

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 28 February 2026 (annualised)

	3M	6M	1Y	2Y	3Y	5Y	Since Inception
Total Return	0.00%	0.97%	3.53%	4.94%	5.20%	3.80%	4.50%
Cash Distribution	1.15%	2.70%	6.38%	6.23%	6.00%	4.89%	5.40%
+/- Growth	-1.15%	-1.73%	-2.85%	-1.29%	-0.80%	-1.09%	-0.90%

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 28 February 2026

Index	1m Return	3M Return	12M Return
Bloomberg Australia Bank Bill Index	0.28%	0.90%	3.83%
Bloomberg Australia Gov't 3-5 Year Index	0.60%	0.09%	2.42%
Bloomberg Australia Composite 0-3 Year Index	0.33%	0.51%	3.31%
Bloomberg Australia Composite 3-5 Year Index	0.59%	0.25%	2.92%
Bloomberg Australia Composite All Maturities Index	0.88%	0.46%	3.15%

Bloomberg Index data is sourced from Evans & Partners.

Fund rating

The Fund has been rated by SQM Research and FundMonitors.com.

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



Fund size

As of 28 February 2026, the Net Asset Value of the Fund was \$107,796,292.97.

Portfolio characteristics 28 February 2026

Running Yield*	6.16%
Yield to Maturity*	6.96%
Average Margin	2.96%
Average Years to Maturity	3.33
Number of Securities Held	59
Fixed	25.08%
Floating	68.47%
Cash	6.45%
Modified Duration	0.67
Credit Duration	3.08

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

Fees

MER*	0.72%
Buy/Sell Spread	+0.15% / -0.15%
Performance Fees	Nil

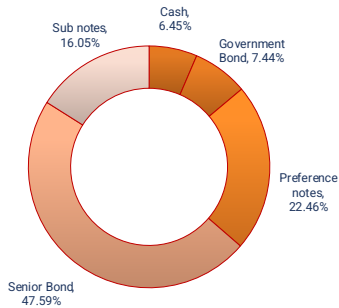
* GST inclusive, net of any reduced input tax credits

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Asset breakdown

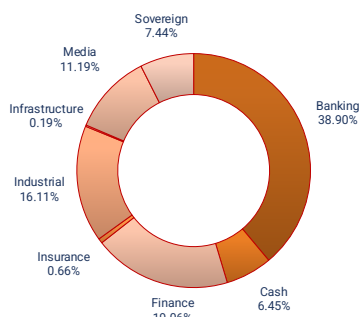
Sub Type Analysis

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



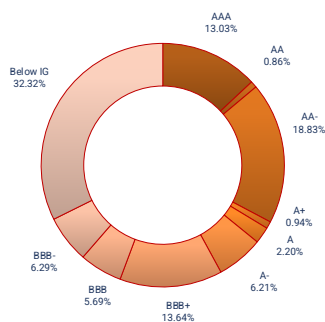
Sector Allocation

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

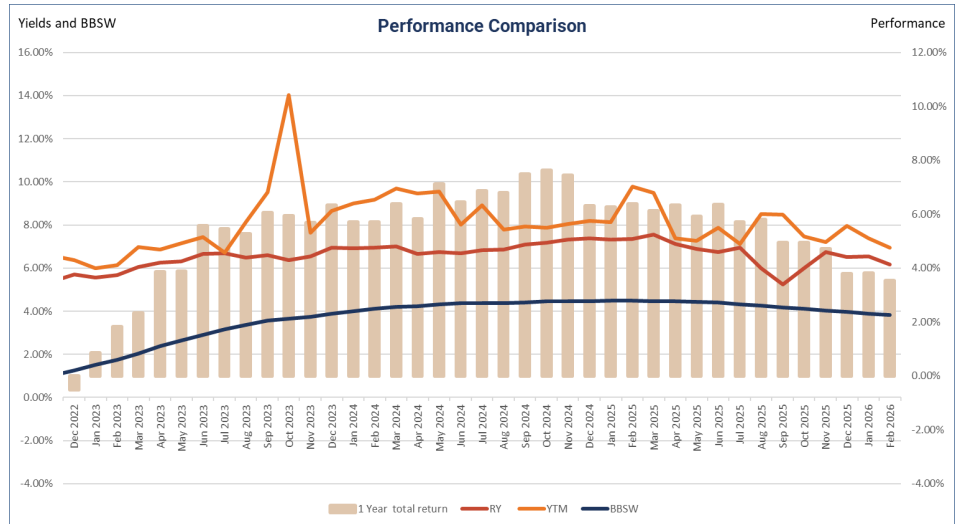


Credit Rating

■ AAA ■ AA ■ 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 27 basis points (bps) after all fees in February. The RBA increased the official overnight rate by 25bps early in the month which pushed the 90-day BBSW rate up to 4% at month end. We expect that rates will increase again once more in 2026 and this may move the 90-day BBSW rate up to 4.10%. This is important because the targeted average return of the Fund is the 90-day BBSW rate plus a margin of 350bps or 7.50% at the current 90-day BBSW rate.

Fund positioning

In the context of absolute return fixed income mandates, February 2026 reinforced the importance of active duration management and careful positioning across the yield curve. The RBA's resumption of tightening, combined with global risk-off volatility, created significant intra-month volatility across all segments of the Australian bond market. The front end remains most sensitive to RBA policy outcomes, while the long end is more influenced by global dynamics and term premium.

Just ahead of and just after the RBA increased rates by 25bps, we added some duration with purchases of both 5-year and 10-year Commonwealth Treasury bonds. As these bonds have low coupons the performance will come, not from the running yield, but the yield to maturity (if held to maturity) and capital gains if traded out at a profit. The reason for taking this position is twofold:

1. The US 10-year yield chart looks increasingly like it will breakdown not up. Even with this expectation we have a trading stop on the Australian Commonwealth bonds on a US 10-year yield breaking 4.11%. The Australian 10-year yield should track the US 10-year yield down if it breaks support.
2. Due to the unwinding of the yen carry trade, following the Australian dollar surging to a fresh high against the yen, the Australian 10- and 5-year Commonwealth bonds are trading at a 75bps premium to the US curve. Such a large premium is unusual. Back in 2022 when the ALP was first elected Federally the premium reached 75bps, but since then it has traded in a 15bps range either side of the US curve. We expect that once the Australian dollar peaks against the yen we will see Japanese selling of Australian bonds abate and the premium against the US curve retract back towards 30bps.

The move into Commonwealth Treasuries has been funded by shifting out of some lower rated senior secured holdings and major bank Tier 2 bonds. We have for some time avoided adding new Tier 2 bonds to the portfolio due to our perception that major bank tier 2 margins under 1.30% (10 non-call 5-year) do not offer enough return for risk. Should global asset volatility spike again then tier 2 margins may move considerably wider.

Update

The military actions taken against Iran on the 28th of February brought about a decision to sell all the Commonwealth Treasuries on the following Monday morning (2nd of March 2026) near the recent price peaks and move funds back into a mixture of floating rate senior bank bonds and cash. This resulted in the portfolio duration falling to near 0.30. The reasoning behind this tactical change is twofold:

1. At the time the US 10-year yield was testing support near 3.95% without breaking the trend line.
2. The military actions were likely to damage oil supply from the middle east leading to a rise in the price of oil that would have inflationary implications.

Market review

February 2026 was a pivotal month for the Australian fixed income market. The Reserve Bank of Australia (RBA) resumed its tightening cycle on 3 February, raising the cash rate by 25bps to 3.85% – becoming the first major central bank to reverse from rate cuts back to hikes following the post-COVID inflation surge. The decision was widely anticipated but nonetheless reshaped the interest rate landscape. Yields rose in the first half of the month before a global risk-off episode in the second half – driven by renewed US tariff tensions and AI-related equity market weakness – resulted in bond yields falling.

RBA February Rate Decision

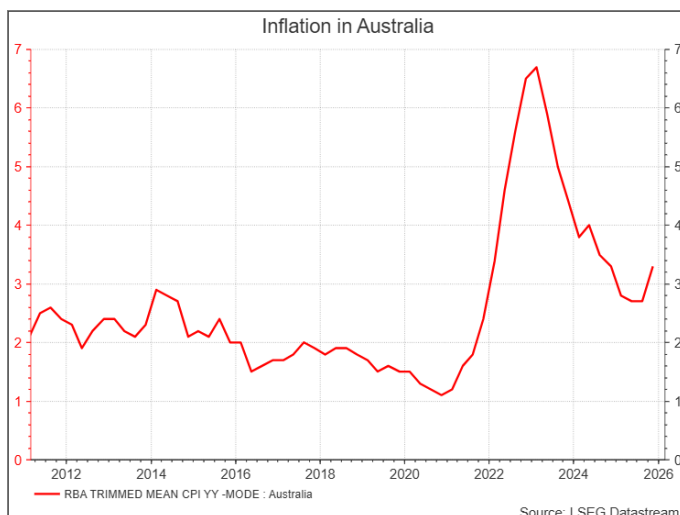
In its most consequential decision in over a year, the RBA Monetary Policy Board unanimously raised the cash rate target by 25bps to 3.85% at its 3 February meeting. The move reversed the easing bias that had characterised much of 2025 and marked Australia as the first major central bank to pivot from a cutting cycle back to tightening – a distinction that underscored the idiosyncratic nature of Australia's renewed inflationary pressures relative to most other advanced economies.

The Board cited a material pickup in inflation in the second half of 2025, driven by capacity pressures arising from stronger-than-expected growth in private demand, continued tightness in the labour market, and elevated unit labour costs. Critically, the RBA significantly upgraded its near-term inflation forecasts, projecting trimmed mean inflation at approximately 0.9% per quarter for the first two quarters of 2026, with annual underlying inflation expected to remain above the 2–3% target band through to the end of 2026 and only approaching the 2.5% midpoint around mid-2028.

Deputy Governor Andrew Hauser reinforced the hawkish message in a mid-month address, stating that inflation remained "too high" and that the Bank stood ready to "continue to do whatever is necessary" to return inflation to target. Governor Bullock, testifying before the Senate, attributed the primary inflation challenge to strong private demand rather than fiscal policy, and signalled the Board would remain data-dependent with respect to further tightening.

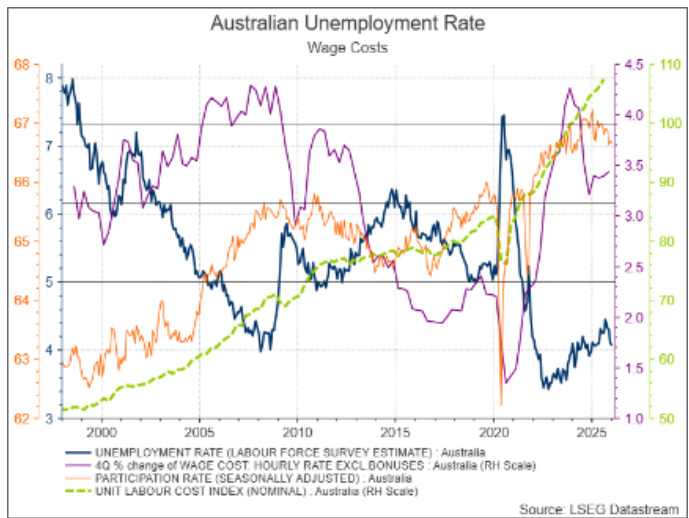
Inflation Data

January 2026 monthly CPI data released in the final week of February reinforced the hawkish narrative. Headline CPI held at 3.8% year-on-year – marginally above the 3.7% market consensus – while the closely watched trimmed mean edged higher to 3.4% year-on-year, beating both the 3.3% estimate and December's reading. This marked the seventh consecutive month that underlying inflation remained above the RBA's target band and materially raised the probability of a further rate increase, with markets pricing approximately an 80% chance of a 25bps hike in May and a full move priced in by June. Most analysts expected the cash rate to peak at 4.10%, in line with levels seen during the previous post-pandemic tightening cycle.



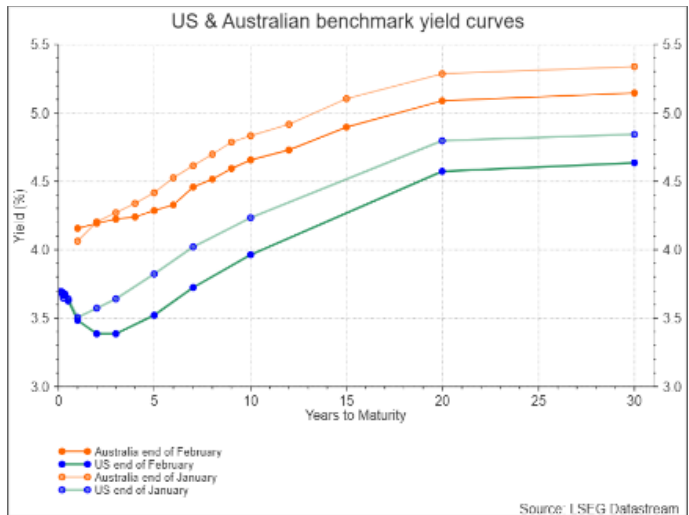
Labour Market and Growth

Labour market conditions remained a key pillar of the RBA's tightening rationale. Employment data released during the month showed continuing strength, with the unemployment rate tracking below expectation and labour underutilisation at low levels. Wage growth remained elevated on broader measures, and growth in unit labour costs continued to pose an upside risk to services inflation. Fourth-quarter GDP data, due in early March, was closely awaited by markets for evidence of whether demand momentum would be sustained into 2026.



Yield Curve Overview

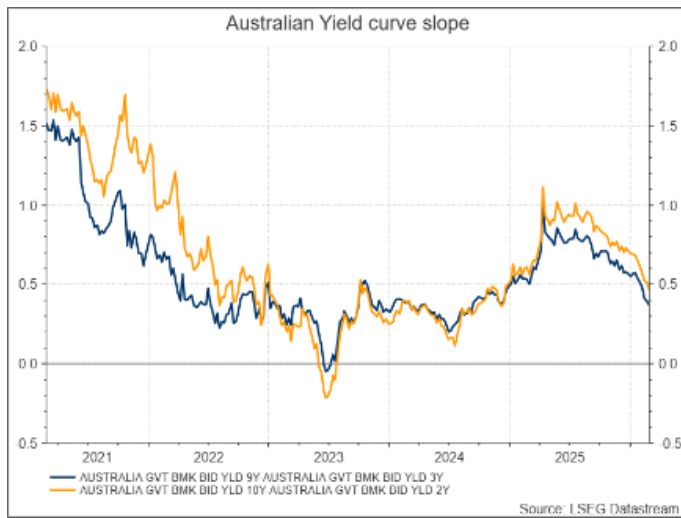
The Australian government securities (AGS) curve experienced significant repricing over the course of February, with the dominant narrative shifting from the RBA rate hike in the first half of the month to global risk-off dynamics in the second half. On a month-over-month basis, yields declined across most of the curve as the risk-off tailwind in the back half of February more than offset the initial sell-off that accompanied the RBA's decision.



The curve was characterised by significant intra-month volatility rather than a clean directional move. In the immediate aftermath of the 3 February rate hike, the front end sold off sharply, reflecting upward repricing of the expected terminal rate. The 2-year yield briefly approached 4.45% and the 3-year yield moved above 4.40% as markets repriced the peak cash rate toward 4.10%. The back end initially lagged, with the 10-year yield trading near 4.95% at its intra-month high.

However, the second half of February saw a meaningful reversal, particularly in the long end. The combination of global risk-off flows, tariff-driven uncertainty, and a decline in US Treasury yields dragged Australian long yields lower.

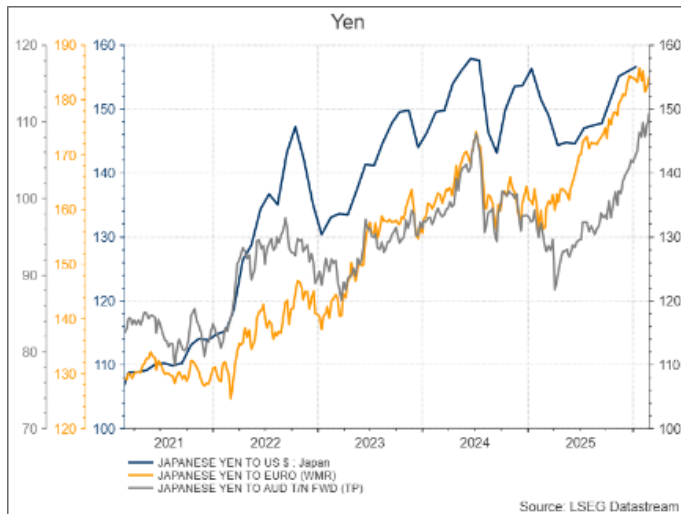
By month end, the 10-year had fallen to approximately 4.64% – a decline of 17bps on the month. The front end was more anchored, with the 2-year yield ending broadly flat at 4.20% and the 3-year edging slightly higher to 4.28%. The net effect was a modest flattening bias in the belly of the curve, and a narrowing of the 3-to-10 spread. The curve remained positively sloped overall, reflecting the market's acknowledgement curve, elevated terminal rate while still pricing an eventual easing cycle over the longer term. The 30-year yield, at 5.34% by month end, maintained a steep premium to shorter maturities, consistent with elevated global term premium dynamics.



Australia–US Spread Premium

A notable structural feature of the Australian rate market throughout February was the persistent premium of the Australian 10-year yield over its US equivalent. This premium, at times reaching approximately 75bps, remained well above the historical norm of around 15bps. One of the most significant technical factors influencing Australian bond markets through late 2025 and into February 2026 has been the AUD/JPY exchange rate and its relationship to Australian bond yields.

The surge of the Australian dollar to multi-year highs against the yen prompted an unwinding of yen carry trades in which Japanese institutional investors had accumulated large, long-positions in Australian government and semi-government bonds. The premium is expected to normalise as the AUD/JPY rate stabilises and Japanese selling pressure abates. Depending on the pace of normalisation, this represents both a technical risk (further selling if the yen strengthens further) and an opportunity (meaningful spread compression as the dislocation unwinds). Our expectation is for the 10-year spread to converge toward 30bps as the carry trade unwind matures.



Senior Unsecured – Major Banks

The major Australian banks continued to demonstrate exceptional credit strength in February 2026. Common Equity Tier 1 (CET1) ratios across the Big Four – Commonwealth Bank, Westpac, NAB, and ANZ – remained comfortably above APRA's "unquestionably strong" benchmark, providing a supportive fundamental backdrop for bank bond investors across the capital structure. The RBA's February Bulletin article on credit markets confirmed that bank funding cost spreads, while edging slightly wider in response to the rate hike, remained approximately 70bps below end-2019 levels – a testament to the structural improvement in bank funding conditions since the pandemic.

Tenor	Major Bank Senior (bps over BBSW)
1-Year	~30–40
2-Year	~40–55
3-Year	~50–65
5-Year	~65–80
7-Year	~80–95

Senior spreads experienced modest upward pressure in the first half of February as the RBA rate decision increased overall funding costs and prompted some re-pricing of the short end. However, credit spreads remained well contained – the broader risk-off shift in the second half of the month, while generating some secondary market widening, was quickly absorbed. New issuance in the 3-to-5-year part of the curve was priced with modest new-issue concessions of 5–10bps, reflecting healthy but not insatiable demand. Kangaroo bond issuers (offshore borrowers accessing the AUD market) also remained active, drawn by favourable relative value compared to other major currencies.

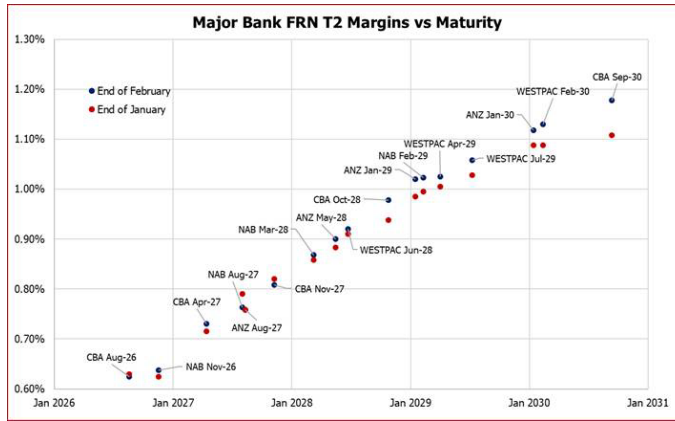
Tier 2 Capital (Subordinated Debt)

The Tier 2 market remained a focus of significant investor and issuer attention in February, primarily reflecting the ongoing structural reshaping of Australian bank capital following APRA's 2024 decision to phase out Additional Tier 1 (AT1) instruments by 2032. Under APRA's framework, banks are substituting 1.5% of risk-weighted assets currently held in AT1 with a combination of 1.25% Tier 2 capital and 0.25% CET1. This regulatory shift has created a structural increase in Tier 2 supply requirements, though it has paradoxically supported spread tightening in the near term due to call risk removal and upgrade dynamics.

Issuer Tier	T2 spread (bps over BBSW)
Major Bank T2 (10NC5)	~140–165
Regional Bank T2 (10NC5)	~175–210
Non-Bank T2	~220–280

Several technical factors impacted Tier 2 spreads:

- Banks are actively building their Tier 2 buffers to comply with APRA's 6.5% of risk-weighted assets requirement, creating a supply dynamic in subordinated debt that, paradoxically, has been well absorbed by investors seeking spread premium in a market with historically tight senior spreads. The continued phasing out of AT1 instruments is expected to reduce the stock of hybrid capital by approximately AUD 40 billion by 2032, with the supply vacuum being filled by a mix of new Tier 2 issuance and higher retained earnings.
- Multiple major banks received ratings upgrades or outlook improvements during and around February, lowering the perceived credit risk embedded in subordinated paper.
- February saw record A\$ Tier 2/AT1 issuance of A\$7.7bn – 92% larger than the previous monthly record – which overwhelmed demand and pushed non-call 5-year spreads 11bps wider, reversing January's rally. The long end underperformed particularly sharply (non-call 10-year: +24bps, 20-year: +27bps), steepening the credit curve after A\$4.1bn of supply came in 7 to 20-year paper.

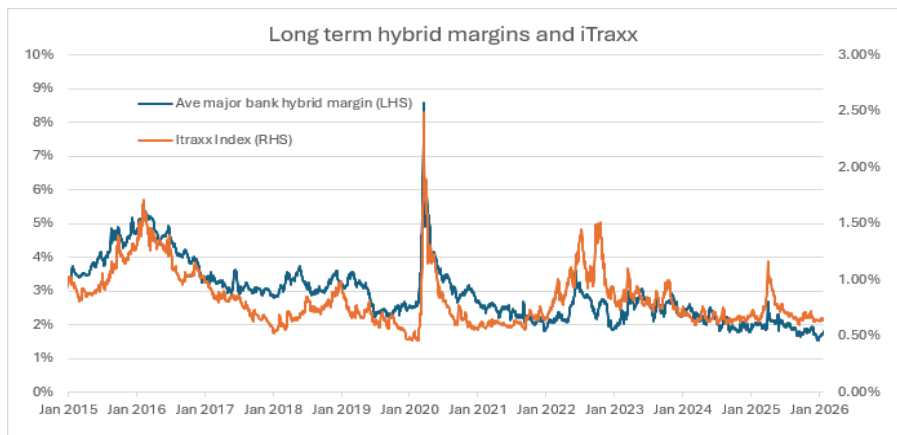


Source: Arculus

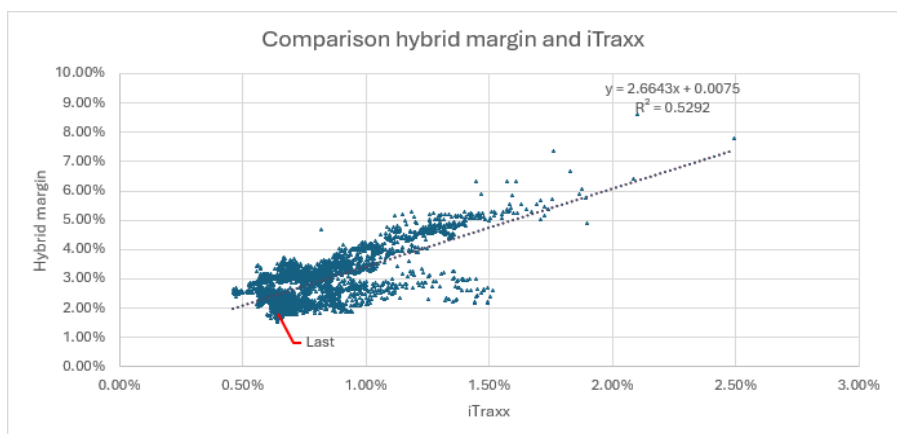
Tier 1 Securities

Over January, Tier 1 margins, on average, increased from 1.55% at the end of December to finish at 1.82%. In context, as shown in the chart below, this is still an extreme low, driven by a lack of new hybrid issuance and less available liquidity.

The chart also shows the iTraxx index, a measure of Australia’s top 25 corporate senior bonds trading margins. Banks represent 20% of the equally weighted iTraxx basket (majors plus Macquarie). This index is close to its lows, as are all corporate bond margin spreads globally. On a relative basis, these two-time series are shown in the second chart as a scatter diagram. The mathematical relationship is also shown in the chart. This chart shows that the long-term relationship between the iTraxx index and hybrid margins, of 2.66 times the iTraxx index, is still being maintained.



Source Refinitiv, Arculus



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These comments reflect the Manager’s current views as at the date of this report. These views are subject to change and are not guarantees of future performance.

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