Clime Australian Income Fund

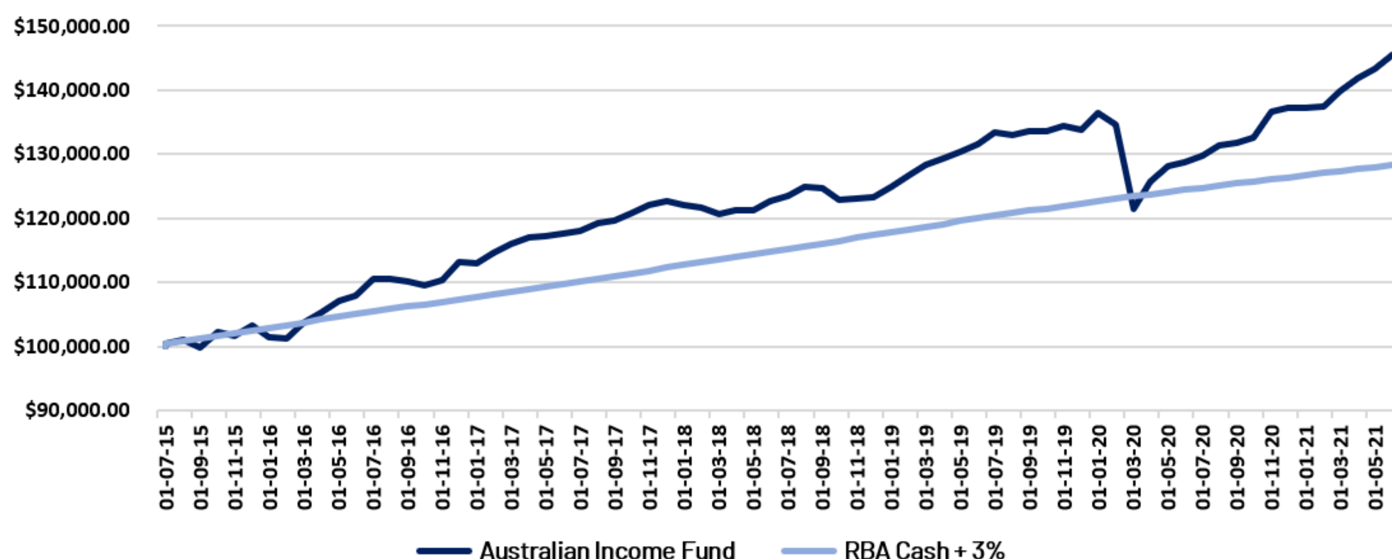
Quarterly Fund Performance | June 2021

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
1.8%	13.3%	6.5%	$46.3m



	1 month	3 months	6 months	1 year	3 years (pa)	5 years (pa)	Since Inception (pa)*
Net Portfolio Return (Wholesale)**	1.8%	4.3%	6.3%	13.3%	6.0%	6.2%	6.5%
Capital Growth	-	-	-	10.4%	2.6%	2.6%	2.8%
Income	-	-	-	2.6%	3.3%	3.5%	3.5%
Franking	-	-	-	0.1%	0.2%	0.2%	0.2%

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.

Fund Facts

Portfolio Manager	Dr Vincent Chin
Fund Inception	1 July 2015
Fund Size	$46.3m
Cash Distributions	Quarterly

Top 5 Holdings

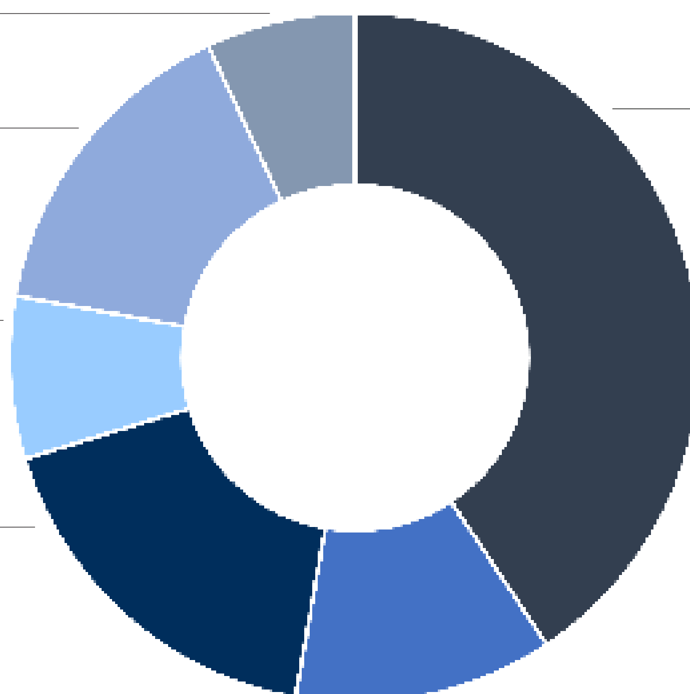
Security	Weight%
Telstra Corporation	2.3%
Spark Infrastructure Group	2.1%
Growth Point Property	2.0%
Iress Limited	1.9%
Charter Hall Social Infrastructure Trust	1.8%

Distributions

Period Ending	Wholesale Units (cents)*
30 June 2021	**1.5544 +0.1700 franking credits**
31 March 2021	0.6265
31 December 2020	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.

Financial year 2021 has ended on a high note for risk assets (equities and property) which significantly outperformed low risk assets (cash and government bonds). Whilst equity returns are immediately calculated from closing share prices and indices at 30 June, in coming weeks we expect revaluations of quality property as capitalisation rates ("cap rates") decline. The cap rate declines are a belated and predictable result of historically low bound yields.

Markets are currently dominated by a consensus based on three core hypotheses: durable high global growth; transitory inflation; and market-friendly central banks. Following the Pandemic Recession and the V-shaped recovery, growth over the next 12 months will be robust in the biggest economic regions in the world - China, the EU and the US - and this will serve Australia's economy well.

Australian 10 year bond yields stabilised in the range of 1.50% to 1.70% in the June quarter, hovering at the low of 1.53% at 30 June 2021. We saw a very strong equity market for the June quarter, with the ASX200 accumulation index rising 8.3% (this on top of the 4.3% increase in the March quarter 2021). During the quarter, telcos, technology, healthcare and A-REITs outperformed while energy, utilities and food retailing underperformed.

At a high level, the Fund will continue its investment strategy of maintaining low cash levels in the range of 5% to 10%, a strategy we adopted in July 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.

During the quarter, we observed more debate around the inflationary pressures due to bottlenecks in global supply chains. The widespread conviction that the current rise in inflation will be transitory remains something of an open question, however. Inflation, while transitory, cannot dissipate until supply chain and other post-pandemic disruptions resolve themselves. Nevertheless, we lean towards the consensus being correct, and that inflation worries will diminish with time.

At close to 7% cash, the Fund is essentially fully invested. We have been gradually stepping away from long duration fixed rate bonds and maintain an average duration of less than 4 years in the portfolio (since early this year). In the equity asset classes, we continue to seek out high quality and selective A-REIT securities that offer consistent and predicable income. As the market cycle matures, we expect that the growth to cyclical rotation will taper and may even revert somewhat. Based on this prognosis, we are in the process of tilting the portfolio to be more defensive, preferring financials including selective REITs, consumer staples and healthcare with predictable and / or growing income streams.

Perfomance and Volatility of Return

	Portfolio Return**	Income	Capital Growth	Franking
1 month	1.8%	-	-	-
3 months	4.3%	-	-	-
6 months	6.3%	-	-	-
1 year	13.3%	2.6%	10.4%	0.1%
3 years (pa)	6.0%	3.3%	2.6%	0.2%
5 years (pa)	6.2%	3.5%	2.6%	0.2%
Since Inception (pa)*	6.5%	3.6%	2.9%	0.2%

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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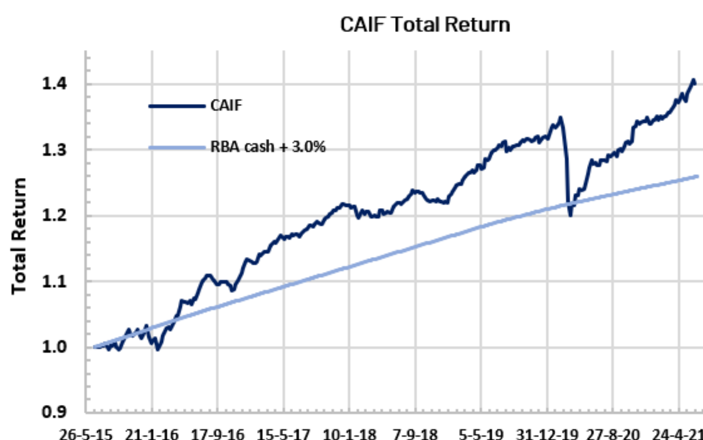
30 June 2021 marks the 6th year of the Fund and the total return over this period was 6.5%. This was achieved with an absolute risk (annualised volatility) of 4.6% and a relative risk of 31.3% compared to the ASX200 index. Over the past 12 months to 30 June 2021, the Fund's 12 month return was 13.3% with an annualised volatility of 3.5%. Please refer to the table below for other time periods and for more information.

Figure 1 shows the total return on a cumulative return basis, compared with the RBA cash rate + 3.0% pa return objective since inception.

	Volatility^			
30/06/2021	CAIF	ASX200	Ratio of CAIF/ ASX200	Sharpe Ratio^^
1 year	3.5%	11.6%	30.3%	4.4
2 year	6.4%	18.7%	34.1%	0.6
3 year	5.4%	16.5%	33.1%	0.7
4 year	4.9%	14.8%	32.9%	0.7
5 year	4.6%	14.4%	31.8%	0.9
Since Inception	4.6%	14.6%	31.3%	0.9

^Volatility is the annualised standard deviation of the NAV/unit as measured on a weekly basis.
^^Sharpe Ratio is calculated on a monthly basis.



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%. During the June quarter, the following actions were taken:

<u>Fixed Income Asset Classes</u>

We participated in the following fixed income issues:

- Victoria Power Network 5y Senior Floating Rate Notes (FRN),
- MyState Limited 4y senior FRN,
- Wesfarmers Limited 7y Senior Sustainable linked bond,
- Subordinated T2 debts of Auswide Bank, BoQ and Macquarie Bank,
- Centuria Capital 4.25% + BBSW90 and Peet Limited 4.85%+BBSW90 high yield (HY) senior debt papers. Both of these are 5y terms while the former has the added benefit of being a senior secured bond.

All the debt papers were in huge demand and we had our allocations scaled back substantially. The Wesfarmers Sustainable linked bond is the third Sustainable / Green bond the Fund has invested in over the past couple of years. We continue to search for these opportunities as we ramp up our focus on sustainable / responsible investing in the Fund.

We also participated in the CBA and ANZ capital notes, PERL XIII and ANZ CN6 respectively. The latter will be listed in early July 2021.

To fund some of these purchases, we exited:

- Bendigo & Adelaide Bank 3y Senior FRN,
- Sunland 6.1% fixed rate HY bond,
- Centuria Capital 6.5% fixed rate HY Senior bond,
- Maurice Blackburn 7.45% fixed rate HY bond.

The latter two HY bonds were redeemed early by the issuer for which the Fund received additional payments.

<u>Equity Asset Classes</u>

In the equity asset classes, we increased or participated in:

- Centuria Capital CNI via a sell down from a majority holder
- The full 1 for 6.6 entitlement of MyState (MYS) and additional shares from an institutional placement,
- Primewest Agriculture REIT #1 offering 7.25% yield.

We funded some of these purchases by reducing our positions slightly in the GPT Group (GPT), Westpac Corporation (WBC) and Arena REIT (ARF) as they ran hard during the June quarter. Following a review, we reduced holdings in Transurban Group (TCL) due to concerns with their social responsibility practices and our macro view on interest rates.

During the quarter, one of the REITs in the portfolio, Australian Unity Healthcare REIT, received a takeover offer from Canadian Northwest with the latest offer at $2.70. This offer was rejected by the manager, Australian Unity, which cited that it undervalues the long term growth potential of the assets. Whilst we are disappointed with the manager opting not to engage with Northwest, we agree that the long term growth prospects of specialised healthcare REITs is strong.

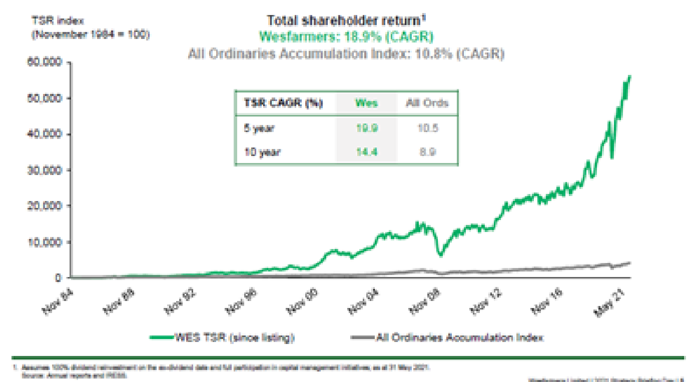
Below we provide summaries of two income generating stocks in which we invested for the Fund: Wesfarmers Limited (WES) and Sonic Healthcare Limited (SHL). While WES has been in the portfolio since inception, SHL was a relatively new addition in 2020.

Why we like Wesfarmers and Sonic Healthcare

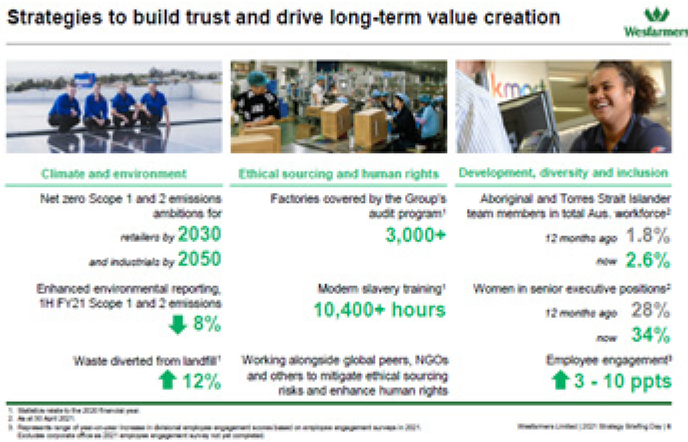
WES is a high quality retailer encompassing household names such as Bunnings, Kmart and Officeworks, which operate across a variety of segments including home improvement, discount department stores, office supplies, chemicals, fertilisers, groceries, industrial and safety. It has been one of the major beneficiaries of the change in lifestyle enforced on the community because of the pandemic. As a result of locked borders and the fact that people have spent more time at home with increased savings, demand for do-it-yourself projects around the house have been brought forward which has directly benefited Wesfarmers' bottom line. Bunnings accounts for 50% of WES revenue, contributing ~ 62% of EBIT.

The company has proven its resilience with a diversified revenue base translating into high operating cashflows, a low annual stock price volatility, a high dividend payout ratio above 85% and a fully franked dividend yield north of 3.1%, attributes that are especially appealing to the equity sleeve of the Fund. This is shown by the chart below, where the total return of WES consistently beat that of the Australian equity index over the long term.

Superior long-term financial performance

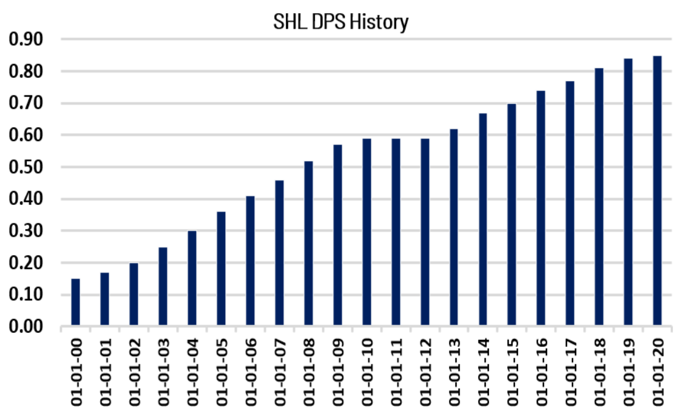


WES has a strong emphasis on and commitment to ESG. This was shown in the latest update in their investor strategy day in early June.



SHL is a healthcare company. It provides medical diagnostic services, and administrative services and facilities to medical practitioners. Its major operations are in laboratory medicine/pathology and radiology/diagnostic imaging services to clinicians, hospitals, community health services, and their patients. The company operates 233 primary care clinics and is the largest pathology provider in Australia with state-of-the-art laboratories and an extensive network of collection centres. It is also the largest player in the UK, Germany and Switzerland and has enlarged its US offering with further acquisitions. Pathology accounts for the majority share ~86% of SHL revenue, followed by Imaging ~10%. The company is expecting a sizeable revenue and EBIT uplift for FY21 driven by high margin COVID-19 testing in the order of +22% revenue and +60% to +90% in EBIT.

Like WES, SHL is an ASX50 company ranked #23 by market capitalization. It has exhibited good price stability and a stable dividend yield of ~3-3.5% with DPS having consistently grown over the past 20 years at a CAGR of 9.1% as shown in the chart below.



Source: IRESS and Clime Asset Management

Sonic Healthcare is committed to operating in a sustainable, ethical and responsible way across all facets of their operations—medical, financial, organisational, social and environmental. They have a variety of programs and policies that operate locally and globally, aimed at fostering a sustainable working environment for their staff, suppliers, customers and communities. This is clearly shown by the following milestones from their 2020 corporate responsibility report:

Source: SHL's Corporate Responsibilities Report 2020.

In summary, these stocks have unique and attractive properties:

- Consistent and predictable grossed up yield (including franking) of ~4.00% or more 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 FY22, we expect the following:

- The yield curve is likely to flatten further as the market anticipates interest rate hikes at the shorter end sooner due to stronger growth,
- Inflation pressures due to the supposedly transitional price effects may last longer than expectations, causing more concerns and debate amongst investors and central banks,
- Potential new variants of COVID-19 likely to disrupt parts of the world, and thus the global economy. The recent outbreak in NSW of the more serious Delta variant and other smaller outbreaks is a reminder that COVID-19 is far from over,
- The growth to cyclical rotation in the equity market is likely to taper off and at some point, it may even revert somewhat if inflation turns out to be relative benign,
- The equity market is likely to rally further and then reach a plateau while it waits for the real economy to catch up. This may create some selling pressure in the market if it runs too hard in the interim.

Given the yield curve is flattening and the market anticipating rate hikes sooner rather than later, we expect volatility in the equity market is likely to increase. As we anticipate the long end of the curve to trade around 1.50% to 1.80% in the near term, this range is still relatively positive for equity and REITs in general.

We maintain our focus on high quality with a value discipline, and relative price stability with stable or growing income generation.

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 June quarter 2021, we distributed 1.5544 cents/unit, thus providing an income yield of 2.6% 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.

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
Platform Availablity	Netwealth, HUB24, OneVue, Praemium & Wealth Portal	**APIR Code**	Retail: SLT1239AU Wholesale: CLA0002AU

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