Equity Trustees

September 2024
Quarterly Report

EQT DIVERSIFIED FIXED INCOME FUND (INSTITUTIONAL CLASS)

PORTFOLIO OBJECTIVE

The Fund aims to provide investors with exposure to high-quality income-yielding investments. The Fund aims to outperform the benchmark over rolling three-year periods, after taking into account fees and expenses.

FUND PERFORMANCE

PERFORMANCE[1]	3 MONTHS	1 YEAR	3 YEARS (P.A.)	5 YEARS (P.A.)	SINCE INCEPTION (P.A.)[2]
Total net return	3.06%	6.95%	-1.37%	-0.58%	1.86%
Benchmark return[3]	3.02%	7.11%	-1.19%	-0.40%	2.33%
Active return	0.04%	-0.16%	-0.18%	-0.18%	-0.47%

Table 1
Source: Equity Trustees as at 30/09/2024

[1] Performance: Total net return is the return after the deduction of ongoing fees and expenses. Results greater than one year are annualised.

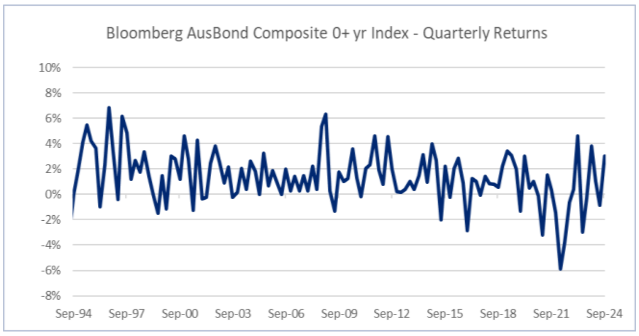
[2] Inception date is 14 October 2014.

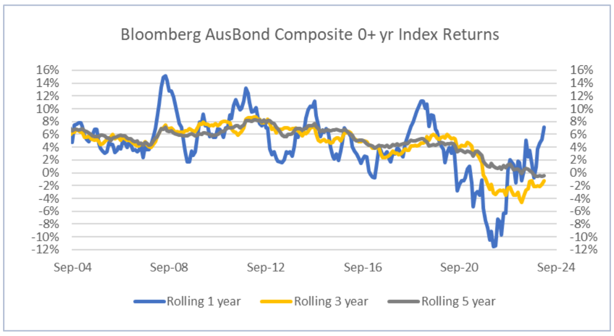
[3] Benchmark is the Bloomberg AusBond Composite 0+ Year Index.

Past performances should not be taken as an indicator of future performance.

PERFORMANCE SUMMARY

The Fund recorded a total net return of 3.06% for the September 2024 quarter, outperforming the Bloomberg AusBond Composite 0+ year Index by 4bps. Over the last 12 months the Fund recorded a total net return of 6.95%, underperforming the Index by 16bps. The total net return since inception is 1.86% p.a., underperforming the benchmark by 47bps over the same period.





Source: Bloomberg, Equity Trustees as at 30/09/2024

MARKET SUMMARY

Softer US economic data saw bond yields tumble in July, as ISM manufacturing and services activity declined, the unemployment rate rose, and headline CPI turned temporarily deflationary. The Fed signalled that a September rate cut was likely and escalating geopolitical events in the Middle East saw investors flock to the relative safety of US treasuries. At home, quarterly trimmed mean inflation data also surprised on the low side which saw domestic yields plunge 15bps immediately following the release into month-end.

August saw further declines in bond yields, this time driven by a weak US labour market report which saw the unemployment rate lift from 4.1% to 4.3%. US Federal Reserve Chair Jay Powell struck a more dovish tone at the Jackson Hole Symposium, all but guaranteeing a rate cut in September and adding ongoing strength to the bond rally seen in the previous month.

Bond markets stabilised in September as an uptick in US inflation offset softer labour market data. The Fed surprised markets by cutting its policy rate by 50bps against the more widely expected 25bp reduction, however, yields drifted higher following the announcement as Jay Powell quashed expectations of a 50bp follow-up move.

At home, employment data released mid-September surprised to the upside which sent local yields higher, however the moves were short lived following the RBA cash rate call the following week which saw Governor Bullock stating the RBA had not considered a rate hike during its deliberations, in turn sending front-end yields cascading lower. Despite the intra-month volatility, bond yields finished the month mostly unchanged.

In terms of market movements, the yield on the Australian 3-year generic bond opened the quarter at 4.08% rose as high as 4.16%, before falling to 3.54%. The yield on the 10-year generic bond opened at 4.31% and moved as high as 4.43% in July before falling to close the quarter at 3.97%. The 3s/10s curve steepened by 20bps to 43bps.

The spread between the Australian 10-year government bond and US 10-year treasury note widened by 28bps, to close the quarter at 19bps.

GLOBAL BOND MARKET MOVES

	JUN QUARTER	SEP QUARTER	MOVE (BPS)	QUICK COMMENT
US 10-year note	4.40%	3.78%	-62	Fed. shifts its focus from inflation to labour market
German 10-year bund	2.50%	2.12%	-38	Manufacturing activity remains weak
UK 10-year gilt	4.17%	4.00%	-17	BOE cuts rates 25bps in August
Japanese 10-year bond	1.05%	0.85%	-20	BOJ lifts its overnight rate to 0.25%
Australian 3-year bond	4.08%	3.54%	-54	RBA no longer considering rate hikes
Australian 10-year bond	4.31%	3.97%	-34	Long-dated bonds underperform US treasuries

Table 2
Source: Equity Trustees as at 30/09/2024

PORTFOLIO ACTIVITY AND ATTRIBUTION

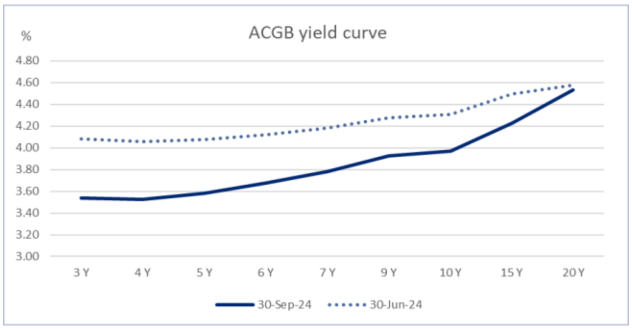
DURATION

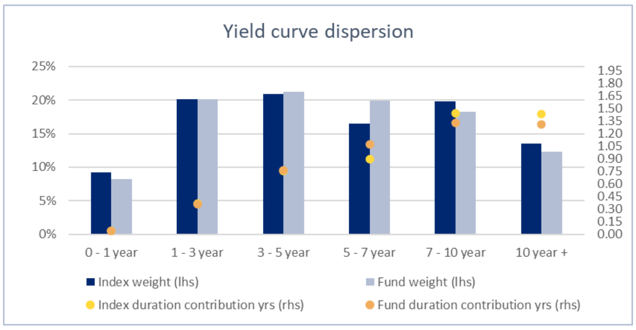
We began the quarter with a slightly longer duration position which we maintained until late August. We preferred to express our duration position with a heavier weighting in the 5–7-year part of the curve. In early September we began to progressively shorten duration, anticipating a repricing of the aggressive rate cuts priced in the US treasury curve. We ended the quarter 0.07 years shorter than the benchmark.

As we maintained on average, a slightly long duration position over the course of the quarter, our active duration positioning added to performance.

YIELD CURVE

The domestic yield curve bull-steepened over the quarter, with front-end yields falling by a greater amount than longer-dated tenors. Domestic yield moves tended to follow events in the US, although lower than expected Q2 inflation data did see a sizeable fall in yields at the front-end of the curve.





Source: Bloomberg, Equity Trustees as at 30/09/2024

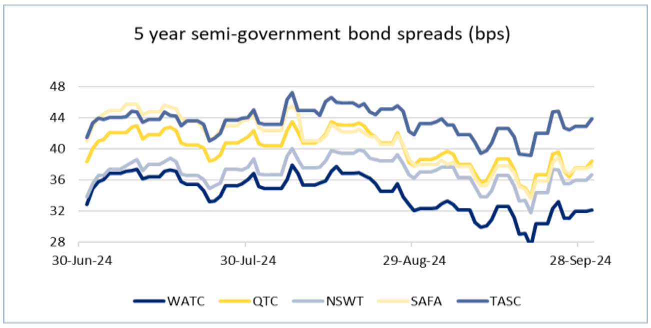
Our active curve positioning added to performance as we maintained an overweight position around 5-year maturities which saw an approximate 50bp fall in yields.

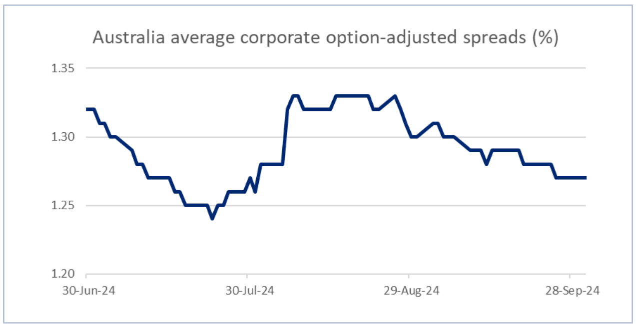
SECTOR ALLOCATION

Corporate bond spreads tightened on average 5bps over the quarter, supported by investor appetite for higher all-in yields and expectations of monetary policy easing.

Semi-government bond spreads saw mixed performance, with spreads mostly wider. States with smaller borrowing programs such as Western Australia and South Australia outperformed as ongoing supply impacted the larger States.

From a benchmark return perspective, the semi-government component performed best, delivering a 3.25% return for the quarter, followed by corporate bonds at 3.06%. Government bonds delivered 2.90% and supranational bonds returned 2.86%.





Source: Bloomberg, Equity Trustees as at 30/09/2024

As we maintained a higher allocation to corporate bonds, our sector allocations made a positive contribution to performance.

Portfolio activity during the quarter saw a slight increase to our semi-government bond holdings, moving from underweight to neutral both in terms of weighting and duration.

Sector allocation as of 30 September 2024

	BENCHMARK [1]		PORTFOLIO		
SECTORS	BENCHMARK [1] WEIGHTS	DURATION CONTRIBUTION	PORTFOLIO WEIGHTS	DURATION CONTRIBUTION	DIFFERENCE
Commonwealth Govt bonds	50.1%	2.58	31.3%	2.19	-0.39
State (semi) Govt bonds	31.5%	1.77	31.1%	1.77	-
Supranational/sovereign/other	5.2%	0.17	6.6%	0.18	0.01
Corporate bonds	13.2%	0.42	29.7%	0.73	0.31
Cash and related	0%	0.00	1.3%	0.00	0.00
	100%	**4.94**	**100%**	**4.87**	**-0.07**

Source: Bloomberg, Equity Trustees as at 30/09/2024
Note: Numbers taken from our Portfolio Management System may vary slightly from accounting or index reports. Numbers may not add precisely due to rounding.
[1] Benchmark is the Bloomberg AusBond Composite 0+ Year Index.

GLOBAL OUTLOOK

United States

August employment data showed the US added 142,000 jobs against an expected increase of 165,000. The participation rate printed at 62.7%, while the unemployment rate remained unchanged (from the prior month) at 4.2% and average hourly earnings rose by 0.4% MoM, above the expected 0.3%.

The US ISM manufacturing index printed at 47.2 from 46.8 in July, improving but implying contraction in the manufacturing sector and the ISM services index increased marginally from 51.4 to 51.5. Factory orders (ex-transport) fell 0.1% in August, and durable goods orders were expected to be flat. Flash manufacturing PMI data printed at 47.3 in September and Flash services PMI data printed at 55.2.

Retail sales rose 0.1% MoM in August against an expected fall of 0.2%.

US headline inflation stood at 2.5% YoY in August and core CPI was running at 3.2%. The Feds preferred Core PCE inflation measure printed at 2.7% YoY.

The third read of Q2 GDP printed at 3%, well above the potential GDP growth rate of 1.8%.

At the September meeting, the FOMC elected to cut the Fed Funds Rate by 50bps, surprising most market participants who expected a smaller cut of 25bps.

China

Economic data released during September was weaker. The Caixin manufacturing PMI index printed at 49.3 versus an expected 50.5 and the services PMI index printed at 50.3 versus 51.6. Industrial production was up 4.5% YoY in August. Fixed asset investment growth increased 3.4% and retail sales rose 2.1% YoY, all printing slightly weaker than expected.

The People's Bank of China introduced a raft of measures to help stimulate the faltering Chinese economy including reducing bank required reserves by 50bps, reducing the reverse repo rate by 20bps and by cutting 30bps from both short and medium-term lending facilities.

Europe

Flash PMI data suggest manufacturing sector activity fell in September, taking the Index level to 44.8, but the services sector remained in expansion at 50.5. Industrial production fell 0.3% MoM in July, while retail sales rose 0.1% MoM against an expected increase of 0.2%.

Q2 GDP printed at 0.2% QoQ and 0.6% YoY.

The annual headline rate of inflation for Europe is expected to print at 1.8% YoY in September, lower than the previous monthly read of 2.2%. Core inflation is expected to be running at 2.7% YoY.

The ECB lowered rates by 25bps in September and current market pricing has approx. 50bps of further easing by December.

Australia

Employment rose by 47,500 in August, well above the consensus of 26,000. The unemployment rate remained unchanged at 4.2%. Job vacancies declined 5.2% QoQ.

Manufacturing and service sector PMI indicators printed at 46.7 and 50.6 respectively, with both flash reads printing lower than the previous month. Business conditions fell three points +3 and business confidence fell five points.

Retail sales rose 0.7% MoM in August and household spending lifted 0.8% in July.

The August monthly CPI data saw inflation fall sharply to 2.7% YoY from 3.5%, as energy rebates and lower petrol prices dragged the headline number lower. The RBA's preferred trim mean measure printed at 3.4% YoY, falling from a prior level of 3.8%. Services inflation remains high.

Q2 GDP came in as expected at 0.2% QoQ and 1% YoY.

The RBA left the target cash rate unchanged at 4.35% in September and at its post meeting press release, stated it had not considered a rate hike as it had in previous meetings. The market reacted to the statement by sending short-dated yields lower.

SUMMARY

Domestic yields followed offshore moves lower as several central banks either began or continued with monetary policy easing. The Fed surprised by starting its easing cycle with a supersized 50bp cut despite core inflation remaining above the 2% target, GDP growth running above potential and the unemployment rate at a historically low level.

Locally, we continue to believe the target cash rate has peaked for this cycle and we expect the RBA to start to lower rates in early 2025, however we do not see much value in adding duration in the immediate term as we believe the market has priced in too much easing and is at risk of repricing higher.

Our preferred portfolio construction is:

- Duration: Short.
- Yield curve: We maintain a slight overweight position around the 5-year part of the curve but remain short beyond 7-year maturities.
- Sector/credit mix: The current backdrop continues to support high quality investment grade credit. We will look to add to semi-government holdings on any further spread widening.