BETASHARES ACTIVE AUSTRALIAN HYBRIDS FUND (MANAGED FUND)
ASX: HBRD
Quarterly Report - March 2021

Performance[1]	1 Month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Inception[2] % p.a.
Fund Return (net)	0.04%	1.02%	2.47%	10.34%	4.64%	4.08%
Growth return	*-0.16%*	*0.40%*	*1.18%*	*7.34%*	*1.22%*	*0.74%*
Income return	*0.20%*	*0.62%*	*1.29%*	*3.00%*	*3.42%*	*3.34%*
Solactive Australian Hybrid Securities Index (Solactive Index)	*0.18%*	*1.14%*	*2.55%*	*11.86%*	*4.87%*	*4.15%*
Active Return	-0.14%	-0.12%	-0.08%	-1.52%	-0.23%	-0.07%

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]	2.57%
Gross Running Yield (% p.a.)[2]	3.58%
Fund Constituents	37

[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	$1083.46m
Historical Tracking Error	0.82%
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	NABPH
ANZPG	WBCPG
CBAPD	WBCPH
CBAPF	WBCPI
NABPF	WBCPJ

[1] As at 31 March 2021

Sector exposure	Fund Weight %[1]	Index Weight%[1]	Active Weight%
Listed Hybrids	95.9	95.2	0.7
Capital Notes	0.0	0.5	-0.5
Subordinated Bonds	3.9	4.3	-0.5
Senior Bonds	0.3	0.0	0.3
Cash	3.9	0.0	3.9
TOTAL	100.00	100.00	0.00

[1] As at 31 March 2021

Fund performance summary

HBRD returned 0.04% before franking credits and after fees in March 2021, ending the month with a net running yield of 2.57% (gross running yield of 3.58%). Over the past year, HBRD has returned 10.34% before franking and after fees. Since inception, HBRD has returned an unfranked 4.08% annualised after all fees, with only an average 88% portfolio weight to ASX hybrids, relative to the benchmark Solactive Australian Hybrid Securities Index's (Solactive Index) 4.15% unfranked, return and the RBA Cash Rate + 2.5% return of 3.42%.

HBRD's since inception volatility of 5.67% has been lower than the Solactive Index's volatility of 6.09% and less than a third of the 18.24% volatility of the All Ords Accumulation Index. At the end of March 2021, HBRD was diversified across 37 hybrids/bonds, and had a 95.8% allocation to hybrids, 0.3% to subordinated bonds, and 3.9% to cash. There were two new hybrid issues in the quarter, MQGPE and CBAPJ, with 5-year major bank hybrid spreads widening in March from +274 basis points (bps) to +277bps above the quarterly bank bill swap rate (BBSW).

Hybrids market and outlook

Over the March quarter, HBRD gained 1.02% (net of fees but before the benefit of franking credits). The credit spread on 5-year major bank hybrids initially tightened from 294bps above BBSW at end December 2020 to 259bps by mid-February, but widened +18bps over the remainder of the quarter, ending at 277bps as both Macquarie and CBA came to market with new issues.

During the quarter, Coolabah took interest in CBA's new $1.2 billion hybrid (ASX: CBAPJ), which was priced with a decent 12bps concession and settled on the last day of the quarter. Given the pricing looked attractive, Coolabah was able to support CBA with a healthy bid. Importantly, size-wise CBAPJ is very small for a major bank deal, which should provide for a constructive technical tail-wind. At time of writing, the security is trading at around $100.25.

NAB announced that it would repay its long-outstanding $2 billion National Income Securities (ASX: NABHA) on 15 February 2021 at full face value (ie, $100 plus the last remaining coupon payment) consistent with the expectations Coolabah had repeatedly outlined in past months.

Hybrids market and outlook continued

NABHA first listed on the ASX in June 1999 and had been subject to intense speculation for many years as to when it might be refinanced. In December, NAB secured shareholder approval at its AGM to repay NABHA and Coolabah forecast that this would occur in February at full face value (ie, for $100). Since late last year they had argued that the likelihood of $2 billion of cash being returned to NABHA holders in February would be positive for the ASX hybrid sector and provide a tail-wind for returns in the first quarter of 2021.

The ASX major bank hybrid market has three major maturities scheduled in 2021: ANZ's Capital Notes 1 (ASX: ANZPD)' CBA's PERLS VIII (ASX: CBAPE); and Westpac's Capital Notes 4 (ASX: WBCPG).

ANZPD is scheduled to be called on 1 September 2021, while CBAPE & WBCPG will most likely be called on 15 October 2021 and 20 December 2021 respectively. These three hybrids amount to approximately $4.3bn of outstanding debt, and will almost certainly be refinanced into new issues. Since hitting a recent peak north of 1.9% on 26 February 2021, the Aussie 10-year government bond yield has range-traded between 1.65% and 1.84%, finishing March at 1.79%.

Coolabah has argued that with the neutral nominal RBA cash rate likely to currently lie somewhere between 2.0% and 2.5%, there is a natural short-to-medium term ceiling on how far long-term interest rates can realistically climb (where the 10-year government bond yield reflects the market's best guess of the RBA's cash rate over the next decade plus a risk premium, or so-called term premium, for interest rate volatility).

This is also likely true of U.S. 10-year interest rates, given the Federal Reserve's experience in 2018 when it lifted its cash rate to 2.25%, thereafter having to aggressively reverse-out these interest rate hikes after a highly adverse reaction in risk markets, and equities particularly, to the spectre of elevated discount rates. It is worthwhile remembering that the U.S. 10-year government bond yield increased to more than 3.2% in August 2018 as a result of upside surprises to wages growth, which printed above 3.5% as the U.S. jobless rate fell below 4% that year for the first time since the early 2000s. For the avoidance of doubt, Coolabah believes the directional trend for 10-year interest rates is to gradually creep higher as the global economy recovers, output gaps close, unemployment rates converge back to their non-accelerating inflation rate of unemployment (NAIRUs) in the 3% band, and wages growth starts to reignite.

While Coolabah is not concerned about inflation in the short-term (save for temporary base-effect driven spikes this year as COVID-induced deflation drops out of the annual numbers), we do think that central banks in developed economies with positive population growth will be successful in restoring consumer price inflation to their targets. In fact, we think there is a risk that inflation overshoots these targets in countries, such as Australia and the U.S., that are not being hollowed out by negative population growth. Yet that contingency is likely several years away, and would be considered by some monetary policy mavens as a high quality problem to have to contend with.

In the floating-rate bond world, which is relatively untroubled on a first-order basis by interest rate increases, March brought more of the same. The AusBond Floating-Rate Note (FRN) Index recorded a tiny 0.01% return after its rare 0.02% loss in February. Credit spreads in March were relatively subdued. Coolabah's proprietary, constant maturity indices had 5-year major bank senior bond spreads effectively unchanged at about 42bps above BBSW, up ever so slightly from 41bps at the end of February. With the RBA's $180 billion term funding facility (TFF) expiring in June, it is reasonable to expect bank funding costs will start to normalise higher over time. Indeed, we have seen BBSW lift from 1bp to almost 4bps since the middle of February. 5-year major bank Tier 2 bond spreads compressed somewhat from 144bps to 133bps above BBSW in March, a touch below their previous post-GFC tights at 135bps in June 2018.

In March, the RBA governor, Phil Lowe, tendered an incredibly important speech in which he revealed that the RBA had materially revised down its estimate of the fully-employed jobless rate—proxied by the NAIRU— from around 4.5% to the low 4s. In fact, Lowe stated it could be in the 3s.

The RBA further doubled down on yield curve control, dismissing economist and market forecasts that they will drop it this year, and strongly rejecting market pricing of rate hikes commencing later next year. Lowe argued rates are likely to remain near zero until at least 2024.

Hybrids market and outlook continued

The RBA again clearly signalled that a third round of QE (or 'QE3') will come after the second $100bn QE2 tranche expires in Q4, and further communicated its willingness to temporarily increase QE if required to smooth market disruptions.

The RBA reiterated that it is singularly focused on getting the jobless rate down to the NAIRU to lift record-low wages growth of 1.4% to over 3%, which will return core inflation to the RBA's 2-3% target band. Coolabah believe it will take considerable time and substantial monetary stimulus to achieve this goal.