Antares Diversified Fixed Income Fund

Monthly Investment Report

June 2020

Fund Performance

Period Ended 30 June 2020	1 mth %	Qtrly %	SI* %
Composite Portfolio	**0.62**	**1.21**	**4.15**
Bloomberg AusBond Composite Bond Index	0.31	0.31	3.90
Difference	**0.31**	**0.90**	**0.25**

Valuation as at month end was $325,630,918.29
** Inception date of the new Fund was 09/07/2019.*
Returns are expressed before deducting tax and investment management fees.

Portfolio Review

Key Drivers of Portfolio Performance:

+ Spreads on Banks and Corporates tightened 5-20bps contributing 35bps to performance.
- Bought CDS protection on iTraxx and major banks detracted 8bps from returns.
- Semis and Supras tightened 6-10bps versus bonds detracting 7bps from returns.
+ Yield enhancement & roll down of quality investment grade bond holdings.

Portfolio Activity and Positioning

- Maintained a 0.15 long duration/flattening position via 10yr futures.
- Switched 3yr major bank frn's into a Sumitomo 5yr frn for a pickup of over 50bp
- Bought 10yr WSO Finance
- We have maintained the very liquid structure of the fund.

Return Attribution

Description	BP's
Duration	0
Curve	+5.2
Sector	+21.0
Yield Enhancement	+5.1
Excess Return	**+31.3**

Exposure

Sector	Interest Rate MDC	Credit Spread MDC	MV%
Cash	0.00	0.00	0.9
Govt Nominal	0.73	0.00	4.5
Semi-Gov Nom	0.92	0.92	10.9
Supra/Agencies	0.00	0.00	0.0
Corp Fin Fixed	0.47	0.47	13.7
Corp Fin FRN	0.04	1.10	32.6
Corp Others Fixed	1.29	1.29	27.4
Corp Others FRN	0.00	0.01	0.6
Covered Bonds	0.00	0.00	0.0
Derivatives Interest Rate	2.43	0.00	0.1
Derivatives CDS	-0.01	-0.76	-0.4
RMBS	0.00	0.16	8.0
Money Market	0.00	0.00	1.9
Total	**5.89**	**3.21**	**100.0**

Key Characteristics

	Fund	Benchmark
Interest Rate Duration (yrs)	5.95	5.80
Running yield + Rolldown (%)	1.74	0.80
Credit spread duration (yrs)**	4.21	2.19
Average credit rating	A+	AA+
Liquidity*	20%	100%

* Liquidity deemed available in 48 hours; includes Government and Semi Government bond holdings.
** Includes credit spread duration from Semi-Government bonds.

Market Outlook

- Notwithstanding still elevated global Covid-19 infection rates, markets retain their positive approach to risk assets but will this be sustained?
- Overwhelming stimulus from central banks with promises to do "whatever it takes" to prevent an economic collapse sustains the widely held belief that the central bank "puts" provide investors with a bet each way. The continuing spread of the virus has seen markets rally on the assumption that Central Banks and Governments will have to provide more stimulus.
- The economic prospects in the major western economies look a lot less positive and expectations of a V shaped recovery seem overly optimistic. The rebound in growth has been driven primarily by monetary and fiscal stimulus; at some stage the stimulus will have to be reduced, placing pressure on the economies to grow unassisted. Furthermore, the stimulus needs to be spent (circulated) to drive growth; to date most of the stimulus is being saved by very cautious consumers and businesses.
- Unemployment has spiked to levels last seen during the Great Depression, and history shows that unemployment remains doggedly high for many years after an economy starts recovering.
- Structural damage to economic and social life will have a negative effect on employment, consumer spending and business confidence for some time to come.
- **In summary, Antares are very cautious about the short to medium term economic prospects, globally and in Australia, and apply that caution to our management of client portfolios.**

Australia risks losing some of its "poster child" reputation as one of the world's standout achievers through the epidemic. The rampant 2nd wave of infections in Victoria and the newly introduced 6 week lockdown are applying the breaks to the fledgling national recovery. As a result, the Government's major stimulus packages such as Jobkeeper, Jobseeker, rental support and deferred mortgage repayments are likely to be extended in some format well past 30 September. With no overseas visitors until well into 2021 at the earliest, domestic tourism and hospitality are crucial to providing some support for the high employment tourism industry. The major setback in Victoria and the closing of some interstate borders is a major setback to the tourism industry. The rapid deterioration in China/Australia relations has yet to play out through the broader economy. Iron Ore exports remain very strong, largely driven by a collapse in supply from a Covid ravaged Brazil. The risk is that China ramps up its trade restrictions/penalties in sectors that hurt Australia such as agriculture, resources and education.

Strategy

Our strategy continues to focus on 3 key objectives:

1. Optimising yield through carry and rolldown, focusing on the inflection points on steep curves
2. Capital preservation by targeting credits with strong balance sheets, those issuers that are expected to be more resilience to the pandemic impact and an economic deterioration
3. A strong level of liquidity that could be realised in stressed conditions

Duration/Yield curve:

With 3yr rates anchored at 25bps by the RBA and near zero return on short term securities, there is a steady reach for yield out along the yield curve which is flattening the curve out to 5 years. We are focusing on 3-8 year Government bonds, Semis and major banks where the curve is steepest. We are hedging duration by selling 3 year or 10 year bond futures, depending on the level of the 3-10 curve.
The AOFM have announced a new 30 year Government bond to be issued in the week starting 27 July. The current Australian 2047 Government bond is trading at extremely attractive yield versus other sovereign 30 year bonds both on an outright and FX hedged basis, as per the table below. This should ensure strong offshore support for the new 30 year bond.
The not insignificant probability of negative yields implies that longer bonds are cheap versus Fair Value. For now, with inflation risks muted we will continue to target flattening strategies when 10 year yields approach 1%.

The following chart shows hedged sovereign 10 year bond yields for Japanese investors. The Australian Government 10 year bond hedged yield (in red) is at the highest level for 12 mths, driving the very strong Japanese demand for AUD bonds especially those of long tenor.

Source: National Australia Bank, Macrobond

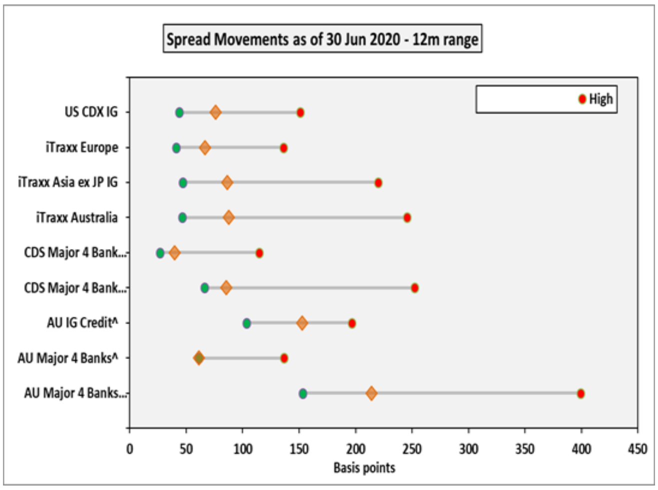
Japanese investors can generate a 142bp yield from a hedged AUD 30 year bond, 50-100 wider than other major sovereign bonds.

Government Bond Generic Yield - 30Yr									
		Currency-based Investor							
Govt Bond	Local	AUD	USD	EUR	JPY	GBP	CAD	CNY	CHF
Australia	1.807	1.807	1.924	1.140	1.421	1.734	1.860	4.063	0.930
United States	1.313	1.197	1.313	0.534	0.814	1.124	1.250	3.442	0.325
Germany	-0.038	0.618	0.733	-0.038	0.239	0.546	0.670	2.837	-0.245
Japan	0.551	0.932	1.048	0.273	0.551	0.860	0.984	3.163	0.065
United Kingdom	0.633	0.706	0.821	0.046	0.324	0.633	0.758	2.936	-0.162
Canada	1.072	1.019	1.135	0.358	0.637	0.947	1.072	3.259	0.149
China	3.801	1.514	1.633	0.838	1.123	1.440	1.568	3.801	0.625

Credit:

Credit markets have tightened considerably since their March wides.
The Cash Bond & CDS Moves tables below show that Aus IG has rallied over the past month but still lags global credit and provides relative value.

<u>Cash Bond & CDS Moves</u>



	Δ (1m)	Δ (3m)	Δ (YTD)	12 mth range High	Low	Current
US CDX IG	-3	-32	+32	151	44	76
iTraxx Europe	-4	-32	+23	136	41	66
iTraxx Asia ex JP IG	-14	-64	+33	220	47	86
iTraxx Australia	-13	-97	+41	245	46	88
CDS Major 4 Bank Snr	+4	-47	+10	114	27	40
CDS Major 4 Bank Sub	-19	-97	+13	252	66	86
AU IG Credit^	-20	-28	+39	197	103	153
AU Major 4 Banks^	-11	-71	-14	137	61	61
AU Major 4 Banks (sub)+	-27	-102	+50	399	153	214

^CGL Margin > 3Y TTM
+Trading Margin >3Y TTM (basket of bonds)

Antares Fair Value Assessment

At the peak of the market panic in mid-March, markets "leapfrogged" into Scenario 5 (Major Downside Shock, Global Deflationary Recession, Global QE). Central Banks then stepped in with large QE programs and Governments stepped in with "whatever it takes" fiscal spending. Markets have rallied about 35% off their lows, moving back into Antares' Scenario 4 (Much Slower Global Growth - Event Driven?). Markets may fluctuate between these 2 scenarios with the key differences being the risk of a 2nd wave of infections, the timing of the relaxation of key fiscal stimulus measures and the speed and success of any recovery. Scenario 4 is a recession (possibly short lived); Scenario 5 could be a depression.

Credit markets have rallied strongly off the back of QE support from various central banks including direct buying of corporates in offshore markets. Antares' FV for iTraxx assumes fundamental valuations of corporates **less a "QE bid". Antares modelling assesses this QE bid to be worth 70bps in credit spreads.** Desperate investor "search for yield" is still creating a wide deviation between Antares' fundamental FV assessment (including the 70bps QE adjustment) and market pricing.

We have factored in 2 QE options for Scenario 5:

1. Positive cash and bond yields and,
2. European/Japan style negative cash and bond yields

We show the 2 options as a range under Scenario 5. The probability/impact of negative rates produces FV's well below current market pricing, implying the longer end is very cheap. In the event of negative rates, we assume the spread between 10 year and 30 year bonds will be 50bps, similar levels to Europe and Japan. Overall Market pricing suggests that investors are pricing in a mix of Scenario 4 and Scenario 5.

The table below provides a summary of the respective conditions in Scenarios 4 & 5 and shows fair values based on Scenario 4 and Scenario 5 and a 50:50 mix of Scenarios 4 & 5.

- Scenario 4: Much Slower Global Growth - Event Driven? GDP 1%, Inflation 1%.
- Scenario 5: Major Downside Shock, Global Deflationary Recession, Global QE, GDP -2%, Inflation -1%, possibly negative rates.

Instrument	Fair Value (FV) Scen 4	Fair Value (FV) Scen 5	50% Scen 4 50% Scen 5 (FV)	Market Price	50:50 FV - Market exp (+)/cheap (-)
Cash (6mth forward)	0.25%	0.05 to 0.25%	0.20%	0.13%	+0.07%
3YB	0.30%	0.15 to 0.30%	0.23%	0.30%	-0.07%
10YB	0.75%	0.55 to 0.75%	0.65%	0.90%	-0.25%
30YB	1.25%	1.10 to 1.50%	1.30%	1.80%	-0.50%
3/10 Spread	0.45%	0.30 to 0.40%	0.40%	0.60%	-0.20%
iTraxx (forward contract*)	100	170	125	80+10	+35
US 10YR	0.90%	-0.20 to 0.40%	0.55%	0.65%	-0.10%

Market Movements

1. **Equity markets continued to consolidate in June with the ASX200 up 2.5% and the S&P500 up 1.8%**
2. Aus bond yields were virtually unchanged in June as central bank action continues to dampen trading ranges
3. BBSW rates traded in a 1bp range in June with 1m and 3m rates hovering around 0.10% and 6m rates fell slightly to 0.15%
4. Credit spreads continue to tighten in June with non-financial corporates outperforming financial corporates. Aus iTraxx tightened 14bps over the month to close at 88bps

Australian Rates	June 2020	Month Change	1 Yr Change
RBA Cash Rate	0.250	0.00	-1.00
90 Day Bank Bill	0.102	+0.01	-1.10
3 Yr Futures	99.715	-0.02	+0.64
10 Yr Futures	99.110	-0.02	+0.44
3/10 Spread (bps)	60.5	-0.5	+20.0
iTraxx Australia 5Y	87.8	-13.6	+24.3
10Yr BEI	1.07	+0.09	-0.31

Global Sovereign Rates	June 2020	Month Change	1 Yr Change
Fed Fund Rates	0.08	+0.03	-2.32
ECB Main Refi Rate	0.00	0.00	0.00
US Sovereign 2 Yr	0.15	-0.01	-1.61
US Sovereign 10 Yr	0.66	+0.00	-1.35
Japan Sovereign 10 Yr	0.03	+0.02	+0.19
German Sovereign 10 Yr	-0.45	-0.01	-0.13

Currencies	June 2020	Month Change	1 Yr Change
AUD/USD	0.690	+0.024	-0.012
EUR/USD	1.123	+0.013	-0.014
USD/JPY	107.930	+0.10	+0.08

Equities	June 2020	Month Change	1 Yr Change
ASX200	5898	+2.5%	-10.9%
S&P500	3100	+1.8%	+5.4%

Commodities	June 2020	Month Change	1 Yr Change
WTI Crude	39.3	+3.4	-16.5
Gold	1781.0	+50.7	+371.4

Australian Economic Data	Latest Monthly Print	Month Change	1 Yr Change
Employment Change (k)	-227.7	+379.7	-228.8
Unemployment Rate (%)	7.1%	+0.7%	+1.8%
Retail Sales (MoM%)	16.9%	+34.6%	+16.8%
Trade Balance Value (m)	8,025	+195	+70
Building Approvals (MoM%)	-16.4%	-14.3%	-17.0%
Consumer Confidence (Westpac)	93.7	+5.6	-7.0
Business Confidence (NAB)	-20.0	+25.5	-23.8
Business Conditions (NAB)	-23.8	+9.9	-28.6

Australian Economic Data	Latest Quarterly (Q1)	Quarterly Change	1 Yr Change
Private Capital Expenditure (QoQ%)	-1.6%	+0.0%	-0.2%
GDP (YoY%)	1.4%	+0.0%	-0.2%
Inflation (YoY%)	2.20%	+0.0%	+0.6%

Global Economic Data	Latest Monthly Print	Month Change	1 Yr Change
US Non-Farm Payrolls (k)	4800	+2,101	+4,618
US Unemployment Rate (%)	11.1%	-2.2%	+7.4%
US Manufacturing ISM	52.6	+9.5	+1.0
US Non-manufacturing ISM	57.1	+11.7	+1.7
China Manufacturing PMI	50.9	+0.3	+1.5
China Non-Manufacturing PMI	54.4	+0.8	+0.2
German Factory Orders (MoM%)	10.4%	+36.6%	+9.0%
German Industrial Production (MoM%)	7.8%	+25.3%	+8.8%

Semis * vs Gov Bonds	June 2020	Month Change	1 Yr Change
3yr (bps)	15.2	-7.96	-5.49
7yr (bps)	38.0	-6.15	+1.17

** Semi calculation comprises an equal weighting of NSWTC and WATC*

Contacts

Ken Hyman
Investment Manager
Antares Fixed Income
Level 20, NAB House
255 George Street
Sydney NSW 2000
Ph: 02 8274 4999

Mark Kiely
Portfolio Manager
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: client.services@mlcam.com.au
Phone: 1300 738 355

About Antares Fixed Income

Antares Fixed Income (Antares) is a specialist fixed interest manager covering a range of domestic and international securities.
Antares has managed fixed interest and cash portfolios for investors since 1990 and currently has over A$26.4 billion* in funds under management across a range of cash management, fixed income and liability driven investment strategies.
Antares is focused on delivering performance objectives for our clients within a carefully managed and defined risk framework.
*as at 30 June 2020