Alexander Funds

# The Alexander Perspective

Quarterly Update

March 2024

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# CEO's Update

### Welcome to our last quarterly update for the 2023/2024 financial year.

During the first quarter of the year, credit markets in Australia exhibited resilience and steady growth despite global economic uncertainties. With the geopolitical tensions that continue to unfold and the sustained strength running through major economies, it appears that market volatility and inflationary uncertainty will continue to create challenges for markets and investors over the course of 2024.

Once again, we were able to navigate the challenges of the markets and the team are pleased to report that both of our funds have exceeded their benchmark returns throughout the quarter. The Credit Income Fund and Credit Opportunities Fund achieved annualised returns to the end of March of 7.62% and 8.71% respectively.

Outside of markets, the timing of this quarters report coincides with the company's 15th anniversary on May 1st. In those 15 years, our funds have only had two negative months (in March and April 2020). Another milestone to mention is the Alexander Credit Income Fund reaching half a billion in Funds Under Management. This is a fantastic achievement only made possible by the continued support of all our investors and supporters.

In other company news, I am pleased to share that we have appointed an Independent Chair of Alexander Funds' ESG Committee, Giles Gunesekera. Giles' expertise in Environmental, Social and Governance (ESG) impact assessment will assist Alexander Funds integrate sustainable factors into our decision-making process. We strive to be forward-thinking within the investment industry, and this ambition extends to ESG considerations. We have always sought independence in our committees and Giles joins our Independent Chair of the Investment Committee, Chris Dalton, Internal Ratings Committee Chair, Belinda Smith and Independent Committee members Nick Bishop and Gerard Minack as our external oversight. All of our committee chairs are independent and provide external integrity to our processes.

In the following pages, our investment team present discussion on the current economic landscape and how they are positioning our portfolios. As always, we are deeply dedicated to keeping open channels of contact with our investors and welcome your thoughts and recommendations as we strive for positive investment outcomes. Thank you for your continuing support and dedication to Alexander Funds; I look forward to providing an update next quarter.

Warm Regards

**Rachel Shirley**
CEO

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# Market Commentary

## What happened over the quarter?

After a positive finish to 2023, financial markets entered 2024 with momentum that continued largely unabated over the March quarter.

In the US, 2023's focus on the probability of a hard versus soft economic landing, transformed into a discussion about soft versus no landing as economic data indicated resilient growth despite the restrictive setting of monetary policy. As a result, the substantial monetary easing the market had priced in at the beginning of the quarter was pared back significantly, with the expectation of 6 rate cuts over 2024 at the start of January, sitting at ~2.5 cuts by the end of March. This change was also reflected in the 10-year bond yield which widened by 32bps to finish March at 4.20%. Despite factoring in an expectation of tighter monetary conditions, US equites performed strongly, with the S&P 500 up 11%.

Domestically the theme was similar, albeit to a much smaller degree, with the market moving from 2.6 cuts for 2024 to 1.8, the Australian 10-year government bond yield remaining unchanged and the ASX 200 rising 4%.

Credit markets also rallied, with the trend towards tighter spreads in place since Oct 2023 largely carrying over into 2024. This dynamic has been most acutely felt within securitisation markets with spreads across the mezzanine notes (i.e. the notes rated below AAA) within new deals tightening significantly over the October 2023 – March 2024 period. Whilst we'll discuss the specifics of each market segment later in this newsletter, it is worth noting that the strength in market pricing has occurred in conjunction with increased supply, with primary issuance in most sectors well ahead of the prior corresponding period.

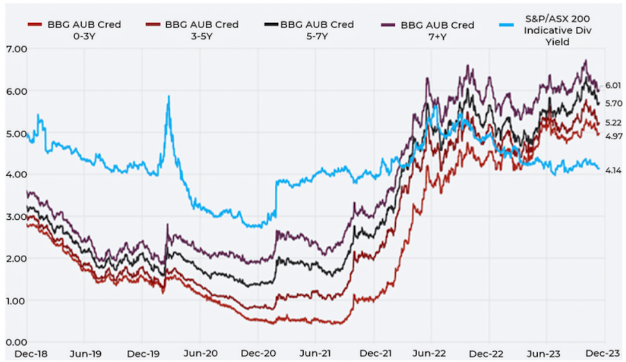
Typically increased supply has a negative impact on credit spreads as the market demands a higher premium to digest a greater amount of bonds, raising the question – why has it been different over the March quarter?... In our view, a large contributor to this dynamic is the impact to the demand for credit from cash rates being set at a level higher than recent history (for context, the current cash rate is higher than any point in the last 12 years).

A starting point of 4.35%, creates all-in yields (i.e. cash rate plus credit spread) that are attractive for a broad range of investors. This includes those that don't think about relative value through the lens of credit spreads, are happy holding bonds till maturity and quite likely don't need to value their security daily. For investors in this category, despite narrowing credit spreads, investment grade credit still provides an attractive nominal return with reliable income and little chance of default.

As an example, the chart below shows the yield over time in the Bloomberg AusBond Credit Index across various maturities with the dividend yield on the ASX 200. Noting that the current yield in the credit index exceeds the dividend yield available from the ASX 200.

**Chart 1**

ASX 200 Indicative Dividend Yield vs Bloomberg Ausbond Yields by Tenor Bucket (%)




*Source: Westpac, Bloomberg*

With cash rates expected to remain elevated into late 2024, we expect the technical tailwind this provides to credit spreads to persist until later in the year.

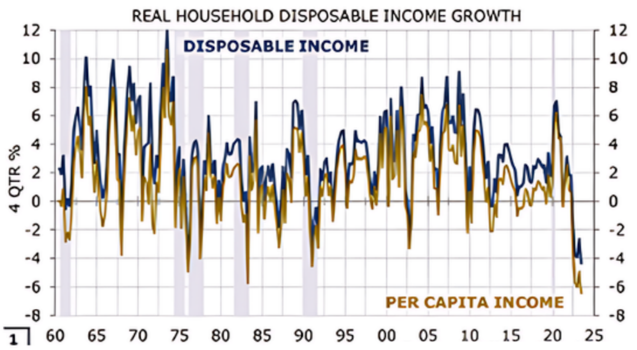
# Market Commentary

## Where to from here?

Regular readers of the Alexander Perspective will be aware that we have held concerns over the ability of the Australian economy to successfully manage the significant tightening in monetary policy over the 18 months ending in November 2023. Our cautious view was based on several factors;

- The average Australian consumer entered the period of RBA rate hikes carrying a substantial debt burden built up over time to buy expensive housing relative to income.
- The policy driven "fixed rate mortgage cliff" delayed the normal impact of monetary policy, leaving the RBA forced to make cash rate decisions without the benefit of understanding the full impact of rate rises already enacted.
- The per capita impact to disposable income from rising rates, inflation and other costs of living was at a level only seen historically during periods of material economic recession.

**Chart 2**




*Source: Minack Advisors*

To date, these concerns haven't translated into a big fall in economic activity as headline data remains resilient - partially due to elevated migration, on a per capita basis the decline in activity is reasonably pronounced.

In addition to public economic data, we're also privy to arrears performance across a wide variety of loan pools by virtue of our investments in the publicly traded (RMBS/ABS) and privately originated (warehouse) securitisation markets.

Our investments cover a broad spectrum of lending types, including residential mortgage, SME, consumer autos and equipment finance. While we saw a small rise in the percentage of loans in arrears across the board in late 2022, mostly this represented a washing out of the impact from COVID stimulus and a return to levels consistent with normal economic conditions.

As we grapple with the outlook for the remainder of 2024, we're considering;

- The technical support for credits market on the back of healthy all-in yields discussed earlier,
- The offsets within the economy from higher rates with more, older consumers versus history who are living off their savings, likely don't have a mortgage and for whom higher rates have increased disposable income, and
- The potential threat sticky inflation poses to the RBA's ability to ease the current restrictive setting of monetary policy later this year.

In weighing these factors, our outlook has moved from the cautious setting held through most of 2022 and 2023 to one that is neutral, albeit with an eye on what scope the RBA has to ease monetary conditions later in the year and provide relief to a large segment of Australian consumers currently under severe financial pressure.

# Market Commentary

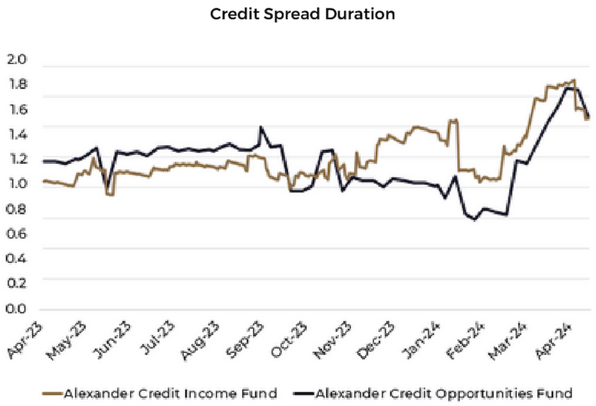
## How are we constructing portfolios?

As our cautious view of the macroeconomic environment has softened, we've become more constructive on adding risk to the portfolio. Across the core risks we consider when constructing portfolios (Credit, Market, Liquidity), we have been selectively adding Credit and Market risk with the objective of bringing the portfolio closer to what we consider appropriate for a neutral market environment.

In practical terms this presents as;

- Increasing credit spread duration. Credit spread duration is the weighted average maturity of all securities within the portfolio, the higher the number, the more exposed the capital value of the portfolio is to changes in credit spreads. As a reminder, our portfolios are always exclusively invested on a floating rate basis, hence we take no active position on the direction of interest rates broadly.

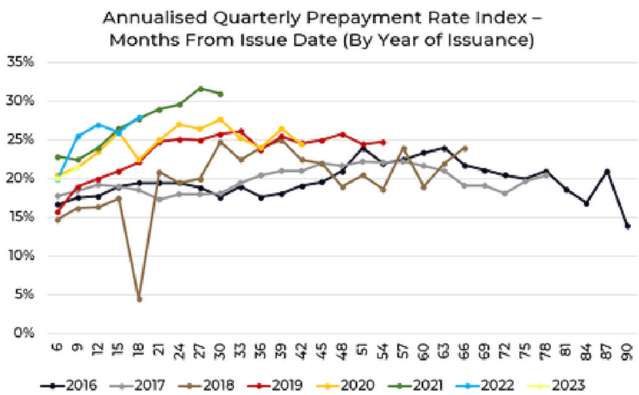
**Chart 3**




- Increased appetite for lower rated credit, during much of 2022 and 2023 our preference was for highly rated credit in keeping with our cautious view. As we move to neutral, our appetite for securities that carry additional credit risk and higher return naturally increases.

When discussing credit quality, there is value in bringing attention to the amortising characteristic of public securitisation (RMBS/ABS) issues that is poorly appreciated outside of those directly involved in these markets. These securities are designed to amortise over their life, as the loans serving as collateral for the issue are repaid. Using the example of RMBS, a portion of a residential loan is repaid monthly via monthly principal and interest payments, in addition to loans that are fully repaid because the mortgage holder has sold the house or refinanced it to another lender. The extent of this prepayment can vary but looking at the last 8 years, it averaged roughly 20%.

**Chart 4**




*Source: S&P, Westpac*

The mechanics of RMBS/ABS securities usually dictate that principal repayment is applied to the notes with the most senior claim on the assets first, this in turn strengthens the position of the remaining notes. As such, the credit rating of RMBS/ABS securities are typically upgraded steadily over their life with most notes rising several notches (i.e. BBB to AA).

The increase in our portfolios exposure to lower rated credit versus our positioning for most of 2023 should be considered in the context of;

- Being predominantly via securitised investments that natrally improve in credit quality over time, and
- Reflecting a transition to a neutral level of credit risk from what has been a very cautious setting.

# Sector Performance & Fund Positioning

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## Debt Capital Markets

New issuance within the domestic debt capital markets was up strongly in the March quarter versus the same period in 2023. Whilst new financial issuance was up 7%, it was the non-financial corporate segment of the market that grew substantially with new issuance from this sector up 275% versus 2023. It's worth noting, this growth is coming off a very low base with corporate issuers sitting out large parts of 2022 and early 2023 due to uncertainty about the ability to execute a new deal in an environment of heightened market volatility.

While spreads within debt capital markets didn't rally as significantly as structured markets, the quarter was highlighted by new deals being significantly oversubscribed and once issued, well supported in secondary markets.

Our focus in this market was largely within the financial space where we see better relative value on a ratings adjusted basis. Of note was March's AUD Tier 2 issue from HSBC at a significant premium to similar bonds issued from the Australian major banks. The deal set a record for the largest order book in AUD Tier 2 market history at $5.8bn (print of $1.5bn) and was a strong performer post issuance.

## Structured Credit

Structured markets set a record pace for new issuance in the March quarter, with RMBS volumes up 135% on 2023. Whilst it remains to be seen how much of this represents supply that was planned for later in the year but has been dragged forward to take advantage of attractive pricing, as it stands the market is on pace for a record year of new transactions.

As mentioned previously, despite the elevated supply, spreads have tightened as investors searching for yield have continued to bid into new deals, with most mezzanine tranches multiple times oversubscribed.

Spread compression was most acutely felt in the sub-investment grade tranches, with total spread compression since October 2023 at ~150bs, whilst investment grade tranches saw spread compression of ~50bps.

## Private Assets

Our activity within Private Assets is exclusively focused on providing warehouse (private securitisation) funding capacity to the non-bank sector. This market remains prospective, although new transactions can have a long gestation period.

This market has also seen some compression in pricing on the back of the significant moves seen in public RMBS/ABS markets. In addition to tighter pricing, the impact of buoyant public markets has meant that non-banks have underutilised their warehouse funding lines.

For context, the warehouse operates as vehicle to fund loans when they are initially issued, with the ultimate objective of taking a cohort of loans from a warehouse to use as collateral for a public RMBS/ABS transaction. This in turn creates capacity within the warehouse that can then be used to fund new loans. With the rapid compression of spreads in RMBS/ABS markets, non-banks have been eager to price new public securities to take advantage of cheaper funding and thus the amount of loans within their warehouse funding lines has been lower. We expect this to be a point in time phenomenon that will balance out with stability in RMBS/ABS pricing.

## Fund Positioning & Activity

While we've added credit spread duration to our portfolios in recognition of our expectation for a benign environment for the next 6 months, we still hold concerns for the state of the economy should the RBA not be in a position to provide rate relief that is largely expected from markets and consumers.

As such, we retain a cautious bias and a willingness to utilise our hedging program to reduce credit spread duration should we begin to see deterioration in broader economic data or the arrears performance of our investments.

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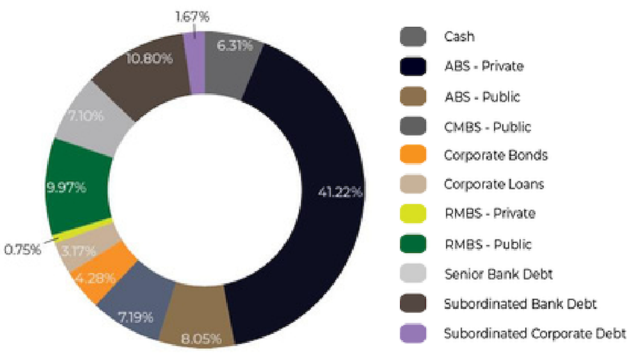
# Fund Performance

## Credit Opportunities Fund

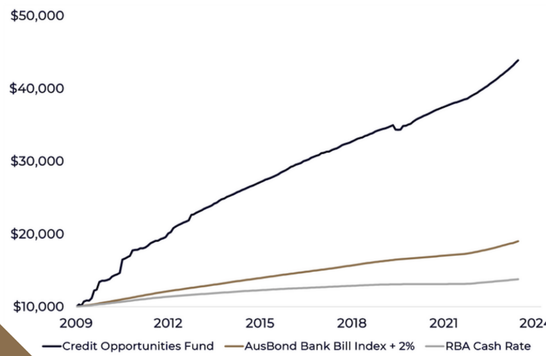
The Alexander Credit Opportunities Fund has a benchmark of the AusBond Bank Bill Index +2% pa. The Fund achieved a net return of 2.38% for the quarter ended 31 March 2024 for an annualised net return over the previous 12 months of 8.71%, and paid a distribution for the quarter of 2 cents per unit.

| | Fund | Benchmark |
|---|---|---|
| 1 Month* | 0.76% | 0.54% |
| 3 Month | 2.38% | 1.56% |
| 6 Month | 4.53% | 3.18% |
| 12 Month | 8.71% | 6.29% |
| 3 Year (pa) | 6.44% | 4.13% |
| Since Inception (pa) | 10.80% | 4.56% |

### Portfolio˜ as at 31 March 2024




### Performance of $10k Invested Since Inceptionˆ

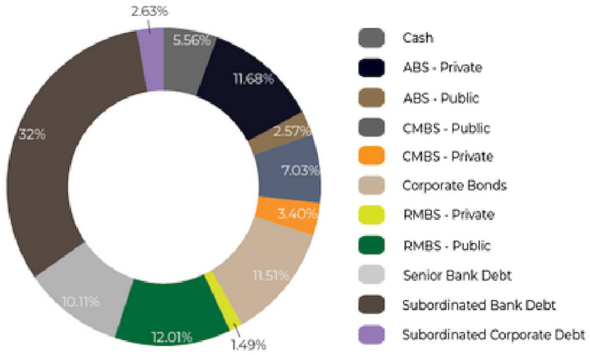



## Credit Income Fund

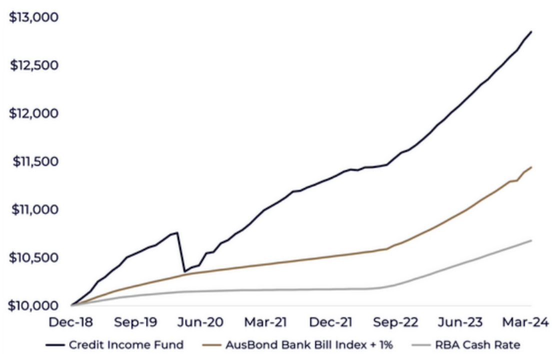
The Alexander Credit Income Fund has a benchmark of the AusBond Bank Bill Index + 1% pa. The Fund achieved a net return of 2.02% for the quarter ended 31 March 2024 for an annualised net return over the previous 12 months of 7.62%, and paid a distribution for the quarter of 1.4 cents per unit.

| | Fund | Benchmark |
|---|---|---|
| 1 Month* | 0.69% | 0.45% |
| 3 Month | 2.02% | 1.31% |
| 6 Month | 3.93% | 2.67% |
| 12 Month | 7.62% | 5.24% |
| 3 Year (pa) | 5.17% | 3.10% |
| Since Inception (pa) | 4.80% | 2.55% |

### Portfolio˜ as at 31 March 2024




### Performance of $10k Invested Since Inceptionˆ



# Notices & Disclaimers

* The monthly return is an actual return net of all fees, costs and taxes generated by dividing the redemption unit price by the previous month's redemption unit price. Past performance is not a reliable indicator of future performance. All return figures for periods greater than 12 months are annualised.
~ Portfolio Composition is net of hedges
^ Assumes reinvestment of all distributions

Alexander Funds Management Pty Ltd (ABN 77 136 871 924) (AFSL 476697) ("Alexander Funds") is the Investment Manager of the Alexander Credit Opportunities Fund (ARSN 156 026 514) ("ACOF" or "Fund") and the Alexander Credit Income Fund (ARSN 629 915 199) ("ACIF" or "Fund"). Equity Trustees Limited ('Equity Trustees) (ABN 46 004 031 298) AFSL 240975 is the Responsible Entity for the Fund. Equity Trustees is a subsidiary of EQT Holdings Limited ABN 22 607 797 615, a publicly listed company on the Australian Securities Exchange (ASX: EQT).

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ACIF's PDS and TMD can also be found at
https://www.alexanderfunds.com.au/alexander-credit-income-fund
ACOF's PDS and TMD can also be found at
https://www.alexanderfunds.com.au/alexander-credit-opportunities-fund

A Target Market Determination is a document which is required to be made available from 5 October 2021. We recommend that you read this document as it describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

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