Antares Diversified Fixed Income Fund

Monthly Investment Report
December 2020

Fund Performance

Period Ended 31/12/2020	1 Mth %	3 Mths %	1 Yr %	Since Inception %pa[1]
Composite Portfolio	-0.05	0.78	5.61	4.12
Bloomberg AusBond Composite Bond Index	-0.27	-0.10	4.48	3.36
Difference	0.22	0.88	1.13	0.76

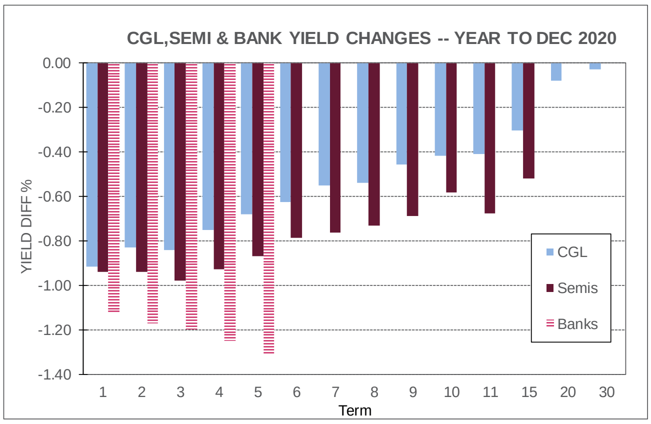
Valuation at month end was $409,279,243.30
Composite Portfolio returns are expressed after investment management fees and before taxes
The difference in returns between the Fund and the benchmark may be out due to rounding
1. Since Inception of the new fund was 09/07/2019

Portfolio Review

Key Drivers of Portfolio Performance:

- Credit spreads were mixed for the month with the vaccine driven "reflation" credits such as cyclicals, airports and office rallying 10-20bps adding 11bps.
- In contrast, COVID defensives such as supermarkets, industrial property and infrastructure had a moderate spread compression of 2-7bps, adding 1.5bps.
- Banks widened 1-3bps, detracting 1bp.
  Bank sub debt tightened 8-15bps adding 5.5bps.
- Bought CDS protection on iTraxx and major banks together detracting 1.5bps.
- Semis tightened 3bps and supras widened 3bps, collectively adding 4.5bps.
- A flattening yield curve position detracted 3bps as the yield curve steepened from 2-30yrs.
- A short duration position added 2.5bps.
- Yield enhancement and rolldown of quality investment grade bond holdings added 5.7bps.

The chart below shows the significant fall in yields for 2020. Shorter government and semi bonds out to 5 years fell 60-100bps, driven by the RBA's YCC and QE. Major banks fell an extra 20-50bps as their funding costs fell to 30bps and then 10bps via funding through the term funding facility (TFF).



Portfolio Activity and Positioning

- We continued our strategy of buying Semis funded by selling major banks, taking advantage of the more attractive carry and rolldown:
  - Bought TCV 2028
  - Bought TCV 2032
- Took advantage of new issues in universities and non-financial corporates.
- Bought Western Sydney University 2027 and University of Wollongong 2028.
- Bought NBN 2030.
- Bought Goodman Industrial 2028
- We have maintained the liquid structure of the Fund.

Key Characteristics at 31/12/2020

	Fund	Benchmark
Interest Rate Duration (yrs)	5.90	6.13
Running Yield + Rolldown (%)	1.37	0.68
Credit Spread Duration** (yrs)	4.42	2.15
Average Credit Rating	A+	AA+
Liquidity*	43%	100%

* Liquidity deemed available within 24 hours; includes Government and Semi Government bond holdings.
** Includes credit spread duration from Semi Government bonds.

Excess Return Attribution

Description	BP's
Duration	+2.8
Curve	-1.0
Sector	+19.5
Yield Enhancement	+3.7
Investment Manager Fees	-2.8
Total Excess Return	+22.2

Sector Exposures

Sector	Interest Rate MDC	Credit Spread MDC	MV%
Cash	0.00	0.00	0.5
Govt Nominal	0.62	0.00	3.0
Semi-Gov Nom	2.57	2.57	30.7
Supra/Agencies	0.00	0.00	0.0
Corp Fin Fixed	0.08	0.08	2.6
Corp Fin FRN	0.03	0.76	20.4
Corp Others Fixed	1.41	1.41	27.0
Corp Others FRN	0.00	0.01	0.5
Covered Bonds	0.00	0.00	0.0
Derivatives Interest Rate	1.19	0.00	0.1
Derivatives CDS	-0.01	-0.55	-0.4
RMBS	0.00	0.14	6.4
Money Market	0.00	0.00	9.3
Total	5.89	4.42	100.0

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Market Outlook

With the Democrats winning control of the Senate, Joe Biden has more leeway to implement his spending initiatives. We can expect greater policy support for labor relative to capital and in a post-Trump world, less partisan gridlock; at least in the next two years, before the 2022 mid-term elections. Markets have responded to this "mini-blue wave" by buying the "reflation trade" through equities and widening real yields and break-even inflation rates through bond sales.

The Democrat's wafer-thin margin in the Senate should act as a break on implementing all of the Democrat's more "progressive" policies such as "Medicare for all" and the "Green New Deal".

Moderates in both parties could coalesce in a "moderate centre" which could lead to more bipartisan support for key initiatives.

Joe Manchin, Democrat senator from West Virginia, has a long record of being prepared to cross the floor on specific issues. And there are other moderate Democrats who would back him. This very threat could be an invaluable tool for Biden to focus on policy that could find bipartisan support. Over his 30 years in the senate, straddling the partisan divide has been one of Biden's key strengths.

The consensus is that a Biden administration will tone down geopolitical rhetoric, in the short term, while remaining firm on China policy.

With the reflation trade in full swing, a recent press conference conducted by US Federal Reserve Chairman Powell is worth noting:

> *"**The old model was [that] inflation would come along and the Fed would tighten, and we'd have a recession.** Now inflation has been low, and we haven't had that dynamic. And the result has been three of the four longest expansions in modern history, in recorded history…**We're thinking that this could be another long expansion, and…we're going to keep policy highly accommodative until the expansion is well down the tracks. And we're not going to pre-emptively raise rates until we see inflation actually reaching 2% and being on track to exceed 2%.** That's a very strong commitment."*
>
> *—Chairman Powell, December Press Conference*

A challenge for investors will be balancing their bullish reflation scenarios with a "lower for longer" Fed. If inflation rises above 2%, bond vigilantes may return from hibernation, inflicting some steep losses on bond portfolios. If the bear steepening continues as investors price in rising inflation, bond proxies and long duration equities (technology and growth) could fall steeply, creating alarm for investors and central banks alike.

Australia

The spate of COVID outbreaks during December and the ensuing lockdowns have dampened the buoyant pre-Christmas confidence. As a result, the federal government's plans to reduce/withdraw crisis fiscal support measures during the March 2021 quarter may be delayed. There is also a growing realisation that the country and all stakeholders may have to learn to live with the virus, even when vaccines are broadly available.

The expected growth pickup under a Biden administration augurs well for commodities and the strength in the AUD could continue. Hopefully the reestablishment of a democratic consensus, led by the US, will serve to reduce Australia's tensions with China.

Strategy

Our strategy continues to focus on three key objectives:

1. Optimising yield through carry and rolldown, focusing on the inflection points on steep curves. With Yield Curve Control (YCC) depressing yields out to five years, the 7-10yr segment offers the best value.
2. Capital preservation by targeting credits with strong balance sheets and those issuers that are expected to show more resilience through the pandemic.
3. A strong level of liquidity that could be realised in stressed conditions.

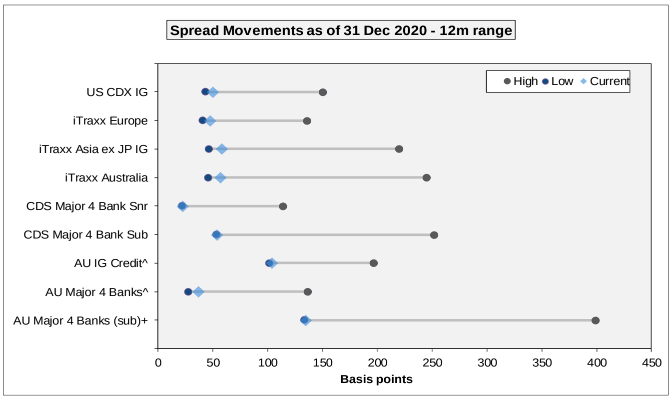
Duration/Yield Curve

The Democrats gaining control of the Senate has reignited the bear steepening pressure as markets anticipate an earlier economic recovery with some latent inflation risks.

Our scenario analysis points to a steeper yield curve, driven by weakness in 10-30yrs. We are adopting an underweight position in longer bonds which implies a curve steepening strategy. We still see 7-10yr semis as attractive, notwithstanding the fact that their spreads to government bonds have tightened considerably. In many cases the expected annual rolldown exceeds the running yield.

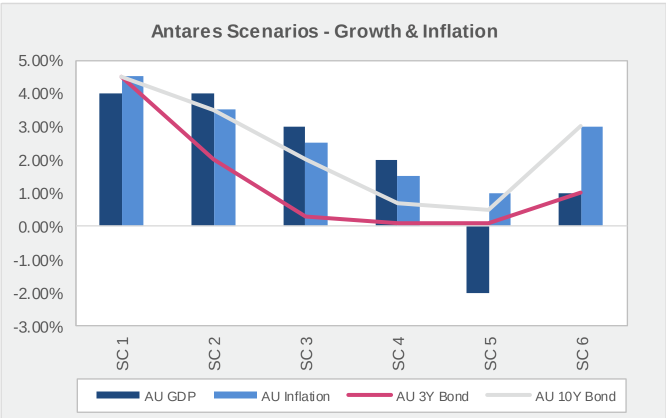
Credit

The strong rally in COVID-impacted cyclicals has seen Australian corporate investment grade spreads trading at 12-month lows, as reflected in the chart below. Notwithstanding the recent strong outperformance of semis and major bank sub debt versus senior unsecured bonds, we still see attractive switching opportunities into semis and sub debt, primarily due to more attractive carry and rolldown.



Antares Fixed Income Fair Value Assessment

The Antares Scenarios graph reflects the interplay between growth, inflation and bond yields, and how they will drive the level and shape of yield curves in the different scenarios.



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The Democrats' control of all three houses and the expected front-loaded fiscal spending have further increased Antares' weighting to the higher growth/higher inflation Scenarios 3 & 2. This has increased the probability weighted fair value yields of all bonds from 3 to 30 years by 5-30bp.
The rise in FV's has exceeded the rise in market yields, leaving bonds more expensive than a month ago.

For the quarter, the rise in bond FV's is significant, particularly AUS 30yrs (+90bp) and US10yrs (+65bp). This has been developing in stages over the quarter; Initially the Democrats winning the election, then the vaccine breakthroughs and finally the Democrats controlling the Senate.

The table below provides a summary of the respective fair values and comparisons to current market pricing and changes over the quarter:

Instrument	FairValue (FV)*	Fair Value (FV) Range ^ Range ^	Fair Value (FV) change for quarter	Market Price	Market price change for quarter	FV – Market Price (+)/cheap (-) /expensive
Cash (6mth forward)	0.12%	0.10 - 0.15%	-0.08%	0.04%	-0.03%	-0.08%
3YB	0.30%	0.20– 0.40%	-0.05%	0.19%	+0.01%	-0.11%
10YB	1.35%	1.10 – 1.60%	+0.40%	1.12%	+0.27%	-0.23%
30YB	2.60%	2.40 – 2.80%	+0.90%	2.15%	+0.35%	-0.45%
3/10 Spread	1.05%	0.90 – 1.20%	+0.45%	0.93%	+0.25%	-0.12
iTraxx (forward contract*)	85	70 - 100	-10	60+10	-5	-15
US 10YR	1.40%	1.30 – 1.50%	+0.65%	1.10%	+0.30%	-0.30%

*Antares current Fair Value (FV) based on current probability weighting.
^Antares assessment of the broad range of Fair Values across all of Antares' scenarios.

Market Movements

1. Equity markets had another strong month with the ASX200 up 1.1% while the S&P500 was up 3.7% for the month.
2. AUS bonds bear steepened over the month with 3yr yields falling 1bp to 0.17% and 10yr yields rising 7bps to 1.02%. The 3-10 curve steepened 9bps to 0.85%. US 10yr Treasury yields rose 7bps to 0.91%
3. BBSW rates continue to hit record lows with BBSW3m down 1bp at 0.01%, while BBSW6m fell 0.4bps to close the month at 0.02%.
4. Credit spreads continued to compress in December with the S&P downgrade of NSWTC and TCV causing spreads to widen in semis. AUS iTraxx tightened 3.5bps over the month to close at 56bps.

Australian Rates	December 2020	Month Change	1 Yr Change
RBA Cash Rate	0.100	0.00	-0.65
90 Day Bank Bill	0.010	-0.01	-0.91
3 Yr Futures	99.830	0.00	0.75
10 Yr Futures	98.980	-0.13	0.37
3/10 Spread (bps)	85.000	12.50	38.00
iTraxx Australia 5Y	57.256	-2.11	10.59
10Yr BEI	1.768	0.22	0.36

Australian Economic Data	Latest Monthly Print	Month Change	1 Yr Change
Employment Change (k)	90.0	-90.4	59.2
Unemployment Rate (%)	6.8%	0.0	1.7%
Retail Sales (MoM%)	7.0%	5.6%	7.8%
Trade Balance Value (m)	5022.0	-1561.0	-110.0
Building Approvals (MoM%)	2.6%	-0.7%	-3.7%
Consumer Confidence (Westpac)	112.0	4.4	16.9
Business Confidence (NAB)	12.4	9.2	17.4
Business Conditions (NAB)	8.8	6.8	5.2

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Global Sovereign Rates	December 2020	Month Change	1 Yr Change
Fed Fund Rates	0.09	0.00	-1.46
ECB Main Refi Rate	0.00	0.00	0.00
US Sovereign 2 Yr	0.12	-0.03	-1.45
US Sovereign 10 Yr	0.91	0.07	-1.00
Japan Sovereign 10 Yr	0.02	-0.01	0.03
German Sovereign 10 Yr	-0.57	0.00	-0.38

Currencies	December 2020	Month Change	1 Yr Change
AUD/USD	0.769	0.035	0.067
EUR/USD	1.222	0.029	0.100
USD/JPY	103.250	-1.060	-5.360

Equities	December 2020	Month Change	1 Yr Change
ASX200	6587	1.1%	-1.5%
S&P500	3756	3.7%	16.3%

Commodities	December 2020	Month Change	1 Yr Change
WTI Crude	48.5	3.0	-7.1
Gold	1898.4	121.4	381.1

Australian Economic Data	Latest Quarterly (Q3)	Quarterly Change	1 Yr Change
Private Capital Expenditure (QoQ%)	-3.0%	3.4%	0.0%
GDP (YoY%)	-3.8%	2.6%	-6.0%
Inflation (YoY%)	0.70%	1.0%	-1.1%

Global Economic Data	Latest Monthly Print	Month Change	1 Yr Change
US Non-Farm Payrolls (k)	245	0	61
US Unemployment Rate (%)	6.7%	0.0%	3.2%
US Manufacturing ISM	60.7	3.2	12.9
US Non-manufacturing ISM	57.2	1.3	2.3
China Manufacturing PMI	51.9	-0.2	1.7
China Non-Manufacturing PMI	55.7	-0.7	2.2
German Factory Orders (MoM%)	2.3%	-1.0%	3.6%
German Industrial Production (MoM%)	3.2%	0.0%	4.9%

Semis * vs Gov Bonds	December 2020	Month Change	1 Yr Change
3yr (bps)	6.3	-1.0	-22.2
7yr (bps)	13.7	-3.6	-34.1

* Semi calculation compromises an equal weighting of NSWTC and WATC

About Antares Fixed Income

Antares Fixed Income (Antares) is a specialist fixed interest manager covering a range of domestic and international securities. Antares has managed fixed interest and cash portfolios for investors since 1990 and currently has over A$26.4 billion* in funds under management across a range of cash management, fixed income and liability driven investment strategies. Antares is focused on delivering performance objectives for our clients within a carefully managed and defined risk framework.

*as at 30 June 2020

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