

Strategy & Objective

The investment strategy of the Arculus Fixed Income Fund 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 of the 90-day BBSW rate plus 150bps. The Fund is best suited to investors who seek a low to medium risk investment over a 1 to 3-year period.

The Fund aims 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 (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 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 June 2024 (annualised)

	1M	3M	6M	1Y	2Y	3Y	5Y	Since inception
Total Return	0.38%	1.41%	3.23%	6.26%	4.87%	1.44%	1.25%	1.61%
Cash Distribution	1.14%	1.16%	2.31%	4.73%	3.78%	2.85%	2.24%	2.30%
+/- Growth	-0.76%	0.25%	0.92%	1.52%	1.09%	-1.41%	-0.99%	-0.68%
Index	0.35%	1.08%	2.18%	4.37%	3.63%	2.44%	1.64%	1.71%

* Fund returns are net of all fees. 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 inception date of the Fund was 16 November 2017.

Australian index returns 30 June 2024

Index	1M Return	3M Return	12M Return
Bloomberg Australia Bank Bill Index	0.35%	1.08%	4.37%
Bloomberg Australia Gov't 3-5 Year Index	0.35%	-0.60%	3.90%
Bloomberg Australia Composite 0-3 Year Index	0.29%	0.45%	4.37%
Bloomberg Australia Composite 3-5 Year Index	0.43%	-0.44%	4.50%
Bloomberg Australia Composite All Maturities Index	0.77%	-0.84%	3.68%

The benchmark is the Bloomberg Australian Bank Bill Index. Bloomberg Index data is sourced from Evans & Partners.

Fund rating

Initially rated 'Favourable' by SQM Research in December 2018, the Fund was upgraded to 'Superior' in December 2020 and retained annually. Last updated February 2024.



Fund size

As at 30 June 2024, the Net Asset Value of the Fund was \$67,486,674.29.

Portfolio characteristics 30 June 2024

Running Yield	5.42%
Yield to Maturity	5.22%
Average Margin	0.88%
Average Years to Maturity	2.41
Number of Securities Held	26
Floating	81.77%
Fixed	14.78%
Cash	3.46%
Modified Duration	0.25
Credit Duration	0.58

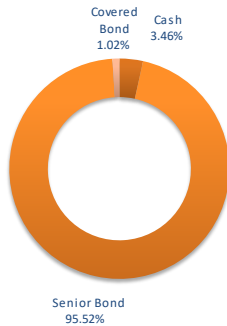
Fees

MER	0.368% + GST
Buy/Sell Spread	+0.10%/-0.10%
Performance Fees	Nil

Asset breakdown

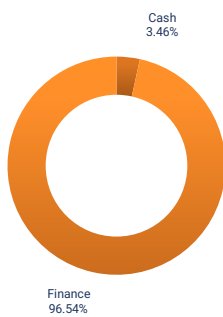
Sub Type Analysis

■ Cash ■ Senior Bond ■ Covered Bond



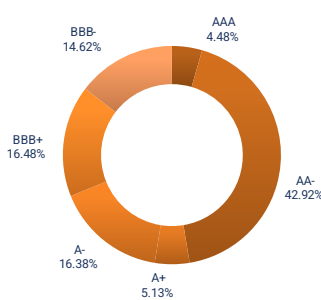
Sector Allocation

■ Cash ■ Finance

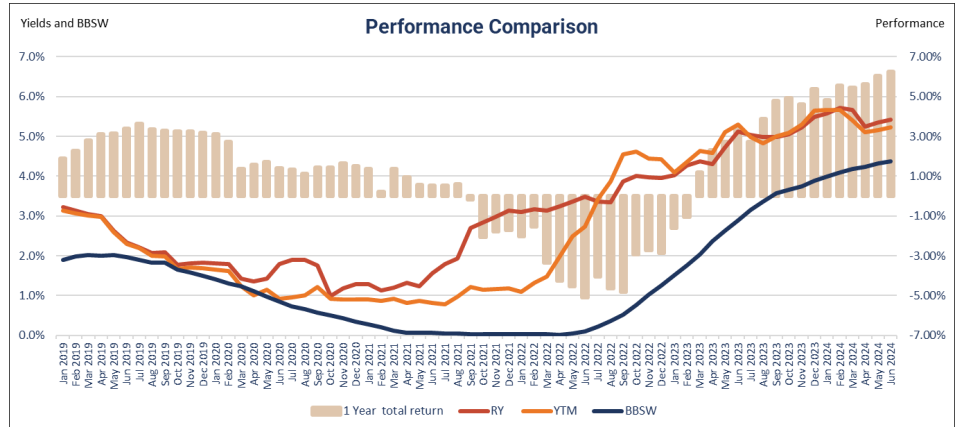


Credit Rating

■ AAA ■ AA- ■ A+ ■ A- ■ BBB+ ■ BBB-



Performance

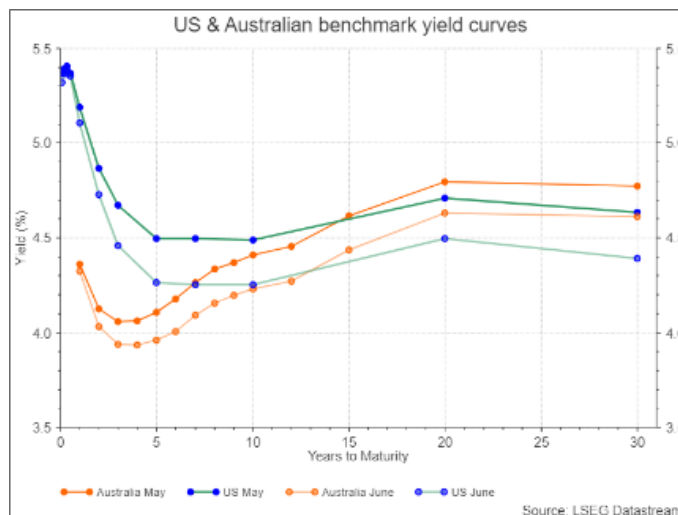


Source Arculus, DDH Graham Limited data.

The Fund delivered a 38 basis points (bps) return in June, net of the 114bps distribution and has now recorded a total net return of 141bps for the past three months. The Fund returned net of all fees a 6.26% return for the year to 30 June.

Performance over the next 12 months will be supported by the current running yield of 5.42% and the yield to maturity of 5.22%. The investment management approach is to deliver consistent returns with a low level of volatility. The current low duration positioning of the portfolio will mean that performance is sourced primarily from the portfolio’s coupon running yield.

Market review & outlook



The Australian benchmark yield curve continued to move in line with movements in the US yield curve in June, however, 10 & 5-year yields have now reached a difficult level of asset allocators and investors. When US 10 & 5-year yields were near 4.60% the risks of buying and being wrong were seen as limited because in November last year the US Treasury (by switching from issuing bonds to bills) and the Federal Reserve (with its dovish speeches and FOMC dot point chart that set out three rate cuts in 2024), acted to prevent the US 10 & 5-year yields breaking above the 5% yield area. Most investors would have been happy to buy the US 10 year at 4.5% knowing that if the yield rose to 5% this would have only meant a 4.5% capital loss (A purchase of a 5-year bond at 4.5% with a stop loss at 5% would have amounted to a 2.25% loss). Now we have the US 10 & 5-year yields near 4.20%, where the risk of a move back to 5% represents 80bps or a 7.2% capital loss (10-year bond) and the profit at the lower end of the range at 3.90% is only 30bps, or near a 3% capital gain. The simple maths makes the investment decision difficult and so investors buying the US 10-year at 4.20% need a deep level of conviction that the US economy is about to contract sharply.

There are several reasons why they may be wrong to believe that a US recession is imminent and in fact why the economy looks robust:

- The employment data and the forward-looking PMI data.
- The ISM manufacturing PMI index at 48.7 (previously 49.2) was weaker than expected and is indicating that the manufacturing sector will contract in the months ahead. It is difficult to rely on the ISM manufacturing in isolation as a forward indicator because of the nature of the pandemic lockdown which resulted in a series of false signals in 2022 and the alternative S&P manufacturing PMI last week increased to 51.3 last month from 50 previously.

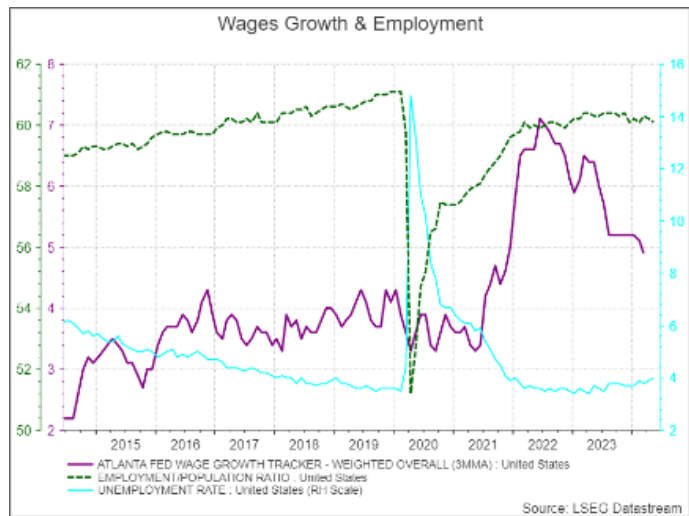
- The ISM services PMI should be of far greater concern to the US bond market. The reading increased to 53.8 in May from 49.8 previously. The market had expectations of services activity receding so that wages growth eased long enough for labour productivity to improve. The S&P services PMI May at 54.4 was consistent with the lift in the ISM services PMI. Taken together the S&P composite PMI reading surged to 54.8 in May from 51.3 in April. This is consistent with an ongoing robust economic expansion for the US economy.

ISM PMI



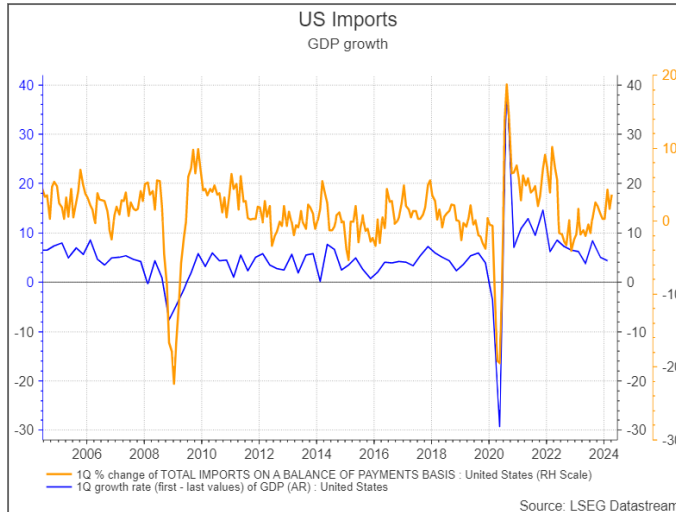
Source: LSEG Datastream

1. The US non-farms payroll data again surprised the market with a much stronger than expected 277,000 increase last month. At this stage employment remains strong enough to sustain wages growth well above the 3% level consistent with inflation returning to 2% on a sustainable basis.

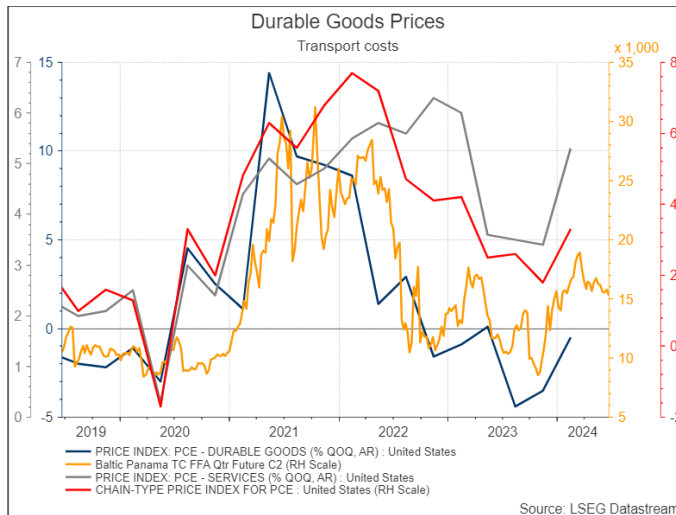


Source: LSEG Datastream

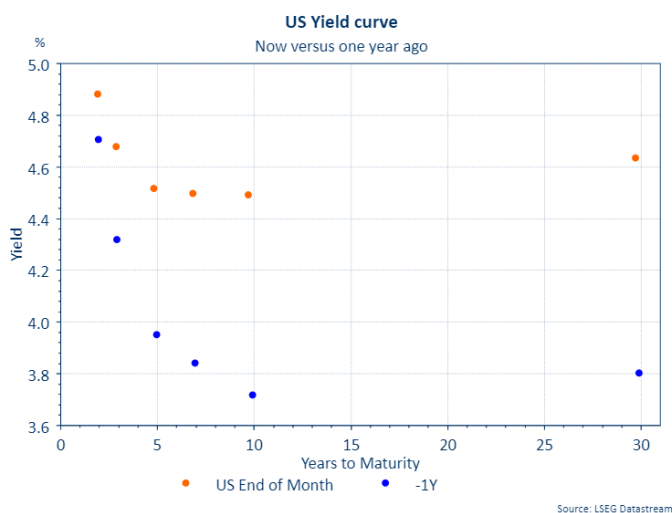
- US Imports as a leading indicator are not signalling an economic contraction. Historically US imports have begun to contract one quarter ahead of an economic contraction.



- The US inflation rate actually stopped falling last June (2023). The decline up to that point had been due to the abatement of the 'transitory factors' (transport costs, energy & durable goods prices) caused by the pandemic lockdowns. These factors are now exhausted, and we are left with an inflation rate that is well above the Federal Reserve target.



- If the actual Federal Reserve statement last month is read, it states that there will no longer be three rate cuts this year, but one and that their estimate of the neutral rate of interest has risen from 2.6% to 2.8%. This increase in the neutral rate reflects the Federal Reserve's estimate of R-star (real interest rate) increasing from 0.6% to 0.8%. In our view it is premature for the Federal Reserve to talk about the neutral rate of interest until it has inflation sustainably back at its 2% target.
- The US yield curve remains inverse but has flattened a great deal over the past year. Back in mid-2022 the markets and many leading economists (not quite all economists) were predicting the US economy would be in recession from the March quarter of 2023. These forecasts were based on two indicators that have historically been 100% accurate when they coincided. These indicators were the ISM PMI index dropping below 50 (a leading indicator 6-9 months ahead) in June 2022 and the US benchmark yield curve being steeply inverse. As it turns out these previously reliable indicators appear to have been distorted by the nature of the pandemic and the fiscal and monetary responses.



As we enter July the market will need to form a view on a growing list of longer-term issues such as:

- The election in France.
- The UK election.
- The US Democratic Convention where the presidential candidate will be confirmed.
- Trump’s economic thoughts on items like increasing import tariffs that have the potential to cause structural change to the US economy.

Taken together we are about to enter a period of heightened political risk.

Fund positioning

Throughout June there was no material change in either medium or long-term positioning of the portfolio. The portfolio remains strategically positioned with both a low fixed and credit spread duration. This reflects the absolute return focus of the mandate. At the same time, the portfolio is both a low-risk alternative to fixed rate – long duration – funds (in anticipation of inflation and growth being stronger for longer) and a low-risk alternative to credit funds (in anticipation of a recession risk pushing out floating rate margins).

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