

# Sustainable Short Term Income Fund - Retail Units

Fund Update  
**31 August 2022**

The Fund invests in a combination of short-term money market instruments and medium-term floating securities that are investment-grade rated. The investment process is designed to maximise returns while balancing the risk and liquidity of the portfolio.

## Performance as at 31 August 2022

	1 mth %	3 mths %	1 yr %	Since inception % p.a.
Net return	0.34	0.37	(0.68)	(0.47)
Benchmark	0.15	0.33	0.37	0.32
Excess to benchmark	0.19	0.04	(1.05)	(0.79)

Inception date for performance calculations is 28 June 2021.

Net returns are calculated after fees and expenses and assume the reinvestment of distributions. Past performance is not a reliable indicator of future performance.

The benchmark is the Bloomberg AusBond Bank Bill Index.

Excess to benchmark is calculated on Net return.

## Portfolio Performance and Activity

After consolidating late in July credit markets performed well in August with spreads contracting between 0.05%–0.10%. Corporate spreads outperformed financials with property trusts and infrastructure experiencing the largest contraction in August. The reporting season concluded in August with no material surprises. Of particular interest for the portfolio was the REIT and banking sectors. The property trust sector, in particular retail, benefitted from the reopening in retail traffic however the CBD has lagged. While the CBD office market has been slower to rebound the long lease profiles and a preference for prime assets has seen this sector hold up very well. One small concern across the sector is the higher interest rate environment and its impact on asset revaluations, particularly for issuers with gearing covenant's.

Turning to the financial sector capital remained strong and the higher interest rate environment should improve margins. Arrears are very low and household savings help provide some buffer if an economic deterioration occurs in 2023/24. Primary issuance was strong in August with multiple deals coming from the financial sector. Westpac and CBA returned to the market. Westpac issued \$2.450B multi tranche three year at a margin of 0.80% while CBA issued a \$4.5B multi tranche three and five-year deal at 0.80% and 1.02%. Highlighting the improved technical environment both trades were well oversubscribed. Investment was made into the CBA three-year deal. Other

notable financial issues include Natwest Investment Bank three year and HSBC five year at a margin of 1.12%. After postponing the launch of their transaction in July University of Melbourne returned to the market to price a seven-year green bond at a margin of 1%. The bond refinanced six existing buildings, five holding a green star 6 rating and one holding a 5 star. A 6-star rating demonstrates a building that is World class and highly efficient with it being fully powered by renewables which is a significant positive for the environment. Credit duration was unchanged over the month at 1.91 years with corporates contributing 1.50 years and asset backed securities contributing 0.43yrs.

## Socially Responsible Investments in Focus

Australia's energy system needs urgent investment in new wind, solar and storage capacity, and new transmission lines to cope with electricity supply shortfalls that may affect NSW in 2025, followed by other states shortly thereafter. In its latest annual report, AEMO said the acceleration in coal and gas plant closures, delays in new transmission projects and expectations of rising demand meant that reliability standards for electricity will be breached 7 years earlier than it foresaw last year.

The AEMO has adjusted its assumptions for electricity demand and supply in accordance with the "step change" scenario for transition, which assumes closure of 5 coal plants over the next decade taking out 8.3GW or 14% of the national energy

Contact us  
[australianunity.com.au/wealth/](https://australianunity.com.au/wealth/)  
[australianunitywealth@unitregistry.com.au](mailto:australianunitywealth@unitregistry.com.au)

Investor Services  
T 1300 997 774

Adviser Services  
T 1300 997 774

market's total capacity. Furthermore, demand is expected to rise more than previously assumed with greater electrification across households and industry. New generation in the pipeline is not sufficiently advanced to give much comfort to the regulator. Holding back project commitments has been lack of clarity for market rules, although the new government's commitment to 82% renewables by 2030, and the injection of environment and emissions into the national electricity objective, should smooth the path. Sufficient labour and supply of materials are also constraining new projects.

Of some assistance regarding energy demand management, energy-efficiency standards for new residential buildings in Australia are being upgraded for the first time in a decade. New homes will be required to improve minimum performance from 6 stars to 7 stars under the Nationwide House Energy Rating Scheme (NatHERS), with the new provisions will be reflected in the 2022 National Construction Code. The rating will also use a whole-of-home energy "budget". This will allow homes to meet the new standard holistically after consideration of the efficiency of appliances and self-generation from roof top solar and batteries. The changes apply from May 2023, and all new homes will have to comply by October 2023. The new code is expected to reduce emissions by 1.64 million tonnes and would assist in Australia reaching its goal of net zero by 2050. The NSW government is also introducing a new state environmental policy (SEPP) with new standards for energy, water and thermal performance, and extend Building Sustainability Index (BASIX) standards to some non-residential buildings for the first time. Under the BASIX, new homes and renovations will have to reach a 7-star rating from the current 5.5 stars minimum and a range of large commercial developments will also have to submit "net-zero statements" showing their buildings are either all-electric or can fully convert to renewable energy by 2035. Residual scope one emissions can be offset through Climate Active Carbon Neutral certified credits. Under consideration is how to change building standards to facilitate EVs in new buildings.

The RBA has flagged that climate change can have a significant impact on the structure of the economy, and the pricing and return on assets, with clear implications for the efficiency and stability of the financial system. The RBA warned banks, insurers, and other businesses to act now to manage the financial threats from global warming, with directors and trustees likely to face increasing litigation risks if they don't take "appropriate actions". A key concern is that climate change can significantly affect asset prices and reduce the stability of future cashflows. At the same time, climate change may also reduce the ability of households and businesses to meet their repayments, by impacting incomes and houses will likely become harder to insure. The RBA also called for the development of an Australian taxonomy for sustainable finance to provide consistency of definitions for what is appropriate in the context of the local high emission economy. A taxonomy would assist those making and interpreting disclosures to make informed investment decisions that will drive the adaptation and mitigation actions needed to manage the risks of climate change.

ANZ is facing increasing pressure by a shareholder to follow peers in disclosing biodiversity and natural capital loss risks. New reporting obligations proposed by the Taskforce on Nature-related Financial Disclosure (TNFD) will require banks to disclose the impact on biodiversity loss or land clearance from activities within their lending portfolios. ANZ shareholder Catherine Rossiter argues that ANZ bank would have failed its

legal obligation under the Corporations Act to disclose and outline its management of these risks, given the bank's material exposure to the agriculture and agribusiness sectors.

In global Green, Social, Sustainability, and Sustainability-linked (GSSS) development, bond issuance is \$522 billion so far this year, roughly 30% lower than last year. Social bond issuance has dropped the most reflecting less financing for the Covid-19 crisis. New Green Bonds supply was reduced due to geopolitical and macroeconomic factors, with China bucking the trend to become the largest single issuer. China also published new Green Bond Principles (GBP) which are broadly in line with ICMA's in requiring 100% of the proceeds from green bond issues to be invested in green projects (70% previously) and mandatory for exchange traded bonds. Singapore issued its inaugural Green Bond, a S\$2.4 billion 50-year issue, their first ever 50-year bond and well oversubscribed. Switzerland is expected to issue its first green bond later this year having identified CHF 4.5 billion in eligible green expenditures.

### Outlook

Australian bond yields have likely peaked but are expected to remain elevated within a reasonably broad range. Financial markets are oscillating between nascent inflation pressures driving central bank tighter monetary settings and a potential economic hard landing.

Australian bond yields are towards the higher end of their anticipated range. Excessive recession fears had led markets to believe central banks would soften their inflationary stance. During August, this gave way to European bond yields driving most other yields higher. Concurrently the US Federal Reserve reiterated what we believe to be important; an easing cycle unlikely to commence immediately after the tightening cycle ends and that combatting inflation may come at the expense of jobs.

Although some of the initial drivers of inflation are likely peaking over coming quarters, the second order sources of inflation that are emerging will dictate that inflation will remain elevated for an extended period.

Global oil prices are approximately 30% off their highs, but other energy costs are still rising. Although some of these factors are regional, they spill over into global labour and product markets. The weaponizing of gas within the European market, is slowing economic growth but pushing inflation above 10% in many European nations, with the peak yet to be seen. The most "acute drought in 500 years", according to the European Commission, is contributing to the upward pressure on global food prices.

Given 40-year lows in unemployment, the Reserve Bank primary objective will continue to ensure there is no inflation spiral. It is worth noting that many rent indexation clauses in the economy are linked to headline CPI. And wage negotiations generally take place with the rate of headline inflation as a key input rather than the underlying rate. The increased industrial action is one hallmark of better labour force bargaining power.

We believe the RBA will lift cash rates, from the current 2.35%, by one further 50 basis point increments and a further two 25 basis point rate rises before year end with a terminal cash rate around 3.25%. The market, however, is currently pricing a slightly excessive peak in cash rates at just under 4% by June 2023. As a result of market pricing the portfolio maintains a

bias to hold longer than benchmark duration.

The portfolio retains an inflation hedging strategy by actively managing a holding of inflation linked bonds. The current "Break-Even" Inflation mid-point is a little less than 2.4%. Should inflation become, more acute or chronic in nature, the value of the inflation linked bonds rise relative to the nominal bond overlay.

For the first time in over a decade, higher cash and bond rates have pushed the yields on many senior bank bonds higher than the dividend yields on the same bank. Coupled with a solid reporting season, low defaults and generally conservative balance sheets we continue to see value within the corporate bonds.

### Fund snapshot

APIR code	AUS1392AU
Inception date	28 Jun 2021
Distribution frequency	Monthly
Minimum initial investment	\$5,000
Fund size (net asset value)	\$457.75m
Management fee*	0.30% p.a.
Buy/Sell spread	Nil

\*Refer to the Fund's Product Disclosure Statement for more details on the Fund's management costs which also include recoverable expenses and indirect costs. Total management costs may vary.

### Sector Profile

Asset Class	Portfolio %
Supranationals	6.28
Industrials	7.16
Financials	61.05
Asset Backed	17.38
Money Market	3.06
11AM	5.86
Cash at Bank	-0.79

### Portfolio Summary Statistics

Asset Class	Portfolio	Benchmark
Yield to maturity (%)	4.17	2.17
Modified duration (days)	24.49	47.51
Credit duration (years)	1.83	N/A

### Interest Rate Profile

Term	Portfolio %
0 - 30 Days	8.57
1 - 3 Years	31.57
3 - 5 Years	36.66
30 - 90 Days	6.21
90 Days - 1 Year	16.98

### Top 10 Holdings

Issuer	Senior Rating	Portfolio %
National Australia Bank	AA-	9.22
ANZ Banking Group	AA-	6.69
Bank Of Queensland Ltd	BBB+	6.41
Suncorp-Metway Ltd	A+	5.78
Macquarie Bank Ltd	A	3.81
Bendigo And Adelaide Bk	BBB+	3.23
Commonwealth Bank Aust	AA-	3.05
ING Groep Nv	A-	2.84
Societe Generale Sydney	A	2.82
UBS Ag Australia	A+	2.67

### Ratings Exposure

Rating	Portfolio %
A	31.57
AA	12.31
AAA	25.12
BBB	30.99

### Ratings / Awards



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