FundMonitors.com Trusted Targeted Research — Highly Commended

Fund Dashboard

31 July 2024

7.31%
% Yield to Call
(Portfolio as bought)

5.82%
% Yield to Call
(Portfolio if bought today)

6.01%
Running Yield

4.0 Years
Weighted Average Term to Call

98.6%
Portfolio Floating Rate

0.21 Years
Interest Rate Duration^

22%
Top 5 Holdings As % of Fund*

37
Number of Holdings*

Source: Seed Funds Management.
As at 31 July 2024.

*Excluding cash.
^Maximum duration of 1.

Hybrid Income Fund Strategy Net Performance

31 July 2024

FIGURE 1.

	1 Month	3 Months	6 Months	1 Year	3 Years Annualised	5 Years Annualised	SI (Sep 15) Annualised
HYBRID INCOME FUND STRATEGY	**0.98%**	**2.00%**	**4.38%**	**8.40%**	**5.79%**	**4.91%**	**6.38%**
Hybrid Benchmark (Solactive*)	1.09%	1.33%	4.13%	6.57%	4.16%	3.70%	4.84%
RBA Cash Rate	0.36%	1.09%	2.19%	4.37%	2.60%	1.71%	1.66%

The performance table above represents The Hybrid Income Fund Strategy ("Strategy"). The Strategy commenced in September 2015 and has been continuously operated with identical investment parameters and processes by its portfolio manager, Nicholas Chaplin. The Strategy began in 2015 as the Paraclete Investment Fund until June 2022. The Hybrid Income Fund commenced in June 2022 operating under Evolution Trustees as trustee. Investment management services were novated to Seed Funds Management in March 2024. Performance figures for the Strategy to March 2022 have been reviewed in accordance with ASRS 4400 "Agreed-Upon Procedures Engagements" by Hall Chadwick Corporate (NSW) Limited.

Monthly Commentary

Financial securities continued to tighten in all sub-asset classes with Tier 1, Tier 2 and Senior securities all performing positively through July. Interestingly, while volatility was seen in equity prices through the month, we saw much less volatility in prices for financial capital instruments due to consistent market demand.

With the reported CPI outcome for the June quarter being relatively benign (no major increase versus consensus), the market is now trading on a reduced chance of rate rises in the shorter term. The base 90-Day Bill Rate has traded off its recent high of 4.49% to 4.41% at the time of writing. Most intermediaries are now noting no material direction for rates, either up or down although some continue to price in a rate reduction for Q1 2025. The floating nature of our portfolio provides protection, regardless of the direction of rates, and we remain focused on yield enhancement through careful selection of bonds. However, it remains important to examine the market's view on the direction of rates as opportunities arise through price reaction to economic data.

Political outcomes can also impact the market. For example, there remains some chance of the federal government calling a snap-election before Christmas, or shortly thereafter – likely depending on the economic mood in the electorate. Since 1960 in Australia, there have been four elections held in November and five held in December, so plenty of precedent here. The earliest election held in a new calendar year over that time was 2 March in 1996.

Hybrid Income Fund Is Now Available for Retail Investors

The fund is now open to retail investors via a Product Disclosure Statement (PDS). Other changes include the following effective 30 July:

- Unit prices will now be provided daily;
- Distributions will now be monthly;
- The management fee has been lowered to 0.55%.

The PDS is available on the fund's website and can be accessed here

Key Portfolio Moves in July

We reduced our exposure to Bank of Queensland's BOQPG during the month after some positive gains recently. We also noted BOQPE ceased trading on 27 July 2024 in anticipation of it being called on 15 August. This reduces our exposure to Bank of Queensland substantially. BOQ has clearly agreed with APRA that a replacement issue for BOQPE was not required in advance of the call date for BOQPE. An issue may yet come to market in the future as a completely new money issue.

*Solactive Australian Hybrid Securities Index (Net)

During the month we increased our exposure to Westpac through its new Tier 2 issue with a call date in mid-2029. Tier 2 margins have tightened considerably as noted earlier, but there remains plenty of scope for continuing performance.

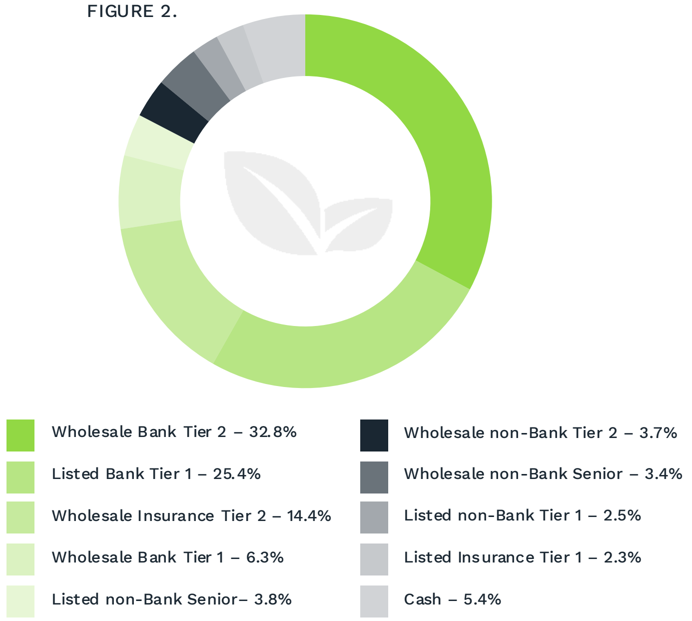
We took some profits in some additional listed hybrids including NABPK which performed particularly well through the month. There remains scope for new listed hybrid issues to come at margins near or lower than this NAB issue given recent performance in this sub-asset class. The potential new Macquarie issue (see below) may yet come at a margin close to +260/270 bps. Every new issue at or below the +260 mark should strengthen the performance of all others with wider issue margins, all other things being equal.

Some good investment inflow has increased our cash holdings temporarily and this will be put to work in new opportunities as we enter August.

Portfolio Holdings

(as at 31 July 2024)

FIGURE 2.



APRA Provides a Reprieve to Small Financials on Liquidity

On 24 July, APRA announced changes to the liquidity requirements of entities operating under the Minimum Liquid Holding (MLH) regime. These entities include smaller financials including Mutuals and neo-banks. In good news to these entities, not all of the recommendations will be progressing this year. APRA is delaying the implementation of a proposal to make investment in bank debt securities ineligible for the liquidity requirements of these smaller financials. We flagged this proposal recently noting it would have materially impacted margins for the smaller ADI's ultimately creating profitability concerns as their only choice for bond investments is limited to much lower yielding Government bonds. The proposal is not off the table, however, and will still be revisited in 2025.

Macquarie Plans New Hybrid Issue

On 2 August, Macquarie Group announced that it is considering a new hybrid capital offer to replace $1 billion of capital notes which are callable in December. The potential size of the offer matches the issue approaching its call date although there would be expected to be some capacity for upsize, particularly noting high bid volumes for new hybrid offers through 2024 to date.

A large syndicate of banks has been assembled for the potential issue which remains subject to market conditions. Macquarie itself will act as the sole Arranger and Joint Lead Manager, with ANZ, Citigroup, Commonwealth Bank, Evans & Partners, Morgans Financial, National Australia Bank, Ord Minnett, Shaw and Partners, and Westpac jointly leading the issue. We would expect an issue to be launched in early August to ensure no clash with any large market issues that could be announced by CBA simultaneous to their results announcement on 14 August 2024.

Increasing Volatility Means Increasing Opportunity

A number of broad concerns have been contributing to an increase in market volatility lately. From the perception of over-priced equity markets to election outcomes in Europe and election preparations in other jurisdictions to continuing geo-political tensions and economic pressures being a universal problem. Most prominently, we will see this volatility play out in equity markets. However, bond markets are also susceptible and we will always see an element of the investing public rush to cash from both shares and bonds.

While volatility brings uncertainty around price direction, it is a different concern for bond markets. Moments of price volatility often provide good opportunities to take advantage of over-sold securities. The value of a bond will generally have a strong link to its maturity date, or in the case of hybrids and subordinated bonds, around expected call dates.

While the future of equity prices is always unknown, the future of bond prices is somewhat more predictable. This means that volatility brings opportunity. Running to cash is one way to deal with instability, but it may ultimately lead to a passive outcome of lost advantage.

With an eye to known future values, it is important to take advantage of these moments of volatility. Share and Bond prices may behave similarly initially, but future prices do not follow the same path.

Expert Management

The HIF provides access to highly skilled specialist management, with extensive expertise in regulated capital products including hybrids, subordinated debt and mutual equity.

Senior Portfolio Manager

Nicholas Chaplin is an authority in the Hybrid and capital issuance market having structured, originated, distributed, and educated on many issues since 1998.

Over his career he has originated over $200 billion in hybrid & capital issues. From 2009 to 2021, Nick was Head of Hybrid & Structured Capital at NAB and prior to that he was Head of Hybrid Origination at Westpac.

Unit Pricing:	Daily
Applications:	Daily
Distributions:	Monthly
APIR Code:	EVO3184AU
Management Fee:	0.55% per annum
Performance Fee:	Not Applicable
Website:	Click here
Offer Document:	Click here
How to Apply:	Click here
Contact Details:	Click here

Fund Information

The Hybrid Income Fund strategy was established in September 2015.

Hybrid Income Fund (HIF) actively invests in a diversified portfolio of financial capital with a heavy weighting to Australian-regulated capital instruments. The underlying securities include hybrids (Tier 1 capital notes and convertible preference shares), Tier 2 bonds, subordinated debt, senior debt, mutual capital instruments and cash. The Fund typically holds ~40 positions whose underlying issuers are banks, insurance companies and non-bank lenders.

Fund Objective

HIF aims to provide returns that exceed the hybrid benchmark on a net basis. The Fund has a meaningful track record of exceeding its target after fees through active management with low volatility and access to franking credits.

The Hybrid Market

The listed hybrid market includes issues totalling approximately $45 billion across a broad range of financial and corporate issuers. In focusing on the financial issuers in this market, over 90% of listed hybrid issuers will be available for investment. Additional diversity and liquidity will be achieved via investment in wholesale unlisted senior, hybrid capital issues and subordinated bonds issued by banks, insurers and other financial entities.

The Investment Strategy

The investment manager intends to apply a tactical approach in terms of which securities it invests in and the timing of such investments with a focus on delivering a robust risk adjusted yield through market and interest rate cycles.

The investment manager will:

- Manage interest rate risk by holding predominantly floating rate instruments;
- Provide portfolio diversity by security type, credit risk, duration and issuer;
- Aim to distribute franking credits;
- Aim to provide regular income.

Platform listings

HUB24 · Australian Money Market · præmium · Powerwrap · netwealth

Unit Price and Core Data

The unit price on 31 July 2024 was $1.0578. This is after the recent payment of the June quarter distribution. The unit price is published daily on our website here.

As at 31 July, the weighted average yield to call of the portfolio was 7.31%. This is the yield of the portfolio to its collective call dates based on the prices at which each security was purchased. Please note we also show below the yield to call based on security prices today. The running yield of the portfolio was 6.01%.

Franking credits provide an additional return which will depend on the investor's own tax situation. Currently, 32% of the portfolio is receiving full franking value. Franking credit exposure is reduced with additional investment in Tier 2 securities or senior bonds as these are debt instruments for tax purposes.

Fund returns are made up of three key aspects: 1) regular distributions (either taken as cash or reinvested according to your preference, 2) franking credits associated with these distributions, and 3) changes in the capital value (unit price) over time.

We continually measure the relative value of the prime asset classes of the fund and adjust weightings actively. On 31 July, the fund was holding 36.5% Tier 1 instruments (including both listed and wholesale), 50.9% Tier 2 instruments, 7.2% senior bonds, and 5.4% cash. Figure 2 on Page 2 depicts these current allocations.

The average credit rating of the portfolio is investment grade at BBB+.

Glossary

The following details are provided to assist in understanding of terms used in this report:

Credit Spread Duration: Measures the sensitivity of a bond's price to changes in its credit spread. This measure reflects the potential change in the bond's value in response to a 100-basis point (1%) change in the credit spread. For example, if credit spreads tighten by 100 bps for a portfolio with a credit spread duration of 2.5 years, it will result in a + 2.5% return assuming all else is equal.

Interest Rate Duration: The weighted maturity of a fixed-income investment's cash flows, considering all coupon interest payments and the maturity date - used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates i.e. shorter duration bonds are less sensitive to interest rate movements than long bonds.

Running Yield: The ratio of interest to the current market price of the bond, stated as a percentage. For example, a bond with a current market price of $100 that pays $6 per year in interest would have a running yield of 6%.

Yield to Call: A yield on a security calculated by assuming that interest payments will be paid until the call date, when the security will be redeemed at the call price.

Yield to Maturity: A yield on a security calculated by assuming that interest payments will be made until the final maturity date, at which point the principal will be repaid by the issuer. Yield to maturity is essentially the discount rate at which the present value of future payments (investment income and return of principal) equals the price of the security.

General Disclosures

The material contained within this Report (The Report) has been prepared by Seed Funds Management Limited (Seed), a Corporate Authorised Representative (no 001308397) of its related body corporate, Seed Partnerships Ltd the holder of AFSL No. 492973. It is issued by the Responsible Entity of the Fund, Evolution Trustees Limited (ABN 29 611 839 519, AFSL 486217) (Evolution).

Figures referred to in The Report are unaudited. The NAV Unit Price has been used for performance reporting, however if an investor is to come out of the fund that would be done at the exit price.

The Report is not intended to provide advice to investors or take into account an individual's financial circumstances or investment objectives. This is general investment advice only and does not constitute advice to any person. Neither Evolution nor Seed guarantee repayment of capital or any particular rate of return from the Fund. Neither Evolution nor Seed gives any representation or warranty as to the reliability, completeness or accuracy of the information contained in this Report.

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