Antares Inflation Linked Bond Fund

Monthly Investment Report

November 2019

Performance

Period Ended 30 November 2019	1m %	Qtrly %	1 Yr %	2 Yr %	SI* % pa
Portfolio*	**1.02**	**1.13**	**7.49**	**4.68**	**4.73**
Bloomberg Govt Inflation Index 0-10	1.01	1.12	7.37	4.53	4.60
Difference	**0.01**	**0.01**	**0.12**	**0.15**	**0.13**

Funds under management: $122,220,900
* 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)	4.44	4.39
Active Nominal Duration	0.03	-
Running yield (RY %)	-0.53	-0.57
Semi spread duration (yrs)	0.96	0.76
Weighted Avg Credit rating	AAA	AAA

Portfolio positioning and review

Strategy	Position	Market movement	Performance (bp)
Duration (ix30):	+0.05	-12bps	+0.6
Curve:			
2022-27 RY	-0.05	+14bps	-0.07
10-20 RY	-	-	
BEI (ix20)	0.05	+22bps	+1
RV:			
ZCS – BEI iota	-		
Credit:	-	-	-
Semis	+0.5	-	-
Running Yield	flat		-
Other (pricing/t-costs)			
Total			**+1 bps**

Performance and Attribution

The performance from Inflation linked bonds evident this month was driven in a large part by a solid rally in BEIs across the shorter maturities. The fund maintained a small overweight to short BEIs. A combination of cheap valuations, positive Q3 CPI and positive projections for Q4 CPI resulted in the shorter maturities outperforming. Specifically, long ix20 positioning, combined with overall long (real yield) duration, modestly hedged with short nominal futures, to contribute to alpha performance over the month.

Market Overview

Nominal bond yields rallied through November with the Aussie 10yr bond (futures) rate lower by 11bps, lagging the move in the 3yrs, which rallied 16bps. This took the curve 5bps steeper to 38.5bps. US treasuries underperformed both relative and outright terms, with the UST 10yr and 2yr selling off 9bps, respectively.

After a solid bounce in Australian 10yr BEIs, off all-time lows of 1.10%, longer dated BEIs steadied in November, rising 1.6bps for the 2030s. From its trough in late August, the 2030 BEI rose 26bps to peak at 1.47% in early November, and close the month at 1.40%.

Over November shorter tenors continued to accelerate higher driven by expectations for another elevated CPI print forthcoming for Q4 and for high carry to continue driving valuations. The 2022 BEI rose 14bps over the month while the 2020 BEI lifted an impressive 22bps over the same period. As a result, the BEI curve has become quite flat and inverted in places, with the generous carry in the shorter bonds and lack of term risk premia in the longer bonds largely responsible for this.

Strategy and Outlook

Looking forward, BEIs are likely to see some near term downward pressure, as domestic data continues to roll in with negative overtones, while poor liquidity conditions through to year end could lead to greater volatility around real yields making linker-nominal hedging this time of year more challenging.

Over the medium term however several factors remain supportive of long BEI positioning. Longer dated tenors, such as the 2030s+ offer running yields which compare very favourably with their nominal counterparts. For instance, the 2030 linkers running yield (real yield accrual + inflation accrual) currently provides investors with an annualised 2%, some 85bps above the prevailing running yield for the 10yr nominal bond. Equally, the short real bonds offer attractive IRRs, when we project inflation forward. At this stage Q4 CPI looks to be on par with both Q3 and Q2, helping to maintain an elevated inflation carry for at least another 3 months, with the all-in carry for the ix22s dwarfing that of equivalent nominal bonds and Bank Bill rates.

Whilst overall BEIs typically move in the direction of changes in carry (currently very favourable) the global backdrop will continue to heavily influence valuations. Recent economic data has improved from the depressed levels seen in recent months, and financial conditions remaining highly supportive given the easy stance of most central banks. Hence, conditions for reflationary trades remain intact provided confidence around durable US-China trade negotiations and more positive geopolitics can be maintained.

Domestically, household consumption continues to weigh on GDP and business sentiment, raising the spectre that further rate cuts will be ineffective and QE may be required. Indeed, in November we heard from Dr Lowe from the RBA outline that the effective lower bound in the cash rate is 0%-0.25%, at which point QE and/or Fiscal policy would need to be considered if further stimulus were required. If the QE option was exercised the RBA has a clear preference for government bond purchases over LTRO style QE measures. Bond purchases would likely be across the curve and would signal to the market that the RBA was serious about keeping rates lower for longer.

The implication of this for portfolio positioning is ultimately a bond bull flattening trade, with Australian rates likely to become even more inverse to US treasury rates. If linkers were also included in the mix, BEIs would very likely receive a significant boost in performance.

Contacts

Tano Pelosi
Antares Fixed Income
Level 20, NAB House
255 George Street
Sydney NSW 2000
Ph: 02 8274 4999

Reporting & Client Services
Level 21, NAB House
255 George Street
Sydney NSW 2000
Email: info@mlcam.com.au
Phone: 1300 738 355

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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 June 2019

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