

Description/strategy

The Fund's investment strategy is to identify appropriate investments from the pool of Australian sovereign and Australian senior bank bonds that are expected to generate a sufficiently high yield, commensurate with the assumed risk, with minimum volatility of returns. The Fund is not benchmark aware so is without a duration target. It is focused on achieving an absolute return. The Fund is best suited to investors who seek a low to medium risk investment over a 1 to 3-year period.

Investment objectives

To provide income and capital stability and a high degree of liquidity in all market conditions. The total return will mainly comprise income from security income payments. The target rate of return is the Bank Bill Swap Rate plus 1.5% before fees.

ESG

Environmental, Social and Governance issues form part of the risk analysis framework.

Fund details

DDH Graham Limited (DDH) is the responsible entity of the fund. As responsible entity, DDH is responsible for the management and administration of the Fund, including the issue of the fund's Product Disclosure Statement and all other public announcements concerning the Fund.

DDH has appointed GCI Australia Pty Ltd ABN 68 140 364 576 (GCI) as the Fund's outsourced investment manager. GCI is a private, boutique asset manager that has significant experience across the many facets of financial markets.

APIR Code DDH8305AU
ARSN 622 419 578

Fund availability

This Fund can be accessed by investing directly, or indirectly, using the BT Panorama, Allan Gray, HUB24, Netwealth and Macquarie Wrap platforms.

Performance to 30 September 2022 (annualised)

	1M %	3M %	6M %	1Y %	2Y %	3Y %	5Y %	Since inception
Total Return	-0.53	0.17	-1.46	-4.80	-2.51	-1.21	n/a	0.24
Cash Distribution	0.30	0.30	0.60	1.14	1.09	1.20	n/a	1.65
+/- Growth	-0.83	-0.13	-2.06	-5.94	-3.60	-2.41	n/a	-1.40
Index	0.15	0.42	0.49	0.52	0.28	0.38	n/a	0.92

*Fund returns are net of all fees – may not sum due to rounding

Australian index returns 30 September 2022

Index	1M Return	3M Return	12M Return
Bloomberg Australia Bank Bill Index	0.15%	0.42%	0.52%
Bloomberg Australia Gov't 3-5 Yr Index	-0.91%	-0.38%	-8.38%
Bloomberg Australia Composite 0-3 Yr Index	-0.29%	-0.07%	-2.99%
Bloomberg Australia Composite 3-5 Yr Index	-1.01%	-0.37%	-8.76%
Bloomberg Australia All Maturities Composite Index	-1.36%	-0.64%	-11.36%

Returns are calculated using exit prices and are calculated after all fees and costs have been deducted, assumes any distributions are reinvested and no allowance made for tax. The 'distribution' component represents the amount paid by way of distribution, including net realised capital gains. Numbers may not sum due to rounding. Past performance is not an indicator of future performance.

The benchmark is the Bloomberg Australian Bank Bill Index. The inception date of the fund was 25 October 2004. E&P commenced as Investment Manager on 31 December 2010. GCI commenced as Investment Manager on 01 July 2015.

Fund rating

Initially rated 'Favourable' by SQM Research in December 2018, the Fund was upgraded to 'Superior' in December 2020.



Fund Size

As at 30 September 2022, the Net Asset Value of the Fund was \$78,813,546.32.

Portfolio characteristics 30 September 2022

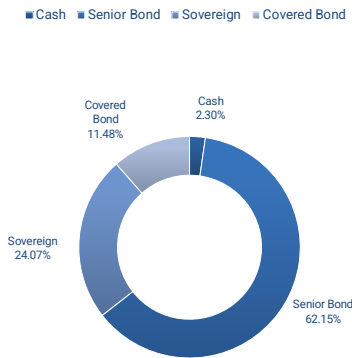
Running Yield	3.86%
Yield to Maturity	4.55%
Average Margin	1.49%
Average Years to Maturity	2.89
Number of Securities Held	36
Floating	28.04%
Fixed	69.66%
Cash	2.30%
Modified Duration	2.61
Credit Duration	0.54

Fees

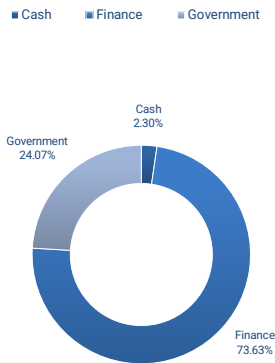
MER	0.40%
Buy/Sell Spread	+0.10%/-0.10%
Performance Fees	Nil

Asset breakdown

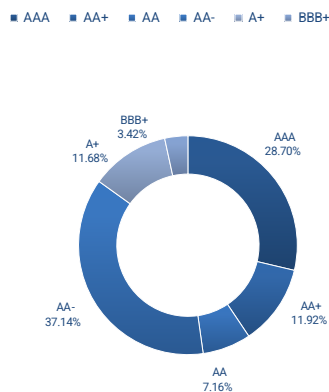
Sub Type Analysis



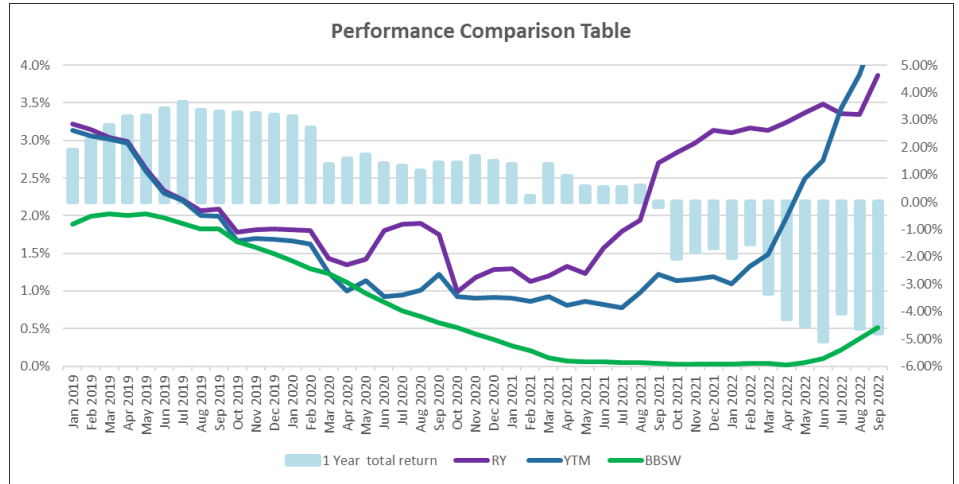
Sector Allocation



Credit Rating



Performance

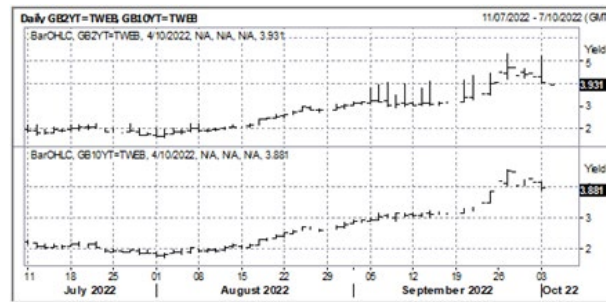


Source GCI Australia, DDH Graham data

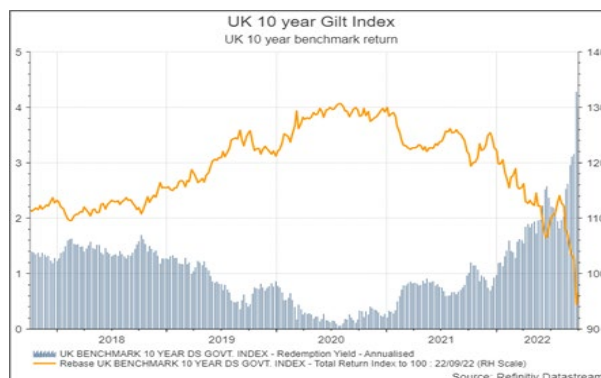
The current market dynamic to appreciate, is that the sharp rise in rates recently has meant that a good portion of the portfolio holdings are trading below par value with less than 18 months to redemption. As there is little credit risk in the portfolio, given the universe of sovereign and bank senior bonds, the value of these bonds must naturally rise to par value as the maturity dates approach. This will mean that performance volatility will decline, and the portfolio will look and behave much more like a term deposit portfolio because, like a term deposit, you are buying bonds trading at a discount to par value. This will mean that the return should rise steadily towards the YTM of 4.55% (or higher if the 90-day BBSW rate keeps rising).

Market review & outlook

September has proved to be a dramatic month for global bond markets with yields under growing pressure from the lagging impact of the pandemic shutdowns that are contributing to the inflation readings right across the developed world. This culminated in the dramatic and exaggerated reaction to the new UK budget, which once again showed that the markets can become unstable and inefficient at pricing information, in the short term. The UK 2 & 10-year yields began to surge on the 20th of September (notably 2 days ahead of the budget announcement) with the 2-year gilt yield surging from 3.16% on the 20th to the intraday peak of 5.51% on the 28th. The markets over reaction to the budget announcement was why the Bank of England was compelled to engage a bond price stabilization programme on the 28th.



The other aspect that needs to be appreciated is that markets are often volatile at key turning points, in reflection of the thundering herd shifting its consensus view on the outlook. Although it is too early to definitively call September as the peak in bond yields, the pivot point is certainly a lot closer than it was just a month ago. The following chart displays the capitulation like sell-off in UK bonds (increase yield) and the dramatic impact on the benchmark return index.



The sell-off of UK bonds then flowed into all developed economy bond markets with an adjustment made to the forecast real 5-year rates. The following chart shows this move in 5-year yields in both the UK and the US.



In an Australian context the benchmark yield curve initially moved upwards by a similar degree to the US benchmark curve in reaction to the UK bond sell off. Bond yields then fell heavily when the Bank of England announced a bond buying program intended to stabilise what was described as a dysfunctional market.



At the September RBA interest meeting the RBA increased rates by 50 basis points (bps) as expected. The speech that accompanied this decision by Governor Lowe contained three key phrases.

These were:

- “We are conscious that there are lags in the operation of monetary policy and that interest rates have increased very quickly”.
- “And we recognise that, all things equal, the case for a slower pace of increase in interest rates becomes stronger as the level of cash rate rises”.
- “But how high interest rates need to go and how quickly we get there will be guided by the incoming data and the evolving outlook for inflation and the labour market.”

In early September some market participants interpreted this statement as ‘dovish’, but it was not until the October meeting that this dovish tilt was confirmed when the RBA only increased rates by 25bps. The smaller than expected rate increase was widely interpreted as the first dovish pivot by a developed economy central bank. This also accentuated a fall in the Australian dollar to fresh 2-year lows suggesting that the market believes that the RBA terminal interest rate peak will be below the market consensus of 3.10% - 3.35%. This change to the outlook by the market resulted in the 2 to 10-year yield spread increasing from near 40bps to near 60bps. At least one major bank interpreted the dovish tilt by the RBA as increasing the risk of higher inflation readings that will require a higher terminal rate in 2023.

Fund positioning

The GACS is an absolute return fund without a fixed duration mandate. At this stage we do not plan to alter the fixed duration from the current 2.6 years as the benchmark curve has still a normal shape and is relatively steep in the 2 to 5-year part of the curve. This fixed duration level provides a balance between the certainty of returns over the near term and avoiding credit risk exposure (5-year iTraxx index has jumped from near 100 to over 144 in just the past week). It also provides scope to roll out to longer duration bonds as maturities occur and attain a yield increase.

We have been gradually, and will continue, shifting funds out of bank bonds and into sovereign bonds where the recent rise in yields offers the same or higher yields with much lower risk. Two years ago, the average rating of the fund would have been AA- whereas it is now AA+. There may come a time where the portfolio is entirely sovereign holdings.

ESG

As an Investment Manager we employ the same ESG policies across all our mandates. We recognise that certain industries represent increased risk from not meeting prescribed ESG principles. This risk can be at a few levels:

- Government regulatory changes.
- Access to capital markets.
- Market pricing reflecting community perceptions.

Our focus is primarily on investigating the governance structures of each issuer as this is central to understanding the underlying business risks. Attention is also given to the level of equality and diversity because we have found that in the long term, businesses that employ the best people regardless of their gender, racial background or age tend to outperform. As part of this we would exclude any business that relies on a supply chain that utilises modern slavery.

Across all the discretionary mandates of GCI Australia there is no exposure to the following industries:

- Gambling.
- The Australian power sector at both generation and distribution levels.
- Fossil fuel mining (coal, gas, oil, uranium).

We do not chase higher short-term returns by investing in offshore company securities because of the increased risks that include currency but also regulatory differences that protect the Australian financial system. Identifying inadequate governance practices is more difficult offshore when we don't fully understand the cultural practices.

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