ActiveX Ardea Real Outcome Bond Fund (Managed Fund) (ASX:XARO)

ARSN 629 403 925

Fund Facts – 30 November 2021

ASX Ticker	XARO		
Fund Inception Date	10 December 2018	**Fund Size**	$877.4 million
Underlying Fund Inception Date	20 July 2012	**Underlying Fund Size**	$11 billion
Distribution Frequency	Quarterly	**Unit Registry**	Link Market Services
Management Fee	0.50% p.a.	**Fund Issuer**	Fidante Partners Limited

Fund Overview

The ActiveX Ardea Real Outcome Bond Fund (Managed Fund) is a defensive fixed income solution that targets stable returns exceeding the cash rate and inflation, with a quarterly income distribution and daily liquidity.

The Fund does this by employing Ardea's 'relative value' investment approach, which combines the safety of high quality government bonds with proven risk management strategies to deliver low volatility returns, while protecting capital from interest rate fluctuations and general market volatility. (Note: neither the Fund nor the Underlying Fund are guaranteed).

Suits Investors Seeking

- a higher expected return than cash[1]
- an alternative source of income, with low volatility
- a defensive fixed income anchor to diversify portfolio risk away from equities, property and credit investments
- investors who accept some risk and that their investment will include exposure to derivative strategies

1 Neither fund performance nor capital is guaranteed.

Monthly Performance Report – 30 November 2021

Fund Performance[2, 3]	1 month	3 months	1 Year	2 years	3 years	5 years	Since inception[4]
Fund	0.06%	-1.12%	-1.15%	2.29%	-	-	4.43%
Australian Consumer Price Index	0.27%	0.69%	2.87%	1.83%	-	-	1.81%
Excess Return	-0.21%	-1.81%	-4.02%	0.46%	-	-	2.61%

2 Performance figures are based on the Fund's net asset value, are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of likely future performance. All periods longer than 1 year are annualised.
3 The performance of the Fund will not exactly replicate that of the Underlying Fund, for example, where cash is held by the Fund.
4 The Fund's inception date is 10 December 2018.
Source: Fidante Partners Limited, 30 November 2021.

Underlying Fund

The Fund invests in Ardea Real Outcome Fund (Underlying Fund). In this report, where we refer to the Fund's investments we generally do so on a 'look-through' basis; that is, we are referring to the underlying assets that the Fund is exposed to through its investment in the Underlying Fund.

Underlying Fund Performance[5]	1 month	3 months	1 Year	2 years	3 years	5 years	Since inception[6]
Underlying Fund	0.08%	-1.11%	-1.13%	2.33%	4.43%	4.43%	3.82%
Australian Consumer Price Index	0.27%	0.69%	2.87%	1.83%	1.82%	1.83%	1.91%
Excess Return	-0.19%	-1.79%	-4.00%	0.50%	2.61%	2.60%	1.91%

5 Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of likely future performance. All periods longer than 1 year are annualised.
6 The Underlying Fund's inception date is 20 July 2012.
Source: Fidante Partners Limited, 30 November 2021.

Underlying Fund Exposure

Sector Exposure	
Government – National	73%
Government - State	27%
Total	100%

Interest Rate Duration (years)	
12-month average	0.1
Since inception average	0.2

Rating Exposure	
AAA	50%
AA	37%
A	13%
Total	100%

Region Exposure*	
Australasia	31%
Europe	14%
North America	55%
Total	100%

* Australasia = Australia, New Zealand, Japan; Europe = France, Germany, UK; N. America = USA, Canada

Sources: Ardea Investment Management, S&P Ratings. Noting investors accept some risk and that their investment will include exposure to derivative strategies.

Fund Benefits

Higher expected returns than cash[1]
The Fund has a track record of delivering returns exceeding cash and inflation since inception[2]. As these returns are independent of market direction, Ardea expects to maintain a level of outperformance in rising and falling markets irrespective of the level of the cash rate.

An easier way to access your investment
The Fund offers daily trading on the ASX, without break costs that can apply to certain cash products.

Lower risk than many income seeking investments[3]
The Fund invests in high-quality government bonds and cash securities, which have lower credit risk, unlike bank hybrids and corporate bonds, while also using sophisticated risk management strategies to help volatility compared to dividend paying stocks.

Defensive fixed income anchor that helps diversify investment portfolio risk
The Fund targets positive returns that are independent of interest rate fluctuations and general market volatility. Combining this with proven risk management strategies allows the Fund to help diversify your portfolio risk away from equities, property and credit investments.

Protect the purchasing power of your investment
In addition to outperforming[4] cash, the Fund targets returns exceeding inflation, which helps protect the long term purchasing power of your investment.

Experienced and stable investment team: Ardea's investment team has decades of experience across global fixed income markets. Majority employee ownership of the Ardea business fosters team stability.

Fund Risks

The Fund is exposed to a number of risks including interest rate risk, market risk, and collateral risk. Please refer to the Product Disclosure Statement for more information.

1 Past performance is not an indicator of future performance. Neither fund performance nor capital is guaranteed.
2 Inception date is 20 July 2012
3 When compared to Equities (S&P/ASX200 Accumulation), REITs (S&P/ASX200 A-REIT), Ausbond Composite (Australian govt and non-government bonds) and Ausbond Govt (Australian govt bonds).
4 Refers to the Fund's historical track record since inception

Monthly Commentary

Portfolio Commentary

Performance for the month of November was +0.06% (net of fees), which is within the range of expected performance variability (see the *Understanding Performance* section below for details).

The performance attribution refers to risk-factor level exposure for the Fund overall, rather than individual trades. The following themes impacting risk factor exposures were notable in November:

- The Fund benefited from **Options** and related **RV Rates** exposures as interest rate markets were moderately volatile over the month. Following a large increase in October, implied volatility in options with shorter underlying maturities remained elevated as central bank policy uncertainty persisted. Further out the curve, longer term rates volatility picked up a bit as markets grappled with uncertainty over the Omicron COVID variant. These moves, however, were not extreme by historical standards. The Fund buys options based on RV considerations and to provide risk balance to the portfolio.
- **RV Curve** exposures were a modest detractor from performance. This exposure represents a large number of underlying trades – some were contributors in the month, while others were detractors. A general theme is that interest rate markets recovered somewhat from the extreme disfunction of late October. However, many RV relationships targeted by the Fund across yield curves remained distorted. Over short-term periods, there is substantial noise associated with the behaviour of these constrained RV relationships.
- **Inflation Beta** exposure - expressed via AUD inflation-linked bonds - was near flat overall. Intra-month, however, there was significant volatility in inflation pricing levels. Market-based inflation expectations lifted sharply over the first half of the month in the wake of stronger global CPI data. But over the second half of the month, inflation expectations retreated as focus switched to more hawkish central banks and COVID risks. High levels of inflation uncertainty are driving higher than normal volatility in these exposures.

The Fund's performance is not driven by a few key trades or broader macro themes, so we focus the commentary below on examples of RV-specific themes that the Fund is positioning around. The performance of many individual trades underlying these themes and a large number of other themes, has contributed to the Fund's performance this month.

RV Theme – AUD swaptions

These trades contributed to the Options attribution.

The Fund holds options as RV trades and to provide the portfolio with risk balance. These positions are held in multiple currencies. The Fund recently added long "swaption straddle" positions in the AUD market – a structure that benefits from higher interest rate swap volatility without the need to pick whether swap rates go up or down (the main risk to the trade is falling volatility). Hedging related to structured bond issuance by banks has resulted in larger selling flows in AUD swaptions with underlying maturities at long tenors. These flows have cheapened these options to attractive levels to buy.

These trades are relatively flat over the last month (other similar style swaption positions in shorter maturities outperformed).

RV Theme – AUD bonds vs derivatives

These trades contributed to the Bonds vs Derivative and Curve attribution.

AUD government bonds in the 10-20Y segment have been priced cheap relative to closely related derivatives. This RV opportunity is driven by demand / supply imbalances caused by bond issuance on the supply side vs market segmentation on the demand side (i.e. demand for bonds is currently more focused in 10Y and shorter segments, where the RBA is also buying bonds).

These trades added value over the month and further outperformance is expected.

RV Theme – EUR long maturity bonds vs swap

These trades contributed to the Bond vs Derivative attribution.

The Fund has been positioned in ultra-long maturity EUR bonds with offsetting duration hedges in long-dated swaps. These bonds were targeted as relatively cheap to comparable maturity bonds, reflecting temporary supply/demand imbalances. The swap curve is inverted at longer dated maturities and large flows from other funds closing steepening trades in this part of the curve have led the swaps to recently outperform the bonds, leading this position to be a detractor from performance.

The underlying rationale for this position remains intact and is expected to outperform over time.

Market Commentary

Below is a summary of key points covered in this month's market commentary. The full article is available on Ardea's website here.

5 Key Themes for 2022

As each year draws to a close, it's common for investment managers and banks to publish predictions for the year-ahead. In fixed income, these notes tend to be heavily focused on the macroeconomic and central bank policy forecasts that drive yield predictions. Forecasting is a tough gig. Even seasoned market professionals have a patchy record in accurately predicting key variables like growth, inflation, and the level of bond yields.

At Ardea Investment Management, macro forecasting is not part of our investment process because we adopt a pure relative value investment approach that aims to be independent of the level of bond yields, the direction of interest rates and the macroeconomic factors that dominate the performance of conventional investments. Therefore, instead of the traditional year-ahead forecasts, in this note we highlight 5 key themes that will impact the risk/reward balance for fixed income in 2022: 1) high expectations and risks to global growth; 2) peak inflation; 3) peak quantitative easing (QE) and bond supply/demand dynamics; 4) rate hikes to further un-anchor yield curves; 5) cross-market rates divergence and volatility.

A common link among these broader market themes is the rising level of macro uncertainty (as also outlined in a recent note on central bank policy tightening). For relative value, this uncertainty is likely to manifest in further distortions in yield curve shapes, interest rate volatility and changes in the relationship between bond and interest rate derivative curves.

Understanding Performance

Performance is evaluated over rolling 2 year periods for consistency with the recommend minimum investment horizon of 2 years. Over short-term horizons it is expected that portfolio performance will fluctuate in a range around the expected long-term investment outcome, including periods of negative returns. This is because the Fund's targeted return is not expected to materialise evenly over the investment horizon.

We use the concept of 'expected performance variability' to objectively define a range of short-term performance fluctuation that is consistent with the investment strategy operating as expected. This range is based on the Fund's volatility target of 2% p.a. and translates to an expectation for monthly performance to commonly fluctuate in a range of -0.4% to +0.7%.

The Fund's highly differentiated investment approach generates returns exclusively from capturing RV mispricing opportunities across global interest rate markets. This approach is intentionally independent of the level of bond yields, the direction of interest rates and broader bond market themes.

The Fund's portfolio construction process intentionally diversifies risk across many different types of independent and modestly sized RV trades. Therefore, performance is the cumulative result of interactions between hundreds of trades entered, exited, and held over the preceding months.

For these reasons, the Fund's performance is ordinarily not driven by a few key trades, nor can it be mapped to broader market fluctuations or macro themes. This is intentional, because the Fund aims to deliver volatility controlled returns that exhibit low correlation to the performance of government bond, credit, and equity markets. This is precisely why the Fund can offer compelling diversification benefits when combined with conventional investments.

Please note that monthly performance attribution is heavily influenced by short-term 'noise' and ordinarily offers little genuine information value.

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Underlying Fund Ratings

Zenith RECOMMENDED

Recommended Lonsec Research

MORNINGSTAR Bronze

Ardea Real Outcome Fund received a Morningstar Analyst Rating™ of 'Bronze' on 17 July 2021

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