

March 2021

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

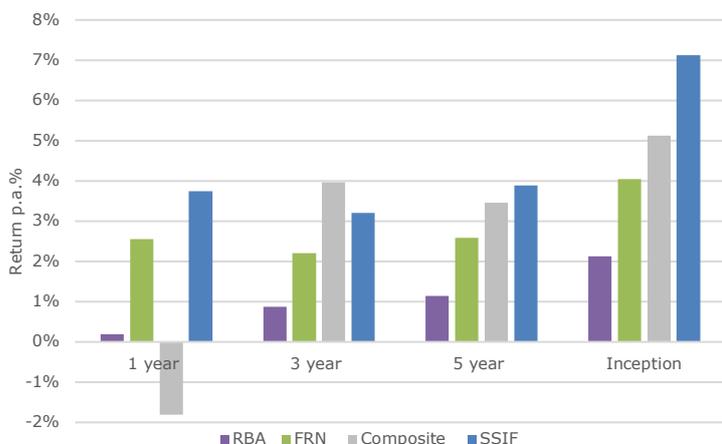
RBA Cash Rate +1.50% p.a. net of fees.

Investment Highlights

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

APIR	ETL0072AU
Entry / Exit Price	\$1.0714 / 1.0682
Fund Size	\$74.4m
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 (%)	0.14	1.81	3.75	3.21	3.89	7.13
RBA Cash Rate (%)	0.01	0.06	0.19	0.88	1.15	2.12
Spread to RBA (%)	0.13	1.75	3.56	2.33	2.74	5.01
Income Distribution	0.43	0.94	3.02	3.15	3.30	3.97

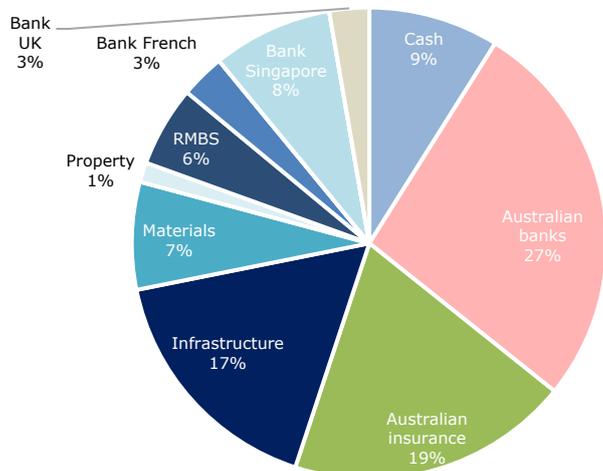
NOTE: Past performance is not a reliable indicator of future performance.

INCOME DISTRIBUTIONS

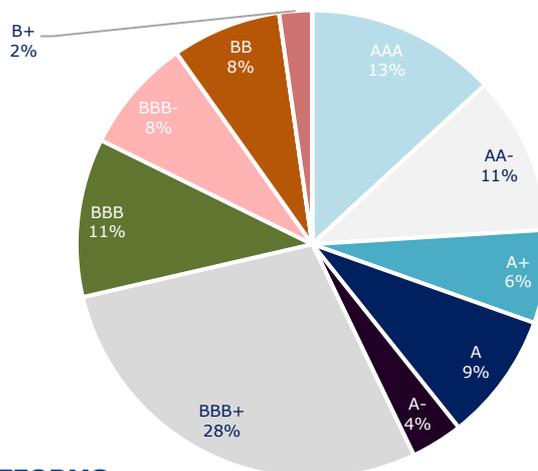
	2020 /2021	Jun	Sep	Dec	Mar
Distributions (cents per unit)*		1.63	0.45	0.51	0.43

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

SECTOR ALLOCATION



CREDIT RATING



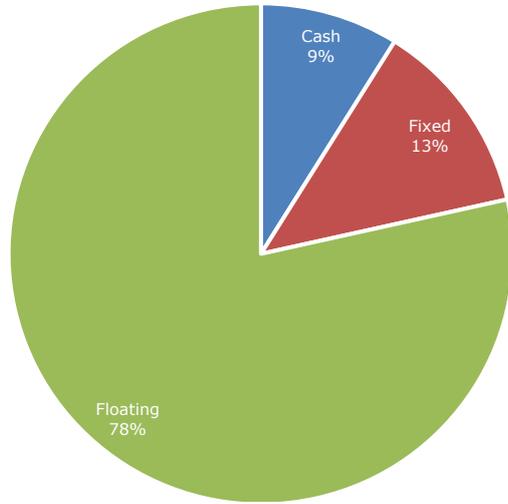
RATINGS



PLATFORMS

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

FIXED / FLOATING



GROWTH OF \$10,000 SINCE INCEPTION



TOP TEN HOLDINGS as Securities

Cash	8.8%	Ausgrid Finance Snr	4.0%
DBS Group T2	6.8%	Suncorp Covered	4.0%
Verizon Snr	5.7%	AMP Ltd T2	3.9%
AAI sub T2	5.4%	AMP Ltd T2	3.6%
NAB T2	5.3%	NAB AT1	3.5%

MARKET COMMENTARY

The market volatility continued over the month of March. The volatility was as a result of a tech rout caused by concerns over a COVID-19 funding package, a large position going horribly wrong for the Archegos Family Office resulting in significant losses and losses incurred in several investment banks including Nomura (\$2b) and Credit Suisse (\$4b).

During the month we saw banks issuing short tenor senior unsecured securities in response to fulfil the LCR (Liquidity Coverage Ratio) requirements as CLF is being reduced. Banks are now managing their short-term exposures more proactively. We expect to see an increase in issuance from the banks in the second half of the year and that issuance is more likely to be longer-term debt.

Tier 2 bank spreads continued their tightening cycle over the month. T2 spreads tightened some 3-8bp over the month depending upon name, and tenor. Senior bank paper was relatively stable over the month.

The Bloomberg Composite All Maturities Index year on year return continues its negative cycle. March was the second consecutive month where the rolling year on year returns was negative. This trend may continue as interest rates appear to have reached their secular lows.

During the month equity markets were quite volatile. Credit however was relatively stable. High yield was volatile and reflected the volatility of the equity market. Over the month, high yield closed at its widest at 309bp, but at one point was trading at 294bp.

The outlook for both credit and equity markets appears positive. The Biden package in the U.S. of U.S. \$2tr will have a major impact on both growth and the U.S. markets and ergo markets in general. The Biden package is expected to lead to growth in the U.S. in excess of 7% and global growth is expected to grow at a rate of 6% or more. Credit spreads probably cannot tighten significantly from current levels however, any selloff should be viewed opportunistically.

Central banks will continue to hold interest rates steady. The challenge will be stabilising the long end of the bond market as it will grow weary of current levels and especially so if there is a hint of inflation. It is also worth noting that budgets will need to be repaired and for many countries that will be in the form of higher tax rates or higher long-term bonds or a combination of both.

The challenge for central banks will be keeping economies growing and keeping bond rates steady.

One should not be fearful though if rates do inevitably rise. Higher yields with improving credit fundamentals are credit positive. The fall in bond prices is due to duration, not interest rates, improves the risk-reward for credit. The net effect is that effects of duration, convexity and event risks fall, and this attracts the flows into credit. Higher yields lead to long end performance and spread compression eventually. The impact of duration is further reduced if the portfolio is skewed towards floating-rate assets.

PORTFOLIO MANAGEMENT

Investment Strategy

It is our belief that rates have probably fallen as far as they can for the moment and that bond yields will gradually drift higher. This is bad for holders of fixed-rate bonds as those holders can expect capital losses as interest rates and bond yields rise. Fixed-rate bonds will suffer for several reasons. One, the duration effect as rates rise, two, a rise due to an increase in credit spreads and three, switching activity as bonds are sold to allow investments in other asset classes.

Believing that the RBA can support the long end of the curve was somewhat debunked by the events of February. Up until February Japanese investors net purchased some \$50b of bonds. However, in February some \$30b was sold into the market and that goes some way in explaining the significant deterioration in bond yields in February. Bonds have rose some 60bp over this period.

The Portfolio will also benefit materially if interest rates were to move higher. Because of the absolute focus for the Fund through investing predominantly in floating rate securities, the Fund benefits as rates move higher. Floating-rate note coupons are normally reset every three months and an increase in rates will see higher coupons being paid. The Portfolio is not immunized to any credit spread widening, however, that widening could be offset to some degree by the higher coupon rates. In a rising interest rate environment, floating-rate notes are often keenly sought by investors and funds alike as they provide some protection and increasing income as rates rise. The Portfolio is well-positioned to take advantage of any hike in rates, a sell-off or widening of credit spreads. Our maturity profile and cash position will allow the Fund to benefit by being able to invest opportunistically.

Given the current outlook for growth in both Australia, the U.S. and globally, credit should continue to perform and especially so as equity markets continue to perform. Delinquency rates are stable, and this will assist market sentiment. We see credit spreads tightening but not to the extent of the last couple of years. High yield should struggle to rally significantly as spreads are already very tight.

The Fund holds a small amount in non-investment grade securities, and Bank hybrid securities. There are some relative value opportunities, but one must be mindful of liquidity and volatility. Hybrids lack the liquidity of their unlisted counterparts, consequently one should consider the liquidity conundrum.

The Fund has a holding in several AMP securities. These holdings are strategic and are based on the possible outcome that the AMP Bank or other business units may be sold to another counterparty. The Group already has surplus capital. We expect to see some capital gain in this

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holding as they have been purchased at a discount to par and are likely to mature over the next two years. Should AMP not proceed with a sale, then the security structure could see the securities called given that those not used for capital reasons are treated as corporate debt on balance sheet.

The Fund's strategy is to invest as opportunistically as our maturity profile allows. This means that we have the option of maintaining a large cash base to invest if there is a market dislocation or reinvesting the proceeds. The Manager is looking to improve the creditworthiness of the Fund over time and improve the diversification and credit quality whilst investing in securities that are expected to have lower volatility during a period of dislocation or rising interest rates. This means we will be when possible investing in corporates with solid cash flows or opportunistically in hybrids that have in our view some chance of capital gain due to mispricing. Demand for investment-grade corporates is expected to continue. Bank capital products continue to attract attention.

The Portfolio has now returned 12 positive months at a time since the drawdown suffered in March. The rolldown effect of the year's past performance has flowed through and the Fund return for the year is now 3.75%. As interest rates stall at current levels, the Composite Index will cease to provide significant performance due to the impact of duration. The Composite Index has now recorded two consecutive negative rolling year on year returns which is unusual and is likely to continue and especially so as it appears the long-term secular rally is stalling around current yield levels.

With corporate reporting season now behind us, we expect primary issuance markets to be more buoyant and will look to allocate our cash holdings accordingly.

The Fund is well positioned to take advantage of any dislocation in credit.

The outlook for the Fund is positive. The Fund is protected against the impact of rising yields and duration as a significant proportion of the Fund is in floating rate assets. The fixed-rate bonds that are held in the portfolio are short-dated and less than 3 years. As rates rise, demand for floating-rate assets will continue and increase. A bifurcation of the credit market is possible leading to FRN's trading at a premium to their fixed-rate cousins.

The Fund is rated 4 Stars by SQM Research.

SSIF vs Correlation to	1yr	3yr	5yr	10yr	Incep.
FRN Index	41.8%	79.6%	78.4%	54.0%	60.2%
Composite Index	14.5%	31.6%	32.5%	9.6%	-6.5%
ASX 200 Total Return	10.0%	75.8%	68.3%	40.0%	39.0%

Fund Metrics	
Tracking error to FRN Index 5 years	0.57
Tracking error to FRN Index since inception	2.97
Largest drawdown since inception	1.86%
Total drawdowns since inception	8.7%
Average drawdown	-0.51%
Number of negative months since inception	17
Number of positive months since inception	125
Best monthly return	4.49%
Consecutive Positive Returns	12

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