Fund Update

31 May 2017

ALTIUS ASSET MANAGEMENT

Altius Sustainable 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. The Altius Sustainable Bond Fund (Fund) is an Australian fixed interest fund that invests in companies which conduct their business and apply capital responsibly, giving full consideration to a range of environmental, social and governance (ESG) issues.

Performance as at 31 May 2017

	1 mth %	3 mths %	6 mths %	1 yr %	2 yrs % p.a.	Since inception[1] % p.a.
Total Return	**0.43**	**1.12**	**1.39**	**1.46**	**2.74**	**3.41**
Benchmark[2]	0.65	1.37	1.87	2.03	2.67	3.23
Active Return	-0.22	-0.25	-0.48	-0.57	0.07	0.18

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 21 November 2014.

[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 Fund performed

The portfolio produced a total return of 0.43% 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%.

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.

Rating exposure

	Portfolio %
AAA	57.80
AA+ to AA-	18.92
A+ to A-	15.85
BBB+ to BBB-	7.43

Top 20 holdings

	Portfolio %
Commonwealth of Australia	17.23
State of NSW	10.99
State of Victoria	6.84
NAB	5.41
State of Queensland	4.18
Westpac Banking Corp	3.63
ANZ Banking Corp	3.55
World Bank	3.05
Canada	2.42
Federal Republic of Germany	2.06
Nissan Motor Corp	2.05
Kingdom of Norway	2.04
Asian Development Bank	1.71
Kingdom of Netherlands	1.61
Citigroup	1.58
Nordic Investment Bank	1.27
New Zealand	1.15
GPT Group	1.13
Idol Trust	1.11
Kingfisher Trust	1.07

Maturity profile

Term	Portfolio %
0 – 1 year	21.47
1 – 3 years	21.02
3 – 5 years	29.57
5 – 7 years	13.72
7+ years	14.23

Sector Profile

Asset Class	Portfolio %
As at 30 April 2017	
Commonwealth Government	16.20
Semi Government	23.07
Supra Nationals	14.64
Financials	14.41
Industrials	11.14
Asset Backed	8.58
Money Market	3.05
11am	3.06
Cash at Bank	5.85

Portfolio summary statistics

	Portfolio
Running yield	2.16%
Modified duration	0.51 years

Fund snapshot

APIR Code	AUS0071AU
Inception date	21 November 2014
Fund size (net asset value)	$100.9m
Minimum initial investment	$5,000
Management Fees	0.5681% 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

How Altius measures sustainability

The Altius sustainability screen automatically excludes companies whose primary business activity is armaments, uranium, gambling, tobacco production, pornography, alcohol production and the production or sale of thermal coal.

Companies may also be excluded from the investment universe if, in the opinion of the Altius Sustainability Advisory Committee, they are materially involved in certain practices, such as causing or perpetuating injustice and suffering, infringing human rights and supporting oppressive regimes.

Altius then rank companies according to:

1. Environment effect
2. Social consequences and
3. Governance.

Full details of the Fund's investment criteria are in the Product Disclosure Statement.

About Altius Asset Management

Altius Asset Management, the appointed investment manager of the Fund, is part of the Australian Unity Group of companies which undertake investment activities, known generally as Australian Unity Wealth.

Altius takes a diversified approach to fixed interest funds management, combining both credit and duration strategies, and seeks to optimise returns for investors in all market conditions
The Altius investment team has an average of 25 years financial markets experience across global and domestic markets. The team's depth and breadth of experience in fixed interest markets enables it to remain flexible and adopt a high conviction investment style.

Its combined experience delivers a heightened understanding and appreciation of best practice implementation strategies in the fixed interest market.

RIAA-certified responsible investment product provider

Altius Asset Management Pty Ltd ABN 62 148 000 355, AFS Licence No. 401820 has been certified by RIAA according to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See www.responsibleinvestment.org for details.+

Award Winning Fund

Lonsec

The Fund recently won the Lonsec Innovation Award 2016, which recognises the major innovators and industry leaders who are shaping the future of Australia's wealth creation sector.
The Lonsec Awards go beyond the pure quantitative, looking at the people behind the investment decisions, the rigour of the investment process and philosophy, and the new thought and innovations that create real value for investors.

Lonsec does not issue, sell, guarantee or underwrite this financial product. Go to www.lonsec.com.au for details of its ratings criteria.

Zenith*

Zenith initiated a rating of Recommended on the Fund (as at June 15th 2017)

Important Information

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