

Clime Fixed Interest Fund



Monthly Report - February 2020

The Clime Fixed Interest Fund's primary objective is capital preservation. It aims to generate income returns above the RBA cash rate in the form of monthly income distributions. Its return objective is to outperform the benchmark of the RBA cash rate +2.0% p.a. The Fund's risk objective is set at 1.5% ± 1.0%, as defined by the weekly change of the annualised standard deviation of the unit price movement.

Portfolio Month Net Return	Portfolio 6-Month Net Return	Portfolio Net Return Inception p.a.	Fund Size	
0.1%	1.5%	2.8%	\$18.5m	
	1 month	3 months	6 months	Since Inception (Total)
Portfolio Net Return**	0.1%	0.8%	1.5%	2.8%
Risk	-	-	0.4%	0.5%

*Inception date: 17 April 2019

**Portfolio return is based on the change of the unit price including distributions and franking.

^The volatility of return is based on the change in the weekly unit price. Since the Fund is less than 12 months old, it is likely that risk indicated here is only an approximation.

Portfolio Commentary

The financial narrative in February can be divided into two halves. In the first half, the equity market as measured by the S&P/ASX 200 Index continued to rise to reach an intraday all-time high of 7,197 while bonds marked time after a strong rally in January. By the end of the third week of the month, the equity market sharply reversed, playing catch-up with the bond investors in assessing the risk of the COVID-19 outbreak. We now know that bond investors read the risk of the outbreak better than equity investors, as the contagion gained a foothold in South Korea, Italy and Iran with the number of confirmed cases and fatalities rapidly rising in these nations.

Via Italy and Iran, COVID-19 is now threatening at the doorsteps of Europe and the Middle East. Locally and overseas, we note that fatalities have occurred in the USA, Thailand and Australia. Moreover, with the open door policy across Europe and poorer health systems in the Middle East, the picture looks menacing: by the end of February, 60 countries (from 22 at the end of January) across all continents (bar Antarctica) are infected with COVID-19, with fatalities and confirmed cases increasing sharply outside China. As we write, human to human transmission has been confirmed locally and in other nations for the first time. The spread of COVID-19 has moved to a more serious phase.

The risk of Australia falling into recession has ratcheted up. Australian 10-year bonds are starting to price this in with travel, discretionary retail, education and associated sectors likely to be hit hard. By month end, the Australian 10y bond yield finished at 0.82% (from 0.95% at the beginning of the month). US 10y Treasuries compressed even more as global investors' flight to safety resulted in yields compressing by 35bp to 1.15%.

For the Fund, we adhered to our mandate of capital preservation and income generation. In February 2020, the Fund participated in short dated senior debt securities of SMBC, Members Bank and Liberty Financial and bid for Macquarie Bank's Capital Notes (MBLPB). The latter was 4 to 5 times over-subscribed, resulting in a tight margin of 2.9% over the BBSW. We also bought a small parcel of Ausgrid Senior FRNs when it was available in the secondary market.

The Fund posted a return of +0.1%. Given the widening of the credit spread towards the end of February, this small positive return was a satisfactory outcome for a capital preservation-style fund. At month end, the asset allocation was 10.4% cash (including term deposits), 56.1% IG senior bonds, 16.2% IG subordinated FRNs, 7.2% HY unrated corporate bonds, 4.1% RMBS and 6.2% AT1 Capital Notes / hybrids.

On 3 March, the RBA cut the official cash rate to an all-time low of 0.50% (from 0.75%), while the US Fed sought to pre-empt the risk to the economy inflicted by COVID-19 with an emergency cut of 0.50% (to between 1.00% and 1.25%) the following day. Other central banks may follow shortly and more cuts are likely by the US Fed. With the RBA cash rate forecast to fall further, the running yield for the portfolio is low and will remain so for some time. That said, the Fund should be able to provide consistent monthly cash distributions, but we expect the Fund's volatility to increase as credit spreads widen.

Dr Vincent Chin
Portfolio Manager

Fund Facts

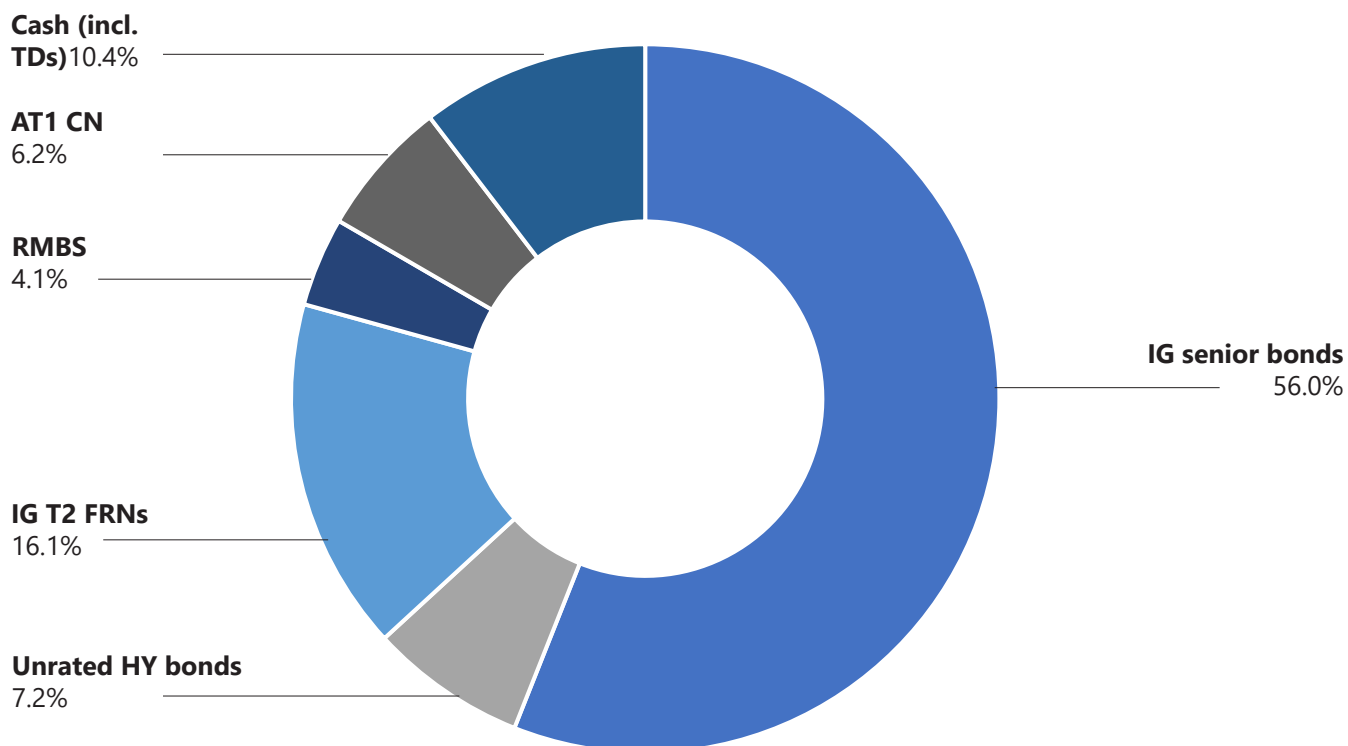
Portfolio Manager	Dr Vincent Chin
Fund Inception	April 2019
Fund Size	\$18.5m
Cash Distributions	Monthly



Distributions

The Fund distributes monthly on a cash basis (if any). In other words, all interest available for the month once received is distributed. For the February month, we distributed 0.1178 cent / unit.

Asset Allocation





Market Commentary

With February 2020 came the first half reporting season and a significant equity market correction, reflecting growing global fears pertaining to the spread of the coronavirus (COVID-19). When coupled with a somewhat elevated level of equity pricing, the scene was set for a swift reassessment of risk asset exposure. Key indices delivered the following returns for the month:

- S&P/ASX200 Accumulation Index: -7.7%
- All Ordinaries Accumulation Index: -8.1%
- S&P 500 Index (US): -8.2%
- Small Ordinaries Accumulation Index: -8.7%
- FTSE 100 Index (UK): -9.0%
- Emerging Companies Accumulation Index: -14.1%

Many global indices, including those in Australia and the US, corrected in the space of just five days in the final week of February (a correction being a greater than 10% fall). This was the first such occurrence since October 2008 during the depths of the Global Financial Crisis (GFC). It has been an unusual time to say the least!

With the rolling news cycle omnipresent these days, you would be hard pressed to go a day without hearing anything of COVID-19. News of the virus' spread well beyond Chinese borders saw global markets sell off sharply and bond yields collapse, in turn reflecting expectations for a significant slowdown in global growth. While yet to flow through in many datasets, the first insight was provided via China's PMI (Purchasing Managers' Index, a measure of manufacturing trends) release. China's official PMI fell to a record low of 35.7 in February, from 50 in January. Incredibly this was the fastest pace of contraction on record for the survey, surpassing the decline registered during the GFC. Non-manufacturing PMI came in at 29.6, versus the prior reading of 54.1, also the lowest on record. We note that 50 is the level that separates expansion from contraction.

The Current Situation in Context and the Outlook for 2020

Clime's investment strategist Paul Zwi recently noted 'As investors, we are required to deal with probabilities rather than certainties.' While evergreen in nature, this statement is particularly relevant when assessing the degree of social and economic dislocation to be felt in 2020.

We are obviously not epidemiologists, but what happens in the near term will likely depend on several factors, including the tenure of the pandemic, its geographic spread, when a vaccine is prepared for human use and whether the arrival of the northern hemisphere summer provides a degree of abatement. We can observe that all major outbreaks to date (Wuhan, South Korea, northern Italy and Iran) have occurred in geographies with an average maximum February temperature of no more than 11 degrees Celsius.

Travel

In terms of first order effects, we expect the near-term restrictions imposed on travel to adversely impact all travel and tourism related businesses. In the past week alone, leading Australian companies including Lendlease, Telstra, the major banks, and IAG (to name a few) have all banned staff from international travel for work.

Our recent investment management meetings with travel focused businesses suggest a significant curtailment of forward bookings, with employees being requested to use all annual leave and/or cut back to part time for the next few months. We also perceive some risk to the collection of receivables, so balance sheet strength in this sector will never be more important for those exposed.

Education

The education sector forms a significant backbone of Australia's services sector and still represents a fantastic long term opportunity for our country and its plethora of well-respected tertiary institutions. With the imposition of travel bans and a general reluctance to travel, we expect this sector to also be directly impacted.

Manufacturing & Retail

From various recent management meetings and company outlook statements, it is clear that manufacturing and broader supply chains are being directly impacted. Even if goods are not being manufactured in China, significant amounts of componentry are sourced from within China. Some retailers and hardware technology businesses that we have spoken to added inventory prior to the Chinese New Year, so are fortuitously better placed to ride out short term impacts to supply chains. We expect retail more broadly to be impacted by soft consumer sentiment, itself already under pressure from Australia's tragic bushfire season.

Commodities

While the outlook for commodities appears to wax and wane on an almost daily basis, with ongoing monetary support soon to be coupled with significant fiscal stimulation, we remain constructive on exposures to dominant low cost producers with strong balance sheets and healthy cash flows, most notably BHP Group (BHP) and Rio Tinto (RIO).

Concluding Thoughts

The maintenance of focus on investing in quality companies with strong valuation discipline, which when given time allows the wonders of compounding to take place, has to remain the cornerstone of successful long term investment (as opposed to speculation).

We are not seeking to downplay COVID-19 and the likely flow on effects for the global economy in the near term. This will be an especially difficult period for economies and markets. Some counterbalance may be provided by further central bank support (globally co-ordinated) and fiscal stimulus.



Borrowing from Clime Director John Abernethy's recent note in 'The View' (available to Clime Direct subscribers), in Australia, we note that the Government has relented on its promise to produce a budget surplus in FY20. We predict that if the coronavirus continues to affect the Australian economy into the June quarter, substantial tax payment relief will be given to small and midsized businesses. This would help business cashflows at a time when stock levels are falling, and consumer sentiment is challenged.

There is much that can be done by sensible fiscal governance and there is little that the RBA through monetary policy can do other than ensure liquidity is plentiful in financial market and that banks do not restrict essential credit. It will be an interesting few weeks and possibly months for markets. The coronavirus, the US election and the US China trade deal are amongst many other unknowns, but the likely behaviour or responses of central banks and governments is more predictable.

Is that a reason to be bullish in the short term? No. But it is a reason to remain calm, not panic and invest logically at a time when markets are being driven by wild speculation. The long term outlook for world growth looks good and that is what investors (not speculators) need to focus upon.

Specific to asset allocation, we remind investors that tilting asset allocation both across and inside of asset classes will act to build portfolio resilience. Further strategies to bolster resilience include diversifying across asset classes, including cash (even if the return from cash is only marginal); ensuring asset allocations are fit for purpose; focusing on high quality companies; and maintaining a focus on sustainable yield. These strategies have stood the test of time and will continue to do so in the future.

At a portfolio level, we look across our Australian All Cap, Small Cap and International equity portfolios and are excited about the long term opportunity sets for each of these businesses, many of which are executing well on a global scale. When coupled with strong balance sheets and capable management, we anticipate that in aggregate, earnings, dividends and ultimately valuations will be far higher in five to ten years' time. Of course, we remain vigilant and aware of new information but are determined to stay the course, remaining focused on long term objectives.

Thank you for investing alongside us and for your ongoing support of Clime.

Adrian Ezquerro
Head of Investments



Fund Information

Investment Objective

The Fund's main objective is capital preservation. In addition, we aim to generate income returns above the RBA cash rate in the form of monthly income distributions, with a target of 2% over the RBA cash rate (including franking if available). The Fund's risk objective is set at 1.5% \pm 1.0%, as defined by weekly changes of the annualised standard deviation, which is substantially lower than the equity market. In order to maximize the chance of achieving these objectives, the recommended investing time frame is at least 2 years.

Investment Methodology

The Clime Fixed Interest Fund seeks to provide an income stream above the RBA cash rate by investing mainly in the over the counter (OTC) market from a range of investment grade senior and subordinated debts, high yield bonds, asset backed securities, RMBS, income notes, capital notes and other fixed income / hybrids securities with a strong capital preservation focus. The portfolio will invest in selected high-quality individual debt and hybrid securities with consistent income generation.

Portfolio Manager

Dr Vincent Chin

Vincent joined Clime in February 2009. He has a wide range of investment experience spanning fixed income to equity. He has more than 10 years of portfolio construction and managing risk across multi-asset classes. Before joining Clime, he gained his investment experience in the late 1990s to 2000s at Ausbil Dexia and Maxim Asset Management (now wholly subsidiary of Charter Hall) where he has developed multi-factor quantitative models for stock selection and attribution performance analysis. Vincent is passionate about ethical investment across any asset including alternative investments. Prior to this, Vincent worked in semiconductor device and material research in academia and industry for more than 15 years. His research spanned III-V and IV groups semiconductor materials and its application. He specialised in transport properties (numerical modelling and characterisation) in these semiconductors for devices and solar cell applications. He has published about 50 international refereed scientific publications and co-edited a proceeding in opto-electronics.



Fund Information

Name	Clime Fixed Interest Fund	Investor Eligibility	Wholesale
Structure	Managed Investment Scheme	Minimum Investment	100,000
Investment Universe	< 90 to 95% over the counter (OTC) in the capital debt market, AUD denominated only	Liquidity	Weekly Unit Pricing Applications and Redemption
Benchmark	Return : RBA cash rate + 2.0%; Risk : 1.5% \pm 1.0%	Fees	0.41%
Fund Size	\$18.5m	Admin	Mainstream Fund Services Pty Ltd
APIR Code	CLA0724AU		

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