Managed Income Portfolio Service (MIPS)

Including The FIIG Australian Bond Fund (Fund)

Quarterly Report – December 2023

Welcome. This report contains a selection of summary information relevant to the fixed income market, informing readers of the major influences impacting the price of the assets from which the performance of portfolios is derived.

The Quarterly Report (QR) is written by the MIPS Portfolio Management Team (PMT).

Key Observations

- FIIG Australian Bond Funds stunning debut
- Central Banks (CB) remain hawkish – would we expect anything less?
- Inflation (and oil price) falls continue on trend
- RBA tightens monetary policy
- Geopolitical tension remains hyper elevated

Generation and distribution of both total return and income

The PMT endeavours to generate the highest possible total return for investors, commensurate with the risk profile chosen from the MIPS product menu of opportunity:

- Three MIPS Investment Mandate (IM) designs
- Customised Individually Managed Accounts (IMA)
- FIIG Australian Bond Fund (FIIG Fund)

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 (CM) over floating benchmarks. However, market interest rates (and therefore 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, it is total return that is the key outcome of merit.

Product differences and Investment Strategy application

The MIPS PMT applies the same Investment Strategy equally across all MIPS, Customised IMA and Trust (FIIG Fund) based products, adjusted by ratio^, for IM design differences.

Floating Rate IMs, dominated by investment opportunities in senior and subordinate bank debt, alongside Asset-Backed Securities (ABS), including Residential Mortgage-Backed Securities (RMBS) will target weighted average terms to maturity (TTM). Where the PMT is bullish credit margins for the sector, the portfolio target TTM will be extended. The performance of portfolios will be a function of both the base accrual yield (BBSW) plus any change in value derived from changes in CM's.

Fixed Rate IMs, dominated by investment opportunities in Federal, State and Corporate Debt, will also target a TTM, expressed as a Modified Duration (MD). The longer a portfolio MD, the more sensitive the portfolio is to changes in interest rates. Where the PMT is bullish in the interest rate direction, the portfolio target MD will be extended. The performance of portfolios will be a function of both the base accrual (book value) yield of the asset plus any change in value derived from changes in both base interest rates and credit margins.

Clearly, various IMs encompass exposure to debt products from the two separate floating and fixed rate pools of opportunity issued by governments and corporate entities.

^ Key ratio applications are based upon benchmark index differentials.

MIPS Investment Returns

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

Total GROSS Returns to 31 December 2023	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.
Income Plus	2.26	3.85	4.98	10.21	8.32	3.33	4.13	1.93	2.62
Core Income	2.55	3.85	4.57	9.35	7.44	1.77	2.10	1.80	2.80
Conservative Income	2.49	3.75	4.80	9.82	7.52	1.47	1.35	1.99	3.00
Customised Liquidity: Bank (FRN) 4	0.60	1.51	3.12	6.34	6.00	3.06	2.35	2.29	2.60
FIIG Australian Bond Fund	2.76	4.23	n/a						

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

Benchmark Fixed Income Index Returns to 31 December 2023	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	2.79	4.24	5.61	11.54	8.97	-0.71	-1.06	0.76	2.16
Australian Fixed Interest 1-5 year	1.61	2.48	3.51	7.14	4.42	-0.01	-0.50	0.42	1.15
Australian Fixed Interest (All Maturities)	3.05	4.20	3.65	7.43	5.46	-3.19	-3.18	-1.22	0.49
Bank Bill	0.37	1.06	2.14	4.32	3.89	2.55	1.71	1.37	1.40
Bloomberg AusBond Composite 0+ Yr Index	2.69	3.79	3.49	7.13	5.06	-2.61	-2.70	-0.95	0.64

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

The following two examples reference the FIIG Australian Bond Fund (Trust) and MIPS Conservative Income (IMA) to showcase how the Investment Strategy is applied equally.

Example: MD Investment Strategy application

- The 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 PMT Investment Strategy 'bullish' interest rate direction, and elected to be 10% longer than the index, the FIIG 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.

Example: Credit Exposure Investment Strategy application

- The 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.

Readers are invited to review the performance of all products managed by the MIPS PMT, as displayed in Table 1. We note the consistency of investment performance as described by the ratio analysis above.

During the December Quarter of 2023, all products performed exceptionally well because the PMT set MD "long" and longer than respective benchmark indices. And the longer the benchmark, the better the performance.

Macroeconomics, base interest rates and investment strategy commentary

In our September 2023 QR, the PMT stated:

"Given monetary policy tightening by the RBA to 4.10% to date, with potentially another round (of 0.25% if inflation disappoints on 25 October) demand will continue to be stifled and so too will inflation (eventually)"... so....." ***In the coming quarter modified duration will be extended because inflation is trending down*** and bonds at current book value entry levels represent a positive real yield opportunity" ... and further .... "***This is the first time since 2019 that the MIPS PMT will be investing LONG duration and is a significant change in Investment Strategy***."

Rather than repeat further key messaging contained within all prior QRs, we request readers review all prior editions.

All reports are available here: fiig.com.au.

Table 3: Gross IMP Performance versus Benchmark Indexes

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	2.79	4.24	5.61	11.54	8.97	-0.71	-1.06	0.76	2.16
75% BBB, 25% 1-5yr	2.50	3.80	5.09	10.44	7.83	-0.54	-0.92	0.68	1.91
50% BBB, 50% 1-5yr	2.20	3.36	4.56	9.34	6.70	-0.36	-0.78	0.59	1.66
100% Bank Bill	0.37	1.06	2.14	4.32	3.89	2.55	1.71	1.37	1.40
Bloomberg AusBond Composite 0+ Yr Index	2.69	3.79	3.49	7.13	5.06	-2.61	-2.70	-0.95	0.64
Performance v Index & Blend Indexes									
MIPS Income Plus	-0.53	-0.39	-0.63	-1.33	-0.65	4.04	5.19	1.17	0.46
MIPS Core Income	0.05	0.05	-0.52	-1.09	-0.39	2.31	3.02	1.12	0.89
MIPS Conservative Income	0.29	0.39	0.23	0.48	0.83	1.83	2.13	1.40	1.35
MIPS Bank FRN 4	0.23	0.45	0.98	2.02	2.11	0.50	0.64	0.93	1.20
FIIG Australian Bond Fund	0.07	0.45	n/a						

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

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Table 4: Commonwealth (benchmark) Bond Yield volatility in the December 2023 Quarter

CGL Maturity	Sources: ^ & ^^	Open ^	High ^^	High date	Low ^^	Low date	Close ^^	Current ^^#
(near) 3-year	SFE 3 & 10-year Futures	4.090%	4.520%	1 Nov	3.510%	28 Dec	3.570%	3.780%
(near) 10-year		4.500%	5.035%	1 Nov	3.890%	28 Dec	3.965%	4.185%

^ 3yr: YUZ23 (December 23 Deliverable), ^^3yr: YTH24 (March 24 Deliverable)
^ 10yr: YUZ23 (December 23 Deliverable), ^^ 10yr: YUH24 (March Deliverable)
 # Current date: 8 January 2024

In summary, the PMT had kept MD extremely short throughout late 2020 all the way through to late 2023, in both anticipation of higher inflation and a deterioration in bond prices. The PMT sought to protect investor capital by exposing investors to short-dated fixed assets and higher percentages of floating-rate debt in an environment perceived to be conducive to rising interest rates.

With evidence of inflation peaking having emerged and indeed met forecasts posted in our June 2022 QR, alongside the concurrent rise in yields for long-dated government debt to levels not seen for 10 years, the PMT commenced duration extension.

Returns in the December Quarter of 2023, as evidenced by both program and index returns, were strong. However, the quarter was a 'tale of two halves'! Initially, the market believed the Federal Reserve 'jawboning', fearing their tough talk would indeed mean tighter monetary policy for longer, but later decided that the economic evidence of dissipating inflation was sufficient to entice investment long on the yield curve. Talk is cheap. Rhetoric without action is hot air.

Refer to Table 4.

Yields of benchmark Commonwealth Government three- and ten-year (maturing) bonds weakened considerably in the first month of the quarter, climbing 43 and 53 basis points from their opening yields. That period encompassed significant 'jawboning' by central banks, particularly the US Federal Reserve. But despite the RBA subsequently tightening on November 7, the market had seen enough economic evidence and, bought long-dated bonds, mostly because they were oversold, but additionally, because they didn't believe the story the Central Banks were spinning. What ensued was a monster rally off highs in yield to see the December month-end close t he quarter about 1.00% lower in yield across the curve.

The Fund and all MIPS IMA's delivered positive returns during the quarter. Income Plus, despite an impressive 3.85% absolute return, was the only program that did not deliver returns in excess of its benchmark index. This was not an unexpected development, as forecast within the September 2023 QR.

Summary events in the December quarter?

- Despite weak Eurozone economic data releases, October was initially dominated by strong US employment data and the US Federal Reserve, concurrently and alongside other Central Banks, continually 'jawboning' the markets, expressing a united stance of continuation of tight policy.
- US Federal Reserve Chairman Powell stated the Federal Open Market Committee (FOMC):
  - is 'proceeding carefully' and that evidence of above potential growth could warrant a hike.
  - Was monitoring geopolitical changes for 'economic implications'
  - was not thinking or talking about rate cuts, but questioning 'should we hike more?'
- The geopolitical change referred to the developing conflict in the Middle East. The potential for the US and Iran's involvement in an expanded theatre of conflict was real. Markets do not like conflict and uncertainty and demanded a premium, so yields weakened.
- However, the tail end of October saw weak GDP and CPI data releases out of the Eurozone, immediately preceding the US Federal Reserve announcing 'no change' despite an extended prior period of jawboning. Subsequent weak US and Canadian employment data releases were a catalyst for a reversal of market trends.
- Bond yields, having weakened to above 5.00% in the US and Australia (despite resilience to change in Europe) commenced rallying.
- The rally continued despite the RBA tightening monetary policy on November 7.

Was the rate hike in Australia 'necessary'?

We don't think so. The RBA expressed impatience with the gradual improvement in inflation over 2023. Readers of our quarterly series will have no doubt about our opinion.

The RBA was late to the party tightening policy. As we stated in 2020 and 2021, as evidence of strong inflation emerged, they 'dragged the monetary policy chain'. And, given evidence that inflation is retracing from highs alongside evidence of discretionary expenditure being crushed by policy positioning prior to November 7, we suggest the chain is now a heavier shackle around the necks of Australian consumers than is warranted.

Table 5: Index and Blend Index Durations

Benchmark Index Name / Investment Manager / Program Name	Benchmark Index Name / Blend Index Splits	Index Modified Duration (MD) @ 31 Dec 2023	Inv' Mandate		Dec Qtr End	Difference MD v Index
			Max MD	Min MD		
Benchmark Index 1	S&P/ASX BBB Rating Band	4.04	n/a			
Benchmark Index 2	S&P/ASX AFI 1-5 Year	2.83				
Income Plus	100% Index 1	4.04	5.00	0.00	3.01	-1.03
Core Income	75% Index 1, 25% Index 2	3.74	5.00	0.00	3.70	-0.04
Conservative Income	50% Index 1, 50% Index 2	3.44	5.00	0.00	3.52	0.09

Key Global monetary policy changes during the quarter / official cash rates:

- UK (BoE): unchanged @ 5.25%
- Europe (ECB): unchanged @ 4.00%
- AUS (RBA): tightened 4.10% → 4.35%
- Canada (BoC): unchanged @ 5.00%
- New Zealand (RBNZ): unchanged @ 5.50%
- USA (Federal Reserve): unchanged @ 5.375%

During the December 2023 Quarter, and essentially during the October month as yields climbed, the PMT extended duration positions of all Fund and IMA positions aggressively longer than respective indices.

Whilst the FOMC jawboned and the conflict out of Israel elevated, we elected to extend because economic news was compelling. Inflation was easing and yields were rising …..

… and the real yield opportunity to invest long was more compelling than CB rhetoric and the developing geopolitical risk.

We note that within our September 2023 QR that we were not enticed to be cautious as geopolitical concern elevated ….

"The most recent bout of long bond yield rises is attributable to continuing CB hawkish activity, coupled with the OPEC threat to oil prices and the US budget impasse. The MIPS PMT see it all as a buying opportunity, for OPEC cannot simply restrict supply and push prices too high in a world where demand is already weak. Consumption of oil will just decrease".

Summary outlook

We perceive the market will likely move 'sideways' from here for a period, awaiting further economic evidence to justify an extension of the current rally.

We favour remaining bullish in the longer term, but we need more compelling evidence that inflation can fall toward the lower end of the RBA range

At 4.00%, 10-year Commonwealth Government Bonds are essentially pricing in long-term inflation at 3.00%. (Readers are asked to refer to our June 2022 QR that analyses historical real rate return history). Whilst 3.00% is at the higher end of the RBA inflation range, implying the RBA will likely retain a tightening bias to push inflation a full percentage lower toward 2.00%, the job may well take some time and roadblocks can be expected.

The heady days of globalisation brought peak economic prosperity across the globe – low inflationary economic growth. Yet, the geopolitical environment has never been as precarious, and the implications are volatility in the scale and cost of trade. Scale economy specialisation and free trade agreements are threatened by nationalisation at the expense of globalisation. The cost of capital just climbed higher in price.

Whilst the Ukrainian and Israeli conflicts are obvious examples of elevated geopolitical conflict, the less obvious is the possibility or probability of Donald Trump being elected to the office of President of the United States. His nationalistic policies, challenges made to the power of the legal system and potential for unwinding NATO are all extremely concerning.

Our Investment Strategy focus may be a longer-term 'strategic' duration extension or a short-term 'tactical' one.

A strategic move envisions holding the longer duration position in place for a longer period of time. A tactical move envisions holding the position for a short period of time.

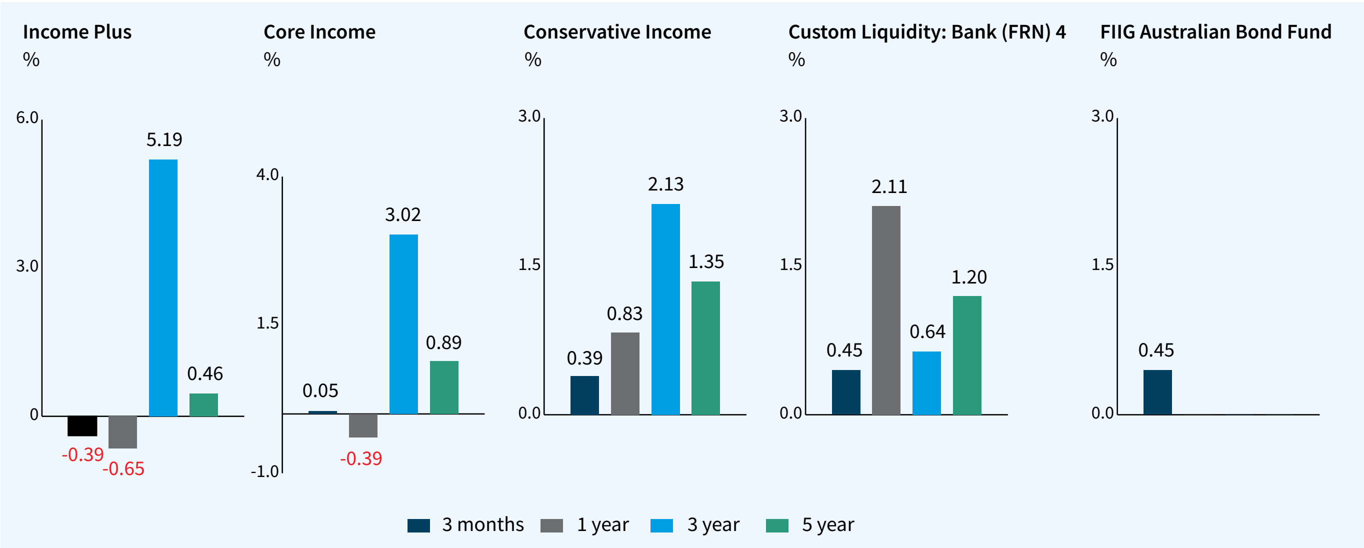
We stated in September 2023 QR that …" In the coming quarter,duration will be extended because inflation is trending down and bonds at current book value entry levels represent positive real yield opportunity".

However, because the rally was so quick and so strong …the envisaged strategic long has effectively become tactically reversed. Not dissimilar to our tactical duration extension of February 2023, we have 'taken profit' and de-risked prior duration extensions and are now, at quarter end, matching index. Quite simply put, we were surprised not by the extent of the rally but by the minimal time it took.

The MIPS PMT subsequently envisage that current yields, as evidenced by the AUD 10-year Federal Government bond yield of ~ 4.00% (quarter end), are appropriately priced for a neutral MD exposure stance. We expect that toward 4.25%, and certainly at 4.50%, we will extend duration, and unless justified by quite strong economic evidence, we will reduce MD as bonds rally towards 3.50%.

We stated in our September 2023 QR that monetary policy tightening by the RBA to 4.35% was possible following

Graph 1: Performance v Benchmark Indices



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

the October Inflation release – if it disappointed. That has occurred. Our perception that consumer discretionary demand had been sufficiently reined in already still stands, and we are even of a firmer belief now that the monetary policy cycle of tightening is over globally and domestically.

Performance commentary

In the December 2023 Quarter, the MIPS PMT has delivered positive absolute and relative performance (excluding Income Plus).

The following commentary very generally attributes performance within each of the following Investment Programs, referencing the key elements of each program IM.

Refer to Tables 1 through 3 for performance. Refer to Tables 5 and 6 for key summary exposure statistics.

Income Plus (IP)

The IP IM allows a maximum capacity of 75% exposure to Unrated (UR) and Non-Investment Grade (NIG) Credit.

Historically, the performance of the program would rise and fall depending on the performance of that sector of asset.

In the December quarter, IP, whilst delivering a stellar 3.85% gross return, underperformed its benchmark: 100% BBB Corporate Rating Band Index. Investors will note our prior statements in previous QR's. The inability to sell underperforming UR assets contributed negatively to performance. Insufficient bid side liquidity in short-maturity UR assets targeted for sale compromised the ability to extend MD. We are however happy to report, as displayed in Table 6, that the UR and NIG exposure has diluted further over the quarter, from 31% to 20%.

The PMT notes that in the long term, IP has outperformed its benchmark index significantly across all time periods to 5years. The MIPS PMT advises they continually intend to hold a significant underweight UR and NIG exposure.

Core Income (CI)

The CI IM allows a maximum capacity of 25% exposure to UR and NIG credit. Subsequently, the IG exposure must sit at a minimum of 75%. Additionally, all investments must rank as senior obligations. Historically the performance of the program is influenced less by UR & NIG asset performance, although that sector can be notoriously volatile, and more so by IG credit and the duration of that credit exposure.

In the December quarter, CI delivered a stellar 3.80% (gross) performance and marginally exceeded its benchmark index return. The ability to outperform its index is, too, a function of the illiquidity in the UR sector that has compromised IP.

Additionally, it has no Investment mandate capacity to invest in subordinate debt, unlike Conservative Income, which benefited from the CM contraction for that sector.

Conservative Income (CV)

The CV IM is 100% IG, with an allowance for a maximum of 20% exposure to IG Subordinate Debt. Historically the performance of the program would rise and fall on the performance of the duration of the exposure held alongside the CM performance of both the IG fixed senior corporate and subordinate bank floating rate debt assets held.

In the December quarter CV outperformed its benchmark because duration was extended and it held sufficient exposure to benefit greatly from the contraction in subordinate debt margins. CV's absolute performance was not as high as IP or CI, yet its excess performance above benchmark is testimony to the correct Investment Strategy application.

Table 6: Key average exposure statistics by Investment Program

Key average exposure statistics by Investment Program at 31 December 2023									
	IG, Non-IG & Unrated Exposure Held verses Investment Mandate Limits								
Investment Program	Minimum IM required IG Exposure	Total IG exposure held	Excess / (defecit) IG exposure	Maximum IM allowed UR/NIG Exposure	Total NIG & UR exposure held	Excess / (defecit) UR & NIG exposure	Modified Duration	Weighted Average Term to Maturity	Cash Held @ Quarter End
Income Plus	25%	80%	55%	75%	20%	-55%	3.01	3.76	2.48%
Core Income	75%	92%	17%	25%	8%	-17%	3.70	4.46	2.32%
Conservative Income	100%	100%	0%	0%	0%	0%	3.52	4.33	1.30%

Duration was easily extended care of liquidity afforded by the IG sector. Subordinate debt (see Table 6) exposure to major banks, held at near an average of maximum capacity of 20% of exposure, performed well. See the next section for an extended discussion of bank debt performance.

Conservative Income also maintains an excellent long-term record of outperformance of its benchmark index for all time horizons out to 5 years.

All Investment Programs

The 'underweight' UR and NIG positioning in both IP and CI portfolios continues as a function of a negative opinion of the direction of the UR and NIG sector credit margins. We wish to extend duration but cannot do so on NIG and UR yield curves. The looming likelihood of tepid economic growth is a contributory factor. Whilst we do not predict a recession, we do predict GDP to fall as consumer discretionary expenditure is curtailed by higher monetary policy yet to be reversed.

Additionally, the pursuit of achieving appropriate exposure diversity remains. The universe of opportunity in the UR and NIG issuance sector has been thin for some time. The MIPS PMT will not compromise diversity requirements to pursue an uplift in percentage exposure to this sector. Currently we have set a preferred maximum of 2.50% exposure to singular names in any singular account.

We await a significant uplift in new issuance before we can contemplate investing at full limit across Income Plus accounts, which currently invest at an average 20% (-11.00% QOQ) exposure versus a 75% limit! Additionally, given the historical record of high default and restructure or default and recovery, lending may well be limited to a maximum of 3-year tenors. We suspect that exposure to UR and NIG debt will fall below 20% in the March quarter within IP, where we will seek to extend duration on IG yield curves, funded by the sales of that UR and NIG debt.

For CI accounts, whilst achieving diversity is less of a problem given the UR & NIG limit (senior only) is 25%, we still remain cautious. Whilst the pool of asset opportunity is theoretically sufficiently large to satisfy diversity, CI accounts are currently invested at an average of 8% (-3% QOQ) exposure to UR and NIG assets, versus a 25% limit, for the same reason explained above.

The PMT flagged the likely reduction of exposure to Subordinate Bank Debt within the Conservative Income Investment Program in the September 2023 QR. Subordinate Debt is now trading at <2 times Senior Debt CM's in the key 5-year TTM. This strategy is also statistically consistent with the credit risk sector metrics applied in IP and CI where we have reduced the UR and NIG exposure percentages (verses mandate limit).

IG Bank Senior and Subordinate Floating Rate Debt

Our headline customised liquidity Investment Product, is the Bank FRN (4) Program. The IM allows investment in Major and Minor Bank Senior and Subordinate FRNs. Prior to the rise in the official cash rate, the performance of the program would rise and fall on the CM performance of the more volatile subordinate debt component. In recent quarters, as the RBA has tightened monetary policy aggressively, bank bill rates have climbed and the accrual component is delivering the most significant contributions to returns.

In the December Quarter 2023, the Bank FRN (4) IP returned +1.51% (gross), significantly ahead of the Bank Bill Index return of 1.06%. The PMT notes that the average CM of the portfolio now contributes ~+1.44% annually and ~0.36% quarterly. The excess performance above benchmark, ex-CM accrual advantage, being a further 0.09%, is attributable to CM contraction and efficient transactional activity by the MIPS PMT.

Readers will note our long-held view that the impending rise in the Official Cash Rate (OCR) would drive fixed rates higher and subsequently floating rate notes (FRN) would outperform on an accrual basis. They will also note our dual long held view that subordinate bank CMs would rally, mean reverting to an expected ≤2.00% CM for benchmark near 5-year major bank subordinated debt products.

As advised in prior QRs, that CM change has now occurred. CM's contracted aggressively into the end of the year.

Our prior forecasts of an expected Subordinate/Senior CM ratio have been exceeded and sit at 1.9x.

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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			
	30/9/2023	31/12/2023	Changes
	Credit Margin	Credit Margin	Credit Margin
Major Bank Senior	0.87%	0.90%	0.03%
Minor Bank Senior	1.10%	1.09%	-0.01%
Major Bank Subordinate	1.89%	1.72%	-0.17%
Minor Bank Subordinate	2.68%	2.08%	-0.60%
Major Bank Subordinate / Senior Ratio	2.2x	1.9x	

^ *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*

Subsequently, going forward, the PMT will reduce exposure to Subordinate Debt as a percentage of total exposure, and will shorten the TTM of that Subordinate Debt exposure percentage retained. We will concurrently extend Senior Debt TTM's to achieve total portfolio TTM targets.

The RBA has clearly met our (and the markets) expectation of higher bank bill rates through raising the OCR to 4.35%. Although the RBA dragged the chain early in 2022, accrual gains for FRN holders have now soared.

Our messaging for the prior quarter is still relevant.

… Whilst there is evidence of improvement in inflation, and subsequently accrual levels may now be approaching a peak in the cycle, the OCR is unlikely to be reversed until inflation is heading on trend to below 3.00%, so investors in this sector can expect accrual gains to continue for some time yet.

We forecast as far back as the June 2022 QR, that we do not expect inflation to mean revert until late 2024. We retain that view. We believe an easing cycle will commence in the later half of 2024, yet inflation gains will likely be smaller from here on in. Subsequently, the sector will retain an attractive accrual base (BBSW) until the end of 2024 at least.

Summary

The economic and investment landscape has changed dramatically.

Throughout 2021 and up until June 2022, inflation was rising, and central banks, particularly the RBA, were dragging the 'monetary policy chain'. The PMT subsequently maintained a short-duration position to protect investor capital.

Since late 2022, the PMT has extended Investment Program duration to near-match benchmark index duration at every opportunity where long-dated benchmark bonds approach target yields of 4.00%. This target was communicated within the June 2022 QR and has been the mainstay focus given an expectation that inflation would peak at or near 7.00% (YOY).

During the last six months, the opportunity to invest in longer dated assets – including corporate debt assets – at higher rates, was accompanied by further risk and volatility of return. The MIPS PMT believed that the risk was warranted and investors are now enjoying the benefits of that risk taken by their Portfolio Managers.

The MIPS PMT invested aggressively longer than benchmark in the September 2023 Quarter and launched a long-dated product basis their belief that fixed rates had approached a (near) cyclical peak.

Now, following a rally of significance, and capital gains of merit, the PMT signal an intent to be cautious. Further falls in yield will be a function of further gains in inflation, and it may be a long road and a grind.

The PMT has subsequently set duration to match the index at the end of the quarter and will continually monitor the markets for catalysts for yield change and will adjust both credit and duration exposure accordingly.

The fixed income experts

Portfolio Management Team

Kieran Quaine
Head of Managed Income Portfolio Service

Kieran has in excess of 30 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 range of investment mandates. His experience includes roles as a proprietary interest rate trader, debt originator, syndicator and in institutional debt sales, with his expertise in the unrated market likely unsurpassed. He has been with FIIG Securities for over 13 years and is the Head of the Managed Income Portfolio Service.

Megan Romeo
Portfolio Manager

Megan Romeo has over 10 years' experience in the financial market data segment with a focus on the Asia Pacific Fixed Income markets. Prior to joining FIIG, Megan was the Valuations Product Manager at S&P Capital IQ which required local Fixed Income market knowledge and a technical understanding of the asset class in order to tailor a Fixed Income market data solution to participants across Asia Pacific. She has been with FIIG Securities for over 7 years, all of which have been with the Managed Income Portfolio Service.

MIPS Example Portfolios

Conservative Income Investment Program
Investment objective

This program provides a portfolio that only invests in investment grade securities while investing across the capital structure. Like the fundamentals of the fixed income asset class, this portfolio, or program option, aims to provide investors with strong levels of capital preservation and regular income flow.

Investment Program Limits (selection)	Min/Max
Investment Grade	0/100
Sub Investment Grade/Unrated	0/0
Senior Debt	80/100
Subordinated Debt	0/20
FIIG Arranged Bonds	0/25
Number of bonds	10/no max
Modified Duration	0/5

Core Income Investment Program
Investment objective

This program aims to provide a portfolio that is primarily focused on investment grade securities, investing in the most senior parts of the capital structure. Like the fundamentals of the fixed income asset class, this portfolio, or program option, aims to provide investors with strong levels of capital preservation and regular income flow.

Investment Grade	0/100
Sub Investment Grade/Unrated	0/25
Senior Debt	100/100
Subordinated Debt	0/0
FIIG Arranged Bonds	0/35
Number of bonds	10/no max
Modified Duration	0/7

Income Plus Investment Program
Investment objective

This program aims to increase the investment return through a larger allocation to high yield securities while still retaining the benefits of a fixed income portfolio. This program allows the Portfolio Management team to invest, with more flexibility along the capital structure and credit ratings spectrum. This additional scope allows the team to identify strong risk returning investments. This is achieved through extensive credit analysis on both the issuer/ guarantor(s) of the bond as well as the security itself.

Investment Grade	0/100
Sub Investment Grade/Unrated	0/75
Senior Debt	80/100
Subordinated Debt	0/20
FIIG Arranged Bonds	0/60
Number of bonds	10/no max
Modified Duration	0/5

Notes:

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.

