



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 1983.96
Distribution frequency	Quarterly
Management fee	0.40%
Buy/sell spread	Please contact us for latest spreads

Fund Statistics

Interest rate duration	0.66yrs
Credit spread duration	1.85yrs
Average credit rating	A-
No of issuers	72
Yield to maturity	5.58%

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

September 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)	0.72	2.48	7.75	3.84	2.94	4.66
Fund Return (after fees, before sell spread) ¹	0.69	2.37	7.28	3.41	2.49	4.29
Fund Return (after fees and sell spread) ²	0.69	2.37	7.29	3.41	2.47	4.29
RBA Cash Rate	0.36	1.10	4.35	2.79	1.79	2.82
Active return ³ (before fees and sell spread)	0.36	1.38	3.41	1.05	1.15	1.84
Active return ³ (after fees and sell spread) ²	0.33	1.27	2.94	0.62	0.69	1.47
Bloomberg AusBond Bank Bills Index	0.36	1.11	4.41	2.82	1.81	3.02

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 September 2024.

Performance Commentary

The Fund added a solid 0.69% in September, taking 12 month returns to 7.29%(after accounting for Class I unit fees). The strong run of outcomes in the past several months reflects a continuation of recent market themes, in the form of solid risk sentiment and central bank rate cut induced declines in bond yields. Credit spreads eked out further gains, modestly adding to performance and allowing carry to again contribute solidly in the month. Similarly, duration made another meaningful contribution as the US Federal Reserve began its easing cycle with a 50bps rate cut, supporting further reduction in bond yields. Our global approach in particular paid dividends, given that Australian bond yields were little moved over the month as the RBA is likely to remain on hold for some time. Returns above the cash benchmark over the past 12 months now stand at 342bps before fees. This sees us perform favourably against peers, with a near peer-leading low volatility profile and low correlations to other asset classes. The yield to maturity on the portfolio of 5.56% remains high by historical standards, providing a strong basis for expected returns looking forward.

Market Commentary

Themes in markets for the past few months continued uninterrupted in September. Risk sentiment generally improved as recession fears subsided, while yields fell as the global easing cycle gets more and more priced in. However, risks and exceptions remain.

In the absence of clear indicators of a recession in the US, economic and earnings growth expectations are supporting risk sentiment. US GDP growth for Q2 was revised up slightly in September to a strong 3.0% annualised pace, well above the historical average of around 2%. Early forecasts for Q3 show a similarly strong rate of change. Payrolls growth has subsequently remained firm, averaging more than 100k per month, however the unemployment rate has maintained an upward trajectory, despite falling 0.1pps to 4.2% in September. The S&P 500 rose 2.0% in September, posting new record highs. Credit spreads similarly compressed, with the Bloomberg US corporate aggregate OAS index in 4bps in September to 90bps - quite close to the post-GFC lows of 80bps. Outside of the US, growth is generally below trend and unemployment rates are rising, but risk markets aren't reflecting



Fund Platform Availability

- AMP North, Wealthview, eWrap
- AMP PortfolioCare (Badge of Asgard)
- Asgard eWrap & Infinity
- Australian Money Market
- Australian Unity Lifeplan Investment Bond
- BT Panorama
- Centric Wealth (Findex)
- CFS Edge, FirstChoice & FirstWrap
- Clearstream/Ausmaq
- DASH
- Grow Wrap (Insignia)
- Hillross PortfolioCare (Badge of Asgard)
- HUB24
- Insignia – eXpand
- Insignia – Rhythm (private label HUB24)
- Insignia – Asset Administrator (BT Badge)
- Macquarie, Accumulator, Wrap IDPS and Super
- Mason Stevens
- Netwealth
- Praemium
- Powerwrap
- Oasis
- OnePath
- OneAnswer
- OneVue
- Platform Plus (Infocus)
- Voyage (Oasis Badge)
- Xplore Wealth

these conditions and are taking their lead from the US. For example, Australia has seen below trend GDP growth since the end of 2022, but the Bloomberg Ausbond Credit 0+ average spread to swap was stable in September at 90bps and is close to its average level since 2015. The post GFC lows of c59bps remain some distance away.

Bond yields fell significantly as the easing cycle gets priced in to a greater degree. The US Federal Reserve finally began to cut official interest rates, starting off with an above expectations 50bps move. Not only has confidence increased that inflation would return to target but the labour market has simultaneously weakened relative to their forecasts. Combined with the fact that official interest rates were more than 250bps above neutral, the Fed chose a more aggressive path back to more neutral settings. Markets have therefore been somewhat vindicated with what has been a much quicker and deeper easing cycle, shifting the average cut per meeting to above 25bps and the terminal rate down to an around neutral 3%. This underscores the sharp drop in bond yields, with US 2-year yields down 28bps to 3.64%. The US 10-year yield fell a smaller 12bps, leading to a steepening of the curve into positive territory for the first time since mid-2022. Yields actually fell similar or in some cases greater amounts in Europe, NZ and Canada on domestic macroeconomic concerns. However, Australian bond yields were largely unchanged in September with inflation stubbornly high and the Governor stating that imminent cuts were unlikely.

Outlook

In most regions the focus has moved away from the start of the global easing cycle to its pace and depth. The Fed's 50bps start to its easing cycle was a departure from that seen in Canada, Europe and New Zealand, where 25bps was the initial move. This has seemingly opened the way to larger cuts inside and outside the US, seeing terminal rates fall towards neutral in most regions. In many regions outside the US, economic growth remains below average, and unemployment rates are increasing, often approaching or surpassing the natural rate. This suggests that the current narrative around monetary policy easing to support an economic recovery is far from over. Central banks in these regions are likely to have an end goal that is below neutral to satisfy their mandates. History also supports that easing cycles are usually accompanied with further declines in the terminal rate, particularly in the early stages of easing cycles. Bond yields should be expected to fall further in such circumstances over the medium term.

Currently, the US economy remains resilient, weathering the significant tightening measures implemented by the Fed to combat inflation without severe distress. However, should the situation shift, leading to a recession, credit markets could face significant challenges, especially with spreads near historically low levels, heightening the risk. Yet, the potential impact of a recession varies. If economic growth stays robust while the unemployment rate slowly increases, prompting only gradual upward revisions to the Fed's unemployment projections, we would likely see a further drop in official rates and bond yields without a retreat in risk markets. Conversely, a more significant downturn in economic growth, such as a move into negative territory, would lead to larger decline in both bond yields and risk sentiment. For the moment, these outcomes seem to be continually deferred to a later date or potentially dismissed altogether.

Portfolio Strategy

After rates positioning was aggressively cut in August, positioning did not change significantly in September. The profit taking we undertook was partly a reflection that we felt the markets had moved too quickly to price in an easing cycle (despite our medium term views). This view did not change considerably reflecting that the negative carry from long positions is now significant at potentially 10bps per month - a high hurdle to clear. Secondly some of the short positioning is in Australia where the central bank has clearly indicated that cuts are not likely until 2025. Positioning only edged up slightly by 0.1 years to 0.7 years in September. The mix is spread across the US, Europe, Canada and New Zealand, whereas outlined above we expect market pricing to move towards pricing in an easing cycle below neutral.



The portfolio's physical spread duration was fairly stable at ~1.8yrs, retaining lower sensitivity to spread change than we have historically targeted. Despite maintaining a fairly short-dated book, our asset allocation overweight to T2 and mezzanine securitised has allowed us to capture very strong credit spread compression compared to many short-dated credit indices over the last year. This month we saw some attractive issuance in AUD denominated financials which rallied.

The high coupon is currently delivering a level of return stability not seen in nearly a decade driven by a portfolio credit spread that is above the average, even though it is primarily from shorter-term assets. This leaves us cautiously optimistic about the prospects of short-term investment-grade credit, buoyed by the high coupon.

However, our outlook becomes more cautious when considering longer-term credits, given the current landscape's various peculiarities. Notable among these are the significant losses incurred by Norinchukin, a domestic systemically important bank in Japan; defaults within AAA-rated Commercial Mortgage-Backed Securities (CMBS) in both the US and Europe; the increasing popularity of more extreme political candidates globally, the unwind of the Yen carry trade and upcoming volatility likely from the US election.

We plan to maintain our spread duration towards the lower range of 1.8 to 2 years in the upcoming months. This will be skewed towards Australian credit because credit spreads in Australia are closer to their long-term averages compared to the significantly tighter spreads observed in the US. Barring a severe global downturn and considering the sustained interest from yield-seeking high-net-worth and Asian investors, we anticipate that Australian spreads will likely play catch-up to the US by moving towards the lower end of their historical ranges.

In terms of asset allocation, the portfolio can be split across three major 'buckets'; financials (~63%), corporates and REITs (~22%), 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, with 'Level 1' liquidity at ~16% (cash, commercial paper, SSGA) and at the high end of the range for 'Level 2' liquidity at ~15% (<1yr investment grade). We believe the high level of liquidity provides the flexibility to buy attractive credits or take advantage of a better entry point should there be a sell-off.

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