DDH PREFERRED INCOME FUND
MONTHLY REPORT – OCTOBER 2022

Description/strategy

The fund's investment strategy is to identify appropriate investments to generate a sufficiently high yield, considering risk and minimum volatility of returns. The fund is constructed with reference to macroeconomic factors and industry exposure. The fund does not employ leverage either directly or using derivatives and has no offshore currency or market exposure. Up to 30% of the Fund can be invested in non-investment grade securities (S&P, Fitch rated below BBB-, Moodys rated below Baa3). The fund is best suited to investors who seek a medium risk investment over a 3 to 5-year period.

Investment objectives

The DDH Preferred Income Fund aims to provide unitholders with returns in excess of cash and bank deposits over the medium to long term by investing in Australian sovereign bonds, senior & subordinate debt issued by Australian financial institutions, senior & subordinate bonds issued by Australian corporates and ASX-listed hybrid and debt securities. The return is a combination of income distribution and capital growth. The target rate of return is the Bank Bill Swap Rate plus 350 basis points.

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 DDH0001AU.

ARSN 108 161 575

Fund availability

This fund can be accessed by investing directly, or indirectly, using the Wealth02, HUB24, Netwealth, OneVue, Praemium Investment, Ausmaq, BT Panorama, Macquarie Wrap and Australian Money Market platforms.

Performance to 31 October 2022 (annualised)

	1M %	3M %	6M %	1Y %	2Y %	3Y %	5Y %	Since Inception
Total Return	**0.47**	**0.94**	**-0.06**	**-1.41**	**1.69**	**1.66**	**2.89**	**4.30**
Cash Distribution	0.00	0.85	1.74	3.39	3.24	3.14	3.62	5.34
+/- Growth	0.47	0.08	-1.80	-4.80	-1.55	-1.48	-0.73	-1.04
Index	0.24	0.54	0.75	0.76	0.39	0.43	0.97	3.33

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

Australian index returns 31 October 2022

Index	1m Return	3M Return	12M Return
Bloomberg Australia Bank Bill Index	0.24%	0.54%	0.76%
Bloomberg Australia Gov't 3-5 Year Index	1.30%	-1.33%	-4.15%
Bloomberg Australia Composite 0-3 Year Index	0.53%	-0.34%	-1.54%
Bloomberg Australia Composite 3-5 Year Index	1.04%	-1.73%	-4.84%
Bloomberg Australia Composite All Maturities Index	0.93%	-2.98%	-7.24%
ASX Bonds and Hybrids; All Issues incl. franking	-0.75%	1.75%	1.83%

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 2016 the Fund was upgraded to 'Superior' in December 2020.

Superior
SQM RESEARCH

Fund Size

As at 31 October 2022, the Net Asset Value of the Fund was $215,869,870.78.

Portfolio characteristics 31 October 2022

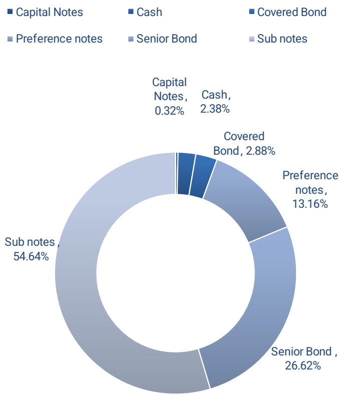
Running Yield	5.38%
Yield to Maturity	6.07%
Average Margin	2.98%
Average Years to Maturity	2.95
Number of Securities Held	41
Fixed	35.20%
Floating	62.42%
Cash	2.38%
Modified Duration	1.54
Credit Duration	1.56

Fees

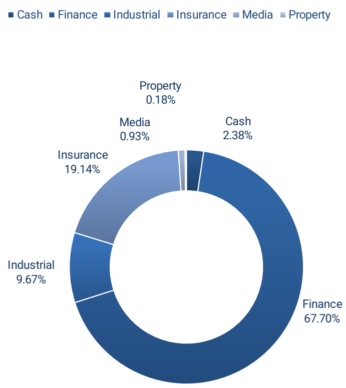
MER	0.82%
Buy/Sell Spread	+0.15% / -0.15%
Performance Fees	Nil

Asset breakdown

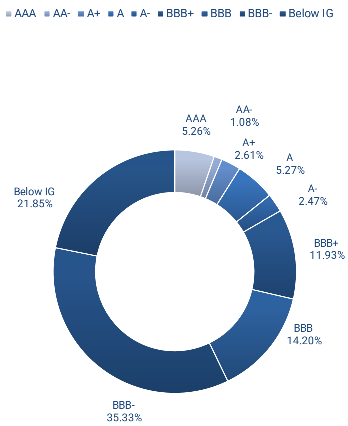
Sub Type Analysis



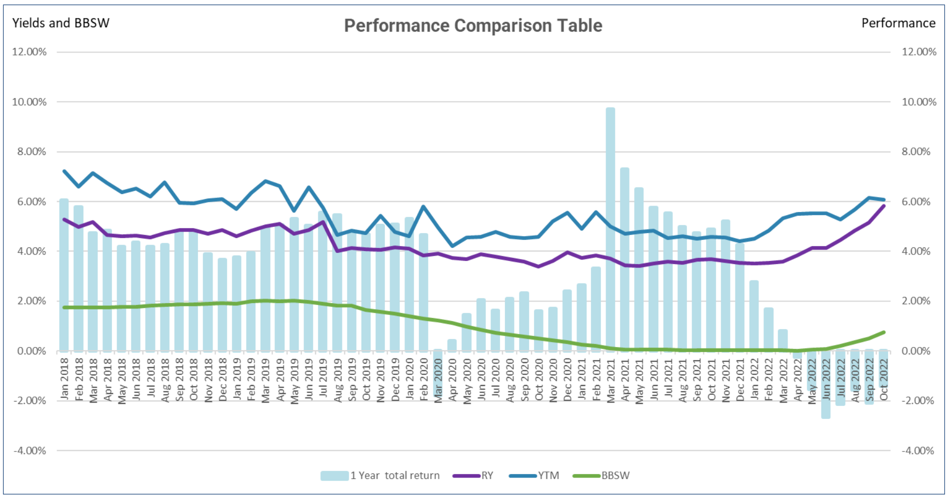
Sector Allocation



Credit Rating



Monthly performance

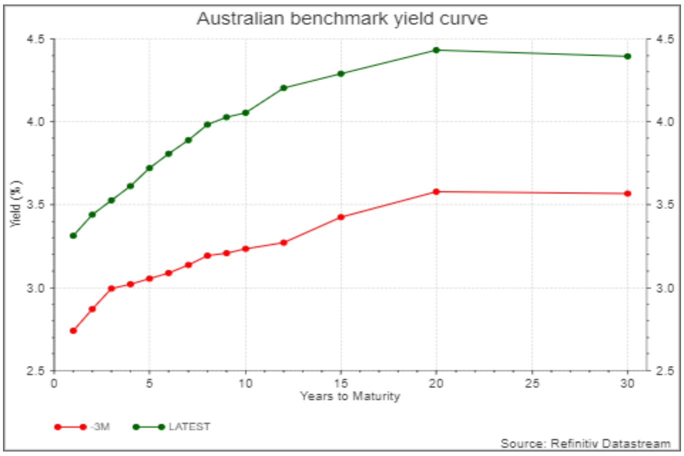


Source GCI Australia, DDH Graham data

The fund performance has begun to recover, underwritten by the rising 90-day BBSW rate linked running yield of 5.38% and the YTM of 6.07%.

Market review

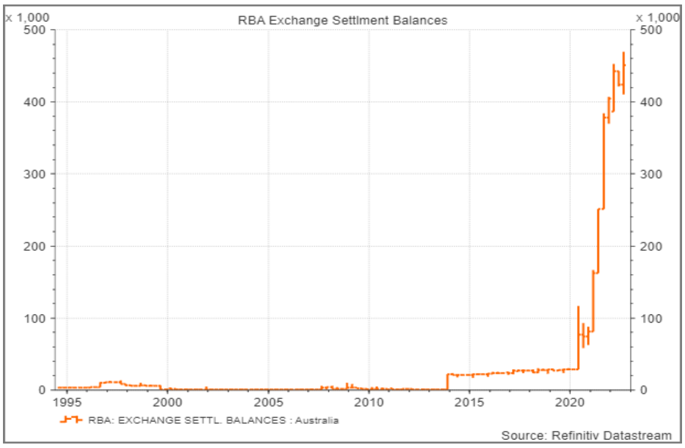
The Australian benchmark yield curve has retained a positive or normal shape, implying that recession is not expected here yet, by bond investors. The move in the curve over the past three months reflects a combination of offshore increases in bond yields and the higher-than-expected Australian inflation reading in September.



To some extent the Australian sovereign bond market – benchmark curve – has been distorted by the pandemic actions of the RBA. These distortions are likely to remain influential until April 2024 when the Term Finance Facility (TFF) funds need to be repaid to the RBA. The key signal that the Australian market is once again free of the pandemic distortions will be a fall in Exchange Settlement balances at the RBA.

The banks, as part of their high-quality liquid assets (HQLA) requirements, can hold either sovereign bonds or hold money at the RBA through the Exchange Settlement Account (ESA). The banks clearly took the excess stimulus of the RBA and parked this money at the RBA in the ESA, earning 10 basis points (bps) less than the RBA official cash rate. There are several implications of this action by the banks:

- It rendered the TFF ineffectual as the funds were lent back to the RBA.
- The banks would rather lend back to the RBA at zero risk, and a low return, than take credit risk lending or duration risk by purchasing sovereign debt as other HQLA assets.
- At the pivot point for rates – or maybe just after it – the banks will move money out of the ESA at the RBA and buy sovereign bonds.



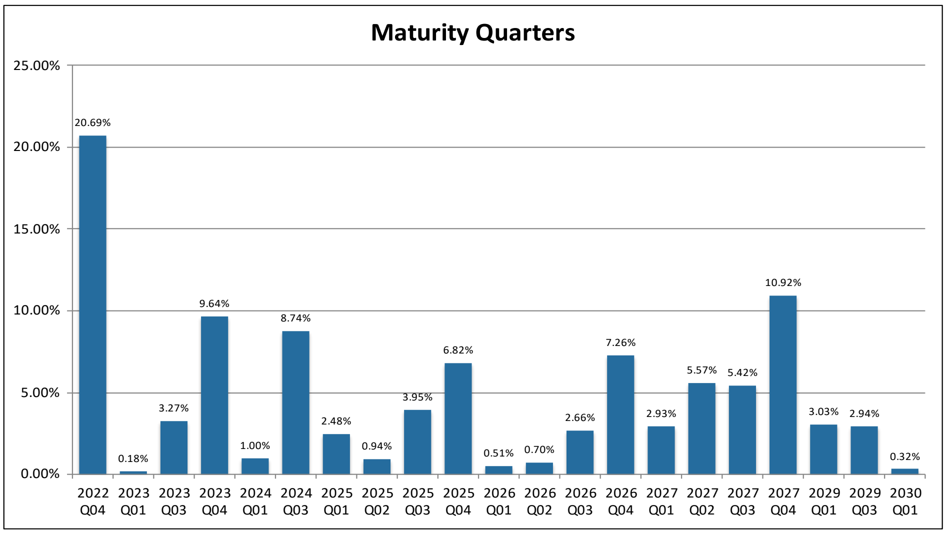
In contrast to the signal from the benchmark fixed yield curve, the Australian 5-year iTraxx index is signalling a rising risk of defaults connected with a deterioration in the economic outlook. This has been reflected in the recent senior bond 5-year bond issues where margins have moved from near 100bps to 120bps.

The margin expansion evident at a senior level, flowed into Tier 2 margins over the month but did not materialise in Tier 1 margins. Just one week apart CBA issued $1.77bn Tier 1 at a margin of 285bps and then $2bn Tier 2 at 280bps. This is an odd outcome as a Tier 2 security has more debt characteristics than a Tier 1 that gives it substantially less risk for investors.

Historically a Tier 1 security has been issued at a margin between 280bps and 500bps while a Tier 2 has been issued at a margin between 170bps and 290bps. The higher margin for the Tier 1 securities reflects that the distribution is discretionary, and while they have a first call date, they are perpetual securities like equity. In contrast, a Tier 2 has a call date but then a defined maturity date (usually 10 years) and its distribution is non-discretionary.

Fund positioning

A strategic move to reduce Tier 1 exposure and increase short-dated sovereign and bank senior bonds has stabilised returns with a strong yield and lower credit risk. This is a rare outcome because normally an increased yield is accompanied with increased risk. Given the current market yield opportunities the Fund can meet its mandate of 90-day BBSW plus 300bps with reduced credit risk by increasing AAA sovereign exposure.



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 longer 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.