

Strategy & Objective

The Arculus Preferred Income Fund is a domestic fixed income portfolio invested in Australian Government and Semi-Government Bonds, Corporate Senior & subordinated Bonds, issued by Australian corporates, ASX-listed hybrid and debt securities, and cash.

The Fund aims to provide unitholders with returns higher than cash and traditional debt securities over the medium to long term with a target rate of return of the 90-day BBSW rate plus 350bps. The target return is not guaranteed. The return is a combination of income distribution and capital growth.

The Fund does not employ leverage either directly or using derivatives and has no offshore currency, structured credit or leveraged securities. Up to 30% of the Fund can be invested in non-investment grade securities (S&P, Fitch rated below BBB-, Moody's rated below Baa3).

The Fund may be appropriate for investors seeking a medium risk investment over a 3 to 5-year period.

ESG

Environmental, Social and Governance issues form part of the risk analysis framework. For further information on Arculus' ESG policies and practices, visit <https://arculus.com.au/environmental-social-and-governance/>.

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 (GCI) ABN 68 140 364 576 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, Clearstream and Australian Money Market platforms.

Performance to 30 September 2025 (annualised)

	3M	6M	1Y	2Y	3Y	5Y	Since Inception
Total Return	1.37%	2.42%	4.95%	6.20%	6.15%	4.17%	4.56%
Cash Distribution	1.57%	3.63%	6.90%	6.43%	5.95%	4.84%	5.45%
+/- Growth	-0.20%	-1.21%	-1.95%	-0.23%	0.20%	-0.67%	-0.89%

The Fund is benchmark unaware, but the target rate of return is the 90-day Bank Bill Swap Rate plus 3.5% before fees.

*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 25 October 2004. Arculus commenced as Investment Manager on 01 July 2015.

Australian index returns 30 September 2025

Index	1m Return	3M Return	12M Return
Bloomberg Australia Bank Bill Index	0.29%	0.92%	4.19%
Bloomberg Australia Gov't 3-5 Year Index	-0.21%	-0.02%	3.73%
Bloomberg Australia Composite 0-3 Year Index	0.08%	0.56%	4.26%
Bloomberg Australia Composite 3-5 Year Index	-0.17%	0.20%	4.38%
Bloomberg Australia Composite All Maturities Index	0.10%	0.40%	4.09%

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. The latest review was March 2025.

As of 30 June 2025, the Fund is also rated by FundMonitors.com.

Fund ratings are not a recommendation and are subject to change.



5 Year



Fund size

As of 30 September 2025, the Net Asset Value of the Fund was \$178,582,380.84.

Portfolio characteristics 30 September 2025

Running Yield*	5.25%
Yield to Maturity*	8.48%
Average Margin	4.92%
Average Years to Maturity	2.59
Number of Securities Held	60
Fixed	8.24%
Floating	84.16%
Cash	7.60%
Modified Duration	0.27
Credit Duration	1.79

* Based on fund metrics at review date. Future returns may be different.

Fees

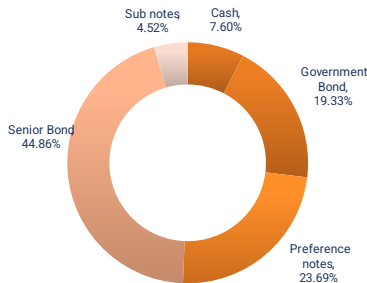
MER	0.75% + GST
Buy/Sell Spread	+0.15% / -0.15%
Performance Fees	Nil

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Asset breakdown

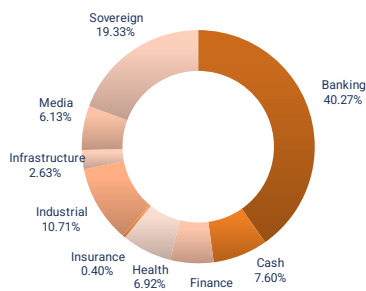
Sub Type Analysis

■ Cash ■ Government Bond ■ Preference notes
■ Senior Bond ■ Sub notes



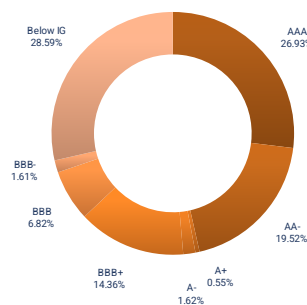
Sector Allocation

■ Banking ■ Cash ■ Finance
■ Health ■ Insurance ■ Industrial
■ Infrastructure ■ Media ■ Sovereign

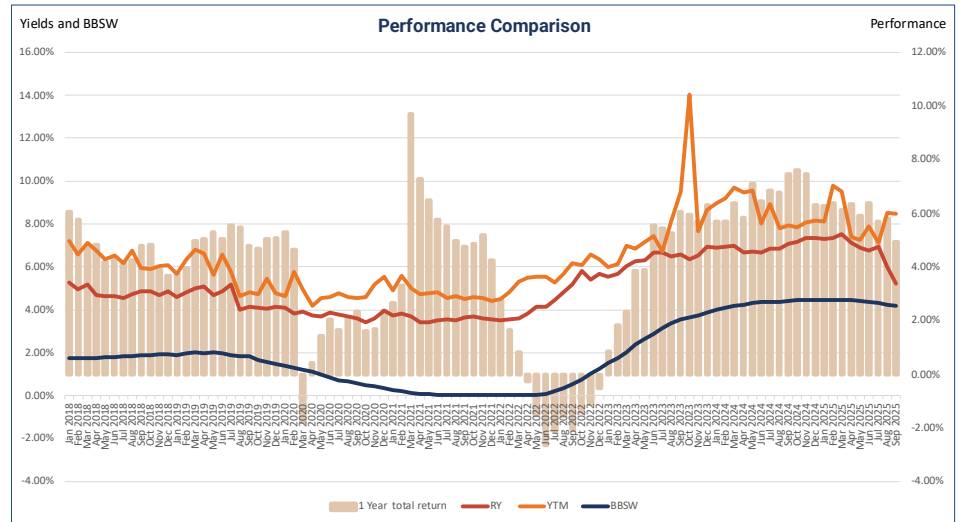


Credit Rating

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



Performance



Source Arculus, DDH Graham Limited data. Past performance is not an indicator of future performance.

The Fund returned, net of all fees, 26 basis points (bps) in September. The September quarter income distribution to unit holders was 1.57%. The Fund's performance throughout the September quarter has been impacted by the short-term maturity profile of the portfolio. The annualised performance is expected to lift over the December quarter as the bonds mature and pay their final coupons.

Fund positioning

The portfolio's current yield to maturity of 8.48% is possible because over half the non-investment grade weighting will mature, or is expected to be redeemed, in the December quarter. Balanced against this higher yielding portion of the portfolio there is a 25% weighting to short-dated Commonwealth treasury bonds (maturing on the 10th of October and the 11th of November) as well as a higher cash weighting.

It is anticipated that as the non-investment grade holdings roll off and the funds from maturing Commonwealth treasury holdings mature, the portfolio will be rebalanced back into Australian major bank senior and Tier 2 bonds that are all investment grade.

Market review

As it should be, the focus of leading economists has shifted back to inflation in September. In the absence of a financial stability crisis, inflation must be the first priority of the RBA mandate, with the level of unemployment a distant second. This is because the government's fiscal settings and immigration policies have a more direct impact on the unemployment rate while monetary policy can have a more direct impact on inflation.

The RBA interest setting board's decision at the September meeting to leave rates on hold was expected because:

- The Australian economy is operating beyond full employment.
- The financial sector is stable (so no need for zero rate like the pandemic, Term Funding Facility or quantitative easing).
- Inflation measured by the Trimmed mean is at 2.6% but not sustainably:
 - Electricity subsidies are now over 12 months old and definitely impacted Trimmed Mean. They have now expired.
- Wages growth is now underwritten at plus 3.5% after the Fair Work Commission's minimum wage decision of 3.5% (above actual inflation).
- Broad money growth is strong and increasing at near 6.4%.

The markets are also pointing to a strong economy not in need of a rate cut:

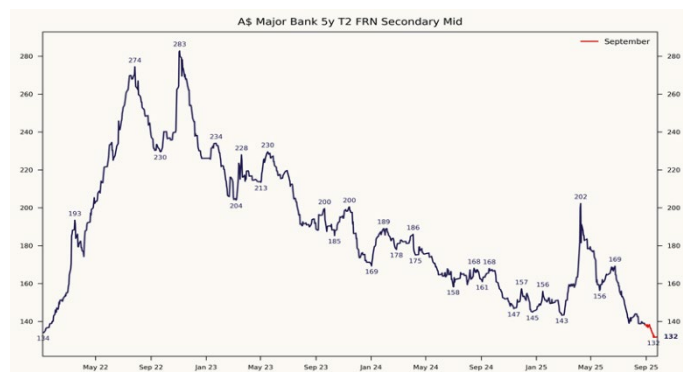
- ASX 200 at record high indicating strong economy.
- Benchmark yield curve positive shape and steepening (strong economy ahead).
- Credit margins back to very tight levels consistent with a strong economy.
- Strong Australian dollar.

In hindsight it is instructive to look at the historical chart of key interest rates in the Australian money market. By mid-2022 the markets had normalised rates after the pandemic. The RBA kept increasing rates in 2023 when in hindsight they should have remained on hold while retaining their original opinion that the pandemic triggered inflation would be transitory. Key interest rates in the money market have now returned to what in time may prove to be the long term or neutral rate.



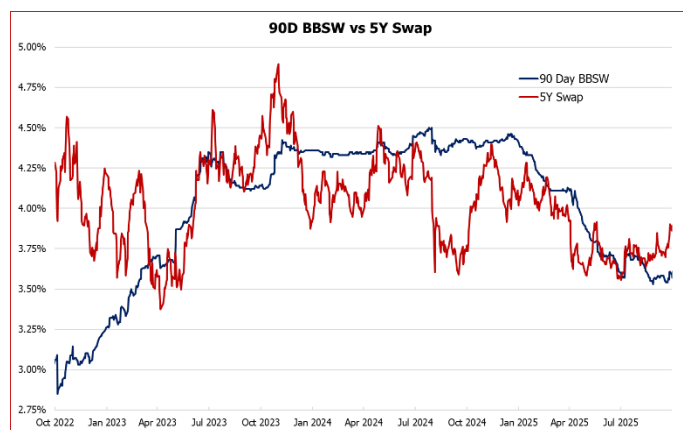
Tier 2 Bonds

In September, major bank non-call 5-year margins contracted 6bps to close the quarter at the levels last seen during the pandemic. During the pandemic lockdowns senior bank margins reached just 40bps and Tier 2 margins 130bps, only due to a lack of supply. Once the pandemic lockdowns were lifted senior and Tier margins widened considerably and rapidly, leaving many credit fund managers with sizable mark to market losses. The extent of this margin widening can be seen in the following chart in the first few months of 2022.



Source: Westpac

The primary reason for the 6bps tightening, in an already expensive market, was a lack of new supply of Australian major bank Tier 2 bonds. During the month there were small issues announced by IAG, Judo and the Defence Bank but these were not able to absorb the redemption of the \$1.4bn CBA Tier 2 bonds, as they are a very different level of risk, so funds flowed into other major bank Tier 2 bonds in the secondary market. The major bank Tier 2 to senior margin ratio moved out to 1.94 times in September from 1.81 times in August and with 5-year swap now trading in above the 90-day BBSW rate we don't expect margins to tighten further. This is because, relative to 5-year major bank senior at 69bps, we see little, if any value, in major bank Tier 2 given the risk of it widening considerably caused by ongoing issuance of non-major bank subordinate bonds.



Source: Arculus

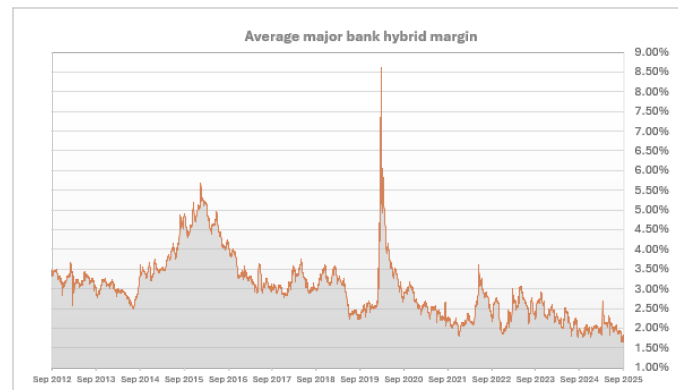
Hybrids (Additional Tier 1 Capital)

September was an eventful month for hybrids, marked by both heavy alternative ASX yield product issuance and the sizeable \$1.7bn WBCPH redemption. While these factors may have balanced each other out – with new issuance well-timed to meet reinvestment demand – the hybrid market nonetheless extended its rally from April. The average major bank hybrid margin compressed by a further 0.15% over the month to 1.75%, supported in part by the regular ex-dividend cycle, where hybrids typically hold much of the franking credit. Strong underlying credit and equity markets added further tailwinds.

The chart below highlights how major bank hybrid margins have compressed to historical lows, dating back to the introduction of Basel III/IV in 2012. While headline comparisons are useful, it is important to note that the average time to maturity will shorten over time as the hybrid market runs off, which will affect relative value going forward. Right now, the average time to maturity is 3.5 years, whereas historically it has been 4.25 - 4.5 years whilst hybrids were being replaced. Hence lower margins should now be the case.

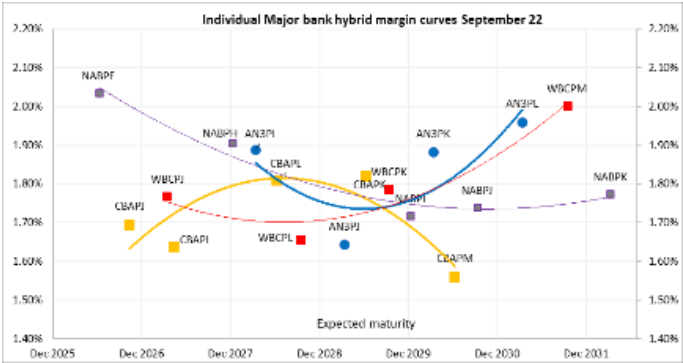
On fundamentals, it is easy to explain the tight margins: bank credit spreads are at their tightest levels in years, bank share prices remain near record highs, and demand for yield continues unabated. But there are additional dynamics at play:

- **APRA-driven de-risking:** By insisting that hybrids be redeemed at their first call date, APRA has removed extension risk, aligning hybrids more closely with subordinated bank debt and reducing uncertainty for investors. Margins may look increasingly like those of subordinated bank notes.
- **Scarcity value:** The redemption of WBCPH in September cut the outstanding major bank hybrid capitalisation to \$30.5bn, down from around \$38bn in early 2024. This supply contraction, combined with strong reinvestment demand, is amplifying price support.
- **Run-off misconceptions:** Some market participants argue the hybrid sector is in permanent run-off. We view this as simplistic – while net issuance has slowed, many hybrids will not mature until well past 2029, ensuring the asset class remains relevant for years.



On Monday 22 September 2025, holders received the largest hybrid cash redemption in a decade, with \$1.69 billion of WBCPH face value plus \$20 million in final coupons hitting bank accounts. While a portion of this liquidity may flow into recent and future yield-focused IPOs settling after that date, much may return to the hybrid market, echoing the reinvestment behaviour seen after CBAPH in April 2024 and AN3PH in May 2025. In those cases, investors split between buying at the short end of the curve – seeking low credit risk yield – and at the long end, replicating the traditional reinvestment offer of longer-dated hybrids. A similar pattern is likely this time, with demand supporting both ends of the hybrid curve and boosting liquidity as funds are redeployed.

Heavy selling in NABPF, with around 180,000 units traded in the week prior to the 22nd, drove NABPF's margin higher, leaving it as the highest-yielding hybrid in the market at that time. With a margin above 2% compared to the major bank's 1.78% average, NABPF, maturing in June 2026 looks particularly attractive, offering less pricing risk should margins rise. At the longer end of the curve, WBCPM (obvious choice, same bank) and AN3PL emerge as strong options. In contrast, what was missed in the reinvestment flows from CBAPH and AN3PH was the belly of the curve, meaning mid-dated hybrids like WBCPL, AN3PJ, and CBAPM. At September 22nd each have margins under 1.70% and are on a relative basis expensive.



Source: Arculus