ALTIUS ASSET MANAGEMENT | Australian Unity Real Wellbeing

Altius Green Bond Fund (Ordinary Units)

Fund Update
30 September 2024

The Green Bond Fund's purpose is to invest in green, sustainable and social bonds, with the primary aim of targeting investments that contribute to lowering carbon emissions. It is aligned with Australian Unity's values to create positive impact.

Performance as at 30 September 2024

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	Since inception % p.a.
Gross total return	0.41	3.33	7.73	(1.10)	(0.66)
Net total return	0.38	3.25	7.41	(1.40)	(0.96)
Benchmark	0.31	3.02	7.11	(1.19)	(0.94)
Excess to benchmark	0.07	0.23	0.30	(0.21)	(0.02)

Inception date for performance calculations is 18 June 2020.
Gross total returns are calculated before fees and expenses and assume 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.
Benchmark is the Bloomberg AusBond Composite 0+Yr Index.
Excess to benchmark is calculated on Net total return.

Portfolio Performance and Activity

Bond markets continued their strong run over September with the Australian Composite Bond Index producing a return of 0.31%. While positive, it lagged global markets with US Treasuries returning 1.2%. Locally, short end bonds drove monthly returns as globally Central Banks activity weighted on local market expectations of when the first policy cut would be delivered. Over the month 3 3-year bonds fell 0.11% to finish at 3.48% while 10-year rates were unchanged at 4.01%. Over the month the fund reduced its short duration position to finish the month at 4.78 years versus the benchmark of 4.93 years.

After Fed Chairman Powell delivered a dovish speech at Jackson Hole in August the Fed went on to deliver a 0.50% rate cut at the September meeting, marking the first rate cut since March 2020. The decision was larger than many in the market expected. Still, the larger move helped reassure market participants that the Fed would move quickly if an economic and job deterioration were to occur. Following the reduction the market moved quickly to price in additional easing by the December meeting. By the end of September, the market expected the cash rate to fall 4.20% by year-end.

As widely anticipated the RBA left policy rates unchanged at 4.35%. The post-meeting statement retained some hawkish language, the bank "remains vigilant to upside risks to inflation" and is "not ruling anything in or out" The key message communicated by Bullock at the press conference was that the bank was largely comfortable with the current policy settings, however, the market latched onto the comment that a hike was not explicitly considered at the meeting. Bullock later clarified that this was mostly because their assessment hadn't substantively changed since August. Short-end rates quickly moved lower by 0.10%, touching on monthly lows of 4.43% as confidence grew that rates could be lower at the December meeting. However, these lows were unable to be maintained as it became clear following the Q3 24 CPI release that Q1 2025 was more likely for the first easing of domestic policy.

Closing out the month was the significant stimulus package announced in China. Based on what was announced in mainstream media, it was estimated stimulus could exceed CNY 5tr, much larger than what the Government had announced over the past 2 years. It included a PBOC a policy cut, an RRR cut, property credit policy easing, and capital market support all at the same time. It quickly become clear that the government is trying to boost asset prices to break the deeply entrenched negative sentiment that has characterized the consumer and economy for the last few years. The announcements saw a sharp rally in the Chinese equity markets with the Hang Seng gaining 18% over September. Other notable events included the continuation of the global easing cycle with rate cuts being delivered by the ECB, Canada, Sweden, and Switzerland.

Globally credit markets started the month under a risk-off cloud amidst falls in equity markets, a challenging absolute yield environment, and a high level of primary issuance, however, spread volatility remained low, with the dominant driver being US fund's continued rotation into Fixed Income with a focus on High-Grade funds. The .050% cut from the Fed in the last week gave a boost to risk assets as investors' expectation of a soft landing grew, leading to a partial reversal of the earlier months' underperformance. At the end of the month five-year senior bank spreads had widened to 0.83% while Tier 2 debt underperformed by 0.05% to finish at a margin of 1.67%.

Increased allocations to Fixed Income in the US provided the backdrop for the continued strength of the US and European primary market but was the headwind for spread performance in September. Gross issuance in the US exceeded previous September records of $168bn marking the fourth month of record issuance. Issuance in the local market reached $11bn in September. On the

corporate front, Woolworths, Origin Energy, and Ausgrid all issued 7 years with Woolworths issuing 200m at the margin of 1.38%, Origin $500m at 1.65%, and Ausgrid $150m at 1.38% while Telstra issued $450m to 2030 at 1.05%. All deals were well supported. Lighter Financials issuance with Westpac issuing $2.7bn for 5 years at 0.85% and Norfina (Suncorp Bank) issuing $500m for 3 years and $900m for 5 years at 0.74% and 0.92% respectively.

Asset Backed markets continued a record setting pace in September with another 13 deals being bought to market. Auto transactions again featured heavily with five deals totaling $3.5bn. Four Residential (RMBS) deals priced totaling $3.7bn taking YTD issuance to $59,6bn the largest ever Q3 number and looks well on track to break the full year record with nine deals announced in early October. The high demand for low rated BBB tranches highlighting the strength of the securitised markets. The spread between the AAA tranches and BBB tranches on non-confirming mortgage deals now sits at just 0.65% compared to 3.15% in 2023.

Socially Responsible Investments in Focus

The Climate Bonds Initiative (CBI) has launched its updated Climate Bonds Taxonomy for 2024, a valuable tool for identifying climate-resilient investments. This comprehensive guide extends the 2012 taxonomy to include adaptation and resilience measures. The taxonomy categorizes investments into four types: adapting measures, adapted activities, enabling measures, and enabling activities. This framework aids issuers, investors, governments, and municipalities in understanding and accelerating climate-resilient investments.

Over 1,444 resilience and adaptation investments have been identified by CBI across sectors such as agriculture, infrastructure, healthcare, and more. Of these, 400 are automatically aligned with the taxonomy, demonstrating their direct contribution to climate resilience. For investments that don't automatically align, strict requirements are in place to ensure they manage "maladaptation" risks and contribute substantially to climate resilience without harming other climate objectives.

European banks are leading the charge in climate action. ING, a major European bank, has announced plans to phase out financing for clients lacking adequate climate transition plans. This follows a comprehensive assessment of 2,000 clients, revealing that one-third have insufficient disclosures.

ING has given clients until 2026 to demonstrate progress towards their climate goals. Those unable or unwilling to comply face stricter financing conditions or complete termination of their relationship with the bank. This proactive stance reflects a broader trend among European banks prioritizing climate action and aligns with increasing pressure from climate activists.

The Australian Securities and Investments Commission (ASIC) is taking a proactive approach to oversee compliance with mandatory climate reporting rules, which will take effect on January 1st, 2025. A new team within ASIC will develop regulatory guidance, assess applications for relief, and supervise compliance, ensuring a smooth transition for businesses.

ASIC will conduct its first annual climate-related disclosures surveillance program in 2026, examining the disclosures made by reporting entities. The regulator emphasizes a proportionate and pragmatic approach, acknowledging the need for a transition period as businesses adapt to the new requirements.

To facilitate compliance, the government has introduced modified liability settings until December 28th, 2024, protecting "protected statements" in sustainability reports from legal action. Mandatory audits will be required from July 1st, 2030, with phased-in assurance requirements under consultation.

The Science Based Targets initiative (SBTi) has released a decarbonization framework specifically designed for the buildings sector. This framework applies to developers, owners, property managers, and financial institutions. The framework focuses on four key actions for emissions reduction: halting fossil fuel installations, reducing in-use operational emissions, reducing embodied emissions, and retrofitting existing buildings. Measures include halting Fossil Fuel Installations: such as heating, cooking, power generation, and hot water equipment by 2030 or earlier.

Reducing In-Use operational and embodied emissions: and lastly the retrofitting inefficient buildings: As 80% of current buildings are expected to remain standing until 2050, retrofitting is crucial for decarbonisation.

The Climate Change Authority has released its Sector Pathways Review, which will inform the Australian Government's Net Zero by 2050 plan. The review considered the pathways for six sectors – agriculture and land; built environment; electricity and energy; industry and waste; transport and resources. It emphasized the importance of a national effort.

The report emphasizes the critical role of the electricity and energy sector in decarbonizing other sectors. It highlights the need to switch to electricity or electricity derivatives like electrolytic hydrogen and recommends strengthening the Capacity Investment Scheme to drive clean energy transition.

The review also addresses the challenge of removing hard-to-abate CO_2 emissions, proposing strategies like carbon uptake on land and technological advancements. It advocates for a broad-based carbon price and emphasizes the importance of policy reforms, workforce development, financial support, and collaboration to overcome barriers and achieve emissions reduction targets.

Outlook

Globally, many major central banks have commenced a rate cut cycle aimed at reducing the restrictiveness of monetary settings.

Interest rate markets have removed the excessively sharp adjustment of expected cash rates to across dollar bloc economies over the next year. As highlighted last month, the speed and quantum priced into short term rates we believed was too aggressive in jurisdictions where the labour market is not significantly weak.

The current pricing of four to five 25 basis point rate cuts in the US, and for Australia, one rate cut with a chance of a second 25 basis point cut by mid- 2025 put associated bond pricing at attractive levels.

Inflation is gradually shifting lower toward central bank targets There is an unevenness in inflation profiles across regions and this will impact the timing and quantum of central banks adjustments to policy settings. The lags have largely resulted from variation in energy costs, labour market and wage negotiation rigidities, population growth, fiscal pulses and financial conditions.

The US Federal Reserve commenced its rate reduction cycle with a larger than expected 50 basis point cut. The size of the cut doesn't reflect a dire economic scenario. Instead, it depicts an intention to remove excessively tight monetary settings that had built up whilst the Fed has waited for greater clarity around the path (lower) of inflation.

Reflecting the lag between the US and Australia, and an incremental difference in labour market balance, the Fed President

specifically noted that "wages are unlikely to contribute to inflation". By contrast, Australian wage settings remain an area where the RBA is keeping a watchful eye.

The Canadian and New Zealand inflation has fallen meaningfully toward target as monetary settings were sharply cutting into aggregate demand and the housing cost pressures due to the population surge eased. Materially weaker labour markets have resulted in a central bank pivot toward employment objectives with justifiable pricing in interest rate markets.

New Zealand long dated sovereign bonds are expected to outperform Australian peers. Given the expectation of cash rate convergence and ten year New Zealand Bonds offering a 0.40% pickup; there is strategic value in holding New Zealand bonds (hedged into Australian dollars).

In contrast, Australia's inflation is tracking at higher levels than many of its global peers. While interest rate sensitive discretionary spending has collapsed, falling 1.2% over the last quarter, Inflation is being driven by non-discretionary items such as insurance, transport costs and food prices. Record levels of public infrastructure and consumption are underpinning aggregate growth and pockets of cost pressures.

Housing has a large weighting within the inflation basket. Australian "asking rents" are tracking at 8.4 per cent- higher than measured rents currently in the CPI. The significant population growth and shortage of housing supply mean rents will still have an upward bias to the CPI going forward.

Labour market conditions have not particularly deteriorated in aggregate. Indeed, underemployment has not lifted at all over the last year. Australian wage bargaining outcomes are bias to redress cumulative fall in living standards, resulting in inflation remain stickier for longer. Importantly, the RBA is careful to not cause longer term damage to the economy by weakening the labour market in an effort to shift inflation lower more swiftly.

The case for a rate hike has likely only just been avoided, with the decision not to tighten more reflective of international central banks easing.

That global cash rate expectations have shifted market implied Australian cash rates to an easing cycle commencing this year. We think this premature. The RBA likely needs a further two quarterly inflation readings that display progress towards inflation returning to target slightly more quickly than forecast before cash rate cuts can be considered.

Australia's real cash rate is 0.55%, suggests that monetary settings, while restrictive, are not as restrictive as peers. By contrast, US, Canadian and New Zealand real cash rates vary between 1.75 and 2.75%.

Contained interest rate volatility and / or the likelihood of a soft landing is a tailwind for high grade credit, but risk premiums are at the lower end of recent ranges which will slow further spread performance.

In general, inflation is retreating. This biases the portfolio toward increasing exposure to longer dated bonds. The stepped and somewhat uneven inflation path points to periods of range trading. The range on Australian long dated bonds is expected to oscillate around a midpoint in 10-year Australian sovereign bonds of 3.8%.

The portfolio strategy is to actively manage duration settings; incrementally increasing long bond exposure above this point and vice versa. At time of writing, Australian sovereign yields are around 4.20% implying the expectation of capital gains.

Fund snapshot

APIR code	AUS0084AU
Inception date	18 Jun 2020
Distribution frequency	Quarterly
Minimum initial investment	$100,000
Fund size (net asset value)	$159.09m
Management fee*	0.30% p.a. expressed as a percentage of the net asset value of the Fund
Buy/Sell spread	0.05%/0.05%

*Refer to the Fund's Information Memorandum 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 %	Benchmark %
Supranationals	11.37	7.44
Industrials	18.12	4.78
Financials	15.24	4.50
Asset Backed	3.58	0.00
Agencies	10.14	1.43
11AM	0.02	0.00
Cash at Bank	1.86	0.00
Sovereigns	9.58	50.17
Semi Government	30.10	31.67

Ratings Exposure

Rating	Portfolio %	Benchmark %
A	13.65	2.99
AA	44.68	32.87
AAA	33.63	61.25
BBB	8.04	2.89

Maturity Profile

Term	Portfolio %	Benchmark %
0 - 1 Year	2.45	9.22
1 - 3 Years	29.03	20.14
3 - 5 Years	17.39	20.88
5 - 7 Year	13.62	16.45
7+ Years	37.51	33.32

Top 10 Issuers

Issuer	Portfolio %	Benchmark %
New South Wales Treasury Corp.	12.34	8.76
Government of Australia	9.58	50.17
Treasury Corporation of Victoria	7.86	9.23
Queensland Treasury Corp.	7.41	6.66
Housing Australia	6.19	0.14
Commonwealth Bank of Australia	5.80	0.40
NBN Co Limited	4.47	0.31
Bank Australia Limited	3.82	0.00
International Bank for Reconstruction & Development	3.67	0.79
Woolworths Group Limited	3.61	0.13

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	4.32	4.11
Running yield (%)	3.63	
Modified duration (years)	4.78	4.93

Ratings / Awards

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Effective 25 September 2024, Australian Ethical Investment Ltd (ABN 47 003 188 930, AFSL 229949 was appointed by AUFM as the investment manager of the fund.