June 2020

SPECTRUM STRATEGIC INCOME FUND

FUND INFORMATION

Fund
Spectrum Strategic Income Fund

Responsible Entity
Equity Trustees Limited (RE)
ABN 46 004 031 298; AFSL 240 975

Manager
Spectrum Asset Management Ltd (Spectrum) ACN 096 442 198; AFSL 225 069. Spectrum is a Sydney based fund manager that focuses on income. Our strength is corporate debt. We take and manage credit risk with moderate interest rate risk.

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.

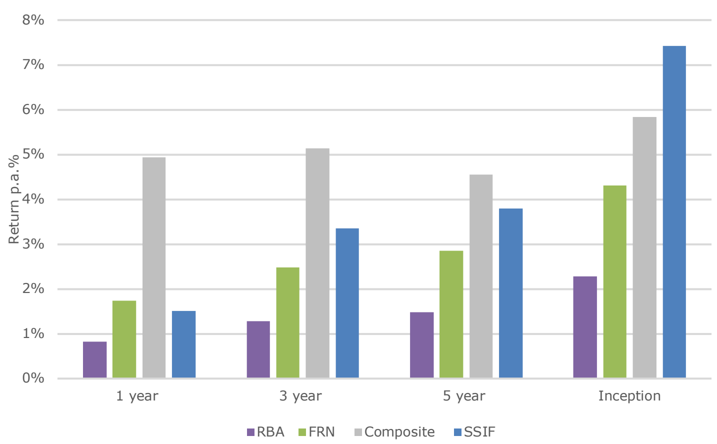
Investment Strategy
The Fund holds a diversified portfolio of debt and income securities with a view to minimising any loss of income and capital of the Fund. Issuers may be government bodies, banks, corporations and, to a limited extent, specialist financing vehicles. To maintain a diversified portfolio structure, certain limits are imposed on security type, credit risk, industry and issuers.

Target Return
RBA Cash Rate +1.50% p.a. net of fees.

Investment Highlights
- Experienced and active management team with proven track record
- Quarterly distributions
- Low duration portfolio
- Diversified portfolio of AUD denominated corporate securities
- Consistent top quartile performance

APIR	ETL0072AU
Entry / Exit Price	$1.0566 / $1.0534
Fund Size	$79.3 m
Unit Pricing	Daily
Distributions	Quarterly
Inception Date	31 May 2009

PERFORMANCE COMPARISONS



FUND PERFORMANCE

	1mth	6mth	1yr	3yr p.a.	5yr p.a.	Incep p.a.
Net Return (%)	0.42	-0.25	1.03	3.33	4.04	7.36
RBA Cash Rate (%)	0.02	0.21	0.65	1.21	1.42	2.25
Spread to RBA (%)	0.40	-0.04	0.38	2.12	2.62	5.11
Income Distribution	-	2.02	3.57	3.30	3.76	4.17

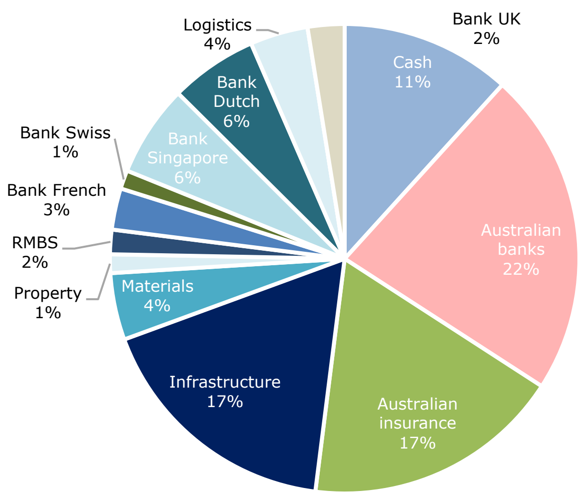
NOTE: Past performance is not a reliable indicator of future performance.

INCOME DISTRIBUTIONS

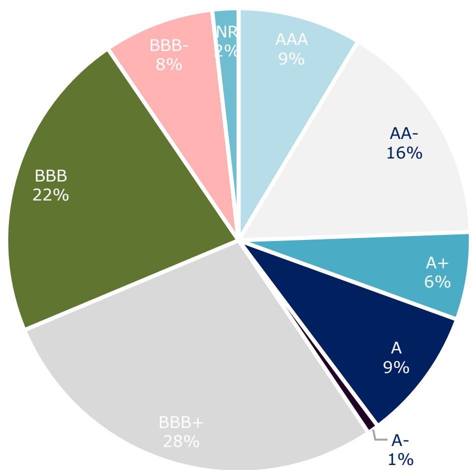
2019 / 2020	Sep	Dec	Mar	Jun
Distributions (cents per unit)*	0.57	0.66	0.71	1.63

* Net Return after fees and expenses assuming reinvestment of all distributions.

SECTOR ALLOCATION



CREDIT RATING



RATINGS

PLATFORMS

AMG Super	ausmaq	Australian Money Market
Bell Direct	CMC Stockbroking	Freedom of Choice
HUB24	mFund	nabtrade
netwealth	Powerwrap	uXchange

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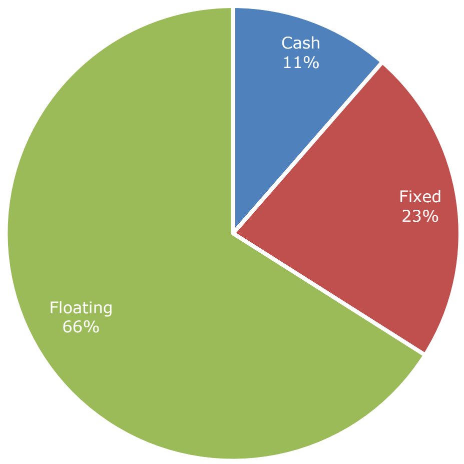
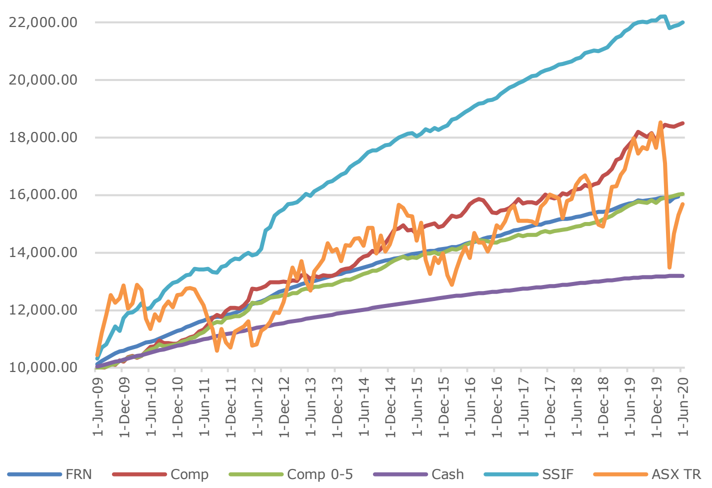
FIXED / FLOATING



GROWTH OF $10,000 SINCE INCEPTION



TOP TEN HOLDINGS

Cash	11.4%	Rabobank UA	5.9%
Suncorp Group Ltd	8.7%	Verizon	4.2%
National Australia Bank	7.5%	Paccar Financial	3.8%
AMP Group Ltd	6.9%	Brisbane Airport	3.8%
DBS Group Holdings Ltd	6.2%	Westpac Banking Corp	3.8%

MARKET COMMENTARY

The month of June saw the recovery within the credit markets continue. Equities rallied, equity volatility fell, and globally central banks continued to provide liquidity to both credit and bond markets. Equity markets rallied as a result of the increased liquidity and a belief that a Covid-19 vaccine was in the offing.

Credit in the U.S. was well supported as investors are of the opinion that the Fed would intervene to settle markets should a disruption occur. This belief has carried through to most markets and is currently supporting markets globally.

The intervention in the domestic market by the RBA continues. The RBA expanded the universe of eligible non-ADI's for its repo activities. A quantum of $18 billion (approximately 25% of the non-financial universe) of $A non-financial securities are now repo-eligible. This means that the credit market has bifurcated further and for those securities that are eligible, their spreads have tightened significantly. The list is likely to expand as any counterparty that is a member of RITS (Reserve Bank Information and Transfer System) has the potential to be set up as counterparty and lodge an application for securities to become repo-eligible.

The challenge for markets will be if we see an increase in Covid-19 infections. Markets are rallying because there is a belief that a vaccine is a possibility. What markets will have to decide is if this event is merely wishful thinking on behalf of a U.S. President desperate for some good news, reality or just wishful thinking. Normally vaccines take some time to produce and given the virus behaves in a manner that is difficult to understand, a vaccine may take longer than expected. What may happen is that an antiviral drug that minimizes the severity of the disease is found.

As we swing towards the U.S. Presidential elections, we may see a rise in volatility. Trump is desperate to pass on the blame for the lagging economy and Covid-19 on the Chinese. This has led to increased tensions between the Chinese and the U.S. and the resultant is that trade tensions are rising. The changes in law in Hong Kong are also a catalyst for increasing tensions between the U.S. and China and a number of countries. One should also expect to hear much discussion over a potential vaccine which is keeping equity markets optimistic.

The receivers for Virgin Australia announced that Bain Capital were the successful bidder for the airline. The expected recovery rate for unsecured creditors remains low and there still appears to be several hurdles that may jeopardise the sale. One of those hurdles being an action by one of the aircraft lessors demanding the return of engines and equipment. The waters are being muddied for Virgin Australia.

Qantas also has their problems and reduced its workforce by 6,000 staff in an attempt to help reduce costs. Qantas also has reduced flights, types of planes used and does not expect to be flying international routes until late-2021.

Airport operators are also under pressure to reduce costs. With significantly declining revenue and with passenger numbers down some 95%. The outlook remains challenging.

The conundrum faced is that we are sceptical of the rally, however, one has to invest monies to obtain the best return possible. We continue to remain concerned over the economic outlook for both domestic and international markets and as such are defensive. With this in mind, the portfolio over this month has seen an improvement in credit quality. Of interest will be major bank T2 paper as these are trading significantly wider than historical averages at around 3.7 times senior bond trading margins. We believe that they represent value against bank capital hybrids and senior unsecured securities. Some short term paper has been bought where we felt the margin was attractive and that in the event of another major selloff the portfolio will be insulated to absorb a fall in capital prices.

Over the course of the fiscal year the environment has been challenging. Interest rates have fallen significantly and so too government bonds. The equity market (S&P/ASX 200) fell 10.9% for the fiscal year, its first annual decline since 2016 and its worst return in eight years.

The Fund has over the past three months performed strongly. It has significantly outperformed the Bloomberg All Maturities Composite Index by 1.8%. The income component has remained remarkably steady over the year despite significant falls in interest rates with cash rates 1.25% a year ago compared to a current level of 0.25%.

PORTFOLIO MANAGEMENT

The markets are transitioning through a period of uncertainty. The main themes that the Manager will be considering are the return of capital, ensuring that income is reasonable, improving the quality of the portfolio and seeking opportunities without significantly altering the risk profile.

The Manager over the past three months has replaced maturing securities in both the over the counter and listed markets which has marginally reduced duration and credit duration within the portfolio.

In June some longer dated bank LT2 was sold and replaced with shorter dated bank LT2 (Australian bank and insurers). We also took advantage to buy some shorter dated corporate securities. Overall the impact has been net positive to achieve our capital and income objectives.

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The Portfolio continues to chase opportunities. Part of strategy for switching long term securities has seen longer securities switched for shorter securities however with a relatively flat credit curve the impact has been marginal. This improves the quality and also shortens the duration which leads to a reduction in risk. Should the markets become skittish again the portfolio will be impacted less than it would have otherwise been.

We continue to invest in the NABHA (Income Securities) as we believe that the security will become expensive for the NAB to maintain as by the end of CY2021 its equity credit on the security will be lost. If the security is converted to a preference share, then the mechanism in the conversion itself could be expensive as there would be a requirement for the security to be franked. NAB recently raised A$600m of AT1 capital in July. We expect that NAB will look to raise AT1 capital again towards the end of the year and if they raise circa $2 billion (+) from a hybrid capital instrument that would allow the NAB to call its NABPB and potentially the NABHA and replace two issues with one. A raising of AT1 securities would be beneficial for a potential earlier redemption of the NABHA.

A significant goal for the portfolio has been maintaining a distribution that beats the RBA cash rate by approximately 1.50%. To provide such a distribution, the Manager has been looking to source securities that are trading at a slight premium/discount but are paying a relatively high coupon by current standards. By doing so, the Fund has been able to pay a distribution of 3.57% for the fiscal year.

The portfolio has now returned three positive months at a time since the drawdown suffered in March. Equity markets despite a spectacular June quarter, in our view appear overvalued. The S&P/ASX 200 was down 10.9% for the financial year. The Fund has in some ways provided a safe haven on a stormy sea over the same period – outperforming the equity index by 12%.

Since inception, the Fund is negatively correlated to the Bloomberg All Maturities Composite Index and is partly correlated to the Composite FRN Index. See the table below.

SSIF vs Correlation to	1yr	3yr	5yr	10yr	Incep.
FRN Index	86.3%	81.7%	53.9%	51.1%	56.6%
Composite Index	39.2%	42.2%	39.7%	3.5%	-9.4%
ASX 200 Total Return	88.9%	79.3%	50.5%	43.0%	41.9%

Fund Metrics	
Tracking error to FRN Index 5 years	0.56
Tracking error to FRN Index since inception	2.9
Largest drawdown since inception	1.86%
Total drawdowns since inception	8.7%
Average drawdown	-0.5%
Number of negative months since inception	17
Number of positive months since inception	116
Best monthly return	4.49%

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