Investment Report

January 2023

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Executive Summary

Compliance

Compliance Measure	Within Policy Limits (Y/N)	Reason if Not Compliant
Term to Maturity	Yes – Compliant	n/a
Counterparty	Yes – Compliant	n/a
Credit Quality	Yes – Compliant	n/a

Performance

As at 31/01/2023	1m (actual)	1m (% p.a.)	FYTD (actual)	FYTD (% p.a.)
AusBond Bank Bill Index	0.27%	3.18%	1.44%	2.46%
Council's Portfolio^	**0.18%**	**2.11%**	**1.11%**	**1.90%**
Relative Performance	-0.09%	-1.07%	-0.33%	-0.56%

^Total portfolio performance excludes Council's cash account holdings.

Market Update Summary

Risk markets were aided in January as recent data indicated there were signs the global economy may be weathering inflation better than previously anticipated. Several global central banks also hinted they may pause their aggressive rate hike cycles in the near future.

Domestically, the labour market remains tight, but timely indicators of labour demand are off their peaks as labour supply has normalised and frictions associated with rapid employment growth out of pandemic impacts moderate. Although labour costs pressures are evident in the latest CPI figures for Q4 2022, there are reasons to be optimistic that some stabilisation in wages growth can occur without a sharply higher unemployment rate, including the normalisation in labour supply. For now, the RBA continues to signal that it expects to increase interest rates further over the period ahead, with up to 2-3 hikes already largely priced into the market by Q2-Q3 2023, taking the cash rate up to 3¾%. Thereafter, noting the lags in monetary policy, a pause around the end of Q2-Q3 is likely whilst the RBA monitors the economic data.

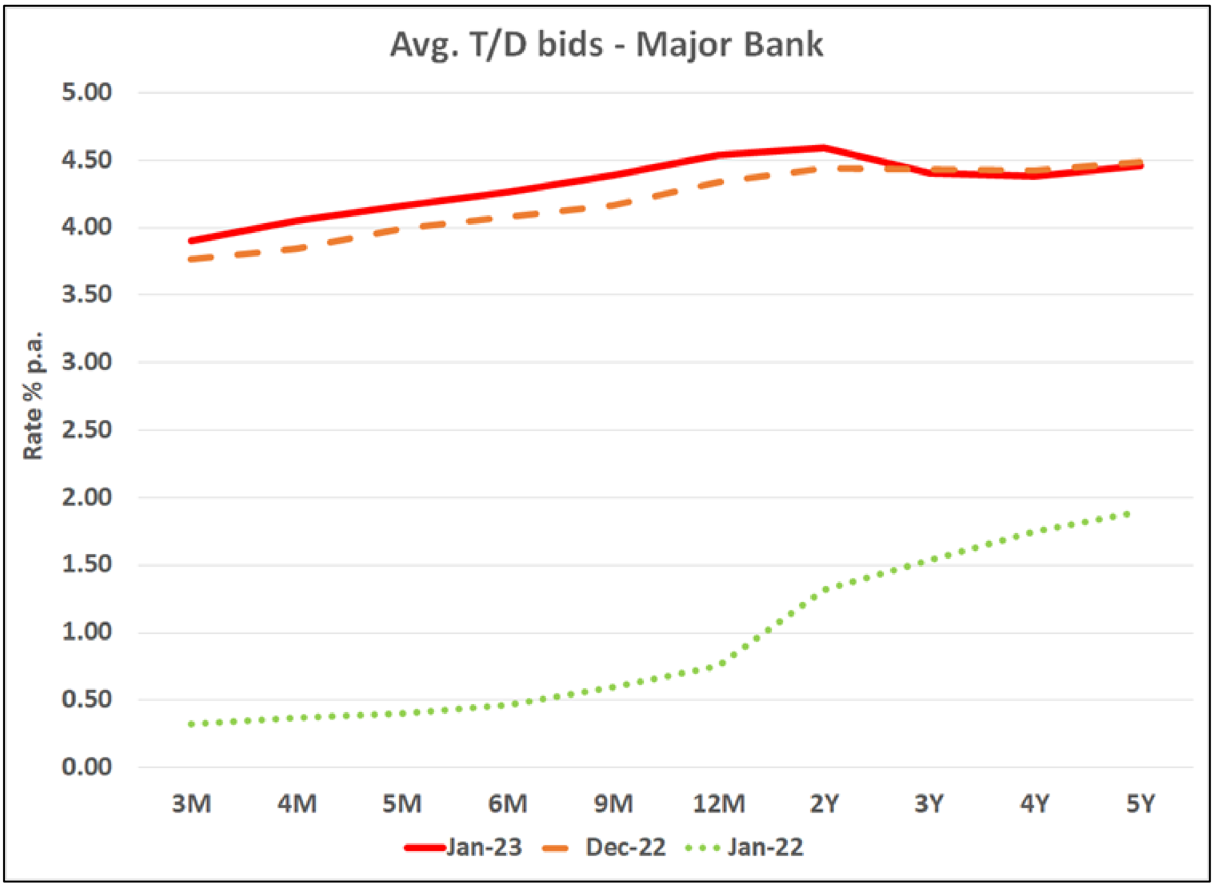
The biggest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits, which accounts for around ~89½% of Council's total investment, and cash (~5% of the total investment portfolio).

Council's term deposit portfolio was yielding 2.08% p.a. as at 31/01/2023, with a weighted average duration of around 592 days or ~1.60 years. We note the current interest rates in the term deposit market:

- The highest deposit rate from any rated ADI in the market is now ~4.80% p.a. for 5 years;
- The highest deposit rates amongst the "AA-" rated ADIs (major banks) is now yielding between 4.50%-4.60% p.a. (depending on terms between 12m – 5 years);
- The highest deposit rates amongst the "A" rated ADIs was yielding between 4.50%-4.80% p.a. (depending on terms between 12m – 5 years);

- The highest deposit rates amongst the "BBB" rated ADIs was yielding between 4.50%-4.75% p.a. (depending on terms between 12m – 5 years).

The deposit market has largely already factored in the current rate hike cycle, reflected by the flattening of the curve over the past few months, particularly at the long end of the curve (+2yrs). Interestingly, amongst the major banks, 2-5 year deposit rates are now being offered slightly below 12 month rates:



Source: Imperium Markets

'New' investments above 4¼-4½% p.a. now appears likely if Council can continue to place the majority of its surplus funds for terms of 12 months to 2 years. *With recessionary fears being priced in coming years, investors may take an insurance policy by investing across 3-5 year fixed deposits and locking in rates above 4½% p.a. (small allocation only).*

Council's Portfolio

Asset Allocation

The portfolio is predominately directed to fixed term deposits (89.53%). The remainder of the portfolio is directed to fixed bonds with the Northern Territory Treasury Corporation (4.81%), the overnight cash account with Westpac (4.94%) and the single FRN with Bendigo-Adelaide (0.72%).

Senior FRNs are now becoming more attractive as spreads have widened over the past year – new issuances should now be considered again on a case by case scenario. In the interim, fixed deposits for 12 months to 3 years appear quite appealing following the spike in medium-to longer-term yields during the rate hike cycle. With recessionary fears being priced in coming years, those investors that can allocate longer-term surplus funds may take an insurance policy by investing across 3-5 year fixed deposits, locking in and targeting yields above 4½% p.a.

Term to Maturity

All maturity limits (minimum and maximum) comply with the Investment Policy. Short-Medium Term (1-3 years) assets account for around 50% of the total investment portfolio, with capacity of around $83m remaining. Future investments should be directed to the 1-3 year horizon as this is where we currently see the best value.

Where there is (counterparty) capacity to invest in attractive 1-3 year investments, we recommend this be allocated to new any remaining attractive fixed term deposits (refer to respective sections below).

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 365 days	$152,065,878	36.55%	0%	100%	$264,004,330
✓	1 - 3 years	$208,004,330	49.99%	0%	70%	$83,244,816
✓	3 - 5.5 years	$56,000,000	13.46%	0%	40%	$110,428,083
✓	5.5 - 10 years	$0	0.00%	0%	10%	$41,607,021
		$416,070,208	**100.00%**			

Counterparty

As at January 2023, Council did not have an overweight position to any single ADI. Overall, the portfolio is diversified across the investment grade credit spectrum (rated BBB- or higher).

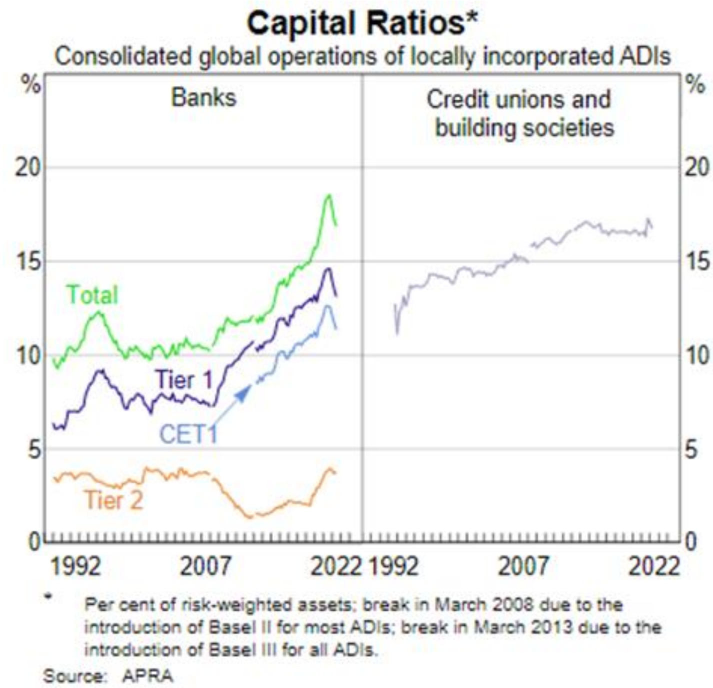
Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	NAB	AA-	$66,000,000	15.86%	30.00%	$58,821,062
✓	North. Territory	AA-	$20,000,000	4.81%	30.00%	$104,821,062
✓	Westpac	AA-	$93,565,878	22.49%	30.00%	$31,255,184
✓	ICBC Sydney	A	$72,000,000	17.30%	20.00%	$11,214,042
✓	ING Bank	A	$47,500,000	11.42%	20.00%	$35,714,042
✓	Aust. Military	BBB+	$3,000,000	0.72%	10.00%	$38,607,021
✓	Australian Unity	BBB+	$5,000,000	1.20%	10.00%	$36,607,021
✓	BOQ	BBB+	$38,000,000	9.13%	10.00%	$3,607,021
✓	Bendigo- Adelaide	BBB+	$3,004,330	0.72%	10.00%	$38,602,691
✓	AMP Bank	BBB	$8,000,000	1.92%	10.00%	$33,607,021
✓	Auswide Bank	BBB	$3,000,000	0.72%	10.00%	$38,607,021
✓	MyState Bank	BBB	$18,000,000	4.33%	10.00%	$23,607,021
✓	P&N Bank	BBB	$39,000,000	9.37%	10.00%	$2,607,021
			$416,070,208	**100.00%**		

We remain supportive of the regional and unrated ADI sector (and have been even throughout the post-GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 25-40% more capital than the domestic major banks, and well above the Basel III requirements.

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). APRA's outgoing Chair Wayne Byres recently noted that the Common Equity Tier 1 capital of Australian banks now exceeds a quarter of a trillion dollars. It has increased by $110 billion, or more than 70%, over the past eight years. Over the same time, banks' assets have grown by 44%. Some of the extra capital is supporting growth in the banking system itself but clearly, there has been a strengthening in overall resilience and leverage in the system is lower.

We believe that deposit investments with the lower rated ADIs should be considered going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities are generally deemed to be the more 'ethical' ADIs compared to the higher rated ADIs.

In the current environment of high regulation and scrutiny, all domestic (and international) ADIs continue to carry high levels of capital. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC and the pandemic period. **APRA's mandate is to "*protect depositors*" and provide "*financial stability*".**



Fossil Fuel Investments

What is Council's current exposure to institutions that fund fossil fuels?

Using the following link http://www.marketforces.org.au/banks/compare, based on the Council's investment portfolio balance as at 31/01/2023 ($416.07m), we can roughly estimate that ~66% of the investments have some form of exposure.

Transition to investments without major exposure to fossil fuels

Council has not made a decision to divest from the current portfolio of investments which have exposure to fossil fuels. To do so would have unfavourable implications to the credit quality, rating and interest income forecasts.

However, where possible, and within the ministerial and policy guidelines, Council will continue to favour newly issued fossil fuel free investment products, providing it does not compromise the risk and return profile.

In time it is Councils intention to move to a more balanced portfolio which has less exposure to fossil fuels, providing it is prudent to do so.

What would be implications on our portfolio credit rating?

By adopting a free fossil fuel policy or an active divestment strategy, this would eliminate the major banks rated "AA-" as well as some other "A" rated banks (e.g. Macquarie and ING). Council would be left with a smaller sub-sector of banks to choose to invest with.

What would be risks and implications on Council's portfolio performance?

Some implications include:

- High concentration risk – limiting Council to a selected number of banks;
- Increased credit/counterparty risk;
- May lead to a reduction in performance (e.g. most of the senior FRN issuances are with the higher rated ADIs);
- Underperformance compared to other Councils which could result in a significant loss of income generated – could be in excess of hundreds of thousands or millions of dollars per annum.

It may actually be contrary to Council's primary objective to preserve capital as the investment portfolio's risk would increase (all things being equal). Council may not be maximising its returns – this is one of the primary objectives written in the Investment Policy.

Council's exposure is summarised as follows:

Counterparty	Credit Rating	Funding Fossil Fuel
NAB	AA-	Yes
NTTC	AA-	Yes
WBC	AA-	Yes
ICBC, Sydney	A	Yes
ING Bank Australia	A	Yes
Australian Military	BBB+	No
Australian Unity	BBB+	No
BoQ	BBB+	Yes
Bendigo-Adelaide	BBB+	No
AMP	BBB	Yes
Auswide	BBB	No
MyState Bank	BBB	No
P&N Bank	BBB	No

Source: https://www.marketforces.org.au/info/compare-bank-table/

Funding Fossil Fuel	Amount	Invested %	Wgt. Avg. Yield % p.a.
Yes	$345,065,878	83%	1.92%
No	$71,004,330	17%	2.89%
Total / Wgt. Avg.	**$416,070,208**	**100%**	**2.09%**

T/D Rates Before & After COVID

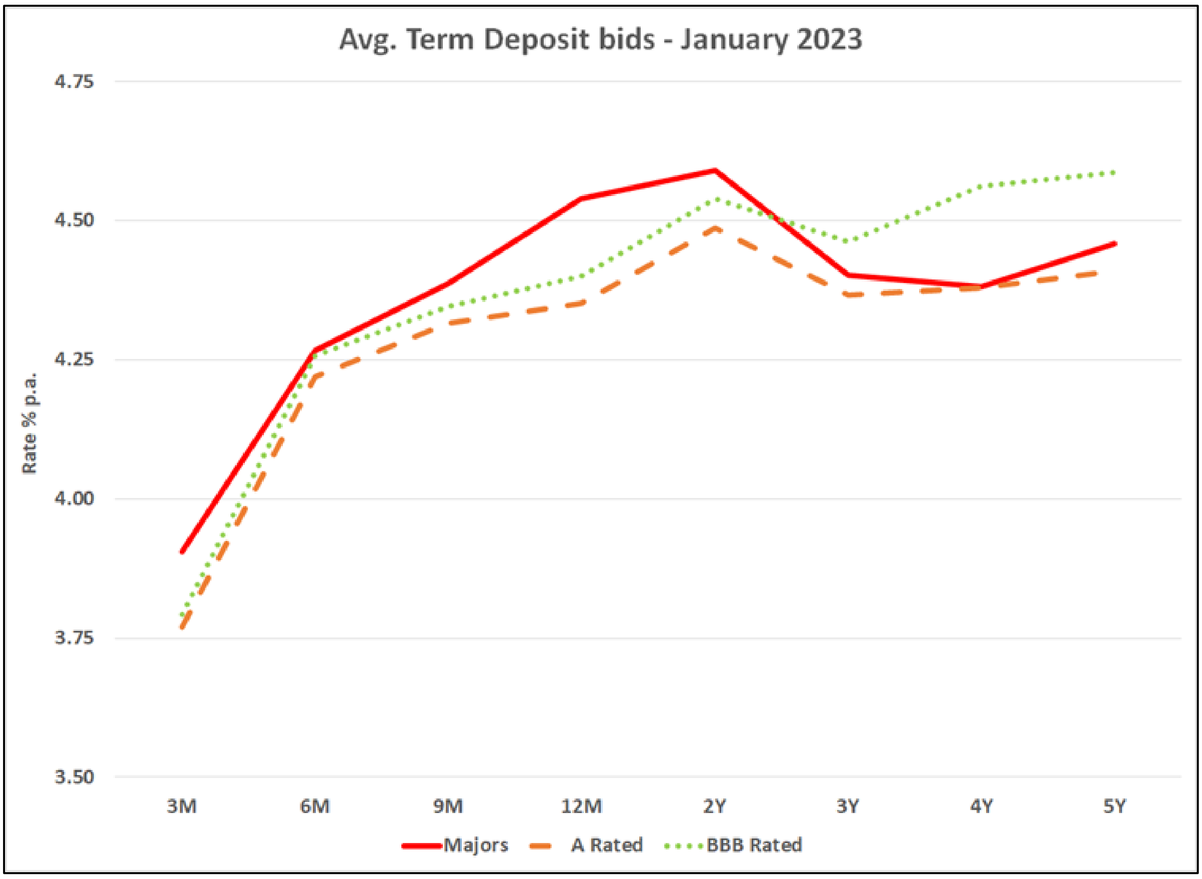
Pre-pandemic (March 2020), a 'normal' marketplace meant the lower rated ADIs (i.e. BBB category) were offering higher rates on term deposits compared to the higher rated ADIs (i.e. A or AA rated). But due to the cheap funding available provided by the RBA via their Term Funding Facility (TFF) since mid-2020[1], allowing the ADIs to borrow as low as 0.10% p.a. fixed for 3 years, those lower rated ADIs (BBB rated) did not require deposit funding from the wholesale deposit from the likes of PMHC. Given the higher rated banks had more capacity to lend (as they have a greater pool of mortgage borrowers), they subsequently were offering relatively attractive deposit rates. In fact, some of the lower rated banks were not even offering deposit rates at all. This is why PMHC has invested a higher proportion of deposit investments with the higher rated (A or AA) banks over the past ~3 years.

Prior to the pandemic, PMHC locked in higher yields with the BBB rated banks given they were generally offering higher rates than the higher rated banks (a 'normal' market). This is also the reason why the BBB category's current yield is still higher than the higher rated banks - it is largely driven by the investments placed prior to the pandemic.

In the interim, the 'abnormal' marketplace still largely exists, with the higher rated banks (majors) often paying a higher rate of return over the lower rated institutions across various parts of the curve on any particular day.

Over the next few years, with the RBA now removing these cheap borrowing facilities, this should result in some of the lower rated banks (BBB rated) starting to become more competitive as the market starts to 'normalise'. PMHC should have a larger opportunity to invest a higher proportion of its surplus funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry. We are slowly seeing this trend emerge, as has been the case in recent months:

[1] The RBA's Term Funding Facility (TFF) allowed the ADI to borrow as low as 0.10% fixed for 3 years: https://www.rba.gov.au/mkt-operations/term-funding-facility/overview.html



Source: Imperium Markets

Credit Quality

The portfolio remains diversified from a credit ratings perspective. The portfolio is mainly directed to the investment grade ADIs (BBB- or higher). There is high capacity to invest in the higher rated ADIs (A or higher), particularly after the downgrades of BoQ and Bendigo-Adelaide Bank in May 2017.

There is currently sufficient capacity to invest with the “BBB” rated ADIs (~$28m remaining as at the reporting date). From a ratings perspective, the “BBB” rated banks now generally dominate the number of ADIs issuing deposits within the investment grade space. There has been further signs of appetite developing in the wholesale deposit market as additional lower rated (“BBB” and unrated) ADIs have come to market to raise ‘new’ money.

Over the coming year, we may start to see a more ‘normalised’ environment where the lower rated banks start to offer higher rates compared to the higher rated banks as the competition for deposits grow. As more of these banks become more competitive for funds, Council may look to allocate additional funds amongst this sector, particularly with those ADIs that are not lending to the Fossil Fuel industry i.e. the more ‘ethical’ banks.

If there are any attractive deposits being offered in the “BBB” rated sector (outside of BoQ, which Council is close to maximum limits), we will inform Council to take advantage and invest accordingly.

All ratings categories are within the current Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$179,565,878	43.16%	100%	$236,504,330
✓	A Category	$119,500,000	28.72%	60%	$130,142,125
✓	BBB Category	$117,004,330	28.12%	35%	$28,620,243
✓	Unrated ADIs	$0	0.00%	5%	$20,803,510
		$416,070,208	**100.00%**		

Performance

Council's performance for the period ending January 2023 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.26%	0.75%	1.32%	1.44%	1.56%	0.83%	0.64%
AusBond Bank Bill Index	0.27%	0.77%	1.31%	1.44%	1.52%	0.77%	0.61%
Council's T/D Portfolio	0.18%	0.52%	0.98%	1.12%	1.75%	1.74%	1.94%
Council's FRN Portfolio	0.35%	1.01%	2.03%	2.37%	4.04%	2.51%	2.09%
Council's Bond Portfolio	0.10%	0.30%	0.61%	0.71%	1.20%	-	-
Council's Portfolio^	**0.18%**	**0.51%**	**0.97%**	**1.11%**	**1.74%**	**1.72%**	**1.93%**
Outperformance	**-0.09%**	**-0.25%**	**-0.35%**	**-0.33%**	**0.22%**	**0.95%**	**1.32%**

^Total portfolio performance excludes Council's cash account holdings. Overall returns would be lower if cash was included.

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	3.10%	3.02%	2.64%	2.45%	1.56%	0.83%	0.64%
AusBond Bank Bill Index	3.18%	3.08%	2.63%	2.46%	1.52%	0.77%	0.61%
Council's T/D Portfolio	2.14%	2.07%	1.95%	1.92%	1.75%	1.74%	1.94%
Council's FRN Portfolio	4.17%	4.08%	4.06%	4.06%	4.04%	2.51%	2.09%
Council's Bond Portfolio	1.24%	1.21%	1.21%	1.21%	1.20%	-	-
Council's Portfolio^	**2.11%**	**2.05%**	**1.93%**	**1.90%**	**1.74%**	**1.72%**	**1.93%**
Outperformance	**-1.07%**	**-1.03%**	**-0.70%**	**-0.56%**	**0.22%**	**0.95%**	**1.32%**

^Total portfolio performance excludes Council's cash account holdings. Overall returns would be lower if cash was included.

For the month ending January 2023, the total portfolio (excluding cash) provided a solid return of +0.18% (actual) or +2.11% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.27% (actual) or +3.18% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be temporary. Council should also remind itself it has consistently 'outperformed' over longer-term time periods as demonstrated by the longer-term returns of the overall investment portfolio (+2yr tenors).

We are pleased that PMHC remains amongst the best performing Councils in the state of NSW where deposits are concerned. We have been pro-active in our advice about protecting interest income by strategically maintaining a slightly longer duration position. Council has reaped the benefits during the pandemic period and the portfolio should outperform by undertaking a similar strategy in the long-run.

Council's Term Deposit Portfolio & Recommendation

As at the end of January 2023, Council's deposit portfolio was yielding 2.08% p.a. (unchanged from the end of the previous month), with a weighted average duration of ~1.62 years. Where possible, we recommend Council maintains this weighted average duration.

In the long-run, investors are rewarded if they can continue to maintain a slightly longer average duration. In a 'normal' marketplace, yields at the long-end are generally offered at a slight premium over shorter tenors.

At the time of writing, we see value in:

	LT Credit Rating	Term	T/D Rate
ING	A	3 years	4.62% p.a.
ING	A	2 years	4.61% p.a.
CBA	AA-	2 years	4.64% p.a.
BoQ	BBB+	2 years	4.55% p.a.
Westpac	AA-	2 years	4.50% p.a.
NAB	AA-	2 years	4.50% p.a.
Hume Bank	BBB+	2 years	4.50% p.a.
Suncorp	A+	2 years	4.45% p.a.

The above deposits are suitable for investors looking to maintain diversification and lock-in a premium compared to purely investing short-term. For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (dependent on daily funding requirements):

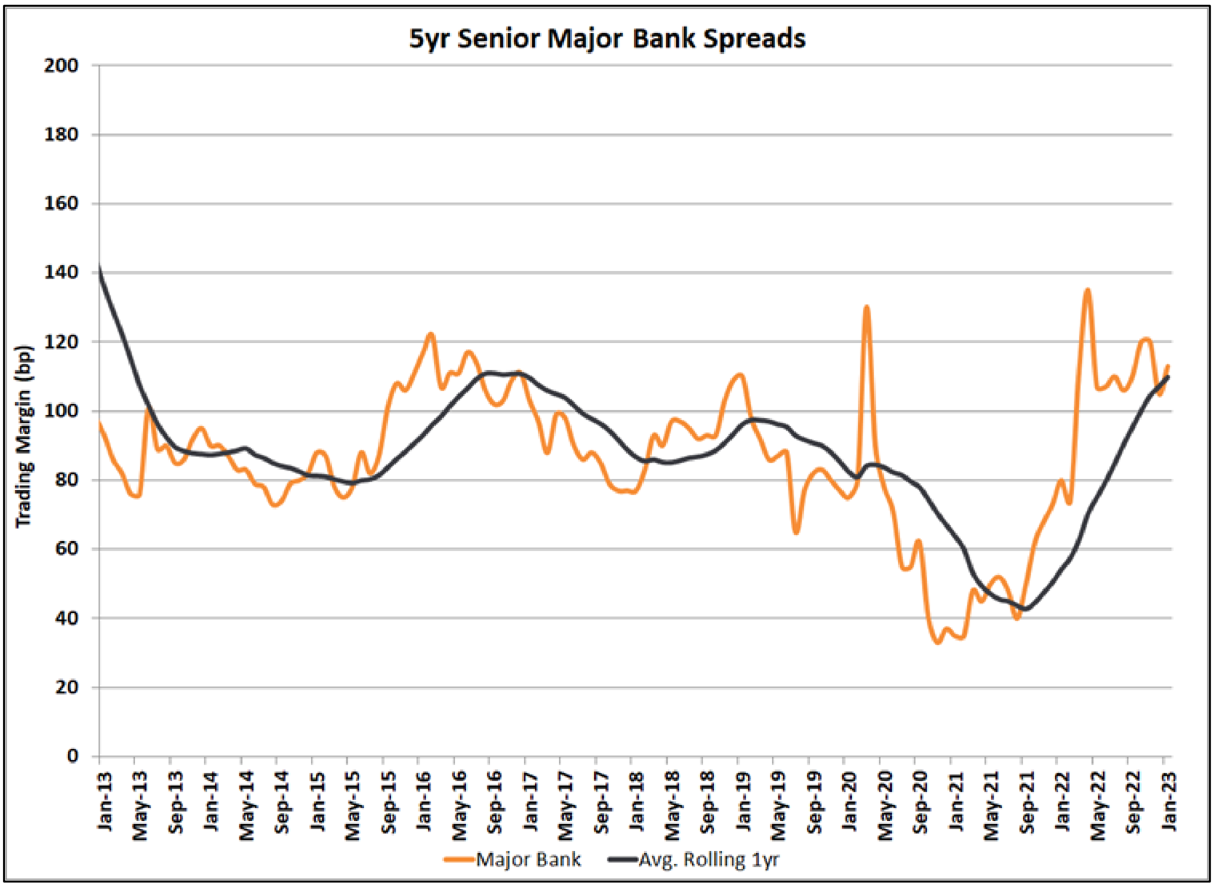
ADI	LT Credit Rating	Term	T/D Rate
CBA	AA-	12 months	4.69% p.a.
NAB	AA-	12 months	4.60% p.a.
Westpac	AA-	12 months	4.59% p.a.
ING	A	12 months	4.55% p.a.
Suncorp	A+	12 months	4.50% p.a.
BoQ	BBB+	12 months	4.50% p.a.
Hume Bank	BBB+	12 months	4.50% p.a.
CBA	A+	6 months	4.41% p.a.
BoQ	BBB+	6 months	4.40% p.a.
CBA	BBB	3 months	4.13% p.a.

If Council does not require high levels of liquidity and can stagger its investments longer-term, it will be rewarded over coming years if it can roll for an average min. term of 12 months - 2 years (this is where we see current value), yielding, on average, up to ¼% p.a. higher compared to those investors that entirely invest in short-dated deposits (under 6-9 months).

With recessionary fears being priced in coming years, assuming inflation is under control, Council may consider taking an insurance policy by investing across 3-5 year fixed deposits and locking in rates above 4½ p.a., ahead of any potential future rate cuts.

Senior FRNs Review

Over January, amongst the senior major bank FRNs, physical credit securities widened up to 10bp at the long-end of the curve. This was mainly driven by CBA's (AA-) dual 3 and 5 year primary issuance at +90bp and +115bp respectively. Major bank senior securities are now looking fairly attractive again in a rising rate environment (5 year margins above the +110bp level):



Source: IBS Capital

During January, there were other noticeable new primary issuances from:

- ICBC, Sydney Branch (A) 3 year senior 'green' FRN at 103bp
- Rabobank, Australian Branch (A+) 5 year senior FRN at +118bp
- Bendigo-Adelaide (BBB+) 4 year senior FRN at +135bp
- BoQ (BBB+) 4 year senior FRN at +135bp
- Great Southern Bank (BBB) 4 year senior FRN at +165bp

Amongst the "A" rated sector, the securities were marked up to 5bp wider at the 5 year part of the curve, whilst the "BBB" rated sector was marked up to 15bp tighter (on the 3 year part of the curve) due to recent new issuances.

Credit securities are looking much more attractive given the widening of spreads in 2022. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/01/2023	31/12/2022
"AA" rated – 5yrs	+113bp	+105bp
"AA" rated – 3yrs	+88bp	+82bp
"A" rated – 5yrs	+130bp	+125bp
"A" rated – 3yrs	+103bp	+105bp
"BBB" rated – 3yrs	+150bp	+165bp

Source: IBS Capital

We now generally recommend switches ('benchmark' issues only) into new primary issues, out of the following senior FRNs that are maturing:

- **On or before early 2025 for the "AA" rated ADIs (domestic major banks)**;
- On or before early 2024 for the "A" rated ADIs; and
- Within 6-9 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last few years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current challenging economic environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

Council's FRN & Recommendation

In late August 2019, Council placed a bid of $3m into the new Bendigo (BBB+) 5 year FRN at +97bp maturing 06/09/2024 (ISIN: AU3FN0050019). This FRN should be viewed as a 3½-4 year holding period, with the ability to 'roll down the curve', realise capital gains which would boost the overall return of the investment portfolio. As at 31/01/2023, the security was marked around +85.5bp (from +89.0bp at the end of the previous month) or a capital price ~$100.14 or unrealised capital gain of ~$4.3k. We recommend Council holds this FRN at this stage.

Council's Senior Fixed Bond

During September 2021, Council placed parcels in NTTC (AA-) fixed bonds as follows:

Investment Date	Maturity Date	Principal	Rate % p.a.^	Remaining Term (Yrs)	Interest Paid
7/09/2021	15/12/2024	$5,000,000	0.90%	1.87 yrs	Annually
14/09/2021	15/12/2025	$5,000,000	1.10%	2.87 yrs	Annually
2/09/2021	15/12/2026	$5,000,000	1.40%	3.87 yrs	Annually
7/09/2021	15/12/2026	$5,000,000	1.40%	3.87 yrs	Annually
	Totals / Wgt. Avg.	**$20,000,000**	**1.20%**	**3.12 yrs**	

^Council will receive the full rebated commission of 0.25% (plus GST) on the face value of investment on all these parcels (currently totalling $55,000).

We believe these investments were prudent at the time of investment, especially after the rate cut delivered in early November 2020 and the RBA's forward guidance on official interest rates (no rate rises '*until at least 2024*').

The NTTC bonds are a 'retail' offering and not 'wholesale' issuances. Given the lack of liquidity and high penalty costs if they were to be sold/redeemed prior to the maturity date, they are considered to be a hold-to-maturity investment and will be marked at par value ($100.00) throughout the term of investment.

Senior Fixed Bonds – ADIs (Secondary Market)

As global inflationary pressures have escalated, this has seen a significant lift in longer-term bond yields (valuations fell) as markets have reacted accordingly.

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the majority now being marked at a significant discount to par (please note supply in the secondary market may be limited on any day):

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0255776	ING	AAA	Covered	07/09/2023	0.60	3.00%	4.21%
AU3CB0258465	Westpac	AA-	Senior	16/11/2023	0.79	3.25%	4.17%
AU3CB0265403	Suncorp	AA-	Senior	30/07/2024	1.50	1.85%	4.53%
AU3CB0265593	Macquarie	A+	Senior	07/08/2024	1.55	1.75%	4.53%
AU3CB0265718	ING	AAA	Covered	20/08/2024	1.55	1.45%	4.39%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	1.59	1.55%	4.30%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.62	1.70%	4.57%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.76	2.00%	4.65%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	1.98	1.65%	4.37%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	1.98	1.65%	4.32%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	2.05	1.70%	4.56%
AU3CB0287415	Westpac	AA-	Senior	17/03/2025	2.14	2.70%	4.30%
AU3CB0291508	Westpac	AA-	Senior	11/08/2025	2.54	3.90%	4.34%
AU3CB0291672	CBA	AA-	Senior	18/08/2025	2.56	4.20%	4.30%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	3.26	1.40%	4.97%
AU3CB0234623	CBA	AA-	Senior	11/06/2026	3.35	4.20%	4.47%
AU3CB0282358	ING	AAA	Covered	19/08/2026	3.56	1.10%	4.61%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.75	2.10%	4.89%
AU3CB0286037	Westpac	AA-	Senior	25/01/2027	4.00	2.40%	4.55%

Economic Commentary

Risk markets were aided in January as recent data indicated there were signs the global economy may be weathering inflation better than previously anticipated. Several global central banks also hinted they may pause their aggressive rate hike cycles in the near future.

Across equity markets, the S&P 500 Index rose +6.18%, while the NASDAQ surged +10.68%. Europe's main indices also gained, led by France's CAC (+9.40%), Germany's DAX (+8.65%) and UK's FTSE (+4.29%).

The US core CPI index, which excludes volatile food and energy items, rose +0.3% m/m, in line with the consensus. Encouragingly for the Fed, the core PCE printed +4.4% y/y, the lowest since October 2021, generating a 3-month annualised rate to +2.9% from +3.5%, the lowest read since January 2021.

US Q4 GDP beat expectations at +2.9% quarter annualised versus +2.6% expected. US headline retail was -1.1% m/m versus -0.9% expected. The important core control measure was also weak at -0.7% m/m against -0.3% expected.

The Bank of Canada (BoC) explicitly signalled a pause to the hiking cycle after hiking by 25bp during the month. Their explicit pause signal has many thinking whether other central banks will do likewise noting they were one of the first to start the initial hiking cycle. Canadian CPI data supported the theme of slower global inflationary pressure, with the headline and core measures falling to +6.3% and +5.6% respectively.

The Bank of Japan (BoJ) bought ¥5 trillion of JGBs to defend the target, its largest ever daily amount of bond buying, which followed ¥4.6 trillion of purchases earlier.

Eurozone Q4 GDP surprised at +0.1% q/q against -0.1 expected, raising hopes that a recession may be avoided. However, Italian GDP was weaker at -0.1% q/q, along with German GDP at -0.2% q/q with the possibility of downward revisions given German retail sales for December printed at -5.3% m/m against -0.2% expected.

Chinese trade data saw exports at -9.9% y/y (consensus -11.1%) and imports down -7.5% y/y (consensus -10.0%), though the impact of Covid in December clouds the numbers. China's population dropped in 2022 for the first time since 1961, by 850,000 to 1.412 billion. There are fears that as China's population declines, this will constrain potential growth. Meanwhile, China's re-opening continues to drive optimism, resulting in most commodity prices to trade higher.

The MSCI World ex-Aus Index rose +6.92% for the month of January:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+6.18%	+5.28%	-9.72%	+8.12%	+7.62%	+10.53%
MSCI World ex-AUS	+6.92%	+9.06%	-9.32%	+5.98%	+4.78%	+7.29%
S&P ASX 200 Accum. Index	+6.23%	+9.59%	+12.21%	+5.96%	+8.51%	+8.75%

Source: S&P, MSCI

Domestic Market

The unemployment rate in December was unchanged at 3.5% from an upwardly revised November figure. The participation rate fell 0.2% to 66.6% from 66.8%, back to its October level after the bounce in November, and has also been broadly steady at 66.6% in H2 2022.

With unemployment hovering around a 48-year low, businesses are finding it incredibly difficult to find workers. About 90% of bosses expect staffing shortages will affect their business this year, according to the Australian Industry Group's annual survey of CEO expectations.

Q4 CPI rose more than expected at +1.9% (consensus +1.5%), taking the annual rate to +7.8%, the highest peak since 1990, driven by increases in domestic holidays, international travel and higher electricity prices. The trimmed mean rose +1.7% over the quarter, with the annual rate coming in at +6.9%.

Sydney house prices have had their steepest annual fall on record, declining 10.9% last year as rising interest rates took a toll on buyer demand and spending power. House prices are now 11.3% below their early 2022 peak, but is still 24.2% higher than they were when the market troughed in mid-2020.

Dwelling approvals fell -9.0% m/m in November (consensus 0%). That's the third consecutive month of decline and follows October's 5.6% fall.

Retail sales fell a sharp -3.9% m/m in December (consensus -0.2%), following an upwardly revised November to +1.7% m/m (from 1.4%). The key implication is that we may be starting to see the first signs that monetary tightening is starting to weigh on consumption.

The November trade balance was up 0.5bn to $13.2bn from an upwardly revised October figure.

The Australian dollar gained +3.87%, finishing the month at US70.37 cents (from US67.75 cents the previous month).

Credit Market

The global credit indices tightened significantly over January in the 'risk-on' environment. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	January 2023	December 2022
CDX North American 5yr CDS	72bp	86bp
iTraxx Europe 5yr CDS	79bp	98bp
iTraxx Australia 5yr CDS	82bp	91bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	January 2023	December 2022
Bloomberg AusBond Bank Bill Index (0+YR)	+0.27%	+0.25%
Bloomberg AusBond Composite Bond Index (0+YR)	+2.76%	-2.06%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.42%	+0.34%
Bloomberg AusBond Credit Index (0+YR)	+2.19%	-0.62%
Bloomberg AusBond Treasury Index (0+YR)	+2.94%	-2.37%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+4.87%	-2.74%

Source: Bloomberg

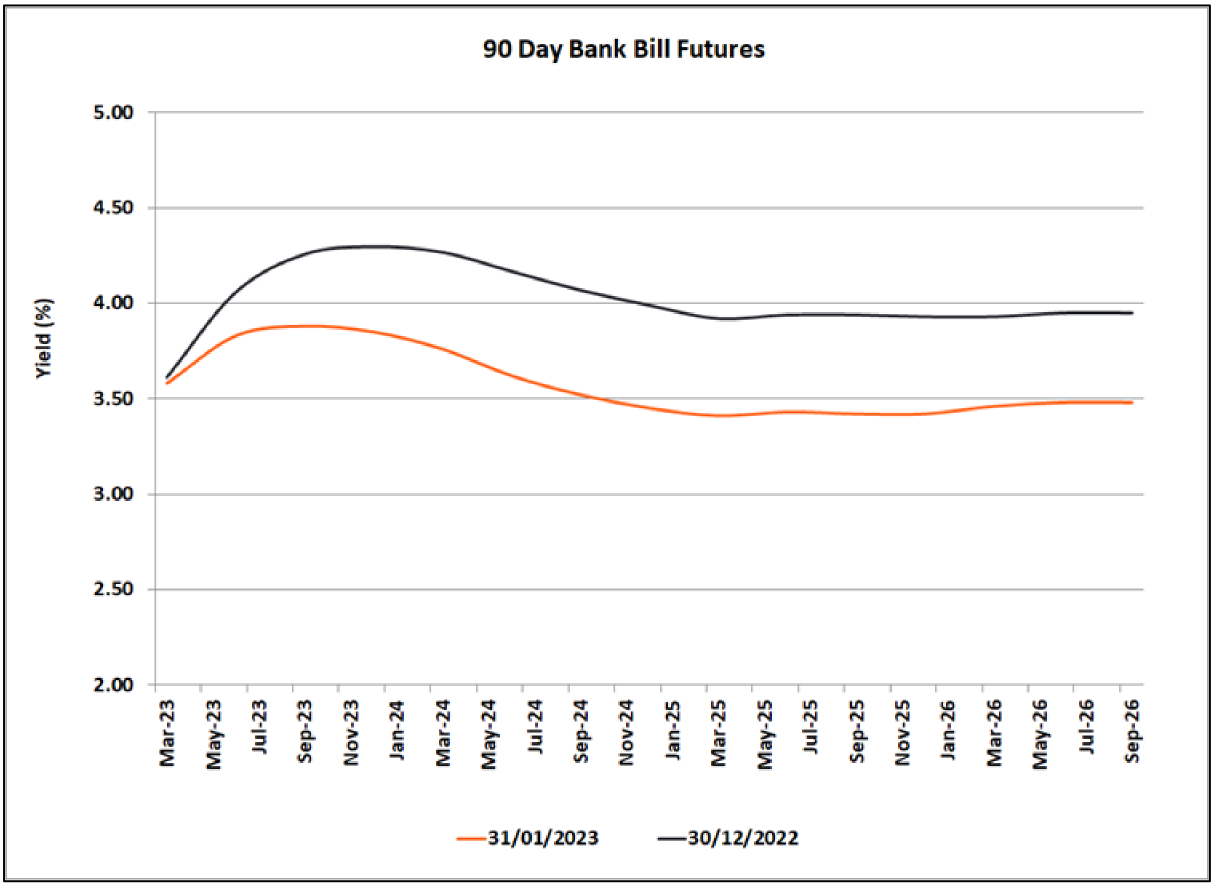
Other Key Rates

Index	January 2023	December 2022
RBA Official Cash Rate	3.10%	3.10%
90 Day (3 month) BBSW Rate	3.37%	3.26%
3yr Australian Government Bonds	3.17%	3.51%
10yr Australian Government Bonds	3.55%	4.05%
US Fed Funds Rate	4.25%-4.50%	4.25%-4.50%
3yr US Treasury Bonds	3.90%	4.22%
10yr US Treasury Bonds	3.52%	3.88%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over January, bill futures fell across the board, with the market reacting to central bank rhetoric, hinting that a pause in the rate hike cycle was fast approaching. The markets continue to factor in the possibility of a global recession over the next few years, highlighted by the drop in the futures pricing in early 2024:



Source: ASX

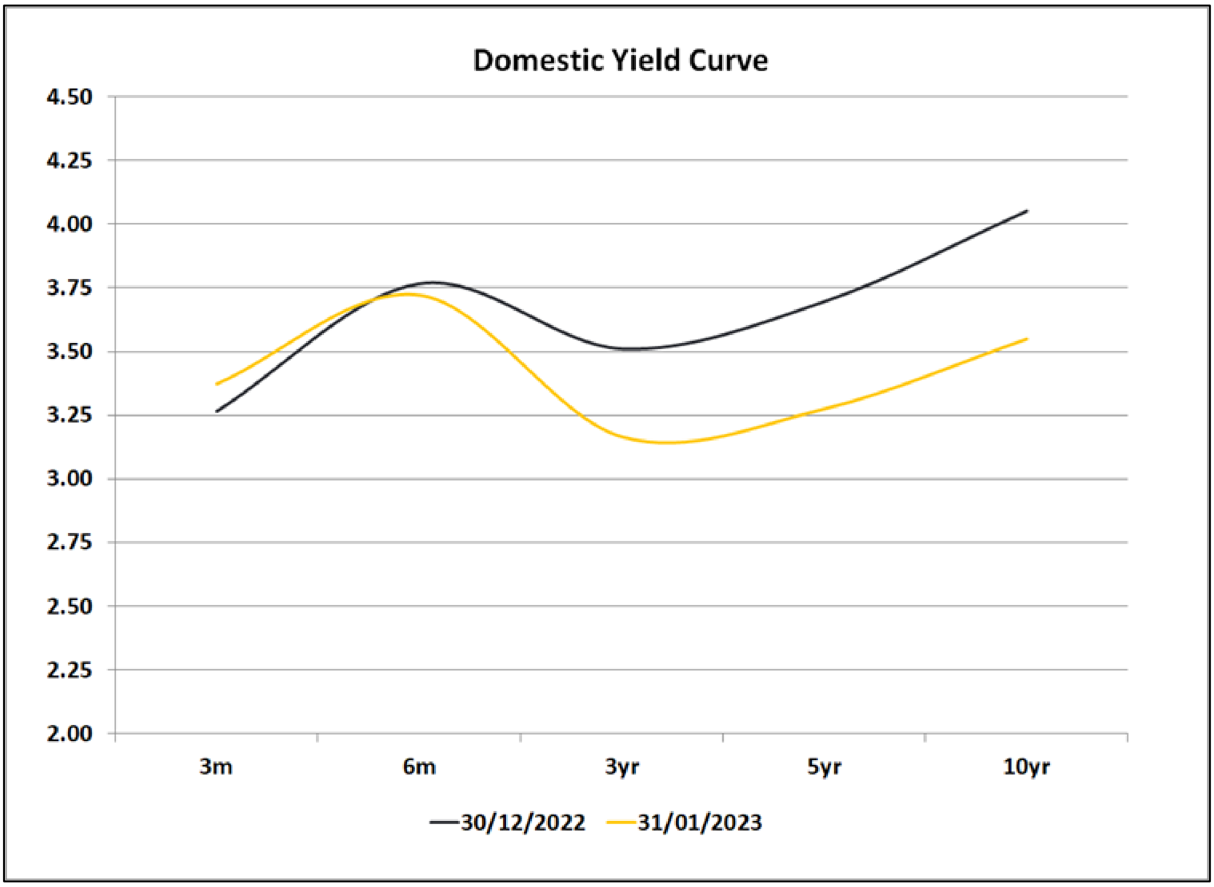
Fixed Interest Outlook

Following the recent soft inflation figures in the US, Fed Funds pricing is now expecting a 25bp hike on 1st February, with around a 40% chance they may also leave rates unchanged.

Domestically, the headline inflation outlook has somewhat receded with growing confidence that construction inflation is in retreat and signs of goods disinflation globally. The labour market remains tight, but timely indicators of labour demand are off their peaks as labour supply has normalised and frictions associated with rapid employment growth out of pandemic impacts moderate. Although labour costs pressures are evident in the latest CPI figures for Q4 2022, there are reasons to be optimistic that some stabilisation in wages growth can occur without a sharply higher unemployment rate, including the normalisation in labour supply.

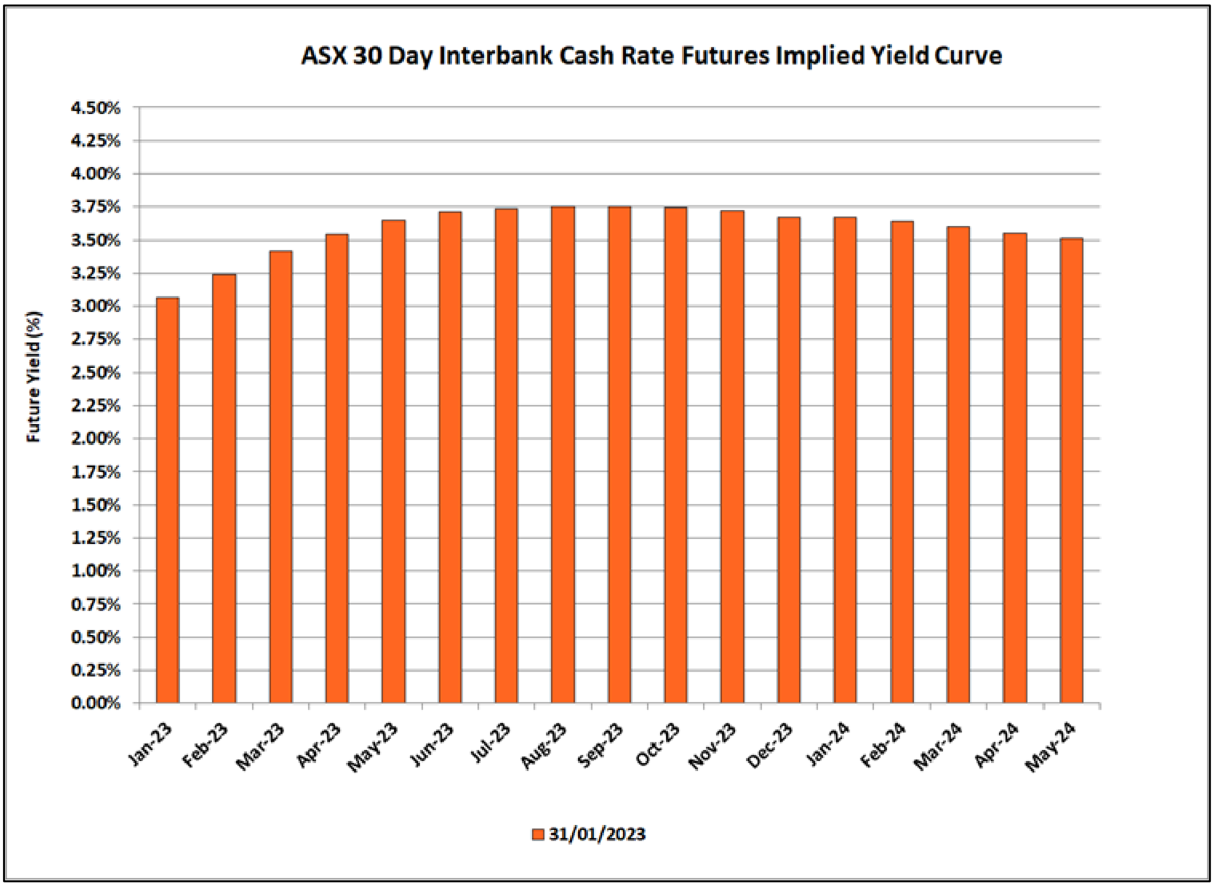
For now, the RBA continues to signal that it expects to increase interest rates further over the period ahead, with up to 2-3 hikes already largely priced into the market by Q2-Q3 2023, taking the cash rate up to 3¾%. Thereafter, noting the lags in monetary policy, a pause around the end of Q2-Q3 is likely whilst the RBA monitors the economic data.

Over the month, yields fell up to 50bp at the long-end of the curve:



Source: AFMA, ASX, RBA

Markets are currently pricing in around 2-3 additional rate rises into mid-2023 (up to 3.75%). Fears of a looming global recession have actually seen rate cuts start to be priced in towards the start of 2024, although this seems unlikely for now.



Source: ASX

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