FIIG The fixed income experts

FIIG Investment Management

September 2024 Quarterly Report

Welcome. This Quarterly Report (QR) encompasses a selection of summary information relevant for investors in all products managed by the FIIG Investment Management Team (IMT), that include the:

- FIIG Australian Bond (FAB) Fund (Trust).
- Managed Income Portfolio Service (MIPS) Individually Managed Accounts
  - Standard IMA Programs
  - Customised IMA's.
- FIIG Monthly Income Fund (MIF), launched 1 October 2024.

The QR references the domestic and international fixed income market, informing readers of the major influences impacting the price of the assets from which the performance of all portfolios and all products is derived.

The QR is written by the Head of the IMT, Mr Kieran Quaine.
Contact via: Kieran.Quaine@fiig.com.au

Protection of capital, generation of return and distribution of income

The IMT implements a modified duration (MD), term to maturity (TTM) and credit exposure investment strategy that is applied consistently across all products. The IMT pursues dual objectives of both protection of investor capital and generation of the highest possible total returns, whilst operating within the boundaries of risk tolerance set by each product Investment Mandate (IM).

Income derived for any portfolio and available for distribution will be a function of coupon income paid by assets held during the quarter. Fixed income products pay fixed coupon rates, and floating products pay fixed credit margins (CMs) over floating rate benchmarks. However, market interest rates (and therefore

Key Observations

- FIIG Australian Bond Fund delivers a 'stellar' first year performance
  - 8.15% (Gross) and 7.53% (Net of fees)
  - +1.03% (Gross) and +0.41% (Net) over Benchmark Index
- MIPS (fixed) IMA product one year performance even higher
  - 9.35% to 10.42% (Gross)
  - 8.50% to 9.37% (Net of fees)
- FIIG launches Monthly Income Fund (MIF)
  - Floating Rate (Trust) product
  - Anticipating BBSW (4.40%) + 2.00% Returns
- RBA holds 'tight' as the domestic economy slides and inflation falls
  - GDP flat, spending subdued and unemployment climbing
  - Impending easier monetary policy expected by the market
- US Federal Reserve joins the easier monetary policy club
  - But (possibly) in 'no hurry' to ease further
- **But wait ... the Middle East theatre of conflict expands**
  - Are global inflation gains about to be reversed ... again?

MIPS Investment Returns

Table 1: Average Gross Fund and Individually Managed Portfolio (IMP) performance per Investment Program

Total GROSS Returns to 30 September 2024	1 mth	3 mths	6 mths	6 mths annualised	1 yr	2 yrs p.a.	3 yrs p.a.	4 yrs p.a.	5 yrs p.a.
MIPS Income Plus	0.53	3.26	4.17	8.52	10.42	7.58	3.77	5.58	2.70
MIPS Core Income	0.47	3.21	3.71	7.55	9.64	6.79	2.52	3.75	2.58
MIPS Conservative Income	0.46	3.17	3.61	7.35	9.35	6.98	2.49	2.92	2.72
MIPS Bank FRN	0.46	1.72	3.39	6.89	6.79	6.44	4.04	3.63	3.32
FIIG Australian Bond Fund	0.37	3.22	2.44	4.94	8.15		n/a		

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*Table 2: Benchmark Index Fixed Income Investment Returns^*

Benchmark Fixed Income Index Returns to 30 Sept 2024	1 mth	3 mths	6 mths	6 mths annualised	1 yr	2 yrs p.a.	3 yrs p.a.	4 yrs p.a.	5 yrs p.a.
Corporate Bond BBB Rating Band	0.66	3.73	3.92	7.98	10.27	7.91	0.77	1.22	1.68
Australian Fixed Interest 1-5 year	0.43	2.65	2.59	5.26	6.21	4.57	0.72	0.62	1.01
Australian Fixed Interest (All Maturities)	0.31	3.28	2.21	4.47	7.60	4.49	-1.59	-1.63	-0.64
Bank Bill	0.36	1.11	2.21	4.47	4.41	3.98	2.82	2.11	1.81
Bloomberg AusBond Composite 0+ Yr Index	0.31	3.02	2.16	4.37	7.11	n/a			

asset prices) and total returns of all underlying products are volatile, and subsequently income during any one quarter may not match total return.

Whilst income may exceed or be lower than total return in any one time period, it is total return for that time period that is the key outcome of merit.

Product differences and Investment Strategy application

The IMT applies the same Investment Strategy equally across all IMT products, whether Unit Trust (the Funds) or IMA (Direct) based, adjusted by ratio, for IM design differences. Key ratio applications are based on benchmark index differentials.

Duration and credit exposure investment strategy application, as applied to fixed and floating rate products, whether they be Direct Bond Individually Managed Accounts (IMA's via MIPS) or Trust based Accounts (the FAB Fund or MIF) is discussed within Appendix 1.

Readers are invited to review the performance of all products managed by the IMT, as displayed in Table 1. We note the consistency of investment performance, across the wide variety of investment products, as described by the methodology of application of the Investment Strategy within Appendix 1.

Strategic and Tactical Investment Strategy explained

Our Investment Strategy focus may be a longer-term 'strategic' implementation, or a short-term 'tactical' one. Each application can be duration and or credit based. A strategic move envisions holding a position in place for a longer period of time. A tactical move envisions holding the position for a short period of time.

The implementation of both strategic and tactical investment strategy, across the wide variety of investment products the IMT manages, is discussed within Appendix 2.

Macroeconomics, base interest rates and investment strategy commentary

It is, has always been, and always will be about inflation.

Domestic and global inflation has continued its rapid fall from the dizzy heights of early 2022 and has breached, or is, basis momentum, set to breach the higher end of all important Central Bank (CB) tolerance ranges. Domestically, the RBA targets inflation tolerance within a range of between 2.00% to 3.00%, whilst the US upper band limit is 2.00%.

Policy has been eased internationally. The US Federal Reserve (US Fed) eased 50 basis points in September, joining the easier policy club of members that include Canada (BoC), Europe (ECB), Britain (BOE) and New Zealand (RBNZ). Each member expressing

Table 3: Gross Fund and IMP Performance versus Benchmark Indexes 30 Sept 2024

Index & Blend Indexes	1 mth	3 mths	6 mths	6 mths annualised	1 yr p.a.	2 yrs p.a.	3 yrs p.a.	4 yrs p.a.	5 yrs p.a.
100% BBB	0.66	3.73	3.92	7.98	10.27	7.91	0.77	1.22	1.68
75% BBB, 25% 1-5yr	0.60	3.46	3.59	7.30	9.26	7.08	0.76	1.07	1.51
50% BBB, 50% 1-5yr	0.55	3.19	3.26	6.62	8.24	6.24	0.75	0.92	1.35
100% Bank Bill	0.36	1.11	2.21	4.47	4.41	3.98	2.82	2.11	1.81
Bloomberg AusBond Composite 0+ Yr Index	0.31	3.02	2.16	4.37	7.11	n/a			
Performance v Index & Blend Indexes									
MIPS Income Plus	-0.13	-0.47	0.25	0.54	0.15	-0.33	3.00	4.36	1.02
MIPS Core Income	-0.13	-0.25	0.12	0.25	0.39	-0.29	1.76	2.68	1.07
MIPS Conservative Income	-0.09	-0.02	0.36	0.73	1.11	0.74	1.75	2.00	1.38
MIPS Bank FRN	0.10	0.61	1.18	2.42	2.38	2.46	1.22	1.52	1.51
FIIG Australian Bond Fund	0.06	0.20	0.28	0.57	1.04	n/a			

^ Source: S&P Dow Jones Indices, Bloomberg Australia.

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confidence with both inflationary gains to date and that the momentum (lower) would continue.

Key Global monetary policy changes during the quarter

Official cash rates @ September quarter end and changes made:

- UK (BoE): down 0.25% @ 5.00%
- Europe (ECB): down 0.25% @ 3.50%
- AUS (RBA): unchanged @ 4.35%
- Canada (BoC): down 0.50% @ 4.25%
- New Zealand (RBNZ): down 0.25% @ 5.25% ##
- USA (Federal Reserve): down 0.50% @ 4.875%

and post September down a further 0.50% to 4.75%

QOQ inflation in Australia to June 2024 maybe in the 'mid 3's (%)' but the most recent MOM data suggests it is below 3.00% annualised .... so why, unlike many peers, has the Reserve Bank of Australia (RBA) not eased the Official Cash Rate (OCR)?

Yes, the RBA did not tighten as much as other western nations ... but that is hardly relevant when the impact of tighter monetary policy has softened the economy so dramatically.

The IMT suggest, not unlike we suggested in late 2021 and through to mid-2022, that the RBA is again 'behind' the curve ....

From our March 2022 QR: "The RBA, despite mounting (core) inflationary evidence to the contrary, have persisted with forecasting inflation to mean revert to within the 2.00% to 3.00% inflation tolerance band, subsequently exercising 'patience' and holding monetary policy stable at the emergency levels of 0.10% initially set during the onset of the Covid-19 health crisis. They are now appearing to be the lone wolf cut away from the global central banking pack.

And again, paraphrasing from our June 2022 QR: "The RBA falls on its bloody sword" ... raising "the official cash rate three times in the June quarter" ... (now) predicting ... "inflation peaking next year at an (annualised) 7.00% for the June 2023 quarter.

Historically it is clear they were too slow to raise ... and now they appear too slow to ease.

Having previously expressed dismay within our QR series, at former RBA Governor Phillip Lowe holding policy (too) low for too long in 2021 (and into 2022), it should be no surprise that, consistent with our forecasts, we express a similar difference of opinion to the RBA currently. They appear to be making the same mistake in reverse, by now holding policy too high for too long.

Have they not learnt from Lowe, who infamously expressed confidence (in late 2021) that according to RBA forecasting there was no reason to see cash rate rises anytime soon (this side of 2025), only to reverse tack given their forecasting was overly optimistic? The RBA is not paying attention to the bond market. It is not paying attention to aggressive capital movements, both globally and domestically. As any Bond Trader worth their salt was selling duration in late 2021 and into 2022, so too have they been buying in late 2023 and into 2024. And whilst long dated bond yields in Australia have rallied a full percent in the last year, inflation has fallen like a stone, GDP is flat, unemployment has risen aggressively, and all key global CB's have eased ... the RBA is somehow scared that easing policy domestically will reignite domestic inflation.

Up until geopolitical tension in the Middle East elevated (2nd October Iran missile strike), that (domestic assumption) would appear incorrect and unlikely, given the factors that drove inflation higher are dissipating continually:

- Oil prices declined following OPEC increased supply
- Global supply chain repair continued
- The Ukraine conflict is somewhat closer to a resolution
- The Federal Government is reigning in excessive spending
- The US isolationist policy overhang (of Trump years) has been reversed
- China is in an economic hole and initial policy stimulus has not ignited demand
- Large domestic corporates are under microscope of the competition watchdog
- Domestic mortgage holders under stress (arrears rising) and discretionary expenditure is suppressed.

We suggest Monetary Policy, both domestically and internationally, has done its job and so we now repeat what we said in March 2022 ....

"They (the RBA) are now appearing (yet again) to be the lone wolf cut away from the global central banking pack".

The short-term RBA response to a weak economy, via adjustments to the OCR, is of minimal relevance now. That is because fixed rate bond investors, whether via the IMT MIPS IMA service, customised or through our programs, or via our FAB Fund, have all benefited from the market revaluation of bond yields lower. The IMT has been 'long' and investors have benefited. Bond Traders do not wait for a CB to ratify their decisions. Performance is ratification. For floating rate investors, a higher OCR has delivered a higher BBSW return,

Table 4: Commonwealth (benchmark) Bond Yield volatility in the Sept 2024 Quarter

CGL Maturity	Source^	Open	High	High Date	Low	Low Date	Close	Current#
(near) 3-year	SFE 3 & 10-year Futures	4.06%	4.17%	2 July	3.27%	17 Sep	3.46%	3.71%
(near) 10-year		4.33%	4.47%	1 July	3.80%	17 Sep	4.00%	4.19%

^3yr: YTZ24 (Dec-24 Delivereable) ^ 10yr: YUZ24 (Dec-24 Deliverable) # Current date: 8 Oct 24

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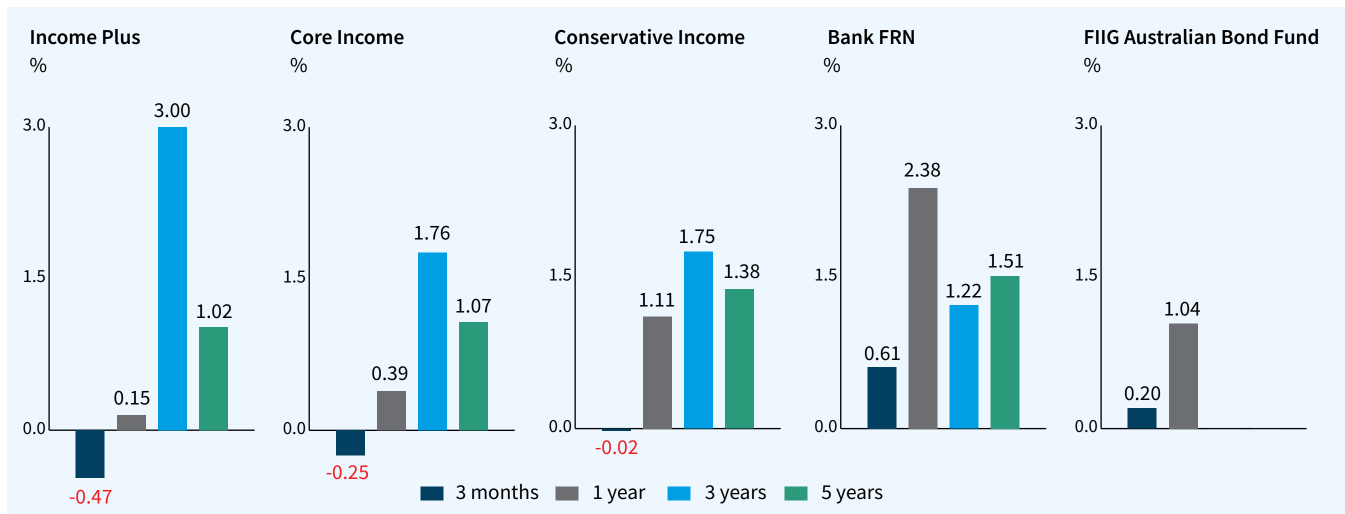
Graph 1: Performance v Benchmark Indices 30 September 2024



^ Out/Under performance v benchmark is per annum (p.a.) for periods ≥1 year, and notional for periods ≤1 year (3 months).

and investors have benefited from higher accrual returns ... but a lower performance than was otherwise available through fixed rate product investing.

However, as I write this report, the gains made in the bond market in late 2023 and to date in 2024 are slipping back under the pressure of a strong US labour report and the broad concern about the elevated risk in the Middle East with Israel and Iran now exchanging missile fire.

We suggest that it is the latter, and not the former (US labour report) that has the capacity to upset the inflation apple cart. An expanded theatre of conflict in the Middle East could impact oil prices and re-disrupt global goods supply chains, re-igniting inflation yet again.

The market acknowledges the RBA reasons for holding policy tight but is patiently waiting for them to come to the party. The US Federal Reserve, by comparison, 'came to the party'. They drank two cups of punch and are now stating they won't (necessarily) drink anymore .... being in 'no rush to ease again'. That is code for another round of jawboning the market. They want to dance but they do not want to give away their moves too early.

Domestically, the annualised CPI headline rate fell to 3.80% (June QOQ release) but to 2.70% (August MOM release). But the CPI Core (ex-volatiles) sat at 4.10% (June QOQ) and 3.40% (AugustMOM). The RBA is focused on the core outcome and is especially focused on avoiding the short-term noise created by the government energy rebates distributed as part of the 'cost of living' assistance, that have contributed to the recent (large) CPI decline. The RBA will also focus on QOQ numbers and not likely be swayed by MOM figures, although they too support obvious trend direction and momentum to lower CPI. Apart from the contention (mostly from the RBA) of the gains made in fighting inflation, the balance of economic news points continually to a softer economy and is subsequently supportive of the rally in fixed interest rates to date.

Unemployment is rising as the economy barely grows and retail sales are subdued as consumers reign in their discretionary expenditure. And iron ore prices are falling, correlating positively with the outlook for the Chinese economy. Mining corporation revenue and profitability reductions will negatively impact government tax receipts.

Ex the elevated Middle East conflict outcome, we have doubts that inflation is really 'sticky' (at above 3.00%) at all. There is an improbable, but not impossible chance that a Melbourne Cup Day easing could still occur ... if for example September Quarter inflation prints lower than expected and the next MOM figure does the same. In the history of RBA monetary policy moves since 1991, a pre-Christmas move, and especially in the November month, figures more highly than all other periods. CB's have a habit of jawboning. Historically it is often best to pay attention to what they do, not necessarily what they say. Remember the 4th quarter bond rally of 2023 came on the back of continual jawboning by the US Federal Reserve Chairman, Jerome Powell. Maybe Bullock is doing the same.

We suggest policy will be eased eventually, likely by February 2025 at the latest, commencing incrementally with a small (0.25% or 0.35%) move, followed by the expectation of further small moves based upon subsequent positive data releases. The RBA would otherwise be faced with the likelihood of larger cuts down the track as the economy softens further under the weight of retained high policy settings.

Whilst the RBA has determined (to now) that the evidence is not sufficient to ease the OCR, the bond market has, since October 2023 been rallying, with a few steps 'back' along the way. The IMT has captured the lion's share of the rally, best described by the change in yield for the 10-year Commonwealth Government

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Table 5: Index and Blend Index Durations

Benchmark Index Name / Investment Manager / Program Name	Benchmark Index Name / Blend Index Splits	Index Modified Duration (MD) @ Sept 2024	Inv' Mandate		Sept 2024 Qtr End	Difference MD v Index
			Max MD	Min MD		
Benchmark Index 1	S&P/ASX BBB Rating Band	4.14	n/a			
Benchmark Index 2	S&P/ASX AFI 1-5 Year	2.77				
Income Plus	100% Index 1	4.14	5.00	0.00	3.05	-1.09
Core Income	75% Index 1, 25% Index 2	3.80	5.00	0.00	3.47	-0.33
Conservative Income	50% Index 1, 50% Index 2	3.46	5.00	0.00	3.29	-0.17

Bond from a decade high of 5.00% in October 2023

The IMT wrote, within their June 2024 QR that ..."The RBA is treading carefully, fearful that any early move to ease policy in response to inflationary gains that may not be sustainable may well ignite inflation again" ... but that, despite this, our Investment Strategy application remains consistent, for we will continue to ... "extend duration upon given any price advantage offered by the market, or confidence that inflationary numbers will improve yet again.

The September Quarter saw yields closing 32 basis points lower, reversing the capital losses of the prior quarter significantly. The Bloomberg All Composite Bond Index delivered a 3.02% return for the quarter and the FAB Fund delivered a further 20 basis points (gross) in excess of that.

Summary Outlook

The IMT remain consistently bullish. We expect to extend duration, longer than the benchmark index, as opportunity presents. We forecast the RBA will eventually set the OCR lower in response to evidence of lower inflation continuing and would not be surprised to see the OCR at 3.25% by EOCY2025. Whilst the bond market has currently priced in an OCR of ~3.60%, we suggest once the RBA eases policy the first time, likely now in February 2025^, the market will move to price that rate to move lower again.

^ *But not improbable to occur on Melbourne Cup Day (November 5).*

Adding to the fray is continuing geopolitical tension.

- Israelis and Palestine, Hamas/Hezbollah, Lebanon and now Iran.
- Russians in Ukraine and continually antagonising NATO
- Trump and Harris and policy differences.
- The possibility of an early (domestic) Federal election.

Yet, political and geopolitical tension will eventually dissipate. Markets have historically taken an initial 'hit' and then recovered. A threat to an oil price rise would impact negatively upon growth and therefore equity markets, and negatively upon inflation and therefore bond markets. Given the expanding theatre of conflict in the Middle East now includes Iran, it is worth noting its position as the sixth largest producer of oil globally and a key member of OPEC. However, the conflict is not necessarily about oil production setbacks. In fact, Iran exports a large proportion of its oil production to China.

The major concern is more about safe passage of oil to global demand via the Persian Gulf. Should we see elevated terrorist activity along transport routes, more likely as a function of the Israeli/Iran conflict, then yes, the current geopolitical tension will likely elevate oil and therefore petroleum prices and that will impact the speed of the fall in inflation, and likely hold bond yields higher in the medium term.

The IMT has determined that current economic evidence warrants a long duration position, and it subsequently expects to extend duration upon given any price advantage offered by the market. However, rather than intending to extend duration 'strategically' and by larger amounts, we are likely to extend 'tactically' and by smaller amounts, because the market has already moved to price a lot in. We envisage that we will continue to 'trade from the long side', but equally envisage that a longer-term outlook for an aggressive rally in long dated bonds will require more convincing evidence that falls in inflation can continue and geopolitical tension will ease.

Performance commentary

The IMT Investment Strategy has been seamlessly applied across all products. Investors in all IMT products receive the benefit of the same Investment Strategy application, as proven by the performance outcomes across all products and as described on pages 1-3 of this report.

The FAB Fund (Trust) and all MIPS IMA's (Direct IMA's) have delivered significantly high absolute and relative performance, having all outperformed their respective indexes by significant margins.

Refer to Tables 1–3 and Graph 1 for all quarterly and annual (to 30 September 2024) returns. Of significant note:

- The FAB Fund has delivered an 8.15% gross and 7.53% net in its first full year.
  - It outperformed the benchmark Bloomberg All Composite Index by 104 basis points (Gross) and 41 points (Net).
- All MIPS IMA's have delivered even higher returns.
  - Between 9.35% and 10.42% gross
  - Being 0.15% to 2.38% above respective indexes.

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Table 6: Key average exposure statistics by Investment Program

Key average exposure statistics by Investment Program at 30 Sept 2024									
	IG, Non-IG & Unrated Exposure Held versus Investment Mandate Limits								
Investment Program	Minimum IM required IG Exposure	Total IG exposure held	Excess / (deficit) IG exposure	Minimum IM allowed UR/NIG Exposure	Total Non-IG & Unrated exposure held	Excess / (deficit) UR & NIG exposure	Modified Duration	Weighted Average Term to Maturity	Cash Held @ Quarter End
Income Plus	25%	90%	65%	75%	10%	-65%	3.05	3.83	2.51%
Core Income	75%	94%	19%	25%	6%	-19%	3.47	4.32	1.95%
Conservative Income	100%	100%	0%	0%	0%	0%	3.29	4.08	1.63%

- Fixed products outperformed floating yet:
  - All fixed benchmarks outperformed BBSW
  - The Bank FRN Program posted the highest relative return, delivering 2.38% in excess of the BBSW Index (care of contraction in Bank CMs).
- Income Plus IMA investors enjoyed the highest absolute return but lowest relative return
  - The 0.15% excess return a function of difficulty in finding long duration, high yielding product to match the BBB Index duration (of 4.02 years).

Of note is the maintenance of long-term outperformance of indexes across all MIPS products, over all periods out to 5 years, care of a sound Investment Strategy. It is a trend that is now being replicated within the FAB Fund.

Within all MIPS Programs, duration exposure was derived through investment in predominantly Investment Grade Corporate debt, alongside a near limit (long) exposure to Bank Subordinate Debt and an increasing exposure to Asset Backed Securities (ABS) including Residential Mortgage Bonds. Federal and State debt exposure in MIPS Programs was low.

The FAB Fund however, derived near 100% of duration exposure via exposure to Federal and State Government Bonds. The FAB Fund will commence investing more significantly in Corporate Debt as FUM grows to exceed $50m, whereby it will satisfy diversity scores. Simply put, given that wholesale market parcel sizes are transacted at minimums of $500k, then, given a preferred maximum exposure of 1% of FUM to any singular corporate credit (issue), the manager will require FUM to exceed $50m to satisfy their exposure requirement. The FAB Fund is currently managing $40m of assets.

Average Investment Program credit and duration exposures across all IMA's are listed in Table 6.

What is significantly notable is the continuation of extremely low exposure to the Unrated (UR) and Non-Investment Grade (NIG) sector. Readers of the quarterly report series will note the IMT's prior commentary advising that the pool of opportunity is insufficiently diversified enough to encourage increased exposure into this sector. Please review prior quarterly reports for an expanded commentary on this topic.

The IMT has continually lent on the IG ABS/RMBS sector to fill the hole otherwise left by the lack of suitable Non-IG and UR opportunity.

Commentary – Floating Rate ABS (including RMBS) Debt

The September quarter ABS activity in the Australian market was significant, marked by numerous primary RMBS issues. The IMT successfully secured new issue exposure for various IMA's and the FAB Fund, from a diversified pool of issuers that included Allied Credit, Think Tank, Metro, Bluestone Sapphire, Mortgage House, and Athena Olympus.

Throughout the month, the IMT determined the best 'relative value' lay in the tranches with a credit rating of "A", given the excess CM paid for lower-rated tranches (BBB notes) did not sufficiently compensate us, as the investor, for the (slightly) higher risk profile, given the lower volume protection of subordinate tranches. Whilst the volume, structure and CMs for each tranche of every new issue varied, the average risk/return profile outcome was similar and the IMT on average, determined investing in the A or near A rated tranches the best outcome for our clients.

The IMT strategically invests in both primary and secondary market ABS issues in tranches that align with the risk and return objectives of each portfolio, that encompass average TTM and Credit Rating targeting. The IMT expects heightened activity in the ABS primary market to continue in October and will subsequently be busy maintaining client TTM profiles which include, in many portfolios, assets with prepayment (amortisation) levels that are approaching likely clean up call (full amortisation by the issuer) dates.

Commentary – Floating Rate Bank Debt

Our headline, customized liquidity Investment Product, is the Bank FRN (4) Program. The IM allows investment in Senior and Subordinate FRNs issued by Major and Minor Banks. Prior to the rise in the OCR, the performance of the program would rise and fall on the CM performance of the more volatile subordinate debt component. However, throughout 2022 and toward late

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Table 7: IG Bank Senior and Subordinate Floating Rate Debt

Bank (FRN) Investment Program Key (average) Credit Spread @ 5-year Maturity Dates			
	30/06/2024	30/09/2024	Changes
	Credit Margin	Credit Margin	Credit Margin
Major Bank Senior	0.83%	0.83%	0.00%
Minor Bank Senior	0.91%	0.91%	0.00%
Major Bank Subordinate	1.60%	1.62%	0.02%
Minor Bank Subordinate	1.82%	1.77%	-0.05%
Major Bank Subordinate / Senior Ratio	1.9x	2.0x	

^ *The universe of Minor Bank Subordinated debt is on average 0.5 year longer in maturity than the universe of opportunity in Major Bank Subordinated Debt*

2023, as the RBA tightened monetary policy aggressively, bank bill rates have climbed, and the accrual component is delivering the most significant contributions to returns.

In the last year a 'perfect storm' has emerged. Tight monetary policy ensured high accrual returns, but that has also been accompanied by large capital gains as CMs for both Subordinate and Senior issues contracted significantly.

The annual 6.79% (gross) return for period end 30 September 2024, being 2.38% above the BBSW index is evidence. The portfolio average market value CM contracted from ~+1.750% to ~+1.25% for the 'near 5-year TTM benchmark assets.

During the September Quarter, as listed in Tables 1-3, the Bank FRN sector outright and relative (to benchmark index) performance continued a strong run, contributing 0.61% performance excess above index. Bank Debt CMs continue to rally, with subordinate debt performing extremely well. We envisage this to continue, but in moderation, as a function of strong bank sector profitability, retained profitability and high (although dissipating)^ T1 Capital ratios.

We noted last quarter that S&P have upgraded all Major Bank Subordinate Debt by half a notch, from BBB+ to A-. This rating upgrade is continuing to resonate as lower CM's and higher FRN prices. The IMT will in future periods likely maintain a long TTM profile and favour a higher weighting in Subordinate Debt exposure (over Senior).

The September quarter was also a significant month for the Australian subordinated Tier 2 markets, as APRA^ announced a proposed change to the capital framework for banks. APRA plans to phase out AT1 (hybrids) and replace them with more reliable forms of capital, such as Tier 2. For the four major banks plus Macquarie and ING, APRA propose to replace the AT1 with 1.25% Tier 2 and 0.25% Common Equity Tier 1 (CET1), while for other banks, it will be fully replaced with Tier 2. Initially, investors expressed concerns that the increased Tier 2 supply would negatively impact spreads. However, the capacity for the market to absorb supply is substantial. We have seen the major banks successfully add 4.5% Tier 2 over the past three years (following APRA's ALAC requirements), with spreads currently at the tighter end of historical ranges. In contrast, this new proposal requires only an additional 1.25% Tier 2 to be issued over the next eight years.

There was no Tier 2 issued by Australian banks in the primary market this month. However, Suncorp Bank (also known as Norfina Limited after the acquisition by ANZ) issued $1.4bn in the form of a senior 3-year and 5-year FRN (the proposed 5-year fixed tranche did not proceed). Cash was deployed into senior FRNs as the IMT await further subordinated debt issues to launch in the primary market or when favourable secondary market opportunities arise.

Summary and conclusions

During the last quarter market yields experienced some volatility, but eventually rallied strongly into the close care of improving inflation figures and slow economic growth.

The IMT outperformed the benchmark index during the quarter through tactical long duration trading but closed the period near matching index durations of all benchmarks for all products.

The IMT continue to intend to transact 'from the long side' for all products under their direction. That means long duration and long IG credit.

Duration will be extended upon weakness, but, that same exposure will likely be reduced upon strength, unless a definitive economic release justifies maintaining the exposure extension at lower yields. That definitive data might well be the September 2024 Quarterly inflation data.

It can be difficult to hold 'long' positions in this market especially now that the benchmark Australian Government 10-year bond as a reference, has seen a 1.00% rally to new lows before recent retracement. Yet we remain bullish bonds.

We expect that monetary policy will be eased globally in 2025. It just may take a little tighter domestic policy pain to get there.

Additional commentary from Megan Romeo, Portfolio Manager & Head of MIPS

As evident on page 10, readers will note that the Core Income Product is no longer displayed. The product is now closed to new investors, whilst existing investors retain the right to continuance. Non customised new investors are encouraged to consider the Conservative Income or Income Plus Investment Mandates.

Earlier this year we modified the Income Plus Investment Mandate (IPIM) to dilute a reliance upon the UR sector to deliver higher yield. Historically we have expressed our view that the universe of available securities within the AUD UR sector does not offer sufficient yield for the elevated risk and poor liquidity. We subsequently modified the IPIM to enable inclusion of a higher percentage exposure to the higher yielding Subordinated Debt and ABS sectors and concurrently reduced the maximum percentage exposure to UR (& NIG) debt to 20% from 75%. The allowance for up to 40% of exposure to ABS assets is double the allowance within the Conservative Income Program.

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FIIG The fixed income experts

Clients now have a clear 'book end' choice.
The (100%) IG Conservative Income IM or the (80%/20%) IG/NIG Income Plus product.

Contact via: megan.romeo@fiig.com.au

Additional commentary from Garreth Innes, Portfolio Manager, FIIG Monthly Income Fund

It is my pleasure to be addressing IMT clientele for the first time in my role as the Portfolio Manager for the MIF. We currently have c$20m of capital invested in MIF with daily applications continuing to flow in. In the first week of operations, we have been busy with both primary and secondary fixed income markets investing across a diversified range of assets.

The MIF will implement Investment Strategies consistent with those applied successfully over a long period of time within the MIPS floating rate IMA's, with particular regard to the banking and ABS sectors. However, the MIF has an additional and broader suite of investment options and will subsequently build a diversified exposure to both floating and fixed-rate assets. In respect of duration positioning, the MIF will attempt to reflect the broader interest rates view of the Investment Management Team, adjusted for MIF mandate objectives (outlined within Appendix 1).

Contact via: garreth.innes@fiig.com.au

Appendix 1: Investment Strategy and application

The IMT applies the same Investment Strategy equally across all IMT products, whether Unit Trust (the Funds) or IMA (Direct Bond ownership) based, adjusted by ratio, for Investment Mandate (IM) design differences. Key ratio applications are based on benchmark index differentials.

Duration and credit exposure investment strategy application, as applied to fixed and floating rate products, whether they be Direct Bond Individually Managed Accounts (IMA's via MIPS) or Trust based Accounts (the FAB Fund or MIF) are discussed herein using the following four examples.

1. Modified Duration (MD) Investment Strategy application

- The FAB Fund is benchmarked to the Bloomberg Composite Index, which has a MD of ~ 5.00 years.
- Conservative Income is benchmarked to a blend S&P Index that has an MD of 3.50 years.
- Were the IMT Investment Strategy 'bullish' interest rate direction, and elected to be 10% longer than the index, the FAB Fund MD would be set at 5.50 years, and Conservative Income MD would be set at 3.85 years.
- The extension ratio applied to floating rate debt would be similar, with TTM the statistic of merit.

2. TTM Investment Strategy application

- The IMA Bank Programs are benchmarked to BBSW and have a Senior and Subordinate TTM exposure of 4.00 and 5.00 years.
- The MIF, also benchmarked to BBSW, would, for that component percentage of capital invested in Senior and Subordinate Bank Debt, have the same TTM exposure.
- Additionally, the TTM of ABS exposure held in both the IMA's and MIF would be similarly consistent, and similarly diversified, with differences explained by specific Investment Mandate differences.

3. MD and TTM Investment Strategy application

- The MIF would also, given capacity to invest 'up to 30%' of FUM in fixed rate assets at a maximum of 2.50 years, be using that 'long' duration limit when the IMT Investment Strategy was 'bullish' interest rate direction.
- Given MIF is benchmarked to BBSW, which has a tenor of 0.12 years, expect MIF to be in the order of +0.12 long when the IMT MD Investment Strategy is neutral.
- If the FAB Fund MD were 5.50 years as per example 1, which is 25% of the maximum of 2 years, expect the MIF to be in the order of 0.68 years long, being 0.56 longer than the base 0.25 years of BBSW (0.50/2.00 x 2.25).

4. Credit Exposure Investment Strategy application

- The FAB Fund has the capacity to invest a maximum of 15% of funds under management (FUM) in subordinate bank debt. Conservative Income has capacity to invest in a maximum of 20% of FUM in subordinate bank debt.
- Subsequently, expect the Fund exposure to subordinate bank debt to be 75% of the exposure applied to Conservative Income.
- Subsequently also expect the MIF exposure to subordinate bank debt to be a function of its ratio capacity to invest in that sector compared to the FAB Fund (and CVI).

Appendix 2: Strategic and Tactical Investment Strategy applied

Strategic (longer term) and tactical (shorter term) investment strategy application is relevant for both interest rate and credit spread direction, whether products managed are either fixed or floating.

It is however worth noting that, generally, the cost of implementing short term or tactical credit exposure changes is often prohibitive, given a bid or offer CM and therefore price differential must be crossed. Additionally, bid or offer volume at the higher cost bid or offer price, may not match required volume.

Subsequently, most tactical investment strategy application is MD based because the manager has the capability to implement changes quickly, at very efficient prices, across highly liquid products.

1. Interest rate direction

If the IMT envision that interest rate direction will be lower in the longer term and are prepared to suffer the volatility of yield movement that will encompass holding longer term positions, any duration extension would be categorised as 'Strategic'. Such positions are held given longer term targets and are held envisioning accompanying economic data that will justify the exposure position.

2. Credit Margin (CM) direction

If the IMT envision that CM's are likely to contract generally (all credits across all ratings) or specifically (by industry or by issuer) over the longer term, and are prepared to suffer the volatility in valuation changes that will encompass holding longer term positions, then any credit exposure 'extension', manifested as higher percentage holdings or higher percentage and/or longer tenor holdings, than benchmark, could be categorised as 'Strategic'.

- What categorises a strategic position may well be evident in arrears only. The ability to suffer not only short-term mark to market losses, but experience short-term mark to market gains, without either stop losing or taking profit to alleviate pressure, maintaining confidence of achieving even higher gains, are hallmark examples longer term strategy application.
- Conversely, a tactically held position will be quickly stopped out (loss taking to minimise) where the market moves against the position and will additionally see crystallisation of profits given any gains.

In reality, the lines of definition between strategic and tactical positions are often blurred given the constant change in information that affects bond prices and confidence in forward price projections. What does not change is the requirement to never convert a tactical position into a strategic one without justifying information. Many less experienced portfolio managers and fixed income traders have, and will continue to, hold onto tactical positions that have hit stop loss settings, justifying the hold by re labelling the position as strategic. It would not be unexpected to see the (loss) hole grow deeper in this scenario. And too, many have and will continue to prematurely take profit on tactical positions that are justifiably held given new information.

The FIIG Investment Management Team (IMT)

Extensive and combined experience of in excess of 65 years. Your capital is in safe hands.

Kieran Quaine

Head of Investment Management

Kieran has in excess of 35 years' experience in senior roles in the fixed income market, primarily as a fund manager in charge of investing multiple billions of dollars across a wide and complex range of Investment Mandates. His experience includes roles as a US Investment Bank proprietary interest rate trader, as a debt originator, syndicator and institutional client relationship manager. Kieran has worked at FIIG Securities for over 15 years, including the last 9 years as Head of MIPS, developing the IMA business with Megan Romeo. Kieran has a BA (Accounting) from Canberra University and is a former Chairman of the AFMA Debt Capital Markets Committee.

Megan Romeo

Head of MIPS
Portfolio Manager

Megan has in excess of 15 years' experience in the Asia Pacific fixed income markets. Before joining FIIG in 2015, Megan worked for Standard & Poor's Capital IQ, tailoring technically complex data and algorithm solutions for clients across the Asia Pacific. Megan holds a Bachelor of Science (Hons) in Quantum Physics and a Diploma of Financial Services (Securitisation). Her mathematical and statistical data analysis skillset, and development of trading and allocation algorithms, has been instrumental in the generation high alpha returns within all MIPS products, and the emerging equivalent record for the FIIG Australian Bond Fund.

Garreth Innes

Portfolio Manager

Garreth has over 15 years' of extensive experience in financial markets, including portfolio management roles with multi asset class exposure. He has individually managed significant volumes of capital invested in the fixed income asset class across a complex array of Investment Mandates and has lead teams of analysts and junior managers. Garreth has additionally been a member on Tactical Asset Allocation committees and has successfully launched and managed an Australian Dollar Income Bond Fund for Asian Private Bank clients. Garreth holds a Master's Degree in Finance (UNSW) and is a CFA Charter holder.

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FIIG The fixed income experts

FIIG Investment Management Product Suite and Summary Investment Mandate limits.

Individually Managed Account (IMA) opportunities

1. MIPS Conservative Income (CVI) Investment Program

Provides investors with exposure to a diversified portfolio of risk averse IG Senior and Subordinate fixed income securities, which additionally produce reliable and regular income that can be distributed or retained for reinvestment.

Number of Bonds	Minimum 10	**Subordinated Debt**	Up to 20%	**FIIG Arranged Bonds**	0%, not allowed
Investment Grade	100%	**Asset Backed Securities**	Up to 20%	**Modified Duration**	Up to 5 years

2. MIPS Income Plus (IP) Investment Program

Provides investors with a potentially higher return than the CVI Program through exposure to a diversified portfolio of both IG and NIG fixed income securities, which additionally produce reliable and regular income that can be distributed or retained for reinvestment.

Number of Bonds	Minimum 10	**Non-Investment Grade**	Up to 20%	**Asset Backed Securities**	Up to 40%
Investment Grade	Minimum 80%	**Subordinated Debt**	Up to 20%	**FIIG Arranged Bonds**	0%, not allowed
				Modified Duration	Up to 5 years

3. MIPS Customised IMA Program

MIPS offers the ability to create a bespoke 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	$10,000,000	Currency	Australian dollar	**Management Fee**	Negotiated

Unitised Trust Fund opportunities

1. FIIG Australian Bond Fund

Provides investors with exposure to a portfolio of longer maturity Australian IG fixed income securities that are benchmarked to the (near) 5-year long (MD) Bloomberg AusBond Composite 0+Year Index. Suits investors with a longer term (3-5 years) investment horizon, who also seek exposure to the tenor, returns, volatility and income delivered by the Australian Bond market, through exposures that include government, semi government bonds, corporate bonds and asset backed securities. The fund aims to deliver returns in excess of the benchmark, net of fees, over a 3-year rolling period.

Investors should read the PDS via, available via the following link: 62932 FIIG AUSTRALIAN BOND FUND PDS

Minimum investment	$1,000 AUD	**Corporate Debt**	Up to 70%	**Asset Backed Securities**	Up to 30%
Investment Grade	Minimum 100%	**Subordinated Debt**	Up to 30%		

2. FIIG Monthly Income Fund

Provides investors with exposure to a portfolio of shorter maturity floating rate and short dated fixed rate securities that are benchmarked to the Bloomberg AusBond Bank Bill Index. The Investment Mandate includes capacity to invest a maximum of 30% of exposure in NIG debt and carry a 10% exposure to unhedged foreign currency debt. Suits investors with a medium term (3-year) investment horizon. The fund aims to deliver returns in excess of the benchmark, net of fees, over a 3-year rolling period.

Investors should read the PDS via, available via the following link: 63281 FIIG MONTHLY INCOME FUND PDS

Minimum investment	$10,000 AUD	**Investment Grade**	Minimum 70%	**Non-Investment Grade**	Up to 70%

ABS: The Investment Programs 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 program.

IMP: Individually Managed Portfolio.

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.

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