

Antares Inflation Linked Bond Fund

Monthly Investment Report



December 2018

Period Ended 31 December 2018	1m %	Qtrly %	1 Yr %	2 Yr % pa	SI* % pa
Portfolio*	0.54	0.83	2.97	2.87	4.39
Bloomberg Govt Inflation Index 0-10	0.58	0.83	2.82	2.78	4.27
Difference	-0.04	0.00	0.15	0.09	0.13

Funds under management: \$126,582,964.69

* Inception 7 June 2011 therefore part month performance

Returns are expressed before deducting tax and investment management fees

Key Characteristics

	Trust	Benchmark
Real Interest Rate Duration (yrs)	4.94	4.88
Active Nominal Duration	-0.04	-
Running yield (RY %)	0.69	0.62
Semi spread duration (yrs)	1.11	0.89
Weighted Avg Credit rating	AAA	AAA

Portfolio positioning and Quarterly review

Strategy	Position	Market movement	Performance (bp)
Duration (ix27):	0.1	-17bps	+1.3
Curve:			
2022-27 RY	0.1 flattener	-22bps	+2.25
10-20 RY	-	-	-
BEI (10yr)	flat	-30bps	-
RV:			
ZCS – BEI iota	-		
Credit:	-	-	
Semis	0.3	+1bps	-0.25
Running Yield			+0.5
Other (pricing/t-costs)			-4.0
Total			+0.0

Attribution

Excess returns were flat for the quarter notwithstanding a significant repricing in BEIs across the curve. Weighing on performance was semi spread widening (-0.25bps) after some repricing in December following general risk aversion and push wider in the more illiquid semi linkers. The portfolio also saw some tracking error into month end between Bloomberg (ausbond index) and custodial pricing (-4bps). For most of the quarter global growth concerns and a precipitous fall in oil prices weighed on investor sentiment resulting in 3 standard deviations moves lower in BEIs, falling to levels last seen in early 2016 when the CPI printed negative, and the RBA subsequently cut rates twice that year. In the later stages of the quarter the portfolio reduced some its short reals positioning to a relatively square overall risk position.

Semi government bonds widened with the Tcorp 2025 linker repricing over 4bps wider in December while the TCorp 2028 Green bond with its 0.3 modified duration contribution led to a modest drag on alpha, as well. Elsewhere, the real yield curve continued its prodigious flattening 10bps in the month and 22bps through the quarter, assisted by rising funding costs impacting shorter bonds and a hiatus in issuance following the AOFMs' cancellation of its December bond tender.

Market Overview

Bonds saw bullish moves across all markets in the December quarter. These bullish conditions had several catalysts, including deteriorating US data, concerns over a global slowdown, fears over Fed policy error and ongoing trade tensions between the US and China. Compounding the concerns over global growth was also a USD28 decline in WTI, which closed the quarter at USD45.33. The collapse in the U.S economic surprise index reflected the broad deterioration in economic data through November and December, with significant misses in the ISM manufacturing, jobless claims job opening (JOLTs), housing starts, new home sales and durable goods orders. The one bright area however was the labour data with payrolls remaining above 300k with hourly earnings rising above 3%.

In terms of Fed policy, the FOMC hiked 25bps in its December meeting while leaving their balance sheet run-off programme unchanged. The latter in particular disappointed markets given concerns over growth and the effective tightening perceived from the Fed's Quantitative Tightening programme. Real yields rallied through the quarter albeit with a lower beta to nominal bonds, as the market revised its inflations expectations lower. The 2027 linker rallied 11bps, at a beta to the Nov 2027 nominal equivalent to 0.3.

The short end of the inflation curve was hit particularly hard given the confluence of falling oil prices, rising funding pressures and higher repo costs combined with deteriorating sentiment over US-China relations and slowing global growth. The 2020 Real yield struggled to perform, in fact moving higher in yield over the quarter (+33bps) leaving its BEI 29bps lower at 1.38. The 2022 BEI became inverted to the 2020 as the nominal curve started to price in the prospect of rate cuts from the RBA. The 2022 BEI fell 38bps over the quarter to 1.33%, equivalent to 2.29 standard deviations on a rolling 3 month basis (3.8 standard deviations,

annualised). The 2027 BEI fared only slightly better, falling to 1.66%, down 20bps over the quarter, helping to push the BEI curve steeper and the 2022/2027 real yield curve flatter by 23bps to a low of 16bps.

Strategy and Outlook

At the end of the quarter money markets were discounting the prospect of rate cuts in Australia and the US, with general bond pricing factoring a more negative fundamental global outlook. Still, we expect economic data to continue to deteriorate, with China the focal point for the global slowdown. Coupled with this, domestic conditions following the Q3 GDP argue for continued caution and with house prices and building activity falling, leaving near term pressures on inflation absent for now. Against this backdrop, the RBA will be sidelined for the foreseeable future and may be compelled to change its forward guidance, introducing a greater level of risk symmetry around the path for interest rates. Any increase in tail risks from here, including trade wars, funding pressures, housing market wobbles and what that might mean for household consumption bare watching closely. In the meantime, the portfolio looks constructively to adding cheap inflation protection while maintaining modest long positioning in rates, primarily through real yields.

Australian Rates	December 2018	Month Change	Quarterly Change
RBA Cash Rate	1.500	0.00	0.00
90 Day Bank Bill	2.090	+0.14	+0.15
3 Yr Futures	98.200	+0.28	+0.31
10 Yr Futures	97.680	+0.28	+0.37
3/10 Spread (bps)	52.0	0.0	-6.5
ITraxx Australia 5Y	95.1	+8.6	+20.5
10Yr BEI	1.64	-0.16	-0.22

Global Sovereign Rates	December 2018	Month Change	Quarterly Change
Fed Fund Rates	2.40	+0.20	+0.22
ECB Main Refi Rate	0.00	0.00	0.00
US Sovereign 2 Yr	2.49	-0.30	-0.33
US Sovereign 10 Yr	2.68	-0.30	-0.38
Japan Sovereign 10 Yr	0.00	-0.09	-0.13
German Sovereign 10 Yr	0.24	-0.07	-0.23

Currencies	December 2018	Month Change	Quarterly Change
AUD/USD	0.705	-0.026	-0.018
EUR/USD	1.147	+0.015	-0.014
USD/JPY	109.690	-3.88	-4.01

Equities	December 2018	Month Change	Quarterly Change
ASX200	5646	-0.4%	-9.0%
S&P500	2507	-9.2%	-14.0%

Commodities	December 2018	Month Change	Quarterly Change
WTI Crude	45.4	-5.7	-27.3
Gold	1282.5	+62.0	+91.6

Australian Economic Data	Latest Print	Month Change	Quarterly Change
Employment Change (k)	37.0	+8.3	-6.4
Unemployment Rate (%)	5.1%	+0.1%	-0.2%
Retail Sales (MoM%)	0.4%	+0.1%	+0.1%
Trade Balance Value (m)	1,925	-88	-74
Building Approvals (MoM%)	-9.1%	-7.7%	+0.7%
Consumer Confidence (Westpac)	104.4	+0.1	+3.9
Business Confidence (NAB)	3.2	-1.3	-2.3
Business Conditions (NAB)	10.6	-2.1	-4.3

Australian Economic Data	Latest Quarterly (Q3)	Quarterly Change	1 Yr Change
Private Capital Expenditure (QoQ%)	-0.5%	+0.4%	-0.3%
GDP (YoY%)	2.8%	-0.3%	+0.4%
Inflation (YoY%)	1.90%	-0.2%	+0.0%

Global Economic Data	Latest Print	Month Change	Quarterly Change
US Non-Farm Payrolls (k)	312	+136	+312
US Unemployment Rate (%)	3.9%	+0.2%	+3.9%
US Manufacturing ISM	54.1	-5.2	+54.1
US Non-manufacturing ISM	57.6	-3.1	+57.6
China Manufacturing PMI	49.4	-0.6	+49.4
China Non-Manufacturing PMI	53.8	+0.4	+53.8
German Factory Orders (MoM%)	-1.0%	-1.2%	-1.0%
German Industrial Production (MoM%)	-1.9%	-1.1%	-1.9%

Semis * vs Gov Bonds	December 2018	Month Change	Quarterly Change
3yr (bps)	23.7	-2.92	+3.38
7yr (bps)	41.6	+4.06	+3.94

* Semi calculation comprises an equal weighting of NSWTC and WATC

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Antares is focused on delivering performance objectives for our clients within a carefully managed and defined risk framework.

*as at 30 Sept 2018

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