# ARCULUS FIXED INCOME FUND

MONTHLY REPORT – MARCH 2025

## 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 90-day 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 31 March 2025 (annualised)

| | 3M | 6M | 1Y | 2Y | 3Y | 5Y | Since Inception |
|---|---|---|---|---|---|---|---|
| **Total Return** | **1.13%** | **2.53%** | **5.55%** | **5.50%** | **4.04%** | **1.99%** | **2.00%** |
| Cash Distribution | 1.34% | 2.66% | 5.16% | 4.87% | 3.92% | 2.77% | 2.60% |
| +/- Growth | -0.21% | -0.13% | 0.39% | 0.63% | 0.12% | -0.78% | -0.60% |
| **Index** | 1.07% | 2.20% | 4.46% | 4.32% | 3.56% | 2.15% | 1.99% |

* 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 31 March 2025

| Index | 1M Return | 3M Return | 12M Return |
|---|---|---|---|
| Bloomberg Australia Bank Bill Index | 0.35% | 1.07% | 4.46% |
| Bloomberg Australia Gov't 3-5 Year Index | 0.45% | 1.42% | 3.61% |
| Bloomberg Australia Composite 0-3 Year Index | 0.41% | 1.24% | 4.37% |
| Bloomberg Australia Composite 3-5 Year Index | 0.48% | 1.51% | 4.33% |
| Bloomberg Australia Composite All Maturities Index | 0.17% | 1.29% | 3.20% |

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 March 2025.

Superior
SQM RESEARCH

## Fund size

As of 31 March 2025, the Net Asset Value of the Fund was $61,366, 731.45.

## Portfolio characteristics 31 March 2025

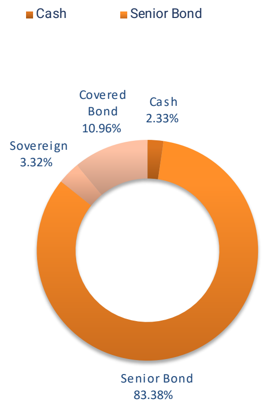
| | |
|---|---|
| Running Yield | 5.62% |
| Yield to Maturity | 5.39% |
| Average Margin | 1.25% |
| Average Years to Maturity | 2.94 |
| Number of Securities Held | 34 |
| Floating | 95.02% |
| Fixed | 2.64% |
| Cash | 2.33% |
| Modified Duration | 0.30 |
| Credit Duration | 1.47 |

## Fees

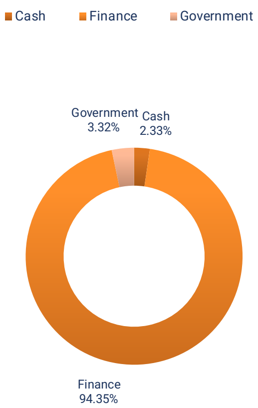
| | |
|---|---|
| MER | 0.368% + GST |
| Buy/Sell Spread | +0.10% / -0.10% |
| Performance Fees | Nil |

## Asset breakdown

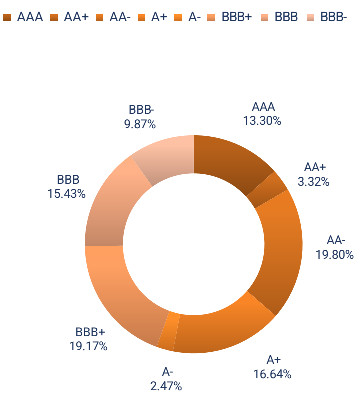
### Sub Type Analysis



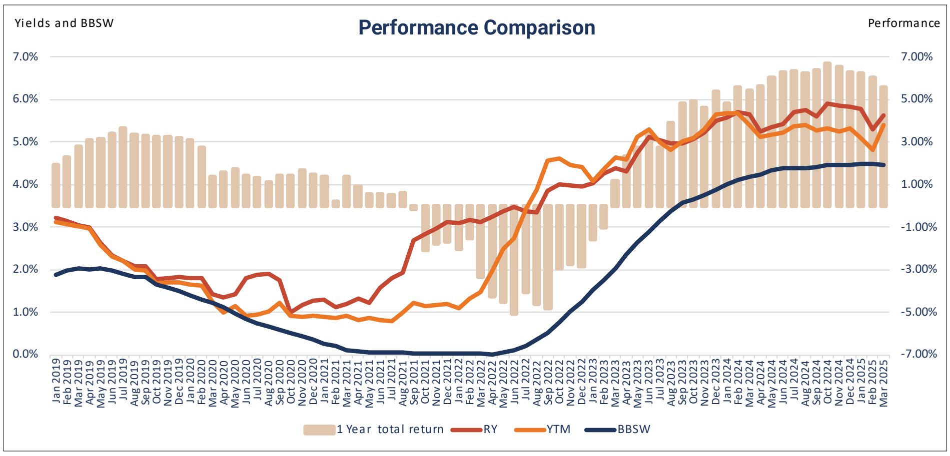

### Sector Allocation




### Credit Rating




## Performance

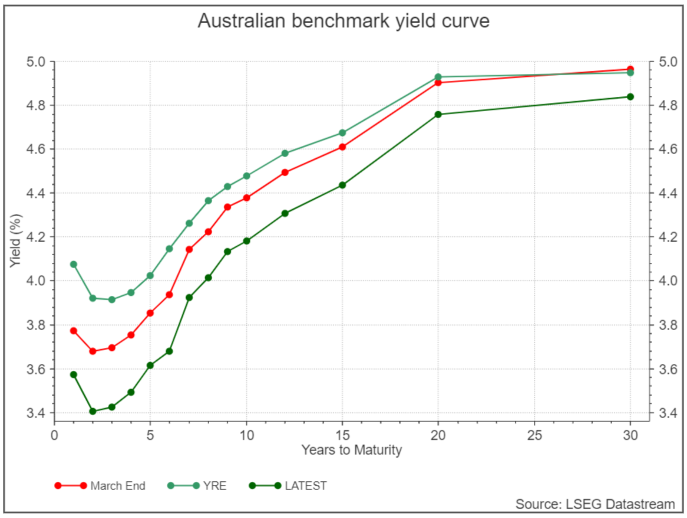



Source Arculus, DDH Graham Limited data.

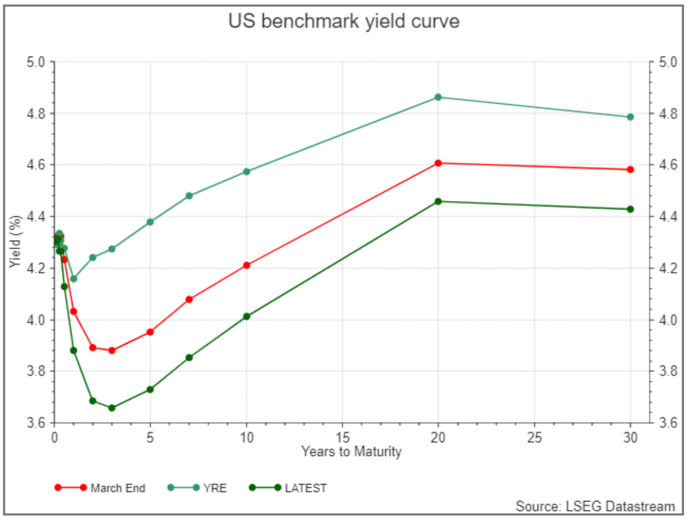
The Fund delivered a performance of 9 basis points (bps) in March. This is much lower than the average of 40bps that the Fund has delivered consistently over the past 18 months. This change in performance reflects the sharp widening of credit margins on the last day of the month when the market began to anticipate the implementation of the Trump tariff policies. We do not believe the credit quality of the portfolio (Australian only sovereign and senior APRA regulated bonds) will be impacted by the Trump tariff policies and over the medium term the portfolio's coupon driven performance is also not expected to be impacted.

## Market review & outlook

As we move into April (April 6) the bond market has rallied, and the credit market has shifted out 30bps equivalent to a 3% capital value change. While fixed rate bond managers with average durations of five years will have seen a 4.5% capital gain from the 50bps fall in the fixed yield curve, we do not expect this to be maintained because fundamentally the tariffs and falling US (and Australian) currencies are inflationary. The fixed bond market appears to be benefiting from a flight out of equities in much the same way it did briefly in the last quarter of 2008.




As a fixed income asset class investment manager, we must pay a great deal of attention to the US economic outlook as far as it impacts the US benchmark yield curve because the Australian yield curve is highly correlated to the US curve at the long end.




The shape of both the Australian and US benchmark curves reflects the pricing of central bank cuts expected at the short end, but also a positive economic growth outlook **- these are not curves predicting a recession.**

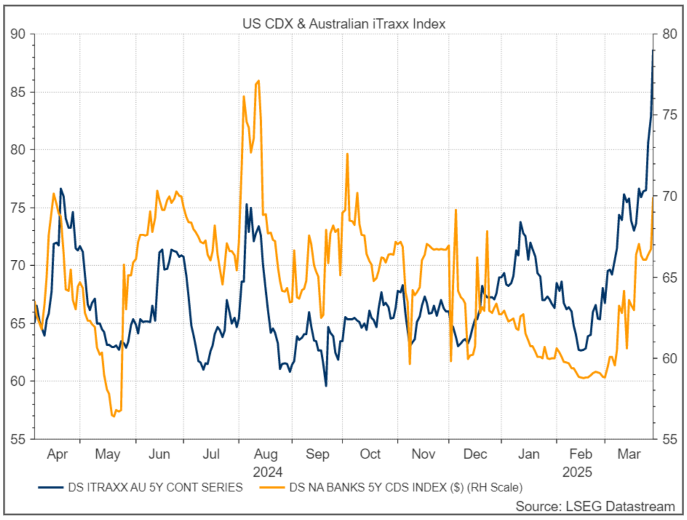
Notwithstanding the equity market meltdown, we must stress:

- The equity market falling reflects the fact that it was overvalued, not that it is predicting a recession or any level of economic contraction at this stage.
- US Treasury bond sales during the pandemic period 2020-2022 will begin maturing in 2025 and the government will be faced with a sharp rise in coupon yields that will further pressure the budget outcome. It is the lack of buying support from the Federal Reserve without quantitative easing (QE) programs that are set to test the true state of underlying demand. Powell, in a speech as the markets were falling heavily on the 4th of April, took a more hawkish tone than heard previously and while this may not translate into an increase in rates it may well mean that the Federal Reserve continues to let its balance sheet debt roll off as the bonds mature (reduce QE).
- The US & Australian governments cannot perpetually keep increasing debt and bond supply. At some point the market will push back and yields will rise sharply.

**Floating rate bonds**

The equity market selloff in early April is triggering a rapid widening in floating rate credit spreads. This is measured at an aggregate level in the US by the CDX and in Australia the 5-year iTraxx index.

This shift in credit margins will impact the mark to market values of credit funds' portfolios where credit duration typically averages 2.9 years. We have, for some time, kept our credit duration exposure quite low at 1.5 years not only because we feared the risk of an external shock occurring, but because credit margins had reached very tight levels where there was little prospect of any further margin contraction.



## Fund positioning

Given the very low risk nature of the AFI investment universe (sovereign and senior APRA-regulated bonds only) where 90% of the portfolio is repo eligible (able to be cashed at the daily RBA open markets window used by the banking system to manage liquidity) we don't expect that the Fund's liquidity will be impacted by the surge in asset market volatility in early April. The portfolio is unleveraged and in Australian currency only. The Fund mandate does not allow investment in the illiquid RMBS or MBS type securities. (*see Sub Type chart on page 1*).

The decision to keep duration risk (fixed and credit) to a minimum has meant accepting a lower YTM in March, so as to position the portfolio at a higher YTM for a longer-term period once margins widen. That opportunity appears to be just around the corner!

The portfolio has a high level of liquidity even in stressed market conditions. The following tables are our estimates of liquidity in both normal and stressed market conditions. The portfolio is highly liquid because the portfolio contains the type of bonds that banks trade daily as part of their liquidity management strategy.

| Days to Liquidate Low Stress | 1 | Grand Total |
|---|---|---|
| Cash | 2.33% | 2.33% |
| Investment Grade Senior | 94.35% | 94.35% |
| Sovereign | 3.32% | 3.32% |
| **Grand Total** | **100.00%** | **100.00%** |

| Days to Liquidate Stressed | 1 | 3 | Grand Total |
|---|---|---|---|
| Cash | 2.33% | 0.00% | 2.33% |
| Investment Grade Senior | 0.00% | 94.35% | 94.35% |
| Sovereign | 3.32% | 0.00% | 3.32% |
| **Grand Total** | **5.65%** | **94.35%** | **100.00%** |