Fund Update as at 28 February 2021
CC JCB Active Bond Fund (APIR: CHN0005AU)

Fund Benefits

Active Management
JCB is a specialist fixed income manager with significant global investment management experience and expertise.

Access
The Fund provides access to investment knowledge, markets, opportunities and risk management systems that individual investors may not be able to obtain on their own.

Diversification and Income
When bonds are held as part of a broader portfolio of different asset classes, diversification may assist in managing market volatility. Bond securities in general are considered a defensive asset class. The income generated by bond securities is consistent and regular (usually semi-annual).

Fund Facts

Investment Manager	JamiesonCooteBonds Pty Ltd or JCB
Portfolio Manager	Charles Jamieson
Structure	AAA or AA rated bond securities issued in Australian dollars
Inception Date^	3 August 2016
Benchmark	Bloomberg AusBond Treasury (0+Yr) Index
Management Fee#	0.45% p.a.
Administration Fee #	0.10% p.a.
Buy / Sell Spread	0.05% / 0.05%
Distributions	Semi-annual
Fund Size+	AUD $1098 million

Fund Performance

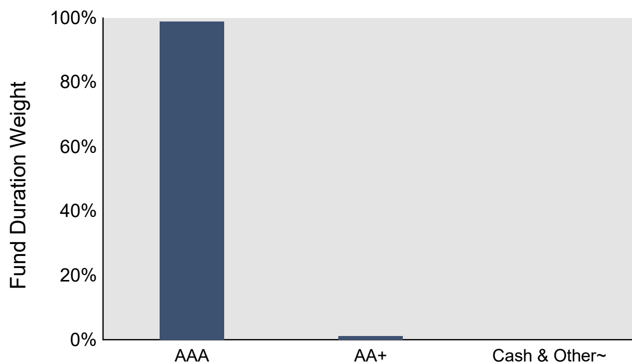
Returns (After fees)	Fund*	Benchmark**	Excess
1 Month	-4.26%	-4.21%	-0.05%
3 Months	-5.25%	-5.16%	-0.09%
FYTD	-4.55%	-4.63%	0.08%
1 Year	-4.31%	-4.62%	0.31%
3 Years p.a.	3.82%	3.98%	-0.16%
Inception p.a.	2.73%	2.50%	0.23%

Fund Overview

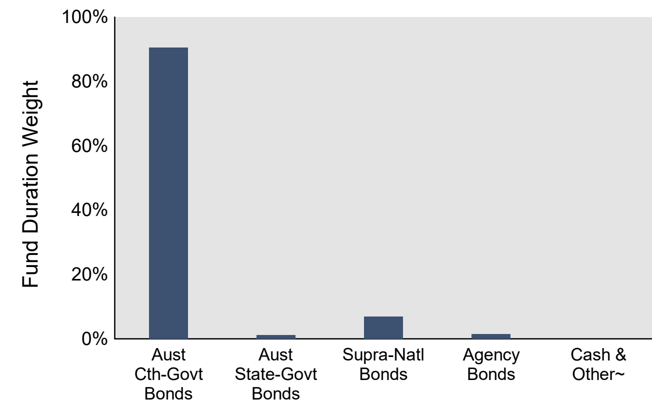
Characteristics***	Fund	Benchmark**
Modified Duration (yrs)	6.29	6.47
Yield to Maturity (%)	1.23	1.20
Weighted Ave. Credit Rating	AAA	AAA
Cash Weighting (%)	10.24	n/a

Source: JamiesonCooteBonds Pty Ltd.

Asset Allocation by Credit Rating (Duration Weight)***



Asset Allocation by Sector (Duration Weight)***



Platform Availabilty

AMP MyNorth	Asgard	Ausmaq
Aust Money Market	BT Panorama	BT Wrap
Colonial First Wrap	HUB24	Implemented Portfolios
Linear	Macquarie Wrap	Mason Stevens
MLC Navigator	MLC Wrap	Netwealth
PowerWrap	Praemium	U-Exchange
Xplore Wealth		

Further Information

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All figures disclosed include the net effect of GST and RITC. ^ Inception Date for performance calculation purposes. + Fund size refers to the CC JCB Active Bond Fund ARSN 610 435 302. * Performance is for the CC JCB Active Bond Fund (APIR: CHN0005AU), also referred to as Class A units, and is based on month end unit prices before tax in Australian Dollars. Net performance is calculated after management fees and operating costs. Individual Investor level taxes are not taken into account when calculating returns.This is historical performance data. It should be noted the value of an investment can rise and fall and past performance is not indicative of future performance. ** Benchmark refers to the Bloomberg AusBond Treasury 0+ Yr Index. *** Refer to Definition of Terms. ~ Cash & Other includes cash at bank, outstanding settlements and futures margin accounts.

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Market Review & Outlook

February market review

Bond markets were on the back foot in February, in a material way, as global positions were liquidated challenging Central Banks in a way we have rarely seen since the GFC. The optimism surrounding the Biden fiscal stimulus (USD $1.9 trillion) and inflation expectations on short run base effects, caused a liquidation of bond positions against the commentary of Central Bankers, who remain committed to low cash rates and easy financing conditions to stimulate demand in the Covid-19 ravaged economies. The sell-off became self-fulfilling in Australia as the RBA did little to redress algorithmic and Commodity Trading Advisor (CTA) style funds continuously selling interest rates futures, causing longer term holders to liquidate as the relative value of Australian rates cheapened against other cross market nations such as the United States. Ironically, this relative value is an explicit objective of the RBA's own QE program combined with the suppression of the Australian dollar. The RBA has failed on both fronts since the inception of the QE program and leads us to believe that further QE will be required.

Whilst Australian interest rates were a surprise under performer over the month, movements across global rates markets also pushed to higher yields in unison with heightened volatility in risk free Government bond markets. This has huge implications for all asset markets the world over. This volatility does not stay in a singular asset class for long, other similar episodes often sees volatility morph to other asset classes as interest rates are the virus that affect all things – they are our funding rates and discount rates. When risk free rates rise quickly in a heavily indebted world, that volatility can spread with dangerous implications. The most recent example of this was Q4 2018 when bonds sold off aggressively late in the year, freezing corporate high yield debt markets (there was no debt capital market issuance of high yield bonds for around six weeks as confidence collapsed) and ultimately triggering -20% liquidation of equity markets (which in and of itself generates a flight to quality bid in Government bonds).

Fast forward to today and we now have corporate credit at more expensive valuations than pre Covid-19 which JCB believes is crazy, especially as risk free rates are rising which usually forces a recalibration of credit spread premiums. As experienced from episodes like last March and April 2020, when credit reprices, it can be truly chaotic with a huge loss of liquidity – volatility in risk free rates often moves into credit before then skipping to risk assets as markets become concerned around low quality corporates, funding themselves at higher interest rates using debt capital markets or rolling existing debt obligations.

Defensive longer-term portfolio returns delivered by carry and roll

With the sell-off in risk free markets has come a reestablishment of yield (carry) and importantly delivered a steep term structure of interest rates curve (roll). Whilst duration often gets all the attention in bond markets for its short run movement of prices, it is actually a minor contributor to total return over time. This is critical to understand when building defensive longer-term portfolios as the major returns are delivered by carry and roll. Looking at the last decade of bond returns, almost everyone would tell you that bonds performed because duration rallied, and that was helpful no doubt, but the vast majority of performance happens slowly in an accretive and continuously compounding manner of carry and roll (roll in very simple terms is as a 5 year bond becomes a 4 year bond in one years' time, it has a capital accretion down a steep term structure curve generating total return). This rebuilds the defensive characteristics materially for a future time and has been met with interest from many of our clients, most of whom have been underweight Government bonds within their own asset allocations and are excited to rebuild more material positions into higher yields and steeper curves. Having just witnessed the tremendous power of the liquidity optionality available in Government bonds in March and April of 2020, many clients are now acknowledging that it was the ability to sell easily (at a premium) in times of stress that allowed them to invest in deeply discounted equities. For many, this move made substantial portfolio returns over the later part of 2020, thanks to a clean asset allocation that is not co-mingled with corporate credit making the entire structure vulnerable (many corporate credit funds were semi-gated during this time by raising sell spreads significantly as corporate credit froze).

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Over the inflation hill

JCB has written previously about the mechanical pathway for higher US inflation (remember Q2 2020 the entire world was closed and we had negative oil prices) on data rotation alone, inflation should peak in May (base effects). We can work out a fairly tight lane way on this scenario pathway, but the one thing that is difficult to economically estimate is how long supply blockages take to clear. Once the base effect gives inflation velocity, it also takes it away just as quickly. JCB is preparing a white paper titled ''Over the inflation hill'' and believes its hugely relevant as it will have impacts on so many asset classes as the journey evolves. JCB will also build useful and actionable documents applicable to bonds, credit, alternatives, value and growth equity etc via the lens of the bond market.

From a secular viewpoint, disinflationary forces of poor demographics, high debt levels (interest rate sensitivities and zombie corporate funding), technology, automation, robotics, lack of unionisation and globalisation have all been an overarching deflationary force. You can now add to that list massive economic slack and untapped labour pools the world over, so its hard to get excited about medium to long run 'self-reinforcing' inflation. However, short run inflation is transitory and will be much higher before base effects fall out and inflation will cool .

So the major questions now asked by many investors are; what are the triggers or the pathway towards a short run inflation peak, how chaotic can this movement become across portfolios that are broadly long risk assets, and what would be the reflexive feedback loops to other assets markets? JCB cannot caution enough that this volatility will be very unlikely to remain in the risk free complex. Modern day markets are actually quite fragile, and whilst prices are observable at great valuations in many things, the true test remains how deep that pricing tension really is. If bullish risk allocations go for the door, we know that opening can become a keyhole very quickly where only the first few folks get through.

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Fund Review

For the month ending February, the CC JCB Active Bond Fund - Class A units (the Fund) returned -4.26% (after fees), underperforming the Bloomberg AusBond Treasury (0+Yr) Index.

Global bond markets encountered a challenging month in February with the reflation narrative maintaining momentum in expectation of a post Covid-19 snapback in global growth and as the accommodative stance from fiscal and monetary authorities remained extremely easy. There is particular angst emanating from the US where Biden's administration is proposing a USD1.9 trillion fiscal support package, which is the equivalent of around 10% of GDP. The Australian bond market unexpectedly underperformed through the month as markets challenged the RBA's QE program. The thematic for February remained steeper global curves, which along with inflation expectations, is starting to become exhausted. Going forward JCB feels this may become somewhat challenged as Central Banks become reactive as risk markets can't co-habitat with higher yields.

The Fund entered the month closer to home as the Australian 10 year remained on crucial support, albeit with a flattening bias. Expectations of the reflation theme to continue, encouraged a net short duration stance early in the month. The Fund maintained a flattening bias in the long end as JCB expected the 10-year would lead the selloff given the propensity of the 10 year futures to be driven by the short bias of the Commodity Trading Advisor (CTA) community. JCB remains of the view that the RBA is committed to an easing stance and as such it has anchored front-end yields, in this case the belly of the curve provides a compelling carry and roll profile. Tactically JCB also deployed some bond switches through the curve with some dislocations emerging on the sell-off after assessing the relatively cheapness/richness of neighbouring bonds. Into the back-up in yields, JCB trimmed the flattening bias in the long end and took profit of the short duration position as JCB achieved their targets and remained on process.

Into month end Australian bonds were pushed lower following comments from Bill Evans, Westpac Chief Economist, shifting his year-end ACGB target to 1.9%, which triggered a break of 1.50% and fuelled the feedback loop of lower prices in line with global bond markets. JCB was cognisant of the deteriorating liquidity profile following the inability of the RBA to step up and subsequently generated cash by selling 10-year future basket ACGB bonds vs hedging with futures. JCB intended to deploy the cash when valuations presented after the dislocation and the RBA stabilised the market. The RBA YCC strategy, which failed to account for the cash settled futures basket, distorted the curve as the 3s5s curve steepened aggressively through the month. The Fund continued to lighten its exposure in the long end through the month and reduced some 10 year semi-government risk. The monthly close of Australian bonds were exacerbated by lack of liquidity and a fast money community that could massage their underweight position in Australian rates with aggressive futures selling into the month end 10 year futures close. This enabled them to close the bond market on the lows for the year which was illustrated in the Australian/US 10 year spread which closed the day session at 51 bps and less than hour later was back under 30 bps in the London session.

Looking forward into March JCB is acutely aware of the quarterly SFE futures rolls and as such the Fund maintains a neutral stance and flattening bias and JCB will continue to remain on process and tactically tilt the Fund given the change in the curve steepness. JCB maintains the RBA QE program should be very beneficial for the bond market on a net supply narrative. Additionally, ACGB bond yields after fx hedging are highly attractive for foreign investors – Japan and Europe in particular. JCB anticipates that foreign investors will enter the ACGB market once global rates markets, particularly US treasury market, stabilise and the hunt for high quality yield resumes.

The cheapening of Australian rates has now breathed some more air into the asset class, JCB remains constructive on the pullback. First, higher yields and steeper curves provide a compelling carry and roll profile, which boosts the long-term return potential of bonds. Historically, carry and roll contributes more return than the duration in ACGB and other rates markets. Second, the negative correlation between equity and bonds should return to the fore as yields moves further away from the zero-lower bound which accentuates the defensive characteristics of the bonds.

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Definition of Terms:

Modified Duration - is a systematic risk or volatility measure for bonds. It measures the bond portfolio's sensitivity to changes in interest rates.
Yield to Maturity - is the total return anticipated on the portfolio if the bond holdings were held until their maturity.
Weighted Average Credit Rating - is a measure of credit risk. It refers to the weighted average of all the bond credit ratings in a bond portfolio.
Duration Weight - refers to the portion of the overall duration attributable to the segment (i.e. credit rating or sector), as a percentage of overall portfolio duration. Contribution to duration is calculated by multiplying an instruments duration by the percentage weight of the instrument in the portfolio. This calculation includes the contribution to duration by holding futures

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