Equity Trustees

March 2024

ASSET CLASS INSIGHTS

WHY INVEST IN A CREDIT FUND?

Credit is presently in a 'sweet spot'. Solid corporate earnings, a resilient domestic economy, robust company profits, high income yields, attractive spreads and increasing investor demand are all supportive features.

In this insight piece we outline the benefits of holding credit in a diversified portfolio and why the outlook for credit should be supported.

WHAT IS A CREDIT PRODUCT AND WHY INVEST IN IT?

Credit products offer exposure to company debt which pays a coupon. A coupon is the annual interest rate paid on a bond expressed as a percentage of the face value and paid from the issue date until maturity. The coupon is linked to bank bill rates and are predominantly floating rate or variable in nature. A corporate bond (or credit) may be viewed as a government bond plus a 'spread'. The 'credit spread' is the risk premium paid over a benchmark bond or interest rate swap (BBSW). The credit spread in theory reflects the riskiness of the issuer. The riskier the issuer, the greater the spread.

There are several reasons why investors should consider credit in a diversified portfolio. These include:

- Regular, stable income stream – Credit products strive to provide a regular income through interest payments which is generally higher than government bonds.
- Defensiveness and risk mitigation – Credit products can offer a level of capital preservation. Credit sits higher on the capital structure than equities representing a debt obligation that is more likely to be paid and is therefore more defensive and lower risk.
- Diversification – Credit can mitigate risk across a diversified portfolio as it will act differently to other asset classes. It can also add diversity amongst broader credit products for example, investment grade corporate credit, high yield corporate credit, Government bonds and private credit.
- Potential for capital gain at opportune times – Active management in credit can lead to capital appreciation if acquired at opportune times in the cycle, for example, when yields are high and then fall as interest rates decline.

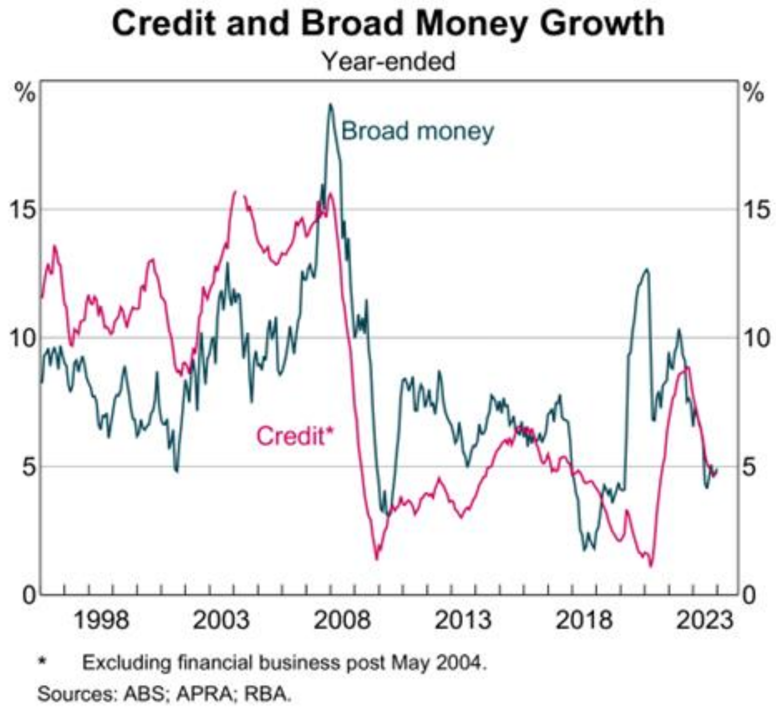
THE OUTLOOK FOR CREDIT

We believe the outlook for credit is positive. This is because:

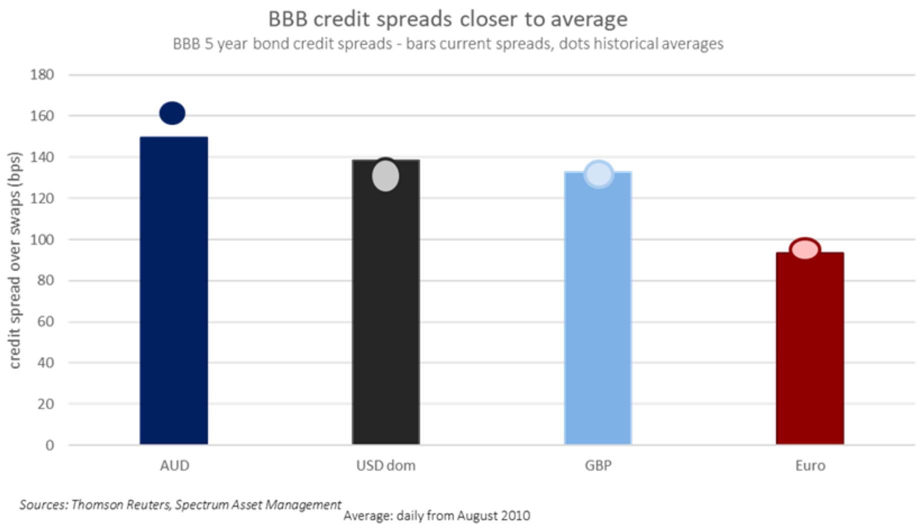
1) In general, during the recent reporting season, many companies reported solid earnings results and a supportive outlook. This is positive for the credit outlook for many corporates and, potentially company credit ratings.

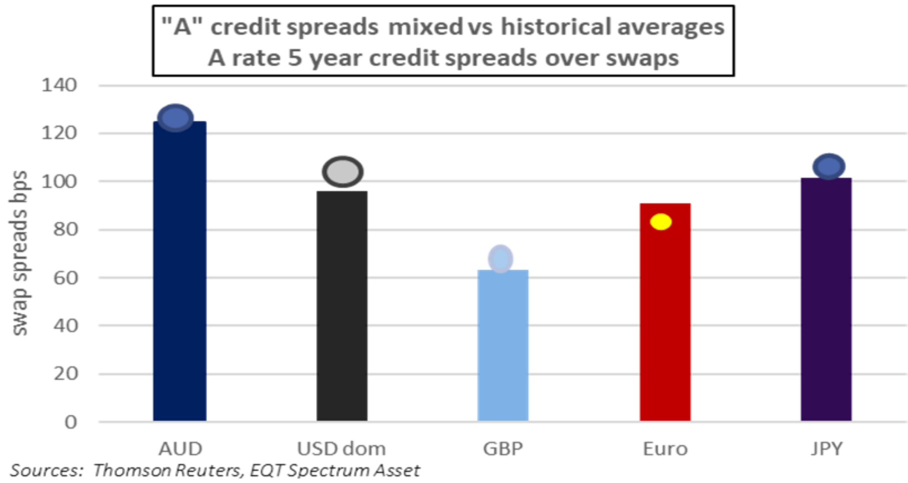
2) The economic environment remains resilient and should be supported by interest rate cuts into 2025. The probability of a recession has lessened. Interest rates are unlikely to rise from current levels and most economists forecast rates will fall either in the second half of 2024 or early 2025 as inflation normalises. A "soft landing" scenario is supportive for credit.

We think interest rates will fall as inflation trends toward central bank target levels. In recent time, central banks have been worried about inflation leading to successive rate hikes. However, the chart below shows the main cause for inflation was the growth in money supply due to loose monetary conditions. Following successive rate hikes, these conditions have now tightened and there has been a significant restriction of lending conditions. "Broad money" has decreased in turn. This fall in broad money has been significant. This fall is consistent with a reduction in inflation and provides the opportunity for the RBA to ease.



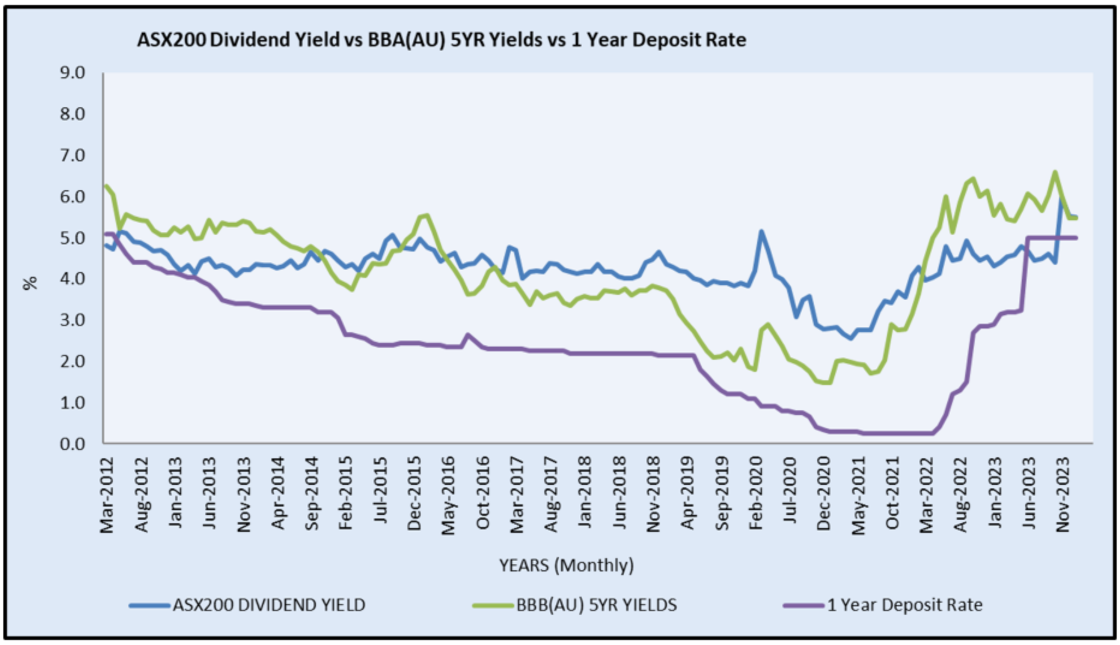
3) Demand for credit looks set to continue. Credit spreads, in general, look attractive or fair value when compared to the long-term averages. While credit spreads have been tightening due to a more optimistic underlying economic environment, spreads remain buoyant. Spreads can compress further should the underlying environment improve. Investor demand for 'high beta' securities has been strong given the attractive all-in yields on offer.





4) All in yields are high and provide attractive levels of consistent income.

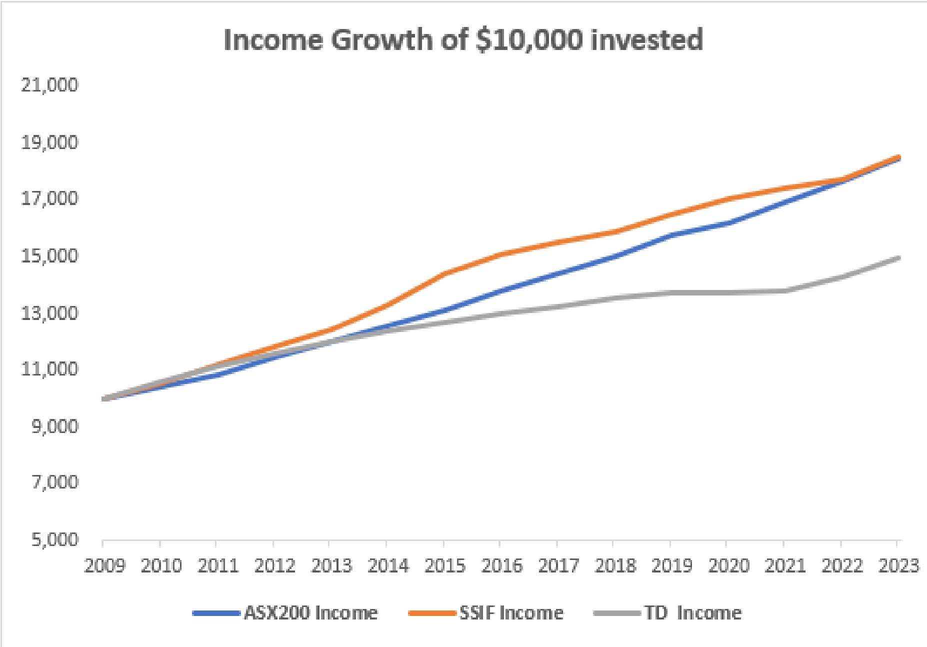
Given where current interest rates are, credit offers attractive levels of income (as shown by the green line in the chart below).



Source: EQT

Even in more adverse economic environments credit provides a steady stream of income versus equity distributions. This is because credit payments, unlike equities, do not require board approvals. At times when equity markets are weak or steady credit provides an alternative solution.

Currently, the EQT Spectrum Strategic Income Fund (SSIF) provides similar levels of income to the ASX200, however the SSIF volatility of returns is significantly lower. The SSIF also provides some capital gain. The current rolling year on year return is 5.43% versus cash 4.12%.



Source: EQT

About

The [EQT Spectrum Strategic Income Fund] is an actively managed credit fund that invests in a range of debt and hybrid securities with the objective of maximising income whilst preserving capital. The portfolio holds a diversified number of securities with risk limits imposed and actively monitored across security type, credit risk, industry, and issuers. Issuers include government bodies, banks, and corporates. The Fund seeks to deliver higher returns to investors than traditional cash management and fixed income investments. Asset Consultant (SQM) has a "Superior" rating for the Spectrum Strategic Income Fund.

Lindsay Skardoon, is the Portfolio Manager for the EQT Spectrum Strategic Income Fund. He has 37 years' experience in investment and portfolio management.

Investing in the EQT Spectrum Strategic Income Fund

How to invest via the PDS: https://www.eqt.com.au/-/media/equitytrustees/files/instofunds/equity-trustees-wealth-services-limited/spectrum-strategic-income-pds.pdf

Platform availability: AMG Super, Bell Direct, mFund, Nabtrade, Hub24, Powerapp, netwealth, CMC Stockbroking, Aust Money Market, Freedom of Choice, uXchange, Ausmaq

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Spectrum Strategic Income Fund's Target Market Determination is available https://swift.zeidlerlegalservices.com/tmds/ETL0072AU A Target Market Determination is a document which is required to be made available from 5 October 2021. 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.