Clime Australian Income Fund

Fund Performance - February 2021

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 1- Month Net Return (Wholesale)	Portfolio 1 Year Net Return (Wholesale)	Portfolio Return Inception p.a. (Wholesale)	Total Fund Size
0.1%	2.1%	5.8%	$42.4m

	1 month	3 months	6 months	1 year	3 years	5 years	Since Inception (pa)*
Net Portfolio Return (Wholesale)**	0.1%	0.7%	4.7%	2.1%	4.2%	6.3%	5.8%
Income	-	0.3%	0.7%	2.2%	3.5%	3.8%	3.5%
Capital Growth	0.1%	0.4%	4.0%	0.0%	0.7%	2.5%	2.3%
Volatility	-	-	-	8.5%	5.4%	4.6%	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%
Telstra Corporation Limited	2.0%
Sparke Infrastructure (SKI)	2.0%
Commonwealth Bank PERL VII (CBAPD)	2.0%
Macquarie Banks Limited capital Notes (MBLPC)	1.8%
National Australia Bank	1.7%

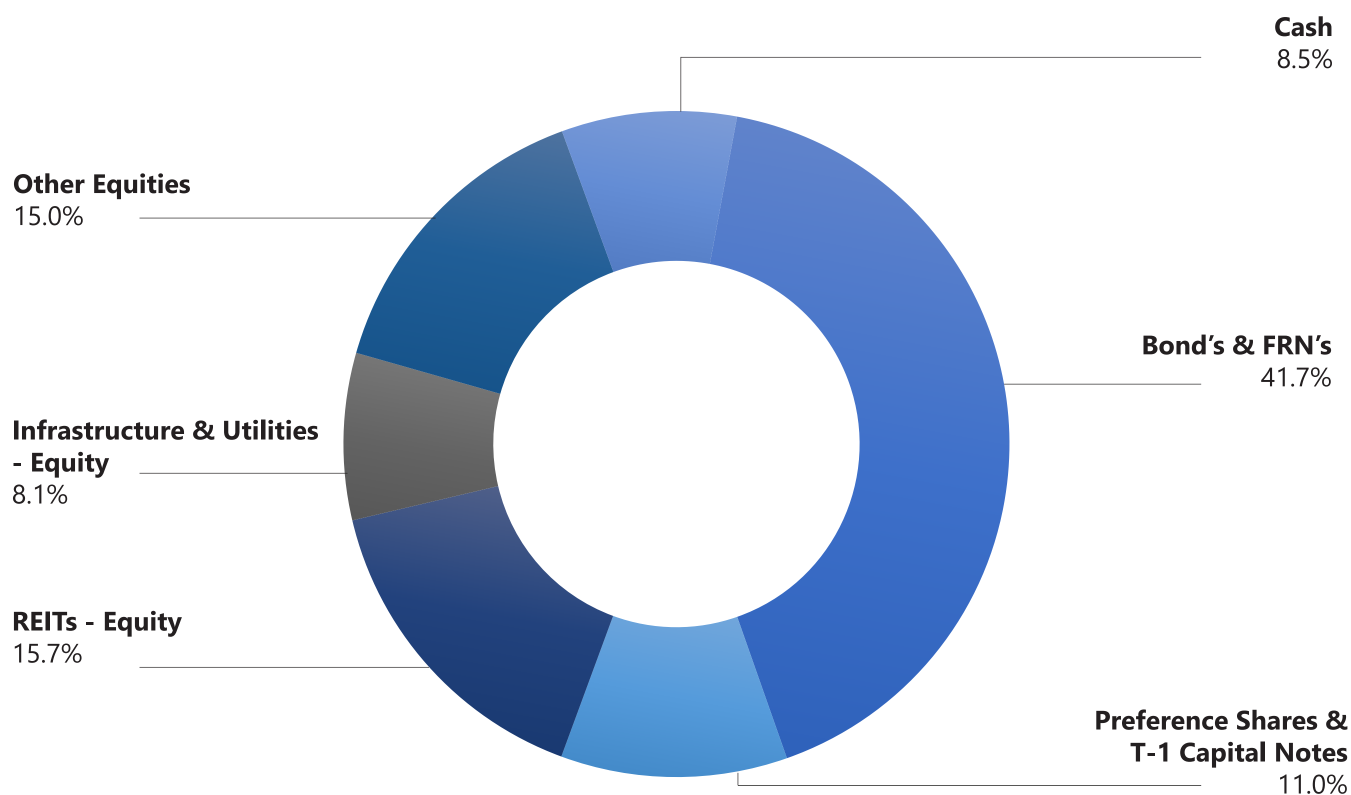
Fund Facts

Portfolio Manager	Dr Vincent Chin
Fund Inception	1 July 2015
Fund Size	$42.4m
Cash Distributions	Quarterly

Distributions

Period Ending	Wholesale Units (cents)
31 December 2020	0.3008
30 September 2020	0.4011
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 so-called "reflation trade" accelerated in February as COVID-19 infections receded and vaccination campaigns gathered pace in most major economies, including (a somewhat slow start) in Australia. Greater optimism about economic growth is evident in the sell-off in government bond yields, which experienced a large and sharp price reversal during February.

Even though the underlying force behind bond market moves is an improvement in the economic outlook, higher yields are raising fears that equity market valuations could be compromised. Given that expensive and "longer duration stocks" such as high growth tech are more vulnerable to higher discount rates, sector rotation to cyclical and value stocks continued during the month; while resources and financials did well, tech, utilities and REITs performed poorly.

By month end, the ASX200 accumulation index managed to add 1.5% after first gaining over 4.9% before a volatile pullback. The sell-off in the latter half of February was almost a repeat of January 2021 as the 10y bond yield moved up sharply from the third week in February to 1.9%.

It is possible that the sharp steepening of the Australian yield curve will continue though we think it may be overdone in the short term. This is because the RBA has reiterated that the AUD is relatively high and intend to modulate its strength. We think that when the RBA start buying more aggressively, yields could recede slightly. That said, with the strengthening local economy and short of RBA intervention, the 10y Australian bond would likely be over 2% as the local economy is sufficiently strong to justify a 2%+ long bond. However, questions remain whether this would be tolerated by the equity market if this occurs in a short period as experienced this month. We therefore anticipate volatile sessions in the coming months and will exploit this to position the Fund's portfolio for income and price stability.

In February 2021, we did not introduce any new fixed income securities. In Utilities and Infrastructure (U&I), we accumulated Spark New Zealand (SPK) as we anticipate a sustainable dividend of more than 5% with price stability; indeed, they reaffirmed the dividend at the top of the range during their half year results. In REITs, we introduced Centuria Capital (CNI) and accumulated Growthpoint Properties (GOZ) prior to their results as we see value here. To fund this switch, we exited Centuria Office Fund (COF). For other equities, we continue to accumulate WES and increased our exposure to IRE. To fund these purchases, we exited WBC Capital Notes (WBCPE) and proceeded to lighten MQG Capital Notes (MQGPC). These moves accord with our view of "cyclical over growth" sector rotation, which we expect to be sustained for some time.

In the March meeting, the RBA kept cash rates at 0.10% and they reiterated the doubling of the daily bond buying program and stated they are ready to step in as required. Long bond yields receded from the high on the RBA announcement. This reinforces our view that there is a need to deploy cash into other asset classes to seek out higher yield.

We remain vigilant of market volatility while focusing on certainty of income from quality securities. We are incrementally increasing our exposure to cyclical growth with strong income yield and are ready to seize any short term opportunity to generate income if they present themselves. We remain confident of the Fund's ability to provide regular quarterly distributions, albeit on a lower basis compared to pre-COVID-19 periods in the near term. As the pandemic subsides and the economy opens up, dividends will gradually increase over time and the regular distributions should move up. During the half year reporting season, we noted that most of the leaders in the market such as BHP, CBA, WES, WOW, etc. have all announced increases in their dividends as management are increasingly confident of the outlook and the local economy.

Dr Vincent Chin
Portfolio Manager

Market Commentary

The so-called "reflation trade" accelerated in February as COVID-19 infections receded and vaccination campaigns gathered pace in most major economies, including (a somewhat slow start) in Australia. Greater optimism about economic growth is evident in the sell-off in government bond yields, which experienced a large and sharp price reversal during February.

Even though the underlying force behind bond market moves is an improvement in the economic outlook, higher yields are raising fears that equity market valuations could be compromised. Given that expensive and "longer duration stocks" such as high growth tech are more vulnerable to higher discount rates, sector rotation to cyclical and value stocks continued during the month; thus while resources and financials did well, tech and utilities performed poorly. The US equity market has greater exposure to expensive tech stocks and growth sectors than does the ASX, which has relatively higher weightings to financials and materials.

Rising bond yields did cause some market ructions towards month end. But stock prices need not suffer from rising bond yields as long as the yield increase reflects favourable economic conditions (which also push up earnings and dividends), rather than a perception that inflation is about to break out in a sustained manner. Evidence from history suggests that the relationship between bond yields and equity prices shifts with changes in inflationary expectations.

The question being asked by market participants is whether a structural rise in inflation will occur that will cause inflation expectations to become uncontained. Our thoughts are that this is unlikely; with significant excess capacity still available in most economies, and with unemployment levels still high and minimal signs of wages growth, inflation is unlikely to rise above central bank targets in a sustained way. However, we recognise that a durable increase in prices on the back of very loose policy settings is a risk to this view.

The US$1.9 trillion Biden virus relief bill that is making its way through Congress could have a large impact on whether or not inflationary pressures are transitory or become entrenched. The current price tag being advocated by President Biden (it may be slimmed down in the Senate) is roughly twice the size of the stimulus bill President Obama signed in 2009 to combat the GFC. That reflects the fact that Biden does not want to repeat the mistake of the 2009 bill, which many believe was too small to prevent a sluggish recovery. This time, Biden is erring on the side of aggressiveness, hoping to return the economy to full employment and spark wages growth.

Whether the Biden relief bill sparks inflation or not, at present the Federal Reserve remains committed to an ultra-accommodative policy stance. Central banks would prefer to consolidate the recovery rather than risk its fading, even if that means some tolerance of inflationary pressures. When considering the inflation outlook, note that US inflation has averaged slightly below 2% for the last 25 years. In the nine years since the Fed's announcement of a 2% inflation target, 12-month inflation has averaged under 1.5%.

The surge in bond yields does not reflect hawkish policy, and therefore should not weigh on equities over the next 12 or 18 months. Thus, we continue to have reasonable confidence in the market environment for risk assets, which benefit from the current backdrop of solid growth and accommodative monetary policy. This is especially true for cyclical sectors and value stocks.

Meanwhile, industrial commodities generated significant positive returns, powered higher by both the economic normalization theme and bullish supply-side fundamentals. This occurred despite the US dollar's advance, which tends to weigh on the commodity complex.

Industrial metals are particularly well poised to rally further: over the next 12 months, they will benefit from robust demand on the back of the recovering global manufacturing cycle. Stronger consumption will probably outpace supply, which is suffering from years of mining capex neglect. Longer term trends are likewise supportive. Metals benefit from the need to expand the global power grid in order to accommodate renewables amid the push for cleaner energy. This is particularly true in the case of copper, which is experiencing a decline in inventories amid mine supply disruptions and resilient demand. The International Copper Study Group estimates global copper markets experienced a significant shortage in 2020, and that this gap will only grow until more supply comes to the market, which will take many years.

In Australia, the corporate reporting season was better than expected, with "beats" exceeding "misses" by about 3x. More significantly, the forward-looking market Price Earnings ratio, which had stretched to around 20x in early January, has now reduced to around 18.5x based on upgraded results and forecasts for the next year – a ratio closer to longer term averages.

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	$42.4m	**APIR Code**	Retail: SLT1239AU Wholesale: CLA0002AU
Platform Availablity	Netwealth, HUB24		

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