Spectrum Asset Management

Fact Sheet

September 2018

Spectrum Strategic Income Fund – Fact Sheet – 30 September 2018

Investment Objective	The Fund aims to generate higher returns than the RBA Cash Rate over the short to medium term with lower volatility than equities.
Investments held	The Fund holds a diversified portfolio of debt and income securities with a view to minimising any loss of income and capital of the Fund. Issuers may be government bodies, banks, corporations and, to a limited extent, specialist financing vehicles. To maintain a diversified portfolio structure, certain limits are imposed on security type, credit risk, industry and issuers.
Investment Manager	Spectrum Asset Management Limited
APIR	ETL0072AU
Commencement	31 May 2009
Fund Size	$66.9m

Management costs[1]	0.75% p.a.	Buy Spread	+0.15%
Minimum initial investment	$5,000	Sell Spread	-0.15%

Unit Prices	Purchase	Net Asset Value	Withdrawal
30/9/2018	$1.0778	$1.0762	$1.0745

Performance as at 30/9/2018*	1 mth %	3 Mths %	6 Mths %	1 Yr %	3 Yr % p.a.	Inception % p.a.
Total Net Return[2]	0.26%	1.18%	2.04%	4.04%	4.76%	9.34%
Average RBA Cash Rate	0.125%	0.38%	0.75%	1.50%	1.62%	2.53%

**Past performance is not an indicator of future performance.*

Income distributions	31/12/2017	31/03/2018	30/06/2018	30/09/2018
Distribution rate (cents per unit)	0.5631	0.6399	0.7303	0.4500

[1] Includes estimated GST payable, after taking into account Reduced Input Tax Credits ("RITC").

[2] Total Net Return is the Fund return after the deduction of ongoing fees and expenses assuming the reinvestment of all distributions.

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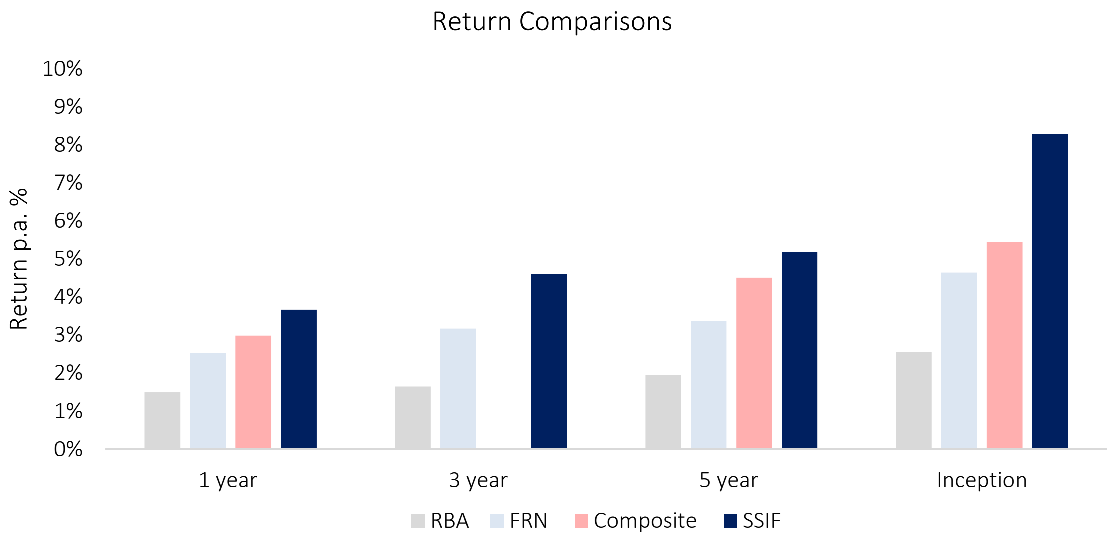

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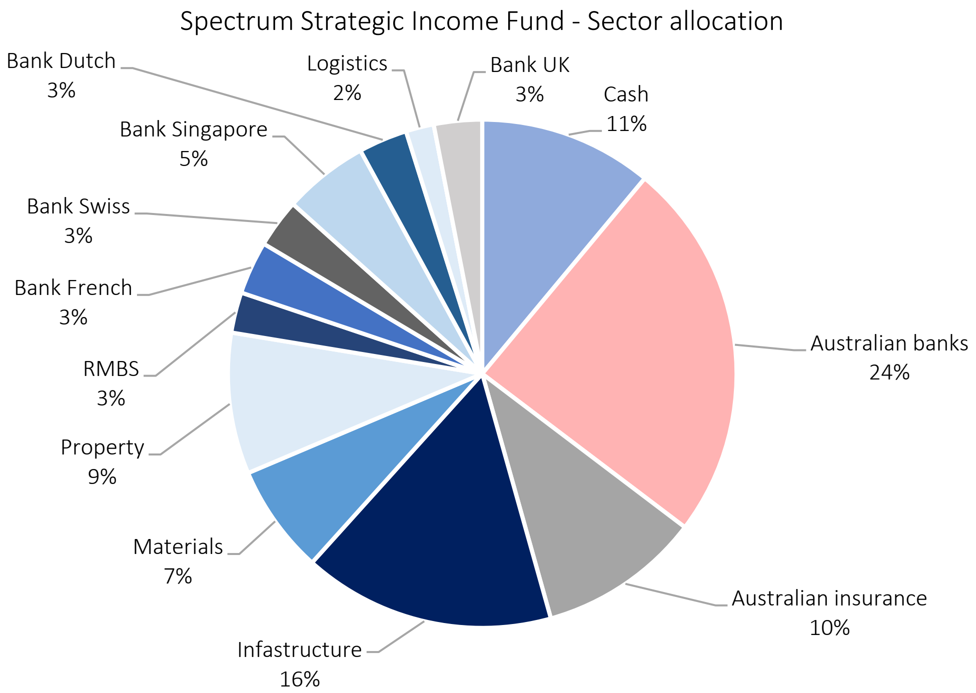
SSIF = Spectrum Strategic Income Fund.
Composite = The Bloomberg Composite Index.
FRN = The Bloomberg FRN Index.
RBA = RBA Cash Rate.



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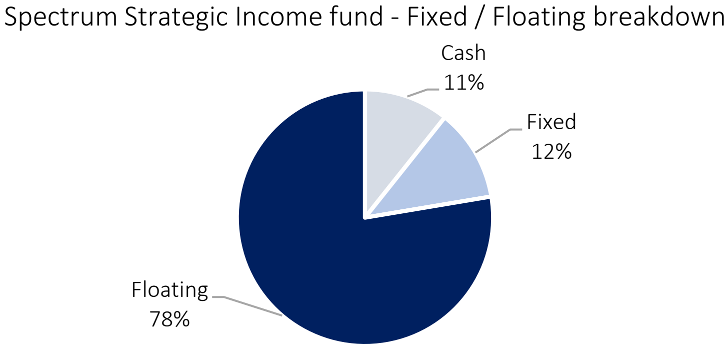

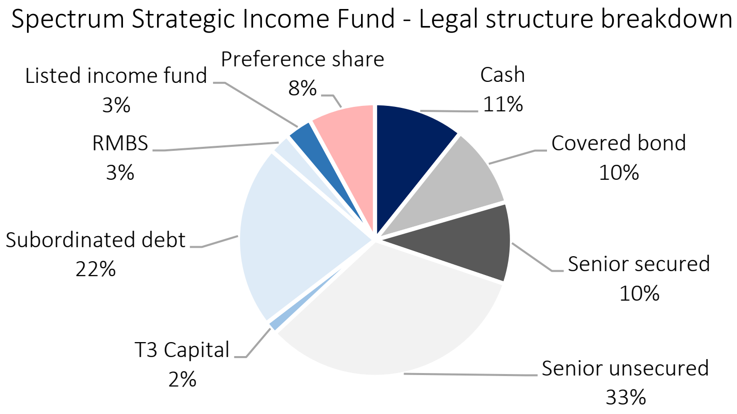

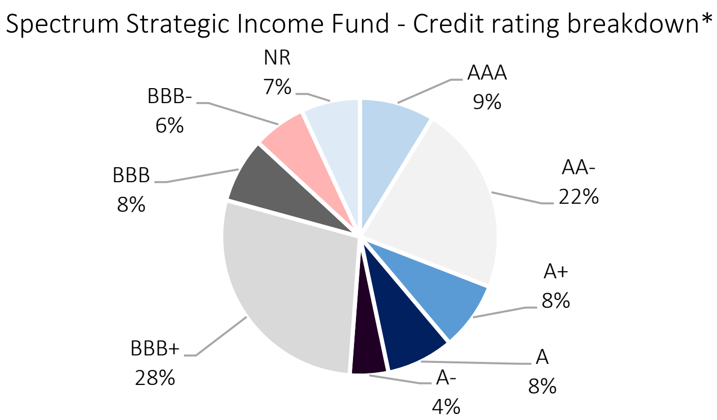

**Spectrum utilises a linear credit rating methodology which incorporates the lower of the two credit ratings from S&P and Moodys. For investments which do not carry a credit rating, the investment is deemed as not rated. As at the 30th of September 2018, 93% of the portfolio has an official credit rating from one (or both) of these agencies. Cash is rated 'AA-' to reflect the credit ratings of where the cash accounts are held. The portfolio has an average linear credit rating of 'A'.*

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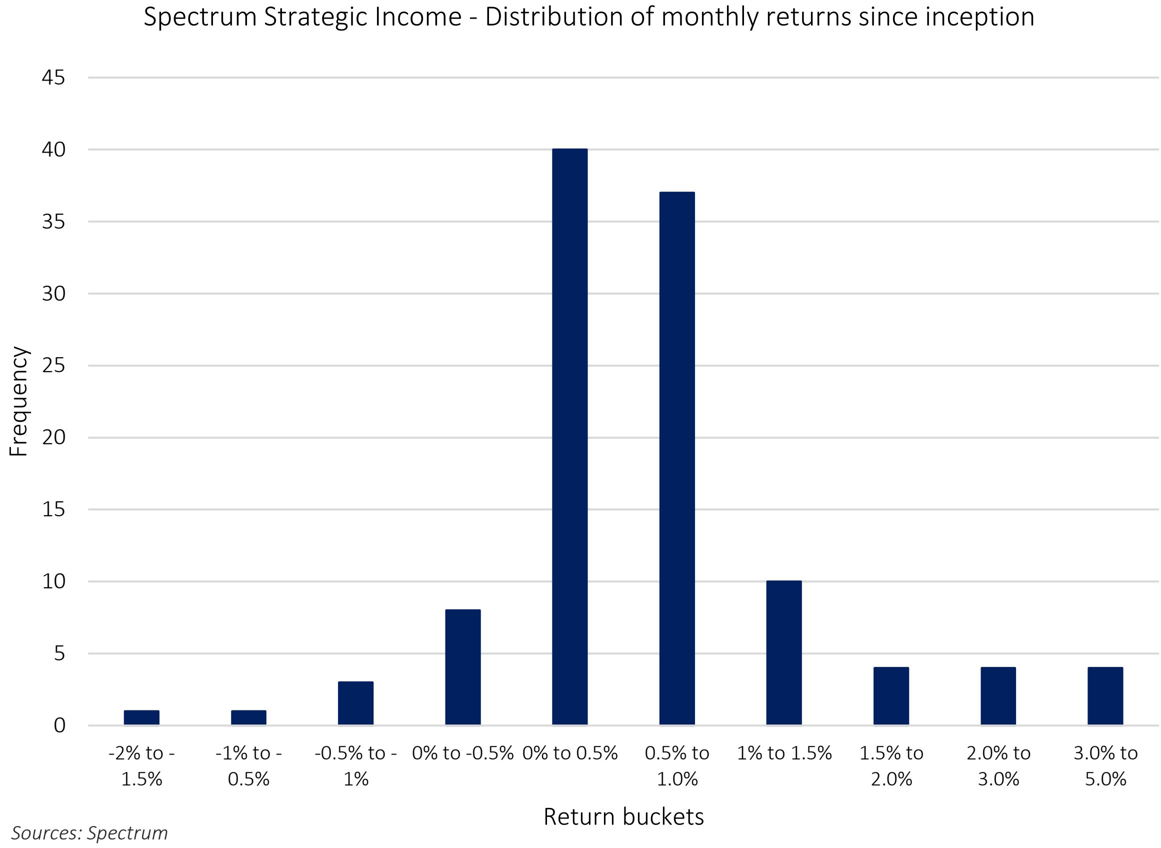
This report was prepared by Spectrum Asset Management Limited (Spectrum) (ABN 31 096 442 198, AFSL 225069) as investment manager for the Spectrum Strategic Income Fund (Fund). Equity Trustees Limited (ABN 46 004 031 298, AFSL 240975), a subsidiary of EQT Holdings Limited (ABN 22 607 797 615), a publicly listed company on the Australian Securities Exchange (ASX: EQT), is the Responsible Entity of the Fund. This document has been prepared for the purpose of providing general information only, and not taken into account the investment objectives, financial situation and particular needs of any particular person. Before making an investment decision an investor needs to consider, with or without the assistance of an advisor, whether the advice is appropriate in the light of particular investment needs, objectives and financial circumstances of the investor. Past performance is not a reliable indicator of future performance. Investment returns cannot be guaranteed. In deciding whether to acquire, or to continue to hold, units in the Fund please read the current Product Disclosure Statement (PDS) available from Spectrum of Equity Trustees. The information contained in this report has been obtained from sources believed to be reliable. Neither Spectrum, Equity Trustees Ltd, nor any of its related parties, its directors or employees, provide warranty of accuracy or reliability in relation to information on this publication or accepts liability to any person who relies on it. This Fact Sheet reflects the information available as at the date this Fact Sheet and is subject to change without notice to the recipient.



Sources: Spectrum
Returns are on a monthly basis.
Returns in bucket of 50bp range.
Each bucket contains the number of results in each band.
**Past performance is not an indicator of future performance.*

	Fund statistics
Correlation to Bloomberg FRN Index	37%
Correlation to Bloomberg Composite Index	2%
Tracking error to Bloomberg FRN Index	1.8%
Proportion of positive Fund returns %	88%
Proportion of negative Fund returns %	12%
Number of consecutive positive returns	34 months
Largest drawdown %	-1.6%
Time to recovery from largest drawdown	2 Months
Average drawdown %	-0.2%

Source: Spectrum

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Top ten holdings:

	Holding %
CASH	10.7%
NATIONAL AUSTRALIA BANK	4.7%
SUNCORP METWAY LTD	4.5%
TOYOTA FINANCE AUSTRALIA	4.5%
AUSGRID FINANCE	4.5%
NETWORK FINANCE	4.5%
AAI LTD	4.4%
MULTIPLEX SITES	3.2%
APN REGIONAL PROPERTY FUND	3.2%
VERIZON COMMUNICATIONS	3.0%

Commentary:

The Fund has produced 34 consecutive positive monthly returns.

September was a month where sabres over trade were rattled between the U.S. and China. In the real economy we note shipping rates for capsize vessels plummeted by some 39%. The JP Morgan Global Manufacturing PMI also posted a 22-month low.

For financial markets trade dominated the month and risk was applied, reduced and apportioned according to the riskiness of an escalation in the trade dispute.

During September we saw a blowout in U.S. treasury yields as risks eased a little and then the market started to focus on inflation and a ballooning deficit which has to be financed.

Concerns are mounting over U.S household data that showed that the bottom 60% of income earners are driving spending, however, their finances are deteriorating. Normally it's the top 30% of earners that drive spending.

Signs of financial stress are rising despite what appears to be a robust economy with strong jobs growth. The main takeaway is that there are signs of growing financial fragility and increasing use of credit card debt and, as a consequence, increasing credit card delinquencies. Savings are evaporating.

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Meanwhile U.S equity prices continue to improve. The tax dividend is paying off, however, much of the dividend is being spent on buybacks and dividends with little going into capex. In fact, the largest two investors in capex are the oil drillers and the technology companies. And interestingly both of these sectors are providing large gains to the S&P 500.

The bond market in the U.S. is interesting. Every time that the market weakens, investors pile in and this is having the absurd effect of flattening the yield curve. This is made even more interesting by the record number of shorts on the futures market. Some of the shorts are as a result of investor and bank hedging and some are actually betting against interest rates falling.

Over the month the Fed tightened 25bp and there is an air of expectation that the Fed will tighten again in December.

One should also be cognisant of the trade dispute between China and the U.S for monitoring bond yields. When it appears as though an agreement may be reached the bonds sell off and when talk of a trade war is made, bonds rally. It's very much a binary trade.

The markets appear somewhat confused. The outlook for the U.S is positive, well at least into 2019 however 2020 appears to be the year many economists have the U.S. economy turns. Some 41% of business economists see downside risks due to trade policy whilst 18% see interest rate hikes as reason for the U.S. to slip into recession.

As we head towards the U.S mid-term elections the consensus expectation is that the Democrats will control the Congress and the GOP will control the Senate.   However, as we know, not all goes to plan. Should the Republicans hold Congress expect a significant upswing in U.S. equities and a strengthening U.S. dollar. If the Democrats win the Congress the odds are that we would see a mild retracement in equities and the dollar whilst bond yields could fall up to 15bps. Trump would then be operating in what could be seen as an unsympathetic or hostile political environment.

Back home the RBA maintained the cash rate at 1.5% - a rate it set in August 2016 and has now gone 26 months without hiking rates. Given the current economic environment the RBA may feel well satisfied with its performance. The economy is solid, and credit is slowly tightening as a consequence of tighter lending standards and central banks globally moving to a tightening phase rather than an easing phase.

Domestically this has meant that home lending has fallen and so too housing prices which has come as some relief to first home entrants. Structurally this is leading to some concern over ongoing bank profitability as more borrowers, in particular some investors, become stressed. The outlook is for the housing market to retrace further.

The cost of borrowing for the banks to fund their mortgage book is also climbing and it is inevitable that the banks will continue to raise mortgage rates, irrespective of what the RBA does.

A key source of bank funding is local and offshore bond markets. Yields there have moved up significantly over the past few months. For example, the 5-year bond in the U.S. has risen 20bps in yield since June 30, and the 5-year is the main maturity that the Australian banks use to fund their mortgage books.

Meanwhile the Australian dollar is falling against the U.S dollar. This is partly in response to the widening differential between U.S. rates and Australian rates. With the Fed locked into a tightening phase and the RBA consolidating, this gap will only widen. As the gap widens the Australian dollar may get weaker.

For the Australian economy it may be important for the RBA to hold rates and allow the economy to grow. Inflation, however, may become a problem with a weaker currency.

The month of September saw $7.9 bio of issuance across 17 transactions and was the most for the month of September since September 2009.

During September some of the more notable issues are below: -

- Liberty 2018-3 issued $500m
- Svenska Handelsbanken issued 5-year floaters and fixed rate securities.
- FIRSTMAC Limited
- AT&T issued a multi-tranche transaction across 5, 7 and 10-year maturities.
- Societe Generale issued a 5-year and a 10-year non-preferred fixed rate issue.
- GPT issued a 6-year fixed rate note.
- Toronto Dominion issued a 3-year Kangaroo issue.
- MUFG issued a 3-year FRN.