Antares Inflation Linked Bond Fund

Monthly Investment Report
November 2021

Fund Performance

Period Ended 30/11/2021	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %	Since Inception %pa[1]
Portfolio	1.75	-1.36	1.40	3.86	3.42	2.98	4.22
Bloomberg Govt Inflation Index 0-10	1.58	-1.41	1.28	3.66	3.26	2.87	4.07
Difference	0.17	0.05	0.12	0.19	0.16	0.11	0.15

Valuation at month end was $113,374,703.16
Portfolio returns are expressed before investment management fees and taxes; The difference in returns between the Fund and the benchmark may be out due to rounding.
1. Since Inception 07/06/2011

Expected Return Objective

The Antares Inflation Linked Bond Fund aims to outperform (before fees) the Bloomberg AusBond Inflation Government 0-10 Yr Index over an interest rate cycle.

Portfolio Review

Following a solid Q3 CPI report, BEIs rallied and then collapsed following the shock removal of yield curve control (YCC) only to rally and sell-off again in November. BEIs rose by 26bps and then retraced by November end, with the 10yr BEI falling back towards 2% due to renewed concerns over central bank hawkishness and aggressive rate hikes. Through this heightened volatility, portfolio positioning remained relatively undeterred with only a moderate addition to BEI longs near the lows once markets had stabilized.

The debacle around the ending of YCC and the market volatility that ensued dissipated by the November RBA meeting. In the Q&A session that followed Dr Lowe outlined the reasoning for ending YCC and reaffirmed the RBA's baseline view that rates were likely to remain steady until 2024. (It was conceded however that rate lift-off could come earlier.) Anticipating the RBA's ongoing dovishness, the portfolio increased both its BEI and its duration positioning.

The upshot for the portfolio was a significant rebound in alpha for November, more than offsetting the negative performance seen a month earlier. Specifically, contributors to the alpha performance for November were:

i. BEIs and Curve: Long BEI positioning with BEI longs run primarily through 2025s. Long 2030 vs 2027 real yield flattening.
ii. Duration: Net long 2030s real yield position (This delta-adjusted duration positioning helps protect long BEI performance once BEIs started to fall again)
iii. Retracement in the (October) tracking error relating to security revaluation differences, between the benchmark and the portfolio as well as some retracement in semi spreads.

Key Characteristics at 30/11/2021

	Fund	Benchmark
Real Interest Rate Duration (yrs)	4.89	4.70
Active Nominal Duration	-0.16	-
Running Yield (RY%)	-0.69	-1.129
Semi Spread Duration (yrs)	0.565	0.61
Weighted Avg Credit Rating	AAA	AAA

Portfolio Strategy and Positioning

The rollercoaster ride in BEIs took on a greater intensity in November. October's BEI underperformance was almost completely reversed by mid-November. Early in the month the portfolio had its BEI and duration positioning increased to take advantage of an imminent market snap-back once the dislocation started to recede. Portfolio positioning continues to be underpinned by supportive carry (due to the elevated Q3 CPI) and an underlying inflation pulse that is strengthening.

In addition to carry, the portfolio would benefit from steeper yield curves and therefore more positive inflation risk premia (IRP). With inflation running much higher in the US, the pressure is on the Fed to tighten monetary policy, which if realised may see the RBA pressured to raise rates prematurely, thereby snuffing out any chance of higher IRP.

Whilst it is difficult to see steepening BEI curves in the short term, several factors could conspire to push yield curves steeper including a sudden stop to QE, persistent inflation and above trend growth, and a better distribution of inflation sources. The portfolio is positioned for higher CPIs and inflation carry over the coming quarters, but the above factors would likely result in a much greater impact on alpha if they were to transpire.

Excess Returns vs Benchmark

Strategy	Sep	Oct	Nov
Duration	1.0	-1.0	2.0
Curve	-	-1.0	1.0
Sector	0.5	-2.0	2.0
BEI	-0.5	-4.0	6.0
ZCS	-	-	-
Yield Enhancement	-	-	-
CPI Accrual	-	-	-
Other (t-costs, pricing tracking error)	1.0	-6.0	6.0
Total	**2.0**	**-14.0**	**17.0**

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Market Review

November saw bond yields fall and yield curves flatten off the back of more hawkish comments from Fed Chairmen, Jerome Powell, removing the word transitory from the Fed's vocabulary and news of the Omicron variant providing a new source of uncertainty in markets. As a result the US treasury yield curve bear flattened and the AUD yield curve bull flattened.

Credit markets underperformed with credit spreads continuing to widen over the month. Major banks underperformed with the expectation of supply to increase in 2022. Credit spread volatility picked up towards the end of the month with the Omicron news. 5 Year AUD iTraxx pushed out from 65 to 75.

Coming off the back of the strong October CPI data, November saw a fall in BEIs, driven by the same factors as per noted earlier. AUD government 10 year BEIs fell from a peak of around 2.3% after the US CPI data release in mid November to 2.05% at the end of November.

Macro Outlook

Global

Geopolitical risks have escalated recently and could dampen 2022 growth prospects somewhat.
China - threat to acquire Taiwan by force.
Iran – playing "hardball" on curtailing nuclear program.
Russia – threatening an invasion of Ukraine.
The common theme is to challenge the USA at a time of perceived weakness including Biden's slump in the polls and the 2022 mid-term elections where the Democrats could lose control of Congress. There's definitely some coordination in the escalation of these flashpoints.

The new COVID virus, Omicron, has unnerved investors but there is a developing consensus that the risks could be more symmetrical. It appears more infectious than the Delta strain but shows milder symptoms and lower hospitalisation rates.

Australia

Australia is at a sweet spot on vaccinations with some states above 90%. Furthermore, there are still three months of relatively high immunity in the community as the bulk of vaccinations were in the September quarter, providing six months of immunity up to March.

Antares Scenario Analysis

The Antares Scenarios table below reflects the interplay between growth, inflation and bond yields, and how they will drive the level and shape of yield curves in the different scenarios.

Scenarios	AU GDP	AU Inflation	AU 3YR Bond	AU 5YR Bond	AU 10YR Bond	AU 30YR Bond	US 10YR Bond
Strong Growth	4.00%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%
Above Trend	4.00%	3.00%	2.00%	2.50%	3.50%	4.50%	3.50%
Trend	3.00%	2.25%	1.25%	1.75%	2.25%	3.00%	2.25%
Below Trend	1.50%	1.50%	0.30%	0.50%	1.00%	1.75%	0.75%
Recession	-2.00%	1.00%	0.10%	0.30%	0.50%	1.40%	0.50%
Stagflation	1.00%	3.00%	1.50%	2.25%	3.00%	4.25%	3.00%
Antares Latest Fair Value (FV)	2.20%	2.15%	1.04%	1.47%	2.04%	2.88%	1.97%
Market Yield Latest			0.95%	1.37%	1.70%	2.40%	1.52%
FV - Market (+exp / -cheap)			0.09%	0.10%	0.34%	0.48%	0.45%

Given the record levels of household debt, Antares has lowered the expected real yields for the stronger growth scenarios. This produces nominal bond yields close to the inflation rate, implying real yields close to zero. As a result, fair values have fallen marginally but longer bonds are still well above market pricing.

Interest Rate & Inflation Outlook

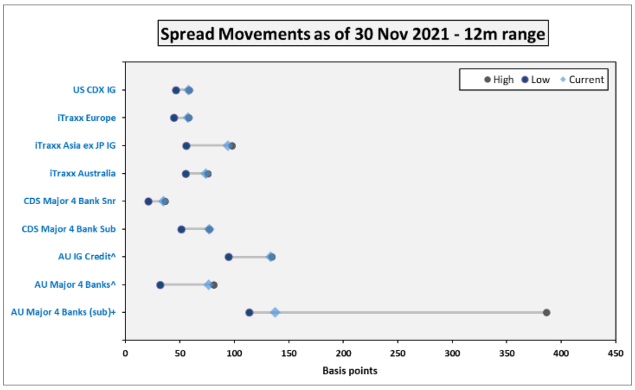
The direction of interest rates continues to be driven by central banks' policy stance and their characterisation of current inflation. With improving economic data and rising core measures of inflation, central banks are reconsidering the transitory nature of inflation. The recent pricing of more aggressive rate hike paths are resulting in falling near term inflation expectations, while inflation curves remain very flat to mostly inverted.

For yield curves to re-steepen, this would require more term premia, balanced growth and demand-driven inflation coinciding with central banks falling deliberately behind the curve.

Credit Outlook

With a hawkish Fed and the Omicron variant driving a deterioration of risk sentiment, credit spreads pushed wider in November and we would not be surprised to see this trend continue as we move into the end of the year especially in light of fixed income funds being seen to build up liquidity buffers.

APRA has also announced its finalised requirement for major bank loss-absorbing capacity. Whilst this announcement will require marginally higher issuance volumes of Tier 2 capital, the majors are well progressed on their respective funding tasks. Post the announcement, Tier 2 spreads were well behaved.



ESG

In November, Mercury NZ brought to market its debut AUD issuance under its Green Financing Framework. Issuance proceeds are earmarked to finance expenditures relating to renewable energy and other eligible projects. In Mercury's case, eligible projects include hydroelectric, solar and wind powered electricity generation capacity.

Antares did not participate in this 7-year deal as we continue to prefer deploying capital in shorter dated credit exposures, where we see better risk adjusted returns from a spread duration perspective.

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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$27.91 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 its clients within a carefully managed and defined risk framework.

*as at 30 June 2021

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