Alexander Funds

The Alexander Perspective

Quarterly Update
December 2023

www.alexanderfunds.com.au
1300 138 401
info@alexanderfunds.com.au
AFSL 476697

Alexander Funds

CEO's Update

Welcome to the first quarterly update for 2024.

As we dive into a new year, let me extend my gratitude for your support of Alexander Funds throughout 2023. As an organisation we achieved a number of milestones during the year, allowing us to fine-tune our strategies, explore new opportunities, and further strengthen our foothold as fixed income credit managers in the Australian market.

2023 was not without its challenges, with further cash rate rises in the second half of the year and the expectation that rates would remain higher for longer impacting the broader market. This was followed toward the end of the year with commentary around a potential 'soft landing' by the RBA buoying markets into the new year. While volatility was not as extreme as we thought it may be, our investment team worked diligently to ensure the portfolios were well protected against downside risks. As a result, performance numbers for both the Credit Income Fund and Credit Opportunities Fund were strong, achieving annual returns for the calendar year of 7.26% and 8.05% net of fees respectively.

One of our milestones was the celebration of the Credit Income Fund's 5-year anniversary in December. We introduced the Credit Income Fund into our suite of products in response to demand for a diversified portfolio of Australian fixed income credit assets that offered daily pricing and a larger allocation to investment grade credit. The Fund continues to be a standout among peers, consistently outperforming its benchmark and no negative return periods on an annualised basis.

Organisational change forms part of every enduring business, and after an 8-year tenure Tim Cox has moved on as Alexander Funds' Chairperson. After careful consideration the Board has appointed Trevor Chudleigh as the new Chairperson for Alexander Funds. Trevor brings a wealth of experience and a proven track record of success in the financial services industry, with particular experience in funds management. With a distinguished career spanning over 30 years, he has consistently demonstrated strategic vision and a commitment to driving sustainable growth. We have already seen the benefit of this appointment and look forward to growing the business with Trevor in this role.

As Trevor assumes this position, we express our sincere gratitude to the outgoing Chairperson, Tim, for his invaluable contributions during his tenure. Tim played a pivotal role in steering Alexander Funds during this time. Additionally, we thank him for staying involved with the business during this transitional phase in leadership. Tim's direction and corporate oversight set us up to be in the advantageous position for the future that we find ourselves in.

As you read through the report, our investment team will deliver their thoughts on how we are positioning our portfolios to reflect renewed economic and market expectations for 2024. As always, I hope the information provided will be informative and welcome any feedback or questions you may have.

Here's to a successful, prosperous, and collaborative 2024.

Warm Regards

Rachel Shirley
CEO

Alexander Funds

Market Commentary

What happened over the quarter?

In our September report, we discussed the difference between "soft" and "hard" landing economic scenarios. As a reminder, a soft landing refers to the scenario where;

- In response to rising inflation, monetary policy has tightened by increasing interest rates;
- The rise in interest rates has the desired impact on inflation by lowering it and putting it on a path to reaching the central bank target;
- The higher interest rates required to lower inflation have softened growth but not to the extent it pushes the economy into recession.

This is in contrast to a "hard landing" where a meaningful recession is the outcome of rising rates. In the final 3 months of calendar year 2023, financial market behaviour oscillated between attributing a higher probability to hard and soft landings.

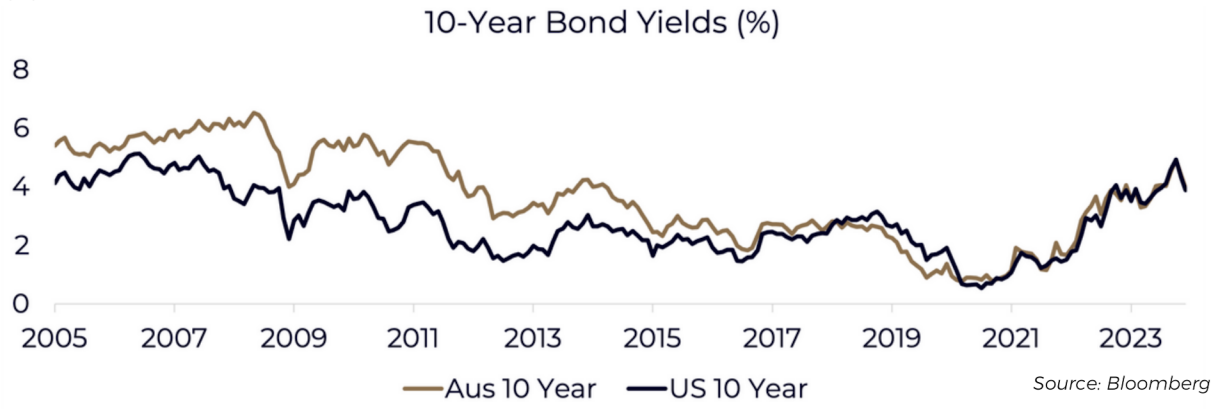
October was a continuation of the trend established in the previous month of rising interest rates, increasing volatility and dampening risk appetite (hard landing). In the US, the yield on the 10-year government bond touched 5% in October. As context for that level versus recent history, the last time it traded at 5% was in 2007. In Australia the story was similar, with the 10-year yield peaking just shy of 5% and reaching a level not seen since 2011 (Chart 1).

The impact of higher rates and the potential for them to restrict economic activity directly fed into other asset classes. The end result was that over September/October the S&P 500 and ASX 200 were down 9% and the Australian iTraxx widened by 25 bps.

From the beginning of November to the end of the quarter, markets more than retracted the entire Sept/Oct move. Economic data suggesting that inflation was falling, but not at the expense of a dramatic drop in growth, increased the market's assessment of a "soft landing" in both the US and Australia. In addition, dovish rhetoric from the Federal Reserve contributed to expectations of a material reduction in policy rates, to the extent that by the end of December, the market had priced in 150 bps in rate cuts over 2024.

In Australia, resilient inflation and labour data kept further interest rate rises in 2024 on the agenda, but overall markets were happy to assume the impact to growth would be moderate and that there would be scope for the RBA to provide rate relief in the second of half of 2024.

Chart 1



Source: Bloomberg

Market Commentary

Alexander Funds

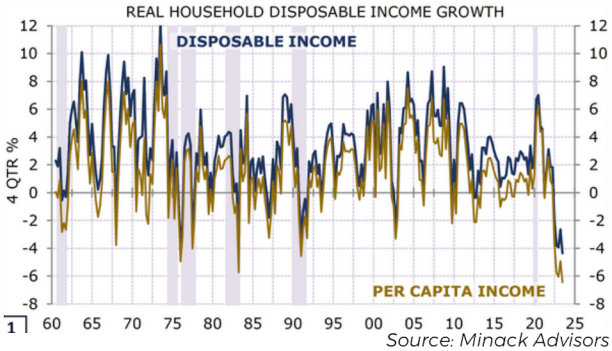
Where to from here?

For the bulk of 2022 and 2023, we have held concerns about the ability of the Australian economy to withstand one of the largest and most aggressive interest rate hiking cycles seen in recent memory. The core tenets of our cautious stance are:

- The Australian consumer having built up significant leverage over a long period of time to support expensive housing;
- The Australian mortgage market being a floating rate market, therefore, any rise in rates immediately flows into household budgets;
- With the caveat that in this cycle, emergency monetary policy measures designed in response to COVID created a unique dynamic that resulted in a high amount of 3-year fixed rate mortgages being issued with the majority rolling onto current variable rates by the end of 2023 (fixed rate mortgage cliff);
- This in turn has forced the RBA to make policy decisions based on data that likely doesn't fully reflect the impact of rate rises already implemented, creating fertile ground for monetary policy to be tightened too far.

As it stands, by the end of 2023, at a headline level the Australian economy and more specifically the Australian consumer, has been successful in navigating a reduction in income typically only associated with recessions. Chart 2 below shows the annual growth in total disposable income and per capita income over the past 60 years, the current levels are analogous with the early 90s, mid 80s and mid 70s recessionary periods.

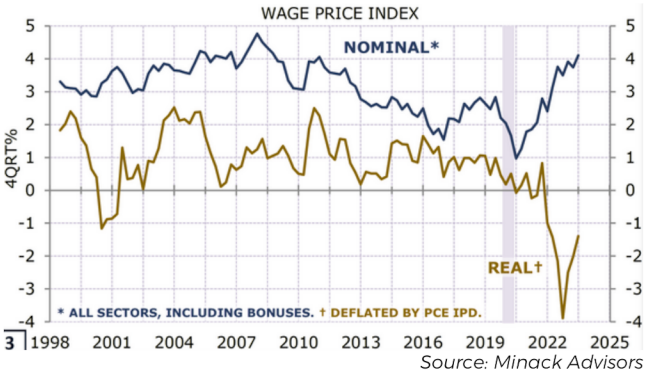
Chart 2



Source: Minack Advisors

Demonstrated from another angle (Chart 3), while on average Australians, over the past 18 months, have enjoyed nominal salary increases at levels not seen for over 10 years, when adjusted for inflation, most Australians have seen their wages go backwards.

Chart 3



Source: Minack Advisors

As the 2 charts above clearly demonstrate;

- Higher interest rates and inflation have impacted household income in a profound way; and
- The current setting of monetary policy is at a level that is restrictive.

As we think about what to expect over 2024, the core questions remain, why has the Australian economy been relatively resilient in an environment that typically cause recession? And are these factors sustainable?

We have discussed some of the potential mitigants to the negative impact to the economy from rate rises in previous reports, including:

- The fixed rate mortgage cliff – with the bulk of the fixed rate loans issued over 2020/2021 now expired and transitioned to the current level of interest rates, we anticipate that any residual impact from this dynamic will be at its largest in the first quarter of calendar year 2024;
- The excess savings hangover – On average, Australians were able to build up significant excess savings over the COVID lockdown years of 2020 and 2021 due to a combination of less opportunities to spend and fiscal/monetary support. To date, some of this savings buffer has already been exhausted but the collective decision by the average Australian as to whether they continue to use savings to support lifestyle or cut back spending will be crucial. If the majority decide to use savings to support their spending habits, it will likely push out the timing of any potential rate relief from the RBA;
- Elevated migration – post COVID lockdowns, Australia has elevated its migration intake over and above pre COVID levels with the aim of compensating for the lost years of 2020/2021. The benefit to GDP from the increase in population has helped mask the fall in per capita income and the influx of new people and the economic activity created to serve their needs provides a boost to aggregate growth.

In the work we undertake trying to understand the state of the domestic economy, our focus over the first half of 2024 will be monitoring the ongoing impact of restrictive monetary policy, the resilience of the Australian consumer and the direction of inflation.

How are we constructing portfolios?

Our portfolio construction process is designed to provide an outcome that represents a collection of the best risk-adjusted returning opportunities across our investment universe, while keeping overall risk levels consistent with our view of the economy.

We recognise that the reasons for our caution on the Australian economy have a natural expiry over 2024 as either our concerns are;

- Well founded, and the economy falls into recession and risk assets (including credit) reprice to reflect the deteriorating environment ("hard landing"); or
- The Australian economy is able navigate the transition to an environment of lower inflation without dramatically impacting growth ("soft landing") and leaving the RBA with scope to move monetary policy away from its current restrictive setting.

In both outcomes, the response as it pertains to portfolio construction is to add risk to either take advantage of better pricing or an improved environment.

Market Commentary

Alexander Funds

As a reminder, when we discuss risk, it covers several core varieties;

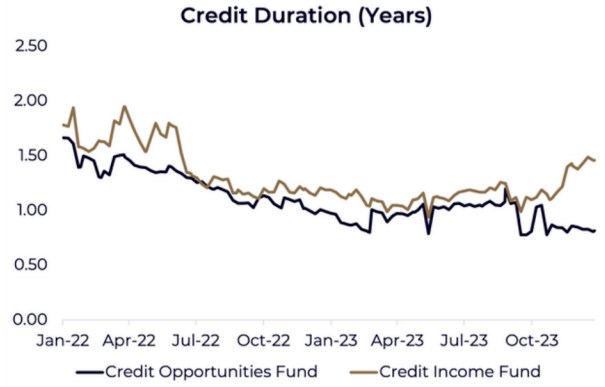
- Credit Risk – the risk that an individual investment doesn't meet its interest and principal commitments. The typical indicator of the level of credit risk within an individual security is its credit rating.
- Market Risk – the risk to the portfolio's capital value from a change in risk appetite (and thus credit spreads) for the entire market. The core indicator for the level of market risk within our portfolios is credit spread duration (Alexander Funds portfolios are purely floating rate and don't take direct exposure to changes in interest rates).
- Liquidity Risk – the risk that changes in the liquidity within the markets where we invest, leaves the portfolio unable to meet the liquidity requirement of our investors. We are acutely aware that we invest in markets with a variable liquidity function and that any robust portfolio construction process needs to have an assumption that liquidity within different markets can change quickly in the face of volatility.

Since early 2022, our skeptical view of the Australian economy and its ability to withstand the significant increase in interest rates required to tame inflation but avoid a recession has resulted in us:

- Favouring investments with higher credit rating (credit risk);
- Constructing portfolios to have shorter duration (market risk); and
- Carrying excess cash and highly liquid assets (liquidity risk)

As we move closer to a time when it is appropriate to increase risk, we have been selectively adding securities with additional credit and market risk where we are being adequately rewarded for the associated risk of investment through price. In addition, we have been utilising credit derivatives as a hedging tool to maintain our level of market risk (duration) at very conservative levels (Chart 4).

Chart 4



As we get more clarity on the Australian economy over 2024, either;

· A recession will push pricing wider across the credit market, with the hedging working as an offset to the impact on the capital value of the securities we hold, or

· The economy navigates a soft landing and we can remove the hedging having made meaningful inroads into repositioning the portfolio away from conservative positioning back towards levels we consider neutral.

In terms of liquidity risk, we retain a bias towards carrying excess cash and highly liquid assets.

Alexander Funds

Sector Performance & Fund Positioning

Debt Capital Markets

While credit was impacted by the increase in volatility during October, overall it was an outperformer versus other asset classes. As base rates have risen, credit spreads have been supported by a technical bid from investors due to the attractive all-in yield (i.e. base rates plus credit spread) on offer within credit markets.

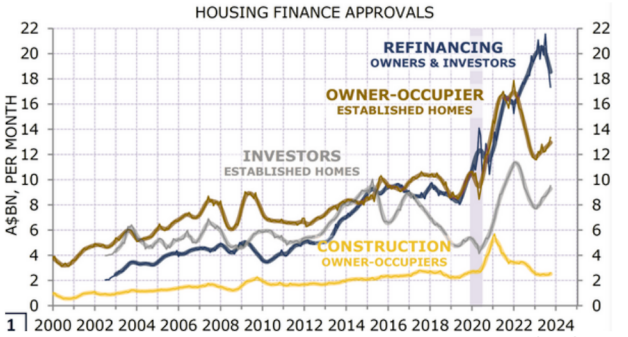
Once risk sentiment flipped in November to positive, despite not being as dramatically impacted by the selloff in September/October, credit still rallied strongly. In Australia, the credit market had the additional benefit of investors scrambling to put money to work before a Jan/Feb period that is traditionally characterised by lower levels of primary transactions.

Whilst issuance from the banks and financials was robust for most of 2023, the last quarter saw a meaningful pick up in issuance from the non-financial corporate sectors after being close to non-existent during 2022 and relatively slow through most of 2023. Highlights included new issues from Coles (7.6yr/10yr) and Woolworths (7.5yr) which were well supported by the market and enabled both deals to price at significant premium to similarly rated bonds issued by banks and financials. The better value on offer in financials meant that our funds were active participants within new issues in this segment, including Westpac's 15NC10 Tier 2 bond that was issued at a significant concession to secondary markets.

Structured Credit

A very active last quarter in primary markets saw total new issuance in the Australian securitisation market post its biggest year since the GFC. RMBS markets were slower in the first half as non-banks dealt with very aggressive competitive behavior from the major banks, who were focused on maintaining their book size in an environment of lower property sales volumes (as evidenced by house finance approvals - Chart 5). However, in the last quarter, an active primary market left issuance volumes up on 2022.

Chart 5



Source: Minack Advisors

Significant growth in ABS volumes was driven by exponential growth in issuance from the auto sector. The face of the domestic auto lending market has changed dramatically post the banking royal commission, with several large bank participants removing themselves from the market and leaving a large funding gap to be filled from the non-bank sector. As the non-bank presence in the auto market has grown, so has their need for funding, hence the large lift in ABS issuance in 2023 (Chart 6). This trend is secular and we expect auto ABS volumes to continue to grow over the next few years in line with the growth in market share of non-banks.

Our Funds were active across new issuance in both RMBS and ABS markets, where we were able to find value despite our cautious stance on the domestic economy.

Chart 6

$AUD (million)	2021	2022	2023
RMBS	39,131	35,142	37,118
CMBS	1,650	1,450	2,000
Other ABS	8,014	6,154	13,184
Total ABS	**48,794**	**42,746**	**52,304**

Source: ABS

Alexander Funds

Sector Performance & Fund Positioning

Private Assets

Our activity within Private Assets is exclusively focused on providing warehouse (private securitisation) funding capacity to the non-bank sector. This market remains prospective, although new transactions can have a long gestation period.

Within our existing holdings, we continue to see requests for additional limit as the non-bank market expands its presence in a variety of domestic lending markets. Our pipeline of new opportunities heads into 2024 in robust shape and we have several new transactions that are looking to close in Q1 24.

Fund Positioning & Activity

As discussed under portfolio construction, at a headline level, market risk (duration) remains very conservative in light of our ongoing concerns about the ability of the Australian consumer to manage the current interest rate cycle. However, we are slowly positioning the portfolios for an environment where we have more certainty on the direction of the domestic economy.

Over the next quarter, we expect to continue to add credit risk where we believe;

- The cashflows underpinning the investment have been thoroughly stress tested under a recessionary environment;
- The price being offered compensates us adequately for the credit risk of each security

Where appropriate, we'll use credit derivatives to hedge additional market risk that comes with buying these securities with the aim of removing the hedges as we get more clarity on the state of the economy over the next 3-6 months.

Fund Perfomance

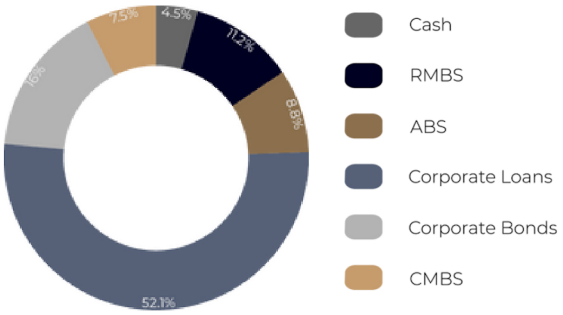
Alexander Funds

Credit Opportunities Fund

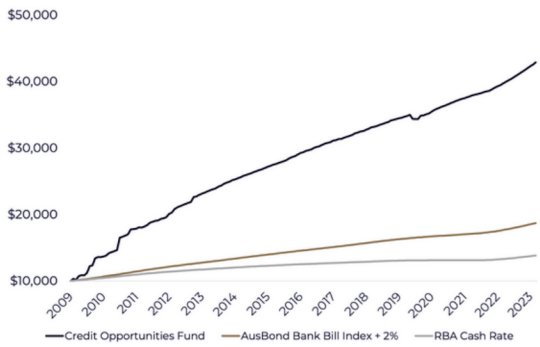
The Alexander Credit Opportunities Fund has a benchmark of the AusBond Bank Bill Index +2% pa. The Fund achieved a net return of 2.10% for the quarter ended 31 December 2023 for an annualised net return over the previous 12 months of 8.05%, and paid a distribution for the quarter of 2 cents per unit.

	Fund	Benchmark
1 Month*	0.74%	0.56%
3 Month	2.10%	1.59%
6 Month	4.15%	3.20%
12 Month	8.05%	6.00%
3 Year (pa)	6.08%	3.77%
5 Year (pa)	5.31%	3.45%
Since Inception (pa)	10.82%	4.52%

Portfolio˜ as at 31 December 2023



Performance of $10k Invested Since Inception^

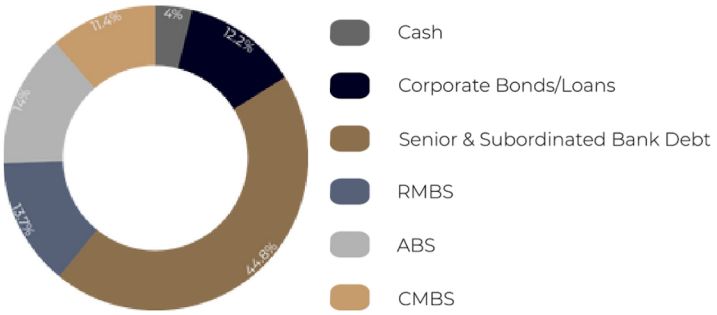


Credit Income Fund

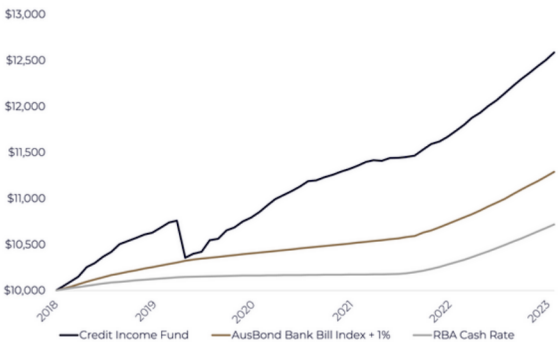
The Alexander Credit Income Fund has a benchmark of the AusBond Bank Bill Index + 1% pa. The Fund achieved a net return of 1.88% for the quarter ended 31 December 2023 for an annualised net return over the previous 12 months of 7.26%, and paid a distribution for the quarter of 1.37 cents per unit.

	Fund	Benchmark
1 Month*	0.66%	0.48%
3 Month	1.88%	1.34%
6 Month	3.67%	2.69%
12 Month	7.26%	4.95%
3 Year (pa)	5.07%	2.74%
5 Year (pa)	4.62%	2.42%
Since Inception (pa)	4.63%	2.42%

Portfolio˜ as at 31 December 2023



Performance of $10k Invested Since Inception^



Alexander Funds

Notices & Disclaimers

* The monthly return is an actual return net of all fees, costs and taxes generated by dividing the redemption unit price by the previous month's redemption unit price. Past performance is not a reliable indicator of future performance. All return figures for periods greater than 12 months are annualised.
~ Portfolio Composition is net of hedges
^ Assumes reinvestment of all distributions

Alexander Funds Management Pty Ltd (ABN 77 136 871 924) (AFSL 476697) ("Alexander Funds") is the Investment Manager of the Alexander Credit Opportunities Fund (ARSN 156 026 514) ("ACOF" or "Fund") and the Alexander Credit Income Fund (ARSN 629 915 199) ("ACIF" or "Fund"). Equity Trustees Limited ('Equity Trustees) (ABN 46 004 031 298) AFSL 240975 is the Responsible Entity for the Fund. Equity Trustees is a subsidiary of EQT Holdings Limited ABN 22 607 797 615, a publicly listed company on the Australian Securities Exchange (ASX: EQT).

This publication is general information only. It is not intended to take the place of independent professional advice and you should consider the appropriateness of this general information in light of your own financial situation, objectives and needs before making a decision on how to proceed. Neither Alexander Funds, Equity Trustees nor any of its related parties, their employees or directors, provide and warranty of accuracy or reliability in relation to such information or accepts any liability to any person who relies on it. Past performance should not be taken as a reliable indicator of future performance. You should obtain a copy of the Product Disclosure Statement (PDS) and Target Market Determination (TMD) before making a decision about whether to invest in this product, which may obtained from www.eqt.com.au/insto

ACIF's PDS and TMD can also be found at
https://www.alexanderfunds.com.au/alexander-credit-income-fund
ACOF's PDS and TMD can also be found at
https://www.alexanderfunds.com.au/alexander-credit-opportunities-fund

A Target Market Determination is a document which is required to be made available from 5 October 2021. We recommend that you read this document as it describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

Any reproduction of these materials, in whole or in part, without the prior consent of Alexander Funds is prohibited. All information contained herein is confidential and proprietary to Alexander Funds. Nothing in this document should be construed as Alexander Funds providing an opinion, statement or research dealing with the creditworthiness of a body or the ability of an issuer of a financial product to meet its obligation under the product; nor should it be treated as "credit service" under the National Consumer Credit Protection Act 2009 (Cth).

This document is not, and is not intended to be, an offer or invitation for subscription or sale, or a recommendation, with respect to any securities, including to any jurisdiction outside Australia where it would be unlawful to make such an offer, invitation or recommendation, nor is it to form the basis of any contract or commitment.

Alexander
Funds

www.alexanderfunds.com.au
1300 138 401
info@alexanderfunds.com.au
AFSL 476697