Clime Australian Income Fund

Quarterly Fund Performance | March 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 Quarter Net Return (Wholesale)	Portfolio 1 Year Net Return (Wholesale)	Portfolio Return Inception p.a. (Wholesale)	Total Fund Size
2.0%	15.1%	6.0%	$43.6m

	1 month	3 months	6 months	1 year	3 years (pa)	5 years (pa)	Since Inception (pa)*
Net Portfolio Return (Wholesale)**	1.8%	2.0%	6.3%	15.1%	5.1%	6.2%	6.0%
Income	0.7%	0.7%	1.0%	2.8%	3.5%	3.8%	3.6%
Capital Growth	1.1%	1.3%	5.3%	12.4%	1.6%	2.4%	2.5%

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. Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. 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.
**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.

Top 5 Holdings

Security	Weight%
Telstra Corporation	2.2%
Spark Infrastructure Group	2.1%
CBA PERLS VII	1.9%
AusNet Services Limited	1.8%
Growth Point Property	1.8%

Fund Facts

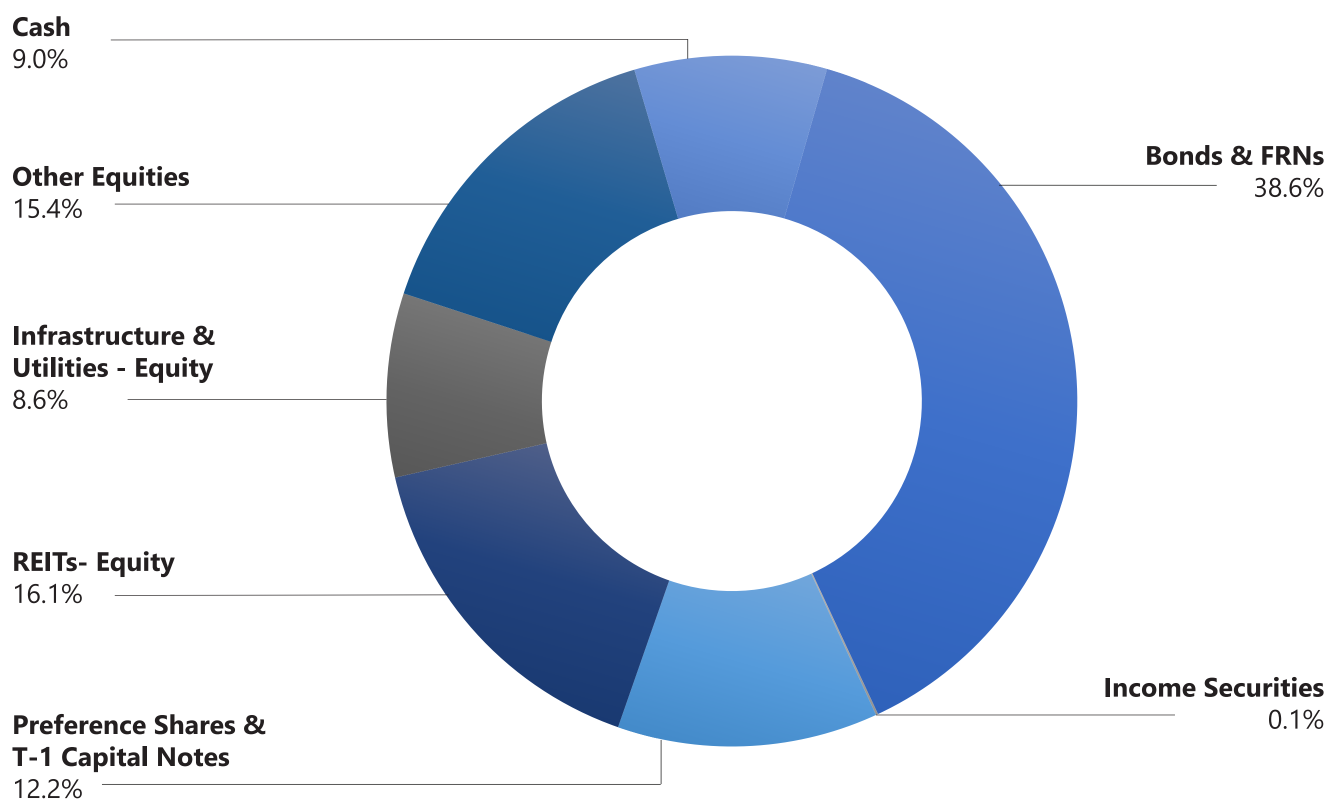
Portfolio Manager	Dr Vincent Chin
Fund Inception	1 July 2015
Fund Size	$43.6m
Cash Distributions	Quarterly

Distributions

Period Ending	Wholesale Units (cents)*
31 March 2021	0.6264
31 December2020	0.3007
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
31 December 2018	0.8859
30 September 2018	0.8045
30 June 2018	1.835 + 0.2025 franking credits
31 March 2018	0.7455
31 December 2017	0.7602
30 September 2017	0.6015
30 June 2017	1.84571 + 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
30 September 2015	0.5383

*The distributions and franking credits shown above are reflective of the returns for the Wholesale class only. Returns for the Retail class will be lower due to the higher fees associated with this investor class.

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.

We have reported with growing confidence of a return to strong growth following the pandemic recession, supported by extraordinary fiscal and monetary programs on a global scale. This has been borne out by both economic data and the performance of financial markets over the first three months of the calendar year. A corollary of this reflation narrative has been the surge in yields of government bonds as economic growth accelerates and normalisation approaches (more later).

Growing economic optimism and increasing inflation expectations are reducing demand for government bonds at a time when supply of bonds is rising as governments borrow more. The unwinding of the extreme valuation distortions in US and G7 government bond markets due to QE programs has probably only just begun and will likely be an ongoing investment theme for years to come.

Supporting the current favourable environment for risk assets, the US Federal Reserve reiterated its dovish policy of ultra-easy monetary conditions, while noting that a full economic recovery still remained distant. The Fed stated that no rate changes were planned until 2023 at the earliest, and that bonds and mortgage-backed securities would continue to be purchased until further notice.

These policies have however fuelled talk of higher inflation expectations, leading to a sharp sell-off of bonds globally (including Australian bonds) towards the end of February 2021. The Australian 10y bond yield soared above 1.9% in late February from less than 1.0% at the beginning of this quarter. This resulted in a market pull-back in late February. Yields stabilised around 1.7% to 1.8% by late March 2021, and the equity market rallied to finish the March quarter with a strong total return of 4.3%. However high growth, technology and yield sensitive sectors (such as A-REITs and Utility & Infrastructure) underperformed while cyclical / value sectors powered ahead. In other words, cyclical rotation is gaining momentum and poised to go higher - at least in the near term.

Against this backdrop, our key convictions are that as the reflation trade continues, investors should favour equities and property to cash and bonds. Investors should monitor the impact of inflation on interest rates and corporate earnings. As there is a rising consensus on cyclical securities with the re-opening of economies, selection in equities is increasingly relevant. The focus should be on sound businesses with a preference for quality and value.

At a high level, the Fund will continue its investment strategy of maintaining low cash levels in the range of 5% to 10% for the foreseeable future, a strategy we adopted in the September quarter 2020. 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 is almost fully invested in the Fixed Income asset classes and any additions may require some switching. In the equity asset classes, we will continue to seek out high quality, selective A-REITs and U&I (in that order of preference) which offer consistent and predicable income. As the market become more mature, we will not hesitate to be active in rebalancing the portfolio.

Perfomance and Volatility of Return

	Portfolio Return**	Income	Capital Growth
1 month	1.8%	0.7%	1.1%
3 months	2.0%	0.7%	1.3%
6 months	6.3%	1.0%	5.3%
1 year	15.1%	2.8%	12.4%
3 years (pa)	5.1%	3.5%	1.6%
5 years (pa)	6.2%	3.8%	2.4%
Since Inception (pa)*	6.0%	3.6%	2.5%

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. Performance figures for more than 1 year are annualised, calculated after all applicable fees and taxes. 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.
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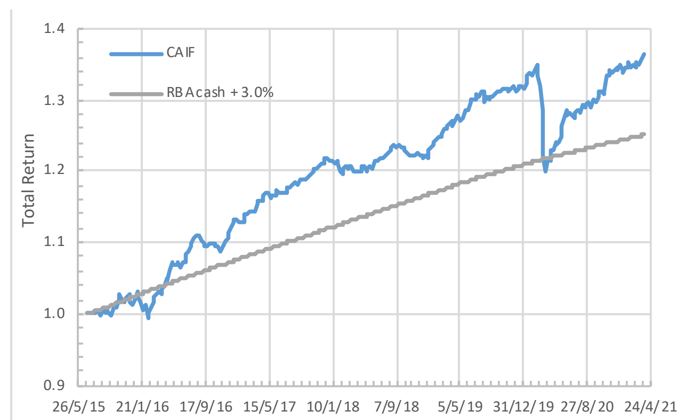
The equity market troughed in March 2020 resulting in the ASX200 accumulation index rebounding strongly with a 37.5% return for the 12 months to 31 March 2021, but with a heightened annualised volatility of 15.3%. On the other hand, the Fund's 12 month return was 15.1% with an annualised volatility of 4.2%.

Over the 5 year period to the end of March 2021, the Fund's total return was 6.2% pa and the split between income and capital returns is 3.8% and 2.4% respectively. The annualised volatility over this 5 year period is 4.6%. Over the last 5 years, the Fund was able to capture more than 60% of the equity market total return with less than 32% of the ASX200 market volatility – consistent with the Fund's major objectives of good income and growth with price stability. Please refer to the table below for more information.

	Volatility^			
30/09/2020	CAIF	ASX200	Ratio of CAIF/ ASX200	Sharpe Ratio^^
1 year	4.2%	15.3%	27.2%	3.8
2 year	6.3%	18.9%	33.6%	0.5
3 year	5.4%	16.4%	32.9%	0.6
4 year	4.8%	15.0%	32.2%	0.6
5 year	4.6%	14.6%	31.4%	0.8
Since Inception	4.6%	14.7%	31.2%	0.8

^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 shows the total return on a cumulative return basis, compared with the RBA cash rate + 3.0% pa return objective since inception.



Sources: Clime and RBA

Figure 1: Total Return of the Fund since inception. The grey line represents the minimum return that the Fund aims for, namely the RBA cash rate + 3% pa.

Investment Commentary

The Clime Australian Income Fund was diversified across six underlying sub-asset classes: Domestic Debt; Income & Preferred Securities; A-REITs; Utilities & Infrastructure (U&I); Equities; and Cash. Note A-REITs and U&I are 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 based on past observations. The underlying security weights in the portfolio ranged from around 0.5% to just over 2.0%.

As of 31 March 2021, the cash level was 9.0%, a slight increase since the December quarter partly due to the NABHA having been bought back by NAB and positive inflows. In this March quarter, the following actions were taken:

Fixed Income Asset Classes

We did not participate in any OTC bonds/FRNs issuance this quarter. To lower our interest and credit duration in this asset class, we exited the Origin Energy 8 year fixed rate bond. In addition, DJ Finance Pty Limited redeemed their HY bond early as they sold their Melbourne and Sydney properties.

In the March quarter, our long held National Bank income securities were bought back by NAB. We have used part of the proceeds to participate in the following Capital Notes:

- Macquarie Capital Notes 5 (MQGPE)
- CBA PERL XXIII (CBAPJ).

While MQGPE was listed in March 2021, CBAPJ will list in early April. As we introduced these new Capital Notes, we took profits in WBCPE and MQGPC as both are trading well above par.

Equity Asset Classes

We did not introduce any new U&I securities, but continued to increase our exposure to Spark New Zealand Limited (ASX: SPK). In the A-REIT asset class, we exited Centuria Office Fund (COF) and switched the proceeds to Centuria Capital Limited (CNI) and Growth Point Property (GOZ) as we see better value there.

In the general equity asset class (ex-U&I and A-REITs), we continued to top up BHP Limited (BHP) and Wesfarmers Limited (WES) with fund flows. We re-introduced Sonic Healthcare (SHL) in the portfolio after a short absence as it declined quite sharply, possibly due to investor perception that it will underperform as the roll-out of vaccines will reduce COVID-19 testing. We think these views are misplaced, as the pandemic is far from over and significant testing will be required for some time. Indeed, it is possible that the so-called long COVID-19 phenomenon will provide a higher growth trajectory for pathology testings over the long term on top of the ageing population in a post COVID-19 world.

Below we provide summaries of two income generating companies we invested in for the Fund: Transurban (TCL) and Arena REIT (ARF). Both ideas have been in the portfolio since inception.

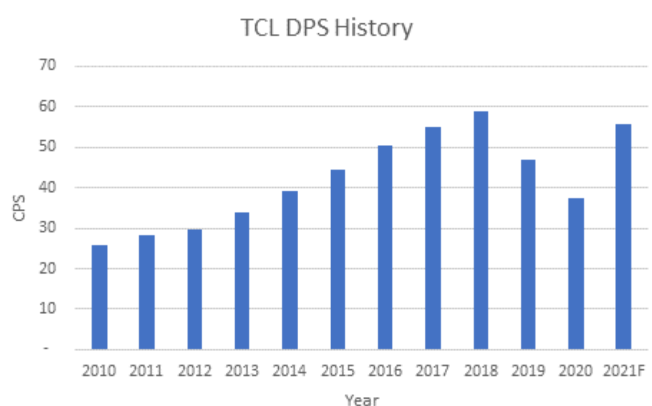
Why we like TCL and ARF

Listed in March 1996 as a stapled security, Transurban Group (ASX: TCL) manages and develops urban toll road networks in Australia, the United States and Canada. It operates toll roads in Sydney, Melbourne and Brisbane, the Greater Washington area of Virginia in the United States (although these have recently been sold) and in Montreal Canada. Its principal Australian assets are the Melbourne CityLink (100%), the Sydney M2 motorway (100%) and the Brisbane Gateway and Logan motorways (62.5%).

Before the pandemic, TCL derived the biggest chunk of its profits from CityLink (a 22Km Melbourne toll road that connects the city's airport with the CBD with an average daily traffic volume of ~850K). This road, along with other major toll roads closest to business districts, has taken a hit due to the pandemic, hence the drop off in the distribution for calendar year 2020. Other roads similarly affected include the Eastern distributor (the road near Sydney's CBD which drivers use to get to Sydney airport), the Lane Cove tunnel near the North Sydney business district, and in Brisbane the toll roads Legacy Way and Airport Link. In comparison, traffic on TCL's outer suburban roads such as Sydney's M7 and M5 held up better. It is also now earning income from its new 9km tunnel NorthConnex, which opened in Sydney at the end of October 2020, and which connects the M1 Pacific motorway with the Hills M2 motorway in Sydney's northern suburbs.

On a positive note, there could be potential traffic tailwinds from a structural diversion from public transport as Work From Home trends translate to an increase in preference for private vehicles. Furthermore, via toll escalations (CPI linked annual toll rises) and heavy vehicle recovery (trucks are charged 3 times as much as cars), the stock is well positioned relative to other utility bond proxy-type stocks, as future cashflows increase in line with inflation. Furthermore, increased workplace flexibility may ease congestion on TCL toll roads leading to a better customer value proposition and in turn increase patronage.

TCL now has around 234kW of solar energy generation capacity that is used directly onsite. The majority of their energy needs are supplied by electricity purchasing, and Transurban has thrown its support behind clean energy by entering into Power Purchase Agreements with renewable energy developers in New South Wales and Queensland with a target of all Sydney roads to have 80% of their power needs met by renewable energy from wind generation by 2021, and Brisbane roads to achieve that target by 2022. The company is also working to halve their emissions by 2030 and actively reduce the emission intensity in their supply chain.



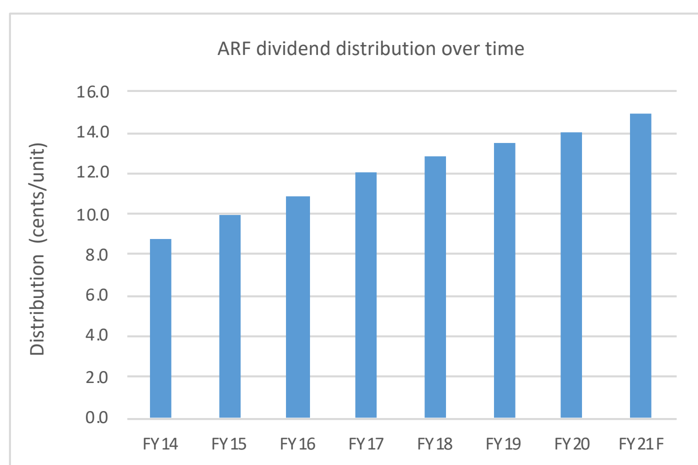
Source: Clime and IRESS

Arena REIT (ASX: ARF) is an ASX300 listed property group that owns, manages, and develops social infrastructure properties across Australia. Arena REIT's investment strategy is to invest in sectors such as childcare, healthcare, education and government tenanted facilities leased on a long-term basis with the objective to generate an attractive and predictable distribution to investors, and with earnings growth prospects over the medium to long term. As an active property manager, ARF focus on enhancing portfolio quality and mitigating risk.

ARF have an experienced team with a solid track record in the identification of development opportunities, management of project risk and completion of quality projects, as well as success in the management of unlisted funds that invest in the healthcare property sector.

As an owner and developer of social infrastructure properties, Arena play an important role within society, since the underlying assets contribute to increased levels of community access, inclusion, and wellbeing.

Below is the dividend payment history for ARF since FY2014. ARF has been a consistent income generator, and has increased its dividend year on year since listing in June 2013, resulting in a compounded annual dividend growth of more than 6% over the past 5 years.



Source: Clime and IRESS

In summary, these stocks have unique and attractive properties:

- Consistent and predictable yield of 4.0% to 5.0% and/or growing dividends year on year,
- Offer a resilient or essential product or service for the community as a "for profit" organisation,
- A responsible corporate citizen that also cares about the community and the sustainability of the environment in which they operate.

Outlook

As we move into second quarter of 2021, there are reasons to be optimistic about the Australian economy. However, stronger growth may result in higher inflation. Whether or not inflation is returning has been one of the most debated topics in financial markets over the last few months. As expected, we are seeing pricing pressures on food, energy and commodities as economies re-open following lockdowns. Yet despite these trends, absolute core inflation levels remain generally subdued.

Some further inflationary pressures are expected in coming months (on base effects), however the problem is less a short-term rebound of inflation, but the possibility of change in the inflation paradigm ahead. In other words, are we heading towards a prolonged period of higher inflation? The "return of inflation" narrative is gaining traction, propelled by the $1.9 trillion US fiscal package as well as anticipated multi-trillion dollar infrastructure programs and the recovery in demand expected as vaccination programs accelerate.

While there is a great deal of uncertainty, an important factor is the labour market, which we do not see fully recovering to pre-crisis levels for at least another year if not longer. There are divergences, in terms of unemployment in different sectors and industries and across markets, but our view is that the labour market recovery will be uneven and take some prolonged time, thereby dampening down inflation pressures at least in 2021 and most of 2022.

Against this backdrop, and as the reflation trade continues, investors should favour equities and property over cash and bonds. Investors should monitor the impact of inflation on interest rates and corporate earnings. Selection in equities is increasingly important, and the focus should be on sound businesses with a preference for quality and value. As we have been increasing the Fund's equities asset class over the past 2-3 quarters, we are now approaching the higher end of the equity asset class target range. We are nevertheless still relatively confident of the equity market in the near term.

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.

In March quarter 2021, we distributed 0.6264 cents/unit, thus providing an income yield of 2.8% for the last 12-months. We aim to achieve a modest capital growth of 2% to 3% pa to supplement the income yield over the long term.

Finally, we thank you for your ongoing support.

Sincerely,
Vincent Chin, Portfolio Manager - Multi-Asset Income Strategies

Market Commentary

We have reported with growing confidence of a return to strong growth following the pandemic recession, supported by extraordinary fiscal and monetary programs on a global scale. This has been borne out by both economic data and the performance of financial markets over the first three months of the calendar year. A corollary of this reflation narrative has been the surge in yields of government bonds as economic growth accelerates and normalisation approaches.

The bond market has been in a strong bull trend for 40 years, driven by factors including low inflation, globalisation, technology, demographics, monetary and fiscal policy, commodity prices and "secular stagnation". It now appears that this four-decade trend may finally be ending. Growing economic optimism and increasing inflation expectations are reducing demand for government bonds at a time when the supply of bonds is rising as governments borrow more. The unwinding of the extreme valuation distortions in US and G7 government bond markets due to QE programs has probably only just begun and will likely be an ongoing investment theme for years to come.

Nevertheless, at present the cost of capital remains historically low and is unlikely to derail the recovery in the global economy (or corporate profits) over the next year or two. Therefore, investors are encouraged to maintain a pro-growth bias in portfolios, but favour equities that are less vulnerable to a rising bond yield environment. And prudent investors should ensure that all bond exposures in portfolios are carefully monitored and limited to an appropriate weighting.

Supporting the current favourable environment for risk assets, the US Federal Reserve reiterated its dovish policy of ultra-easy monetary conditions, while noting that a full economic recovery still remained distant. The Fed stated that no rate changes were planned until 2023 at the earliest, and that bonds and mortgage-backed securities would continue to be purchased until further notice.

Fed officials sharply upgraded their US growth forecasts due to the massive fiscal stimulus passed by the Biden administration and an accelerating vaccine rollout. The upgrades to the forecasts were significant: whereas in December they predicted 4.2% GDP growth this year for the US, that estimate was increased to 6.5%, which would be the fastest economic expansion since 1984.

Of course, risks remain in markets which have rallied sharply since the emergence of covid vaccines in early November last year. Nevertheless, with ultra-easy monetary conditions and massive fiscal support in the world's largest economy, the road towards rising asset prices appears to be the path of least resistance.

Whether or not inflation is returning has been one of the most debated topics in financial markets over the last few months. As expected, we are seeing pricing pressures on food, energy, and commodities as economies re-open following lockdowns. Yet despite these trends, absolute core inflation levels remain generally subdued.

Some further inflationary pressures are expected in coming months (on base effects); however, the problem is less a short-term rebound of inflation, but the possibility of change in the inflation paradigm ahead. In other words, are we heading towards a prolonged period of higher inflation? The "return of inflation" narrative is gaining traction, propelled by the $1.9 trillion US fiscal package as well as anticipated multi-trillion dollar infrastructure programs and the recovery in demand expected as vaccination programs accelerate.

While there is a great deal of uncertainty, an important factor is the labour market, which we do not see fully recovering to pre-crisis levels for at least another year if not longer. There are divergences, in terms of unemployment in different sectors and industries and across markets, but our view is that the labour market recovery will be uneven and take some time, thereby dampening inflation pressures at least in 2021 and for most of 2022.

Against this backdrop, our key convictions are that as the reflation trade continues, investors should favour equities and property to cash and bonds. Investors should monitor the impact of inflation on interest rates and corporate earnings. As there is a rising consensus on cyclical securities with the reopening of economies, selection in equities is increasingly relevant. The focus should be on sound businesses with a preference for quality and value.

Markets are looking beyond the near-term headwinds of Covid-19 and a sluggish vaccine rollout across some countries in Europe and in Australia. Positive sentiment has been driven by hopes of continued policy support combined with an increasingly clear path to reopening. Substantial fiscal stimulus, progress on the vaccination front, and strong corporate earnings make economic rebound, profit recovery and reflation the main themes in the near term.

Investors should rely on fundamental analysis and process discipline to unearth businesses with sustainable income streams and sound balance sheets. We are constructive on cyclical sectors (such as materials) as they gradually price in the economic recovery. From a sector perspective, a steeper yield curve should support financials, and this marks a switch from 2020, when yields were very low and asset write-offs expected. Importantly, investors should explore sectors where recovery is not yet priced-in by the market. Overall, while many uncertainties persist and market volatility is anticipated, we remain cautiously optimistic that the favourable environment for risk assets such as equities and property should endure for the rest of the calendar year.

Adrian Ezquerro
Head of Investments

Fund Information

Investment Objective

The Fund's objective is to provide regular income in the form of quarterly cash distributions, and it aims to achieve a return of the RBA cash rate + 3.0% pa. It seeks to deliver strong risk-adjusted total returns 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 of its unit price) is 4.0% ± 1.0%, a relative risk measure of less than 40% of the S&P/ASX 200 Index. In order to maximize the chances of achieving these objectives, the recommended investment time frame is at least 3 to 5 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 has been with Clime for more than 12 years of his 22-year in financial services spanning both Fixed Income and Equities. Due to client demand, he established a goals-based investment style using quantitative analysis with qualitative top-down process which is utilised in the Clime Income strategies. Vincent is passionate about sustainable ethical investing which forms part of his investment philosophy. Prior to working in financial services, Vincent worked as a scientist specialising in infrared and photovoltaic solar cells. In this time Vincent produced about 50 internationally peer reviewed scientific and technical papers. Vincent holds a PhD in Physics from the University of New South Wales.

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**	Daily Unit Pricing Applications and Redemptions
Benchmark	3% p.a. above RBA cash rate	**Fees**	Retail: 1.13% p.a. management fee Wholesale: 1.03% p.a. management fee
Number of Positions	60-80	**Admin**	Mainstream Fund Services Pty Ltd
Fund Size	$43.6m	**APIR Code**	Retail: SLT1239AU Wholesale: CLA0002AU
Platform Availablity	Netwealth, HUB24, OneVue, Praemium & Wealth Portal		

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