BetaShares
Exchange Traded Funds

BETASHARES AUSTRALIAN BANK SENIOR FLOATING RATE BOND ETF
ASX: QPON
Quarterly Report - June 2021

Performance[1]	1 Month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Inception[2] % p.a.
Fund Return (net)	0.06%	0.10%	0.03%	1.47%	2.42%	2.51%
Growth return	*-0.05%*	*-0.18%*	*-0.45%*	*0.67%*	*0.72%*	*0.65%*
Income return	*0.11%*	*0.28%*	*0.48%*	*0.80%*	*1.70%*	*1.86%*
Index return	*0.08%*	*0.17%*	*0.14%*	*1.69%*	*2.66%*	*2.70%*

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 1 June 2017*

Investment objective
The Fund aims to track the performance of an index (before fees and expenses) that provides exposure to a portfolio of some of the largest and most liquid senior floating rate bonds issued by Australian banks.

Responsible entity
BetaShares Capital Ltd

Distribution frequency
Monthly

Fund Facts	
Inception Date	1-Jun-17
Fund Size	$673.6m
Historical Tracking Error	0.09%
ASX Code	QPON
Bloomberg Code	QPON.AU
IRESS Code	QPON.ASW

Fees	% p.a.
Management fees	0.19
Recoverable expenses	0.03

Investment strategy
The Fund will generally invest in a portfolio of bonds that comprise the Index in proportion to the weightings of these bonds in the Index.

In order to be eligible for inclusion in the Index, each bond must be a senior floating rate debt security denominated in AUD and issued by an eligible Australian bank. In addition, eligible bonds must have amounts outstanding of at least $500 million and a term to maturity (“TTM”) of between one to five years. Current eligible banks are classified into two bands as follows:

- **Band 1**: ANZ Bank, Commonwealth Bank of Australia, National Australia Bank, Westpac
- **Band 2**: AMP Bank, Bank of Queensland, Bendigo & Adelaide Bank, Macquarie Bank, Members Equity

Eligible bonds with the longest TTM are selected with up to two bonds selected from each Band 1 bank, and one bond from each Band 2 bank. Bonds from Band 1 are given a total weight of at least 80% based on market value, with each bond equal weighted. Bonds from Band 2 are given a total weight of up to 20% based on market value, with each bond equal weighted (with no Band 2 bond allowed to have a weight in excess of 5%).

Top 10 Exposures[1]	%		%
NAB Frn Jan-25	10.1	CBA Frn Jan-24	10.0
WBC Frn Apr-24	10.0	CBA Frn Aug-23	9.9
WBC Frn Aug-24	10.0	NAB Frn Jun-24	9.9
ANZ Frn Jan-25	10.0	Macquarie Group Frn Dec-25	5.0
ANZ Frn Aug-24	10.0	BOQ Frn Feb-23	5.0

[1] As at 30 June 2021

Global macro and rates

Global bond yields fell over the June quarter, partly unwinding the prior quarter's rise, amid growing concerns about the global economic rebound and a relaxation of policy accommodation, with 10-year U.S. Treasury yields ending the period 27 basis points lower in a curve flattening move (5y: -5bps; 30y: -32bps). The June quarter was defined by competing inflation narratives, a more hawkish posture from several central banks and a late quarter unwind of the reflation trade across asset classes, as expectations of U.S. policy normalisation were brought forward following the June FOMC meeting.

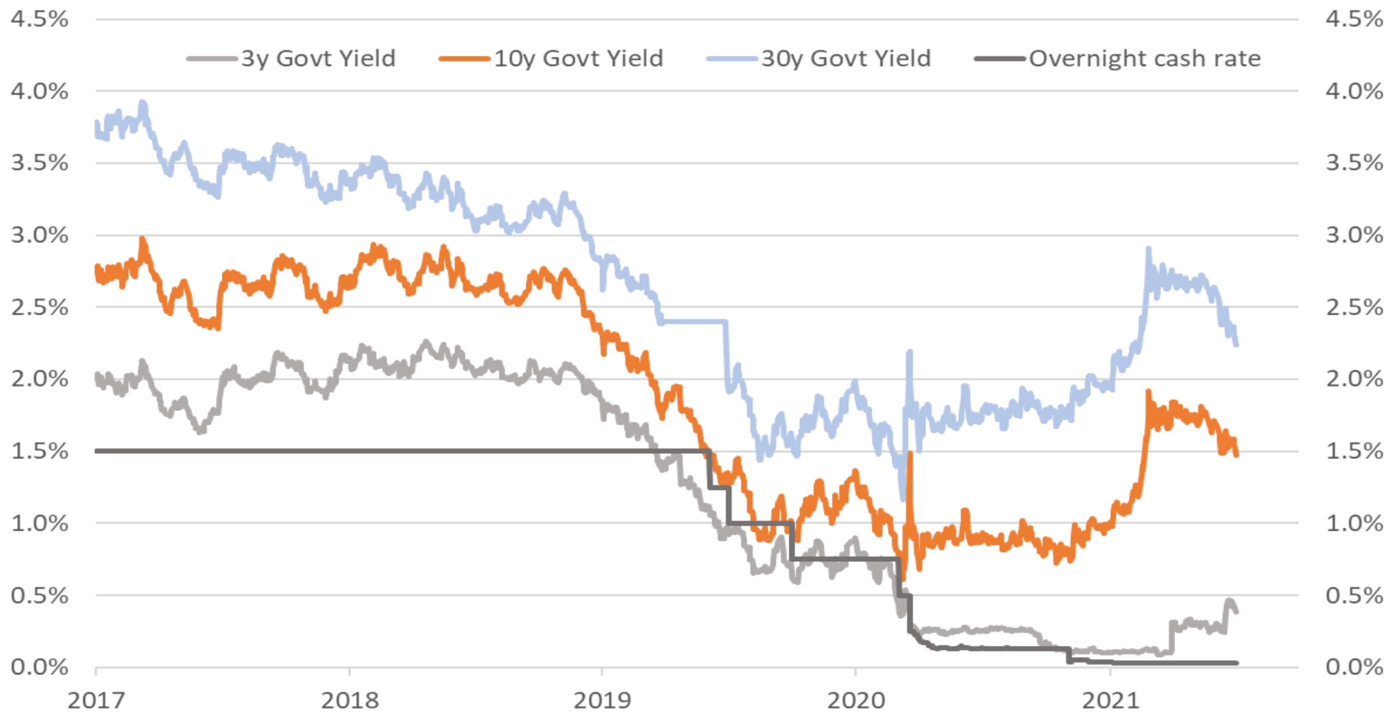
Throughout much of the quarter, the broader macro debate focused on whether the rising price pressures in the U.S. would prove transitory or persistent, with the April and May y/y headline CPI prints of 4.2% and 5.0% capturing widespread attention. A large proportion of these higher than expected prints can be explained by higher crude oil prices and supply chain disruptions clashing with a material pickup in demand in reopening-sensitive sectors, with used car and truck prices, flights and other travel related components making outsized contributions. Throughout the period, major central banks noted the pickup in prices, but stressed the importance of patience and the limits of monetary policy in addressing price pressures caused by supply side constraints. Over the quarter, market pricing was also consistent with the transitory view, with the U.S. inflation compensation term structure in inflation swaps and inflation linked government bonds remaining inverted.

The June FOMC meeting saw members bring forward rate hike expectations to 2023, triggering an aggressive flattening in the U.S. curve, with the 5-year sector initially coming under heavy selling pressure and the long end (10y+) rallying as inflation expectations retreated, terminal policy rates recalibrated lower and the broad USD firmed. This move spilled over to other reflation expressions, with commodities, high beta currencies and cyclical equities coming under pressure. Many market participants interpreted the move as not simply a hawkish tilt based on an improved economic outlook, but a hawkish tweak to the underlying policy reaction function, given FOMC members largely kept inflation expectations for 2022 and 2023 unchanged from March. This was seen by some as a rejection of the average inflation targeting (AIT) framework introduced last year (which promised an extended period of inflation overshoots would be tolerated to make up for prior misses), although various Fed officials have pushed back on such concerns in recent weeks.

Australian benchmark yields largely moved in sympathy with U.S. Treasuries (10y -26bps), with stronger than expected local employment data bringing forward market-implied RBA rate hike expectations to as early as 2022, despite the Bank maintaining forward guidance of no rate hikes before 2024. Although rate hike expectations were brought forward, terminal policy rate expectations (as defined by 5y5y forward swap rates) retreated, consistent with the moves in the U.S. rates complex, supporting a sharp drop in 30-year Australian bond yields (-48bps). Updated issuance guidance from the AOFM also possibly supported the fall in long term bond yields at the margin.

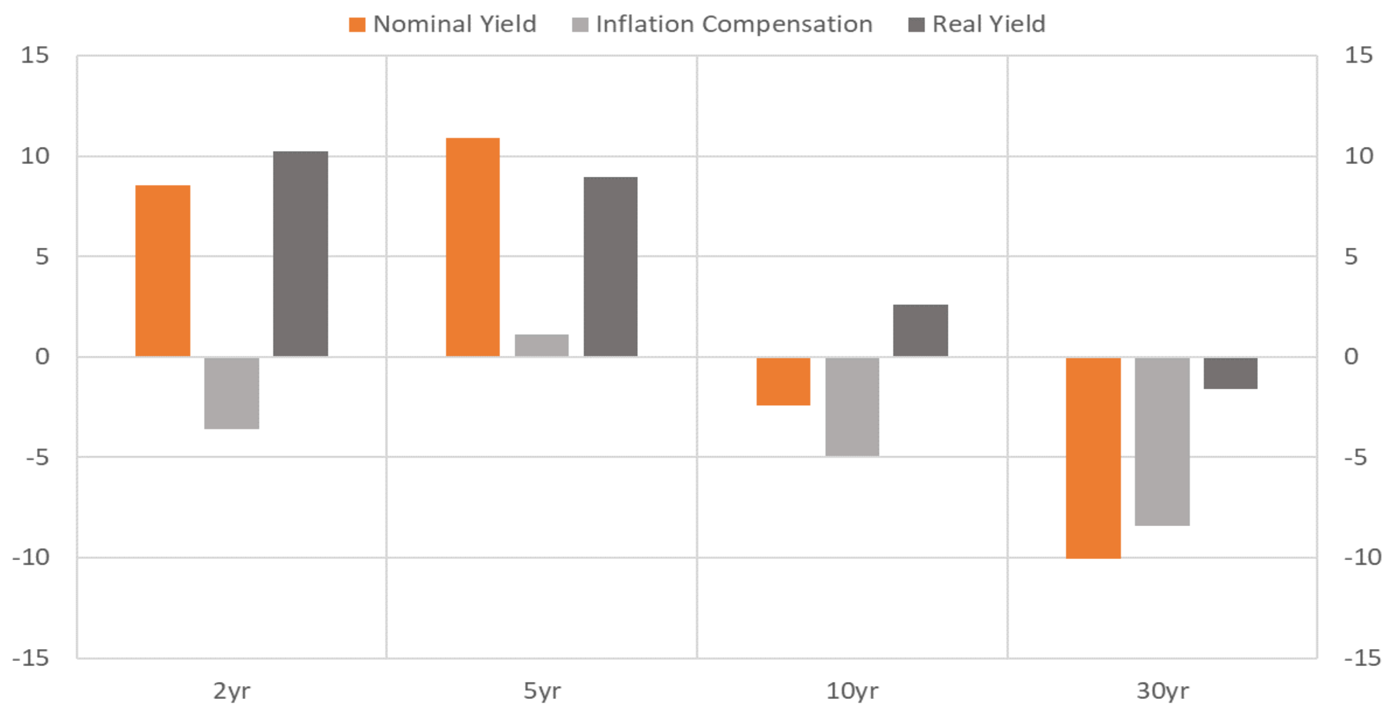
The July RBA meeting provided no major surprises, although the Yield Curve Control (YCC) bond was not rolled from April to November, and the pace of QE was tapered slightly to $4b/week (from $5b/week previously), with the pace to be reassessed again in November, following an earlier announcement that the Bank would be more 'flexible' with its application of QE. Despite the marginal hawkish tilt in response to the faster-than-expected economic rebound and fall in unemployment, the Bank continued to stress the importance of wage growth in achieving its inflation target and that it's likely that significant slack still remains in the labour market, especially once borders reopen.

Chart 1: Australian benchmark yields



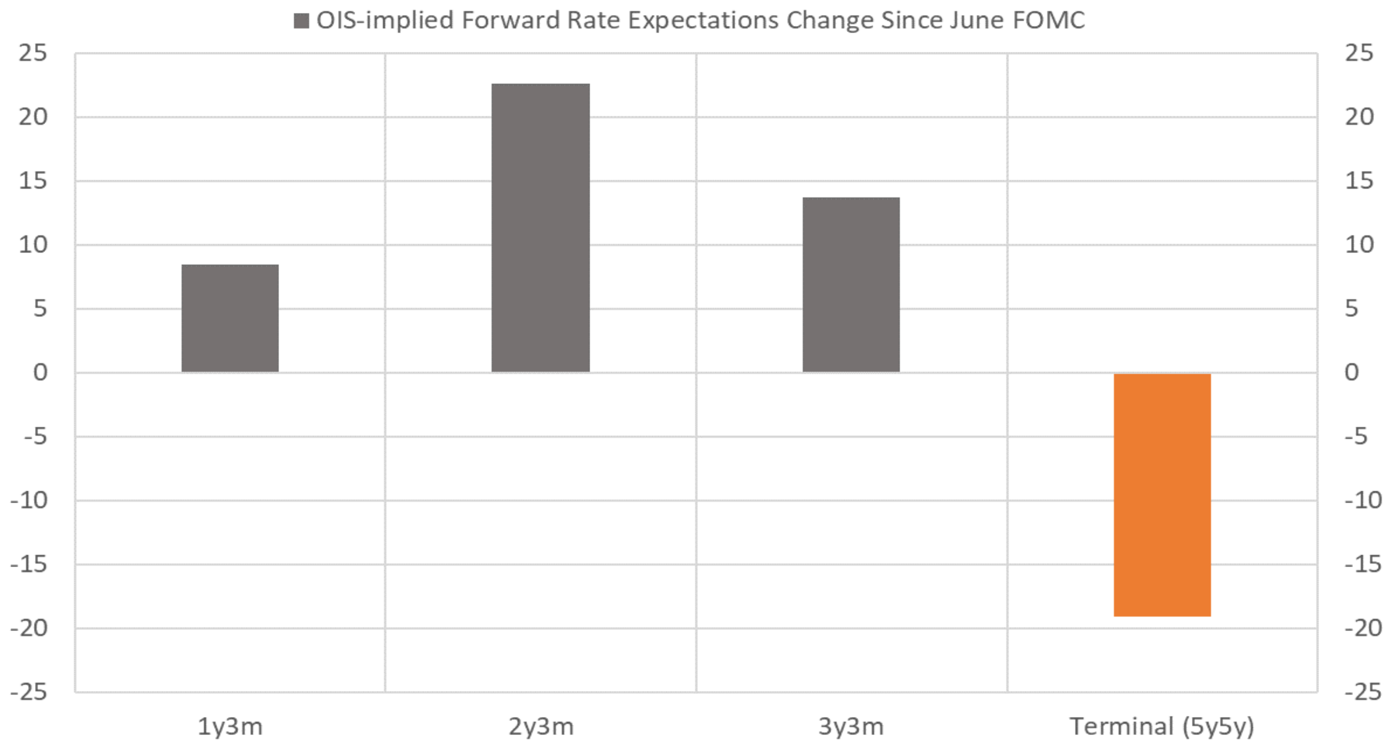
Source: Bloomberg.

Chart 2: Change in U.S. Treasury Yields (in basis points) post-June FOMC meeting; 15-June-2021 to 30-June-2021



Source: Bloomberg.

Chart 3: Change in U.S. forward rate expectations (in basis points) post-June FOMC meeting; 15-June-2021 to 30-June-2021



Source: Bloomberg.

Credit

Despite the correction in many reflation expressions, global credit markets were largely unaffected, with both investment grade and high yield corporate bond spreads continuing to grind lower, as the search for yield dynamic dominates any broader concerns around risk asset valuations. One exception was Chinese credit, which remains under pressure amid concerns around implicit government guarantees and a broader tightening of financial conditions in China.

In Australia, investment grade credit spreads were largely unchanged over the period, although spreads on state government bonds shifted slightly higher into quarter-end ahead of the July RBA meeting. Australian senior bank FRN spreads remain extremely tight by historical standards, despite the RBA's term funding facility (TFF) having now ended for new applications. Primary market activity remained quiet and new regional bank senior FRN issuance during the quarter was met with a lukewarm reception, with credit spreads still seen as too tight by many investors.

Although it is expected the TFF unwind may see the major banks return to the primary market, many participants have pointed out the Australian banks are still behind on Tier 2 subordinated debt issuance to meet APRA's December 2022 targets, so it remains to be seen which parts of the capital structure banks will target over the coming quarters. However, it is expected that corporates will return to the bond market now that policy-supported cheap banking funding is less readily available.

Outlook

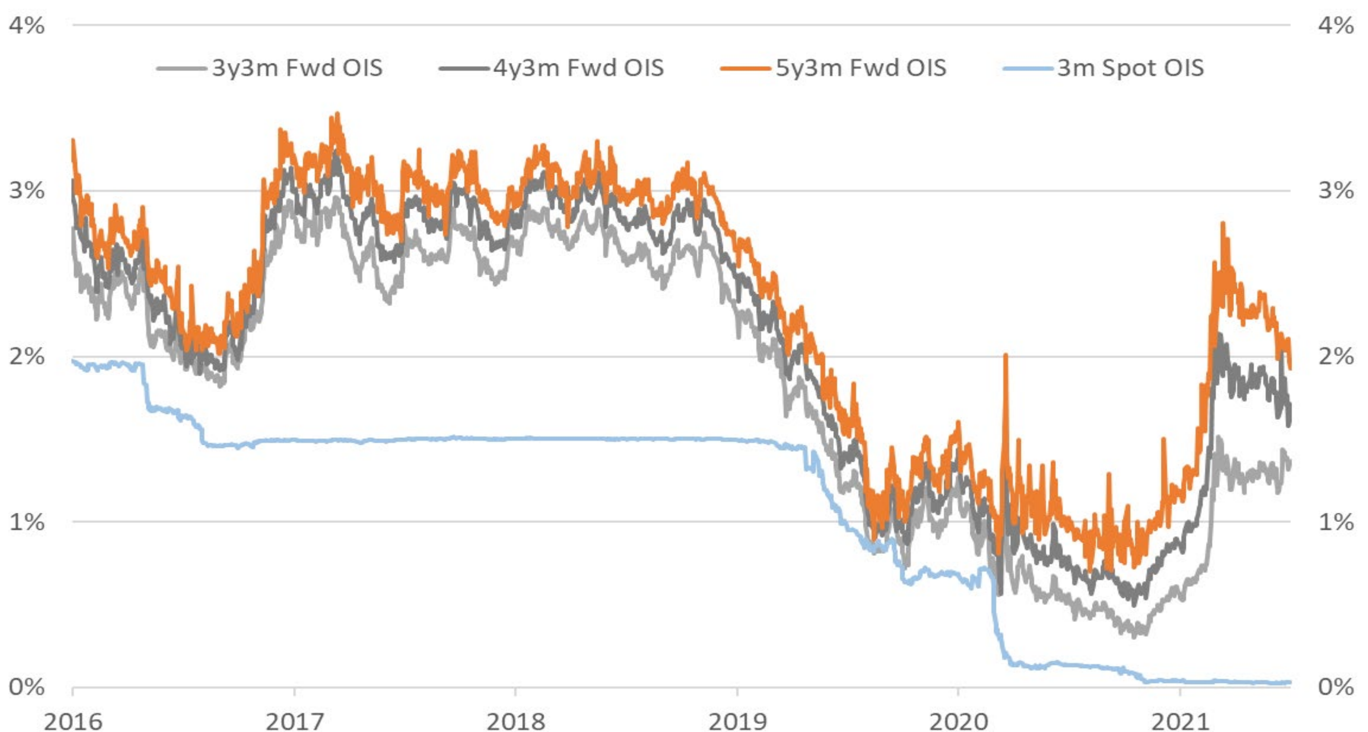
As we enter Q3, global bond yields have continued their declines on emerging global growth concerns, with the Chinese economy showing clear signs of deceleration and U.S. fiscal stimulus hopes also fading amid various political obstacles for the current administration. Added to this is the persistence of COVID and the emergence of mutations forcing several governments to remain cautious around the reopening. Building disagreements within the OPEC+ body are also threatening to derail the rally in crude oil, which has been a key driver of price pressures and inflation expectations for much of the past 12 months.

Outlook continued.

The Fed remains key for financial conditions and assuming they are committed to a more hawkish posture, it's likely that the combination of a global growth slowdown and a scaling back of asset purchases would likely support a further flattening in global sovereign curves. However, if the slowdown is strong enough or inflation pressures dissipate significantly, the Fed could adopt a more dovish posture and delay a tapering of asset purchases, which would likely be supportive of risk assets and re-start a steepening of the back end of the Treasury curve.

In Australia, employment remains key to the RBA's likely policy trajectory. Although there are signs of tightness in the labour market, with both the unemployment and underemployment rate falling rapidly, these could be influenced by artificial constraints imposed from the border closures. It's likely that the RBA is looking ahead to the reopening of borders, which could significantly increase the amount of slack available. Given wage growth has been stubborn so far, achieving 3% over an extended period in a post-reopening world would appear a very high bar to meet. Although the recent RBA tilt is hawkish at the margin, forward guidance remains extremely dovish relative to market expectations.

Chart 1: Australian benchmark yields



Source: Bloomberg.

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