Fund Update

31 May 2017

ALTIUS ASSET MANAGEMENT

Altius Bond Fund

Altius Asset Management (Altius) employs a diversified strategy to fixed interest funds management that aims to take advantage of the mispricing of bonds in all market conditions.

Performance as at 31 May 2017

	1 mth %	3 mths %	6 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a	Since inception[1] % p.a.
Total Return	**0.42**	**1.13**	**1.50**	**1.65**	**3.18**	**3.87**	**4.85**
Benchmark[2]	0.65	1.37	1.87	2.03	3.42	3.41	4.26
Active Return	-0.23	-0.24	-0.37	-0.38	-0.24	0.46	0.59

Total Return is calculated after fees and expenses and assumes the reinvestment of distributions. Past performance is not a reliable indicator of future performance.

[1] Inception date for performance calculations is 14 June 2011.

[2] Effective 1 July 2016, Benchmark is 50% Reserve Bank of Australia (RBA) Cash Rate and 50% Bloomberg AusBond Composite 0+Yr Index and applied retrospectively for all periods.

How the Altius Bond Fund performed

The portfolio produced a total return of 0.42% for the month, performing better than cash but trailing our blended benchmark. Long bond yields again fell over the month despite rising in response to relatively upbeat economic data in early May following strong tightening in the Australian-US bond spread. The RBA once again left the cash rate unchanged at 1.50% in May. No other decision was expected and it had no impact on markets, which continue to price in little risk of a change in monetary policy for the foreseeable future. As with the April statement, the board noted that global growth has picked up and commodity prices are higher despite recent reversals. Overall the Bank's macro forecasts are little changed. Currency strength continues to confound while briskly rising housing prices (debt) are acknowledged with a nod toward regulatory measures. A large element of the global support for bonds reflects political risk around the ongoing FBI investigation into interactions between the Trump Campaign/administration and Russia feeding the growing market conviction that the administration will not deliver on its fiscal programs in the foreseeable future.

Overall the contribution to returns from duration management was negative due to our core short duration position. Yield curve positioning was also a drag on performance, while credit was positive contributor. Portfolio duration began the month at 0.7 years, reached 1.6 years mid-month as bonds sold off, before being sliced to 0.5 years by month end. The fund retains a preference for high quality corporate bonds and continues to avoid long dated Commonwealth bonds, where we continue to believe the risk to capital is greatest.

May was a relatively stable month for credit markets with spreads trading largely sideways. Primary markets remained buoyant with a total of $3.2bn issued, broadly split between corporates and financials. In the mortgage backed market, multiple deals printed with the portfolio participating in Harvey Trust (originated by Credit Unions Australia). We continue to favour the prime mortgage backed sector, supported by the low arrears performance and high levels of subordination supporting these transactions. We remain mildly positive credit markets and expect credit spreads to trend sideways or lower over coming months. The view is supported prudent balance sheet management, with only modest increases in leverage and gearing seen in 2017. Excess global liquidity continues to also play an important role in supporting spreads at current levels and reducing credit spread volatility.

Outlook

In our March outlook, as expectations of a significant lift in world growth built, fuelled by an expansionary fiscal narrative, we discussed with our investors, a number of factors that led us to believe markets had become overly bearish on fixed income.

Since 2000, Chinese foreign reserve management has due to its sheer size, become a significant influence on capital markets. Capital flows have become fundamental economic drivers. In the decade to 2014, Chinese foreign reserves grew to approximately $4 trillion US dollar equivalent.

Between January 2015 and December 2016, China's foreign reserves fell by more than $800 billion. This was because as Chinese growth slowed, capital flowed out of the country, compelling the Chinese monetary authorities to arrest the pace of outflows and currency depreciation. Given the Chinese Yuan was pegged against the US dollar, authorities sold the US dollar to buy the Yuan to offset the impact of the capital outflow. In excess of $220bn of US Treasuries were sold to facilitate this currency intervention; $190 billion between July and December 2016, accelerating at year end when the US dollar strengthened swiftly, in reaction to the Republicans gaining control of both houses of government. Over that period, US Treasuries climbed from 1.40% to 2.60%.

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This year, the US congressional fiscal policy standoff has contributed to a steadily weakening US dollar. Coupled with Chinese capital controls and pegging the Yuan to a basket of currencies rather than exclusively the US dollar, this weaker dollar has re-established stability in local currencies. Consistent trade surpluses and reduced need for central bank intervention is naturally replenishing foreign reserves. The end result is a return to central bank buying of Treasuries.

China has bought $38 billion during the first quarter of 2017. More recent increases in foreign reserves imply continued demand for US Treasuries, contributing to the fall in yield. That in turn has caused hedge funds and money managers to exit from or pare back bets that bond yield would climb. Ten year US Treasuries have rallied to 2.20%.

There are limited options for foreign central banks to diversify their portfolios away from the Treasury bond market, but Australia is one of them. Sino – Australian trade flows underpin Australia as natural alternative. Central bank demand has contributed to the 0.60% fall in Australia's Government Bond yields since early March. Australia's ten year yields are approximately 2.40%, only 0.20% higher than comparable US bonds. This highlights the role central banks have had in driving the global hunt for yield. Trade surpluses in China and Japan are expected to endure for the foreseeable future providing their currencies remain stable. This will see "excess savings" used to buy foreign assets with US Treasuries and Australian bonds a major beneficiary.

Recent returns highlight the opportunities for investors that are otherwise foregone by avoiding fixed income as an asset class and remaining in cash or term deposits. The fast moving and opaque nature of capital flows provide active fixed interest managers many opportunities to create significant value for investors. We are monitoring these movements closely with a view to actively managing our interest rate exposures to benefit from the cross currents of rising Fed funds rates duelling with the suppression of bond yields resulting from Asian central bank reserve accumulation.

Altius Bond Fund

Rating exposure

	Portfolio %
AAA	55.08
AA+ to AA-	20.79
A+ to A-	13.76
BBB+ to BBB-	10.37

Maturity profile

Term	Portfolio %
0 – 1 year	11.93
1 – 3 years	29.93
3 – 5 years	27.32
5 – 7 years	16.47
7+ years	14.35

Fund asset allocation

	Fund%
Australian fixed interest	95.82
Cash and cash equivalents[2]	4.18
Total	**100.00**

[2] Cash and cash equivalents may include cash at bank, 11am cash (i.e. overnight bank deposits) and discounted securities (e.g. bank bills).

Portfolio summary statistics

Running yield	2.37%
Modified duration	0.63 years

Top 10 holdings

	Portfolio %
Commonwealth of Australia	16.91
State of Victoria	7.14
State of NSW	6.73
State of Queensland	6.07
Commonwealth Bank of Australia	5.78
ANZ Banking Corp	3.24
Westpac Banking Corp	3.14
World bank	2.41
Federal Republic of Germany	2.37
Royal Bank of Canada	2.32

Fund snapshot

APIR Code	WFS0486AU
Inception date	14 Jun 2011
Fund size (net asset value)	$221.79m
Minimum initial investment	$5,000
Management Fees	0.5531% p.a.
Estimated Recoverable Expenses	0.1045% of net asset value of the Fund for each financial year ending 30 June.
Buy/Sell spread	Nil
Distributions	Quarterly
Advice fee	Available