# Monthly Investment Report

# June 2022

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# Summary

## *Market Update*

The COVID-19 pandemic has adversely impacted financial markets, which in turn, has also affected Council's investment portfolio. We provide a quick summary in this section.

The RBA cut rates to record lows on 3rd November 2020 to 0.10%, consistent with most global central banks resetting their official rates to emergency levels. As global markets transitioned to the recovery phase, supply chain issues has resulted in surging inflationary pressures. Longer-term bond yields have risen significantly in recent months as central banks reverse their easing policy measures (i.e. quantitative easing), whilst also moving to undertake aggressive hikes to mitigate surging inflation. **Markets are now factoring the possibility of a recession in 2024-2025 as official rates move higher**. **The RBA increased the official cash rate by 50bp in both June and July 2022, taking the official cash rate to 1.35%, and flagged further rate rises over coming months**.

## *Term Deposits*

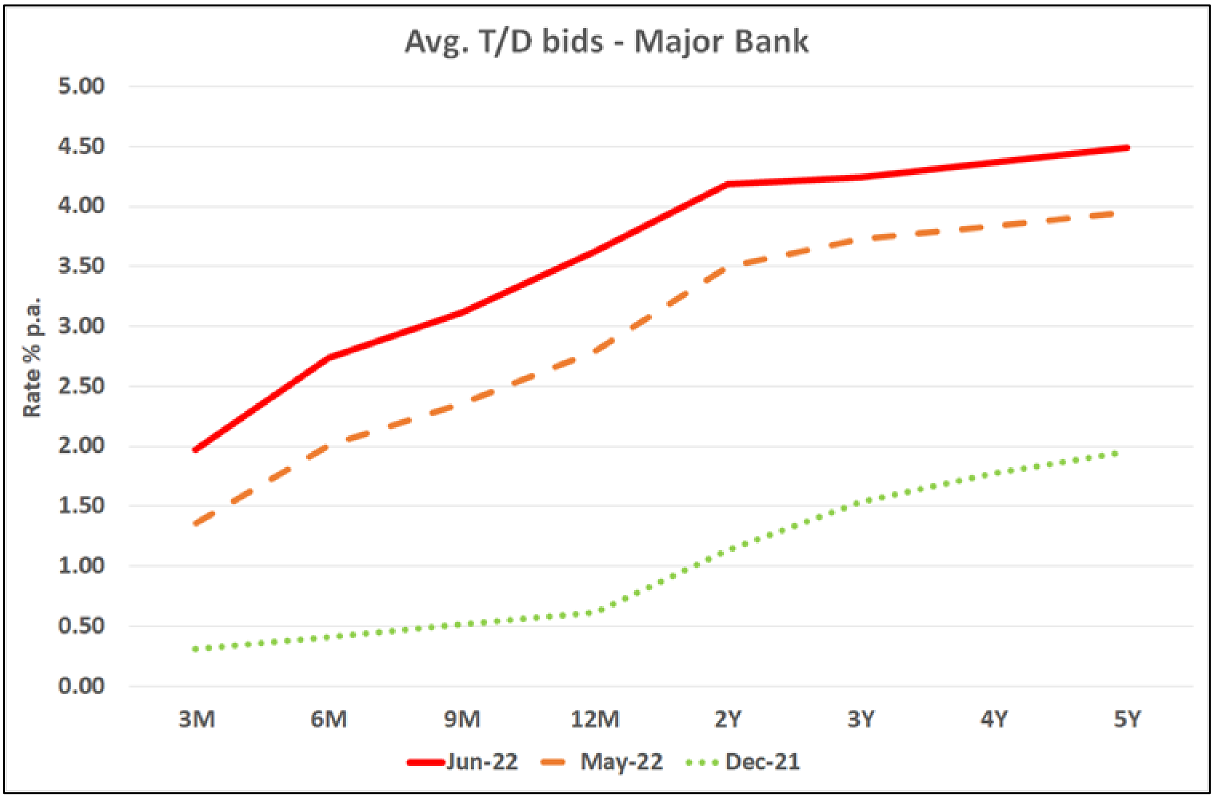
Term Deposits (fixed and floating) account for around 73% of the total investment portfolio at month-end.

Council's term deposit portfolio was yielding 1.83% p.a. at month-end, with a weighted average duration of around 485 days or ~1.33 years. The current average yield remains very attractive given the dramatic falls in the official cash rate. With an upward sloping deposit curve, investors are rewarded if they can continue to maintain a longer average duration.

As the past decade or so has highlighted (post-GFC era), we have seen too many portfolios overpay for liquidity and generally not insured themselves by diversify their funding across various tenors. Those investors that can maintain a weighted average duration of +12-18 months are likely to yield, on average, up to 1% p.a. higher than those investors who maintain a weighted average duration of less than 6-9 months.

- The highest deposit rate from any rated ADI in the market is now ~5.07% p.a. for 5 years;
- The highest deposit rates amongst the "AA-" rated ADIs (major banks) is now yielding between 3.70%-4.65% p.a. (depending on terms between 12m – 5 years);
- The highest deposit rates amongst the "A" rated ADIs was yielding between 4.00%-5.07% p.a. (depending on terms between 12m – 5 years);
- The highest deposit rates amongst the "BBB" rated ADIs was yielding between 4.00%-4.85% p.a. (depending on terms between 12m – 5 years).

With markets factoring in additional rate hikes over coming months, this has seen a significant shift in longer-term deposit rates, particularly over the past 6 months:




*Source: Imperium Markets*

**'New' investments above 3½% p.a. now appears likely if Council can continue to place the majority of its surplus funds for terms of 12 months to 2 years.**

## ***Senior FRNs***

Council's senior floating rate notes (FRNs) make up around 3½% of the total investment portfolio at month-end. The market valuation of Council's FRNs collectively fell around **-0.08% (actual)** in June 2022 (**or -$14,171 in dollar terms**).

| Summary | 31 May 2022 | 30 June 2022 | Net Flow ($) | Monthly Change % |
|---|---|---|---|---|
| Face Value | $18,850,000 | $18,850,000 | $0 | +0.00% |
| Market Value | $18,840,025 | $18,825,854 | -$14,171 | -0.08% |

We highlight that Council's FRNs are senior ranked assets and high in the bank capital structure. We expect that, if held to maturity, the FRNs will pay back its original face value ($100.00), along with its quarterly coupons throughout the life of the security. That is, we do not expect Council to lose any capital or interest payments from its current holding in its senior FRNs given all banks continue to maintain high capital buffers as required by APRA.

At month-end, Council's FRNs are now marked at an **unrealised capital loss of -$17,196** *(noting some were purchased at a slight discount to par in the secondary market).*

### *BBB rated senior FRNs*

As per all FRNs, we have no issues with Council's investments in "BBB" rated senior FRNs given all counterparties continue to hold robust balance sheets with high levels of capital. On a mark-to-market basis, collectively they fell around **-$2,994 in dollar terms or -0.05% (actual)** for the month:

| Summary | 31 May 2022 | 30 June 2022 | Net Flow ($) | Monthly Change % |
|---|---|---|---|---|
| Face Value | $5,500,000 | $5,500,000 | $0 | +0.00% |
| Market Value | $5,510,793 | $5,507,799 | -$2,994 | -0.05% |

At month-end, Council's "BBB" rated FRNs are now marked at an **unrealised capital gain of ~$7,799**.

### *Senior Bonds*

Since September 2020, Council has collectively invested $31m in Northern Territory Treasury Corporation (NTTC) fixed bonds rated AA- (same as the domestic major banks), locking in yields between 0.90%-1.40% p.a. The weighted average yield on these investments was 1.07% p.a., with a current weighted average duration of 3.05 years.

We believe these investments were sensible given the unprecedented low rate environment and the RBA's forward guidance at the time of investment. We reiterate that the NTTC bonds are a 'retail' offering and not 'wholesale' issuances. Given the lack of liquidity and high penalty costs if they were to be sold/redeemed prior to the maturity date, they are considered to be a hold-to-maturity investment and will be marked at par value ($100.00) throughout the term of investment.

During August 2021, Council purchased $600k in the ING (AAA) covered fixed bond at a yield of 1.16% p.a., which we thought was an attractive yield given the super-senior and highly ranked asset. This is likely to be held for at least 3-4 years, with a view to reassess depending on the prevailing market conditions. Given it is now trading at a significant discount to par, we recommend buying additional units if available, to average-in at a more attractive yield.

### *TCorp Long-Term Growth Fund*

The NSW TCorp Fund accounts for ~5% of Council's total investment portfolio. **The Fund returned -4.17% (actual) during June**. The biggest detractor to the Fund's performance this month was the exposure to domestic and international shares (both falling more than 8%) as markets continue to react to expectations of a series of aggressive rate hikes by global central banks to combat the surge in inflation.

| Summary | 31 May 2022 | 30 June 2022 | Investment ($) | Net Return ($) | Net Return (%) |
|---|---|---|---|---|---|
| Market Value | $28,473,719 | $27,287,112 | $0 | -$1,186,607 | -4.17% |

While shares were sold off aggressively, there was also ongoing moves in both government bond markets and credit markets, which detracted from performance. Renewed hawkish rhetoric from several central banks disrupted risk assets including shares and bonds. Markets have been focusing on the risk for a recession as the global economy is facing strong headwinds from both inflation and policy. This environment has just started, and this ebb and flow of market sentiment is likely to persist for months, or even quarters, and provide a volatile backdrop for investors.

The Fund should be looked at with a long-term view, with a minimum holding period of +7 years. Given the exposure to the volatile asset of shares, Council should expect to see, on average, a negative month once every 3 months over a long-term holding period.

### *CFS Global Credit Income*

The CFS Global Credit Income Fund accounts for around 2½% of Council's total investment portfolio. **The Fund returned -2.12% (actual) in June**, as the market valuation of the fund's assets in global credit securities fell during the month.

| Summary | 31 May 2022 | 30 June 2022 | Difference ($) | Difference (%) |
|---|---|---|---|---|
| Market Value | $14,036,488 | $13,738,336 | -$298,152 | -2.12% |

The Fund holds a diverse range of securities across the global credit market. It remains very well diversified by issuer in order to mitigate default risk. It invests in nearly 600 corporate bonds from issuers in various countries and industry sectors. Any spread contraction going forward allows credit and asset-backed holdings to enjoy significant capital gains.

With a running yield of around +4% p.a., we recommend Council retains this "grandfathered" Fund given the alternative to invest in cash and deposits (Council's approval list) are yielding comparably lower.

### *Cash Accounts*

Cash accounts make up just under 10% of Council's investment portfolio at month-end. Council's cash accounts are likely to yield up to 0.15% p.a. (at most) above the official cash rate over coming years i.e. yield up to 1.00% p.a. at current yields, but likely higher as the RBA increases official rates. Short-dated term deposits will continue to outperform overnight cash accounts in most cases so we recommend keeping cash levels at a bare minimum to meet ongoing liquidity requirements.

## *Council's Budgeted Income for FY2021-2022*

Council's budgeted income for FY2021-2022 was revised to $4.0m. Based on an average total investment portfolio size of around $500m, that equates to a budgeted yield of around 0.80% for the financial year.

As at the end of June 2022, the cumulative actual interest earned was below the revised budgeted income by around $1.77m, largely driven by the significant sell-off in shares and bonds since the start of 2022. The first half of the financial year was tracking well but was reversed due to the significant selloff in financial markets (e.g. equities, credit assets), escalated by the war in Ukraine and the aggressive rate hikes undertaken by global central banks. The TCorp Long-Term Growth Fund alone has fallen by $3.57m in 2022, being the biggest detractor to Council's budgeted income this financial year:

| Month-End | Cumulative Budget | Cumulative Interest | Difference ($) |
|---|---|---|---|
| Jul 2021 | $333,333 | $1,016,808 | $683,475 |
| Aug 2021 | $666,667 | $2,030,123 | $1,363,456 |
| Sep 2021 | $1,000,000 | $1,819,096 | $819,096 |
| Oct 2021 | $1,333,333 | $2,032,410 | $699,077 |
| Nov 2021 | $1,666,667 | $2,832,022 | $1,165,355 |
| Dec 2021 | $2,000,000 | $3,665,308 | $1,665,308 |
| Jan 2022 | $2,333,333 | $3,412,974 | $1,079,641 |
| Feb 2022 | $2,666,667 | $2,615,086 | -$51,581 |
| Mar 2022 | $3,000,000 | $2,810,591 | -$189,409 |
| Apr 2022 | $3,333,333 | $2,885,936 | -$447,397 |
| May 2022 | $3,666,667 | $2,807,748 | -$858,919 |
| Jun 2022 | $4,000,000 | $2,229,259 | -$1,770,741 |

For the upcoming financial year, we remain cautious given that risks remain to the downside, particularly if there is a continued selloff in equities and/or bonds.

The decision to adopt TCorp's Policy, whereby it has restricted the universe of complying investments and particularly the duration of investments - this has compounded and resulted in the significant drop in income generated over the past 2 years.

# Council’s Portfolio & Compliance

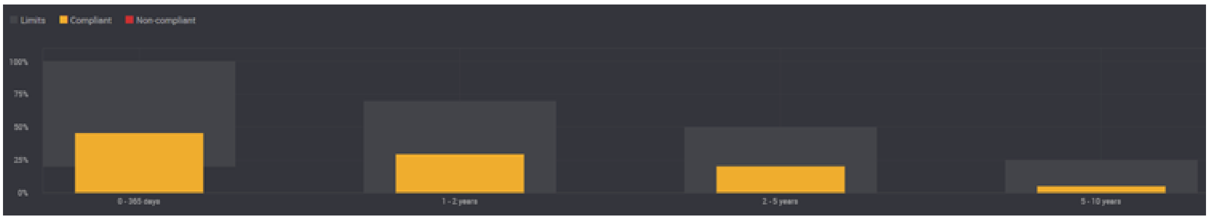
## *Asset Allocation*

As at the end of June 2022, the portfolio was mainly directed to fixed and floating rate term deposits (73%). The remaining portfolio is directed to FRNs (3%), overnight cash accounts (10%), bonds (6%), and the managed funds with CFS Global Credit Income Fund and NSW T-Corp Long Term Growth Fund (8%, combined).

**Senior FRNs are now becoming more attractive as spreads have widened in recent months – new issuances should now be considered again on a case by case scenario**. In the interim, fixed deposits for 12 months to 3 years appear quite appealing following the spike in medium-to longer-term yields in recent months. With recessionary fears being priced in coming years, those investors that can allocate longer-term surplus funds may take an insurance policy by investing across 3-5 year fixed deposits and locking in rates between 4%-5% p.a.

## *Term to Maturity*

Overall, the portfolio remains well diversified from a maturity perspective with around 20% of assets directed to medium-term assets (2-5 years). There is still capacity to invest in the medium-term horizon and this is where we believe the most attractive value is along the curve. All minimum and maximum criteria meet within the Policy guidelines:




Where liquidity permits, we recommend new surplus funds be directed to 1-2 year horizons given this is where the most attractive value can be found. We suggest this be allocated to any remaining attractive fixed term deposits (refer to respective sections below).

| Compliant | Horizon | Invested ($) | Invested (%) | Min. Limit (%) | Max. Limit (%) | Available ($) |
|---|---|---|---|---|---|---|
| ✓ | 0 - 365 days | $247,747,407 | 45.48% | 20% | 100% | $297,027,074 |
| ✓ | 1 – 2 years | $159,400,000 | 29.26% | 0% | 70% | $221,942,137 |
| ✓ | 2 – 5 years | $110,339,962 | 20.25% | 0% | 50% | $162,047,278 |
| ✓ | 5 – 10 years | $27,287,112 | 5.01% | 0% | 25% | $108,906,508 |
| | | **$544,774,481** | **100.00%** | | | |

## *Counterparty*

As at the end of June 2022, Council did not have an overweight position to any single ADI. Overall, the portfolio is well diversified across the entire credit spectrum, including some exposure to the unrated ADIs.

| Compliant | Issuer | Rating | Invested ($) | Invested (%) | Max. Limit (%) | Available ($) |
|---|---|---|---|---|---|---|
| ✓ | BoQ Covered | AAA | $900,753 | 0.17% | 100.00% | $543,873,728 |
| ✓ | Suncorp Covered | AAA | $525,772 | 0.10% | 100.00% | $544,248,710 |
| ✓ | ING Covered | AAA | $704,353 | 0.13% | 100.00% | $544,070,128 |
| ✓ | CBA (BankWest) | AA- | $77,384,705 | 14.20% | 100.00% | $467,389,776 |
| ✓ | NAB | AA- | $147,179,172 | 27.02% | 100.00% | $397,595,310 |
| ✓ | Northern Territory | AA- | $34,000,000 | 6.24% | 100.00% | $510,774,481 |
| ✓ | Westpac | AA- | $50,900,000 | 9.34% | 100.00% | $493,874,481 |
| ✓ | Citibank NA | A+ | $998,667 | 0.18% | 30.00% | $162,433,678 |
| ✓ | Macquarie | A+ | $1,028,314 | 0.19% | 30.00% | $162,404,031 |
| ✓ | Suncorp | A+ | $2,492,947 | 0.46% | 30.00% | $160,939,398 |
| ✓ | UBS AG | A+ | $3,237,872 | 0.59% | 30.00% | $160,194,472 |
| ✓ | CFS Global CI | A | $13,738,336 | 2.52% | 30.00% | $149,694,008 |
| ✓ | ICBC | A | $93,250,000 | 17.12% | 30.00% | $70,182,344 |
| ✓ | ING Bank Aus. | A | $16,000,000 | 2.94% | 30.00% | $147,432,344 |
| ✓ | Aus. Military Bank | BBB+ | $8,000,000 | 1.47% | 10.00% | $46,477,448 |
| ✓ | Aus. Unity Bank | BBB+ | $10,000,000 | 1.84% | 10.00% | $44,477,448 |
| ✓ | BoQ | BBB+ | $23,002,467 | 4.22% | 10.00% | $31,474,981 |
| ✓ | Bendigo-Adelaide | BBB+ | $1,749,541 | 0.32% | 10.00% | $52,727,907 |
| ✓ | QT Mutual Bank | BBB+ | $1,000,761 | 0.18% | 10.00% | $53,476,687 |
| ✓ | AMP Bank | BBB | $17,138,681 | 3.15% | 5.00% | $10,100,043 |
| ✓ | CUA | BBB | $1,755,030 | 0.32% | 5.00% | $25,483,694 |
| ✓ | MyState Bank | BBB | $6,000,000 | 1.10% | 5.00% | $21,238,724 |
| ✓ | P&N Bank | BBB | $5,000,000 | 0.92% | 5.00% | $22,238,724 |
| ✓ | Judo Bank | BBB- | $1,000,000 | 0.18% | 0.18% | $0 |
| ✓ | Bank of Sydney | Unrated | $250,000 | 0.05% | 0.05% | $0 |
| ✓ | Comm. First CU | Unrated | $250,000 | 0.05% | 0.05% | $0 |
| ✓ | TCorpIM LTG | Unrated | $27,287,112 | 5.01% | 100.00% | $517,487,369 |
| | | | **$544,774,481** | **100.00%** | | |

In April 2020, NSW Treasury Corporation imposed changes to the counterparty limits on the Investment Policy, with the major changes summarised as follows:

- A+ and A rated term deposits have maximum duration of 3 years;
- BBB+ rated assets have a maximum duration of 3 years;
- Limit of 5% to be placed with any BBB rated ADI with a maximum duration of 12 months;
- Limit of $1m to be placed with any BBB- rated ADI with a maximum duration of 12 months;

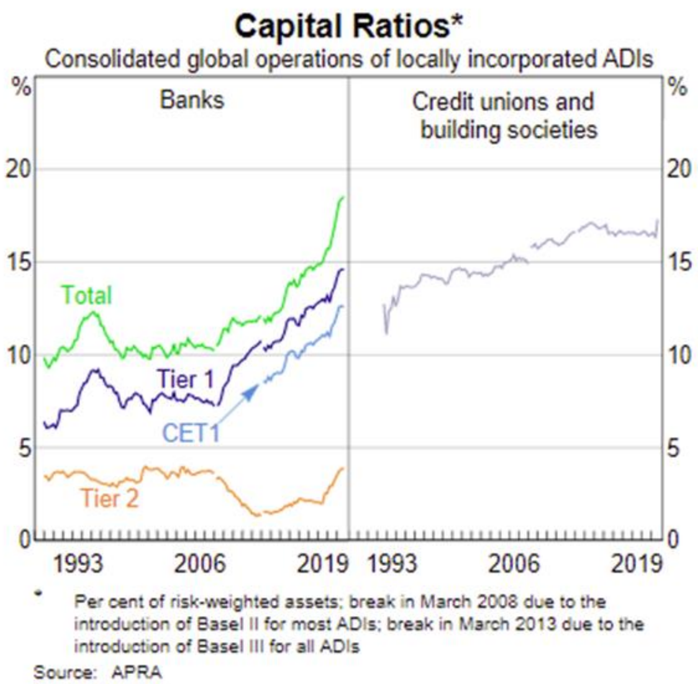
- Limit of $250k to be placed with any Unrated ADI with a maximum duration of 12 months;

We remain supportive of the regional and unrated ADI sector (and have been even throughout the GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 25-40% more capital than the domestic major banks, and well above the Basel III requirements.

APRA's Chairman affirmed that the banks had satisfactorily moved towards an '*unquestionably strong*' capital position and that bank's stress testing contingency plans were now far better positioned that was previously the case years ago. ***RBA Governor Lowe has commented that they have not seen any signs of stress in the financial system and that unlike during the GFC, the banks now have cash, are well capitalised and are acting as "shock absorbers" in the current crisis***.

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). We believe that deposit investments with the lower rated ADIs should be continued going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities are generally deemed to be the more 'ethical' ADIs compared to the higher rated ADIs.

In the current environment of high regulation and scrutiny, all domestic ADIs continue to carry high levels of capital, particularly amongst the lower ("BBB") and unrated ADIs. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC. **APRA's mandate is to "*protect depositors*" and provide "*financial stability*".**




**We do not understand the covenants imposed by NSW Treasury Corporation and their concerns surrounding the "BBB" and unrated ADIs. The adopted Policy will not only increase concentration risk, but also lead to lower returns on Council's surplus investments over the long-term**.

Given Council can only invest in senior-ranking assets with ADIs regulated by APRA, fundamentally, their concerns surrounding Council's investment in "BBB" rated senior ranking assets and deposits with the local credit unions are unwarranted.

While any potential future loans offered by TCorp are likely to be competitive against the traditional method through the major banks, any proposed recommendations led by TCorp needs to be weighed against the opportunity cost i.e. the loss of income throughout the term of which the covenants are imposed on Council. In the long-term, we believe the opportunity cost to Council in the form of lost interest would amount in the millions of dollars, per annum. This loss of income may also have a detrimental effect on the local community in terms of economic activity and employment.

*(Other NSW Councils are in fact now getting a cheaper borrowing rate from the major banks compared to TCorp).*

## ***Domestic versus International***

Noting Council's (internationally) demographic ratepayer base, we summarise where its investments are currently placed:

| ADI Category by APRA / Country of Region | Amount Invested | Percentage |
|---|---|---|
| Australian Owned ADI | $339,585,390 | 62.34% |
| Australia | $339,585,390 | 62.34% |
| Branches of Foreign Bank | $147,387,872 | 27.05% |
| China | $93,250,000 | 17.12% |
| Switzerland | $3,237,872 | 0.59% |
| United States | $50,900,000 | 9.34% |
| Foreign Subsidiary Banks | $16,775,772 | 3.08% |
| Lebanon | $250,000 | 0.05% |
| Netherlands | $16,525,772 | 3.03% |
| Global^ | $41,025,448 | 7.53% |
| International | $41,025,448 | 7.53% |
| **Total** | **$544,774,481** | **100.00%** |

*Source: https://www.apra.gov.au/register-of-authorised-deposit-taking-institutions*

*^Global: The NSW TCorpIM LTGF and CFS Global Credit Income Fund invests in hundreds of underlying securities globally, from which the portfolio composition is likely to change regularly.*

Overall, approximately 62% of Council's total investment portfolio is placed with domestic ADIs, while the remaining 38% is placed with international banks and corporate entities.

In response to global financial crisis (GFC), the Financial Stability Board (FSB) came up with a range of financial metrics to ascertain which banks were effectively deemed "*too big to fail*". A list of Globally Systemic Important Banks (G-SIBs) was developed, in which these banks required to hold much higher levels of capital compared to their smaller peers to ensure their financial stability under various stress test scenarios (e.g. another GFC).

We note that Council's exposure to the international banks are generally with such Globally Systemic Important Banks (G-SIBs), including ICBC (China), ING Bank (Netherlands), UBS (Switzerland), Credit Suisse (Switzerland), HSBC (Hong Kong) and Citibank (US).

**Overall, we have no concerns with Council's exposure to international banks given they are largely considered to be globally systematic important banks that are '*too big to fail*'.**

## *Fossil Fuel Investments*

**What is Council's current exposure to institutions that fund fossil fuels?**

Using the following link http://www.marketforces.org.au/banks/compare, based on the Council's investment portfolio balance as at 30/06/2022 ($544.77m), we can roughly estimate that ~75% of the investments have some form of exposure. This is likely to drift higher given the new Policy limits imposed by NSW Treasury Corporation.

**How would Council modify its Investment Policy to cater for divestment of fossil fuels?**

If the major banks were withdrawn from investments, some members of the community may look at that remaining list of ADIs (banks) and say "*Why do we have all our money with those no-name institutions? I've never even heard of them. We don't want to take risks with our money after councils lost $100's of millions speculating in the GFC*". It will be difficult to please everyone. We suggest starting the discussion with all Councillors asking "*are you comfortable investing all the money with the lower rated regionals and credit unions?*" If not, then a full divestment campaign will be complicated.

Some ways to potentially 'make changes' to the policy, or at least have a discussion, includes:

- *"Where possible within policy and without compromising the risk and return profile, we favour..."*
- *"We have not yet made a decision to divest because it will have implications on credit quality, ratings and income, but we are actively discussing..."*

**What would be implications on our portfolio credit rating?**

By adopting a free fossil fuel policy or an active divestment strategy, this would eliminate the major banks rated "AA-" as well as some other "A" rated banks (AMP, Citigroup and ING). Council would be left with a smaller sub-sector of banks to choose to invest with.

**What would be risks and implications on Council's portfolio performance?**

Some implications include:

- High concentration risk – limiting Council to a selected number of banks;
- Increased credit/counterparty risk;
- May lead to a reduction in performance (most of the senior FRN issues are with the higher rated ADIs) which could result in a significant loss of income generated – could be in excess of hundreds of thousands of dollars per annum;
- Underperformance compared to other Councils.

It may actually be contrary to Council's primary objective to preserve capital as the investment portfolio's risk would increase (all things being equal). Council may not be maximising its returns – this is one of the primary objectives written in the Investment Policy.

Council's exposure is summarised as follows:

| Counterparty | Credit Rating | Funding Fossil Fuel |
|---|---|---|
| BoQ Covered | AAA | Yes |
| Suncorp Covered | AAA | No |
| ING Covered | AAA | Yes |
| CBA (BankWest) | AA- | Yes |
| NAB | AA- | Yes |
| Northern Territory | AA- | Yes |
| Westpac | AA- | Yes |
| Citibank NA | A+ | Yes |
| Macquarie | A+ | Yes |
| Suncorp | A+ | No |
| UBS AG | A+ | No |
| CFS Global Credit^^ | A | Yes |
| ICBC | A | No |
| ING Bank | A | Yes |
| Aus Military Bank | BBB+ | No |
| Aus Unity Bank | BBB+ | No |
| BOQ | BBB+ | Yes |
| Bendigo-Adelaide | BBB+ | No |
| QT Mutual Bank | BBB+ | No |
| AMP Bank | BBB | Yes |
| CUA | BBB | No |
| MyState Bank | BBB | No |
| P&N Bank | BBB | No |
| Judo Bank | BBB- | No |
| Bank of Sydney | Unrated | No |
| Comm. First CU | Unrated | No |
| T-CorpIM LTG Fund^^ | Unrated | Yes |

*^^The underlying exposure in these managed funds includes the domestic major banks.*

*Source: https://www.marketforces.org.au/info/compare-bank-table/*

| Summary | Amount | Invested % |
|---|---|---|
| Yes | $410,083,978 | 75% |
| No | $134,690,503 | 25% |
| | **$544,774,481** | **100%** |

## *Credit Quality*

Following the adoption of the Policy in mid-April 2020, in order to adhere to the prohibitive restrictions imposed by NSW TCorp, Council decided to forego extra yield and has subsequently redeemed deposit investments amongst the BBB and Unrated ADI ratings category over the past year (with the exception of government guarantee parcels of $250k deposits).

All aggregate ratings categories are currently within the Policy limits:

| Compliant | Credit Rating | Invested ($) | Invested (%) | Max. Limit (%) | Available ($) |
|---|---|---|---|---|---|
| ✓ | AAA Category, TCorp | $29,417,990 | 5% | 100% | $515,356,491 |
| ✓ | AA Range | $309,463,877 | 57% | 100% | $235,310,604 |
| ✓ | A+ or A | $130,746,135 | 24% | 100% | $414,028,346 |
| ✓ | A- | $0 | 0% | 40% | $217,909,793 |
| ✓ | BBB+ | $43,752,769 | 8% | 25% | $89,785,865 |
| ✓ | BBB | $29,893,710 | 5% | 10% | $24,583,738 |
| ✓ | BBB- & Unrated ADIs | $1,500,000 | 0% | 5% | $25,738,724 |
| | | **$544,774,481** | **100.00%** | | |

The main changes to the Credit Quality limits imposed by NSW Treasury Corporation were as follows:

- BBB+ rated assets: 30% less any BBB rated assets;
- BBB assets: maximum 10% of portfolio;
- Other (BBB- and Unrated ADIs): maximum 5% of portfolio;

With regards to the duration of each ratings category, based on weighted averages, the portfolio is within the Policy limits across all categories:

| Compliant | Credit Rating | Invested ($) | Invested (%) | Wgt. Avg. Duration (Yrs) | Max Term (Yrs) | Wgt. Avg. Yield (%)^ |
|---|---|---|---|---|---|---|
| ✓ | AAA, TCorp | $29,417,990 | 5% | 4.88 | n/a | 0.12% |
| ✓ | AA Range | $309,463,877 | 57% | 1.32 | 5.00 | 1.32% |
| ✓ | A+ or A | $130,746,135 | 24% | 1.94 | 5.00 | 2.48% |
| ✓ | A- | $0 | 0% | 0.00 | 3.00 | 0.00% |
| ✓ | BBB+ | $43,752,769 | 8% | 0.94 | 3.00 | 1.68% |
| ✓ | BBB | $29,893,710 | 5% | 0.52 | 1.00 | 1.57% |
| ✓ | BBB- & Unrated ADIs | $1,500,000 | 0% | 0.24 | 1.00 | 1.68% |
| | | **$544,774,481** | **100.00%** | **1.59** | | **1.58%** |

*^Assuming TCorp LTGF is yielding 0.00% and CFS Fund (A rated) is yielding 3.50%.*

We note the significant pick-up in yield in the "BBB" rated categories and lower rated ADIs compared to the "AA" rated ADIs. All these assets are for the same type of investment (term deposits and senior FRNs) and rank the same in the bank capital structure (senior ranking, extremely low risk assets). The weighted average duration of the "BBB" and lower rated ADIs is also much shorter than the higher rated ADIs.

*As mentioned in the Counterparty section, we believe TCorp's Policy increases concentration risk and significantly reduces the Council's overall return over the long-term. If possible, Council should consider reviewing the Policy and potentially find alternative sources for a loan in the future given the substantial opportunity cost in the form of lost revenue (millions of dollars) through interest income.* **We have been made aware that a handful of major banks were offering a lower borrowing rate than TCorp over the past few months to other NSW councils**.

## *Performance*

Council's performance (actual returns) for the month ending 30 June 2022 is summarised as follows:

| Performance (Actual) | 1 month | 3 months | 6 months | FYTD | 1 year | 2 years | 3 years |
|---|---|---|---|---|---|---|---|
| Official Cash Rate | 0.07% | 0.11% | 0.13% | 0.18% | 0.18% | 0.17% | 0.33% |
| AusBond Bank Bill Index | 0.05% | 0.07% | 0.08% | 0.10% | 0.10% | 0.08% | 0.33% |
| PCC Internal Benchmark* | -0.06% | -0.07% | -0.43% | 0.00% | 0.00% | 0.77% | 1.04% |
| PCC Cash Portfolio | 0.09% | 0.15% | 0.24% | 0.44% | 0.44% | 0.54% | 0.74% |
| PCC T/D Portfolio | 0.15% | 0.40% | 0.70% | 1.33% | 1.33% | 1.42% | 1.77% |
| PCC FRN Portfolio | 0.14% | 0.35% | 0.73% | 1.54% | 1.54% | 1.61% | 1.72% |
| PCC Bond Portfolio | 0.09% | 0.27% | 0.54% | 1.07% | 1.07% | - | - |
| PCC Credit Fund | -2.12% | -3.14% | -4.18% | -4.50% | -4.50% | 0.33% | -0.12% |
| PCC TCorp Growth Fund | -4.17% | -6.68% | -11.57% | -7.78% | -7.78% | 4.27% | 2.88% |
| TCorp Benchmark | -4.22% | -6.84% | -11.80% | -7.36% | -7.36% | 4.48% | 3.29% |
| **PCC's Total Portfolio** | **-0.11%** | **-0.11%** | **-0.29%** | **0.43%** | **0.43%** | **1.23%** | **1.52%** |
| **Outperf. (BBI)** | **-0.16%** | **-0.18%** | **-0.38%** | **0.33%** | **0.33%** | **1.15%** | **1.19%** |
| **Outperf. (Int. Bench.)** | **-0.05%** | **-0.04%** | **0.14%** | **0.42%** | **0.42%** | **0.45%** | **0.49%** |

**The Internal Benchmark returns are based on Council's individual benchmarks across the various asset classes it invests within its own portfolio. The following individual benchmark's are used for each asset class that Council invests in:*
*Cash: RBA Cash Rate*
*Term Deposits: Deposit benchmark based on Council's weighted average duration using multiple ADIs average monthly rate*
*FRNs: AusBond Credit FRN Index*
*CFS Global Credit Income Fund: AusBond Credit Index*
*NSW TCorpIM Long-Term Growth Fund: NSW TCorpIM Internal Benchmark*

**For the month of June, the total investment portfolio (including cash) provided a return of -0.11% (actual) or -1.33% p.a. (annualised)**, underperforming the AusBond Bank Bill Index return of +0.05% (actual) or +0.61% p.a. (annualised), and Council's internal benchmark return of -0.06% (actual) or -0.69% p.a. (annualised). The CFS (-2.12% actual) and TCorp Fund (-4.17% actual) were again the biggest detractors to performance this month.

**Over the financial year, the total portfolio (including cash) returned +0.43% p.a., outperforming bank bills by 0.33% p.a. and Council's internal benchmark by +0.42% p.a**.

The longer-term outperformance continues to be anchored by the handful of longer-dated deposits that were locked-in prior to the RBA's rate cuts, as well as the FRNs locked in at attractive margins, boosted by the strategic sales implemented over the past year. This is now reflected in the longer-term returns with the FRN portfolio now slightly ahead of fixed term deposits over 1-2 year time periods.

The annualised returns as of 30 June 2022 are shown in the following table:

| Performance (% p.a.) | 1 month | 3 months | 6 months | FYTD | 1 year | 2 years | 3 years |
|---|---|---|---|---|---|---|---|
| Official Cash Rate | 0.85% | 0.43% | 0.27% | 0.18% | 0.18% | 0.17% | 0.33% |
| AusBond Bank Bill Index | 0.61% | 0.28% | 0.17% | 0.10% | 0.10% | 0.08% | 0.33% |
| PCC Internal Benchmark* | -0.69% | -0.27% | -0.87% | 0.00% | 0.00% | 0.77% | 1.04% |
| PCC Cash Portfolio | 1.04% | 0.61% | 0.49% | 0.44% | 0.44% | 0.54% | 0.74% |
| PCC T/D Portfolio | 1.78% | 1.62% | 1.41% | 1.33% | 1.33% | 1.42% | 1.77% |
| PCC FRN Portfolio | 1.69% | 1.40% | 1.48% | 1.54% | 1.54% | 1.61% | 1.72% |
| PCC Bond Portfolio | 1.07% | 1.08% | 1.09% | 1.07% | 1.07% | - | - |
| PCC Credit Fund | -22.99% | -12.03% | -8.24% | -4.50% | -4.50% | 0.33% | -0.12% |
| PCC TCorp Growth Fund | -40.42% | -24.22% | -21.95% | -7.78% | -7.78% | 4.27% | 2.88% |
| TCorp Benchmark | -40.82% | -24.73% | -22.36% | -7.36% | -7.36% | 4.48% | 3.29% |
| **PCC's Total Portfolio** | **-1.33%** | **-0.44%** | **-0.59%** | **0.43%** | **0.43%** | **1.23%** | **1.52%** |
| **Outperf. (BBI)** | **-1.94%** | **-0.72%** | **-0.76%** | **0.33%** | **0.33%** | **1.15%** | **1.19%** |
| **Outperf. (Int. Bench.)** | **-0.64%** | **-0.17%** | **0.28%** | **0.42%** | **0.42%** | **0.45%** | **0.49%** |

## *Council's Term Deposit Portfolio & Recommendation*

As at the end of June 2022, Council's deposit portfolio was still yielding an attractive **1.83% p.a.** (up 5bp from the previous month), with a weighted average duration of around 487 days (~1.33 years). The current average yield remains relatively attractive given the dramatic falls in the official cash rate. With an upward sloping deposit curve, investors are rewarded if they can continue to maintain a longer average duration.

As the past decade or so has highlighted (post-GFC era), we have seen too many portfolios overpay for liquidity and generally not insured themselves by diversify their funding across various tenors. Those investors that can maintain a weighted average duration of +12-18 months are likely to yield, on average, up to 1% p.a. higher than those investors who maintain a weighted average duration of less than 6-9 months.

**We are pleased to see that City of Parramatta Council remains amongst the top performing Councils in the state of NSW where deposits are concerned, earning on average, more than $1,960,000 in additional interest income compared to its peers (as per our April 2022 rankings)**. We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio.

At the time of writing, we see value in:

| ADI | LT Credit Rating | Term | T/D Rate |
|---|---|---|---|
| ICBC, Sydney | A | 3 years | 4.71% p.a. |
| BoQ/ME Bank | BBB+ | 3 years | 4.55% p.a. |
| ICBC, Sydney | A | 2 years | 4.48% p.a. |
| ING | A | 2 years | 4.45% p.a. |
| MyState | BBB | 2 years | 4.40% p.a. |
| P&N Bank | BBB | 2 years | 4.25% p.a. |
| CBA | AA- | 2 years | 4.19% p.a. |
| Westpac | AA- | 2 years | 4.16% p.a. |

The above deposits are suitable for investors looking to maintain diversification and lock-in a premium compared to purely investing short-term.

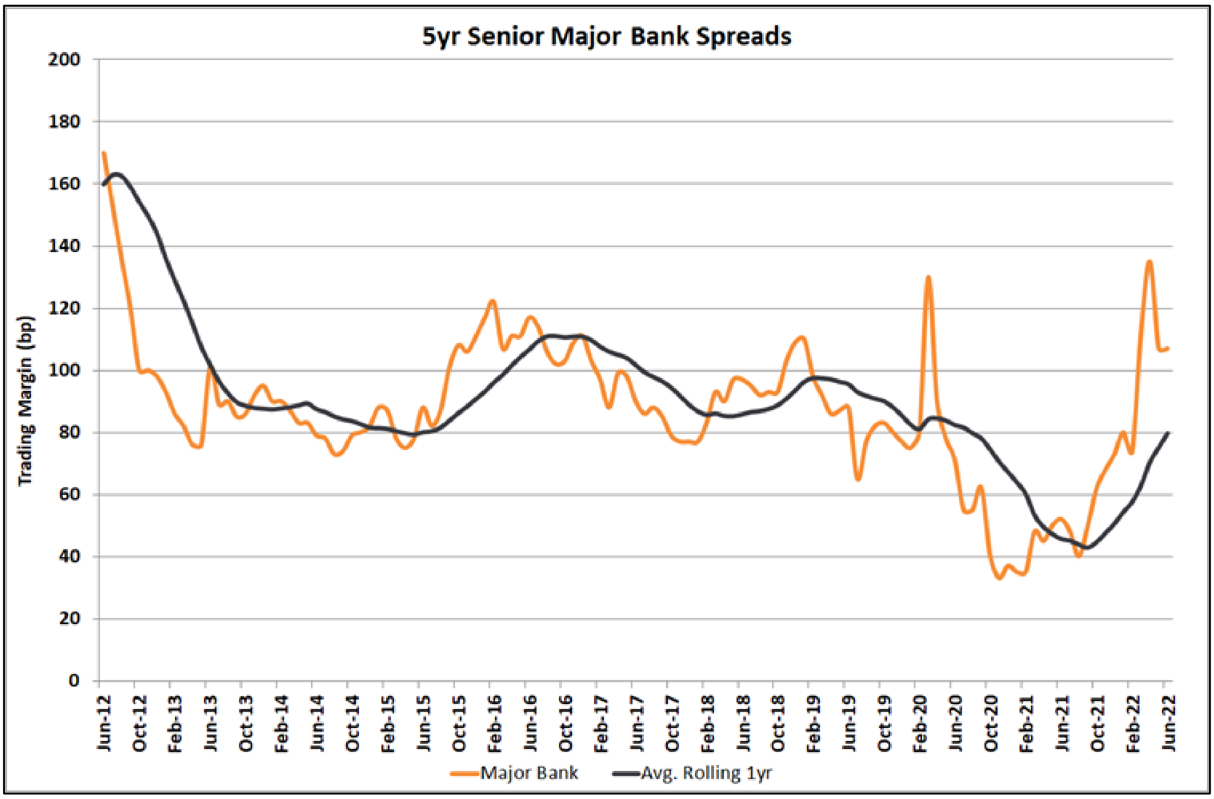
For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (dependent on daily funding requirements):

| ADI | LT Credit Rating | Term | T/D Rate |
|---|---|---|---|
| ING | A | 12 months | 4.00% p.a. |
| Macquarie | A+ | 12 months | 3.92% p.a. |
| CBA | AA- | 12 months | 3.85% p.a. |
| Westpac | AA- | 12 months | 3.81% p.a. |
| BoQ/ME Bank | BBB+ | 12 months | 3.80% p.a. |
| Bendigo | BBB+ | 12 months | 3.75% p.a. |
| NAB | AA- | 12 months | 3.70% p.a. |

*For those investors that do not require high levels of liquidity and can stagger their investments longer-term, they will be rewarded over coming years if they roll for an average min. term of 18 months to 2 years (this is where we current value), yielding, on average, up to ½%-1% p.a. higher compared to those investors that entirely invest in short-dated deposits*.

## *Senior FRNs Review*

Over June, amongst the senior major bank FRNs, physical credit securities remained relatively flat at the long-end of the curve despite the selloff in the credit indices. Major bank senior securities are now looking fairly attractive again in a rising rate environment (5 year margins around the +105-110bp level):




*Source: IBS Capital*

Amongst the “A” and “BBB” rated sector, the securities also remained relatively flat at the long-end of the curve. There was very little new issuance during the month, with only BoQ (BBB+) being an exception, tapping their May 2025 Covered FRN rated AAA at +105bp.

Credit securities are looking much more attractive given the widening of spreads in recent months. FRNs will continue to play a role in investor’s portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

| Senior FRNs (ADIs) | 30/06/2022 | 31/05/2022 |
|---|---|---|
| "AA" rated – 5yrs | +107bp | +107bp |
| "AA" rated – 3yrs | +90bp | +90bp |
| "A" rated – 5yrs | +125bp | +125bp |
| "A" rated – 3yrs | +100bp | +100bp |
| "BBB" rated – 3yrs | +110bp | +115bp |

*Source: IBS Capital*

We now generally recommend switches ('benchmark' issues only) into new primary issues, out of the following senior FRNs that are maturing:

- **On or before mid-2024 for the "AA" rated ADIs (domestic major banks)**;
- On or before mid-2023 for the "A" rated ADIs; and
- Within 6-9 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last few years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current low interest rate environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

*Primary (new) FRNs are now looking more appealing and should be considered on a case by case scenario.*

## *Council FRNs – Recommendations for Sale/Switches*

Following the recent selloff in credit assets in recent months, we now recommend Council holds its FRN portfolio at this stage. We will inform Council when there is an opportunity to sell out of any sub-optimal FRN and switch into a higher yielding complying asset.

This strategy has worked very well as Council has ultimately boosted the overall returns of the investment portfolio. A summary of the current financial year's sales are as follows – given the turn in the market over the past few months, these sales would not have been undertaken unless Council was actively managing its portfolio prudently:

| Issuer | Maturity Date | Month Sold | Face Value | Trading Margin | Capital Price | Realised Capital Gains |
|---|---|---|---|---|---|---|
| ME (BBB+) | 18/07/2022 | Jul 2021 | $2,000,000 | +15.0bp | $100.813 | $16,260 |
| TMB (BBB) | 28/10/2022 | Jul 2021 | $1,000,000 | +23.0bp | $100.839 | $8,390 |
| NAB (AA-) | 19/06/2024 | Aug 2021 | $1,300,000 | +18.25bp | $102.081 | $27,053 |
| ANZ (AA-) | 29/08/2024 | Aug 2021 | $1,500,000 | +19.0bp | $101.744 | $26,160 |
| UBS (A+) | 08/03/2023 | Sep 2021 | $3,000,000 | +23.0bp | $100.963 | $28,890 |
| B. Comm (A-) | 28/10/2022 | Sep 2021 | $1,500,000 | +25.0bp | $100.691 | $10,365 |
| WBC (AA-) | 16/08/2024 | Sep 2021 | $1,600,000 | +29.0bp | $101.682 | $28,416 |
| B. China (A) | 17/10/2022 | Oct 2021 | $1,000,00 | +29.0bp | $100.687 | $6,870 |
| Soc. Gen. (A) | 17/07/2023 | Nov 2021 | $2,750,00 | +33.0bp | $100.992 | $27,280 |
| C. Suisse (A+) | 26/05/2023 | Nov 2021 | $6,500,00 | +32.0bp | $101.252 | $81,380 |
| B. Aust. (BBB) | 2/12/2022 | Jan 2022 | $1,000,000 | +42.0bp | $100.431 | $4,310 |
| NPB (BBB) | 6/02/2023 | Jan 2022 | $400,000 | +35.0bp | $101.121 | $5,088 |
| NPB (BBB) | 6/02/2023 | Jan 2022 | $1,000,000 | +35.0bp | $101.121 | $12,420 |
| NPB (BBB) | 6/02/2023 | Jan 2022 | $2,500,000 | +35.0bp | $101.121 | $28,025 |
| HSBC (AA-) | 27/09/2024 | Jan 2022 | $2,000,000 | +40.0bp | $101.140 | $22,800 |
| | | | **Total Realised Capital Gains FY2021-2022** | | | **$333,707** |

## *Council's Senior Fixed Bonds*

Since September 2020, Council placed parcels in NTTC (AA-) fixed bonds as follows:

| Investment Date | Maturity Date | Principal | Rate % p.a.^ | Remaining Term (Yrs) | Interest Paid |
|---|---|---|---|---|---|
| 10/09/2020 | 15/12/2022 | $2,000,000 | 0.90% | 0.46 | Annually |
| 30/09/2020 | 15/12/2023 | $2,000,000 | 1.00% | 1.46 | Annually |
| 24/11/2020 | 16/12/2024 | $1,000,000 | 0.90% | 2.47 | Annually |
| 16/02/2021 | 16/06/2025 | $1,000,000 | 0.90% | 2.96 | Annually |
| 16/02/2021 | 15/06/2026 | $5,000,000 | 1.00% | 3.96 | Annually |
| 12/05/2021 | 17/06/2024 | $3,000,000 | 0.80% | 1.97 | Annually |
| 12/05/2021 | 16/06/2025 | $3,000,000 | 1.10% | 2.96 | Annually |
| 12/05/2021 | 15/06/2026 | $3,000,000 | 1.30% | 3.96 | Annually |
| 20/05/2021 | 16/06/2025 | $3,500,000 | 1.10% | 2.96 | Annually |
| 09/09/2021 | 16/12/2024 | $2,500,000 | 0.90% | 2.47 | Semi-Annually |
| 09/09/2021 | 15/12/2026 | $5,000,000 | 1.40% | 4.46 | Semi-Annually |
| | **Totals / Wgt. Avg.** | **$31,000,000** | **1.07%** | **3.05 yrs** | |

*^Council has received the full rebated commission of 0.25% (plus GST) on the face value of investment on all these parcels (currently totalling $48,125).*

We believe these investments were prudent given the low rate environment and especially after the rate cut delivered in early November 2020 and its subsequent forward guidance on official interest rates. The NTTC bonds are a 'retail' offering and not 'wholesale' issuances. Given the lack of liquidity and high penalty costs if they were to be sold/redeemed prior to the maturity date, they are considered to be a hold-to-maturity investment and will be marked at par value ($100.00) throughout the term of investment.

During August 2021, Council also purchased into the following AAA rated covered fixed bond with ING Bank Australia. With yields rising significantly in recent months, Council may consider purchasing additional units in this security in the secondary market at the current yield to 'average-in' a better overall purchase price.

| Issuer | Rating | Maturity Date | ISIN | Face Value | Purchase Yield | Current Yield | Unrealised Gain / Loss ($) |
|---|---|---|---|---|---|---|---|
| ING | AAA | 19/08/2026 | AU3CB0282358 | $600,000 | 1.16% | 4.41% | -$72,482 |

## *Senior Fixed Bonds – ADIs (Secondary Market)*

As global inflationary pressures have escalated, this has seen a significant lift in longer-term bond yields (valuations fell) as markets have strongly factored in a tightening of global central bank policy measures (i.e. withdrawal of Quantitative Easing and lifting official interest rates).

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the majority now being marked at a significant discount to par (please note supply in the secondary market may be limited on any day):

| ISIN | Issuer | Rating | Capital Structure | Maturity Date | ~Remain. Term (yrs) | Fixed Coupon | Indicative Yield |
|---|---|---|---|---|---|---|---|
| AU3CB0255776 | ING | AAA | Covered | 07/09/2023 | 1.19 | 3.00% | 3.93% |
| AU3CB0258465 | Westpac | AA- | Senior | 16/11/2023 | 1.38 | 3.25% | 3.93% |
| AU3CB0265403 | Suncorp | AA- | Senior | 30/07/2024 | 2.08 | 1.85% | 4.41% |
| AU3CB0265593 | Macquarie | A+ | Senior | 07/08/2024 | 2.11 | 1.75% | 4.49% |
| AU3CB0265718 | ING | AAA | Covered | 20/08/2024 | 2.14 | 1.45% | 4.47% |
| AU3CB0266179 | ANZ | AA- | Senior | 29/08/2024 | 2.17 | 1.55% | 4.31% |
| AU3CB0266377 | Bendigo | BBB+ | Senior | 06/09/2024 | 2.19 | 1.70% | 4.49% |
| AU3CB0268027 | BoQ | BBB+ | Senior | 30/10/2024 | 2.34 | 2.00% | 4.60% |
| AU3CB0269710 | ANZ | AA- | Senior | 16/01/2025 | 2.55 | 1.65% | 4.41% |
| AU3CB0269892 | NAB | AA- | Senior | 21/01/2025 | 2.56 | 1.65% | 4.41% |
| AU3CB0270387 | Macquarie | A+ | Senior | 12/02/2025 | 2.62 | 1.70% | 4.69% |
| AU3CB0287415 | Westpac | AA- | Senior | 17/03/2025 | 2.71 | 2.70% | 4.51% |
| AU3CB0280030 | BoQ | BBB+ | Senior | 06/05/2026 | 3.85 | 1.40% | 5.09% |
| AU3CB0282358 | ING | AAA | Covered | 19/08/2026 | 4.14 | 1.10% | 4.57% |
| AU3CB0284149 | BoQ | BBB+ | Senior | 27/10/2026 | 4.33 | 2.10% | 5.14% |
| AU3CB0286037 | Westpac | AA- | Senior | 25/01/2027 | 4.57 | 2.40% | 4.77% |

## *CFS Global Credit Income Fund*

For the month of June, the CFS Global Credit Income Fund returned -2.12% (actual), underperforming the AusBond Bank Bill Index return of +0.05% (actual), while outperforming the AusBond Credit Index return of -1.34% (actual).

Credit markets were sold off reflecting a continued lack of liquidity as well as uncertainty over the direction of global growth. The upward pressure on inflation and increasing hawkishness by global central bankers have continued to be the main theme impacting fixed income markets. The second supply shock (following the first, which is the pandemic) from the invasion of Ukraine has been pushing inflation higher, with energy and food the key drivers. Central bankers continue to talk tough and deliver rate hikes or have signalled that a rate hike cycle will soon commence. This global pressure on interest rates have continued to pressure returns from fixed income portfolios.

Although it has been a relatively volatile environment for credit over the past few years, it has been one of Council's best performing assets over the longer-term. The portfolio continues to accumulate high running-income in excess of the benchmark across all corporate and financial sectors. The Fund holds a diverse range of securities across the global credit market. It remains very well diversified by issuer in order to mitigate default risk. It invests in nearly 600 corporate bonds from issuers in various countries and industry sectors. Any spread contraction going forward allows credit and asset-backed holdings to enjoy significant capital gains.

*With a running yield of ~+4% p.a., we recommend Council to retain this investment given the alternative investments in complying fixed interest products are largely earning below this rate of return*.

## *NSW T-CorpIM Growth Fund*

**The Growth Fund returned -4.17% (actual) for the month of June**. The losses this month were led by the selloff in domestic and global shares (S&P ASX 200 Accumulation Index fell -8.77% while the MSCI World ex-Australia Index fell -8.69%), as well as fixed bonds (AusBond Composite Bond Index dropped -1.48%).

While shares were sold off aggressively, there was also ongoing moves in both government bond markets and credit markets, which detracted from performance. Renewed hawkish rhetoric from several central banks disrupted risk assets including shares and bonds. Markets have been focusing on the risk for a recession as the global economy is facing strong headwinds from both inflation and policy. This environment has just started, and this ebb and flow of market sentiment is likely to persist for months, or even quarters, and provide a volatile backdrop for investors.

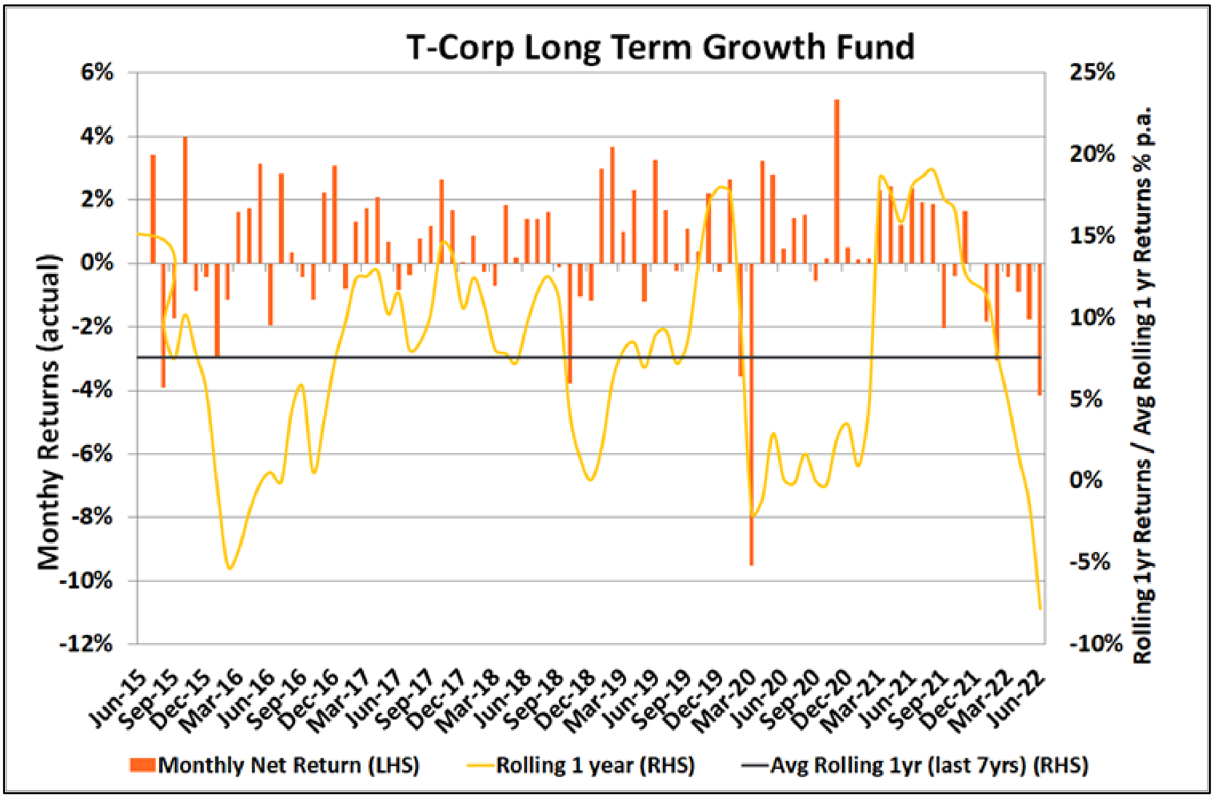
The question investors are seeking is will the rate hikes work effectively to fix the problem? Central banks have tools to manage liquidity and the demand side of the economy. So, if inflation is largely a supply-driven problem, then hiking rates may not resolve the core of the inflation problem. What higher rates will eventually do is slow aggregate demand. Meanwhile, when will the supply shock end?

The economic and policy environment facing asset markets is challenging. We should expect periodic spikes in volatility to continue in the months and quarters ahead.

Overall, we remain cautious on the future performance of the T-Corp Growth Fund given the high volatility associated with a diversified growth fund, which generally allocates a range of 60%-80% in domestic and international shares. Investors are bracing for central banks to raise official rates more aggressively than previously anticipated to combat inflation driven by supply-chain bottlenecks, a global energy crunch and ongoing geopolitical risks.

The Fund should be looked at with a long-term view, with a minimum holding period of +7 years. Given the exposure to the volatile asset of shares, Council should expect to see, on average, a negative month once every 3 months over a long-term holding period.

| Since Inception | T-Corp Long Term Fund |
|---|---|
| Negative Months | 135 (~1 in 3 months) |
| Positive Months | 261 |
| Total Months | 396 (33.0 yrs) |
| Average Monthly Return | +0.64% (actual) |
| Median Monthly Return | +1.02% (actual) |
| Lowest 1 year Rolling Return | -21.12% p.a. (Nov 2008) |
| Highest 1 year Rolling Return | +29.89% p.a. (Jan 1994) |


T-Corp Long Term Growth Fund
Monthly Returns (actual)
6%
4%
2%
0%
-2%
-4%
-6%
-8%
-10%
-12%
25%
20%
15%
10%
5%
0%
-5%
-10%
Rolling 1yr Returns / Avg Rolling 1 yr Returns % p.a.
Jun-15 Sep-15 Dec-15 Mar-16 Jun-16 Sep-16 Dec-16 Mar-17 Jun-17 Sep-17 Dec-17 Mar-18 Jun-18 Sep-18 Dec-18 Mar-19 Jun-19 Sep-19 Dec-19 Mar-20 Jun-20 Sep-20 Dec-20 Mar-21 Jun-21 Sep-21 Dec-21 Mar-22 Jun-22
Monthly Net Return (LHS)
Rolling 1 year (RHS)
Avg Rolling 1yr (last 7yrs) (RHS)

# Economic Commentary

## *International Market*

Risk assets plummeted in June as recessionary fears escalated given the surge in bond yields and the need for central banks to increase their hawkishness to control inflation.

In the US, the S&P 500 Index plunged -8.39%, while the NASDAQ fell -8.71%. Europe's main indices were also sold off, led by Germany's DAX (-11.15%), France's CAC (-8.44%) and UK's FTSE (-5.76%).

The US Federal Reserve increased rates by 75bp in June, the largest rate increase since 1994, taking the Fed funds target range to 1.50%-1.75%. This decision was instigated by their latest headline inflation reading being +1.0% m/m (against +0.7% expected), taking the annual rate to +8.6% y/y, its highest since 1981. The new Funds Rate projections show the median dot for end-2022 lifted from 1.75-2.00% to 3.25-3.50%.

US Fed Chair Powell said the Fed has an unconditional commitment to restoring price stability, commenting "*my colleagues and I are acutely focused on returning inflation to our 2% objective*" and that they would raise rates "*expeditiously*". He also commented that the path to achieving a soft landing is getting narrower.

The US unemployment rate remained unchanged at 3.6%, with gains filled from returning participation. Hourly earnings growth steady at +0.3% m/m.

The Bank of England (BoE) hiked rates by 25bp for its fifth back-to back rise, taking Bank Rate to 1.25%.

UK CPI came in no-worse than expected, lifting to an annual rate of +9.1% from +9.0%. Leading the +0.7% monthly rise was a +1.5% jump in food prices.

ECB President Lagarde said inflation is too high and that the ECB must act but went no further than to reiterate that rates will rise by 25bp in July.

Canada's latest CPI read came in well above expectations, headline CPI up to +7.7% in May from +6.8% and +7.3% expected.

The MSCI World ex-Aus Index fell -8.69% for the month of June:

| Index | 1m | 3m | 1yr | 3yr | 5yr | 10yr |
|---|---|---|---|---|---|---|
| S&P 500 Index | -8.39% | -16.45% | -11.92% | +8.77% | +9.33% | +10.76% |
| MSCI World ex-AUS | -8.69% | -16.56% | -15.60% | +5.49% | +5.98% | +7.70% |
| S&P ASX 200 Accum. Index | -8.77% | -11.90% | -6.47% | +3.34% | +6.83% | +9.29% |

*Source: S&P, MSCI*

## *Domestic Market*

The RBA modestly surprised the market in its meeting in June, with its 50bp hike to the Official Cash Rate, moving it to 0.85%. It cited inflation was higher than they expected just a month ago, with pressure coming not just from global forces but also domestic influences, including higher gas and electricity prices as well as (more tellingly) tight labour markets and therefore an implied expectation that wages are in process of rising more sharply.

RBA Governor Lowe expected inflation will peak at a "*very high*" 7% late this year, from an earlier forecast of 6%. Dr Lowe also commented that it was "*reasonable*" to expect the cash rate to eventually reach 2.5%, in line with the midpoint of the inflation target, but he admitted it was "*unclear*" how high rates would go and how quickly.

The Board is still seen raising rates 50bp in July and August and reinstated the upgraded forecast for inflation to peak around 7% in Q4 this year (from 6% in May). Lowe emphasised that inflation did not need to return to target immediately, but also noted that the RBA needed to "*chart a credible path back to an inflation rate of 2 to 3%*".

The unemployment rate remain unchanged at 3.9% in May, with employment surging +60.6k. The participation rate moved up 0.3% to 66.7%, a new record high.

The trade surplus increased $0.8bn to $10.5bn in April (consensus $9.0bn). The increase was driven by a 1% rise in exports and a 0.7% fall in imports.

APRA finalised revisions to its prudential framework, as contained within APS 220. The final revisions are effectively as set out under the draft proposals published in November 2021. The new macroprudential policy sets out more quantitative measures including the requirement for ADIs to apply residential mortgage serviceability buffers (a loan interest buffer of at least 3.0% applied, unless determined otherwise by APRA).

The Australian dollar fell -4.15%, finishing the month at US68.89 cents (from US71.87 cents the previous month).

## *Credit Market*

The global credit indices widened significantly over the month in the 'risk-off' environment. They are back to their levels experienced during the start of the pandemic (Q1 2020):

| Index | June 2022 | May 2022 |
|---|---|---|
| CDX North American 5yr CDS | 101bp | 79bp |
| iTraxx Europe 5yr CDS | 119bp | 84bp |
| iTraxx Australia 5yr CDS | 130bp | 95bp |

*Source: Markit*

# Fixed Interest Review

## *Benchmark Index Returns*

| Index | June 2022 | May 2022 |
|---|---|---|
| Bloomberg AusBond Bank Bill Index (0+YR) | +0.05% | +0.03% |
| Bloomberg AusBond Composite Bond Index (0+YR) | -1.48% | -0.89% |
| Bloomberg AusBond Credit FRN Index (0+YR) | +0.05% | -0.08% |
| Bloomberg AusBond Credit Index (0+YR) | -1.34% | -0.58% |
| Bloomberg AusBond Treasury Index (0+YR) | -1.32% | -1.00% |
| Bloomberg AusBond Inflation Gov't Index (0+YR) | -2.23% | -2.28% |

*Source: Bloomberg*

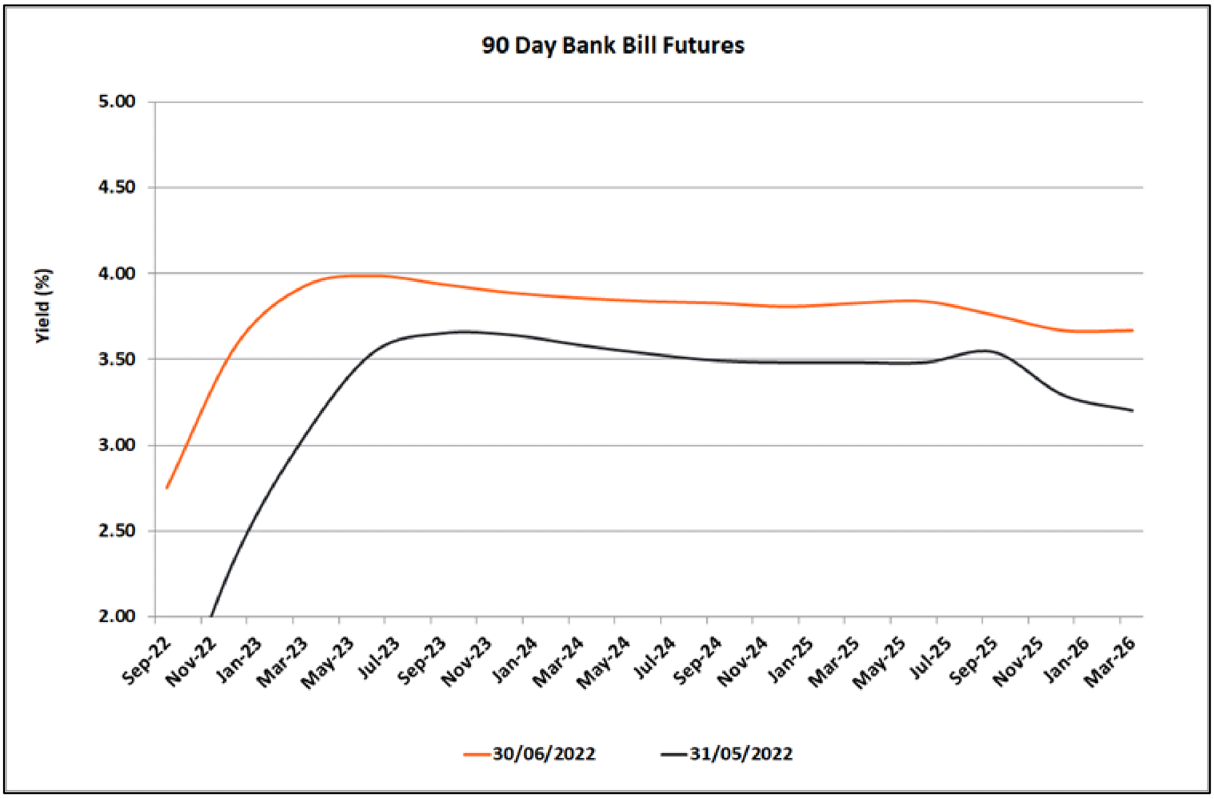
## *Other Key Rates*

| Index | June 2022 | May 2022 |
|---|---|---|
| RBA Official Cash Rate | 0.85% | 0.35% |
| 90 Day (3 month) BBSW Rate | 1.81% | 1.18% |
| 3yr Australian Government Bonds | 3.16% | 2.86% |
| 10yr Australian Government Bonds | 3.66% | 3.35% |
| US Fed Funds Rate | 1.50%-1.75% | 0.75%-1.00% |
| 10yr US Treasury Bonds | 2.98% | 2.85% |

*Source: RBA, AFMA, US Department of Treasury*

## *90 Day Bill Futures*

Over June, bill futures rose sharply at the short-end of the curve after the RBA hiked rates by 50bp and flagged further rate rises in the immediate future. The market continues to factor in the possibility of a recession over the next few years, highlighted by the drop in the futures pricing in 2024-2025:

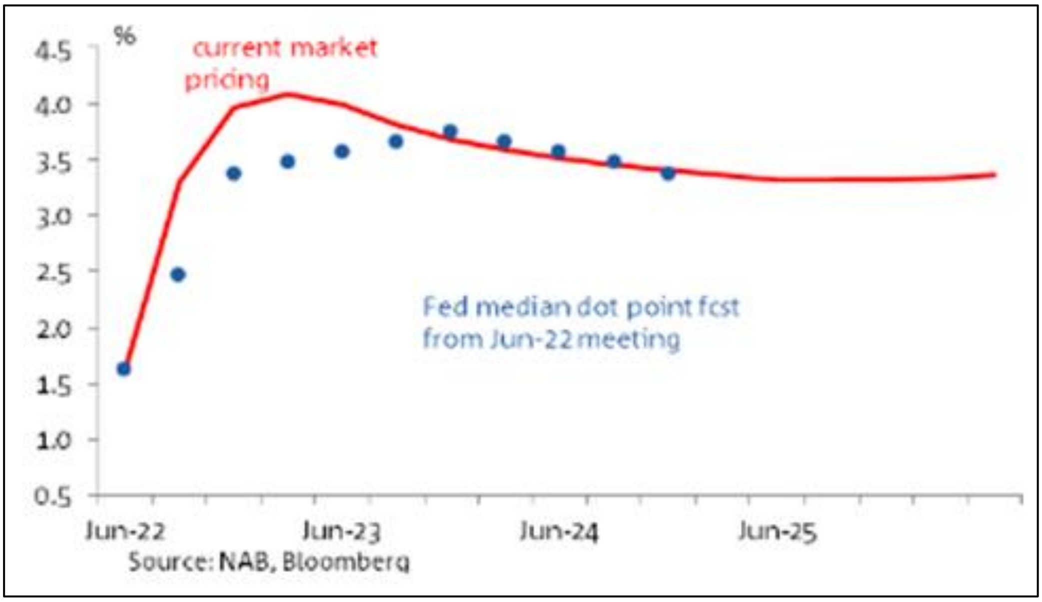



*Source: ASX*

# Fixed Interest Outlook

US Fed Chair Powell reiterated their commitment to raising rates "*expeditiously*" (75bp of tightening on 27th July largely priced in), while acknowledging the path to achieving a soft landing is becoming narrower.

The current US Fed dot plots is now pointing to 325bp of tightening in 2022, up from 175bp. The median projection for the funds rate is 3.375% by end 2022 (up from 1.875%), 3.75% by end 2023 (up from 2.625%) and 3.375% by end 2024 (up from 2.625%).

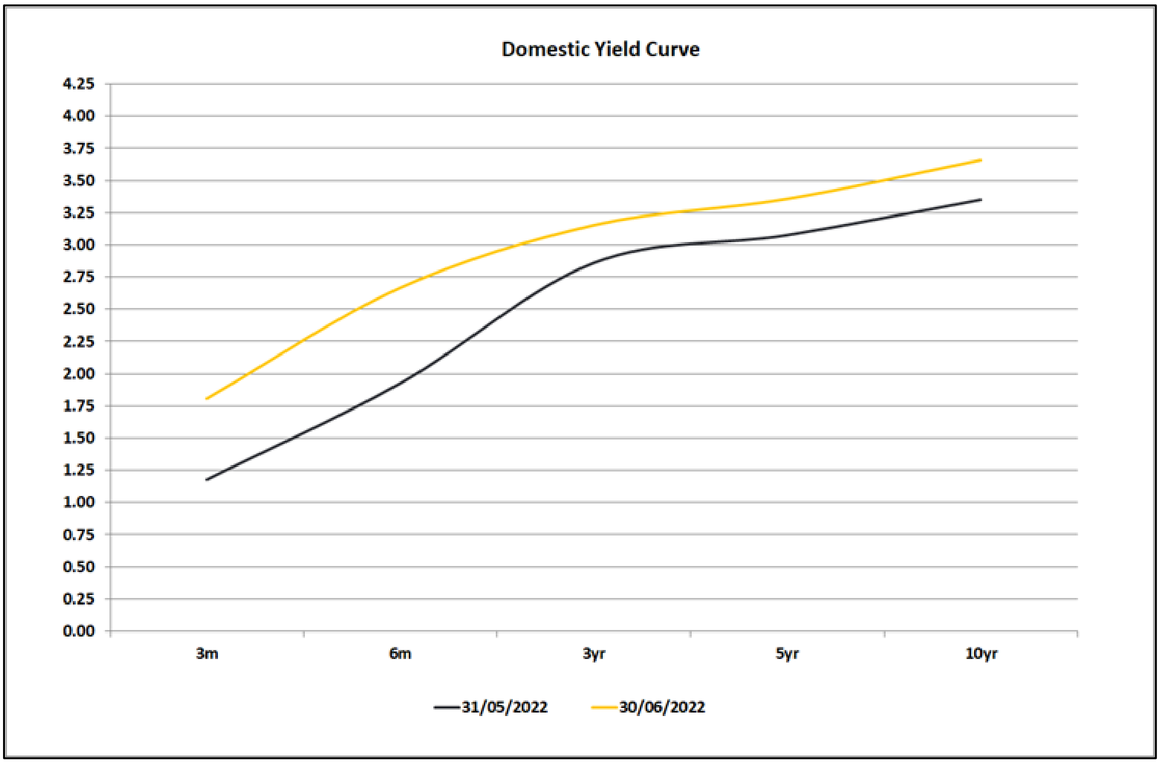



Domestically, after the RBA lifted rates by 50bp in June, they have clearly pivoted along with several other global central banks undertaking the same strategy, commenting "*given the current inflation pressures in the economy, and the still very low level of interest rates, the Board decided to move by 50bp [in June]. The Board expects to take further steps in the process of normalising monetary conditions in Australia over the months ahead".*

The combination reinforced the view that the previous level of extraordinary monetary support was no longer necessary, while a further deterioration in the inflation outlook compared to even the previous month (on higher energy and electricity prices), meant a quicker move was required.

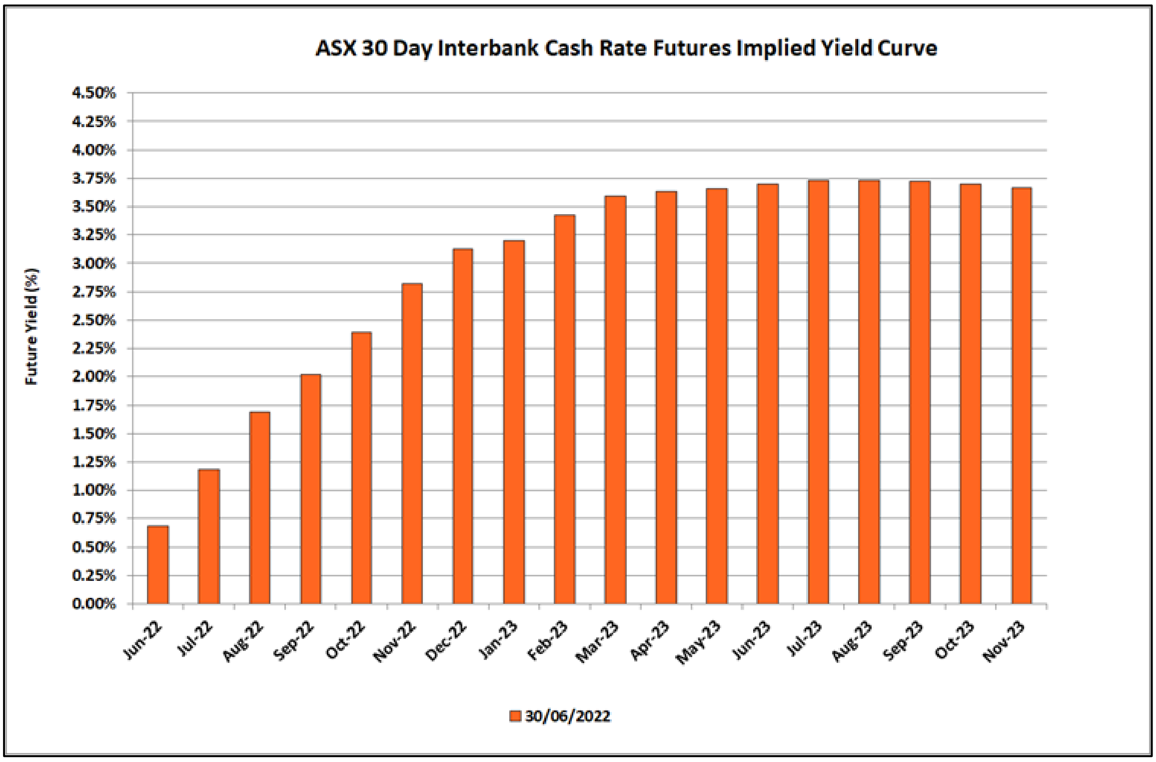
The RBA will continue to adjust rates in the months ahead. Inflation pressures remain strong and core inflation remains significantly higher than expected. With economic activity and the labour market remaining relatively strong for now, it is possible that the RBA will raise rates towards 1.60%-1.85% within the next two months (a further 75-100bp of tightening), with further 25bp moves expected later in the year to deliver a cash rate to at least around 2½-3% by the end of 2022.

The domestic bond market continues to suggest a prolonged low period of interest rates on a historical basis (10-year government bond yields still under 4%). Over the month, yields rose around 30bp at the long-end of the curve:




*Source: AFMA, ASX, RBA*

Markets are currently pricing in around twelve additional rate rises over the next two years (up to 3¾%), although if the recessionary fears come to fruition, the RBA is likely required to monitor its 'terminal rate':




*Source: ASX*

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