

As we move into a new year, our thoughts are with the families that lost loved ones, and everyone impacted by the Bondi terror attack. This will have a profound impact on all Australians for a very long time to come.

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/environment-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 undertake 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 31 December 2025 (annualised)

	3M	6M	1Y	2Y	3Y	5Y	Since Inception
Total Return	0.14%	1.52%	3.79%	5.04%	5.46%	4.00%	4.51%
Cash Distribution	1.15%	2.72%	6.39%	6.23%	6.02%	4.90%	5.44%
+/- Growth	-1.01%	-1.20%	-2.60%	-1.19%	-0.56%	-0.90%	-0.93%

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 31 December 2025

Index	1m Return	3M Return	12M Return
Bloomberg Australia Bank Bill Index	0.31%	0.90%	3.97%
Bloomberg Australia Gov't 3-5 Year Index	-0.54%	-1.06%	2.77%
Bloomberg Australia Composite 0-3 Year Index	-0.01%	0.19%	3.62%
Bloomberg Australia Composite 3-5 Year Index	-0.46%	-0.95%	3.25%
Bloomberg Australia Composite All Maturities Index	-0.63%	-1.15%	3.17%

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.



Fund size

As of 31 December 2025, the Net Asset Value of the Fund was \$110,431,765.59.

Portfolio characteristics 31 December 2025

Running Yield*	6.67%
Yield to Maturity*	7.22%
Average Margin	3.48%
Average Years to Maturity	2.75
Number of Securities Held	56
Fixed	12.49%
Floating	84.11%
Cash	3.40%
Modified Duration	0.36
Credit Duration	2.60

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

Fees

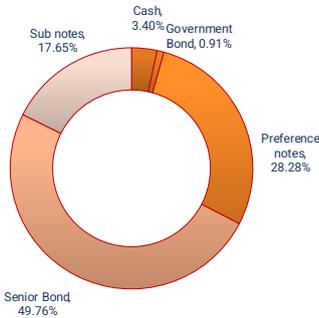
MER	0.75% + GST
Buy/Sell Spread	+0.15% / -0.15%
Performance Fees	Nil

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Asset breakdown

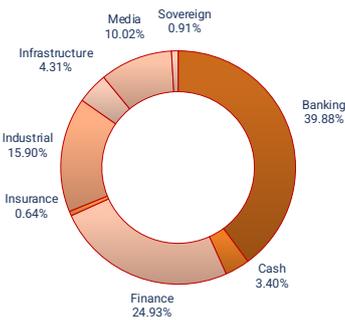
Sub Type Analysis

- Cash
- Government Bond
- Preference notes
- Senior Bond
- Sub notes



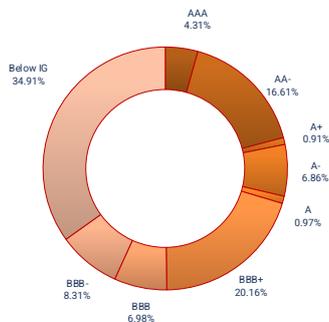
Sector Allocation

- Banking
- Cash
- Finance
- Insurance
- Industrial
- Infrastructure
- Media
- Sovereign

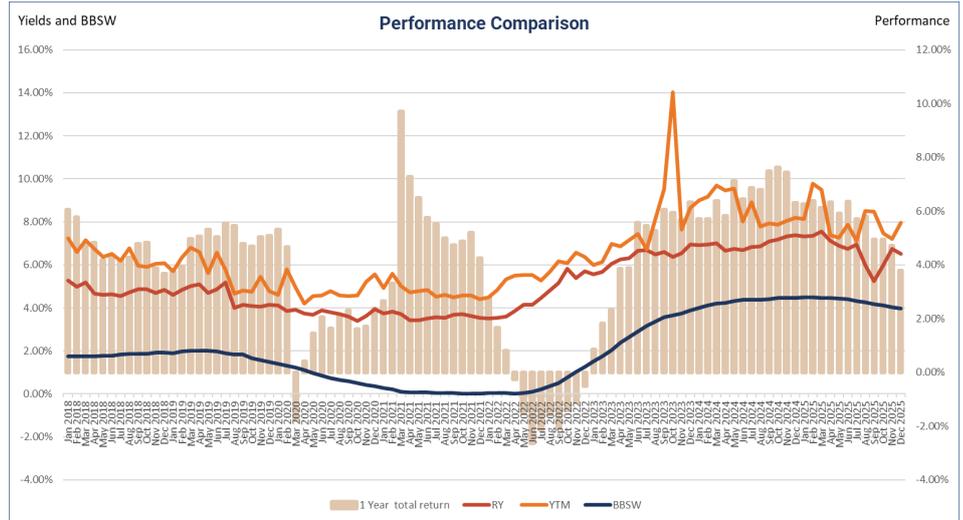


Credit Rating

- AAA
- AA-
- A+
- A-
- 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 -55 basis points (bps) after all fees in the month of December. The performance was significantly impacted by the fall in the price of the ASX-listed Nufarm notes (NFNG). If the 8% fall in the NFNG price is removed from the calculation, then the rest of the portfolio showed a 54bps gain. Our credit analysis has not found any basis for this move in the NFNG price, which as a perpetual security, is comparable to the Nufarm equity price that has been stable over the past six months. The Nufarm notes are lightly traded on the ASX and, as such, are often subject to large swings irrespective of the credit outlook for the security. In the short term this may mean that performance rises sharply if the Nufarm Notes price rises. Over the next 12 months, performance is expected to be supported by the 6.67% running yield and the 7.22% yield to maturity of the portfolio.

Fund positioning

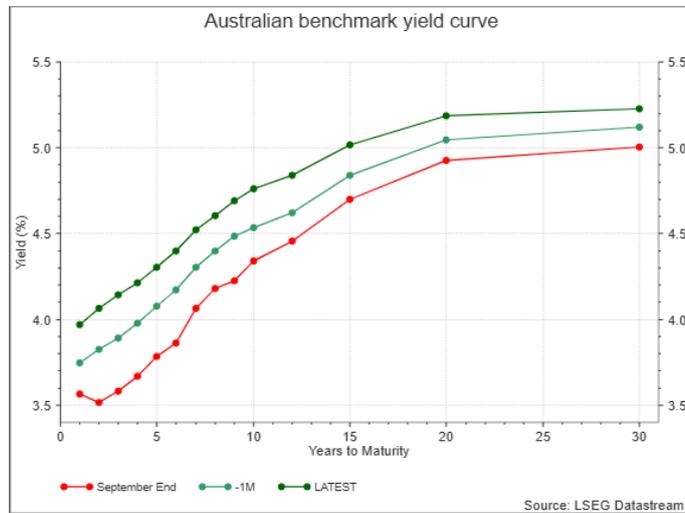
The portfolio remains positioned strategically with a low fixed-duration, reflective of the view that rising inflation may force the RBA to raise rates in 2026 and that there is a risk that the longer end of the Australian benchmark curve will move higher under pressure from rising bond yields offshore (principally Japan and the US). Performance in 2026 will be supported by the portfolio's coupon-driven running yield of 6.67% (inclusive of franking credits that are added to portfolio performance at the end of each financial year) and the yield to maturity of 7.22%. As the portfolio is almost entirely holding floating rate securities the yield will increase if inflation and interest rates move higher in 2026.

Credit risk is measured at a portfolio level by calculating the impact on the capital value of the holdings from a widening of credit spreads. Over the past year, despite the increased level of uncertainty over the geopolitical and economic outlook, credit spreads have tightened, and equity prices have risen. This implies that the markets are confident in the economic outlook remaining positive (default risk is not increasing). There is still some value in the Australian bank senior bond universe, relative to bank subordinate Tier 2 bonds, where margins are tight on an absolute basis and expected to widen with the increased supply needed to replace Tier 1 securities in Australian banks' capital structures in due course.

At this stage the forward economic indicators are supportive of a conclusion that the Australian economy will remain buoyant, in the absence of an external shock. Credit risk, however, has risen from an academic viewpoint because the current level of government and household debt makes the economy more vulnerable to an external shock, causing a deeper and more prolonged economic contraction. This increased risk will be managed by reducing the portfolio's non-investment grade holdings over the March quarter to a less than 10% weighting. Funds from maturing holdings will be rolled into either short duration major bank senior bonds or Commonwealth and semi-government bonds, with a maturity profile of not more than 90 days (low duration risk).

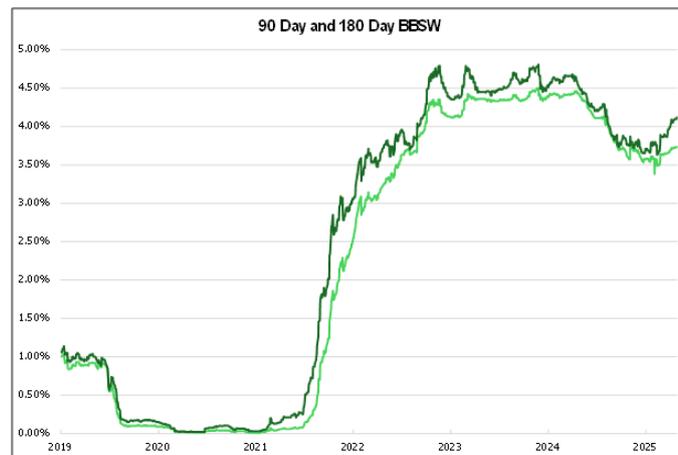
Market review

The Australian benchmark yield curve moved higher in December. The short end is rising with the market now pricing no further RBA official rate cuts and at least one increase in 2026 while the long end is pressured higher by the unwinding of the Yen carry trade (offshore investors selling 5–10-year bonds).



RBA cutting rates.

The RBA cut official rates three times in 2025. Since September, the RBA has been on hold, but the market has already priced rising rates in 2026 with the 90-day BBSW rate moving up from 3.44% to 3.73% at the end of December. The 90-day BBSW rate, not the RBA Official rate, is the key measure of interest rates for investors and borrowers because it is the benchmark used to price floating rate bonds and bank term deposits. At the beginning of the year the 90-day BBSW rate was at 4.40%.

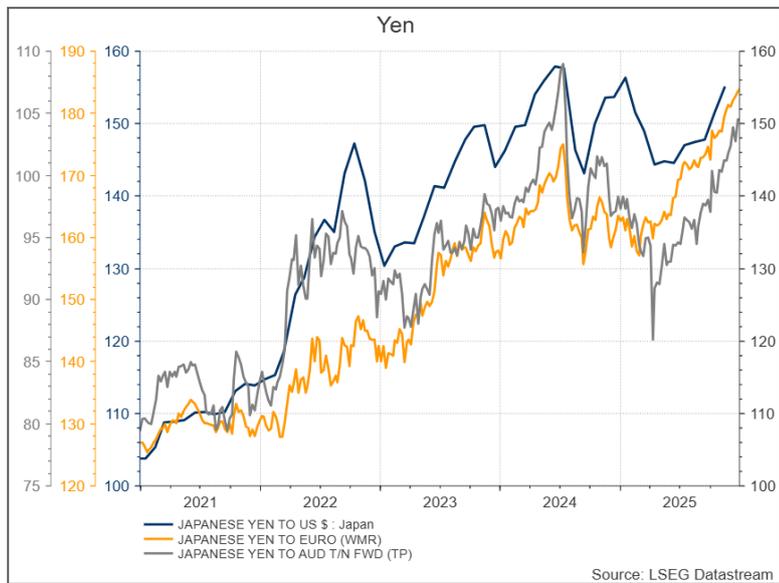


Japanese Yen Carry Trade

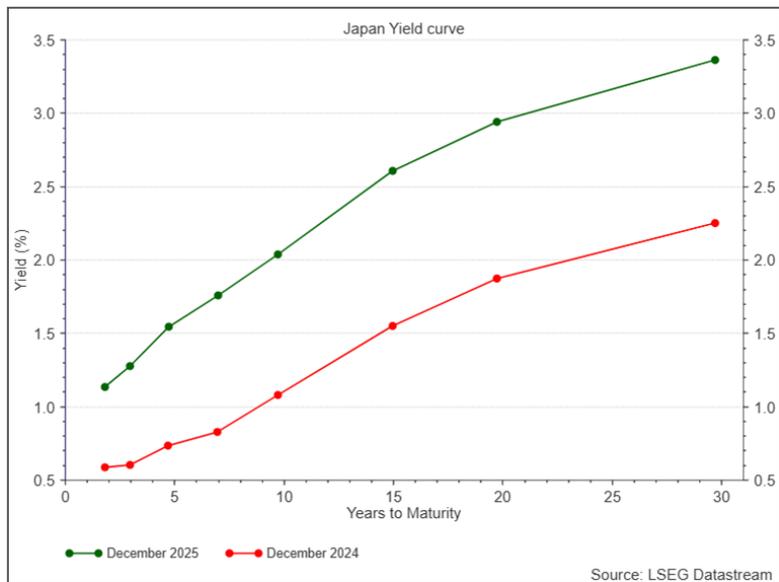
The significance of the Yen carry trade on global bond markets cannot be easily underestimated. There are two factors at work with the Yen carry trade:

- The falling Yen.
- Rising bond yields in Japan.

The Yen carry trade (all currencies) is estimated by the Bank of International Settlements at US\$22 trillion. Since 1990 Japan had engaged in a modern monetary theory experiment whereby the money supply was expanded and interest rates moved to zero. Japanese and offshore investors then borrowed in Yen and invested in offshore bonds to gain not just from the interest rate differential but also the change in the currency. In June 2024 the Yen reached a new low point against the USD and this triggered a rapid unwinding of the US/Yen carry trade and a sharp rise in US bond yields (investors sold US bonds and the USD to move back into Yen). In 2025 the rise in the Euro against the Yen has triggered an unwinding of the Euro/Yen carry trade. Ongoing Yen weakness will have very important implications for all global investors in 2026.

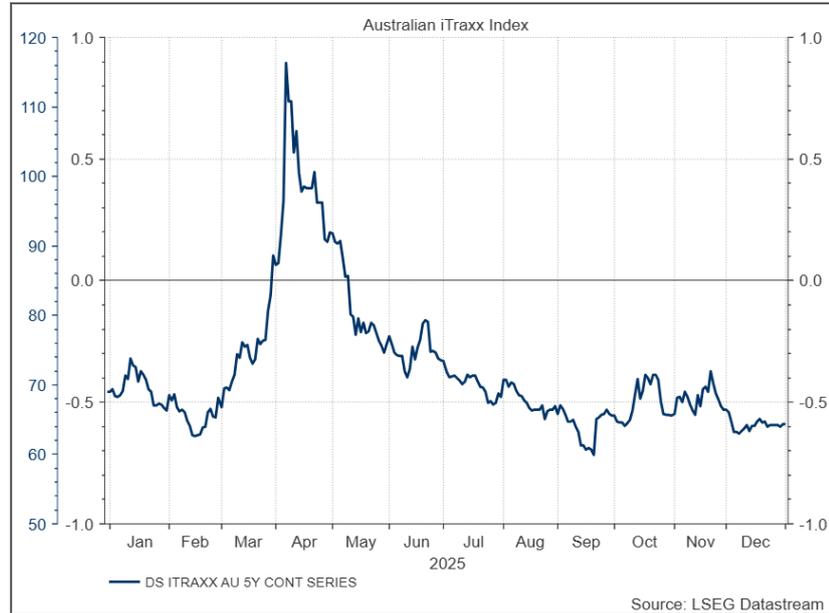


Over 2025 the Japanese yield curve shifted significantly higher with rising inflation triggering a shift out of bonds and the Bank of Japan (BOJ) raising rates at the short end of the curve. Investors in 10-year Japanese bonds are not concerned with the bonds yield but the change in the yield over the past 12 months. The move from 1.08% in December 2024 to the current 2.08% is a 9% fall in the bonds' capital value.



Australian Credit Outlook

The 5-year iTraxx benchmark was very stable throughout December. This reflected a market balanced between new corporate issuance and investor demand. There was very little change in major bank senior margins over the past month. The 5-year continues to trade near 72bps, which looks tight when compared to the 4-year at 68bps. At the Tier 2 level, buying support kept the margins on 10-non-call-5-year issues stable near 125bps.

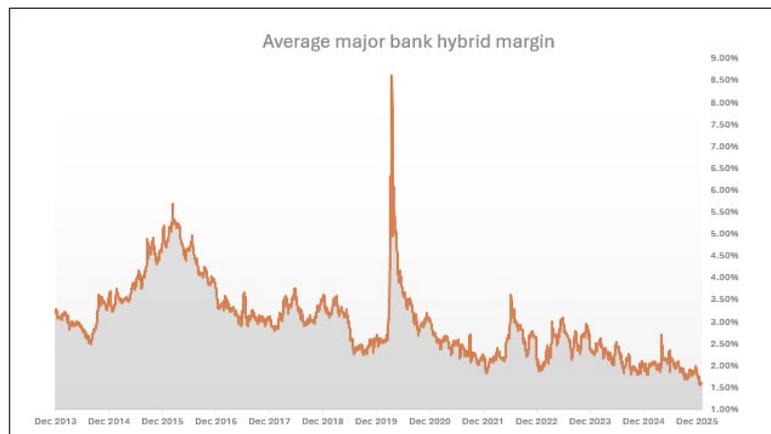


Hybrids

Hybrid securities rallied in December alongside broader equity and credit markets. Average major-bank hybrid margins compressed to a Basel III/IV all-time low of 1.60%, representing a 36bps tightening over the month. For a five-year security, this equates to an approximate \$1.60 price uplift. In the months leading into December, and particularly in the first few weeks of the month, hybrids were used as a funding source for newly listed yield products on the ASX, with approximately \$700m of issuance over the past quarter. Once these new vehicles had fully listed by mid-December, hybrids began to trade more clearly on fundamental drivers. These included relative spreads to bank debt securities, the performance of bank equities and the broader equity market, as well as the absence of near-term hybrid issuance.

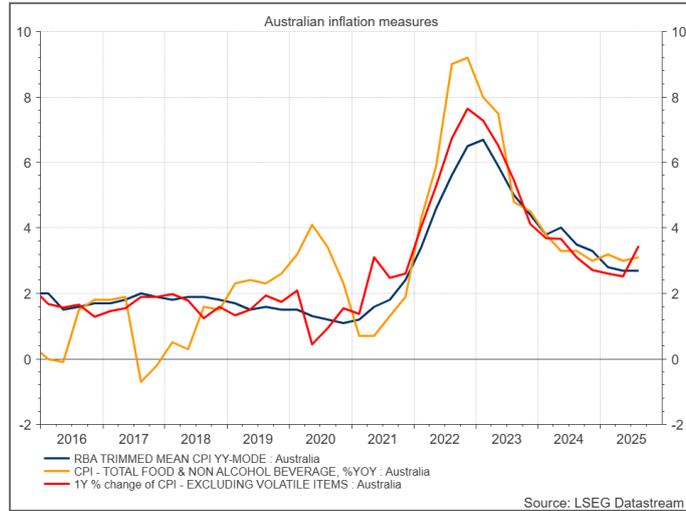
APRA’s push for repayment at the first possible call date materially improves the risk profile of hybrids. In addition, APRA’s decision to phase out hybrids entirely has created a structural scarcity dynamic, particularly for major bank hybrids. The overall hybrid market has contracted from approximately \$45bn in 2023 to around \$35bn today, while still retaining sufficient liquidity for ASX buyers.

Relative to the iTraxx index, hybrid margins remain well below the long-term average ratio of hybrid margin to iTraxx spreads on both a 12-year and 3-year basis, with the latter period encompassing the post-COVID environment and the phase of rising cash rates, where it appears that hybrids were re-rated relative to other bank credit. Given APRA’s stance, this re-rating may remain the case, as mentioned above. The ratio of hybrid to iTraxx, whilst tight, is not at previous lows.

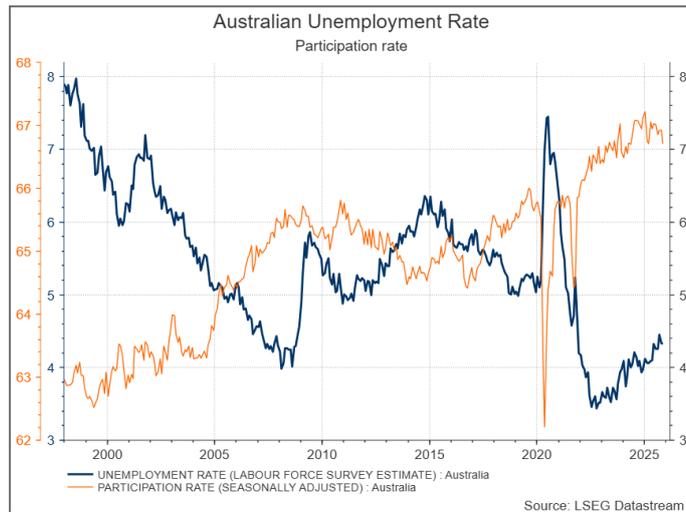


Month Ahead

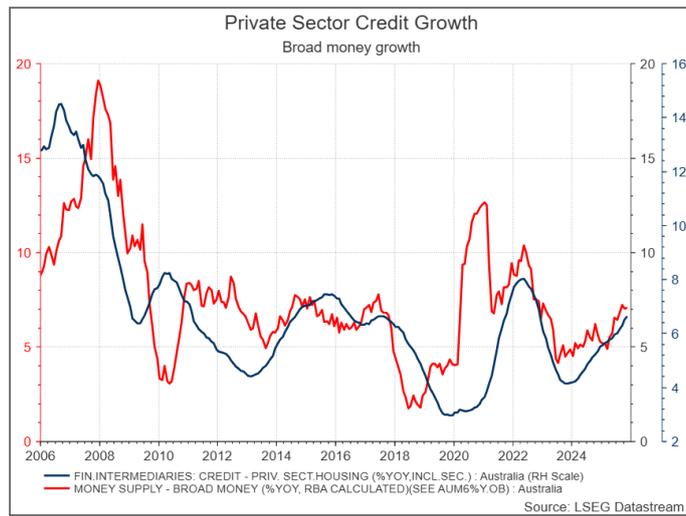
The market will be looking at the November and December inflation data released on the 7th and 28th of January, respectively, for signs that inflation has fallen from the higher-than-expected October readings. If the RBA Trimmed Mean does not fall from the 3.3% recorded in October, then the RBA meeting in February will need to consider an interest rate increase.



The December employment data will be released on the 22nd of January. In November the unemployment rate was 4.3% and the participation rate was 66.7%. Over the past 12 months movements in the participation rate month to month have been the primary reason for movements in the unemployment rate. A rise in unemployment in conjunction with a rise in the participation rate is not indicative of an economic contraction on its own.



We consider the private credit data to be released on the 30th of January as one of the most important economic releases. Private credit growth (borrowing activity by the private sector) has surged since the RBA began cutting rates. **This is indicative of the monetary settings being stimulative, not restrictive.** There is a lag between changes in the money supply and private credit growth. This may mean that the surge in credit growth in July relates to the first rate cut in February and that the two subsequent rate cuts may bring about a further surge in private credit growth. If this is apparent in the December private credit growth data then the RBA may be forced to increase rates, even if the inflation and unemployment data is softer.



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