Clime Australian Income Fund

Fund Performance - June 2020

The Clime Australian Income Fund is a multi-asset class portfolio that invests in high-quality income generating assets. The Fund provides exposure to higher yielding securities in both listed and over the counter (OTC) markets. The Fund aims to achieve a total return of RBA cash rate + 3% p.a. whilst maintaining price stability.

Risk and return are considered to be equally important. As such, we construct the portfolio such that the risk, as defined by the annualised volatility of the change in the unit price, is in the 3% to 5% range (or 4.0% ±1.0%). The Fund pays regular quarterly income distributions in September, December, March and June.

The three interim distributions (September, December and March) are consistent and the final distribution for the financial year (June) includes capital gains and franking credits (if any).

Portfolio Quarter Net Return (Wholesale)	Portfolio 1 Year Net Return (Wholesale)	Portfolio Return Inception p.a. (Wholesale)	Total Fund Size
5.9%	-2.2%	5.1%	$38.2m

	1 month	3 months	6 months	1 year	2 years (pa)*	3 years (pa)*	Since Inception (pa)*
Net Portfolio Return (Wholesale)**	0.4%	5.9%	-3.8%	-2.2%	2.5%	3.1%	5.1%
Income	1.2%	1.2%	1.6%	2.7%	3.7%	3.6%	3.7%
Capital Growth	-0.7%	4.7%	-5.3%	-4.8%	-1.2%	-0.5%	1.4%
Franking	-	-	-	0.1%	0.2%	0.2%	0.3%

Note: Compound (geometric) returns are used in the above table's segmentation of Income and Capital Growth. This may result in small differences when compared with a simple addition of Income and Capital Growth components.
*1 July 2015. Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes.
**Portfolio return is based on the change of the unit price including distributions but excluding franking credits. Franking credits will enhance portfolio returns and historically, have added about 0.2% pa to Fund returns as shown in the last column of the table above.

Top 5 Holdings

Security	Weight%
NAB Income Securities	2.3%
Spark Infrastructure Group	2.1%
Macquarie Bank Capital Notes	1.9%
CBA PERLS VII	1.9%
Telstra Corporation Limited	1.9%

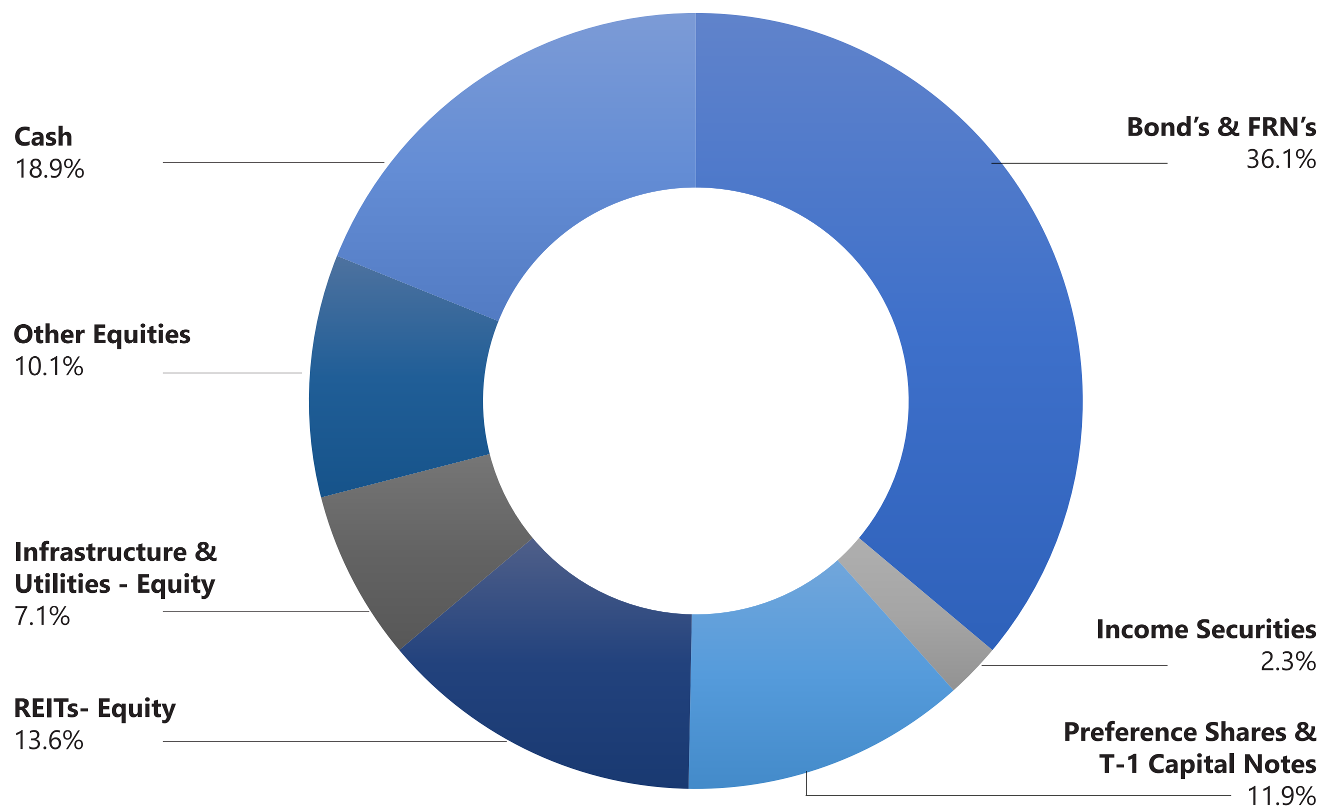
Fund Facts

Portfolio Manager	Dr Vincent Chin
Fund Inception	1 July 2015
Fund Size	$38.2m
Cash Distributions	Quarterly

Distributions

Period Ending	**Wholesale Units (cents)**
30 June 2020	1.2385 +0.1426 franking credits
31 March 2020	0.4215
31 December 2019	0.7480
30 September 2019	0.5160
30 June 2019	2.584 + 0.2533 franking credits
31 March 2019	0.8096
31 December 2018	0.8859
30 September 2018	0.8045
30 June 2018	1.8451 + 0.189 franking credits
31 March 2018	1.0082
31 December 2017	0.9706
30 September 2017	0.5123
30 June 2017	1.8451 + 0.3189 franking credits
31 March 2017	1.0082
31 December 2016	0.9706
30 September 2016	0.5123
30 June 2016	2.1483 + 0.3153 franking credits
31 March 2016	0.8246
31 December 2015	0.2390

Asset Allocation



Investment Strategy

The Clime Australian Income Fund seeks to provide an income stream above the RBA cash rate from a portfolio of Australian listed and over the counter (OTC) securities, with a view to price stability. The portfolio will invest in selected high-quality individual securities with consistent income generation. Portfolio yield is likely to be the bulk of the portfolio return and will likely be enhanced by franking credits.

The COVID-19 pandemic is now in its seventh month since it surfaced in late December 2019. By 30 January 2020, the WHO declared it a global health emergency when it was still confined mainly within China but upgraded to a global pandemic on 11 March 2020 as it began to spread across borders to surrounding nations. By late March 2020, it became apparent that COVID-19 was spreading globally, and most nations including Australian took actions to arrest the spread by implementing social distancing measures, partly shutting down the economy. To cushion the economic blow, central banks including the RBA unleashed emergency monetary easing and introduced QE. The US Fed commenced buying individual corporate bonds to support financial markets. Fiscal policies approximating 10% of GDP are being rolled out by many nations. This has generated enormous amounts of liquidity which inadvertently has found its way into risk assets, hence the sharp recovery of equity markets.

Given the amount of uncertainty still persisting in the economy and no effective health solution yet available, the market appears overbought at present. As the economy falls into recession with unemployment spiking, it will take years for the unemployment rate to drop back to pre COVID-19 levels. The Governor of the RBA has indicated that the cash rate will remain at 0.25% until there is sustainable progress towards full employment and the 2-3% inflation target is achieved. This implies that the cash rate will remain at this ultra-low level for several years, making yield extremely difficult to access.

In the interests of transparency, we provide further details of the Fund's investment strategy below.

We maintain the strategy we have implemented since the March 2020 quarter with some minor changes. To achieve certainty of income, the tilt towards fixed income asset classes will continue. In addition, we continue to incrementally invest in Utilities & Infrastructure (U&I) as the sector offers higher income returns with only a slight increase in risk compared to fixed income asset classes.

To achieve some modest growth, we have pivoted toward healthcare and industrials, particularly the IT sector. This is because:

- Healthcare provides defensive growth as the world faces an ageing population. Putting aside all the pre-COVID-19 health issues amongst developed nations, there is increasing evidence to suggest that even when a person recovers from COVID-19, there are long term impacts that require extended medical care / surveillance. Whilst healthcare stocks offer lower yields, they provide a longer growth runway than many other sectors. Since March 2020, we have added two healthcare names in the equity asset classes.

- We have seen IT, telecommunication services and technology enable significant numbers of employees to work remotely (from home) during the pandemic. This structural change started prior to COVID-19 but employers and employees lacked sufficient data to provide strong evidence for its effectiveness. The COVID-19 pandemic forced this upon us and stakeholders have been surprised by the smooth transition with little or no loss in productivity when workers transitioned to work remotely. We are confident that digitalisation will accelerate in a post COVID-19 world. Some of these features will become permanent and the Fund plans to exploit these structural changes as opportunities arise.

- Lastly, the Fund is overweight major banks' capital notes. Whilst we are confident the banks will continue to pay interest on their capital notes, it is unclear when the banks will normalise and resume paying ordinary share dividends at pre-COVID-19 levels. It is apparent that in a low interest environment, banks are not as profitable. With the added provisions from bad debts caused by COVID-19, we believe it is prudent to hold off adding to major bank ordinary shares.

In summary, our Fund strategy includes:

- To ensure consistency and certainty of quarterly income distributions, we are tilting towards a higher weighting in investment grade fixed income asset classes of OTC debt and banks' capital notes. These asset classes should be able to offer a higher running yield compared to the RBA cash rate and better price stability.

- To focus our attention to U&I, including telecommunication services as more people work remotely, requiring businesses to adapt. We surmise that telecommunication services will become part utility and part infrastructure asset class.

- To monitor for any structural change in the REIT asset class post COVID-19, a theme we alluded to in the March quarterly 2020 report. Traditionally, we had a higher allocation of your capital in REITs for the Fund. This is because REITs offer a higher income yield certainty to industrial equity due to lease agreements in place. After all, rent is a debt obligation which is required to be paid when it is due. As long as we focus on long term leases and low gearing, rental income should be realised.

  However the forced shut down of the economy by the Federal Government mandating tenants, property owners and their bankers to negotiate rental waivers and / or deferrals, have eroded this covenant and thus the risk premium of investing in REITs may rise in a post COVID-19 world. In addition, with a more permanent change to employees working remotely, it is possible that there will be less demand for property, particularly office space, or that companies will ask for shorter leases. These are structural effects that may impact on the valuation of property over the long term.

  Over time, it is possible that the Fund will reduce the neutral asset allocation weighting to REITs, which currently is 20%. In the medium term, it is possible that the Fund's neutral asset allocation may be reduced, perhaps to 15% with a range of ± 5% so that the asset allocation for REITs be altered from 20% ±10% to 15% ± 5%.

- To identify IT and associated industrial sectors that offer superior growth to the major banks or REITs over the medium term for the equity asset class. Some of these related sectors will likely grow above GDP. This is structural as the world continues to digitalise further. That said, the Fund will avoid investing in not-yet-profitable companies and will only consider more mature technology and related industrial securities with some dividend yield.

Perfomance and Volatility of Return

	Portfolio Return**	Income	Capital Growth	Franking
1 month	0.4%	1.2%	-0.7%	-
3 months	5.9%	1.2%	4.7%	-
6 months	-3.8%	1.6%	-5.3%	-
1 year	-2.2%	2.7%	-4.8%	0.1%
2 years (pa)**	2.5%	3.7%	-1.2%	0.2%
3 years (pa)**	3.1%	3.6%	-0.5%	0.2%
4 years (pa)**	4.5%	3.7%	-0.8%	0.2%
Since Inception (pa)*	5.1%	3.7%	1.4%	0.3%

Note: Compound (geometric) returns are used in the above table's segmentation of Income and Capital Growth. This may result in small differences when compared with a simple addition of Income and Capital Growth components.
*1 July 2015. Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes.
**Portfolio return is based on the change of the unit price including distributions but excluding franking credits. Franking credits will enhance portfolio returns and historically, have added about 0.2% pa to Fund returns as shown in the last column of the table above.

The Fund has a goal-based investment style where at the portfolio level, we target a certain level of income (higher than the RBA cash rate) and risk (materially lower than the equity market).

The Fund's short term 12m return was -2.2%. This was affected by the negative return of the ASX200 Accumulation return of -7.7% to June 2020. Of note is the ASX200 REIT sector had a larger negative return of -21.3% which exacerbated the negative return for the Fund as it was overweight REITs.

Over the 5y period since the Fund's inception, the return has been 5.1% pa. This was achieved with an absolute and relative risk measure of 4.8% and 31.6% respectively. The Fund has been able to provide cash returns of 3.7% and 1.4% capital growth with further franking benefits over this period, reinforcing our investment objectives.

In this quarter, we note that the rolling 12m absolute volatility appears to have plateaued and with our strategy in place to assure certainty of income and incremental investment, we are confident that volatility should reduce over time. That said, the Fund is a "medium risk" fund with a recommended three to five year investment time frame. As a consequence of the pandemic, we believe investors should consider viewing the three year data as a better reflection of risk in line with the suggested time frame of this investment.

On a positive note, the relative risk measure did not surpass the 40% ratio to the ASX200 index even for the 12m rolling data, hovering around 33%. The rolling 3y data is similar at 31% once again suggesting that using the 3-5y absolute and relative risk data is probably a better reflection of characteristics of a medium risk product compared to the rolling 12m number shown in Figure 1.

Figure 2 shows the total return on a cumulative return basis, compared with the RBA cash rate + 3.0% pa return objective. It is clear that over this 5 year period, there are two brief periods where the Fund underperformed its absolute RBA + 3.0% pa objective, i.e. during the inception period and during the COVID-19 panic selling in the last quarter of 2020. If we sum it over time, the Fund was able to achieve its absolute RBA + 3.0% pa return objective around 90% of the time during its first 5 years. We think this is a good outcome for the Fund.

	Volatility^			
	CAIF	ASX200	Ratio of CAIF/ ASX200	Sharpe ratio^^
1 year	8.3%	23.8%	34.8%	-0.27
2 years	6.1%	18.3%	33.5%	0.13
3 years	5.3%	15.8%	33.3%	0.23
4 years	4.8%	15.0%	31.9%	0.48
5 years	4.8%	15.1%	31.6%	0.58
Since Inception	4.8%	15.1%	31.6%	0.58

^Volatility is the annualised standard deviation of the NAV/unit as measured on a weekly basis.

^^Sharpe Ratio is calculated on a monthly basis.

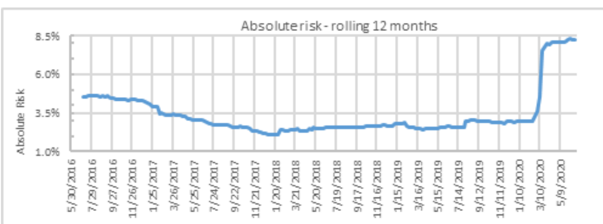


Figure 1 The absolute risk (top) and relative risk (to the S&P/ASX 200 Index) of the Fund using weekly prices since inception. The Fund has shown superior absolute and relative risk attributes since inception.

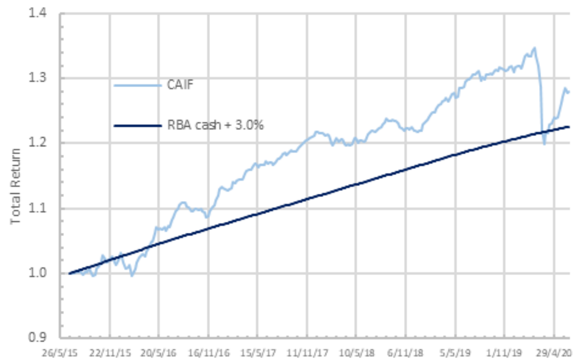


Figure 2 Total Return of the Fund since inception. The orange line represents the minimum return that the Fund aims for, namely the RBA cash rate + 3% pa.

Investment Commentary

At 30 June 2020, the Clime Australian Income Fund was diversified across six underlying sub-asset classes: Domestic Debt; Income & Preferred Securities; REITs; Utilities & Infrastructure (U&I); Equities; and Cash. Note REITs and U&I are also equities, but they are normally classified as a sub-set of the equity asset class as they tend to have a lower volatility under normal conditions. The underlying security weights in the portfolio ranged from around 0.20% to about 2.5%.

At 30 June 2020, the cash level had dropped from about 25% at 31 March 2020 to 18.9%. The bulk of this change was caused by opportunities in the OTC fixed income asset class.

In the June Quarter 2020, we participated in the following investment grade bonds:

- Woolworths Limited 5y OTC senior bond,
- Macquarie Bank Limited OTC 10nc5y subordinated debt,
- Heritage Bank OTC 10nc5y subordinated debt,
- Brisbane Airport 6y OTC senior bond, and
- Singtel Optus 5y OTC senior bond.

Furthermore, Macquarie Bank issued a listed AT1/CNs (MBLPC) in which we participated. These investment grade bonds shown above and the MBLPC capital notes are fixed income securities that should provide a certainty of income for the Fund's quarterly distributions, lowering the elevated cash level as average cash return is very low. This is in line with our strategy described earlier. Unitholders should be aware that there is a fine balance between return and risk. As we reduce cash, the risk of the Fund increases. Lastly, we exited Bendigo 5y Senior Bond in the rebalancing for the fixed income asset class.

For the Utility and Infrastructure asset class, we incrementally topped up Ausnet (AST), Spark Infrastructure (SKI) and Telstra on weakness while we participated in the Arena REIT (ARF), a specialised child and health care REIT. ARF satisfied our selection process where we focus on high WALE and low gearing. It operates in the essential childcare and healthcare service sector, comes with an extremely long WALE of more than 14 years and low gearing of 16% (post placement). Its 12m forecast yield is more than 5.5% which we believe will gradually increase as the economy recovers. The 16% gearing is well below the REIT sector average of 30%.

In the March quarter 2020, we introduced a non-financial defensive healthcare stock, being Sonic Healthcare (SHL). In the June quarter 2020, we took the opportunity to purchase Integral Diagnostics Limited (IDX), a healthcare diagnostic company specialising in medical imaging services for healthcare professionals and hospitals. We aim to accumulate IDX up to 1% of the portfolio in line with our risk investment process for smaller market capitalised securities.

Outlook

As the world and Australia fall into recession, most sectors will be impacted as economic activity slows and unemployment rates increase. Unless we have an effective vaccine or therapeutic medication widely available, COVID-19 will continue to menace and disrupt society. It is likely that more lives and economic activities will be disrupted in the near term.
That said, we believe the economy will eventually recover as we find a health solution or at least ways to minimise the damage to society and the economy. COVID-19 has accelerated or forced changes upon us; some changes will be temporary while some will become permanent. By identifying and segregating these temporary and more permanent changes, it is possible to provide a foundation to assist us to invest for income and price stability post the COVID-19 pandemic crisis.

Putting aside the recession, which will inhibit some companies from paying dividends, we have earlier delineated the investment strategy and changes the Fund will focus on to provide certainty of income, modest growth and price stability beyond this period. Over the next quarter, as we move into global recession, we anticipate that GDP growth will remain weak for some time.

Our immediate concern is to navigate the portfolio through these crises with consistent quarterly distributions and relative price stability. Locally, the recent surge of new infections in Victoria is another reminder of the precarious situation. Without an effective health solution, it is not possible to predict with any certainty whether the economy is back on a sustainable path to recovery.

We reiterate that investors should lower their expectations of high returns over the medium. For the Fund, we adhere to our goal-based investment strategy of generating income higher than the RBA cash rate, yet doing this with relative price stability. Moreover, with more than 50% of the portfolio in debt securities and capital notes, we are confident that we can continue to distribution quarterly income - one of the main objectives of the Fund. We note that we are able to distribute $ 1.2385 +0.1426 franking credits / unit in June quarter 2020, resulting in a running yield of 2.7% for the 12-month rolling.

Finally, we ask for your understanding and patience and thank you for your ongoing support.

Sincerely,

Vincent Chin,
Portfolio Manager - Multi-Asset Income Strategies

Market Commentary

While we remain in the midst of a pandemic-induced global recession, we bear in mind that in due course, this too will end. History is clear – all recessions end, and economic downturns are followed by economic recovery. This recession will be no different even though its genesis is unique, and has been a truly shocking experience for markets and the populace alike.

The severity of the global recession and the significance of policy responses have been extraordinary. But we must guard against confusing short term market price movements with the long term prospects of an investment. The daily movement in the prices of most liquid assets generally reflect the speed and flow of "random information" and elevated levels of "noise", whereas quality assets that benefit from long term economic growth eventually increase in "value" to reflect rising cash flows generated from that growth.

Over time, sometimes quite a long time, the price of the asset will converge with its value. Rational investors patiently seek to generate their returns over long periods. They also diversify their investments across various asset classes and utilise compounding as much as possible.

The onset of this recession has been sharp, and deep. While the policy responses likewise have been rapid and broad, and will dampen the severity of the downturn; they should also continue to aid and hasten the recovery. An unknown factor remains the trajectory of COVID-19 and the burgeoning risk of a second wave. While the timing of any medical solution is still undetermined, history suggests that eventually, human ingenuity will probably discover effective anti-viral drugs and vaccines.

Global central banks have acted in unison to lower the cost of capital and to ensure financial shocks and disruptions are quickly dealt with. In some respects, they appear to be behaving with desperation as they are charged with the funding of government liabilities that have been amassed with unprecedented mountains of debt.

The numbers are huge. To date, the US Federal Reserve balance sheet has expanded to 39% of US GDP – while this is dwarfed (in proportionate terms) in other jurisdictions, as in the European Central Bank (50% of GDP) and the Bank of Japan (117% of GDP). In Australia, the RBA balance sheet has expanded to 14% of GDP after outlaying $50 billion on asset purchases designed to drive down the bond yield curve (with a specific target of 0.25% for 3 year bonds). In years ahead, these debts will need to be reduced and repaid. In the interim, increased leverage in the global financial system introduces increased risk and lowers resilience.

The path to full recovery for Australia's economy is unlikely to occur until some point in 2022 at the earliest. It may be that FY23 is the year that Australia's economic activity and output matches that of FY19. The closure of our borders to international travellers has affected both our tourism and education sectors. Tourism is our fourth largest export earner; in 2019 there were 9.3 million international tourists to Australia who spent a total of $44 billion. Tourism accounts for 8% of our workforce.

Education is also a large export and generated $38 billion in 2019. In 2020, this revenue stream will be decimated and any recovery in the first half of 2021 will require a significant commitment to an arrival isolation program. Another headwind is the slowing of population growth. It is likely that FY21 will see Australia's lowest population growth rate since World War 2.

These observations suggest a significant weakening through 2020 of Australia's production and income. When the economy recoups its 2019 level in a few years' time, it will occur with a moderate increase in both our population and work force. Thus, the per capita income of Australia in FY23 will be lower than in FY19. It is also likely that our unemployment rate in FY23 will be higher than in FY19.

Our view is that after a period of sharp retracement in asset prices, there will likely be a long period of subdued investment returns. The best indicator of this is both the low actual and negative real yields of long term government bonds, which suggest that investment returns across the range of asset classes will be lower for a sustained period.

Whilst the short term is always hard to predict, the longer term is more certain. Because this recession is both sharp and deep, the initial recovery off this lower base will probably be stronger than usual. This gives the appearance of a decoupling of market prices from the short term economic pain that is widely felt and seen. It also leads to seemingly logical speculation that market prices are recovering too quickly, will falter and that a correction is imminent.

Thus, we are concerned that many of today's market prices for liquid assets are already reflecting the expectation of full economic recovery. This implies that in some instances, stock and other asset prices may be excessively optimistic, or indeed over-valued.

We cannot know with any degree of certainty if this will be the case or not. But we do believe that liquid asset prices will be volatile throughout the journey back to recovery. Price volatility is the natural result of zero interest costs and rampant currency printing which creates the fuel for excessive speculation.

Our view is that investors with medium to long term time horizons should stay exposed to growth assets if they are to achieve the returns they require to meet their longer term pension liabilities. The exposure to growth assets (mainly equities and property) can be supplemented and balanced by a measured exposure to corporate debt securities.

Adrian Ezquerro
Head of Investments

Fund Information

Investment Objective

The Fund's return objective is to provide regular income above the RBA cash rate in the form of quarterly cash distributions and aims to achieve a return of at least the RBA cash rate + 3.0% pa. It seeks to deliver a strong risk-adjusted total return and is expected to have a level of volatility of returns significantly less than equity indices, with unit price stability along the way. The Fund's risk objective (as defined by the annualised standard deviation) is 4.0% ± 1.0%, with a rolling 12 months relative risk measure of less than 40% of the S&P/ASX 200 Index. In order to maximise the chance of achieving these objectives, the recommended investing time frame is at least 3 years.

Investment Methodology

The Clime Australian Income Fund seeks to provide an income stream above the RBA cash rate from a portfolio of Australian listed and over the counter (OTC) securities, with a view to price stability. The portfolio will invest in selected high-quality individual securities with consistent income generation. Portfolio yield is likely to be the bulk of the portfolio return and will likely be enhanced by franking credits.

Portfolio Managers

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-factors quantitative models for stock selections and attribution performance analysis. Vincent is passionate about ethical investment across any assets including alternate 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 cells applications. He has published about 50 international refereed scientific publications and co-edited a proceeding in opto-electronics.

Fund Information

Name	Clime Australian Income Fund	**Investor Eligibility**	Retail & Wholesale
Structure	Managed Investment Scheme	**Minimum Investment**	Retail: $10,000 Wholesale: $100,000
Investment Universe	Listed and OTC Markets	**Liquidity**	Weekly Unit Pricing Applications and Redemptions
Benchmark	3% p.a. above RBA cash rate	**Fees**	Retail: 1.13% management fee Wholesale: 1.03% p.a. management fee
Number of Positions	60-80	**Admin**	Mainstream Fund Services Pty Ltd
Fund Size	$38.2m	**APIR Code**	Retail: SLT1239AU Wholesale: CLA0002AU
Platform Availablity	Netwealth, HUB24		

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