

Clime Australian Income Fund



Fund Performance - July 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% \pm 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 1- Month Net Return (Wholesale)	Portfolio 1 Year Net Return (Wholesale)		Portfolio Return Inception p.a. (Wholesale)				Total Fund Size
0.8%	-2.8%		5.2%				\$38.1m
	1 month	3 months	6 months	1 year	3 years	5 years	Since Inception (pa)*
Net Portfolio Return (Wholesale)**	0.8%	3.2%	-4.9%	-2.8%	3.2%	5.2%	5.2%
Income	-	1.2%	1.5%	2.7%	3.6%	3.7%	3.7%
Capital Growth	0.8%	2.0%	-6.4%	-5.4%	-0.4%	1.5%	1.5%
Franking	-	-	-	0.1%	0.2%	0.2%	0.2%
Volatility	-	-	-	8.3%	6.1%	4.7%	4.7%

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 Notes	2.3%
Sparke Infrastructure Group	2.2%
Telstra Corporation Limited	2.0%
Ausnet Services Limited (AST)	1.9%
Macquarie Bank Capital Notes (MBLPC)	1.9%

Fund Facts

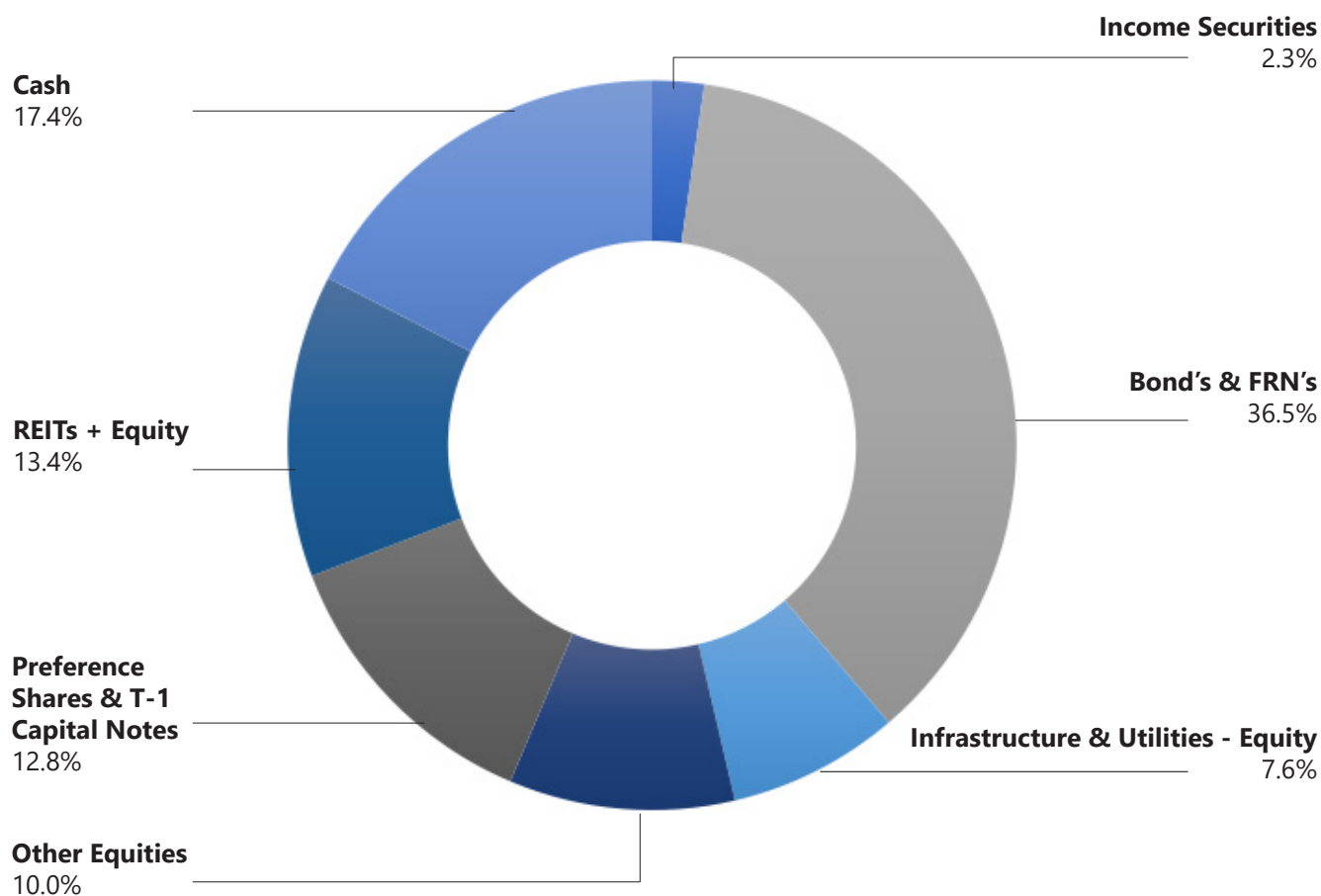
Portfolio Manager	Dr Vincent Chin
Fund Inception	1 July 2015
Fund Size	\$38.1m
Cash Distributions	Quarterly



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	2.5854 + 0.2533 franking credits
31 March 2019	0.8096

Asset Allocation





Portfolio Commentary

The Australian equity market remained characterised by uncertainty and volatility during July, with more than 30% of the month's trading days showing index moves in excess of $\pm 1\%$, and on the last trading day dropping by more than 2%. By month end, the ASX200 Accumulation index had edged higher by 0.5%; value sectors mostly rallied while growth sectors, notably technology, lagged slightly. The market remains about 18% below the peak reached in late February 2020. For the Fund, we continued to invest across different asset classes in high quality names, focusing on the certainty of income, irrespective of debt or equity asset class.

After a busy month in June pivoting to fixed income and Utilities & Infrastructure securities, the portfolio cash level dropped from over 20% to 17%. July activities were decidedly slower due to a lack of quality debt securities in the primary market. With the outlook to remain subdued well into FY21, we intend to be patient. That said, we will continue to search for yield from quality names.

Once again, the bulk of our investment has been in the fixed income asset class. We participated in two new fixed income securities. MyState Limited launched a 5y non-call 10y OTC subordinated T-2 debt to replace the existing T-2 debt. The new T-2 was priced at 4.35% over the BBSW90. NAB launched a 5y OTC perpetual subordinated Tier 1 capital note, priced at 4.00% over the BBSW90. In Utilities and Infrastructure, we like AusNet Services (AST) and Telstra (TLS) and added to these holdings on weakness. We refrained from adding to REITs. We topped up Integral Diagnostics (IDX) as we continued to build larger positions outside of the major banks.

The cash rate remains at 0.25% and Australian 10y bonds below 1%. Short Term Bank Bills have traded below the cash rate since the middle of April 2020. It is likely that the ultra-low yield for cash will remain for at least a year or two, as the RBA recently announced fresh buying of the 3y bond to force the yield to be closer to 0.25%, thereby influencing the entire yield curve.

In Australia, the resurgence of COVID-19 in Victoria was deeply troubling. The Victorian Government declared a State of Disaster and imposed stricter lockdowns, supplemented with a nightly curfew. This reinforces the view that the path of the virus remains highly unpredictable. Certainly, this will cause a further material drop in Australian economic activity as Victoria constitutes roughly 22% of the country's economy.

Globally, the spread of the pandemic is getting worse with second waves popping up across Europe and in parts of Asia while in the Americas, they are still in the midst of their first waves. It is likely that the virus will create intermittent disruptions until an effective health solution is found. To make matters worse, geopolitical tensions and technological competition between the US and China look set to increase in the run up to the US elections in early November.

The Fund posted a return of 0.8% in July. During the month, we continued the measured approach detailed in the March quarterly update. While the 1y volatility of the portfolio remains elevated, the 3y or 5y rolling absolute volatility figures are a more appropriate reflection of the medium term risk investment strategy of the Fund. This is at the upper end of the range of the absolute risk objective of the Fund. Furthermore, we note that the relative risk has plateaued and is now below our targeted 40% or less. We expect it should gradually reduce further over time. We remain confident of the Fund's ability to provide a regular quarterly distribution.

Dr Vincent Chin
Portfolio Manager



Market Commentary

It seems crazy, but world sharemarkets in the three months to June completed one of their best quarters ever - for example, the S&P 500 Index was up 20% - and this during the deepest economic contraction since the Second World War. How can financial markets be so complacent while the COVID-19 pandemic continues to rage, and large sections of the global economy remain shut down?

Since late March, markets have surged back to levels that seem expensive, even as the pandemic rolls on and most companies report pretty awful profits. Of course, markets are forward-looking, so share prices have risen in anticipation of recovery.

Superficially, a number of financial markets appear inflated at present, and that includes sharemarkets and bond markets. Indeed, even precious metals like gold and silver are running hard. A number of markets seem quite divorced from economic fundamentals. On some valuation metrics, the US sharemarket is currently more expensive than it has been since the tech bubble period in 1999-2000.

But valuations have always been very sensitive to interest rates, whether the "official" short term cash rate set by central banks, or longer term Government bonds. Simply put, lower rates "across the curve" make shares look more attractive. And many investors prefer stocks because the dividends they yield are higher than either bank term deposits or fixed income securities. The ultra-low rate policies of the US Federal Reserve and other central banks have clearly acted to inflate asset prices.

Fiscal stimulus or support money from governments attempting to prop up the economic devastation of the pandemic is also finding its way into the sharemarket, further inflating prices. Stuck at home and without sport to watch or bet on, retail investors (the "Robinhood brigade") now account for 20-25% of US trades, up from about 15% a year ago.

Australia sees prices going backwards

In traditional economic models, central banks lower rates to stimulate activity when times are tough, and raise rates when inflation threatens to get out of control. The Australian Bureau of Statistics released its latest Consumer Price Index figures, which fell 1.9% in the June 2020 quarter. ABS economist Bruce Hockman said, "This was the largest quarterly fall in the 72 year history of the CPI." The annual inflation rate was -0.3% in the year to end June 2020 quarter. Since 1949, this was only the third time annual inflation has been negative. The previous times were in 1962 and 1997-98.

Returning to our traditional economic model, if there is no inflation in the system, then the central bank (in this case the RBA) can hold rates low for "as long as it takes". Importantly, this gives the Government the opportunity to borrow in the bond markets at very low rates too. And this is precisely what has occurred.

The Government has rather quickly raised the debt required to fund the forecast \$167 billion increase in gross debt as outlined by the Treasurer recently. It then offered investors \$15 billion in a 30-year bond issue that attracted some \$38 billion in investor demand.

The debt manager for the Government, the Australian Office of Financial Management, has now sold more than \$130 billion through a combination of auctions and capital markets deals since mid-March, when the pandemic prompted a surge in government spending to support the economy.

The 30-year bonds were priced to yield 1.94%. The deal size marks the third-largest Australian Government debt issue in history, and the longest outstanding Australian sovereign debt obligation. Whereas the long-term bond market was all but closed for issuers at the height of the COVID-19 crisis, long term securities are now highly sought-after.

In March, the Reserve Bank intervened in the bond market to restore its functioning and to lower borrowing costs. But unlike other central banks, it has limited its buying focus at the shorter end of the yield curve, with the aim of pinning the 3-year rate at 0.25%.

Concluding remarks

The market is constantly trying to capture every new piece of information or shift in economic sentiment, so its volatility at times suggest that economic conditions are frequently changing, unpredictable, shifting at the margin - responding to good news or bad news. Markets are forward looking. They incorporate all the known information at any point in time - but they also tend to "overshoot" when either going up or down.

Although the US market looks to have performed very well since the bottom on March 23, in fact it is really the mega-cap Tech companies that have lifted it as the pandemic has accelerated the economy's digitization. That is Apple, Microsoft, Facebook, Google, Amazon, Netflix etc; these stocks make up more than 20% of the market index. Most other sectors are flat or negative.

Traditional valuation methods do look stretched, but the market is looking past the pandemic and anticipating a sharp recovery in 2021. Also, if you adjust for the sub-1% rate of most government bonds, markets do not look as expensive.

There are some obvious risks that deserve mention apart from high valuations: geopolitical risks of worsening tension between US and China; the US election on 3 Nov and possibility of change in administration which creates uncertainty; domestic unrest in the US and the risk that President Trump will not accept an election loss; a second wave of the pandemic that necessitates longer and more strict lockdowns.

We would always emphasize the point that accurately timing markets is well-nigh impossible and attempting it is often counter-productive. Prudence suggests a sensible diversified portfolio held for the long term (5 years or more) is a preferable strategy. At present, it seems like the market is treating the pandemic for what it is, a major natural disaster that hits suddenly and then after a year or 18 months, it recedes or disappears - only it is not clear how long it will take to fully disappear. In the meantime, investors appear ready to look across the valley and try to imagine what 2021 will look like.



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	\$38.1m	APIR Code	Retail: SLT1239AU Wholesale: CLA0002AU
Platform Availability	Netwealth, HUB24		

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