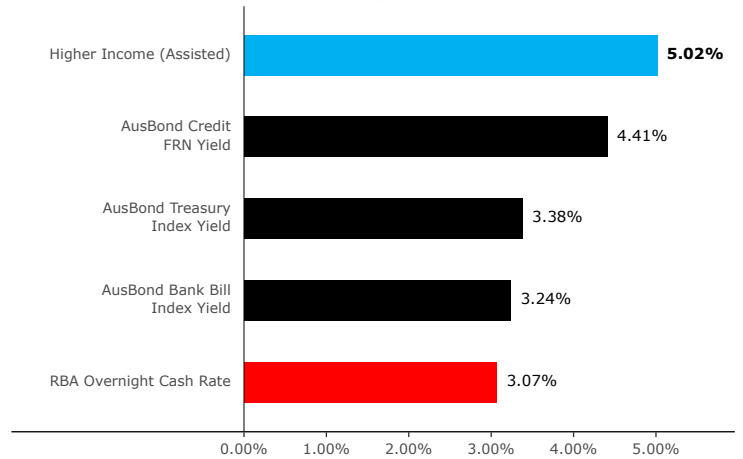
Annualised Total Returns Since Inception in October 2014 to January 2023



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

**Annualised Yield to Call/Maturity**

31 January 2023



Data Source: RBA, Bloomberg, Coolabah Capital Investments

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

**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.

Net Monthly Returns > RBA Overnight Cash Rate	77%	Modified Interest Rate Duration	< 0.1 years
Portfolio Weight to Cash Securities	2.9%	Gearing Permitted?	No
Portfolio Weight to Bonds	96.8%	1 Year Av. Portfolio Weight to Cash	7.5%
Av. Portfolio Credit Rating	A+	Portfolio Weight to AT1 Hybrids	1.0%
Portfolio MSCI ESG Rating	A	Cash Securities + RBA Repo-Eligible Debt	50.7%
No. Cash Securities	11	Net Annual Volatility (since incep.)	0.86%
No. Notes and Bonds	89	Net Sharpe Ratio (since incep.)	1.39x
Av. Interest Rate (Gross Running Yield)	4.17%		

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

Signatory of:



Principles for Responsible Investment

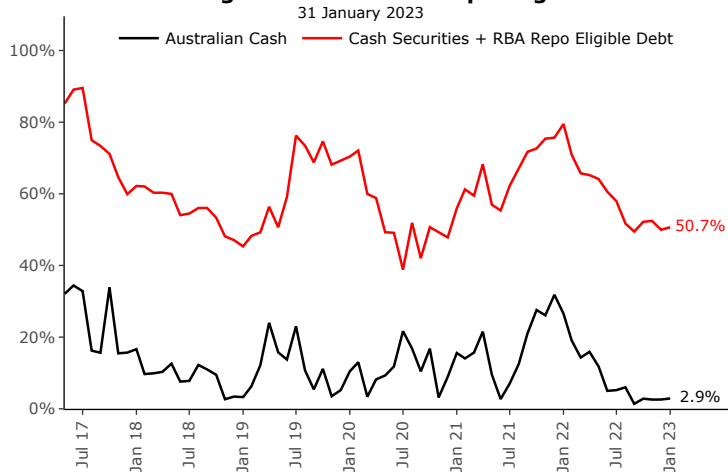


**ALPHA MANAGER 2019**  
Christopher Joye

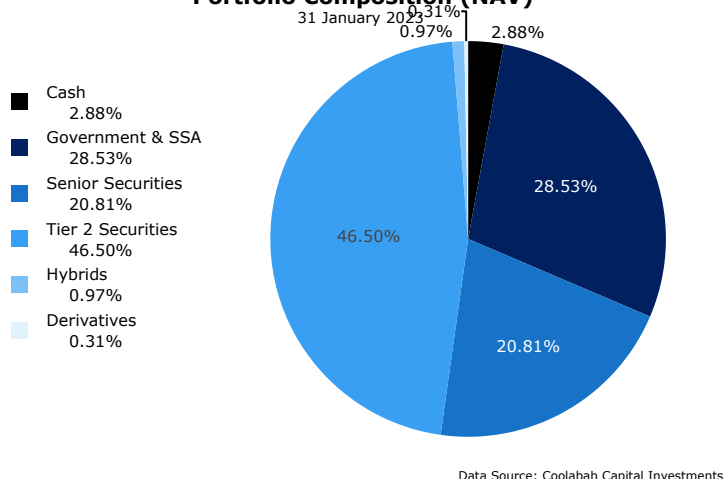


Asset weighted average rating

**Portfolio Weights: Cash + RBA Repo Eligible Debt**

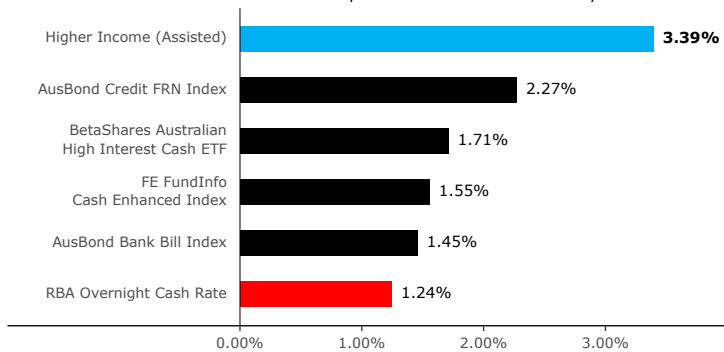


**Smarter Money Higher Income Fund Portfolio Composition (NAV)**



**Smarter Money Higher Income Fund Returns (Gross) vs Comparisons**

Annualized Total Returns Since Inception in October 2014 to January 2023



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The since inception gross (net) return of 3.39% pa gross (2.43% 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 and daily liquidity Smarter Money Higher Income Fund (SMHI) ended January with a yield to call/maturity of 5.02%, a weighted-average credit rating of A+, and a portfolio weighted average MSCI ESG rating of A. In January, SMHI returned 0.54% gross (0.46% net), outperforming the RBA Overnight Cash Rate (0.27%), the AusBond Bank Bill Index (0.27%), the BetaShares High Interest Cash (AAA) ETF (0.28%), the FE Cash Enhanced Index (0.37%), and the AusBond Credit FRN Index (0.42%). Over the previous 3 months, SMHI returned 2.01% gross (1.82% net), outperforming the RBA Overnight Cash Rate (0.74%), the AusBond Bank Bill Index (0.77%), the BetaShares High Interest Cash (AAA) ETF (0.78%), the FE Cash Enhanced Index (1.06%), and the AusBond Credit FRN Index (1.19%).

Since the inception of SMHI 8.3 years ago in October 2014, it has returned 3.39% pa gross (2.43% pa net), outperforming the RBA Overnight Cash Rate (1.24% pa), the AusBond Bank Bill Index (1.45% pa), the FE Cash Enhanced Index (1.55% pa), the BetaShares High Interest Cash (AAA) ETF (1.71% pa), and the AusBond Credit FRN Index (2.27% pa). Since inception, SMHI's Sharpe Ratio, which measures risk-adjusted returns, has been 2.45x gross (1.39x 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:** With the apparent end of the central bank hiking cycles in sight for some, January was another very constructive month for performance with a positive correlation between long-duration fixed-rate bonds and equities once again reasserting itself.

All of Coolabah's absolute return strategies delivered another month of robust performance, which has been particularly striking over the last seven months, care of attractive new primary market bond issues, mean reversion in asset prices, and historically high underlying portfolio yields. The minority of Coolabah's benchmark-aware portfolios also comfortably beat their indices.

In January, both equities and fixed-rate (or long duration) bonds rallied firmly. The S&P500 and the ASX All Ordinaries Indices both jumped by a little more than 6% while the higher-octane Nasdaq Composite Index bounced 10.7%.

This was powered by an accumulation of evidence that core inflation rates have peaked globally and are now rolling over in concert with weaker economic activity data, which pushed long-term government bond yields (aka discount rates) down sharply. The US 10-year government bond yield slumped 36bps in January from 3.87% to 3.51%. The move was even larger in Australia where the 10-year Commonwealth government bond yield plunged 50bps from 4.05% to 3.55%.

This significant downward re-rating of long-term interest rates boosted the value of fixed-rate bonds. The local fixed- (as opposed to floating-) rate benchmark, the AusBond Composite Bond Index, delivered a very strong 2.76% in January while Coolabah's Active Composite Bond Strategy outperformed, returning 3.13%.

The Australian floating-rate note proxy, the AusBond FRN Index, which carries no interest rate duration risk (since all bonds are variable-rate), continued its recent winning streak, returning 0.39% in January care of a healthy underlying yield, which was 4.42% (and up from only 0.5% in 2021).

Coolabah's RBA cash +1% strategy, called the Smarter Money Fund, returned 0.55% gross (0.50% net) in January. Coolabah's RBA cash + 1.5% strategy, called the Smarter Money Higher Income Fund, returned 0.54% gross (or 0.46% net). Both these strategies have zero interest rate duration, carry an average A+ credit rating, and have demonstrated daily liquidity since inception.

Higher-up the risk spectrum, Coolabah's new Floating-Rate High Yield Fund, which has zero duration and an average A- rating, delivered a higher 0.92% gross in January (or 0.96% net). Finally, Coolabah's Long Short Credit Fund, which likewise carries no duration and has an average AA- rating, returned 1.03% in January gross (0.97% net).

**Strategy commentary cont'd:** This performance accrued in the absence of substantial credit spread compression in fixed-income markets. There was a torrent of new bond supply globally in January, which Coolabah participated in aggressively given some handsome new issue concessions. But spreads were largely unchanged over the month.

At the top of the capital stack, Coolabah's proprietary index of 5-year major bank spreads moved only 1 basis point tighter from 102bps to 101bps over BBSW in January. One step down the capital structure, our index of 5-year major bank Tier 2 bond spreads was unchanged at 234bps. And in the comparatively rich AT1 hybrid market, we observed spreads drifting wider from 229bps to 237bps for 5-year major bank securities.

A similar story asserted in the State government bond (semis) market, where our index of 10-year NSW spreads was mostly unchanged in January at an historically very elevated 75bps over Commonwealth bonds despite extraordinarily strong buying of semis from bank balance-sheets desperate to Hoover up high-yielding assets of that quality for their substantial regulatory liquidity needs. This enormous demand was, however, partly sated by strong issuance (supply) from TCV, which represents Victorian taxpayers.

### Attractive New Issues

Coolabah was a very active participant in the global new bond issue market, which carried some attractive concessions.

Early in the month CBA hit the AUD market and issued 3-year and 5-year AA- rated bonds at 90bps and 115bps over BBSW. The fixed-rate versions of these bonds priced at interest rates of 4.76% and 5.05%. Both have since moved tighter by about 10bps.

NAB and Macquarie Bank issued 10-year, BBB+ rated Tier 2 subordinated bonds in the US dollar market on fixed interest rates of 6.43% and 6.80%. Again, both performed robustly (about 35bps tighter).

Staying in the US, CBA and NAB issued 2-year, 3-year, and 5-year senior bonds carrying AA- ratings, yielding around 5%. All have since performed.

In Euros, ANZ issued a \$1bn BBB+ rated Tier 2 bond, which swapped back into Aussie dollars at a rate of 6.35% (275bps over BBSW), and is currently 20bps tighter. In this market, Westpac also issued 3-year and 7-year senior bonds, which that are now 5-10bps tighter.

Back in the AUD market, Rabobank issued an A+ rated 5-year bond at a spread of 118bps above BBSW, or on a fixed rate of 4.75%, and this is now trading on a materially lower spread.

Finally, Bendigo and Bank of Queensland issued 4-year, BBB+ rated senior bonds in Aussie dollars at 135bps over BBSW, or on a fixed rate around 5% pa. They are now trading about 10bps tighter.

We are forecasting substantial ongoing bond supply globally. In Europe, banks are reducing their reliance on the ECB's lending facilities, and leaning more heavily on debt markets. Banks also have to meet loss-absorbing capacity targets that will necessitate further supply.

In Australia, banks have to repay the \$188bn they borrowed from the RBA, starting in March this year. On Coolabah's estimates, the majors have to issue a further circa \$19bn a year in Tier 2 bonds to meet APRA's loss absorbing capacity targets, which is a similar run-rate to what they have raised in recent years. At the margin, slower balance-sheet growth as a result of higher interest rates may mitigate the size of this task.

But the bottom line is that there will be no shortage of high-yielding and highly-rated debt issuance for investors to feast on.

### Strategy commentary cont'd: AT1 Hybrid/Tier 2 Bond Puzzle

One question that has puzzled market participants since last year is whether banks would repay their AT1 hybrids and Tier 2 bonds on the first available call date. This concern was triggered by a letter APRA sent banks on 1 November, highlighting the specific hurdles they need to surmount in order to satisfy the requirements of Prudential Standard APS 111 (and secure APRA's approval to repay these securities on the first call date).

In late January, Westpac announced that APRA had indeed approved its repayment of a \$250m Tier 2 bond on the first available call date that was a test-case for the application APRA's regulatory standards in this context. This had been Coolabah's presumption.

APRA's 1 November letter sent Aussie bank/insurer credit spreads soaring, as much as 50-80 basis points wider on some measures. Aussie bank Tier 2 quickly became some of the highest spread bonds globally compared to similar securities. We were happy to pick-up these assets prior to APRA's letter, and even more eager in the period thereafter.

Spreads on Tier 2 have been very wide compared to long-term historical averages, and also relative to riskier securities from the same issuer lower down the capital structure (see charts below). In fact, Coolabah was the first manager to highlight the historically unprecedented development whereby the spreads on BBB+ rated, 5-year major bank Tier 2 bonds were actually trading wider/higher than the spreads on riskier and BBB- rated, 5-year major bank hybrids. Typically, AT1 hybrids have paid about 1.8x to 1.9x the spread on maturity-matched Tier 2 bonds from the same issuer (see chart below).

Global investors fretted that APRA would prevent Aussie banks/insurers repaying their AT1 hybrids/Tier 2 bonds on the first available call date if (and only if) the original issue margins (or spreads above BBSW at the time of issue) were very tight (cheap for the issuer) compared to current spreads on the replacement AT1 hybrid/Tier 2 securities.

Coolabah's analysis of this subject was broadly as follows:

- In late 2022, two forthcoming Tier 2 maturities from AMP and Challenger had precipitated the contentious APRA letter, the likes of which had not been seen from any other regulator globally (ie, regulators have not attempted to interfere with call dates on regulatory capital securities during normal market conditions)
- In seeking to repay these bonds, AMP and Challenger had not met APRA's APS 111 very granular requirements. Specifically, APS 111 demands that institutions submit a detailed "economic and prudential case" if they are seeking to repay AT1 hybrids/Tier 2 bonds that were issued on credit spreads that are tighter (ie, cheaper for the issuer) than the spreads of the replacement securities that would be used to refinance them
- AMP and Challenger had issued new Tier 2 bonds in late 2022 on spreads of 465bps and 355bps above BBSW, markedly higher than the Tier 2 bonds they were wanting to repay, which had been issued at 180bps and 210bps above BBSW respectively
- AMP and Challenger are not regular issuers of Tier 2, and appeared not to be intimately familiar with APRA's focus on adhering to APS 111's strict terms and conditions
- As much more regular issuers of Tier 2, the major banks do ordinarily make detailed economic and prudential submissions to APRA when seeking approval to repay their regulatory capital securities. The major banks appeared shocked that AMP and Challenger had not followed the same due process
- Coolabah arrived at the conclusion that APRA would approve the repayment of the AMP and Challenger Tier 2 bonds in late 2022 only once these institutions properly revised their call submissions to the regulator to fully meet APS 111's needs, which they had not previously done
- Following the required adjustments from the issuers, APRA did ultimately approve both call notices, and both bonds were, therefore, repaid on their first available call date

**Strategy commentary cont'd:**

- Westpac had an upcoming maturity in early February 2023. This security was a particular focus for global investors because it was issued on a tight credit spread of just 140bps above BBSW. It was also a very small Tier 2 line of only \$250m held by exclusively institutional investors
- In recent months, many large global banks had called at the first available date historically cheap AT1 hybrids and Tier 2 bonds issued on spreads that were materially below prevailing spreads. In one example, UBS called the cheapest hybrid issued in the post-GFC period (on a rating-adjusted basis)
- The originally proposed Basel 3 regulations that APS 111 is intended to emulate, and the European application of these regulations, focus on the replacement of existing AT1 hybrids/Tier 2 bonds with securities that are “sustainable for the income capacity of the institution”. This is arguably more nuanced than APS 111, which is predicated on a more primitive test comparing the credit spread on the old AT1 hybrid/Tier 2 bond to the spread on the replacement securities rather than the issuer’s over the horizon, or intertemporal, cost of capital
- If the spread on the old security is below the new security, APS 111 claims that this is an “uneconomic call” for the issuing institution, which then needs to furnish APRA with a secondary “economic and prudential case” for the replacement of the cheaper incumbent security
- Of course, banks are in practice very rationally replacing cheaper AT1 hybrids/Tier 2 bonds with more expensive securities because they are minimising their through-the-cycle cost of capital (as opposed to simply minimising the cost of one specific AT1/Tier 2 security)
- Minimising their intertemporal cost of capital on Tier 2 is especially important for Aussie banks because APRA has given them the toughest Tier 2 issuance requirements of any institutions globally, which necessitates about \$19bn of annual Tier 2 supply from the majors alone (based on Coolabah's analysis)
- In particular, APRA has made the big Aussie banks meet their Total Loss Absorbing Capacity (TLAC) targets with Tier 2 rather than allowing them to issue cheaper loss-absorbing senior bonds, as is permitted in the US, UK and Europe. This means that Aussie banks are the biggest issuers of Tier 2 globally, and also arguably have the loftiest, rating-adjusted TLAC cost of capital
- While Australian banks have never missed a call date on a Basel 3 AT1 hybrid or Tier 2 bond, there have been two cases where the insurers, Challenger and Genworth, temporarily missed a call date on an AT1 hybrid and a Tier 2 bond during the 2020 pandemic shock, albeit by only by a few months

With the repayment of Westpac's Tier 2 bond, Coolabah expected significant new Tier 2 supply in AUD/USD/EUR. This has been met thus far with the abovementioned ANZ deal in Euros.

**5-Year Major Bank Hybrid Spreads (Red Line) vs 5-year Major Bank Tier 2 Spreads (Red Dotted Line)**



Strategy commentary cont'd:

**5-Year Major Bank Tier 2 Spreads**

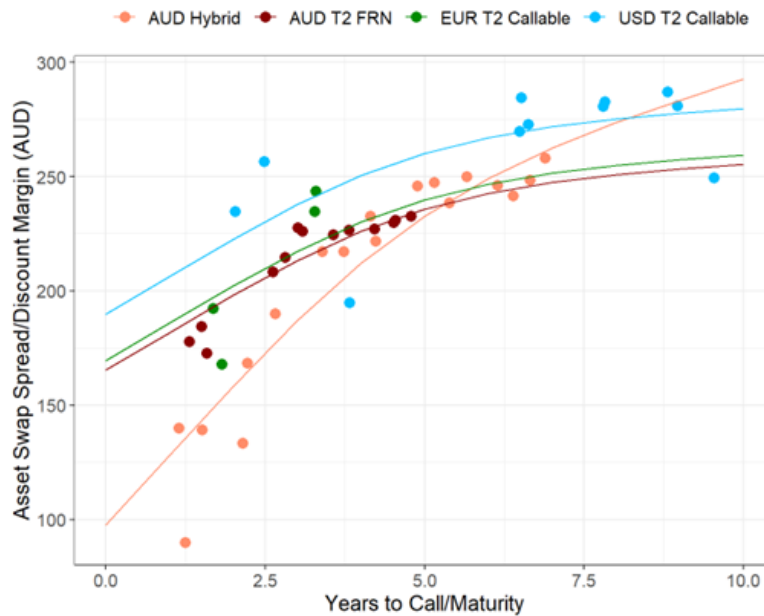


**5-Year Major Bank Hybrid Spreads as a Multiple of 5-year Major Bank Tier 2 Spreads**



**Major Bank Tier 2 Spreads Swapped Back to AUD vs AT1 Hybrid Spreads**

**Majors AT1 vs T2 as at 27-Jan-2023**



### Strategy commentary cont'd: Real Interest Rate Hammer Has Yet To Fall

Let's get real: the Reserve Bank of Australia is not wielding a screwdriver to fine-tune the economy. No, Martin Place has a big, mother-trucking sledgehammer – a veritable Thor's hammer as far as monetary policy tools go.

And that's because the huge preponderance of floating-rate debt in the Aussie economy, which is unusual globally, makes it extraordinarily interest-elastic. This elasticity was seriously impaired during the pandemic by the advent of the RBA's exceptionally powerful term funding facility (TFF).

This involved the central bank giving our private banks \$188 billion of three-year finance, struck at an exceedingly cheap 0.1% to 0.25% annually.

In March, the banks will start repaying this money to the RBA for the first time. The availability of near-zero-cost, three-year loans from the RBA in massive size in turn allowed the banks to offer borrowers those crazy attractive fixed rate home loans at interest rates of about 2% annually.

The proportion of fixed rate loans as a share of all mortgages jumped from a trivial, circa 15% before the pandemic to 46% after it because of the wave of cheap money precipitated by the TFF.

This has been a key reason the domestic economy has yet to be nuked by the RBA's unprecedented 3 percentage points of interest rate increases. The TFF temporarily denied Thor's hammer much of its power.

But as Coolabah has repeatedly explained, roughly one in four Aussie home loans are set to switch from uber-low fixed rates to heinously high variable rates this year. This will be tantamount to another massive round of interest rate increases for these borrowers, as 2% fixed rate mortgages transform into 6% variable rate loans. Hammer time will once again return.

And, crucially, this protracted delay in the pass-through of the RBA's mega rate rises only accentuates the much-mooted long and variable lags that are attributed to monetary policy's transmission mechanism.

It also argues in favour of Martin Place exercising the very valuable option to wait at some juncture soon to observe how its radical changes to the cost of capital are reverberating through the economy.

The bad news is that hopes that the RBA might either pause or be "one and done" in February were possibly dashed by the surprisingly high inflation data released covering the final quarter of 2022.

One positive take-away from this print was that underlying, or core, inflation in Australia peaked in the September quarter at 1.9% and thereafter declined to 1.7% in the December quarter.

There was also the silver lining that the headline inflation result of 7.8% was slightly below the RBA's more pessimistic forecast of 8%. The peak for headline inflation is likely to be the December quarter.

The negative was that the quarterly and year-on-year core inflation numbers of 1.7% and 6.9%, respectively, were above both the market and the RBA's projections of 1.5% and 6.5%.

The fly in the ointment here is that elevated core inflation is not being driven purely by pandemic-affected supply side rigidities. When Coolabah excludes goods most affected by the pandemic from measures of underlying inflation, we still get very high outcomes, which implies that policy-boosted demand – exemplified by Australia's very low, 3.5% jobless rate – has an important role to play in addition to the aforementioned supply chain blockages.

Of course, the RBA has been very aggressive in seeking to destroy demand via its 3 percentage points of rate increases thus far. According to The Australian Financial Review's economics editor, John Kehoe, the central bank is likely to pop off another 0.5 percentage point of rate rises in February and March, lifting its target cash rate to 3.6%.

**Strategy commentary cont'd:** This is broadly in line with where financial markets had in recent months predicted the RBA would land (at various points, bond markets had priced in a cash rate north of 4.3%, although this has since been pared back). It is also consistent with the RBA's own assumptions in much of its modelling when evaluating the ramifications of these policy changes for the wider economy.

The RBA assumed, for example, a 3.6% cash rate when seeking to understand how much households' free cash flow would be squeezed by tighter monetary policy. Readers might recall this column last year highlighting the RBA's conclusion that about 15% of all borrowers would end up with negative free cash flow if it lifted rates this far. The RBA's concept of spare cash was defined as borrowers' leftover income after meeting mortgage repayments and essential living expenses. More than 52% of all borrowers would see their free cash shrink by between 20% and more than 100% in this scenario.

What we do know is that this data is backward-looking, and telling us more about the inflation surge last year than the outlook for 2023. Globally, inflation rates are gradually starting to mean-revert as supply chains normalise and demand inexorably deteriorates.

When making its case to raise rates last year, the RBA was fond of citing business surveys pointing to wage and price pressures. Those same surveys are now signalling that business conditions are weakening, with softer revenues, profitability, and labour demand. Surveyed measures of inflation are also decelerating, including labour costs, purchase costs, and final product prices.

This coincides with Australia's manufacturing and services purchasers manufacturing indices (PMIs) both reporting contractionary results below the 50 threshold. Our manufacturing and services PMIs have, in fact, been falling since May 2021 when the RBA began lifting rates. CBA's economists note that "both manufacturing and services input prices fell in January", which is "in line with other pricing indicators, including those in the NAB business survey [that] suggests the peak of inflation was in late 2022".

These more timely indicators of economic activity resonate with what we are observing in the US, which appears to be cyclically leading Australia with a peak in its core inflation rate in the first half of 2022. Goldman Sachs reports that US "business surveys are flashing red, with Empire Fed business conditions and several other prominent measures already at recessionary levels".

As with Australia, the US is experiencing cross currents in its data releases, as interest rate increases take time to work their way through the system: even though the housing market is rolling over and price pressures have eased from historically lofty levels, employment and recent growth data have remained relatively robust (the US did suffer two quarters of negative GDP growth over the first half of 2022).

The US Federal Reserve has ameliorated the pace of its policy tightening process by shifting to more modest 0.25 percentage point increases at its February meeting, bringing the Fed Funds Rate to between 4.50% to 4.75%.

In January the Bank of Canada joined Norges Bank in declaring it would keep rates on hold for a period after it lifted its policy rate to 4.5%. It is quite possible the Fed will do the same after its March meeting. This would furnish the RBA with elegant cover to take a concurrent breather at 3.6%, subject to the flow of data in the meantime.

With the central banks' final, or terminal, cash rates in sight, some investors have been emboldened by the prospect of an end to the tightening cycle. JP Morgan strategists note that "investors are split between recession and soft-landing, with fixed income markets and our recession models suggesting the former, while buoyant equity markets, the drop in inflation and a potential lift from China reopening point toward the latter".

We are in a similar camp, having presented research forecasting a US recession since the start of last year. We also called for a 30% plus draw-down in US equities at the end of 2021 on the back of a big jump in discount rates, among other things. Notwithstanding the subsequent correction, it is not clear to us that stocks are fully pricing in global recession risks.

**Strategy commentary cont'd:** JP Morgan concludes that “with some of the equity market moves looking extreme, markets pricing in excessive optimism, technical flow drivers running out of steam, and potential for large reallocation from bonds to equities, we are inclined to fade the rally in stocks”.

**Aussie House Price Crash About to Pass Through All-Time Record of an 11% Peak-to-Trough Loss...**

In October 2021 we projected that Aussie house prices would fall by a total of 15-25% as a result of this RBA hiking cycle. This was partly based on applying a refined and upgraded version of the RBA's Saunders/Tulip housing model. We revealed in June 2022 that we arrived at similar predicted losses if we assumed a 100 basis point permanent increase in the RBA's cash rate or a temporary jump from 0.1% to 4.25% followed by interest rate cuts.

As this started to play-out after the RBA commenced its tightening cycle in May 2022, we forecast that the first 10 percentage points of house price losses would likely materialise by February/March 2023.

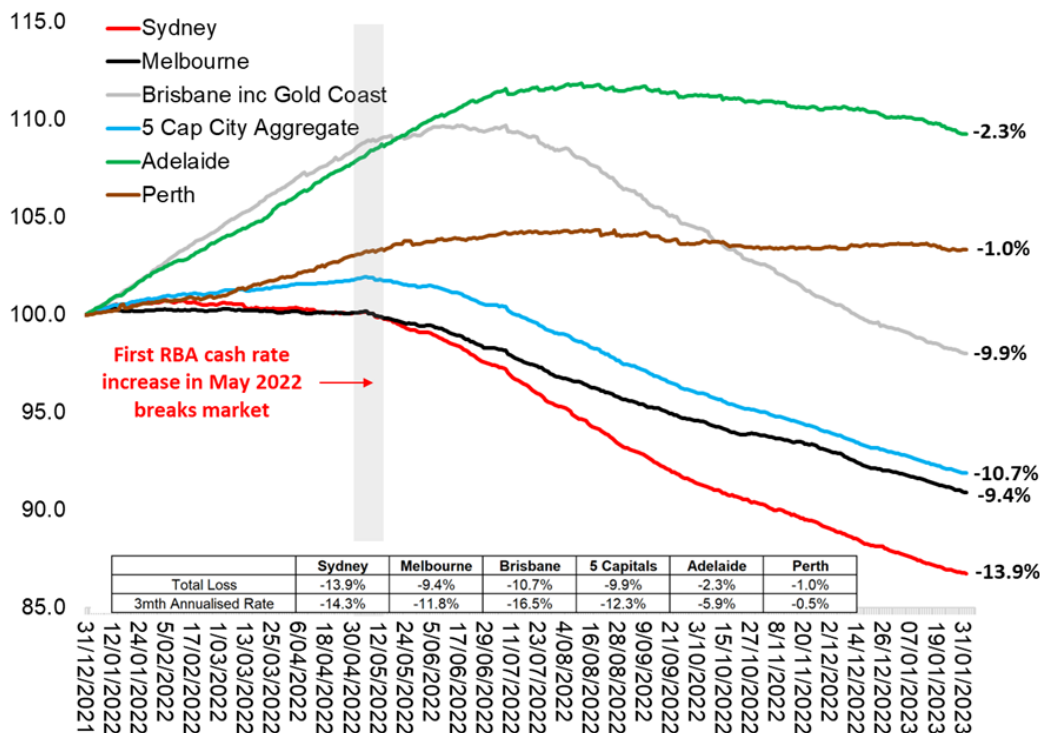
It appears that this central case is on track: CoreLogic's 5 capital city index has now lost 9.9% from its May 2022 peak through to 2 February 2023 care of the RBA's interest rate increases (with more hikes expected in February and March).

We should, therefore, pass through the crucial 10% draw-down threshold this month. And by the end of March 2023, we would expect the Aussie capital city market to record its worst-ever loss - exceeding 11% - since CoreLogic began collecting data in 1980.

Home values in Sydney and Melbourne are now off by almost 14% and 11%, respectively, from their peaks in 2022. Dwelling prices in Melbourne are not far behind with a 9.4% correction. Canberra is faring similarly to the other east coast cities. While Adelaide and Perth remain the outperformers with cumulative retrenchments of only 2.3% and 1.0%, respectively, there is evidence that the house price declines in Adelaide have been accelerating over the last few months (see second chart below).

**Australian Dwelling Values on Track for Record Slump: 2 February 2023**

Source: CoreLogic

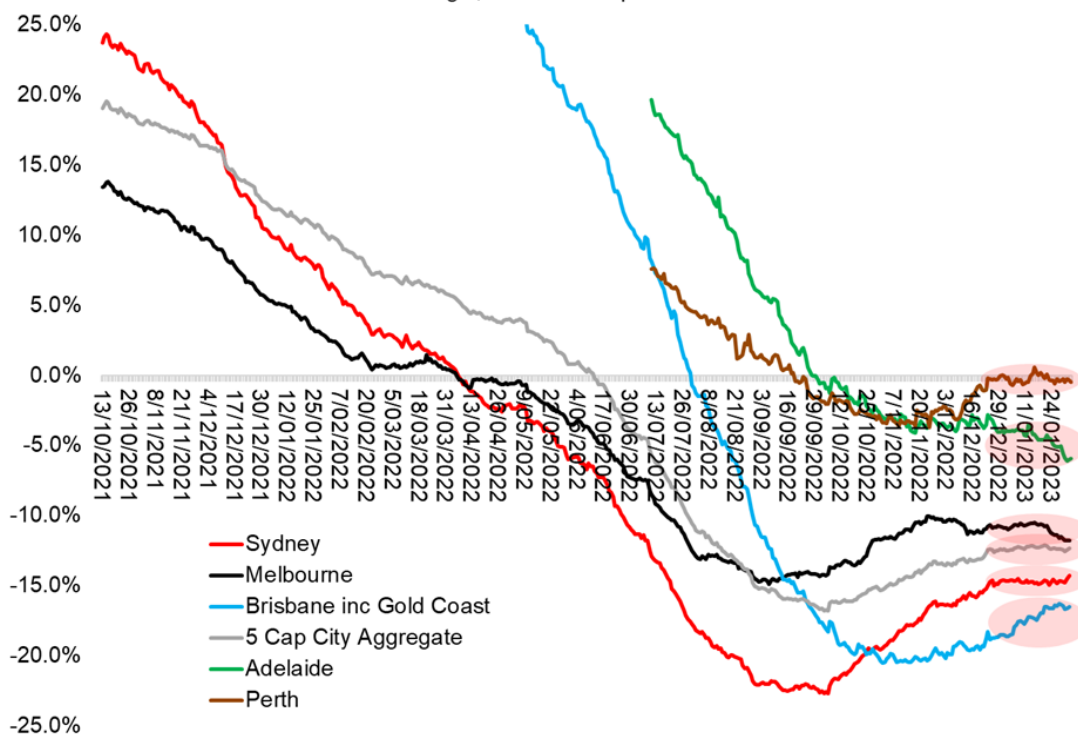


**Strategy commentary cont'd:** Over the last three months, the annualised pace of these house price falls has been fairly stable at somewhere between 12% and 17%, which is something we have been keen to underscore since late last year. There is no evidence currently that the great Aussie house price crash is bottoming-out or slowing, as many have been keen to suggest. And with 1-in-4 home loans switching from fixed to floating this year, which will result in their interest rates soaring from circa 2% to 6% (exacerbated by additional RBA rate hikes in February and March), this housing pain is set to continue for many months to come.

Across the five biggest capital cities, home values have been melting at a 12.3% annual pace over the last quarter (see chart below). The worst performing market has been Brisbane, where prices have been plunging at a record 16.5% annual rate followed by Sydney (14.3%) and Melbourne (11.8%).

**Quarterly House Price Changes Annualised: 2 February 2022**

Source: CoreLogic; Coolabah Capital Investments



Remarkably, when it started hiking in May last year, the RBA was forecasting that an increase in its cash rate from 0.1% to at least 2.5% would precipitate little change in house prices using the same Saunders/Tulip model that we were refining back in 2021. As prices immediately started sliding quickly in May 2022, it was forced to downgrade this view to a much more pessimistic (and record) 11% draw-down a few months later. We have previously argued that the RBA would be eventually forced to once again dump this assumption and embrace our even more negative central case of a 15-25% loss, which now seems likely to be Martin Place's modal expectation...



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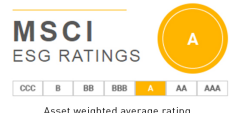
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