



Fund Objective

The fund aims to provide a superior stream of income and capital stability over the medium term while aiming to outperform its benchmark through market cycles.

Fund Application

Investors seeking to enhance their overall fixed income returns with a higher yielding, predominantly investment grade (IG), absolute return-oriented global fixed income portfolio.

Fund Details

APIR code	HOW0165AU
Inception date	31 May 2007
Fund size	AUD 2027.31
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	1.12yrs
Credit spread duration	1.75yrs
Average credit rating	A-
No of issuers	72
Yield to maturity	6.33%

Fund Guidelines

Target return	cash plus 2-3%
Target volatility	less than 1.5% annualised
Duration limits	-2 to +2 years
Credit quality	>85% investment grade



Dan Siluk
Portfolio Manager



Dylan Bourke
Portfolio Manager

April 2024

Performance (%)	1 month	3 months	1 year	3 years p.a.	5 years p.a.	Annualised since inception
Fund Return (before fees and sell spread)	0.24	0.91	5.87	2.70	2.49	4.54
Fund Return (after fees, before sell spread) ¹	0.20	0.79	5.40	2.27	2.04	4.18
Fund Return (after fees and sell spread) ²	0.20	0.79	5.40	2.27	2.03	4.17
RBA Cash Rate	0.39	1.06	4.22	2.20	1.52	2.79
Active return ³ (before fees and sell spread)	-0.14	-0.15	1.65	0.50	0.96	1.75
Active return ³ (after fees and sell spread) ²	-0.18	-0.26	1.18	0.08	0.50	1.38
Bloomberg AusBond Bank Bills Index	0.35	1.07	4.24	2.19	1.55	2.99

Past performance is no guarantee of future results. After fee returns are inclusive of 0.41% annualised total expenses for class I units. Fund inception date 31 May 2007. No allowance is made for tax. Numbers may not add due to rounding. 1) For a continuing investor the actual return experienced based on the NAV performance of the Fund, after accounting for management fees. 2) The return experienced by a redeeming investor, based on the exit price performance of the Fund which accounts for the end of period sell spread of 0.07% and management fees. 3) Active return of the Fund compared to Benchmark (RBA Cash Rate). Source: Fidante Partners Limited, 30 April 2024.

Performance Commentary

The fund returned 20bps in April, lifting the rolling 12 month return to 5.40% (after class I unit fees). Performance was driven by continuing high coupon income with credit spread contraction also a positive contributor, despite equity markets retreating somewhat from their record highs. Yields rose in the month, as the 'higher for longer' inflation and rates thesis pushed back easing cycles in the US and Australia in particular. Despite only modest rate duration exposure focused in markets like Europe and Canada where we expect official interest rates to be lowered sooner, rates positioning detracted from performance. However, the yield to maturity on the portfolio rose in the month, providing an ongoing tailwind for strong returns looking forward.

Market Commentary

The higher for longer thesis for inflation was the key market theme over April. Core PCE inflation figures in the US in the first quarter annualised at 4.4%, a sharp increase on the 1.5% annualised pace in the second half of 2023. Such reversals in the trend in inflation are rare but show the dangers of looking at inflation over short time frames. Yearly core inflation in the US continues to trend lower to 2.8% in March, but the pace of decline has slowed to a crawl and potentially stalled at a rate above the Federal Reserve's 2% target. Australian Q1 trimmed mean inflation of 1%, and yearly 4% level also suggest a slowing pace of decline, at a rate even further above the RBA's 2.5% inflation target midpoint. Yields rose as rate cut expectations were consequently pushed back in both these regions, with US 2yr yields and Australian 3yr yields up 42bps.

It's important to note that the story of a slowing in the pace of decline in inflation is not evident elsewhere. In Europe, core inflation continues to decline rapidly and at 2.7% for April is now below that in the US. Canadian core inflation, after pausing at around 3.5%, has resumed its downtrend and now stands at 3.1%. UK inflation has also fallen but remains high at 4.2% but has some significant base effects that will see it potentially fall in coming months. The falling and near-target core inflation supports that rate cuts are more likely to be sooner in these regions, highlighting that disparity in economic indicators is growing. Yield increases at the front of the curve were smaller in these areas as a result, with German 2yr yields still up by 19bps, and Canadian 2yr yields up 17bps.



Economic activity is also diverging across regions, with US exceptionalism still a theme despite the soft Q1 GDP figures at 1.6%. The 3% pace over the past year as a whole remains strong and well above what is considered trend at ~2%, with the US labour market remaining solid as a result. Most other regions have seen the predictable impact of higher monetary policy and growth has slowed below trend. We are seeing increases in the unemployment rate in those regions, most notably in New Zealand, Canada and Germany. This is highly relevant for central banks, as the above-trend growth in the US means the Fed can afford to be patient before cutting rates relative to other regions.

The still strong economic activity in the US is also important for earnings expectations, as risk sentiment globally largely emanates from the US. With official interest rates in the US likely to stay higher for longer, the S&P 500 fell 4% in the month but is still well up on a year earlier. The more responsive synthetic credit indices were higher in sympathy with equities in April, such as the investment grade CDX which was up 2.3bps to a still low 53.8bps. Nonetheless physical credit was well supported by demand and played some catch up, with the US Credit Aggregate OAS series in 3bps to 87bps. Australian physical credit spreads were in 4bps over April to 138bps, remaining closer to the longer-term average than the US equivalent.

Outlook

The pace of decline in inflation and official interest rates will remain the key focus of financial markets, both in terms of bond yields and risk sentiment. The slower progress for inflation has been the key theme this year and will remain so in coming months. At this stage it is too early to be talking about rate hikes; we would need to see inflation increase, rather than stabilisation, before further tightening of monetary policy is required. The main reason being that official interest rates are already at a restrictive setting, which is constricting demand and eventually bringing inflation into better balance. This may need more time work but applying further tightening is not considered necessary just yet.

Risks of a harder landing in the US are not getting the same airtime as they used to but remain under-priced by financial markets. The probability of recession in the US has fallen further to 30% in April, less than half its peak of 65% as recent as July last year. Outside the US there are already regions which are in recession. New Zealand has already posted two successive negative quarters to be in a technical recession. Other regions have also met Sahm's rule, which is a half a percentage point increase in the (3-month average) unemployment rate, another definition that some economists use to indicate a recession. This is likely to get increased attention going forward as it is a determinant of the timing and depth of rate cuts.

Portfolio Strategy

The higher for longer theme did see us lighten duration exposures in April, as the chance of rate cuts in the US decreased. We reduced our duration (or sensitivity to yields movements) from 1.3 years to 1.2 years in the month, but perhaps more importantly there was a shift further away from the US to those regions more likely to see rate cuts (most notably Europe and to a lesser extent Canada). This highlights the benefit of having an investment manager that is globally focused, as it allows us to concentrate on those areas where rate cuts are more imminent.

The portfolio's physical spread duration reduced slightly to ~1.8yrs, retaining lower sensitivity to spread change than we have historically targeted. This was accomplished by taking profit on recently purchased primary deals, locking in some gains on the elevated new issue concessions resulting from high AUD issuance. We were pleased to continue to see strong credit compression in the portfolio over the month and calendar-year-to-date period, adding to returns, slightly outpacing the compression in broader Australian credit indices, evidencing positive security selection.

The high coupon continues to provide a return robustness which hasn't been seen for around a decade. The quality of this coupon is strong given it is comprised of a higher than average credit spread, despite being focused on shorter dated assets. Given this high coupon we remain cautiously optimistic. Additionally as the odds of a soft landing (rather than hard landing) in the US continues to increase given strong GDP and unemployment data, we expect to hold spread duration around 1.8-2yrs over the coming months in Australian credit, as home market credit spreads remain around long term averages, whilst US credit spreads are significantly tighter against averages, and reflecting our view that if the global macro environment remains stable, Australian spreads will eventually follow the US lead.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~60%), corporates and REITs (~25%), and asset and mortgage-backed securities (<15%), with the residual in cash and liquids. Close to ~85% of the portfolio is held in Australian & New Zealand names, and by currency <5% is held in non-AUD denominated securities.

Portfolio liquidity remains high, though reduced slightly as we invested in new issues, mainly AUD credits, to fund investments despite taking profits on previous new issues from prior months. 'Level 1' liquidity is at ~8% (cash, commercial paper, SSGA) and at the high end of the range for 'Level 2' liquidity at ~18% (<1yr investment grade). We believe this mix provides the flexibility to buy attractive credits.



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