Altius Sustainable Short Term Income Fund (Ordinary Units)

Fund Update
31 January 2024

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 January 2024

	1 mth %	3 mths %	1 yr %	2 yrs % p.a.	3 yrs % p.a.	5 yrs % p.a.	Since inception % p.a.
Gross total return	0.50	1.55	5.63	3.53	2.44	2.30	2.37
Net total return	0.48	1.50	5.41	3.33	2.23	2.08	2.15
Benchmark	0.37	1.09	4.00	2.75	1.84	1.44	1.54
Excess to benchmark	0.11	0.41	1.41	0.58	0.39	0.64	0.61

Inception date for performance calculations is 13 June 2017.
Gross total returns are calculated before fees and expenses and assumes the reinvestment of distributions. Past performance is not a reliable indicator of future performance.
Net total 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 BankBill Index.
Excess to benchmark is calculated on Net total return.

Portfolio Performance and Activity

Credit markets globally were mixed during January. Risk sentiment was extremely strong with global equity indices finishing the month close to record highs. This largely flowed through to global credit where US IG and European IG markets had positive performance, with spreads in those markets tightening by a few basis points. The US high-yield market was a laggard, with spreads widening 20 bps. Despite the widening, high yield spreads are still well below the 5% average of the last 30 years and pricing a goldilocks outlook for the rest of 2024. Australian financials also lagged, with major bank spreads in Australia widening by 3bp and 5bp respectively for the 3-year and 5-year tenors. The underperformance of subordinated spreads was more acute, with 10NC5 lines widening by 17bps over the month, driven by a combined $4bn issuance in subordinated T2 lines by both ANZ and NAB which repriced secondary spreads. Portfolio risk was relatively stable over January with a total spread risk of 2.12 years made up of 1.50 years of credit risk and 0.62 years of asset-backed risk.

Socially Responsible Investments in Focus

The Australian Federal Government's new draft legislation on mandatory climate-related financial disclosures come as a welcome development in the corporate reporting space. The proposed law, which will require companies to report on material climate-related risks and opportunities, metrics, and targets around scope 1, 2 and 3 emissions, as part of their general financial reporting, is an important step in addressing the need for high-quality, transparent and comparable climate-related data. This will allow companies to better consider the financial implications of climate risks and opportunities, facilitate investment decisions and actionable strategies that can drive deeper decarbonisation.

The draft legislation applies to all public and proprietary companies and start dates will be staggered. Reporting for those with revenues over $500 million or assets over $1 billion, with over 500 employees and asset owners with more than $5 billion in assets is expected to commence from 1 July 2024. Medium-sized companies (>$200 million revenue, with over 250 employees) and asset owners with >$500 million assets will be required to commence reporting from July 2026. Smaller companies (revenues >$50 million, over 100 employees or assets over $25 million) will commence reporting in July 2027.

https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/new-climate-reporting-reforms-stronger-financial-system

A report by the ECB and the European Systemic Risk Board (ESRB), has found that EU banks' lending to high-emitting sectors is around 75% higher than its equivalent share in economic activity. At the same time, around 60-80% of all mortgage lending in the Euro area is to high-emitting households.

The report also found that 75% of EU financial institution's loans and more than 30% of insurer investments in corporate bonds and equity are in sectors heavily reliant on at least one ecosystem service. These include services relating to surface & groundwater, mass stabilisation & erosion control, and flood & storm protection.

Furthermore, climate risk is not distributed evenly but concentrated in a subset of banks, which could lead to a 60% increase in lending portfolio losses in the event of a disorderly transition.

Climate shocks can lead to abrupt financial market repricing and the insurance protection gap across Euro area countries is noteworthy, with only 25% of average climate losses currently insured (and up to 95% of climate losses remaining uninsured in some countries). This is likely to worsen if climate shocks continue and can leave financial institutions and governments heavily exposed to climate losses.

The report proposes an additional capital requirement to strengthen the macroprudential framework, increase loss absorption capacity of banks, and influence the appeal of loans more exposed to climate risk. Specifically, it proposes to apply multiple rates to different risk buckets or different sectoral segmentations. It estimates that a one percentage increase in capital requirements could reduce credit growth by up to six percentage points.

https://www.ecb.europa.eu/press/pr/date/2023/html/ecb.pr231218_1~6b3bea9532.en.html

The Global Reporting Initiative (GRI) has launched "GRI 101: Biodiversity 2024", a major update to its Biodiversity Standard aimed to help companies disclose on most significant biodiversity impacts. The GRI collaborated with the TNFD, EFRAG, SBTN and WBA Nature Benchmark to support alignment between the reporting standards and systems.

The new reporting standard will set a new bar for transparency on biodiversity impacts. It will support detailed, location-specific reporting, both within an organisation's operations and throughout its supply chain, to help stakeholders identify, assess and manage the impacts on biodiversity.

GRI will pilot the use of the standard over the next 2 years with formal effect for reporting on 1 Jan 2026.

https://www.globalreporting.org/news/news-center/transparency-standard-to-inform-global-response-to-biodiversity-crisis/

The EU has adopted new legislation to phase out fluorinated gases and ozone-depleting substances. The rules are expected to eliminate 500 million tonnes of CO2-e emissions by 2050, in line with the Paris Agreement and roughly the combined annual emissions of France and Belgium.

The legislation targets fluorinated gases (F-gases) and ozone-depleting substances (OSDs) which are used in a range of industrial applications and found in appliances. An export ban will also ensure obsolete equipment containing such gases are not sold to countries outside the EU and incentives will be provided for climate-friendly alternatives.

Specific dates have been set out for the complete phase-out of the use of F-gases with at worst a 2035 target across all appliances. Strictly limited exemptions such as the use of OSDs as feedstock to produce other substances combined with a requirement to recover OSDs for destruction, recycling, or reclamation to cover sectors such as building materials (insulation foams), refrigeration, air conditioning and heat pump equipment, fire protection systems, and fire extinguishers, where technically and economically feasible.

https://climate.ec.europa.eu/eu-action/fluorinated-greenhouse-gases/eu-legislation-control-f-gases_en

Outlook

Global goods inflation has retreated but the tension between activity and employment data, and the trajectory of services inflation is expected to manifest in oscillating market reactions. The lags in the effect of interest rate adjustments, timing of data, and of wage responses ensure a degree of volatility. The slow but non-linear fall in inflation biases yields lower though with reasonably wide ranges.

Unemployment is beginning to track higher, but still below 4%. We expect lower headline inflation and a less supply-constrained labour market to allow more modest wage growth compared to last year. The cumulative negative wage growth of the last three years likely sees wages react over a longer time horizon, rather than acutely.

Annual Australian inflation has now fallen from 7.8% at the end 2022 to 3.7% at end of 2023. Core inflation has eased from 5.1% to 4.2%. Inflation has fallen largely through goods disinflation with services inflation proving resilient.

Altius' expected flow-through of the reversal in the surge of global oil prices came to fruition. The disinflationary pulse from the 27% fall in Australian dollar terms saw the fall in transport costs flow through to the CPI.

Rent and other housing-related items are a key driver behind domestic inflation. The various government rental subsidies trimmed rent inflation to 0.9%.

These two items contributed to the Reserve Bank not lifting cash rates. They are unlikely to be repeated in the coming quarter with goods disinflation finding some resistance, thus pushing back on the quantum of cash rate cuts implied in the market by year-end.

Global oil prices have stabilized at prices slightly higher than December's prices,

Rental subsidies expire over the coming quarter. Without the subsidies, rents would have lifted 2.2%. New (almost uniformly higher) rents are captured in the next CPI calculation.

The Red Sea conflicts have increased freight rates by about 25%. Insurance costs have lifted to a little less than 1% of hull costs (normally 0.1% to 0.2%), since December. Those containers that travel Asia-Europe via Sothern Africa now take an extra two weeks with higher fuel costs.

The more flexible US economy has seen inflation fall to 3.4%, despite considerable fiscal expansion. Both core and headline are tracking at around 3.2% on a six-month annualized basis.

Fed Governor Powell articulated that the Fed won't wait until inflation reaches 2% before easing interest rates. Cash rates at 5.37% and inflation at 2% leave real cash rates as tight as any time over the last 30 years. The US appears closer to trimming of cash rates whereby cash rates can be reduced but keep monetary settings slightly restrictive. The one hundred basis points fall in long-dated US Treasuries has already meaningfully eased monetary conditions.

The range on Australian long-dated bonds is expected to oscillate around a midpoint in 10-year Australian sovereign bonds of 4.0% with the expected evolution of inflation to allow long bonds to move lower to around 3.75%.

We expect the implied cash rate to remain unchanged over the first half of the year, but following the commencement of a US easing and the lags in the RBA reaction function to the clarifying inflation backdrop, rate cuts are a possibility late in the third quarter.

The portfolio strategy is to actively manage duration settings; incrementally increasing duration above 4.0% or decreasing duration accordingly.

With cash rates above 4% over much of the immediate investment horizon, there is a significant benefit of attractive accrual across the yield curve and capital gains from roll down on fixed-rate corporate bonds.

The portfolio has a strong preference for the superior income generated by higher-yielding high-grade credit. Non-cyclical consumer and financials, including senior and subordinated securities, we believe to be the standout.

A further measure of value that we find in the high-grade corporate market is related to the yield on the Australian Corporate Index being higher than the dividend yield of Australian stocks as defined by the ASX 200. To illustrate at the time of writing, the CBA dividend yield is around 3.8%. By comparison, the higher-ranking CBA (10-year) subordinated bond yields above 6%.

Fund snapshot

APIR code	AUS0079AU
Inception date	13 Jun 2017
Distribution frequency	Monthly
Minimum initial investment	$100,000
Fund size (net asset value)	$426.86m
Management fee*	0.20% p.a.
Buy/Sell spread	0.05%/0.05%

*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 %
Industrials	5.45
Financials	68.71
Asset Backed	18.63
Money Market	3.00
11AM	3.56
Cash at Bank	0.64

Portfolio Summary Statistics

Asset Class	Portfolio	Benchmark
Yield to maturity (%)	5.14	4.33
Credit duration (years)	2.00	N/A
Modified duration (days)	32.45	46.76

Interest Rate Profile

Term	Portfolio %
0 - 30 Days	3.12
1 - 3 Years	46.65
3 - 5 Years	37.91
30 - 90 Days	2.01
90 Days - 1 Year	10.31

Top 10 Holdings

Issuer	Senior Rating	Portfolio %
Australia and New Zealand Banking Group Limited	BBB+	9.32
National Australia Bank Limited	AA-	6.37
Westpac Banking Corporation	AA-	6.01
Suncorp-Metway Ltd.	A+	5.76
Commonwealth Bank of Australia	AA-	4.89
Bendigo and Adelaide Bank Limited	BBB+	4.37
Bank of Queensland Limited	BBB+	3.89
Macquarie Bank Limited	A+	3.82
Teachers Mutual Bank Ltd.	BBB+	3.23
Bank Australia Ltd.	BBB	3.04

Ratings Exposure

Rating	Portfolio %
A	20.23
AA	12.98
AAA	27.33
BBB	39.45

Ratings / Awards

Zenith

RECOMMENDED

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