

Q4 2019 Review

- Overall, credit markets have had a notable 2019 with the senior unsecured credit spread rally continuing in Q4 2019.
 - The fund has outperformed the benchmark, RBA Cash Rate, by 0.24% for the quarter and 1.73% for the year to 31 December 2019 (net of fees)¹.
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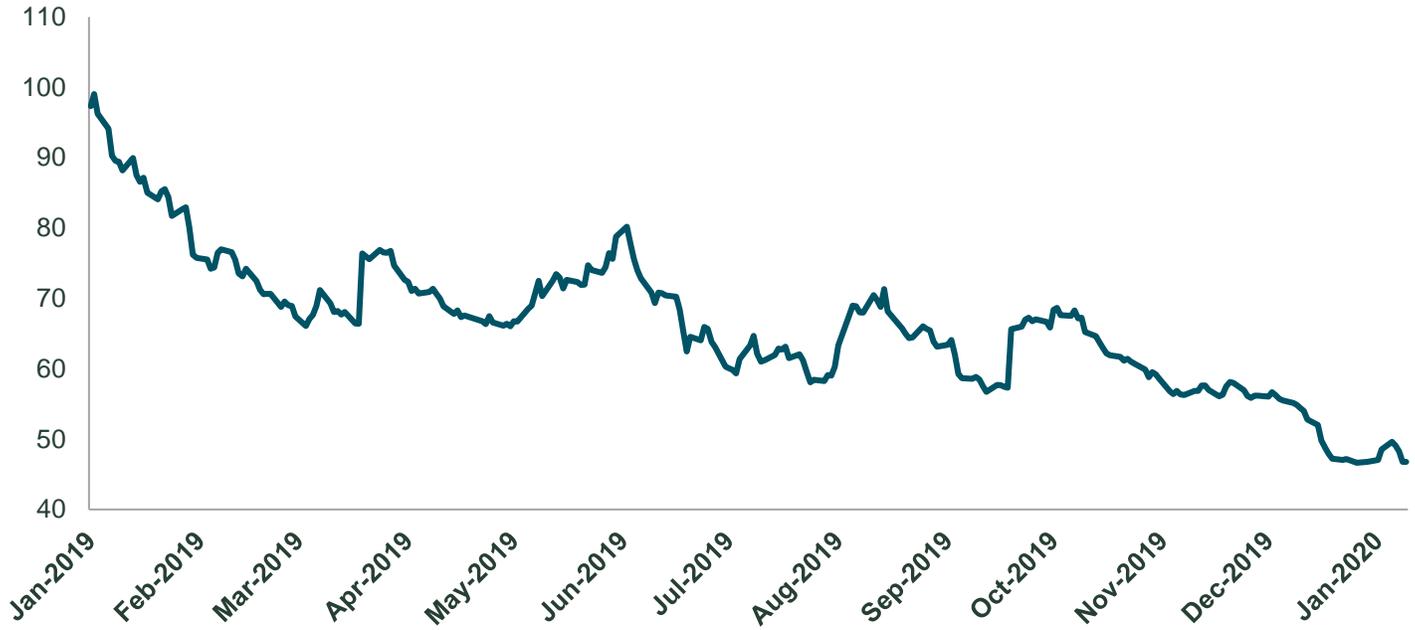
The fourth quarter of 2019 was another impressive couple of months for credit markets. Spreads in AUD senior unsecured bank notes continued to rally and the fund finished the year strongly.

Unlike previous periods during the year where geopolitical uncertainty, in particular escalating US China trade tension and Brexit uncertainty drove markets on a very unpredictable path, September through December of 2019 were far less volatile. There seemed to be a growing consensus that although leading indicators were pointing to key parts of some economies slowing down marginally we were not in the medium term heading into dire recessionary territory. Couple this relief of sorts with a growing conviction amongst both economists and traders that the key central banks globally are on the front foot, and are willing and able to add additional monetary policy stimulus when required with the continued goal of trying to ratchet up inflation, and you have a situation where short rates continue to rally on the back of anticipated central bank easing. Equities rally as risk is bid and longer bonds, susceptible to inflationary expectations, start to sell off as the market acknowledges that yields are very low and inflation is still a target of central banks globally. Don't underestimate the resolve of central banks to create inflation.

This scenario bode well for domestic floating rate notes over Q4 2019. Limited issuance from both domestic and international banks ensured there was a liquid two way secondary market present during the quarter. The portfolio as at the end of December continued to have an average credit quality of A, was running an average coupon of 1.82% and had an average spread duration of 2.54 years. As evidenced by the 5yr iTraxx graph below, credit spreads had a strong 2019 and with banks, through regulatory oversight globally looking stronger than ever, we believe 2020 should start on a positive note for AUD senior unsecured bank floating rate notes once issuers begin to tap the market.

¹ Past performance is not a reliable indicator of future performance. Performance returns for periods of less than one year are not annualized. Net performance figures are calculated using end-of-month exit prices, assume the reinvestment of distributions, are post management and transaction costs, and make no allowance for tax.

Figure 1. 5 Year iTraxx Spreads, 2-Jan-2019 to 2-Jan-2020



Source: Bloomberg Finance L.P., as at 2 January 2020. Past performance is not a reliable indicator of future results.

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