BETASHARES ACTIVE AUSTRALIAN HYBRIDS FUND (MANAGED FUND)
ASX: HBRD
Quarterly Report - September 2020

Performance[1]	1 Month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Inception[2] % p.a.
Fund Return (net)	0.56%	1.70%	7.68%	1.90%		3.92%
Growth return	*0.34%*	*0.99%*	*6.09%*	*-1.94%*		
Income return	*0.22%*	*0.71%*	*1.59%*	*3.84%*		*3.92%*
Solactive Australian Hybrid Securities Index (Solactive Index)	*0.53%*	*1.72%*	*9.08%*	*1.48%*		*3.97%*
Active Return	0.03%	-0.02%	-1.40%	0.42%		-0.05%

Past performance is not a reliable indicator of future performance.

[1] Returns are calculated after fees & expenses have been deducted and distributions have been reinvested.

[2] Inception date for the Fund is 13 Nov 2017.

Yield and Portfolio Characteristics

Running Yield (% p.a.)[1]	2.60%
Gross Running Yield (% p.a.)[2]	3.58%
Fund Constituents	42

[1] Average yield (weighted by market value) of the hybrids portfolio, divided by the current market price of the securities. This provides an indication of expected current income from making an investment at market price. This value will vary over time.

[2] Average estimated gross yield (weighted by market values and inclusive of franking credits) of the hybrids in the portfolio, divided by the current market price of the securities. This provides an indication of the expected current income from making an investment at market price. This figure is indicative only and will vary over time. Not all investors will be able to obtain the full value of franking credits.

Investment objective

The Fund provides investors with a convenient way to access attractive income returns, including franking credits, from an actively managed, diversified portfolio of hybrid securities. As the Fund is overseen by a professional investment manager it actively seeks to reduce the volatility and downside risk that may otherwise be experienced by direct holders of hybrids.

Responsible entity

BetaShares Capital Ltd

Investment manager

Coolabah Capital Institutional Investments Pty Ltd

Distribution frequency

Monthly

Suggested minimum investment timeframe

At least three years

Fund Facts	
Inception Date	13-Nov-17
Fund Size	$850.16m
Historical Tracking Error	0.87%
ASX Code	HBRD
Bloomberg Code	HBRD.AU
IRESS Code	HBRD.ASX

Fees	% p.a.
Management fees	0.45
Recoverable expenses	~0.10
Performance fee[1]	

[1] A performance fee may be payable. This fee is 15.5% of the Fund's performance above the performance benchmark in a calendar quarter.

Investment strategy

The Fund will invest in an actively managed portfolio of hybrid securities, bonds and cash. If and when the hybrids market is assessed to be overvalued or to present a heightened risk of capital loss, the Fund can allocate more of the portfolio to lower risk securities.

Top 10 positions[1]	
ANZPE	NABPD
ANZPG	NABPF
CBAPD	WBCPG
CBAPH	WBCPH
NAB25	WBCPI

[1] As at 30 September 2020

Sector exposure	Fund Weight %[1]	Index Weight%[1]	Active Weight%
Listed Hybrids	84.1	89.2	-5.1
Capital notes	7.5	5.4	2.1
Sub bonds	4.2	5.4	-1.2
Senior bonds	0.0	0.0	0.0
Cash	4.2	0.0	4.2
TOTAL	100.00	100.00	0.00

[1] As at 30 September 2020

Fund performance summary

HBRD returned 0.56% before franking credits and after fees in September 2020, ending the month with a net running yield of 2.60% (gross running yield of 3.42%). Over the last 12 months, encompassing the unprecedented COVID-19 shock, HBRD has returned 1.90% before franking and after fees, outperforming the RBA Cash Rate return of 0.42%, the Solactive Australian Hybrid Securities Index's ('Solactive Index') return of 1.48%, and the All Ords Accumulation Index’s loss of -8.76%.

Since inception, HBRD has returned an unfranked 11.73% after all fees, with an average 86% portfolio weight to ASX hybrids, relative to the Solactive Index's 11.87% return and the RBA Cash Rate + 2.5% return of 10.3%. HBRD’s since inception volatility of 6.12% has been lower than the Solactive Index’s volatility of 6.57%. At the end of September, HBRD was diversified across 42 hybrids/bonds, and had a 91.6% allocation to hybrids, 4.2% to subordinated bonds, and 4.2% to cash. The Investment Manager believes hybrids continue to look attractive at current levels, with the major banks’ BBB-rated hybrids still trading with credit spreads well above pre-COVID-19 despite ongoing easy monetary conditions, and also look particularly cheap against senior unsecured bank bonds, which have rallied through to new post-GFC lows in credit spreads.

Hybrids market and outlook

ASX-listed hybrid securities performed well during the September quarter, driven by ongoing fiscal and monetary policy stimulus to support the Australian banks (the main issuers of listed hybrid securities), optimism around containment of COVID-19 locally, and the worldwide push toward development of an effective COVID-19 vaccine (which has been the Investment Manager's base-case).

HBRD gained 1.70% over the quarter (net of fees but before the benefit of franking credits), exceeding the 1.10% recorded by the ASX All Ordinaries Index (including dividends) over the period, and significantly above the RBA Cash rate return of just 0.03%. The quarterly performance was driven by the credit spread on 5-year major bank hybrids falling from 353 basis points (bps) above the quarterly bank bill swap rate (BBSW) to 311bps.

This extends the recent run, with the Fund recording a gain of 1.90% (after fees but before the benefit of franking credits) over the last 12 months, including the turbulent March 2020 COVID-19 shock. For context, this represents a better outcome than that of the ASX All Ordinaries Index (including dividends), which lost -8.76%, and the Solactive Index, which returned 1.48% before fees.

Hybrids market and outlook continued

July saw a landmark event for the Australian bank hybrid sector, with NAB successfully issuing $600m of a publicly-traded, over-the-counter (OTC) hybrid security. This potentially opens up the wholesale OTC market as a viable alternative to the ASX for the major banks to raise Additional Tier 1 (AT1) capital. In this domain, they can issue much faster and save substantially on distribution and listing fees. While NAB had previously issued $500m of an OTC AT1 security in December 2019, this was markedly different from the structure investors were used to on the ASX (it paid a fixed coupon rather than a floating rate), which severely limited its appeal and liquidity prospects.

The new NAB OTC hybrid is a floating-rate note paying quarterly franked distributions, with a call date in 5 years, and identical to many ASX-listed major bank hybrids. The security was issued at a spread of 400bps above quarterly BBSW, around 50bps wider (with a higher yield) than the level at which equivalent ASX-listed hybrids were trading at the time, and Coolabah was a cornerstone investor for the deal. It has since performed very well, with the spread compressing to approximately 360bps.

The September quarter saw no other new hybrid issuance aside from NAB's foray into the unlisted market in July, creating favourable supply/demand technicals and driving credit spreads tighter. Indeed only Macquarie Bank (MBLPC) has thus far issued a hybrid in 2020 (recall both Macquarie and NAB cancelled planned issues in March 2020).

The Investment Manager expects the return of issuance (and attractive entry-points) in the final quarter of 2020, with NAB likely to roll its $1.7 billion December hybrid maturity alongside other smaller hybrid issues from Challenger, Bendigo and possibly Bank of Queensland to replace or refinance maturities. This should be succeeded with an orderly issuance program in the first quarter of 2021 as only Westpac and Macquarie have hybrid maturities in that period, although the risk is always that the major banks for some reason choose to jam the market with concurrent issues.

With major bank hybrid spreads still materially above pre-COVID-19 levels (circa 310bps vs around 260bps before the crisis) despite record fiscal and monetary stimulus, a near-zero cash rate, and term deposit rates below 1%, the Investment Manager expects ongoing demand for hybrids that pay relatively attractive quarterly cash (and franking credit) income. In contrast to major bank senior bonds spreads, which are back at 2007 levels, hybrid spreads remain significantly higher than their pre-COVID-19 tights and could therefore offer ongoing performance.

Given a jump in purchasing power care of lower mortgage rates and higher incomes, bullish auction clearance rates, and the advent of "positive gearing" (where rents more than cover mortgage repayments), we expect Sydney home values to start punching out capital growth again soon. The laggard is locked-down Melbourne, where dwelling values fell another 0.9% in September, making for cumulative losses of 5.5% since its March peak. Yet with Melbourne likely to come out of lockdown shortly, stability should return as the auction market comes online. Australia's resilient housing performance has again made a mockery of the consensus' extremely bearish forecasts for large price falls of 10%, 15%, 20% or 30%. Housing bears are becoming an extinct species with the likes of CBA and Westpac discarding their dire outlooks for much more bullish perspectives. The latest bear to drop is Capital Economics, which was anticipating losses of up to 10%, but now predicts only a 3% correction. And next year it believes home values will surge 7% higher. Other bears like ANZ, NAB and UBS should roll over soon. An improving housing market is credit positive for Australian banks, the main issuers of hybrids owned by HBRD.

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