

The Floating, The Fixed and The Resilient

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Senior unsecured floating rate bank returns in AUD have again delivered very palatable performance in the face of fixed rate volatility in Q3 2023. Fixed income on a comparative basis versus floaters had a tough quarter as it became clearer that the monetary policy delivered thus far in many central bank tightening cycles might not be over.



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In addition to this higher for longer mentality in most money markets globally, it is becoming evident that the higher interest rates delivered by the RBA (Reserve Bank of Australia) so far has not fractured the Australian economy. Furthermore, the RBA is now going through a period of calibration to gauge what impact the 4% of tightening has had more broadly. Whilst there is still unemployment well inside the RBA's target level of ~4.5% by the end of 2024 and inflation still printing several percentage points above the 2-3% target zone¹, bond yields and Bank Bill Swap Rate (BBSW) yields will continue to edge higher.

Outside of yields curves moving markedly higher over the quarter, there was also good supply from primary issuers in the domestic market. The major four banks provided consistent 3 and 5yr issuance at spreads that were both embraced by the money market and provided consistent new issue primary price points to compare with secondary market pricing. On that note, there were a handful of Term Funding Facility maturities during the quarter that had very little liquidity impact on the market. Even with the primary issuance printing press working well during the quarter, and certain banks repaying substantial Covid period 0.10% term 3yr loans from the RBA, spreads did not move or reprice markedly higher.

The portfolio maintained a very liquid profile during the quarter with an average credit rating of AA-/A+ with spread duration continuing to target the 2.5-3yr zone. Interest rate duration never exceeded 90 days given the fund is made up of floating rate notes that reset their coupon every 3 months. In light of the ongoing push for higher in yield curves, running this short interest rate duration has served investors in the fund very well during Q3 2023.

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¹ Source: Reserve Bank of Australia as at October 2023.

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6038407.1.1.ANZ.RTL | Exp. Date: 31/10/2024