DAINTREE HYBRID OPPORTUNITIES FUND (MANAGED FUND) (ASX: DHOF)

MONTHLY FACTSHEET: 30 September 2023

Fund Description

DHOF targets an absolute return over time by investing in a diversified portfolio of hybrid securities which offer the best risk adjusted returns available from a global universe of securities.

DHOF is quoted on the ASX under the AQUA Rules.

Signatory of:

Fund Objective

The aim of DHOF is to provide a steady stream of income over the medium term, by investing in a diversified portfolio of Australian and global hybrid securities and cash, and to provide a total return (after fees) that exceeds the Benchmark by 3%-4% measured throughout a market cycle.

Monthly Highlights

- High coupon receipts combined with a narrowing of credit spreads were the main drivers of returns as credit markets continued their positive year.
- The Fund saw little change in portfolio composition during the month.

Key Statistics

Modified Duration (Yrs)	0.23
Spread Duration (Yrs)	2.78
Running Yield (%)	6.19
Yield to Call (%)	9.39
Average Credit Quality	BBB
Portfolio ESG score (MSCI)	AA

Note: Average credit quality excludes overlay positions. Portfolio running yield and spread duration reflect the net credit default swap exposures in the portfolio. The Portfolio ESG score is the weighted average portfolio ESG rating based on Daintree Capital's application of MSCI data. Data as of 30 September 2023.

Fund facts

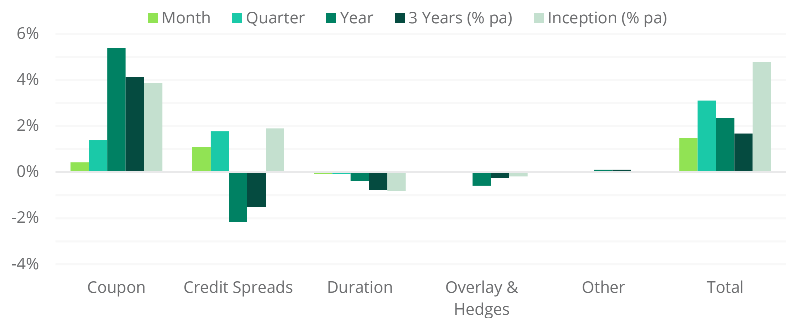
Trust name	Daintree Hybrid Opportunities Fund (Managed Fund) (ASX: DHOF)
Responsible Entity	Perennial Investment Management Ltd
Portfolio managers	Brad Dunn, Mark Mitchell & Justin Tyler
Inception date	1 March 2020
APIR code	WPC2054AU
ISIN	AU60WPC20540
Management costs	0.65% pa + 0.10% pa expense recovery
Buy/sell spread	+0.10% / -0.10% for non-quoted units; exchange-quoted spread for quoted units
Entry and exit fees	None for unlisted units; broker fees applicable to quoted units
Minimum initial investment	$25,000 for non-quoted units; no minimum for quoted units
Distribution frequency	Quarterly
Currency	Australian Dollar

Performance & Analytics

	Month (%)	Quarter (%)	1 Year (%)	3 Year (% pa)	Inception (% pa)
Fund (gross)	1.48	3.11	2.35	1.68	4.78
Fund (net)	1.42	2.92	1.61	0.93	4.03
Distribution (net)	0.00	1.14	2.96	2.01	1.96
Growth (net)	1.42	1.79	-1.36	-1.07	2.07
RBA Cash Rate	0.34	1.04	3.56	1.41	1.23
Excess Return	1.08	1.88	-1.96	-0.48	2.80

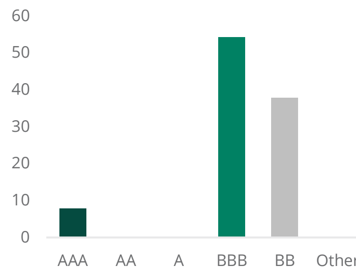
Note: Performance inception is 1 March 2020. Excess return is measured with reference to net performance. Returns for periods longer than one year are annualised. Distribution return is the difference between total return and ex-distribution unit price return. Past performance is not a reliable indicator of future performance.

Performance Contribution (Pre-Fees)



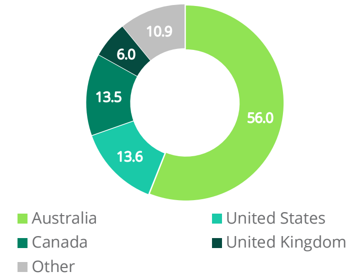
Note: Overlay strategies use derivatives to ensure that the Fund exposure to interest rates, credit and other relevant factors is controlled separately to the physical assets in the portfolio

Rating Exposure (%)



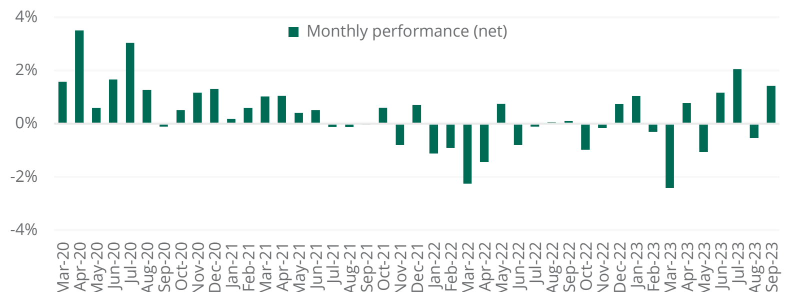
Data as of 30 June 2023

Country Exposure (%)



Data as of 30 June 2023

Monthly Performance



Platforms

The Daintree Hybrid Opportunities Fund (Managed Fund) is available on the following platforms:

◊ BT Panorama ◊ HUB24 ◊ Macquarie Wrap ◊ Netwealth

Cash Income

The Fund distributed 10CPU in July 2023. The next distribution of will be paid in October 2023.

Fund Review

The Hybrid Opportunities Fund returned 1.42% for the month net of fees. The Fund's performance was supported by coupon income and credit spreads thanks to some specific holdings contributing positively, despite a neutral market for bank capital spreads. Duration exposure was kept low which reduced volatility, but the quantum of yield moves still created some drag on performance as yield curves steepened considerably. Overlay was a slight positive contributor for the month.

Hybrid spreads remained stable in September despite uncertainty driven by rising interest rates, notwithstanding that many securities in the Fund will see their coupons reset to significantly higher levels should these higher interest rates persist.

Despite some evidence of a weakening growth outlook, consumers remain employed in near record numbers, while receiving wage increases, but are moderating their spending habits. For banks, this means asset quality remains very strong. With rising borrowing costs and sticky wage inflation, the more immediate challenges are likely to centre around lending demand and cost control.

The Fund saw little change in portfolio composition during the month.

Outlook

Financial conditions tightened materially in September, with higher longer-term interest rates the chief culprit. Long yields are being driven higher by a reassessment of expected future central bank actions. Adding to the upheaval is dysfunction in the US Congress, where another government shutdown is possible and, in a first for the US, the Speaker was ousted after just eight months in the job.

One interesting thing about this move in yields is what it was not driven by – pricing for inflation expectations remained reasonably stable along the curve. Therefore, the higher bond yields have been driven by higher real yields. Historically, changes to longer-term expectations around monetary policy (whether conventional or unconventional) have been responsible for similar abrupt shifts in real yields, for example via shifts lower in the weeks after QE program announcements. The reversal of yield curve control in Japan seems to have had the opposite impact more recently, with yields shifting higher since July, but the latest iteration of the Federal Reserve "dot plot" is the main recent driver. It showed a hawkish shift in the governors' outlook over the longer-term, and markets have come to the view that the US economy, having dealt with a higher Fed Funds rate for some time now without mishap, can also deal with higher rates over the longer-term. This has seen the market's view of longer-term distribution for real rates shift higher. A growing realisation of the budgetary position of the United States, where large (and growing) fiscal deficits look to be the norm for the remainder of the decade, is another driver of higher yields that remains on the minds of market participants.

Higher yields are likely attracting capital at the margin to the large and liquid treasuries market, driving the US dollar higher, even as the fiscal outlook is deteriorating quickly and interest costs alone will soon exceed US$1tr per year. Hyper-partisanship in the houses of government is stymying any chance of finding sensible fiscal solutions. Throw in the upcoming presidential election in late 2024 and the chances of any budgetary reform occurring are exceedingly slim. Therefore, while investors are attracted to rising yields or reflexively favour USD as a haven from global growth concerns, we believe this comes with higher-than-normal risk that domestic fundamentals may eventually exert a contrary influence on the world's reserve currency.

Even Japan has not been immune to the march higher of interest rates. However, this comes at the expense of a weakening yen, which has fallen to its lowest levels in a year and back to the psychologically important 150 per USD level. The Bank of Japan showed its hand with multiple interventions to defend that level in 2022, and despite having eased its yield curve control programme and allowed long-end yields to vary within wider bands, we expect further interventions if yen re-tests the lows of last year.

Oil prices continue to pose a threat to the orderly return of inflation to target levels. Core inflation measures strip out volatile elements such as these, but energy is an essential input across the value chain and could complicate efforts to square inflation data with inflation messaging, where the dominant narrative remains a steady return to target over the medium term.

Despite pausing for a fourth month, a weakening AUD, solid immigration and employment outcomes, and resilient coal and LNG prices will keep pressure on the RBA board to hike further in coming months, possibly as early as Melbourne Cup day. However, financial markets are growing in their conviction that the cash rate has peaked, expecting the impacts of prior increases to be widely felt, particularly in the mortgage belt. We believe the odds are more finely balanced than what markets suggest.

Credit spreads held up well in September against a tumultuous backdrop. Corporates have low gearing in comparison to long-term averages, and cash balances that are benefiting from higher interest rates. Limited refinancing needs are insulating well-rated companies from higher interest rates, although higher funding costs will create an increasing headwind into 2024 and 2025 as cheap pandemic-era debt is repaid or refinanced. Concerns linger in the commercial real estate space and banks are becoming more selective about lending, particularly in the leveraged loan and high yield markets. We cannot rule out further spread widening as the current economic cycle matures, but a strong corporate sector will limit the impact, particularly in the investment grade segment where Daintree portfolios are heavily biased. Strong coupon income will remain the foundation of the return profile over time.

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