



## Fund Performance - June Quarter 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 Quarter Net Return	Portfolio 6-Month Net Return	Portfolio Net Return Inception p.a.	Fund Size
<b>2.3%</b>	<b>-0.4%</b>	<b>1.4%</b>	<b>\$18.3m</b>

	1 month	3 months	6 months	1 year	FYTD	Since Inception*
<b>Portfolio Net Return**</b>	0.5%	2.3%	-0.4%	0.8%	0.8%	1.4%
<b>Risk</b>	0.2%	0.5%	1.2%	2.7%	2.7%	2.8%

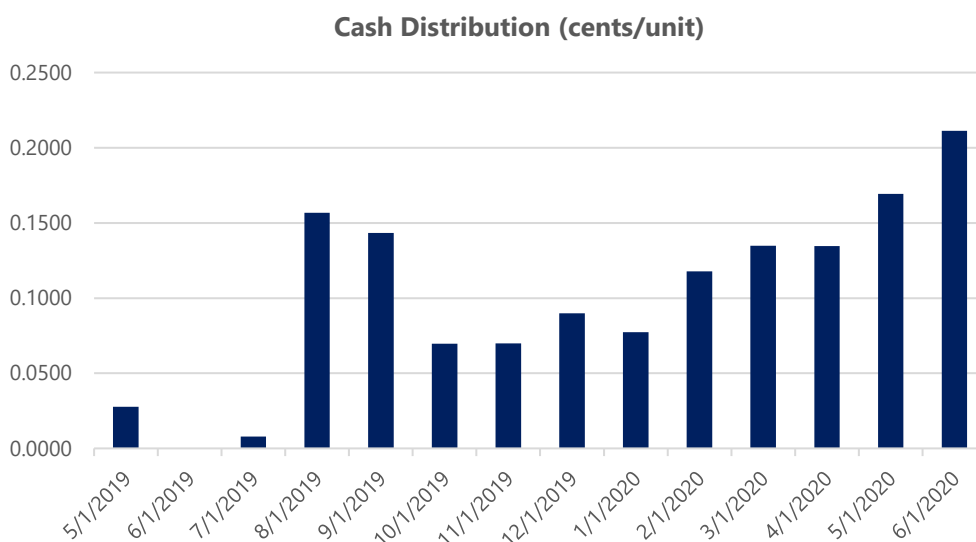
\*Inception date: 17 April 2019

\*\*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.

## Distributions

The Fund distributes income monthly on a cash basis (if available). For the June quarter, we distributed a total of 0.5134 cent / unit (including franking), with the latest distribution of 0.2094 cent / unit for the month of June 2020. The chart below shows the monthly distribution profile since inception. After the initial irregular distributions during the formative stages of the Fund, distributions should be more consistent in the future now that the Fund is relatively more fully invested.



## Fund Facts

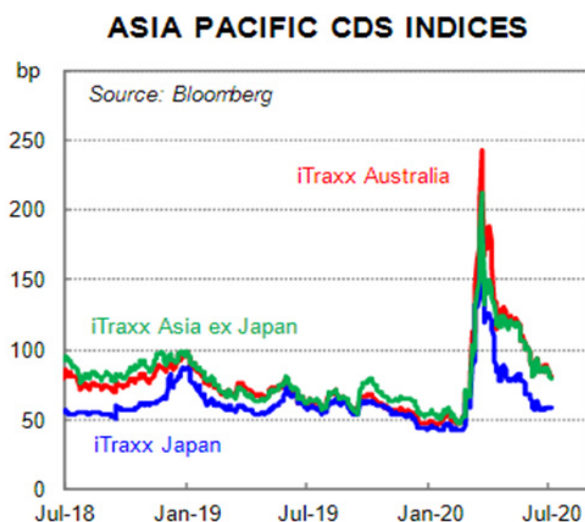
<b>Portfolio Manager</b>	Dr Vincent Chin
<b>Fund Inception</b>	April 2019
<b>Fund Size</b>	\$18.3m
<b>Cash Distributions</b>	Monthly



## Performance & Volatility of Return

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 Australia 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.

The official cash rate is now at a low 0.25%. The RBA has further allowed major banks to borrow at an even lower rate through their various funding mechanisms. These and other actions have generated enormous amount of liquidity, some of which has found its way into the capital debt market. The Australian iTraxx now is closer to 90bp, well down from 240bp at the height of the COVID-19 panic; it is nevertheless still above the 40bp mark pre-COVID-19 in late February early March 2020 as shown in the chart below.



The Fund achieved a return of 2.3% in the June 2020 quarter and 1.4% pa since inception in April 2019. As the credit spread tightens and / or the gradual rolling off of duration, the price of bonds are expected to gradually move back up. Over time, we believe the capital prices of below par bonds will recover. Together with the regular coupon payments from the bonds in the portfolio, the return of the Fund should improve with time.

As the Fund is just over 12 months since inception, we estimate that the risk as defined by the annualised weekly change in the unit price is 2.2% for FYTD and 2.0% since inception. This spike in volatility is a direct result of the sharp spike in credit spreads during the pandemic crisis, resulting in the drop in bond prices alluded to above.

In order to generate some meaningful yield, we rebalanced the portfolio slightly to achieve yield pickup after we observed that credit markets were gaining some support. This was predominantly due to the US Fed buying up individual corporation bonds. As the rates here and in the US are usually positively correlated, this will have some cascading effects on the pricing of corporate bond locally.

## Asset Allocation

### Cash (incl. TDs)

11.1%

### AT1 CN

7.4%

### RMBS

2.9%

### IG T2 FRNs

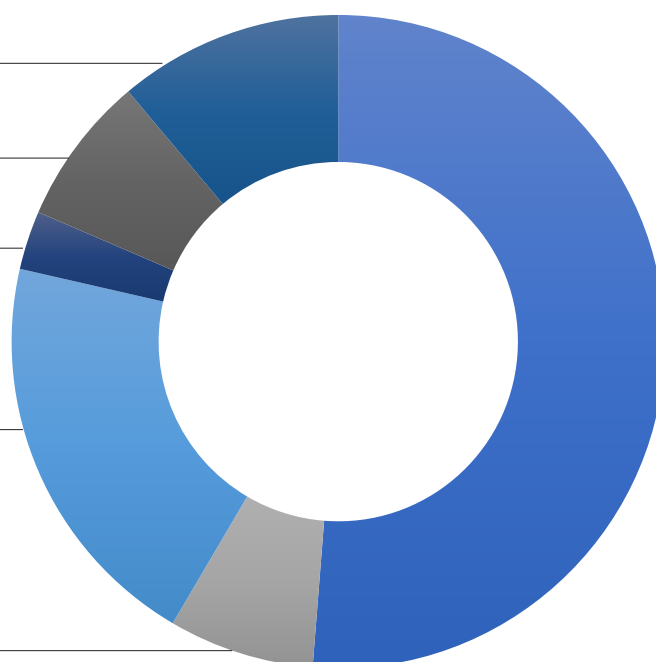
20.1%

### Unrated HY bonds

7.2%

### IG senior bonds

51.3%





## Portfolio Commentary

At 30 June 2020, the Clime Fixed Interest Fund was diversified across investment grade (IG) senior and IG subordinated debt, high yield bonds, RMBS and AT1 Capital Notes / Hybrids. The highest portion of the portfolio is in investment grade FRNs and fixed rate bonds at around 71.0%. This is core to our investment strategy as this will likely provide the capital preservation / price stability required by the Fund while earning interest return above that of the RBA cash rate. The objective of these coupons is to provide steady and regular monthly income distributions.

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

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

Furthermore, we also participated in a recent Macquarie Bank Limited Capital Notes offering (MBLPC). This was priced at 4.70% over the BBSW which we view as attractive. They listed in early June at a premium and have remained at a premium since.

As we were close to fully invested at the beginning of the June Quarter, to facilitate these purchases, we rebalanced the portfolio taking into account the yield, duration and credit risks of these debt securities and those we exited. As the interest rate will remain extremely low for an extended time, during the quarter the Fund exited:

- A 5y Westpac Banking senior debt,
- A 3y Citibank senior debt, and
- A 5y Bendigo & Adelaide Bank senior debt.

We are pleased that the net outcome of disposing of these three bonds has been a slight positive return. This is attributed mainly to the stronger reversion post the COVID-19 panic for highly rated investment senior bonds. In other words, they have more or less reverted to pre-COVID-19 conditions. As we purchased these bonds well before in early January / February 2020 when the iTraxx dropped below +50bp, we were able to sell some of these bonds at higher prices compared to when we bought them, resulting in net positive returns.

By investing in corporate bonds, we have been able to diversify away from predominantly financial debt in the Fund. Moreover, to assist with the smooth functioning of Australia's capital markets, the RBA has announced it will broaden the range of eligible collateral for the domestic market operations to include unsubordinated securities issued by non-bank corporations with an investment grade, subject to an approval process. We believe this will be positive for corporate bonds.

Asset Type	Average Duration (years)
IG Senior Bonds	3.8
IG Tier 2 FRN's	4.2
Unrated HY bonds	3.5
RMBS	2.8
AT1 Capital Notes	6.5

From the table above, you may note that we have kept the duration short with the exception of the AT1 CN asset class. However, the Fund has about 7.5% exposure in this AT1 asset class, of which more than 6.0% is issued by major leading banks.

Figures below show the breakdown of the credit rating of the IG senior debt. As may be seen, more than 66% are rated debts issued by financials and corporates with an investment grade of BBB+ or higher.

Rating	Allocation
AA	3.4%
AA-	6.6%
A+	3.4%
A	9.0%
A-	1.7%
BBB+	41.9%
BBB	14.1%
BBB-	6.7%
BB	2.7%
NR	10.4%

Since the Fund was set up, we have been fairly risk averse as the Fund's primary focus is capital preservation. Had we taken more risk, the Fund would undoubtedly have incurred larger losses due to COVID-19. We intend to maintain a cautious stance in the current environment, staying predominantly with higher rated securities and selective HY bonds. We will keep the duration short (3-5 years) with the RBA's YCC targeting 3 years as our point of reference. This is because as long as the corporations that issue bonds are solvent, they would be expected to meet their interest obligations, and when the bond matures, it would be expected to be redeemed at par. With the rebalancing to focus on yield pickup, duration risk and selective corporate bonds programs, we expect over time the Fund's return should increase. We also expect to be able to continue to pay monthly interest as normal.

### 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.

Due to the vast amounts of fiscal stimulus, extremely low interest rates (expected for many more years) and ongoing QE, it will take future generations many years to pay back the accumulated debts. There will probably be tax hikes and less social security benefits. These consequences are not very encouraging, and we anticipate that GDP growth will remain weak for some time.

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 strong price stability post the COVID-19 pandemic crisis.

Our immediate concern is to navigate the Fund through these crises with certainty of monthly distributions and strong price stability. Without citing the deteriorating situation overseas, 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.

For this Fixed Interest Fund, we adhere to our goal-based investment strategy of generating regular monthly income and capital preservation and expect to continue to do so.

Finally, we ask for your understanding and patience. You can be confident that we will do our best to safeguard your investment in these challenging times.

Please stay safe and thank you for your on-going support.

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 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-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

<b>Name</b>	Clime Fixed Interest Fund	<b>Investor Eligibility</b>	Wholesale
<b>Structure</b>	Managed Investment Scheme	<b>Minimum Investment</b>	100,000
<b>Investment Universe</b>	< 90 to 95% over the counter (OTC) in the capital debt market, AUD denominated only	<b>Liquidity</b>	Weekly Unit Pricing Applications and Redemption
<b>Benchmark</b>	Return : RBA cash rate + 2.0%; Risk : $1.5\% \pm 1.0\%$	<b>Fees</b>	0.41%
<b>Fund Size</b>	\$18.3m	<b>Admin</b>	Mainstream Fund Services Pty Ltd
<b>APIR Code</b>	CLA0724AU		

### Contact Information

#### Investor information

Clime Asset Management  
Ph: 1300 788 568  
Email: [info@clime.com.au](mailto:info@clime.com.au)

#### Administrator

Mainstream Fund Services  
Ph: 1300 133 451  
Email: [registry@mainstreamgroup.com](mailto:registry@mainstreamgroup.com)

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