Equity Trustees

31 August 2024

SPECTRUM STRATEGIC INCOME FUND (SSIF)

Investment Objective

The Fund aims to generate higher returns than the RBA Cash Rate over the medium term with lower volatility than equities.

Investment Strategy

The Fund holds a diversified portfolio of listed and unlisted debt and hybrid debt securities. Issuers may be government bodies, banks, corporations and, to a limited extent, specialist financing vehicles. To maintain a diversified portfolio structure, certain limits are imposed on security type, credit risk, industry and issuers.

Target Return

RBA Cash Rate +1.50% p.a. net of fees.

Investment Highlights

- Experienced and active management team with a proven track record
- Quarterly distributions
- Low duration portfolio
- Diversified portfolio of AUD denominated corporate securities
- Consistent top quartile performance

APIR	ETL0072AU
Entry / Exit Price	1.0794/1.0784
Fund Size	$52m
Liquidity	Daily
Distributions	Quarterly
Inception Date	31 May 2009

Income Distributions

2023/24	JUN	SEP	DEC	MAR
Distribution (CPU)	1.01	1.06	1.68	1.19

Fund Rating

Fund Metrics

Fund Metrics	
Running Yield	5.96%
Average Yield to Maturity / Call	5.70%
Duration	0.71 years
Credit spread duration	2.67 years
Average credit spread	134 bp
Number of positions	51
Percentage floating rate assets	83.6%
Largest drawdown since inception	1.86%
Best monthly return	4.49%
Negative Total return in a calendar year	0/17

Performance

PERFORMANCE	1 MTH	1 YR	3 YRS	5YRS	SI
Distribution return	0.00	4.82	2.97	2.95	4.47
Growth return	0.49	1.67	0.48	-0.18	1.77
Total net return	0.49	6.49	3.46	2.77	6.24
Benchmark	0.36	4.39	2.74	1.77	2.42
Active Return	0.13	2.10	0.72	1.00	3.82

[2] Performance: distribution return is the return due to distributions paid by the Fund, growth return is the return due to changes in initial capital value of th total net return is the Fund return after the deduction of ongoing fees and expenses and assumes the reinvestment of all distributions. Results greater tha year are annualised. Past performances should not be taken as an indicator of future performance.

Performance comparisons

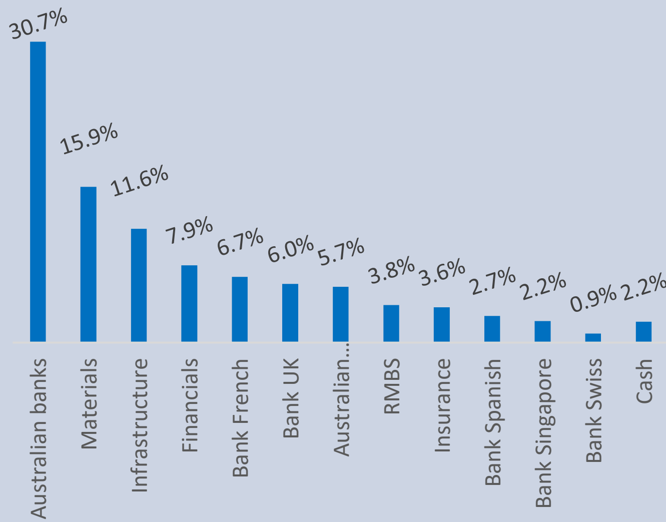
FRN -Bloomberg FRN Index

Composite – Bloomberg Composite Index

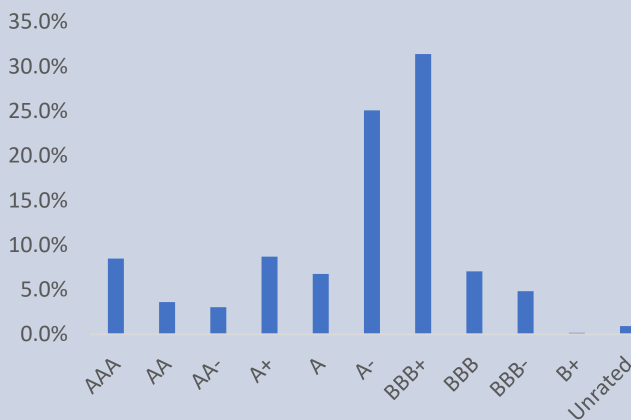
RBA – RBA Cash rate

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

Sector Allocation Breakdown



Security Ratings Profile



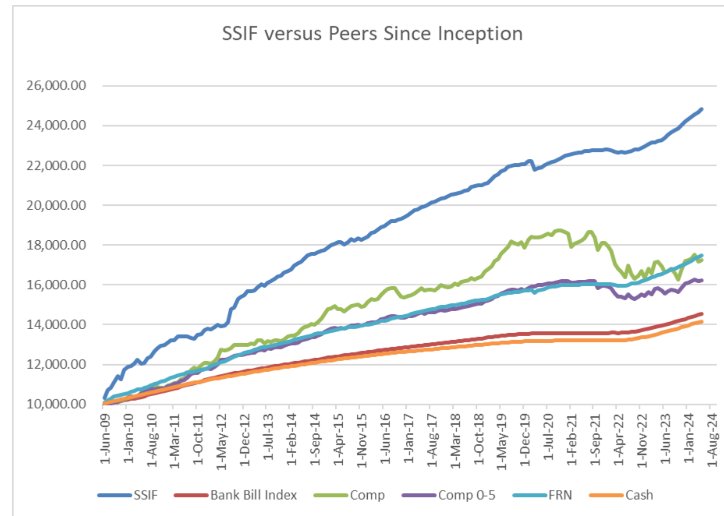
Top 10 Securities

ANZ 34'29	4.87%	ANZ 26/2/31'26	3.64%
NAB 27'25	4.63%	Ausgrid	3.62%
Suncorp Metway 29	3.74%	New York Life Funding	3.62%
Paccar 27	3.69%	Victoria Power Network	3.60%
IAG 45'25	3.67%	Paccar 26	3.06%

Platforms

- AMG Super
- Bell Direct
- HUB24
- netwealth
- Ausmaq
- CMC Stockbroking
- mFund
- Powerwrap
- Australian Money Market
- Freedom of Choice
- Nabtrade
- uXchange

Growth of $10,000 since inception



FRN -Bloomberg FRN Index
Comp – Bloomberg Composite Index
Comp 0-5 – Composite Bloomberg Index 0-5 years
Cash – RBA Cash rate
ASX TR – ASX 200 Accumulation

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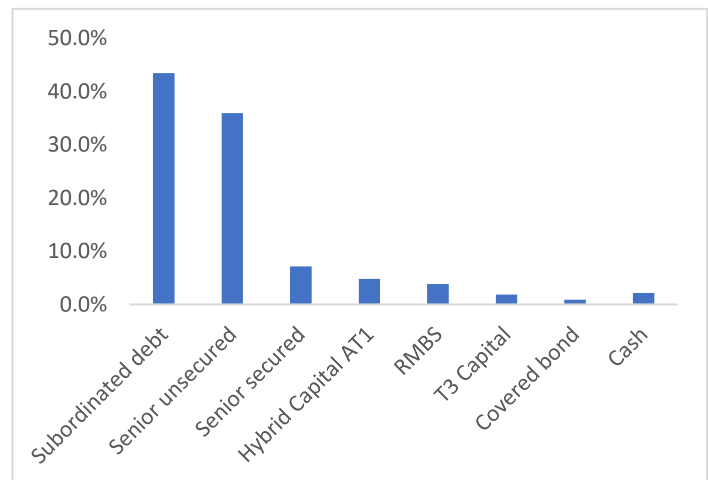
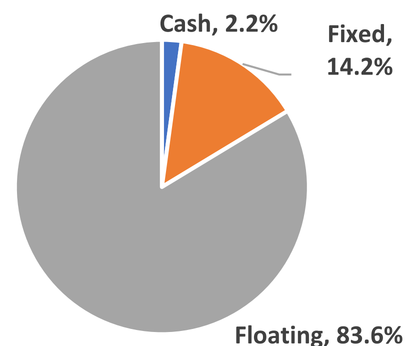
Legal Structure



Fixed/Floating Rate



Portfolio Management

Markets experienced a period of volatility during August. The catalyst was a change in view from potential tightening or rates on hold to a view that rates would be eased in the US in September. The belief that rates in US could ease in September saw markets price in rate cuts of between 50-100 bp for the remainder of 2024 and a further 100bp of cuts in 2025. For instance, the market is pricing in a 64% chance of a 50 bp rate cut in the US in September.

How was the portfolio positioned for these movements? Coming into August, the portfolio had an excess of cash, and some suitably identified securities where profits could be taken. In other words, the portfolio was positioned for volatility and positioned to take advantage. Fortuitously there were several new issues in the month, where the portfolio participated and able to capitalise.

The portfolio is currently well positioned. Recent additions to the portfolio not only provide diversification but also assist in risk mitigation.

Recent additions to the portfolio include New York Life rated AA+, Santander which provides exposure to growing economies, whilst the addition of Macquarie Bank adds diversification versus the Australian banks and exposure to a leading infrastructure bank.

Equity markets are reasonably sound, and earnings have generally been solid. Whilst there are storm clouds on the horizon, they appear someway away. In general, economic conditions are sound, there is an expectation of rate cuts, and any cut should assist equity markets which in turn will assist credit.

Prior to August we saw spreads widen by up to 10 bp and during August we saw spreads return to around 5bp above the recent tights. With credit still pricing slightly above fair value and with new issuance, interest should remain firm, and one can mount the argument for further spread compression.

During the selloff, high beta stocks quickly decompressed versus peers. Bank Tier 2 papers widened to around 2.2x senior spreads and have since contracted to a little above 2 x senior spreads.

The average credit quality has risen to a single A equivalent portfolio rating.

As previously highlighted in the July Report the portfolio had a high cash position and some conservative positions. Since July the portfolio has been reweighted and has an average rating equivalent of A- in the securities held, a pickup in coupon of approximately 50bp and yield to maturity approaching 6%.

Market Commentary

August was a month where sentiment changed and changed with a rush. Many market pundits opined about the Sahm Rule and how labour markets were weakening and unemployment growing. Even the inventor of the Sahm Rule, Claudia, herself was somewhat taken aback by the rush and sentiment change. Claudia has expressed some surprise, and her view is that the Fed is a little behind the curve, that a cut should come soon, however, the economy remains reasonably strong. Her view is that a cut of 25bp is sufficient and would be surprised by a 50bp cut at this stage which she feels is unnecessary.

Her concerns are more around a strong jobs report which in her view could see the Federal Reserve holding rates steady and see a false sense of confidence in policy makers decision making.

The odds of a recession remain low. Some economists have the odds of a recession of between 15-30%. In fact, some of the recession talk is as a result that the unconditional long-term average of a recession 15% and this is because a recession has occurred on average every 7 or so years.

If we assume that the Fed is on target and that the Fed is easing, then what are the consequences?

In general, the times when the Fed eases because it can, as opposed to it must, provides a very different return profile. Equity returns are weak during periods where the Fed has eased because economic conditions necessitated an easing to stimulate the economy. If the Fed eases because it merely wishes to adjust the neutral rate and the economy is growing albeit slowly, those periods have experienced strong equity markets. Credit in the first scenario is supportive rather than strong. In the second scenario, credit performs strongly.

Markets are pricing in the second scenario as equity markets in general are not pricing in a recession, rather growth in some sectors and a small downturn in others. Credit has responded with investment grade spreads moving back to recent ranges and high yield has sluggishly returned to its recent ranges albeit at the upper ranges.

What we are observing is a market that has adjusted its view towards slightly less optimistic growth expectations and a convergence towards fair value rather than the expectation of a recession.

However, should expectations alter and a belief that the economy has stalled, then we could see some equity weakness. Fixed income returns will be strong, and credit would see spreads widen depending upon the expected severity.

Using the U.S. as a proxy for growth, profit margins have continued to rise, consensus estimates have margins expanding and the U.S. avoids a recession then the outlook is robust. Such a scenario would be healthy for credit.

At the start of rate cutting cycles, we often observe the same credit rotations at the start of recessions. Interest cuts usually are based upon a backdrop of slow growth, hence the appeal of stability in coupons is strong.

Currently the outlook is supportive of credit with the one caveat being the increasing cost of debt. Interestingly, markets are looking for a soft landing but also looking for an easing cycle.

The chart below illustrates the different views with the bond market pointing to a recession while equities hits record highs.

The portfolio over the month returned 0.49% and the rolling year on year was 6.5%. If the portfolio can continue to capture coupons at current or similar levels and if we see some spread compression, then the portfolio will provide a very decent return.

Liquidity as always remains important. The portfolio remains very liquid with all securities marked to market daily and with over 90% of the portfolio actively traded via the screens.

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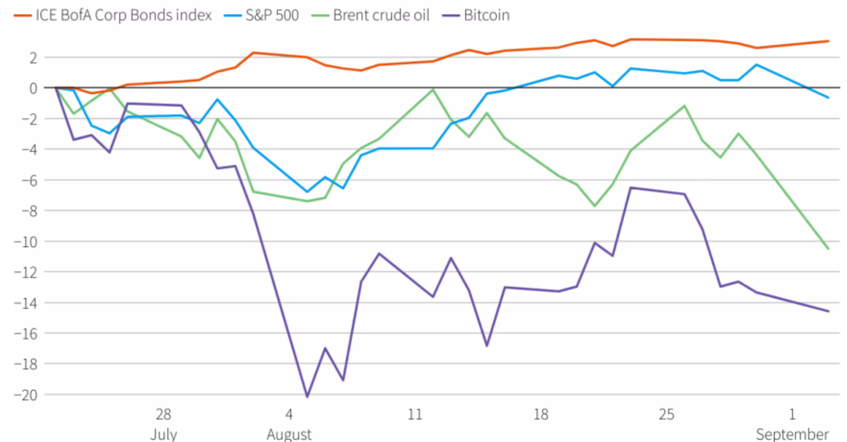

Courtesy LSEG Naomi Rovnick "Recession Fears trounce rate cut cheer in latest market sendoff" 5/9/2024

Companies that have low leverage will benefit at the expense of those more highly leveraged companies. The outlook can be very different. Should interest rates fall then the environment is supportive of tighter spreads.

The portfolio in a rising rate environment should see extra income as the higher interest rate are reflected in the coupon resets. The low duration means that returns are protected to an extent. The high average rating within the portfolio also acts as a mitigant.

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