seed FUNDS MANAGEMENT

Fund Dashboard

31 August 2024

6.43%
% Yield to Call
(Portfolio as bought)

6.05%
% Yield to Call
(Portfolio if bought today)

5.92%
Running Yield

4.4 Years
Weighted Average Term to Call

99.5%
Portfolio Floating Rate

0.18 Years
Interest Rate Duration^

35%
Top 5 Holdings As % of Fund*

44
Number of Holdings*

$186 million
Current FUM

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

*Excluding cash.
^Maximum duration of 1.

Hybrid Income Fund Strategy Net Performance

31 August 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	0.28%	1.88%	3.89%	8.04%	5.85%	4.97%	6.35%
Hybrid Benchmark (Solactive*)	-0.01%	2.06%	3.35%	6.87%	4.16%	3.65%	4.79%
RBA Cash Rate	0.36%	1.09%	2.19%	4.39%	2.72%	1.76%	1.68%

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 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

Hybrid security prices experienced some volatility during the month due to equity disruptions. This resulted in a slight negative outcome for the Solactive index, while the fund performed better thanks to its diverse holdings in subordinated and senior bonds. Once again, a more conservative portfolio position yielded comparatively better results than pure hybrid exposure.

Senior and subordinated bonds saw less price volatility than hybrids during the month, and all three sub-asset classes outperformed equities as impacts on the Japanese and US markets affected Australian securities.

Some investors prefer to watch volatility from the sidelines, leading to the usual selling in equities spilling over into listed hybrids in early August. What we initially thought might be a long-term correction dissipated after just four days as the market regained its losses. Some early-moving investors now face potential capital gains tax while finding rebounding hybrid prices too high to re-enter the market. There is something to be said about not moving too early—at least regarding hybrid investing.

As noted, once the market recovered from equity-driven volatility, hybrid margins recovered but remained flat through August. The positive difference for the fund's performance was due to tightening Tier 2 issues, as the month saw reduced primary issuance, forcing investors to satisfy their requirements through the secondary market.

Key Portfolio Moves in August

Investment flow into the fund in early August led us to purchase value in senior bonds, which greatly helped avoid much of the noted volatility. We have since moved some of these funds into subordinated paper, including Tier 2 and Tier 1 issues from Macquarie Bank.

We saw value in the trading level of NABPK through August and increased our holding, as well as adding to holdings in issues from IAG, Challenger, Bank of Queensland, and Suncorp (now known as Norfina).

We took some profits by selling out of some ANZ and NAB Tier 2 subordinated note holdings and immediately reinvested these funds into alternative Tier 2 issues from Bendigo & Adelaide Bank and Westpac, where we saw particular value.

The move into an increased senior bond position will temporarily impact portfolio yield-to-call. We expect new primary market activity to enable broader spreads as September progresses.

*Solactive Australian Hybrid Securities Index (Net)

With the Macquarie hybrid now completed (to list on 17 September), all expected refinances have either occurred or, in the case of BOQ, not proceeded. The next two issues due for refinance are both optional calls in the new year, with AN3PH due on 20 March and CBAPG due on 15 April.

We believe it would be advantageous for either CBA to bring forward its refinance to October (when the other three majors are in blackout) or for ANZ to bring forward its issue to November to get ahead of any potential market volatility over December/January. Either way, we anticipate a sizeable new hybrid issue before the end of the calendar year.

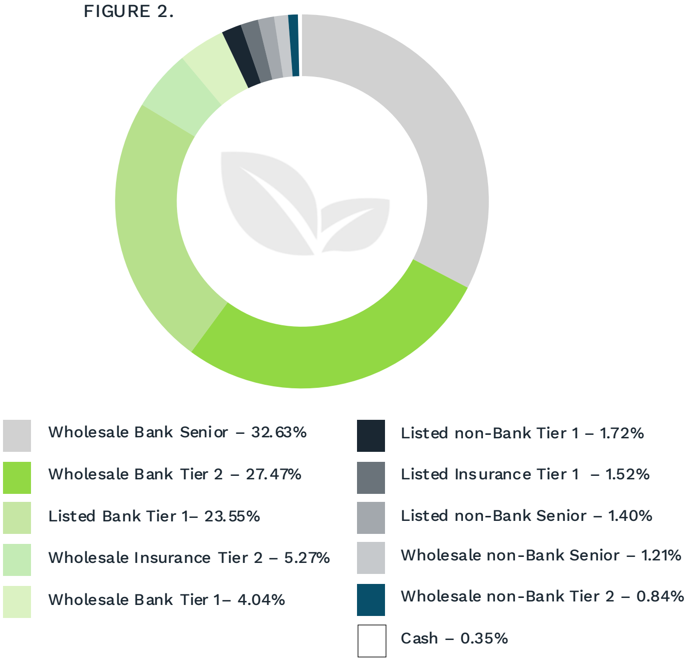
The volumes of the refinances for the two major banks are $931m (ANZ) and $1.365b (CBA). We expect both to increase these sizes given balance sheet growth since their original issues in 2017 and 2018, respectively.

Time will tell whether APRA changes any structural features in advance of these potential issues.

Portfolio Holdings

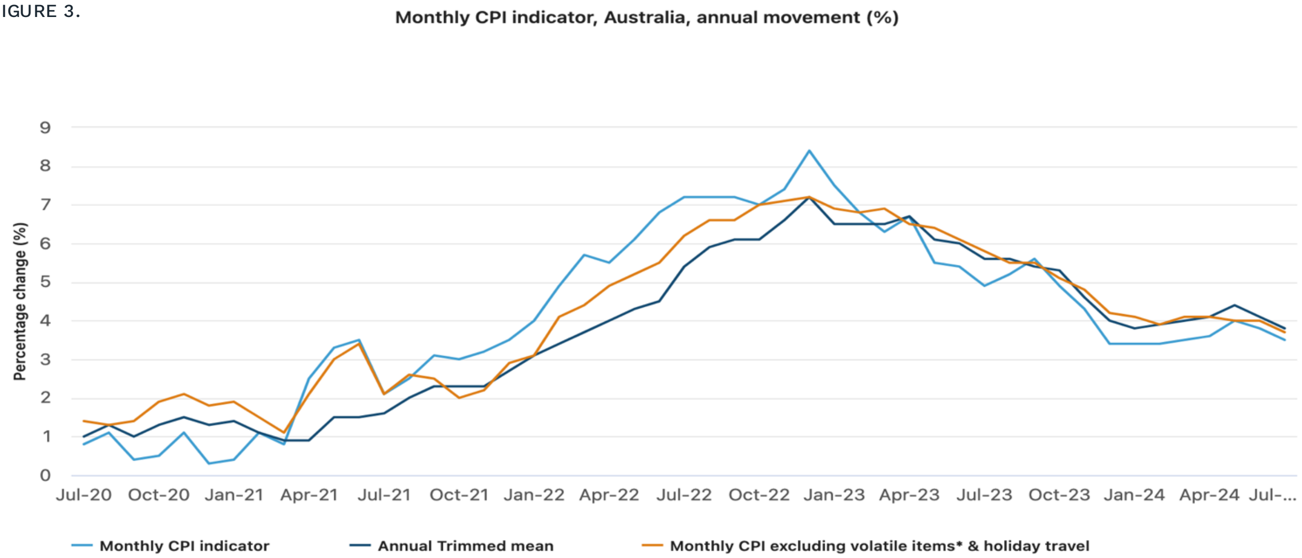
(as at 31 August 2024)

FIGURE 2.



Latest CPI Numbers Still Point to Higher Rates Being Necessary

FIGURE 3.



*Volatile items are Fruit and vegetables and Automotive fuel

Source: Australian Bureau of Statistics, Monthly Consumer Price Index Indicator July 2024

We are often asked about the direction of rates and what that means, particularly for hybrid yields. While it might be simple to note that a change in the 90 Day BBSW rate, which tends to pre-empt cash rate movements, means hybrid yields will follow the trend (all other things being equal), predicting cash rate movements themselves is much more difficult.

Looking at Figure 3, it is clear that monthly Australian CPI outcomes have not improved in nine months. Indeed, the monthly CPI indicator was lower in December 2023 than in July 2024 (reported 28 August 2024). This may be due to the cash rate target not being high enough a year ago. The problem persists, and unless we start to see the CPI trend downwards again, calls for higher rates will grow louder.

The RBA faces many concerns in addressing this sticky inflation, including the risk that raising rates could severely harm weaker parts of the economy. On the other hand, decreasing rates too soon will not solve the remaining inflation concerns.

We, along with the rest of the market, await a clearer decision.

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.

Portfolio Manager
Chair, Investment Committee

John Corr has worked in the finance industry for 40 years and is a highly regarded authority in portfolio risk management. He has experience in banking, broking, proprietary trading and funds management.

John was a founder and CIO of Aurora Funds Management.

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 over the suggested investment timeframe (five+ years). 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 · praemium · Powerwrap · netwealth

Unit Price and Core Data

The unit price on 31 August 2024 was $1.0605. This is ex-distribution price. The unit price is published daily on our website here.

As at 31 August, the weighted average yield to call of the portfolio was 6.43%. 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 5.92%.

Franking credits provide an additional return which will depend on the investor's own tax situation. Currently, 22% 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 August, the fund was holding 30.8% Tier 1 instruments (including both listed and wholesale), 33.6% Tier 2 instruments, 35.2% senior bonds, and 0.4% cash. Figure 2 on Page 2 depicts these current allocations.

The average credit rating of the portfolio is investment grade at A-.

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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