Managed Income Portfolio Service (MIPS) and the FIIG Australian Bond Fund

Quarterly Report – March 2024

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

- AUD Dec' 2023 quarterly inflation @ 0.60%.
- RBA leaning toward a policy easing bias.
- Central Banks become progressively dovish.
- Geopolitical risk elevates (yet) again.

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.

Key ratio applications are based upon benchmark index differentials.

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 CM's 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 CM's.

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.

MIPS Investment Returns

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

Total GROSS Returns to 31 March 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	1.10	2.06	6.00	12.35	6.80	5.09	3.73	4.36	2.69
MIPS Core Income	1.08	1.81	5.72	11.77	5.32	3.98	2.21	2.98	2.71
MIPS Conservative Income	1.06	1.73	5.54	11.39	5.32	3.81	1.90	2.68	2.85
MIPS Bank FRN 4	0.51	1.64	3.17	6.43	6.27	4.27	2.77	3.19	2.69
FIIG Australian Bond Fund	1.23	1.28	5.57	11.46			n/a		

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

Benchmark Fixed Income Index Returns to 31 March 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	1.12	1.82	6.13	12.64	5.74	3.34	0.16	1.14	1.88
Australian Fixed Interest 1-5 year	0.68	1.03	3.53	7.19	2.83	2.11	-0.04	0.29	1.01
Australian Fixed Interest (All Maturities)	1.26	1.04	5.29	10.86	1.37	0.65	-1.67	-1.79	-0.02
Bank Bill	0.37	1.09	2.15	4.34	4.19	3.10	2.08	1.58	1.51
Bloomberg AusBond Composite 0+ Yr Index	1.12	1.03	4.85	9.94			n/a		

^ *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 March Quarter of 2024, all products performed strongly, both in absolute (outright return) and relative (against benchmark indices) terms. The market experienced moderate volatility during the quarter with benchmark yields closing the quarter near where they opened (Table 4) recovering in March from a moderate rise in February.

The PMT, having reduced the prior quarters long duration position, was not threatened by the short term weakness at any stage.

Macroeconomics, base interest rates and investment strategy commentary

In our December 2024 QR, the PMT stated, that post the successful 4th quarter rally that saw significant capital gain across all portfolios … "**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**".

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	1.12	1.82	6.13	12.64	5.74	3.34	0.16	1.14	1.88
75% BBB, 25% 1-5yr	1.01	1.62	5.48	11.28	5.01	3.03	0.11	0.93	1.66
50% BBB, 50% 1-5yr	0.90	1.43	4.83	9.92	4.29	2.73	0.06	0.72	1.45
100% Bank Bill	0.37	1.09	2.15	4.34	4.19	3.10	2.08	1.58	1.51
Bloomberg AusBond Composite 0+ Yr Index	1.12	1.03	4.85	9.94			n/a		
Performance v Index & Blend Indexes									
MIPS Income Plus	-0.02	0.24	-0.13	-0.29	1.06	1.75	3.57	3.22	0.81
MIPS Core Income	0.07	0.19	0.24	0.49	0.31	0.95	2.10	2.05	1.05
MIPS Conservative Income	0.16	0.31	0.71	1.48	1.04	1.09	1.84	1.97	1.41
MIPS Bank FRN 4	0.14	0.55	1.02	2.09	2.08	1.17	0.69	1.61	1.18
FIIG Australian Bond Fund	0.11	0.25	0.72	1.52			n/a		

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

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

CGL Maturity	Source^	Open	High	High Date	Low	Low Date	Close	Current#
(near) 3-year	SFE 3 & 10-year Futures	3.57%	3.89%	14 Feb	3.46%	2 Feb	3.57%	3.81%
(near) 10-year		4.01%	4.35%	19 Jan	3.93%	2 Feb	4.00%	4.26%

^3yr: YTM24 (June 24 Delivereable)
^ 10yr: YUM24 (June 24 Deliverable)
 # Current date: 19 Apr 24

Further …. that "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 (again)".

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.

In summary, the PMT decided to be prudent and to 'take profit' by reducing duration back to at or near index. And, in summary, the March Quarter of 2024 did much as we expected as evidenced by the tight trading ranges for benchmark Federal Debt yields displayed within Table 4.

Whilst Australian CPI for the December 2023 Quarter, released in late January 2024, came in at 0.60%, the subsequent commentary by the RBA made it clear they were not 'satisfied' that the progress was sustainable. They stated that 'despite progress, inflation remains high', referring (specifically) to the YOY result of 4.10% to December 2023. They remain cautious, not forecasting a sustainable recovery in annual inflation to below 3.00% until 2025, despite the 0.60% quarterly result, because both the 'economic outlook is uncertain and geopolitical risk remains elevated'.

The PMT understands their caution.

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. Yet interestingly, the RBA was also very late to tighten policy at the commencement of the cycle, despite significant evidence that they should have done so earlier than later.

Are they about to make the same mistake again?

Globally inflation has cooled significantly, and all western nations are showing evidence that inflation is tracking toward (at least) the top end of their target ranges. In Australia, that is 3.00%.

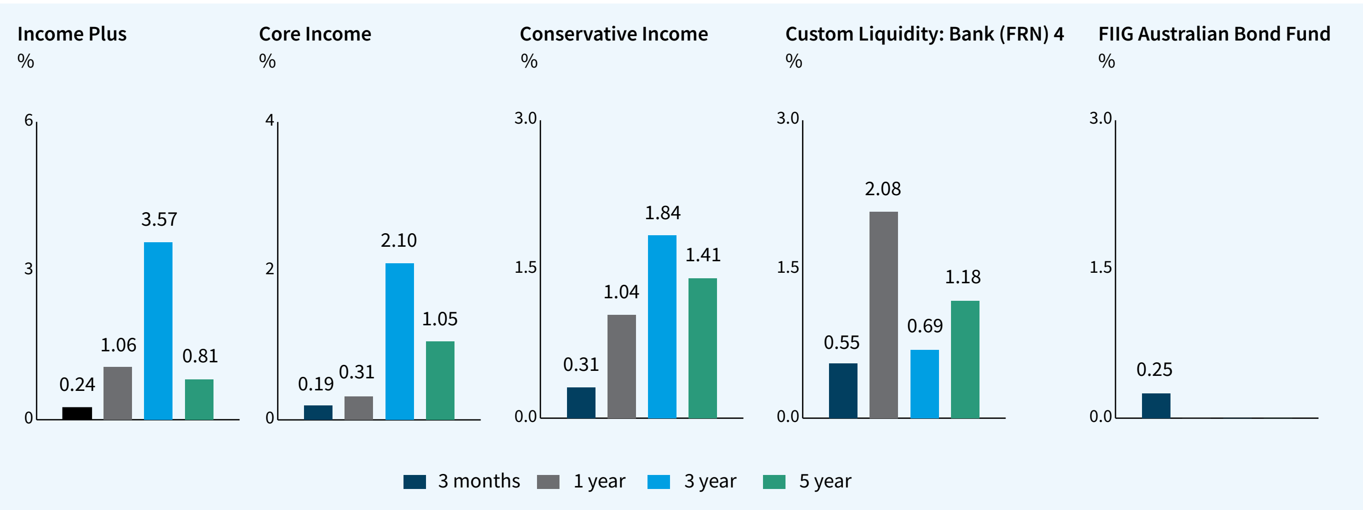
The MIPS PMT notes that the December inflation result of 0.60% is, annualized, within the RBA 2.00% to 3.00% range. The PMT also notes that it is half the result of the September 2023 quarterly outcome of 1.20%.

Key Global monetary policy changes during the quarter

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

- UK (BoE): unchanged @ 5.25%
- Europe (ECB): unchanged @ 4.00%
- AUS (RBA): unchanged @ 4.35%
- Canada (BoC): unchanged @ 5.00%
- New Zealand (RBNZ): unchanged @ 5.50%

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).

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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) @ March 2024	Inv' Mandate Max MD	Inv' Mandate Min MD	March 2024 Qtr End	Difference MD v Index
Benchmark Index 1	S&P/ASX BBB Rating Band	4.04	n/a			
Benchmark Index 2	S&P/ASX AFI 1-5 Year	2.73				
Income Plus	100% Index 1	4.04	5.00	0.00	3.00	-1.04
Core Income	75% Index 1, 25% Index 2	3.71	5.00	0.00	3.55	-0.16
Conservative Income	50% Index 1, 50% Index 2	3.39	5.00	0.00	3.32	-0.06

- USA (Federal Reserve): unchanged @ 5.375%

Summary Outlook

It is all about inflation!

Long dated interest rates at ~4.25% represent a high historical real yield over current quarterly inflation (annualized).

But is that (quarterly inflation) print sustainable?

All MIPS Investment Program and FIIG Australian Bond Fund duration exposure is near one quarter of a year longer than the benchmark index, with an objective of going even longer, and toward at least half a year longer, given any price advantage offered by the market, or confidence that inflationary numbers will improve yet again. Inflation numbers will be released in late April 2024 for the March Quarter period end.

This investment strategy intention is based upon the PMT perception that domestic demand will continue to be stifled by (overly) tight monetary policy.

However, the PMT acknowledges an elevation of global geopolitical risk that is likely stalling the momentum in inflationary gains of 2023 and subsequently the team is cognisant this is a time to be cautious.

Performance commentary

All MIPS Investment Programs and the FIIG Australian Bond Fund, delivered high absolute positive performance and high relative performance, having outperformed their respective indexes by significant margins. Refer to tables 1-3 and Graph 1.

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

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

The FIIG Australian Bond Fund however, derived near 100% of duration exposure via exposure to Federal and State Government Bonds.

The 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.

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

Table 6: Key average exposure statistics by Investment Program

Key average exposure statistics by Investment Program at 31 March 2024									
	IG, Non-IG & Unrated Exposure Held verses Investment Mandate Limits								
Investment Program	Minimum IM required IG Exposure	Total IG exposure held	Excess / (deficit) IG exposure	Maximum 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%	85%	60%	75%	15%	-60%	3.00	3.70	1.29%
Core Income	75%	94%	19%	25%	6%	-19%	3.55	4.24	2.74%
Conservative Income	100%	100%	0%	0%	0%	0%	3.32	4.00	1.88%

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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			
	31/12/2023	31/04/2024	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

quarterly report series will note the PMT'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.

IG Bank Senior and Subordinate Floating Rate Debt

Our headline, customized 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.

During the March Quarter, as listed in Tables 1-3, the Bank FRN sector outright and relative (to benchmark index) performance was very strong.

Bank Debt CM's continue to rally, with subordinate debt performing extremely well. We envisage this to continue as a function of strong bank sector profitability, retained profitability and high T1 Capital ratios.

As this quarterly report is written, S&P have upgraded all Major Bank Subordinate Debt by half a notch, from BBB+ to A-.

The MIPS PMT will in future periods likely maintain a long term to maturity profile and favour a higher weighting in Subordinate Debt exposure (over Senior) given both bank equity performance and the subsequent Rating Agency review outcome.

Summary

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.

Now, following a rally in interest rates of significance to December 2023, and consolidation in the most recent quarter, the MIPS 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.

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 await further economic news and statistical releases, but particularly the March Quarter CPI to be released in late April.

That CPI figure alone will likely be crucial for the direction of long term interest rates.

Can domestic monetary policy ease in advance of a move by the (US) Federal Reserve? Yes, it can. Whilst such a move would likely see AUD weakness, it is not an unlikely scenario given a number of key differentials between the two economies, particularly the disproportionately high exposure to variable interest rates of domestic homeowners. It is notable that recent rhetoric from the ECB is extremely dovish. It would not be unexpected to see the Europeans ease first.

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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.

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.

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 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
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
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.