Clime Fixed Interest Fund

Fund Performance - July 2020

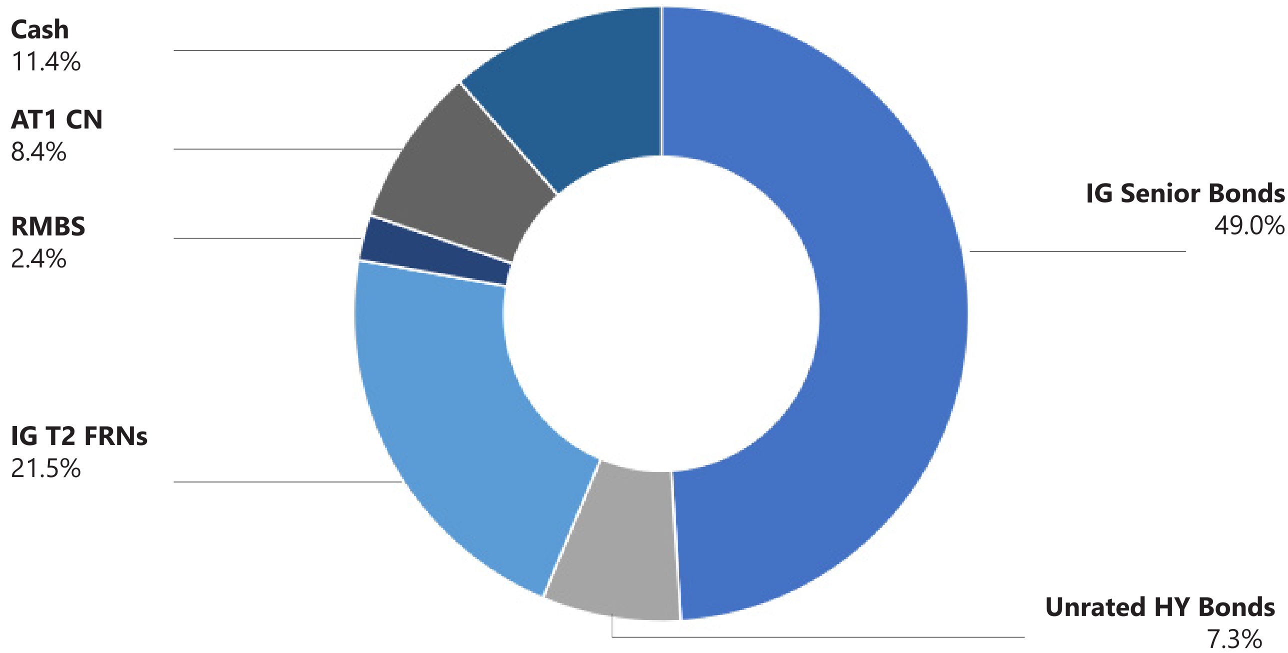
The Clime Fixed Interest Fund's primary objective is capital preservation. It aims to generate income returns above the RBA cash rate in the form of monthly income distributions. Its return objective is to outperform the benchmark of the RBA cash rate +2.0% p.a. The Fund's risk objective is set at 1.5%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

1 Month Net Return	Portfolio 1 Year Net Return	Portfolio Net Return Inception	Fund Size
0.9%	1.2%	2.0%	$18.3m

	1 month	3 months	6 months	1 Year	Since Inception*
Portfolio Net Return**	0.9%	1.9%	-0.2%	1.2%	2.0%
Risk	-	-	-	2.2%	2.0%

*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.

Asset Allocation



Fund Facts	
Portfolio Manager	Dr Vincent Chin
Fund Inception	April 2019
Fund Size	$18.3m
Cash Distributions	Monthly

Portfolio Commentary

With continued liquidity provided by central banks, credit spreads have tightened globally. Australian iTraxx tightened by 10bp in July, now firmly below 100bp and hovering at the 80bp level. The equity market, as measured by the ASX200 Accumulation Index, finished up 0.5% in July, although it remains volatile with more than 30% of trading days seeing ±1% swings.

After a busy May and June rebalancing, we participated in two new credit rated issues, namely MyState Limited subordinated 5y non-call 10y Tier 2 debt and NAB subordinated perpetual 5y AT1 Tier 1 OTC papers. The MyState Limited paper was a replacement of their Tier 2 paper which is being called back, while NAB issued a new OTC AT1 paper. They were priced at 4.35% and 4.00% over the BBSW90 respectively. In the rebalancing, we exited Suncorp 5 year senior debt for a modest profit as credit spreads tightened further.

The cash rate remains at 0.25% and Australian 10y bonds below 1%. Short Term Bank Bills have traded below the cash rate since mid-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, 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 appears to be 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 heightened technological competition between the US and China look set to increase in the run up to the US elections in early November.

As credit spreads tightened further, capital prices of fixed income securities in the Fund continued to appreciate. For the Fund, we adhered to our investment process of capital preservation and income generation, with monthly distributions. The Fund posted a return of 0.9% in July 2020. At month end, the asset allocation was 11.4% cash, 49.0% IG senior bonds, 21.5% IG subordinated FRNs, 7.3% HY unrated corporate bonds, 2.4% RMBS and 8.4% AT1 Capital Notes / hybrids.

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.

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% ± 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

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% ± 1.0%	**Fees**	0.41%
Fund Size	$18.3m	**Admin**	Mainstream Fund Services Pty Ltd
APIR Code	CLA0724AU		

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