FIIG | The fixed income experts

FIIG Managed Income Portfolio Service (MIPS)

Monthly Commentary Report - 31 December 2024

Objective

The Managed Income Portfolio Service (MIPS) provides wholesale investors with access to an actively and professionally managed fixed income portfolio that combines total return, capital stability, and regular income. The service aims to deliver meaningful improvements in returns and liquidity over traditional cash and term deposits through expert management and strategic asset allocation.

Performance[1] as at 31 December 2024

Investment Mandate	Return Type	1 Month	3 Month	6 Month	1 Year	3 Years	5 Years	Since Inception
Conservative Income	Gross	0.72%	0.80%	3.99%	6.26%	3.09%	2.90%	3.70%
	Benchmark*	0.72%	0.54%	3.76%	5.29%	1.28%	1.39%	3.30%
	Excess	0.00%	0.26%	0.23%	0.97%	1.81%	1.51%	0.40%
Income Plus	Gross	0.88%	1.28%	4.59%	7.71%	4.82%	3.14%	4.48%
	Benchmark*	0.78%	0.69%	4.45%	6.53%	1.64%	1.89%	4.20%
	Excess	0.10%	0.59%	0.14%	1.18%	3.18%	1.25%	0.28%
Customised Bank[2]	Gross	0.53%	1.45%	3.19%	6.59%	4.58%	3.45%	3.75%
	Benchmark*	0.37%	1.10%	2.23%	4.46%	3.19%	1.98%	2.08%
	Excess	0.16%	0.35%	0.96%	2.13%	1.39%	1.47%	1.67%

Overview

MIPS offers direct bond ownership of a diverse range of quality assets – including Australian Government, Corporates, Bank and Asset Backed Securities – tailored to meet various investment preferences and risk tolerance as outlined in each investment mandate.

Structure
- Individually Managed Account (IMA)

Currency
- Australian dollar

Derivatives
- Not permitted

Suggested investment timeframe
- At least three years

MIPS Inception date
- 1 May 2015

Investment Team
- Kieran Quaine
  Head of Investment Management & Portfolio Manager (FIIG Australian Bond Fund)
- Megan Romeo
  Head of MIPS & Portfolio Manager (IMAs)
- Garreth Innes
  Portfolio Manager (FIIG Monthly Income Fund)

Conservative Income Mandate Characteristics

Number of Holdings: 32

Modified Duration: 3.26yr

Yield to Maturity: 4.96%

Inception Date: 1 July 2016

Management Fee: 0.54% p.a. (incl. GST)

Minimum Investment: $1m

Income Plus Mandate Characteristics

Number of Holdings: 29

Modified Duration: 3.13yr

Yield to Maturity: 5.49%

Inception Date: 1 May 2015

Management Fee: 0.64% p.a. (incl. GST)

Minimum Investment: $1m

Customised Bank Mandate Characteristics

Number of Holdings: 29

Term to Maturity: 2.68yr

Yield to Maturity: 4.55%

Inception Date: 1 Aug 2015

Management Fee: *by agreement*

Minimum Investment: $10m

***Benchmarks: Conservative Income** 50% S&P/ASX Australian Fixed Interest 1-5 Year Index & 50% S&P/ASX Corporate Bond BBB Rating Band Index (modified duration: 3.5yr), **Income Plus** S&P/ASX Corporate Bond BBB Rating Band Index (modified duration: 4.2yr), **Customised Bank** S&P/ASX Bank Bill Index (modified duration: 0.1yr)

[1] Weighted average returns are based on invested portfolios subscribing to the same investment mandate, weighted by portfolio net asset value (NAV)
[2] Customised Bank is an aggregation of customised MIPS portfolios only investing in senior and/or subordinated debt issued by Australian Domestic Banks
[3] Weighted average metrics are based on invested portfolios subscribing to the same investment mandate, weighted by portfolio net asset value (NAV)

Commentary

In December 2024, the Reserve Bank of Australia (RBA) maintained the cash rate, but a dovish shift in rhetoric spurred a fixed rate rally. This shift was influenced by softer-than-expected economic data, particularly in household consumption and retail sales, which eased inflationary pressures. Additionally, the RBA expressed increased confidence that inflation was declining and emphasized the importance of monitoring key economic indicators to guide future policy decisions. However, this rally was largely reversed later in the month as the unemployment rate dropped to 3.9% - the lowest in eight months – indicating a robust labour market.

In the US markets, the anticipation of Trump's economic policy proposals including new tariffs and tax cuts led to increased concerns about global inflation, causing US bond yields to rise – contributing to local market volatility – as investors demanded higher returns to compensate for expected inflation. In response, the US Federal Reserve adopted a cautious approach at their December meeting where they cut interest rates by 25 basis points while signaling a slower pace of future rate cuts due to the uncertainty surrounding Trump's policies and their potential inflationary effects.

The Australian Prudential Regulation Authority (APRA) has finalised their decision to phase out the use of Additional Tier 1 (AT1) capital instruments by domestic banks. The AT1 will be replaced with capital such as Tier 2 subordinated debt to bolster bank stability in times of financial stress. The additional volume of subordinated debt is expected to be easily absorbed by the market given the high levels of investor demand for this sector. Subordinated Tier 2 issuance reached a total of 21 billion AUD in 2024, exceeding volume issued the prior year. Credit margins (CM) for floating rate notes (FRNs) issued by Australian banks remained stable over the month.

Issuance in the Australian primary markets finally started to slow in December after a record-setting year. Total Asset Backed Security (ABS) issuance surpassed 77 billion AUD breaking the 2006 record. Both ABS and subordinated debt had increased participation from non-bank issuers demonstrating both markets are maturing, and investor confidence remains strong in these sectors.

Positioning

The Investment Team extended duration across all investment mandates, focusing on long duration and investment-grade credit.

Exposure to Unrated (UR) and Non-Investment Grade (NIG) assets in the Income Plus mandate was further reduced. A minimal exposure to this sector will be maintained due to insufficient market volume and limited diversification opportunities. Instead, the focus was on the Investment Grade (IG) ABS sector for all mandates that permit exposure as a placeholder for higher yielding corporate assets. The best relative value was found in tranches rated "A" as the excess credit margin paid for lower-rated tranches (such as the BBB notes) did not adequately compensate for the higher risk.

The Customised Bank mandate again continues to perform– both outright and relative to its benchmark index – as bank subordinate debt continues to perform well. The Investment Team favoured a higher weighting to subordinate debt exposure versus senior and expect this weighting to continue.

Outlook

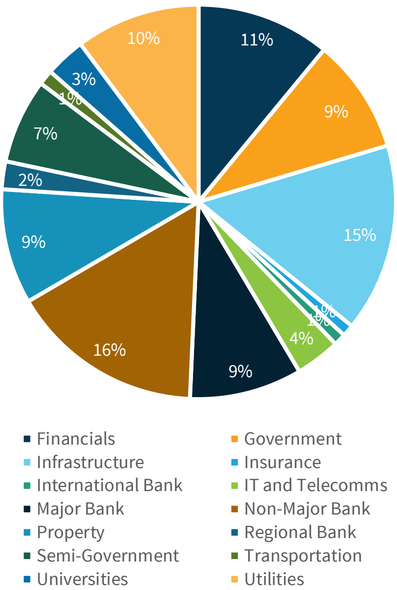
Duration will be extended during market weakness but may reduce exposure during strength unless economic data supports maintaining the extended exposure at lower yields.

Given the robust profitability of the domestic banking sector, the Investment Team anticipates that bank FRNs will continue to perform well. Since 2022, tight monetary policy has led to high accrual returns due to a rising overnight cash rate (OCR). However, as the OCR is expected to fall in 2025, contribution to performance generated from accrual is likely to temper. Momentum in ABS issuance is also expected to continue through 2025 and is a sector favoured highly by the Investment Team.

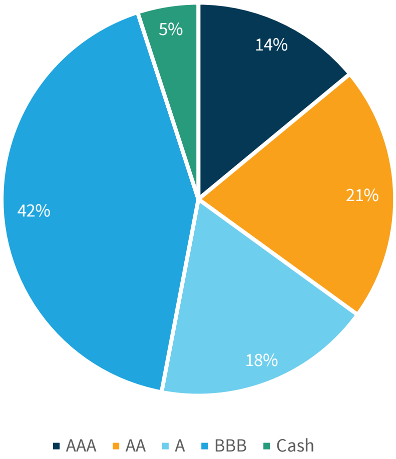
Much to mortgage holders' dismay, the RBA's kept rates on hold for the entirety of 2024. This delay has left the market eagerly speculating on when the cuts will finally materialize. With three domestic banks and several corporates already issuing new deals early in the new year, the primary market couldn't stay still for too long. As we move forward, the Investment Team is closely watching for signs of the RBA's breakout move.

Conservative Income

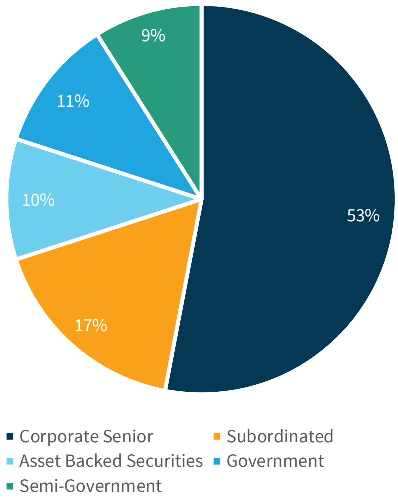
Sector Allocation
as at 31 December 2024



Credit Quality
as at 31 December 2024

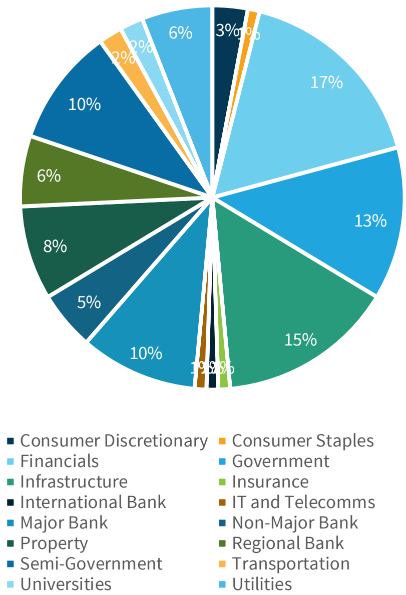


Capital Structure Allocation
as at 31 December 2024

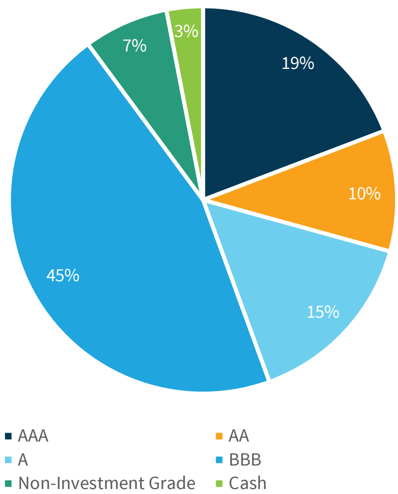


Income Plus

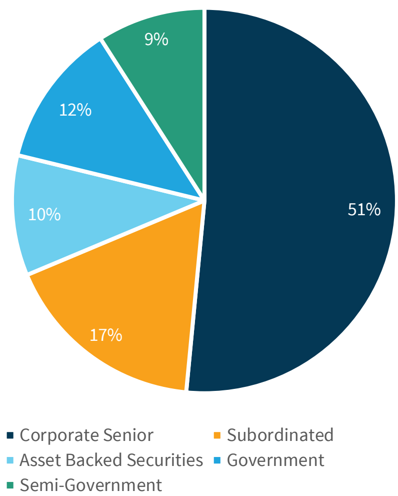
Sector Allocation
as at 31 December 2024



Credit Quality
as at 31 December 2024

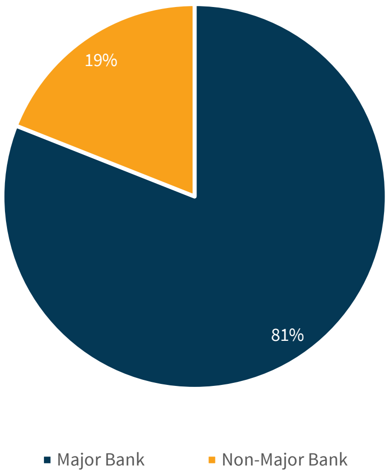


Capital Structure Allocation
as at 31 December 2024

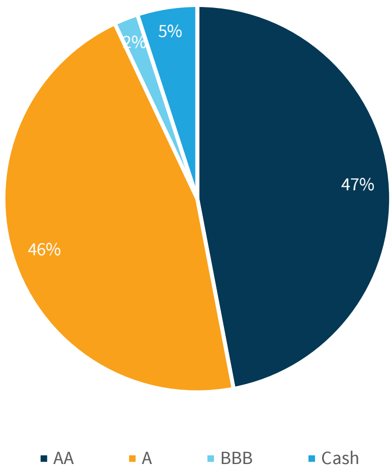


Customised Bank

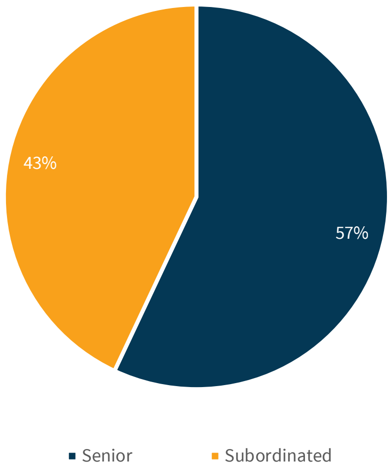
Sector Allocation
as at 31 December 2024



Credit Quality
as at 31 December 2024



Capital Structure Allocation
as at 31 December 2024



Investment Mandate Limits

Conservative Income

Provides wholesale investors with exposure to a diversified portfolio of risk averse Investment Grade (IG) Senior and Subordinate fixed income securities, which additionally produce reliable and regular income that can be distributed or retained for reinvestment.
Minimum investment: $1m | Management Fee: 0.54% p.a. (including GST)

Number of Bonds	Minimum 10	Currency	Australian dollar	Derivatives	Not permitted
Investment Grade	100%	Subordinated Debt	Up to 20%	FIIIG Arranged Bonds	Not permitted
Non-Investment Grade	Not permitted	Asset Backed Securities	Up to 20%	Modified Duration	Up to 5yr

Income Plus

Provides wholesale investors with a potentially higher return than the Conservative Income investment mandate through exposure to a diversified portfolio of both IG and Non-IG fixed income securities, which additionally produce reliable and regular income that can be distributed or retained for reinvestment.
Minimum investment: $1m | Management Fee: 0.64% p.a. (including GST)

Number of Bonds	Minimum 10	Currency	Australian dollar	Derivatives	Not permitted
Investment Grade	Minimum 80%	Subordinated Debt	Up to 20%	FIIIG Arranged Bonds	Not permitted
Non-Investment Grade	Up to 20%	Asset Backed Securities	Up to 40%	Modified Duration	Up to 5yr

Customised

MIPS offers the ability to create a bespoke Australian dollar fixed income portfolio solution for clientele seeking specific key investment objectives, that include, but may not limited to, objectives that can encompass return targets, income distribution, liquidity reliance, credit exposure and duration limitations, diversification minimums and Environmental, Social and Governance (ESG) considerations.
Minimum investment: $10m | Management Fee: by agreement

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NOTES

ABS: The Investment Mandate may contain Asset Backed Securities (ABS) including Residential Mortgage-Backed Securities (RMBS). All ABS generate income from pools of loan receivables that are secured over real assets. They are issued in a Floating Rate Note (FRN) structural form. Please refer to Section 3 of the MIPS Information Memorandum for more detail regarding the parameters of each investment mandate. FRN: Floating Rate Notes. Gross performance: Total yield earned per relevant program for period pre management and custody fees. Investment Grade (IG): An asset is IG if it is rated >= BBB- (S&P) or equivalent by one of three internationally recognised credit rating agencies that include Standard and Poor's (S&P), Moody's or Fitch. Non-Investment Grade (NIG): An asset is NIG if it is rated < BBB- (S&P) or equivalent. Unrated (UR): An asset is UR if it is not rated by any one of three internationally recognised credit rating agencies