

EQT DIVERSIFIED FIXED INCOME FUND (INSTITUTIONAL CLASS)

PORTFOLIO OBJECTIVE

The Fund aims to provide investors with exposure to high-quality income-yielding investments. The Fund aims to outperform the benchmark over rolling three-year periods, after taking into account fees and expenses.

FUND PERFORMANCE

PERFORMANCE ¹	3 MONTHS	1 YEAR	3 YEARS (P.A.)	5 YEARS (P.A.)	SINCE INCEPTION (P.A.) ²
Total net return	-0.91%	3.36%	-2.27%	-0.86%	1.59%
Benchmark return ³	-0.84%	3.68%	-2.06%	-0.60%	2.08%
Active return	-0.07%	-0.31%	-0.21%	-0.26%	-0.49%

Table 1

Source: Equity Trustees as at 28/06/2024

¹ Performance: Total net return is the return after the deduction of ongoing fees and expenses. Results greater than one year are annualised.

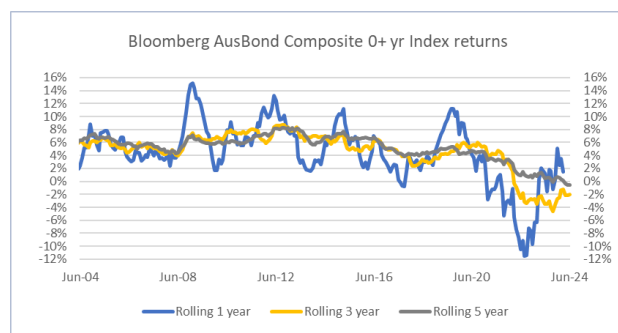
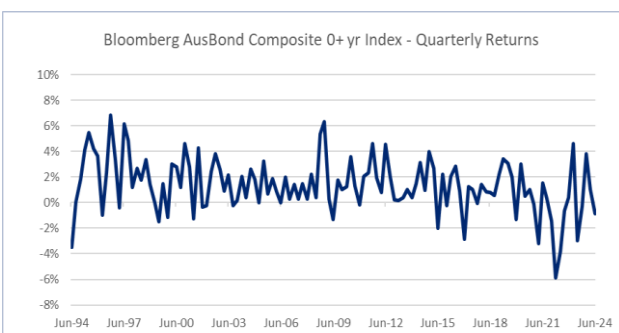
² Inception date is 14 October 2014.

³ Benchmark is the Bloomberg AusBond Composite 0+ Year Index.

Past performances should not be taken as an indicator of future performance.

PERFORMANCE SUMMARY

The Fund recorded a total net return of -0.91% for the June 2024 quarter, underperforming the Bloomberg AusBond Composite 0+ year Index. Over the last 12 months the Fund recorded a total net return of 3.36%, underperforming the Index by 32bps. The total net return since inception is 1.59% p.a., underperforming the benchmark over the same period.



Source: Bloomberg, Equity Trustees as at 28/06/2024



MARKET SUMMARY

In April, US inflation reads saw headline, core CPI and PCE measures all print higher than the market consensus, sending global yields higher. US labour market, wage and retail sales data also surprised to the upside, providing further support to the soft-landing narrative and resilience of the US consumer. Domestically, the Q1 CPI data was released which showed the RBA's preferred trimmed mean measure record a 4% year-on-year level, contributing to a further 10bp sell-off in bonds. By month-end local bond yields had risen around 50bps, resulting in a negative 2% monthly return for fixed income investors.

In May, US treasury yields drifted lower, supported by the Fed's decision to reduce the level of its scheduled treasury note sales program from US\$60b per month to US\$25b. Monthly inflation data also showed signs of easing, and the second read of US Q1 GDP came in slightly lower than expected. The RBA elected to leave the cash rate unchanged at 4.35% and struck a neutral tone in the post meeting press conference, which contributed to a small move lower in bond yields.

Bond markets built on the prior month's gains in June, with US data once again providing direction for global yields. ISM manufacturing data showed a contraction and monthly headline CPI flatlined, as did the core PPI measure. Monthly retail sales also disappointed, resulting in a net fall in bond yields over the month. A more hawkish sounding RBA, followed by a surprisingly high domestic monthly CPI print late in the month took some shine off the earlier fall in yields.

In summary, higher inflation and continued consumer resilience provided much of the impetus for the sharp bond market sell-off in April, setting the tone for the underwhelming quarterly performance.

In terms of market movements, the yield on the Australian 3-year generic bond opened the quarter at 3.62% and rose to 4.08%, as hopes for a 2024 rate cut faded with elevated core inflation. The yield on the 10-year generic bond opened at 3.96% and moved as high as 4.52% in April before easing slightly to close the quarter at 4.31%. The 3s/10s spread narrowed 11bps to 34bps.

With domestic bonds underperforming US counterparts, the spread between the Australian 10-year government bond and US 10-year treasury note rose by 15bps, to close the quarter at -9bps.

GLOBAL BOND MARKET MOVES

	MAR QUARTER	JUN QUARTER	MOVE	QUICK COMMENT
US 10-year note	4.20%	4.40%		Economic data supports higher for longer rates narrative
German 10-year bund	2.30%	2.50%		ECB eases monetary policy, long-end rates sell-off
UK 10-year gilt	3.93%	4.17%		BOE on hold, UK Gilts follow global sell-off
Japanese 10-year bond	0.71%	1.05%		BOJ relaxes bond purchases
Australian 3-year bond	3.62%	4.08%		Risk of further tightening as progress on CPI stalls
Australian 10-year bond	3.96%	4.31%		Long-dated bonds underperform global moves

Table 2
Source: Equity Trustees as at 28/06/2024



PORTFOLIO ACTIVITY AND ATTRIBUTION

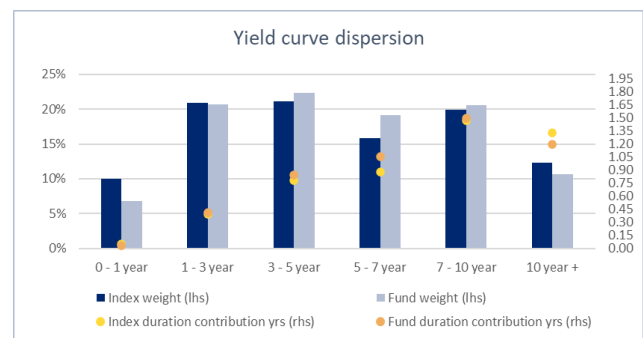
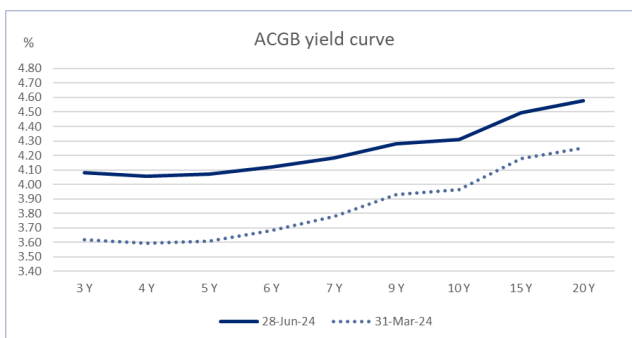
DURATION

We began the quarter with a neutral position and progressively added duration throughout April as yields moved higher. By the end of April, we held a quarter year long position which we maintained through May and into the early part of June. Following the RBA cash rate decision on 18 June, we moderated our long duration position to end the quarter 0.14 years longer than the benchmark.

YIELD CURVE

The AUD yield curve shifted higher over the reporting period, with shorter-dated rates rising more than longer-dated rates. Hawkish comments from the RBA and a high inflation print provided the catalyst for moves late in the quarter.

Our curve positioning detracted slightly from performance as we maintained a small overweight position around the 3–5-year part of the curve which saw an approximate 45bp rise in yields.



Source: Bloomberg, Equity Trustees as at 28/06/2024

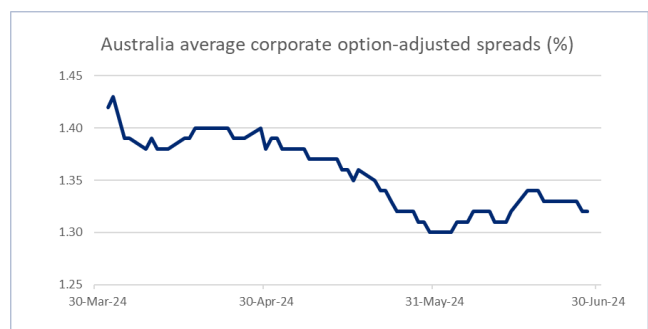
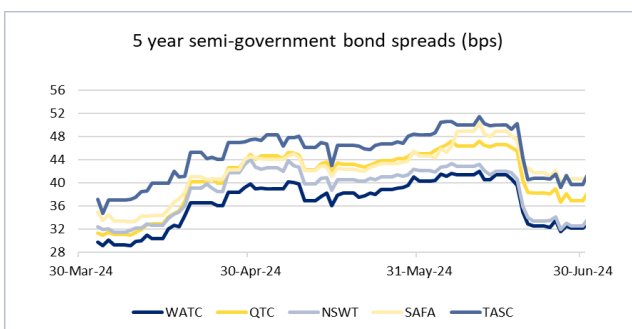
SECTOR ALLOCATION

Corporate bond spreads tightened through April and May but saw minor widening in June as political events in Europe (French election) contributed to mild global risk aversion.

Semi-government bond spreads also widened early in the quarter with State budgets continuing to forecast large borrowing programs. The spread widening throughout May (to 15-month highs) attracted buying interest from relative value investors and spreads narrowed into quarter end.

From a benchmark perspective, the credit component performed best, delivering a 0.23% return for the quarter, followed by supranational bonds at 0.04%. The longer duration components underperformed, with government bonds delivering -1.01% and semi-government bonds returning -1.21%.

Our sector allocations made a positive contribution to performance, mostly due to our higher allocation to short-dated (less than 18-months to maturity) corporate bonds.



Source: Bloomberg, Equity Trustees as at 28/06/2024



Sector allocation as of 28 June 2024

SECTORS	BENCHMARK		PORTFOLIO		DIFFERENCE
	BENCHMARK WEIGHTS	DURATION CONTRIBUTION	PORTFOLIO WEIGHTS	DURATION CONTRIBUTION	
Commonwealth Govt bonds	49.1%	2.58	33.7%	2.42	-0.16
State (semi) Govt bonds	31.6%	1.72	28.8%	1.62	-0.10
Supranational/sovereign/other	5.7%	0.18	6.6%	0.19	0.01
Corporate bonds	13.6%	0.42	29.1%	0.81	0.39
Cash and related	0%	0.00	1.8%	0.00	0.00
	100%	4.90	100%	5.09	0.14

Source: Bloomberg, Equity Trustees as at 28/06/2024

Note: Numbers taken from our Portfolio Management System may vary slightly from accounting or index reports. Numbers may not add precisely due to rounding.

GLOBAL OUTLOOK

United States

May employment data showed the US added 272,000 jobs against an expected increase of 180,000. The participation rate printed at 62.5%, while unemployment rate rose from 3.9% to 4% and average hourly earnings rose by 0.4% MoM, below the expected 0.3%.

The US ISM manufacturing index printed at 48.7 from 49.2 in May suggesting contraction in the manufacturing sector although the ISM services index increased sharply from 49.4 to 53.8. Factory orders (ex-transport) rose 0.7% in April, and durable goods orders increased by 0.1% in May. US Manufacturing PMI came in softer at 51.6, while the Services PMI increased to 55.3 in June.

Retail sales rose by a modest 0.1% in May against an expectation of 0.3%.

US headline inflation stood at 3.3% YoY in May and core CPI was running at 3.4%. The Fed's preferred Core PCE inflation measure printed at 2.6% YoY. The first read of Q1 GDP was 1.4%.

At the June meeting, the FOMC elected to keep policy rates unchanged, however changes to the Fed's 'Dot plot' saw rate cuts removed from the 2024 profile but added to 2025.

Current market pricing has 50bps of rate cuts by the end of the calendar year.

China

Economic data released during June was mixed. The Caixin manufacturing PMI Index improved from 51.7 to 51.8 and the Caixin services PMI Index fell from 54 to 51.2.

Industrial production was up 5.6% YoY in May. Fixed asset investment growth fell from 4.2% to 4.0%. Retail sales rose 4.1% YoY, slightly higher than the 3.9% expected.

The People's Bank of China maintained the medium-term lending facility rate at 2.50% as widely expected.

Europe

Elections in France and UK dominated headlines late in June, with the former leading to a small widening of credit spreads as uncertainty around the implications of a far-right government in France contributed to risk aversion in markets.

The ECB lowered the benchmark interest rate by 25bps at the June meeting as universally expected but struck a hawkish tone suggesting further rate cuts are not necessarily imminent.

PMI data suggest services sector activity rose in June, taking the Index level to 52.8, and the manufacturing sector remained in contraction at 45.8. Industrial production fell 0.1% MoM in April, while retail sales fell 0.5% MoM in April.

The final read of Q1 GDP printed at 0.3% QoQ and 0.4% YoY, suggesting a form of mild recovery.



The annual headline rate of inflation for Europe is expected to print at 2.5% YoY in June, slightly lower than the previous monthly read of 2.6%. Core inflation is expected to be running at 2.9% YoY.

Current market pricing has approx. 40bps of further easing by December.

Australia

The Federal budget was announced in May delivering \$9.5b in new policy announcements. Planned tax cuts for individuals are expected to result in the loss of \$23b in revenue and combined with energy cost rebates, make the budget mildly expansionary.

The Fair Work Commission announced a 3.75% increase in award and minimum wages for FY25.

Employment rose by 39,700 in May, above consensus of 30,000. The unemployment rate fell to 4% from 4.1%. Both ANZ and SEEK job ads declined in May to be down 2.1% and 0.6% respectively.

Manufacturing and service sector PMI indicators printed at 47.2 and 51.2, respectively. Business conditions fell one point +6, in line with the long run average. Business confidence fell five points.

Retail sales rose 0.6% MoM in May as retailers brought forward end of financial year sales. House prices continue to rise despite the significant lift in mortgage rates, gaining 0.7% MoM in June.

The May monthly CPI data saw headline inflation print at 4% YoY against an expectation of 3.8%. The RBA's preferred trim mean measure printed at 4.4% YoY.

Q1 GDP came in slightly lower than expected at 0.1% QoQ and 1.1% YoY. The softness in GDP growth over the past four quarters reflects a broader slowing in the economy to a below trend pace of growth.

The RBA left the target cash rate unchanged at 4.35% in June but confessed that a rate hike was considered given the stickiness of services inflation.

Current market pricing suggests a small probability of a 25bp rate hike this year with no prospect of rate cuts until late 2025.

SUMMARY

The US economy is cooling and therefore we believe the US policy rate has peaked for this cycle, which in turn should protect front-end yields from moving materially higher. Absent a sharp economic contraction, we do not expect long-end rates to move substantially lower in the near-term. Investors will demand a higher term premium given longer-term inflation uncertainty and an expected increase in treasury supply due to fiscal deficits.

Domestic policy rates are in restrictive territory, as evidenced by a slowdown in retail spending and sub trend GDP growth. Despite the below trend growth, the RBA is likely to maintain a restrictive setting until it sees further evidence of inflation returning to target. Services inflation remains key, and the Q2 CPI print due late July will provide better direction on the RBA's next move.

Our preferred portfolio construction is:

- Duration: Neutral.
- Yield curve: We maintain a slight overweight position around the 5-year part of the curve.
- Sector/credit mix: The current backdrop continues to support high quality investment grade credit. We will look to diversify our holdings, maintaining a preference to invest in non-cyclical, defensive sectors.