

Description/strategy

The investment strategy of the Arculus Preferred Income Fund (name changed from DDH Preferred Income Fund on 29 November 2022) 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

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 (one of Australia's leading investment management businesses) ABN 68 140 364 576 (GCI) as the Fund's outsourced investment manager. Arculus Funds Management Pty Ltd (Arculus), a wholly owned subsidiary and Corporate Authorised Representative of GCI undertakes the investment management activities for the Fund.

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 December 2023 (annualised)

	1M	3M	6M	1Y	2Y	3Y	5Y	Since Inception
Total Return	1.41%	2.38%	4.17%	6.32%	2.85%	3.32%	3.48%	4.45%
Cash Distribution	1.43%	1.44%	2.93%	5.58%	4.46%	4.02%	3.78%	5.35%
+/- Growth	-0.02%	0.94%	1.24%	0.73%	-1.61%	-0.70%	-0.30%	-0.90%
Index	0.37%	1.06%	2.15%	3.89%	2.56%	1.71%	1.40%	3.36%

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

Australian index returns 31 December 2023

Index	1m Return	3M Return	12M Return
Bloomberg Australia Bank Bill Index	0.37%	1.06%	3.89%
Bloomberg Australia Gov't 3-5 Year Index	1.97%	2.93%	3.77%
Bloomberg Australia Composite 0-3 Year Index	0.94%	1.68%	3.64%
Bloomberg Australia Composite 3-5 Year Index	2.08%	3.04%	4.77%
Bloomberg Australia Composite All Maturities Index	2.69%	3.79%	5.06%
ASX Bonds and Hybrids; All Issues incl. franking	0.94%	1.52%	5.71%

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. Arculus 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 and reaffirmed in February 2023.



Fund Size

As at 31 December 2023, the Net Asset Value of the Fund was \$172,800,567.02.

Portfolio characteristics 31 December 2023

Running Yield	6.95%
Yield to Maturity	8.65%
Average Margin	4.29%
Average Years to Maturity	2.90
Number of Securities Held	53
Fixed	30.29%
Floating	67.67%
Cash	2.04%
Modified Duration	0.37
Credit Duration	2.15

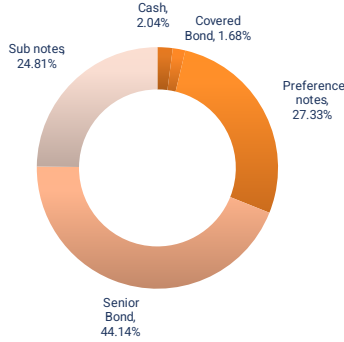
Fees

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

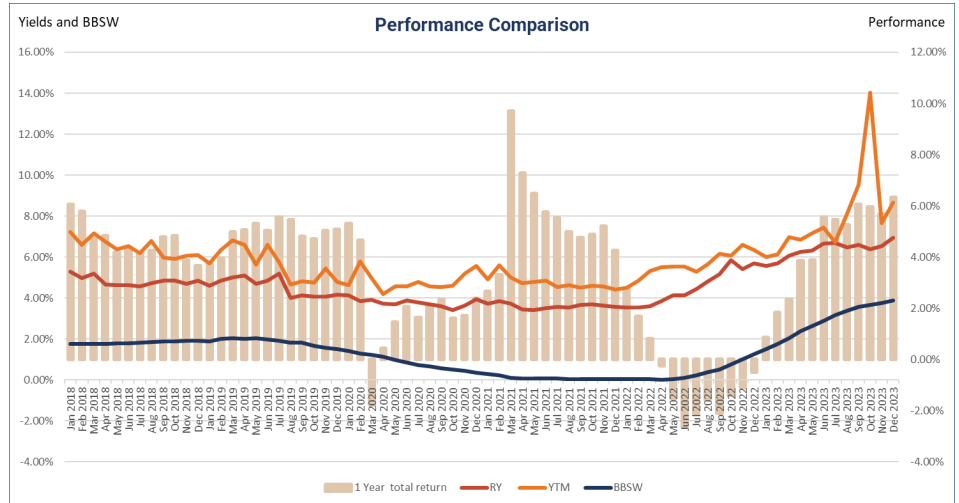
Asset breakdown

Sub Type Analysis

■ Cash ■ Covered Bond ■ Preference notes
■ Senior Bond ■ Sub notes



Performance

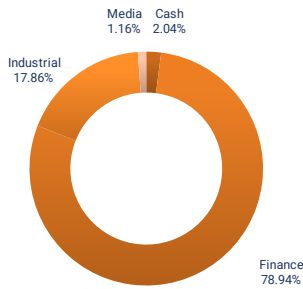


Source Arculus, DDH Graham data

The Fund returned a solid 2.38% over the December quarter which annualises at 9.52%. Performance over the outlook period will be supported by the current running yield of 6.95% and the yield to maturity (YTM) of 8.65%.

Sector Allocation

■ Cash ■ Finance ■ Industrial ■ Media



Market review

Although the investment universe of the Preferred Income Fund is restricted to Australian issuers, in Australian dollars, the free flow of capital across developed economies has meant that the bond markets move in unison. This can be seen in the following 2-year bond chart that shows a synchronistic fall in 2-year bond yields since November.

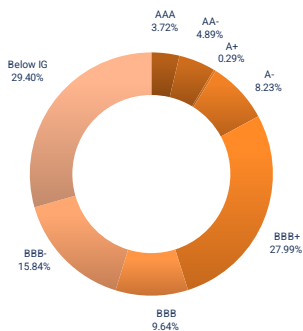


Source: LSEG Datastream

The dominant bond market is the US, where a rush of liquidity from banks exiting the US Federal Reserve Reverse Repo account ignited a rush into bonds in early November, which then spread onto the other developed economy markets. Understanding the US bond market is then pivotal to forecasting bond yields in Australia, not RBA official rate changes, but the changes in the yields of the bonds that are part of the Fund's investment universe.

Credit Rating

■ AAA ■ AA- ■ A+ ■ A- ■ BBB+ ■ BBB ■ BBB- ■ Below IG



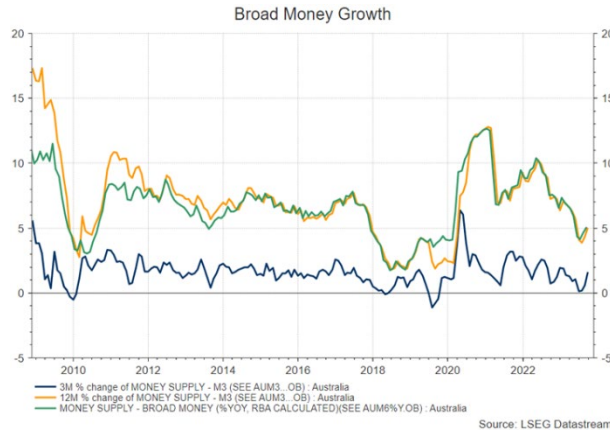
We have been firm believers for some time that the US Federal Reserve can afford and will want to leave rates on hold for quite some time. In contrast the market is currently priced for six (25 basis points (bps) each) rate cuts in 2024.

At the recent December FOMC meeting, rates were left on hold at 5.25%-5.50% and the dot point chart from the committee signalled three rate cuts (75bps total) in 2024. The dot point chart released after every meeting should never be accepted with absolute certainty and this is particularly true at the moment because it is not yet clear that inflation in the US is under control. The Federal Reserve has outlined four key risks to the outlook:

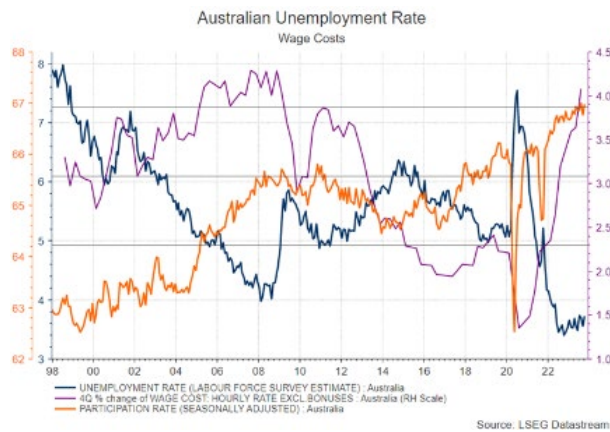
- Although the economy was resilient last year after multiple rate increases the natural lags in the economy may result in a contraction in business and consumer activity in the months ahead.
- Shelter and other services inflation remain higher than historical levels so this could mean that inflation remains above the 2% target longer than expected.
- Many businesses with pricing power may still increase prices more than expected.

- After 11 rate hikes the US economy remains surprisingly resilient with a strong labour market and consumer spending. The recent fresh high of the Dow Jones equity index is inconsistent with an economic contraction which would deliver the targeted lower inflation outcome.

In an Australian context, we have the firm view that the RBA has not done enough to contain the inflation risk. Firstly, it has not achieved negative broad money growth like the ECB and US Federal Reserve.



The RBA strongly believes in the Phillips Curve Theory – a belief that the government, with changes to fiscal policy, can control the unemployment and price outcomes – we can see in the chart below that higher inflation in the future is likely. Unemployment is well below the full employment level of unemployment (4.25%), while labour participation is near a record level and wages growth is accelerating. Consistent with this, the RBA should have begun reducing monetary stimulus the moment that unemployment fell below 4.25%.



Fund positioning

In early December credit duration was increased at a portfolio level when value emerged in the bank Tier 2 sector. Funds were switched from short-dated regional bank senior into major bank Tier 2 on spreads over the 90-day BBSW greater than 190bps. By the end of December these Tier 2 spreads had contracted into 170bps, which was the primary driver of the month's performance.

Over the month the portfolio's running yield was increased from 6.54% to 6.95% and the yield to maturity (YTM) from 7.65% to 8.65% in December. This sets the Fund for a distribution yield for the March quarter of 6.10% per annum.

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