Altius Sustainable Bond Fund

Fund Update
31 March 2024

Altius Asset Management 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 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 March 2024

	1 mth %	3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	7 yrs % p.a.	Since inception % p.a.
Gross total return	0.92	1.41	4.55	1.30	1.44	1.93	2.46
Net total return	0.88	1.28	4.04	0.79	0.85	1.31	1.81
Benchmark	0.74	1.05	2.84	0.43	0.86	1.57	1.92
Excess to benchmark	0.14	0.23	1.20	0.36	(0.01)	(0.26)	(0.11)

Inception date for performance calculations is 21 November 2014.
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.
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Effective 1 July 2016, Benchmark is 50% Reserve Bank of Australia Cash Rate and 50% Bloomberg AusBond Composite 0+Yr Index and applied retrospectively for all periods.
Excess to benchmark is calculated on Net total return.

Portfolio Performance and Activity

Global bond yields drifted lower over March with soft economic data in the first half of the month being the main catalyst. While data surprised to the upside in the second half, bond yields were largely unchanged. Again, inflation was the dominate theme, as concerns about the level of stickiness saw expectations of the first policy easing pushed further into 2024, with the US now expected to start after June 2024 and Australia in November 2024. Over the month, Australian 3 and 10-year yields fell modestly by 0.08% and 0.18% respectively to finish at 3.62% and 3.96%, while the US two years were unchanged at 4.62% and 10 years were 0.05% lower at 4.20%. After starting the month with 2.80 years of interest rate risk we reduced the small overweight to finish the month at 2.70 years.

US economic data and central bank commentary dominated the first half of March. The US ISM manufacturing index kicked off the month, disappointing across the board. Manufacturing was down to 47.8 from 49.1, new orders falling to 49.2 and employment to 45.9. All components surprised to the low side and set the tone for markets. This was followed by a softer than expected US labour force number which saw unemployment rise to 3.9% from 3.7% and revisions lower to the January number. The release of the higher-than-expected CPI saw a reversal in market sentiment. Annual core CPI came in at 3.8% up from 3.7%. The past two months printed at 0.4%, reinforcing the view that inflation is stickier than previously expected, making it harder to mount a case for a pre-June Fed rate cut. The US Federal Reserve met on March 20th, with markets very keen to see the FOMC's assessment of monetary policy direction. The March dot plot continued to show three cuts in 2024 but slightly higher policy rates in the 2025 and 2026 compared to previous forecasts. Although Chair Powell acknowledged the hotter inflation prints, the inflation story was "essentially the same" with recent prints more likely a bump rather than a change in the trend.

March was a significant milestone for the Japanese markets, with the Bank of Japan ending the negative interest rate policy setting, set in 2013. The move had been largely telegraphed to the markets which meant market reaction was very muted with the two years rising a few basis points to 0.18%, a level however not seen for over decade. Even with the hike, the prospect of low rates continuing for some time meant the Japanese Yen remained very weak. A bigger surprise for markets was the Swiss National Bank became the first central bank with a G10 currency to cut rates this cycle, with a 0.25% cut in policy to 1.50%.

Locally, the month opened with the release of the Q4 GDP print of 1.5% YoY. While soft, it was in line with the RBA's February forecasts, meaning it was unlikely to impact the RBA's thinking on monetary policy. The number highlighted the poor state of the customer with spending up just 0.6% over 2023. Looking deeper into the release it was difficult to find any real positives with new dwelling construction negative, business investment lacklustre and public spending being boasted by the one-off spending related to The Voice.

The RBA met on 19 March, leaving cash rates unchanged at 4.35% but the statement was more dovish than many expected. The explicit reference to possible further rate increases was replaced with the more neutral statement of "the path of interest rates that will best ensure that inflation returns to target (is) uncertain, and the Board is not ruling anything in or out". The statement was also more subdued on wages with the Board not expecting wages to increase much further from here and showed an increased comfort on inflation noting "there are encouraging signs inflation is moderating." Finally, days following the RBA meeting saw the release of a very strong employment print. Employment grew by 116k offsetting the weak December and January releases, unemployment rate dropped back to 3.7% from 4.1% and the hours worked grew by 2.8%. While the number had little effect on policy expectations it does reduce the chance of an early move.

Credit spreads were largely unchanged over March as ongoing primary supply started to weigh on markets. While March saw limited issuance from the Major banks, momentum was retained with a mix of other Australian banks and offshore issuers. Tier 2 issuance was particularly high during March. High yielding issuers remained the favored sector as investors continued to search for yield following the strong spread performance over the quarter. The theme of steepening bank spread curves continued throughout March with Major bank short-dated securities performing well, with the one-year tightening 0.09% over the quarter, while the five-year maturity was largely unchanged at 0.90%. Despite the five-year Major curve being unchanged, price makers reported little to no selling pressure from investors.

Primary issuance from the financial and corporate sectors remained high in March. Financial issuance was seen from Mizuho with a 4-year deal at a margin of 0.88% with little new issue concession. This was followed by Suncorp Bank issuing for five years at a price of 0.98%, 0.08% wider than the (likely) new parent, ANZ. ING Australia debuted with a three-year deal at 0.95% while Kiwibank returned to market with a three year at a margin of 1.02%. NAB bought the largest Major bank senior transaction issuing $4.5bn for five years at 0.90%.

March was another active month for Tier 2 issuance. HSBC completed $1.5bn of a 10NC5 at 2.30% and produced a $5.8bn orderbook, eclipsing the previous record set by Macquarie Bank in February. Westpac completed $1.25bn of a 10NC5 deal at a margin of 1.88%, representing the tightest level since August 2021 and the largest order book by a Major bank at $4.3bn. The two transactions took Tier 2 supply to $8bn, the largest quarter on record. Issuance volumes started to weigh on secondary market levels with spreads moving off there mid-month low of 1.80% to finish the month around 1.87%.

Corporate issuance both locally and globally remained strong through March. Over the March quarter the US market saw $529bn of issuance, a record for any Q1. Europe was a similar story with a record $680bn issued. Despite the record volumes the market has been well supported by the stable interest rate outlook and solid funds inflow which saw US Investment grade spreads at their lowest level seen since 2021. It was a similar story in the local market, supply has been strong which has been met with solid order books, limited new issue concessions and strong secondary performance. Corporates issued $6.8bn in March. This included issuance from REIT's (Region and Stockland), utilities (AusGrid, United Energy and Victorian Power Networks) and the first kangaroo corporate deal for 2024 from Nestle, issuing $600m for 5 and 10 years at a margin of 0.78% and 1.13% respectively.

Socially Responsible Investments in Focus

Big Oil Falls Short on Climate Disclosures: A new assessment by Climate Action 100+ reveals major gaps in climate disclosures from the world's 10 largest oil and gas companies. These companies scored poorly on metrics related to emissions reductions and future production plans, raising concerns about their commitment to net-zero goals. European companies performed better overall compared to North American peers, highlighting a regional divide in the industry's climate approach and underlines ongoing risks for investors in traditional fossil fuel companies. https://www.climateaction100.org/news/climate-action-100-publishes-net-zero-standard-for-oil-gas-company-assessments-alongside-analysis/

EU Takes Aim at Biodiversity Risks: The European Commission has released a framework to help financial institutions assess and manage biodiversity risks. This framework aligns with existing environmental risk management standards and encourages institutions to quantify the financial impacts of these risks. As biodiversity loss becomes a growing concern, sustainable debt investors should look for institutions that are proactively addressing this issue. https://www.environmental-finance.com/content/news/eu-releases-biodiversity-risk-assessment-framework.html

ECB Cracks Down on Banks' Climate Inaction: The European Central Bank (ECB) is preparing to fine 18 banks for failing to meet expectations on climate risk management. These banks haven't properly assessed their exposure to climate-related risks, highlighting potential vulnerabilities in the financial system. Investors in sustainable debt may see this as a positive step towards a more climate-conscious financial sector. https://www.environmental-finance.com/content/news/ecb-says-18-banks-face-fines-for-failing-to-meet-climate-expectations.html

Canada Mandates Climate Reporting for Banks and Insurers: Canadian financial institutions will be required to report climate-related financial information in line with international standards. This includes disclosing scope 3 emissions, which are those generated throughout a company's value chain. This move by Canada strengthens transparency and accountability for financial institutions, potentially making it easier for investors to identify sustainable debt opportunities. https://www.osfi-bsif.gc.ca/en/guidance/guidance-library/climate-risk-management

Concerns Raised Over Nature-Based Carbon Credits: A new study by the Environmental Defence Fund questions the carbon reduction benefits of many nature-based carbon credit projects. The research suggests that some project types lack a strong scientific basis for their claimed emissions reductions. Investors in nature-based solutions should prioritize projects with robust methodologies and proven benefits. https://www.nature.com/articles/s41558-024-01960-0

Renewable Energy Investment Slumps in Australia: Australia's renewable energy investment has dropped significantly, jeopardizing the country's ability to meet its 2030 climate targets. This news underscores the need for urgent action to streamline approvals, expand the transmission grid, and attract investment in clean energy projects. Sustainable debt instruments could play a role in financing this transition. https://www.afr.com/companies/energy/investment-in-renewable-energy-slumps-80pc-as-2030-target-fades-20240312-p5fbu9

US Securities and Exchange Commission (SEC) Releases Scaled-Back Climate Disclosure Rules: The SEC has finalized its long-awaited climate disclosure rules for publicly traded companies. However, the final version is less stringent than the initial proposal. Notably, only large companies will be required to disclose certain climate-related information, and scope 3 emissions reporting is not mandated. While this might be seen as a setback for comprehensive climate transparency, it could still provide valuable insights for sustainable debt investors. https://www.sec.gov/news/press-release/2024-31

Outlook

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

Growth is expected to be uneven and weaker in sectors reliant on discretionary consumer activity. In Australia, discretionary spending has virtually stopped, and some degree of savings has lifted among those who can.

Unemployment remains toward 50-year lows and has lunged lower recently, though this may be reflective of the sampling and seasonality issues. While this is the case and inflation is above target, the RBA's inflation mandate remains the greater focus for monetary conditions.

The US economy is benefitting from the fiscal expansion and onshoring associated with the Inflation Reduction Act. Ultra-low mortgage rates have been locked in previously and so most consumers have been barely squeezed (relatively) by the lift in borrowing rates. In contrast to Australia, US real wages were only briefly negative and are once again positive, thus underpinning growth without a wage response needed to (lift) purchasing power.

Key inflation differences have a further impact on monetary settings.

US inflation has eased in no small part due to new "rents" (including owner-occupied equivalent) being below-measured rents. To the extent new rents become part of measured rents, so the measured rent level falls. This segment makes up 33% of the basket; a far larger impact compared to Australia and Europe.

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, noting the rental subsidy effect was temporary.

We expect lower Australian headline inflation and a less supply-constrained labour market to allow more modest wage growth in aggregate compared to last year. But the cumulative negative 7.5% real wage growth of the last three years will likely see wage negotiations attempt to claw back the loss of disposable income. Wage increase pressures should remain elevated – though not acute - over a longer time horizon.

Rising insurance costs, and domestic flood-inspired damage to crops and infrastructure coupled with rebounding global oil prices add some inflation pressure.

Largely reflecting a real rates argument, the US can ease cash rates but retain a restrictive bias to monetary settings. Its strong employment and somewhat uniquely solid economy should determine a cautious approach.

The commencement of a gradual US easing cycle in the middle of the year introduces a disinflationary bias through the currency channel and influences the RBA's reaction function.

We expect Australian cash rates to be eased during the fourth quarter. This reflects the higher starting point and more gradual decline of inflation.

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%. 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 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 extension of a low volatility environment correlates bullishly (via reduced risk premia) with higher-yielding corporate bonds converging with- and outperforming - sovereign bonds with a preference for short-dated financials.

A further measure of value that we find in the high-grade corporate market is related to the yield on the Australian Corporate Index is 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 (10NC5) subordinated bond yields above 6%.

Sector Profile

Asset Class	Portfolio %	Benchmark %
Supranationals	7.93	3.99
Industrials	14.86	2.24
Financials	31.47	2.28
Asset Backed	11.29	0.00
Agencies	6.74	0.70
11AM	5.22	0.00
Cash at Bank	1.57	0.00
RBA Cash	0.00	50.00
Sovereigns	0.94	25.27
Semi Government	19.97	15.53

Ratings Exposure

Rating	Portfolio %	Benchmark %
A	24.68	1.47
AA	36.93	15.87
AAA	23.58	31.25
BBB	14.81	1.41
RBA Cash	0.00	50.00

Top 20 Issuers

Issuer	Portfolio %	Benchmark %
New South Wales Treasury Corp.	8.92	4.29
Treasury Corporation of Victoria	5.76	4.47
Westpac Banking Corporation	4.56	0.29
NAB 11AM A/C - Deposit Accounts	4.00	0.00
Commonwealth Bank of Australia	3.95	0.21
Queensland Treasury Corp.	3.78	3.43
Australia and New Zealand Banking Group Limited	3.67	0.23
National Australia Bank Limited	3.39	0.23
NBN Co Limited	2.95	0.15
Housing Australia	2.55	0.08
KfW	2.51	0.59
Airservices Australia	1.98	0.04
Wesfarmers Limited	1.90	0.03
BPCE S.A.	1.90	0.07
Woolworths Group Limited	1.87	0.07
International Bank for Reconstruction & Development	1.85	0.42
Bank Australia Limited	1.82	0.00
Kommunalbanken AS (Norway)	1.66	0.25
APOLLO Series 2023-1 Trust	1.60	0.00
Macquarie Bank Limited	1.55	0.05

Portfolio Summary Statistics

	Portfolio	Benchmark
Yield to maturity (%)	5.16	4.23
Modified duration (years)	2.70	2.54

Fund snapshot

APIR code	AUS0071AU
Inception date	21 Nov 2014
Distribution frequency	Quarterly
Minimum initial investment	$5,000
Fund size (net asset value)	$163.60m
Management fee*	0.37% p.a.
Buy/Sell spread	0.05%/0.05%
Advice fee	Available

*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.

RIAA - Certified Responsible Investment

The Altius Sustainable Bond Fund 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.

CERTIFIED BY RIAA

Ratings / Awards

Investment Grade Lonsec Research

Zenith APPROVED

2016 Innovation Winner Lonsec

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