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Managed Income Portfolio Service (MIPS)

Quarterly Report – March 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.

Key Observations

- Central Banks continue tightening monetary policy to combat inflation
- Bonds rally aggressively as inflation shows signs of a cyclical peak
- Biden visits Ukraine, Putin visits China and Finland joins NATO
- Banking crisis? What banking crisis?
- The International Monetary Fund (IMF) forecasts global growth is heading lower for longer

Generation of both income & total return during the quarter

The MIPS Portfolio Management Team (PMT) endeavour to generate the highest possible income and total returns for investors, commensurate with the risk profile chosen from a menu of three alternate investment programs or customised investment mandates.

Macroeconomics, base interest rates and investment strategy commentary

Throughout 2021 and 2022, and up until our September 2022 Quarterly Report (QR), the MIPS PMT stated that "all economic, health, fiscal and monetary policy road signs pointed to higher bond yields" … and that we had … "subsequently positioned portfolios short in duration to protect investor capital".

Later in 2022, as yields continued to rise under the weight of higher inflation, the short duration position was partially diluted, defended by our logic, that …. "whilst many of the prior catalysts driving rising yields remain, including inflation, the key catalyst of change is that the previously 'belated' Central Bank (CB) monetary policy action has been replaced by hyper 'aggressive' action on a global and synchronised basis".

In our December 2022 QR we stated in no uncertain terms that:

"with evidence of inflation easing, the PMT will extend duration during the first quarter of 2023, and likely longer than benchmark indices, given our confidence that inflation has peaked, and is likely to fall under the weight of monetary policy change".

Rather than repeat key messaging contained within prior QR's, we request readers review the December 2022 QR alongside prior editions.

During the March 2023 quarter, the bond market, as evidenced by bond benchmark index returns, was extremely strong. Refer to Table 2.

Yields of benchmark Commonwealth Government three and ten year (maturing) bonds rallied strongly from the outset of the year, falling near 1.00% lower by mid-March before retracing marginally to close the quarter 0.75% lower.

This 'price (yield) action' within a range, as documented within Table 4, is what the PMT expected, as was expressed in our December 2022 QR. It is the reason why the PMT positioned client portfolio duration longer and the reason why portfolio performance is so strong.

MIPS Investment Returns

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

Total GROSS Returns to 31 March 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	1.84	3.51	4.02	8.14	3.39	2.22	3.54	1.68	2.53
Core Income	2.00	3.85	4.40	8.95	2.65	0.70	2.21	2.07	2.79
Conservative Income	1.99	3.87	4.91	10.01	2.40	0.32	1.89	2.31	3.03
Customised Liquidity: Bank (FRN) 4	0.25	1.38	2.36	4.77	2.32	1.08	2.20	1.84	n/a

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

Benchmark Fixed Income Index Returns to 31 March 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.
Bank Bill	0.28	0.79	1.54	3.10	2.04	1.03	0.73	0.85	1.08
Australian Fixed Interest 1-5 year	1.96	2.59	3.67	7.47	1.40	-1.44	-0.54	0.56	1.29
Australian Fixed Interest (All Maturities)	3.46	5.12	5.38	11.05	-0.07	-3.16	-2.82	-0.36	1.18
Corporate Bond BBB Rating Band	2.22	4.93	5.98	12.32	1.00	-2.53	-0.34	0.94	1.99

^ Source: Dow Jones S&P Indices.

We stated that … "It is time to extend duration, and possibly longer than benchmark indices … because … we now look at the recent decline in inflationary numbers (December 2022 MOM) as 'green shoots' that will be followed by more sustainable (inflationary decline) gains".

Astute readers will have known, having read Table 5 in our December 2022 QR, that portfolio duration was already well on the way toward exceeding benchmark duration. We were that confident the market would rally, we did not hesitate to deploy investor capital longer on the yield curve.

What happened in the March quarter?

The more it changes … the more it stays the same! The push and pull of volatile global economic statistical releases continued. So too did the markets interpretation of the underlying trend in those statistics, alongside the perceived action CB's would undertake in response.

Inflation was high but was showing signs of slowing and investors started buying long dated bonds aggressively in January. The market groundswell of opinion speculated there was sufficient economic evidence that economic growth was being crushed by monetary policy moves and that the tightening cycle may be near over. The market feared if pushed further, some economies were heading toward recession.

Yet gains of January were quickly crushed by a monstrously large US payroll report for the same month, released in early February. Unemployment fell to 3.40%, from 3.50% against expectations of weakness and a 3.60% print. US Federal Reserve Chairman Jerome Powell's commentary soon after was especially hawkish. The market reversed trend and long duration positions were tested over the next two weeks. It was not one way traffic during the quarter and it was certainly not easy for bond traders and investment managers that had positioned long on the yield curve. Was the employment growth a leading indicator of sustainable inflation at current levels and therefore higher bond yields?

Key Global monetary policy changes during quarter / Official Cash Rates (OCR):

- UK (BoE): tightened / 4.25%
- Europe (ECB): tightened / 3.00%
- AUS (RBA): tightened / 3.60% ^
- Canada (BoC): tightened / 4.50%
- New Zealand (RBNZ): tightened / 5.25%
- USA (Federal Reserve): tightened / 4.875%

^ Update 5 April: RBA pauses and RBNZ tightens.

It is often said a pen can be more powerful than the sword. Equivalently, the rhetoric of a Central Banker can be more powerful than their most recent monetary policy change. As both the BoE and ECB tightened, both Governor Bailey (BoE) and President Lagarde (ECB) communicated a more dovish outlook, stating the end of the tightening phase may be nearing and a re-evaluation of policy in the near-term maybe required …. **if inflation falls as quickly as they forecast.**

Table 3: Average IMP Performance versus Benchmark Indices for period end 31 March 2023

Index & Blend Indices	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	2.22	4.93	5.98	12.32	1.00	-2.53	-0.34	0.94	1.99
75% BBB, 25% 1-5yr	2.16	4.35	5.40	11.11	1.10	-2.26	-0.39	0.85	1.82
50% BBB, 50% 1-5yr	2.09	3.76	4.83	9.90	1.20	-1.99	-0.44	0.75	1.64
100% Bank Bill	0.28	0.79	1.54	3.10	2.04	1.03	0.73	0.85	1.08
Performance v Index & Blend Indices									
Income Plus	-0.38	-1.42	-1.97	-4.18	2.39	4.75	3.88	0.74	0.54
Core Income	-0.15	-0.50	-1.01	-2.16	1.55	2.95	2.60	1.22	0.98
Conservative Income	-0.10	0.11	0.08	0.11	1.20	2.31	2.33	1.56	1.39
Customised Liquidity: Bank Bond (FRN) 4	-0.04	0.59	0.82	1.67	0.28	0.05	1.47	0.99	n/a

^ Source: Dow Jones S&P Indices.

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

CGL Maturity	Source ^	Open	High	High date	Low	Low date	Close	Current #
(near) 3 Year	SFE 3 & 10	3.590%	3.720%	22 February	2.620%	21 March	2.910%	2.91%
(near) 10 Year	Year Futures	4.075%	4.075%	3 January	3.025%	14 March	3.295%	3.28%

^ 3yr: YTM23 (June 23 deliverable)
^ 10yr: YUM23 (June 23 deliverable)
 # Current date: 4 April 2023

Yet again, it is, has and always will be about current and future inflation.

The market began rallying again in mid to late February and has primarily been on a bullish footing ever since.

The (near) 3 year Australian Commonwealth bond, having closed the December 2022 quarter @ 3.59%, rallied from the start of January, retraced briefly in February to a high of 3.72%, then commenced the rally again, reaching a low of 2.62% on the 21st of March, before weakening marginally to 2.91% at quarter close, near where it currently remains.

The (near) 10 year Australian Commonwealth bond, having closed the December 2022 quarter @ 4.075% rallied to a low of 3.03% on 14 March. Whilst a retracement of merit occurred in February, it did not breach the quarter opening yield. It closed the March quarter @ 3.30%, near where it currently remains.

Banking crisis. What Banking crisis?

Market contagion speculation was short-lived. Silicon Valley Bank (SVB), a small(ish) bank in the US that lent at a more speculative level and got their asset liability match wrong, started the fear. Credit Suisse First Boston (CSFB) was the next cab off the rank. But CSFB problems were well known, and Union Bank of Switzerland (UBS) picked them up at a major discount in a rescue package. Government support in both cases – and to calm the markets – worked. Moving on.

If anything, the pressure mounted upon significant name corporates, and therefore perceived forward economic growth potential, which drove bond prices higher.

The difficulty now is, has the market priced in all the gains in inflation that can be reasonably expected?

Political manoeuvres in the east

Hardly a footnote to our economic commentary, but geopolitical manoeuvres must be discussed, given ultimately any escalation in conflict would not only have massive implication for Ukrainian civilians, but undoubtedly massive global economic implications. We continue to watch this space, noting that whilst the conflict itself continues, it has not escalated across further borders or across the use of next level weaponry. However the ingredients for escalation remain.

Biden's visit to Ukraine sent a powerful message of western alliance and solidarity of support of the embattled nation, and occurred concurrently alongside Putin's visit to China. That alongside Finland's imminent entry into NATO will poke the bear. A bear whose friends are dwindling, given it appears the Chinese relationship with Russia is predominantly motivated by a beneficial (non-military weapon) trade alliance.

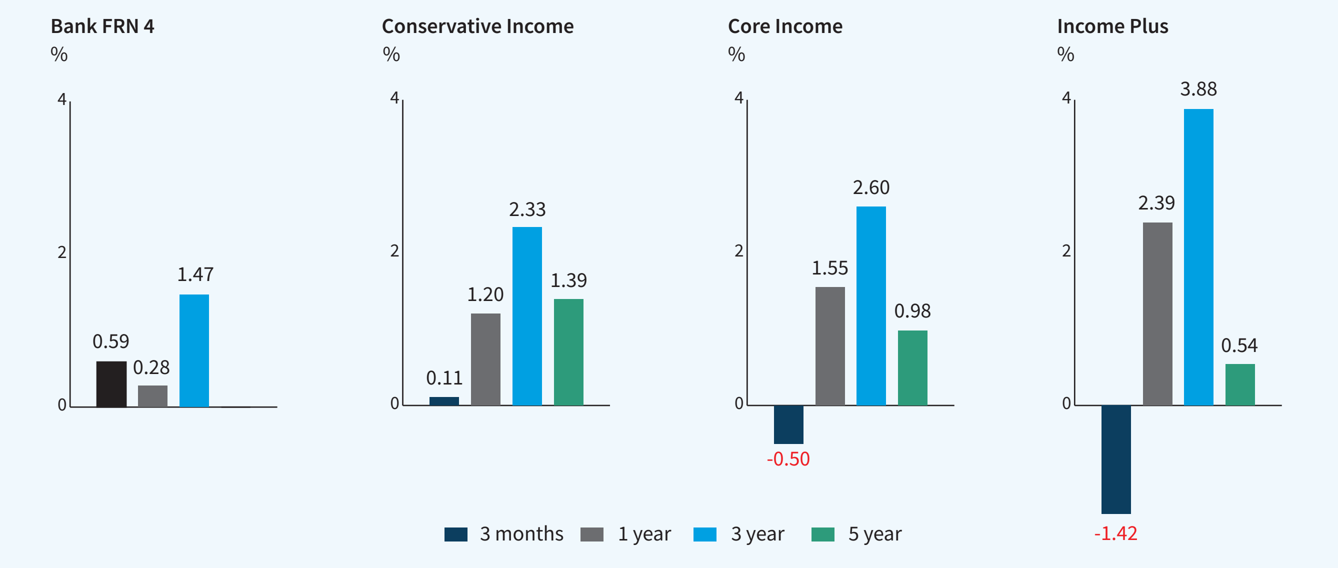
The IMF

The IMF stated within their latest World Economic Outlook report that "the fog around the world economic outlook has thickened" and broadly advised that economic growth would fall below prior forecasts. It has not revised their core inflation forecasts down, stating that despite evidence of lower energy and food prices, inflation is yet to peak in many countries. Further, IMF Chief Economist Pierre-Olivier Gourinchas stated that CB's should not halt their fight against inflation noting that the fight must stay focussed upon delivering (eventual) price stability. The report included a (15% probability) severe downside growth scenario, where global 2023 growth falls 2.50% to 1.0%, as a function of broad bank balance sheet tightening reducing lending.

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 Mar 2023	Inv' Mandate		March Qtr End MD	Difference MD v Index
			Max MD	Min MD		
Benchmark Index 1	S&P/ASX BBB Rating Band	4.03	N/A			
Benchmark Index 2	S&P/ASX AFI 1-5 Year	2.68				
MIPS Income Plus	100% Index 1	4.03	5.00	0.00	2.77	-1.26
MIPS Core Income	75% Index 1, 25% Index 2	3.69	5.00	0.00	3.28	-0.41
MIPS Conservative Income	50% Index 1, 50% Index 2	3.36	5.00	0.00	3.17	-0.19

Graph 1: Performance^ v Benchmark Indices to period end 31 March 2023



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

The IMF is in summary predicting moderation in global growth as CB's hold monetary policy tighter for longer to combat stubbornly high inflation.

Portfolio duration changes

During the March 2023 Quarter, the PMT extended portfolio duration by 0.36 years (Income Plus), 0.05 (Core Income) and 0.09 (Conservative Income). Noting that portfolios lose 0.25 years in duration QOQ naturally, as assets approach their fixed maturity dates, the extension required a lot of work.

The duration extension equation is (often) not easy:

- The PMT are reluctant to lend investor capital to some BBB-rated borrowers for terms greater than 7 years. A lot more can go wrong over a longer time horizon.
- Whilst the market demands a premium of a steeper Credit Margin (CM) for BBB- credit, the MIPS PMT often perceive that equation as insufficient compensation and certainly do at this point in time.
- Extensions of curve shape magnitude are usually in response to capital price moves of magnitude and 'getting set' whilst yields are high and have hit (or exceeded) targets is paramount, given the concern yields could retract quickly.
- Subsequently, as explained within our June 2022 QR, duration extension would likely initially commence through investment in Commonwealth and State bonds before converting to corporate credit via switch.

The PMT may make longer term 'strategic' duration extensions or a short term 'tactical' ones. A strategic move envisions holding the longer duration position in place for a longer period of time. It is premised upon a view that a trend (in this case falling yields) will grind (play out slowly) continuously over a longer period of time. A tactical extension envisions volatility around a mean expectation.

Whilst the PMT duration extension strategy of late 2022 was strategic, it has now become tactical.

The speed of the rally in the first quarter of 2023 has surprised us. We expected a slow grinding rally … and not to be rewarded with such significant capital gains so quickly. We have not even near got close to converting the position, executed by investing in long dated Commonwealth and State bonds, into corporate bonds.

Summary outlook

Can the first quarter 2023 gains (of > 10.00% annualised) be repeated in the 2023 June Quarter?

Has our duration extension already paid the maximum dividend (return) that is reasonably possible given where inflation is and where it is trending?

As I write the RBA has 'paused'. Monetary Policy was tightened in February and March, each time by 0.25%. In late March, February monthly data indicated CPI has fallen from 7.20% to 6.80% YOY.

Is that figure, or the positive momentum sufficient reason to hold longer maturity bonds that, despite evidence of falling inflation, are still trading at significant negative real yields?
Has the RBA paused at exactly the wrong time?

The PMT ask readers to reference the June 2022 QR again. If the average 10 year real rate of return of +0.70% (ex the Covid period) is to hold, at the current 10 year Commonwealth bond yield (see Table 4) of 3.30%, inflation has been priced to fall immediately to 2.60%. We suggest that is somewhat optimistic.

The MIPS PMT expect a longer road must be walked before claims of a definitive victory over (long term) inflation can be made. The PMT simply expect more volatility and are subsequently positioned to shorten duration again, expecting long dated bonds will likely trade in a yield range at these new 'lower' levels. We simply don't expect a straight line to very low inflation because, whilst many of the catalysts for higher inflation are dissipating, the path forward to the globalisation efficiency of the noughties is rocky.

The PMT refer to their June 2022 QR, in which we stated that … "inflation will fall, but doubts about the timeline to the new lower range, will deliver volatility and opportunity … the estimations of significance become that of the speed in which inflation is estimated to fall … (whilst) … the collapse of globalisation may well mean that the heady days of 2.00% inflation are well behind us."

Our modelling, fully tabled within the June 2022 QR, has been spot on. We forecast annual rolling CPI to trend lower from above 6.00% in June 2023, to breach below 3.00% in mid to late 2025.

Given that timeline, we suspect there is not sufficient reason to hold longer maturity bonds at or near current levels. We will subsequently likely be diluting duration into further bond market strength and expect bond yields to trade a range around current levels … before further robust evidence of a sustainable fall in inflation is provided.

Credit and performance commentary

In the March Quarter of 2023, the MIPS PMT has delivered positive large outright performance that is marginally below benchmark indices. This is after a prolonged period of significant outperformance of benchmark indices to the September 2022 quarter. Performance for the most recent quarter is attributable to portfolios being significantly longer in duration than throughout 2021 and early 2022, yet marginally shorter than benchmark index durations since. The yield curve rallied aggressively during the March 2023 Quarter (see Table 4) and corporate CM's were predominantly stable.

The following commentary very generally attributes performance within each of the following Investment Programs, referencing the key elements of each program Investment Mandate (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 on the performance of that asset sector.

In the March Quarter 2023, IP's +3.51% (gross) average return, was marginally lower than that of both Core Income (CI) and Conservative Income (CV) Investment Programs and more than marginally lower than its 100% BBB (Rating Band) benchmark index. The key reason was the inability to extend duration (as long as the other two programs) due to insufficient bid side liquidity in short maturity UR assets it wishes to sell.

The IP program absolute performance near matched that of CI (3.85%) and CV (3.87%). Clearly, the reason is that the CI and CV benchmark indices are shorter by ~0.50 of a year.

The PMT note that in the long term, IP has outperformed its benchmark index significantly (by +3.88% p.a. over the last 3 years) and that they continue to intend to hold a significant underweight in UR and NIG exposure (see Table 6) at near current levels (-40%). Subsequently the PMT are continually endeavouring to sell UR and NIG assets to improve duration exposure opportunity.

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 buy 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 March Quarter, CI delivered +3.85% (gross) performance, near matching the CV program (+3.87%) exactly. It too underperformed its benchmark, in this case by 0.50%, because

Table 6: Key average exposure statistics by Investment Program

Key average exposure statistics by Investment Program @ 31 March 2023									
	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	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%	65%	40%	75%	35%	-40%	2.77 yr	3.63 yr	2.65%
Core Income	75%	89%	14%	25%	11%	-14%	3.28 yr	4.18 yr	2.73%
Conservative Income	100%	100%	0%	0%	0%	0%	3.17 yr	4.14 yr	2.56%

it held 11% exposure to illiquid short dated UR and NIG (senior) assets, that are also targeted for sale, reducing the opportunity to extend easily.

Whilst it underperformed its benchmark this quarter, it was marginal, and in the longer term it retains an enviable record (of +2.60% p.a. over the last three years) advantage.

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 and CM's of the IG fixed senior corporate debt assets held, alongside the CM performance of subordinate floating rate bank debt assets held.

In the March 2023 Quarter, CV delivered +3.87% gross (average) performance for investors, near exactly matching its benchmark index and outperforming both CI and IP Investment Programs. The excess performance over that of CI, despite having a marginally shorter duration, is primarily due to the significant contribution from CM contraction (see Table 6) in major bank subordinate debt, in which it held at an average of 18% exposure during the quarter.

The PMT note that in the long term, CV has outperformed its benchmark index significantly (by +2.33% p.a. over the last three 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 CM's, due to the looming likelihood of an economic downturn. Whilst we do not predict a recession, we do predict GDP to fall as consumer discretionary expenditure is curtailed by higher monetary policy.

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 IP accounts, which currently invest at an average 35% (-4% QOQ) exposure versus a 75% limit. Additionally, given the historical record of high default and restructure, or default and weak 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 30% in the June 2023 quarter within Income Plus, where we will seek to extend duration on IG yield curves, funded by the sales of that UR & 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 11% (-1% QOQ) exposure to UR & NIG assets, versus a 25% limit, for the same reason explained above.

The ratio of UR & NIG exposure maximum between IP and CI is 3:1. Given IP is invested at 35%, an 11% exposure within Core is justified. All portfolios for both programs will be further diluted of exposure to this sector in the coming quarter, as explained above.

In prior quarters, the PMT have stated the CV Investment Program will continue to contain a near maximum 20% exposure to IG subordinated debt issued by both Major and Minor banks. Whilst the MIPS PMT remain bullish this sector, given bank profitability and a history of Net Interest Margin (NIM) maintenance during the most recent period of negative economic activity, our enthusiasm will likely be tempered toward a 15% exposure target in the coming quarter. This is statistically consistent with the credit risk sector metrics applied in IP and CI.

See further commentary in the ensuing section.

IG Bank Senior and Subordinate Floating Rate Debt

Our headline customised liquidity Investment Product, is the Bank FRN (4) Investment Program (IP). The IM allows investment in Major and Minor Bank Senior and Subordinate FRN's. 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. In recent quarters, as the RBA has tightened monetary policy aggressively, bank bill rates have climbed and the accrual component is delivering significant returns.

Table 7: Bank FRN Credit Margins

Bank (FRN) Investment Programs key (average) credit spread information: 5 year (or near) maturity dates			
	31/12/2022	31/3/2023	Changes
	Credit Margin	Credit Margin	Credit Margin
Major Bank Senior	0.97%	0.96%	-0.01%
Minor Bank Senior	1.30%	1.29%	-0.01%
Major Bank Subordinate	2.21%	2.22%	0.01%
Minor Bank Subordinate^	3.00%	2.62%	-0.38%
Major Bank Subordinate/ Senior ratio	2.3x	2.3x	

^ 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

In the March Quarter 2023, the Bank FRN 4 IP returned +1.38% (gross), significantly ahead of the Bank Bill Index return of 0.79%. The PMT note that the average CM of the portfolio contributes ~+1.70% annually and ~0.42% quarterly. The excess performance for the March Quarter (a further 0.17%) is attributable to efficient transactional activity and capital gain (in predominantly Minor Bank subordinate CM's).

The PMT also note their prior commentary, made in the December 2022 QR, prior to the two most recent increases in the OCR … "It is debatable whether CSD extension is warranted at all given all bank FRN product in the 1-5 year maturity range will benefit equally from the surge in BBSW that has now occurred".

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

A highlight of the month, and one that additionally secured our comfort in our CM directional view, was the demand for the new ANZ 15NC10^ primary deal. ANZ printed the deal in $1bn at a CM of +280 basis points and the heavy oversubscription lead to it rallying strongly immediately thereafter. It was the first 15NC10 issue by a Major Bank in the Australian market.

^ *NC: Non Call – implied tenor of 10 years.*

The CM movements for each market sector, at the (near) 5 year maturity date, are displayed in Table 7 above. The table does not however reflect the volatility that occurred during the quarter.

The RBA has clearly met our (and the markets) expectation of higher bank bill rates through raising the OCR to 3.60% throughout 2022 and early 2023. Although the RBA dragged the chain early in 2022, accrual gains for floating rate note holders have now soared.

Unlike prior quarters, the PMT is now not inclined to constantly roll up the yield curve, extending the Credit Spread Duration (CSD) <average maturity profile> positioning of all bank FRN Investment Programs longer. CM's have rallied close to target levels and further gains from here on in may well take a period of time. We note that the SVB and CSFB lead volatility are still disquieting influences, and the banking sector may be on the back foot for a little time yet.

The latest move in monetary policy in March 2023 delivered an accrual uplift of significance. Whilst it may well not be the last, there is evidence of improvement in inflation, and subsequently accrual levels may now be approaching a peak in the cycle. However, 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. As we forecast as far back as within the June 2022 QR, we do not expect inflation to mean revert until late 2024.

Summary

The economic and investment landscape has changed.

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.

From September 2022 onwards, as yields rose concurrently with evidence of inflation peaking, the logic to invest in longer dated bonds became compelling. The MIPS PMT did just that. MIPS investors have benefited greatly through the avoidance of major capital loss that would otherwise have occurred if the PMT had extended duration at earlier dates.

The PMT refer to their statement in the December 2022 QR …

"Whilst the market has rallied (somewhat) during the December quarter, the MIPS PMT believe that a further extension of duration is warranted given the factors that drove rates higher (inflation, easy money supply) are dissipating".

Whilst the returns derived in the March Quarter are extremely pleasing, the ability for this significant rally to continue at this significant pace is improbable. It is possible, but the PMT believe it is improbable, because it has 'priced in' a lot of inflationary gains already.

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 PMT will continually monitor the markets for catalysts for yield change, and will adjust both credit and duration exposure accordingly.

Fixed Interest price volatility has been extremely high throughout 2021 and 2022, and shows no signs of easing in 2023. During these times navigating the complex economic environment that drives bond price volatility is best left to seasoned professionals. The MIPS PMT are focussed on the dual task of protecting investor capital and delivering returns commensurate with the risk profile of the Investment Products to which clients subscribe.

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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.

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.