## 8.3. Investment and Loan Borrowings Report held as at 31 July 2022

**AUTHOR:** Christian Menday, Manager Financial Services

**ENDORSED BY:** Margaret Palmer, Director Corporate Services

**ATTACHMENTS:**
1. Investment Held Report as at 31 July 2022 [**8.3.1** - 20 pages]

**PURPOSE:**

The report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 31 July 2022.

**EXECUTIVE SUMMARY:**

**Investment Portfolio:**

The Investment Portfolio (excluding cash balances) held for the period ending 31 July 2022 had a market value of $116,893,019. The annualised returns were 1.27%. This return exceeded the Australian Bond Bank Bill performance benchmark by 1.05%.

Cash deposits at call were $23,017,307 with $21,070,073 of these held in at-call accounts. $1,947,234 cash is held in Council's transaction account with the Commonwealth Bank to meet day-to-day operational needs. The transaction account balance includes deposits relating to the first instalment of rates, which settled after Close of Business on the last business day (29 July).

The investment portfolio is managed to ensure liquidity to meet operational requirements and to fund outflows on major projects. Cashflow is monitored and assessed on an on-going basis.

The actual year to date returns for cash and investments to 31 July 2022 were $160,000 compared to a year-to-date budget of $108,000.

At its July meeting the Reserve Bank of Australia (RBA) Board increased the official cash rate by 50 basis points to 1.35% citing the need to control unexpectedly high inflation. The RBA Governor commented that he expects the official cash rate will reach its neutral setting of 2.5% in the latter half of 2023. The RBA Board had previously increased official cash rates by 50 basis point in June.

Recent increases in the official cash rate are flowing through to term deposit rates bringing the prospect of improving returns for new investments in the coming months. The best available returns are actively sought when surplus funds are invested.

**Borrowings:**

**Loan Facility for Council Projects**

Council entered into a fixed interest loan of $9.5 million with quarterly interest and principal payments on 31 July 2018. The principal outstanding as at 31 July 2022 is $6,147,428.

The projects funded are outlined in the body of the report.

**North Sydney Olympic Pool (NSOP) Redevelopment**

Council drew-down a $31 million loan from TCorp in April 2022. This loan partially funds the NSOP redevelopment. The funds were externally restricted and will be released as required to fund project cash outflows.

**FINANCIAL IMPLICATIONS:**

Council's total investment portfolio performance for the financial year to date is 1.05% above the benchmark (1.27% against 0.22%). The actual year to date returns for cash and investments to 31 July 2022 were $160,000 compared to a year-to-date budget of $108,000.

Investment returns will continue to be monitored and reported.

**RECOMMENDATION:**
**1. THAT** the report on Investments and Loan Borrowings held on 31 July 2022 be received.

## LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

5. Our Civic Leadership
5.1 Council leads the strategic direction of North Sydney
5.2 Council is well governed, and customer focused

## BACKGROUND

The Responsible Accounting Officer must provide Council with a monthly report detailing all funds:

a. Invested under Section 625 of the Local Government Act 1993. This report must include certification that the investments have been made in accordance with the Act and the Regulations made thereunder, the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.

b. Borrowed under Section 624 of the Local Government Act. This report must comply with the borrowings Order issued by the Minister for Local Government and Council's Debt Management Policy.

## CONSULTATION REQUIREMENTS

Community engagement is not required.

## DETAIL

### Investment Portfolio

The following table provides details of the performance of Council's investment portfolio (excluding cash deposits) against the benchmark for the month of July 2022 and annualised for the year-to-date 31 July 2022 (including investments which have matured prior to 31 July 2022).

| | **July 2022** | **Annualised YTD as at 31 July 2022** |
|---|---|---|
| **Actual Return** | 0.13% | 1.27% |
| **Benchmark** | 0.12% | 0.22% |
| **Variance** | 0.01% | 1.05% |

| Asset Type | Market Value as at 31 July 2022 | Portfolio Breakdown as at 31 July 2022 |
|---|---|---|
| Term Deposits | $99,250,000 | 70.94% |
| Cash (Interest Bearing) | $21,070,073 | 15.06% |
| Cash (Non-Interest Bearing) | $1,947,234 | 1.39% |
| Fixed Bonds | $9,000,000 | 6.43% |
| FRTD | $6,000,000 | 4.29% |
| Floating Rate Notes (FRNs) | $2,643,019 | 1.89% |
| | **$139,910,326** | **100.00%** |

Council's average duration of term deposits which comprise approximately 71% of the investment portfolio was approximately 560 days as at 31 July 2022.

Investment returns continue to exceed the indicative benchmark (Ausbond Bank Bill Index). All funds have been invested in accordance with the Act and the Regulations made thereunder and with Council's Financial Investment Policy. Council's investment portfolio complies with the revised Investment Order issued by the Minister for Local Government, which places restrictions on the type of investments permitted. These restrictions have placed greater emphasis on obtaining competitive investment options and the need for sound investment advice from Council's independent advisor.

Council continues to seek independent advice for all investments and is actively managing the portfolio to ensure that returns are maximised taking into account diversification and risk. A complete analysis of the performance is covered in the Monthly Investment Report prepared by Council's investment advisor (refer to attachment).

The actual investment returns for the year-to-date 31 July 2022 have been reviewed and are $52,000 more than the year-to-date budgeted estimate.

**Summary of Returns from Investments (includes Fair Value adjustments):**

| Year | Original Annual Budget | Revised Annual Budget | YTD Budget (July) | YTD/Annual Actual (July) | YTD/Annual Actual FV adjustments (July) | YTD Budget to Actual Variance (July) |
|---|---|---|---|---|---|---|
| **2022/23** | **$1,290,000** | **$1,290,000** | **$108,000** | $159,500 | $500 | $52,000 |
| 2021/22 | $1,100,000 | $1,300,000 | | $1,244,337 | -$64,865 | $120,528 |
| 2020/21 | $1,350,000 | $1,350,000 | | $1,222,664 | $93,735 | -$33,601 |
| 2019/20 | $1,500,000 | $1,529,055 | | $1,896,660 | -$4,944 | $362,661 |

Floating Rate Notes (FRN's) are required to be revalued each month using the Fair Value (FV) method which is an estimate in time of the potential market value of the investment. As of 31 July 2022, the YTD movement of FRN's has been an increase of $500.

**Financial Investment Policy**

As at the end of July, all categories were within the Policy limits for credit ratings and the portfolio remains well diversified, with all asset credit quality classified as BBB or higher. The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio are as per the following table:

| Long Term Rating Range | Invested as 31 July 2022 | Maximum Policy Holding | Distribution as 31 July 2022 |
|---|---|---|---|
| AA Category | $81,197,234 | 100.00% | 58.04% |
| A Category | $38,310,348 | 60.00% | 27.38% |
| BBB Category | $20,402,744 | 35.00% | 14.58% |
| Unrated ADIs (NR) | $0 | 10.00% | 0.00% |

**Loan Borrowings**

Council's Loan Borrowing Policy provides the framework for Council's borrowing activities and defines key responsibilities and the operating parameters within which borrowing and related risk management activities are carried out.

The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating or a combination thereof to maintain its risk averse strategy.

Loan borrowing will be undertaken in line with the following principles:

a) That the capital cost of infrastructure be recognised over the period during which the benefits will be enjoyed.
b) That loan funds are a resource to fund the replacement and upgrading of existing infrastructure and fund the creation of new infrastructure.
c) That loan funds will be limited to:
   - acquisition or enhancement of income producing assets.
   - construction and/or upgrading of buildings; and
   - infrastructure assets that have a life expectancy of greater than 10 years.

Council has two debt facilities

**Alexander Avenue Carpark and Onstreet Carparking Management System Loan**

This loan is a fixed loan financing option, fully amortising the drawn down amount of $9,500,000 over 10 years, fixed interest rate with quarterly repayments of interest and principal.

The loan details are:

| | | | | |
|---|---|---|---|---|
| **Loan amount:** | $ 9,500,000.00 | | | |
| **Loan term:** | 10 years | | | |
| **From:** | 31/07/2018 | | | |
| **To:** | 31/07/2028 | | | |
| **Interest rate:** | 4.02%p.a.(fixed) | | | |
| **Repayment:** | **Quarterly** | | | |
| | | | | |
| **Dates** | **Principal Outstanding** | **Interest** | **Principal** | **Payment** |
| **1/07/2022** | $6,373,191.95 | | | |
| **29/07/2022** | $6,147,427.51 | $63,875.10 | $225,764.44 | $ 289,639.54 |
| **28/10/2022** | $5,921,431.53 | $63,643.56 | $225,995.98 | $ 289,639.54 |
| **27/01/2023** | $5,691,791.50 | $59,999.51 | $229,640.03 | $ 289,639.54 |
| **28/04/2023** | $5,456,690.24 | $54,538.28 | $235,101.26 | $ 289,639.54 |

The next loan instalment is due on 28 October 2022.

**Loan Funded Capital Projects as at 31 July 2022:**

**Project 1: Upgrading the Car Park in Alexander Street, Crows Nest**
**$5 million** loan was sourced to fund project.

Current length of Loan as per the Long-Term Financial Plan (LTFP): 10 years to 2028

**Project 2: Upgrading of On-Street Parking Management System**
**$4.5 million** loan was sourced to fund project.

Current length of Loan as per LTFP: 10 years to 2028

**Loan for North Sydney Olympic Pool Redevelopment**

In January 2022 Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The drawdown rate is 4.24%. The funds were restricted and will be released as required to fund project cash outflows.

This loan is a fixed loan financing option, fully amortising the drawn down amount of $31,000,000 over 20 years, fixed interest rate with semi-annual repayments of interest and principal.

The loan details are:

| | | | | |
|---|---|---|---|---|
| **Loan amount:** | $ 31,000,000.00 | | | |
| **Loan term:** | 20 years | | | |
| **From:** | 28/04/2022 | | | |
| **To:** | 28/04/2042 | | | |
| **Interest rate:** | 4.24%p.a.(fixed) | | | |
| **Repayment:** | **Semi-Annual** | | | |
| | | | | |
| **Dates** | **Principal Outstanding** | **Interest** | **Principal** | **Payment** |
| **01/07/2022** | $31,000,000 | | | |
| **28/10/2022** | $30,499,987 | $657,200 | $500,013 | $1,157,213 |
| **28/04/2023** | $29,989,375 | $646,600 | $510,613 | $1,157,213 |

The first loan instalment is due on 28 October 2022. At this stage no funds have been applied to the project (internal funding has been used to date) and the entire $31 million is externally restricted.

# Monthly Investment Report

# July 2022

IMPERIUM MARKETS

Imperium Markets Pty Ltd ABN: 87 616 579 527
Authorised Representative of Libertas Financial Planning Pty Ltd AFSL 429 718
Phone: +61 2 9053 2987
Email: michael.chandra@imperium.markets
Level 9 Suite 06, 70 Phillip Street, Sydney NSW 2000

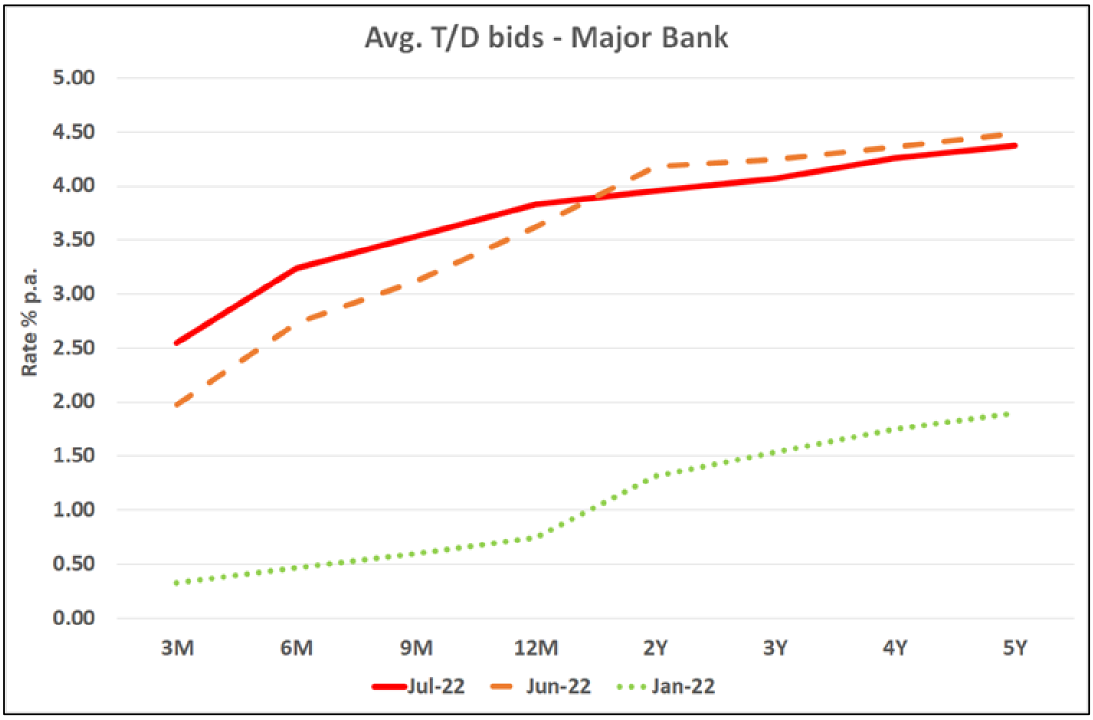
***Impact of COVID-19 to Council's Portfolio***

The COVID-19 pandemic has adversely impacted financial markets, which in turn, has also affected Council's investment portfolio. We provide a quick summary in this section.

After global central banks set official interest rates back to emergency levels during the height of the pandemic (2020), financial markets have transitioned to the recovery phase. Ongoing supply chain issues, China's zero-COVID strategy and the war in Ukraine has resulted in surging inflation. Longer-term bond yields have risen significantly in 2022 as central banks reverse their policy measures (i.e. remove quantitative easing), whilst undertaking aggressive interest rate hikes to try and control inflation. Importantly though when interpreting the stance of monetary policy, it is not just about the cash rate, but how broader financial conditions are influencing the economic outlook, **with markets now factoring the possibility of a global recession as early as the second half of 2023**. **The RBA is expected to increase the official cash rate by another 50bp to 1.85% in early August 2022 and is looking to move towards their neutral setting of 2½% by calendar year-end**.

The largest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits (fixed and floating), which accounts for around ~75% of Council's total investment. The biggest risk that Council faces over the medium-longer term in this environment is not the potential loss of capital (given all the banks are well capitalised and regulated by APRA), but the rapid loss of interest income as interest rates plummeted to all-time lows during the pandemic.

Council's term deposit portfolio was yielding 1.82% p.a. at month-end, with a weighted average duration of around 560 days or ~1½ years. Despite official rates rising, given an upward sloping deposit curve, maintaining a slightly longer duration position will continue to outperform averaging shorter durations. With markets factoring in additional rate hikes over coming months, this has seen a significant shift in longer-term deposit rates, particularly over the past 6 months. The long-end of the deposit curve (+12 months) actually fell over July (compared to June) as the market starts to factor in a global recession:




*Source: Imperium Markets*

**'New' investments above 3½% p.a. now appears likely if Council can place an allocation 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 4% p.a. (small allocation only).*

IMPERIUM MARKETS

# Council's Portfolio & Compliance

***Asset Allocation***

As at the end of July 2022, the portfolio was mainly directed to fixed and floating rate term deposits (75%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (16%).

**Senior FRNs are now becoming more attractive as spreads have widened in recent months – 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 in recent months. 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 and locking in rates above 4% p.a.


***Term to Maturity***

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 36% of assets is directed to medium-term assets (2-5 years), which has resulted in strong outperformance during the challenging low rate environment. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $75m at month-end.

Where liquidity permits, we recommend new surplus funds be directed to 1-2 year horizon given this is where the most attractive value can be found. We suggest this be allocated to any remaining attractive fixed term deposits.

| Compliant | Horizon | Invested ($) | Invested (%) | Min. Limit (%) | Max. Limit (%) | Available ($) |
|---|---|---|---|---|---|---|
| ✓ | 0 - 90 days | $45,017,307 | 32.18% | 10% | 100% | $94,893,019 |
| X | 91 - 365 days | $22,000,000 | 15.72% | 20% | 100% | $117,910,326 |
| ✓ | 1 - 2 years | $22,497,362 | 16.08% | 0% | 70% | $75,439,867 |
| ✓ | 2 - 5 years | $50,395,657 | 36.02% | 0% | 50% | $19,559,506 |
| ✓ | 5 - 10 years | $0 | 0.00% | 0% | 25% | $34,977,582 |
| | | **$139,910,326** | **100.00%** | | | |

Although the 3-12 month allocation is underweight relative to the min. 20% limit, this is more than offset by the large allocation (~32%) to the 0-3 month horizon (highly liquid).

## *Counterparty*

As at the end of July, all individual limits comply with the Policy. Exposures to individual ADIs are driven by the portfolio's movements throughout any month. Overall, the portfolio is well diversified across the investment grade spectrum, with no exposure to the unrated ADIs.

| Compliant | Issuer | Rating | Invested ($) | Invested (%) | Max. Limit (%) | Available ($) |
|---|---|---|---|---|---|---|
| ✓ | CBA | AA- | $29,947,234 | 21.40% | 30.00% | $12,025,864 |
| ✓ | NAB | AA- | $15,000,000 | 10.72% | 30.00% | $26,973,098 |
| ✓ | NTTC Treasury | AA- | $9,000,000 | 6.43% | 30.00% | $32,973,098 |
| ✓ | Westpac | AA- | $27,250,000 | 19.48% | 30.00% | $14,723,098 |
| ✓ | Macquarie | A+ | $15,062,986 | 10.77% | 15.00% | $5,923,563 |
| ✓ | Suncorp | A+ | $6,247,362 | 4.47% | 15.00% | $14,739,187 |
| ✓ | ICBC Sydney | A | $17,000,000 | 12.15% | 15.00% | $3,986,549 |
| ✓ | BOQ | BBB+ | $10,000,000 | 7.15% | 10.00% | $3,991,033 |
| ✓ | AMP Bank | BBB | $6,007,087 | 4.29% | 10.00% | $7,983,946 |
| ✓ | Auswide Bank | BBB | $3,000,000 | 2.14% | 10.00% | $10,991,033 |
| ✓ | Newcastle PBS | BBB | $1,395,657 | 1.00% | 10.00% | $12,595,375 |
| | | | **$139,910,326** | **100.00%** | | |

In late June 2022, Standard & Poor's downgraded Suncorp-Metway from AA- to A+ (negative watch). Suncorp recently announced that it is undertaking a strategic review of its banking operations. The downgrade reflects S&P's view that the Suncorp Group's likelihood of support for the bank had "*slightly*" diminished and that it was no longer a core part of the Group. In July 2022, ANZ (AA-) announced it was putting a bid to buy Suncorp's banking division for ~$4bn. Should that takeover be formalised, Suncorp-Metway's (A+) current credit rating is likely to be upgraded to ANZ's (AA-).

We remain supportive of the regional and unrated ADI sector (and have been even throughout the 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.

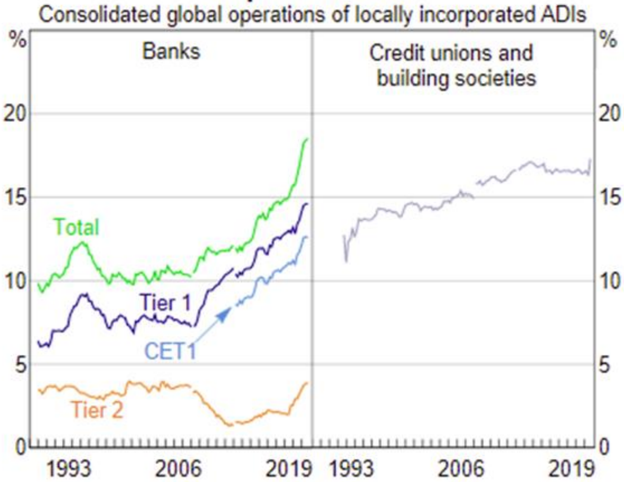
APRA's Chairman affirmed that the banks had satisfactorily moved towards an '*unquestionably strong*' capital position and that bank's stress testing contingency plans were now far better positioned that was previously the case years ago. ***RBA Governor Lowe has commented that they have not seen any signs of stress in the financial system and that unlike during the GFC, the banks now have cash, are well capitalised and are acting as "shock absorbers" in the current pandemic crisis***.

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). We believe that deposit investments with the lower rated ADIs should be continued 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 ADIs continue to carry high levels of capital, particularly amongst the lower ("BBB") and unrated ADIs. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC. **APRA's mandate is to "*protect depositors*" and provide "*financial stability*".**

**Capital Ratios***

Consolidated global operations of locally incorporated ADIs




* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs

Source: APRA

## ***Credit Quality***

The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher).

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 Council. Given the higher rated banks had more capacity to lend (as they have a greater pool of mortgage borrowers), they subsequently were offering higher deposit rates. In fact, some of the lower rated banks were not even offering deposit rates at all. As a result, most investors placed a higher proportion of their deposit investments with the higher rated (A or AA) ADIs over the past two years.

Going forward, with the RBA now removing these cheap borrowing facilities, this has meant the lower rated banks (BBB rated) have started to become more competitive as the market starts to 'normalise'. Investors should have a larger opportunity to start investing a higher proportion of their surplus funds with the lower rated institutions (within Policy limits), from which the majority are considered to be the more 'ethical' ADIs as they generally do not lend to the Fossil Fuel industry.

As at the end of July 2022, all categories were within the Policy limits:

| Compliant | Credit Rating | Invested ($) | Invested (%) | Max. Limit (%) | Available ($) |
|---|---|---|---|---|---|
| ✓ | AA Category | $81,197,234 | 58.04% | 100% | $58,713,092 |
| ✓ | A Category | $38,310,348 | 27.38% | 60% | $45,635,848 |
| ✓ | BBB Category | $20,402,744 | 14.58% | 35% | $28,565,870 |
| ✓ | Unrated ADIs | $0 | 0.00% | 10% | $13,991,033 |
| | | **$139,910,326** | **100.00%** | | |

[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

## *Performance*

Council's performance for the month ending 31 July 2022 is summarised as follows:

| Performance (Actual) | 1 month | 3 months | 6 months | FYTD | 1 year | 2 years |
|---|---|---|---|---|---|---|
| Official Cash Rate | 0.11% | 0.21% | 0.24% | 0.11% | 0.29% | 0.21% |
| AusBond Bank Bill Index | 0.12% | 0.21% | 0.20% | 0.12% | 0.22% | 0.13% |
| Council's T/D Portfolio | 0.13% | 0.32% | 0.62% | 0.13% | 1.28% | 1.40% |
| Council's FRN Portfolio | 0.21% | 0.50% | 0.77% | 0.21% | 1.55% | 1.46% |
| Council's Bond Portfolio | 0.10% | 0.29% | 0.58% | 0.10% | 1.14% | - |
| **Council's Portfolio^** | **0.13%** | **0.32%** | **0.62%** | **0.13%** | **1.27%** | **1.38%** |
| **Outperformance** | **0.01%** | **0.12%** | **0.42%** | **0.01%** | **1.06%** | **1.24%** |

*^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 |
|---|---|---|---|---|---|---|
| Official Cash Rate | 1.35% | 0.85% | 0.48% | 1.35% | 0.29% | 0.21% |
| AusBond Bank Bill Index | 1.45% | 0.83% | 0.40% | 1.45% | 0.22% | 0.13% |
| Council's T/D Portfolio | 1.57% | 1.29% | 1.25% | 1.57% | 1.28% | 1.40% |
| Council's FRN Portfolio | 2.49% | 2.00% | 1.55% | 2.49% | 1.55% | 1.46% |
| Council's Bond Portfolio | 1.17% | 1.14% | 1.16% | 1.17% | 1.14% | - |
| **Council's Portfolio^** | **1.57%** | **1.29%** | **1.25%** | **1.57%** | **1.27%** | **1.38%** |
| **Outperformance** | **0.11%** | **0.47%** | **0.85%** | **0.11%** | **1.06%** | **1.24%** |

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

For the month of July, the total investment portfolio (excluding cash) provided a strong return of +0.13% (actual) or +1.57% p.a. (annualised), outperforming the benchmark AusBond Bank Bill Index return of +0.12% (actual) or +1.45% p.a. (annualised). The strong performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the RBA's rate cuts, as well as the FRNs locked in at attractive margins.

**Over the past year, the total portfolio (excluding cash) returned an outstanding +1.27% p.a., outperforming bank bills by 1.06% p.a**. This has been very strong given deposit rates reached their all-time lows and credit margins have generally contracted over the past 3 years.

**We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned (as per our May 2022 Council Rankings), earning around $540,000 in additional interest income versus the average NSW Council**. We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio.

## ***Council's Term Deposit Portfolio & Recommendation***

As at the end of July 2022, Council's deposit portfolio was yielding an **attractive 1.82% p.a.** (up 55bp from the previous month), with an average duration of around 560 days (~1½ years). We recommend Council maintains an average duration above 12 months where possible.

As the past decade or so has highlighted (post-GFC era), we have seen too many portfolios overpay for liquidity and generally not insured themselves by diversify their funding across various tenors. Those investors that can maintain a weighted average duration of +12-18 months are likely to yield, on average, up to 1% p.a. higher than those investors who maintain a weighted average duration of less than 6-9 months.

At the time of writing, we see value in:

| ADI | LT Credit Rating | Term | T/D Rate |
|---|---|---|---|
| BoQ/ME Bank | BBB+ | 5 years | 4.50% p.a. |
| BoQ/ME Bank | BBB+ | 4 years | 4.40% p.a. |
| BoQ/ME Bank | BBB+ | 3 years | 4.10% p.a. |
| BoQ/ME Bank | BBB+ | 2 years | 4.00% p.a. |
| ICBC, Sydney | A | 3 years | 3.95% p.a. |
| ICBC, Sydney | A | 2 years | 3.87% p.a. |
| CBA | AA- | 2 years | 3.73% p.a. |
| Westpac | AA- | 2 years | 3.70% p.a. |
| Australian Unity | BBB+ | 2 years | 3.70% p.a. |
| Bendigo-Adelaide | BBB+ | 2 years | 3.70% p.a. |
| NAB | AA- | 2 years | 3.60% 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 |
|---|---|---|---|
| BoQ/ME Bank | BBB+ | 12 months | 3.80% p.a. |
| CBA | AA- | 12 months | 3.74% p.a. |
| Bendigo | BBB+ | 12 months | 3.70% p.a. |
| Westpac | AA- | 12 months | 3.69% p.a. |
| NAB | AA- | 12 months | 3.65% p.a. |
| Suncorp | A+ | 6 months | 3.38% p.a. |

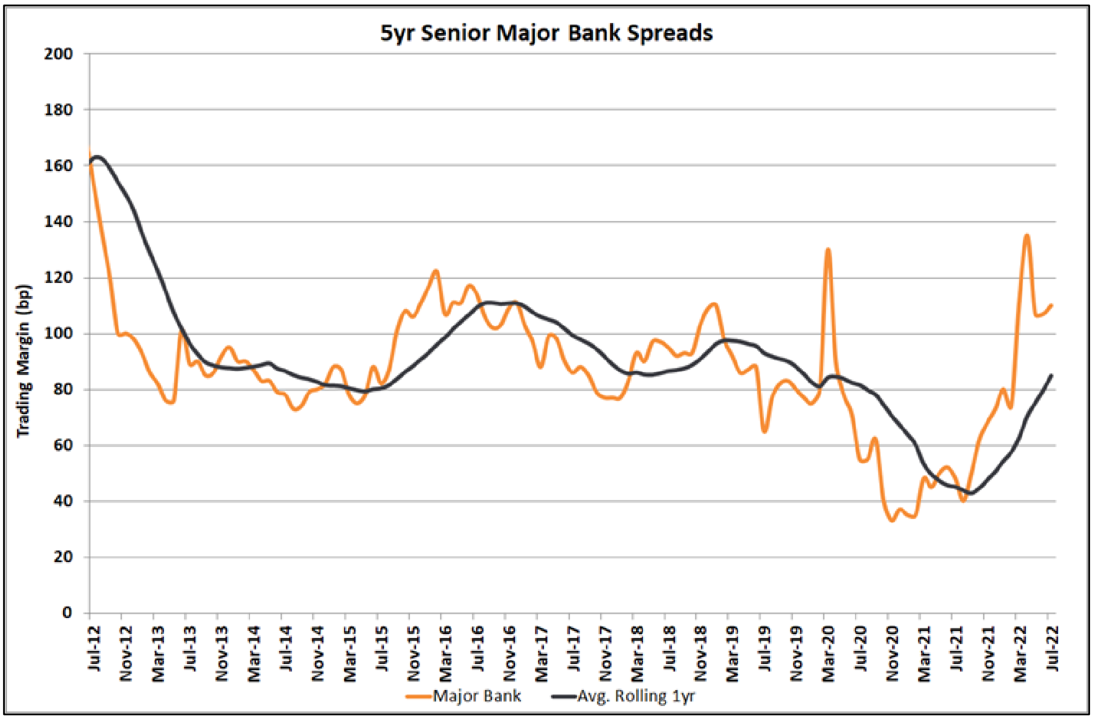
*For those investors that do not require high levels of liquidity and can stagger their investments longer-term, they will be rewarded over coming years if they roll for an average min. term of 18 months to 2 years (this is where we current value), yielding, on average, up to ½%-1% p.a. higher compared to those investors that entirely invest in short-dated deposits.*

*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 4% p.a. (small allocation only).*

IMPERIUM MARKETS

***Senior FRNs Review***

Over July, amongst the senior major bank FRNs, physical credit securities remained relatively flat at the long-end of the curve. Major bank senior securities are now looking fairly attractive again in a rising rate environment (5 year margins around the +105-110bp level):




*Source: IBS Capital*

There was slightly less activity in the primary market during July, with only a few noticeable 3-year AAA rated covered securities issued by RBC and CIBC. Amongst the lower rated sector, the "BBB" rated ADIs were marked around 20bp wider at the 3 year part of the curve. There was minimal movement in the "A" rated category.

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) | 31/07/2022 | 30/06/2022 |
|---|---|---|
| "AA" rated – 5yrs | +110bp | +107bp |
| "AA" rated – 3yrs | +88bp | +90bp |
| "A" rated – 5yrs | +125bp | +125bp |
| "A" rated – 3yrs | +100bp | +100bp |
| "BBB" rated – 3yrs | +130bp | +110bp |

*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 mid-2024 for the "AA" rated ADIs (domestic major banks)**;
- On or before mid-2023 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 low interest rate 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 Senior FRNs Sale/Switch Recommendations***

We recommend Council retains its remaining two FRNs at this stage. We will inform Council when there is an opportunity to sell these assets to boost the overall returns of the investment portfolio.

***Council's Senior Bonds***

During October 2020, Council placed two parcels of $3m (totalling $6m) with the Northern Territory Treasury Corporation (NTTC), locking in yields of 0.90% p.a. and 1.00% p.a. for a 4 and 5 year term respectively. In August 2021, it placed another $3m parcel with NTTC (AA-), locking in a yield of 1.50% p.a. for a 5 year term.

Council received the full rebated commission of 0.25% on the total face value of investments (i.e. $9m x 0.25% = $22,500) as it was introduced by Imperium Markets. We believe these investments were prudent at the time of investment given the low rate environment and 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 strongly factored in a tightening of global central bank policy measures (i.e. withdrawal of Quantitative Easing and lifting official interest rates).

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 | 1.11 | 3.00% | 3.55% |
| AU3CB0258465 | Westpac | AA- | Senior | 16/11/2023 | 1.30 | 3.25% | 3.56% |
| AU3CB0265403 | Suncorp | AA- | Senior | 30/07/2024 | 2.00 | 1.85% | 3.91% |
| AU3CB0265593 | Macquarie | A+ | Senior | 07/08/2024 | 2.03 | 1.75% | 3.88% |
| AU3CB0265718 | ING | AAA | Covered | 20/08/2024 | 2.06 | 1.45% | 3.80% |
| AU3CB0266179 | ANZ | AA- | Senior | 29/08/2024 | 2.09 | 1.55% | 3.65% |
| AU3CB0266377 | Bendigo | BBB+ | Senior | 06/09/2024 | 2.11 | 1.70% | 3.90% |
| AU3CB0268027 | BoQ | BBB+ | Senior | 30/10/2024 | 2.26 | 2.00% | 4.03% |
| AU3CB0269710 | ANZ | AA- | Senior | 16/01/2025 | 2.47 | 1.65% | 3.71% |
| AU3CB0269892 | NAB | AA- | Senior | 21/01/2025 | 2.50 | 1.65% | 3.72% |
| AU3CB0270387 | Macquarie | A+ | Senior | 12/02/2025 | 2.54 | 1.70% | 4.03% |
| AU3CB0287415 | Westpac | AA- | Senior | 17/03/2025 | 2.63 | 2.70% | 3.72% |
| AU3CB0280030 | BoQ | BBB+ | Senior | 06/05/2026 | 3.77 | 1.40% | 4.35% |
| AU3CB0282358 | ING | AAA | Covered | 19/08/2026 | 4.06 | 1.10% | 4.06% |
| AU3CB0284149 | BoQ | BBB+ | Senior | 27/10/2026 | 4.25 | 2.10% | 4.40% |
| AU3CB0286037 | Westpac | AA- | Senior | 25/01/2027 | 4.49 | 2.40% | 3.92% |

# Economic Commentary

***International Market***

Risk assets rebounded in July after steep losses during the first half of the calendar year. In the US, the S&P 500 Index gained +9.11%, while the NASDAQ surged +12.35%. Europe's main indices also gained strongly, led by France's CAC (+8.87%), Germany's DAX (+5.47%), and UK's FTSE (+3.54%).

The US Fed hiked by 75bp, taking the target range to 2.25%-2.50%. Guidance remained unchanged that ongoing increases in the target will be appropriate, although the commentary was evidently less hawkish than feared. US Q2 GDP contracted by -0.9%, prompting some hope that the Fed may move towards a less aggressive rate path.

US CPI printed at +9.1% y/y from +8.8% y/y. Core CPI also exceeded expectations with a +0.7% monthly rise, reducing the annual rate by just +0.1% to +5.9%.

The US unemployment rate printed at 3.6% for the fourth consecutive month, its post-pandemic low.

The Bank of Canada was the first advanced economy central bank to opt for a full 100bp rate hike, to 2.50%, against 75bp generally expected.

The RBNZ offered up a "*no surprises*" Monetary Policy Review, delivering another 50bp hike to 2.50% and indicating comfort with its projections in the May Statement which showed the official rate heading to about 4%, well above its neutral setting.

Eurozone inflation printed a record +8.6%y/y in June vs estimate for an +8.5% outcome. The core reading eased to +3.7%y/y from +3.8%, and against expectations for a rise to +3.9%.

The European Central Bank (ECB) hiked rates by a more-than-expected at 50bp (only 50% chance of a 50bp hike was priced into the meeting), taking the deposit rate back to 0%, and ending its negative interest rate policy that has been in place since 2014.

UK headline inflation continued to rise, hitting +9.4% in June, slightly higher than expected. The Bank of England expects headline inflation to reach 11% later this year after energy companies increase prices.

China's June CPI came in +2.5% y/y from +2.1% (and +2.4% expected). The annual rise in PPI slipped to +6.1% from +6.4%. China's zero covid policy is taking much needed momentum out of the economy. Q2 GDP fell -2.6% (-2% expected) with the annual growth rate slipping to just +0.4% y/y. The government's +5.5% annual growth target is now widely considered to be out of reach.

The MSCI World ex-Aus Index rose +7.89% for the month of July:

| Index | 1m | 3m | 1yr | 3yr | 5yr | 10yr |
|---|---|---|---|---|---|---|
| S&P 500 Index | +9.11% | -0.04% | -6.03% | +11.49% | +10.83% | +11.59% |
| MSCI World ex-AUS | +7.89% | -1.62% | -10.54% | +8.04% | +7.12% | +8.41% |
| S&P ASX 200 Accum. Index | +5.75% | -6.04% | -2.17% | +4.27% | +8.03% | +9.44% |

*Source: S&P, MSCI*

## ***Domestic Market***

As expected, the RBA hiked the cash rate target by 50bp to 1.35% in its meeting in July, its highest level since May 2019. There was little change to the concluding paragraph "*the Board expects to take further steps in the process of normalising monetary conditions in Australia over the months ahead".*

The Board's Statement overall was slightly less hawkish than what markets had thought. Medium-term inflation expectations was depicted as being "*well anchored*". This suggests the RBA does not see itself as needing to race into restrictive territory as the market is currently pricing and the RBA is likely to slow the pace of hikes as it approaches neutral, which it pegs around 2.50%.

The minutes to the RBA's July policy meeting and RBA Deputy Governor Bullock's speech during the month was also seen as hawkish. Governor Lowe still thinks the nominal neutral interest rate is at least 2.50%, although the Board has hinted it may need to go above neutral to control inflation.

Headline CPI came in at +1.8% q/q and +6.1% y/y. The more closely watched core trimmed mean measure rose +1.5% q/q, which was exactly in line with consensus. There was an upward revision to the past quarter helping push the core annual rate to +4.9% y/y.

The labour market has tightened more quickly than the RBA had been expecting with the unemployment rate plummeting by 0.4% to 3.5% in June (from 3.9%), a 48 year low. The decline was driven by a sharp rise in employment of +88k, smashing expectations for a +30k gain.

The participation rate rose 0.1% to 66.8% to a new record high and building on the sharp increase last month. Participation is now 0.9% above pre-pandemic levels. The underemployment rate rose 0.3% to 6.1%.

Treasurer Chalmers and RBA Governor Lowe backed Australia's 2-3% flexible inflation target as the review into the RBA gets underway.

The trade surplus came in at $16bn in May, driven by a surge in coal (+20% m/m) and LNG (+12% m/m) export volumes.

The Australian dollar rose +1.71%, finishing the month at US70.07 cents (from US68.89 cents the previous month).

## ***Credit Market***

The global credit indices tightened over the month as risk markets parred back some of their recent losses. They are back to their levels experienced during the start of the pandemic (Q1 2020):

| Index | July 2022 | June 2022 |
|---|---|---|
| CDX North American 5yr CDS | 83bp | 101bp |
| iTraxx Europe 5yr CDS | 110bp | 119bp |
| iTraxx Australia 5yr CDS | 123bp | 130bp |

*Source: Markit*

# Fixed Interest Review

## *Benchmark Index Returns*

| Index | July 2022 | June 2022 |
|---|---|---|
| Bloomberg AusBond Bank Bill Index (0+YR) | +0.14% | +0.05% |
| Bloomberg AusBond Composite Bond Index (0+YR) | +3.36% | -1.48% |
| Bloomberg AusBond Credit FRN Index (0+YR) | +0.24% | +0.05% |
| Bloomberg AusBond Credit Index (0+YR) | +2.40% | -1.34% |
| Bloomberg AusBond Treasury Index (0+YR) | +3.55% | -1.32% |
| Bloomberg AusBond Inflation Gov't Index (0+YR) | +4.75% | -2.23% |

*Source: Bloomberg*

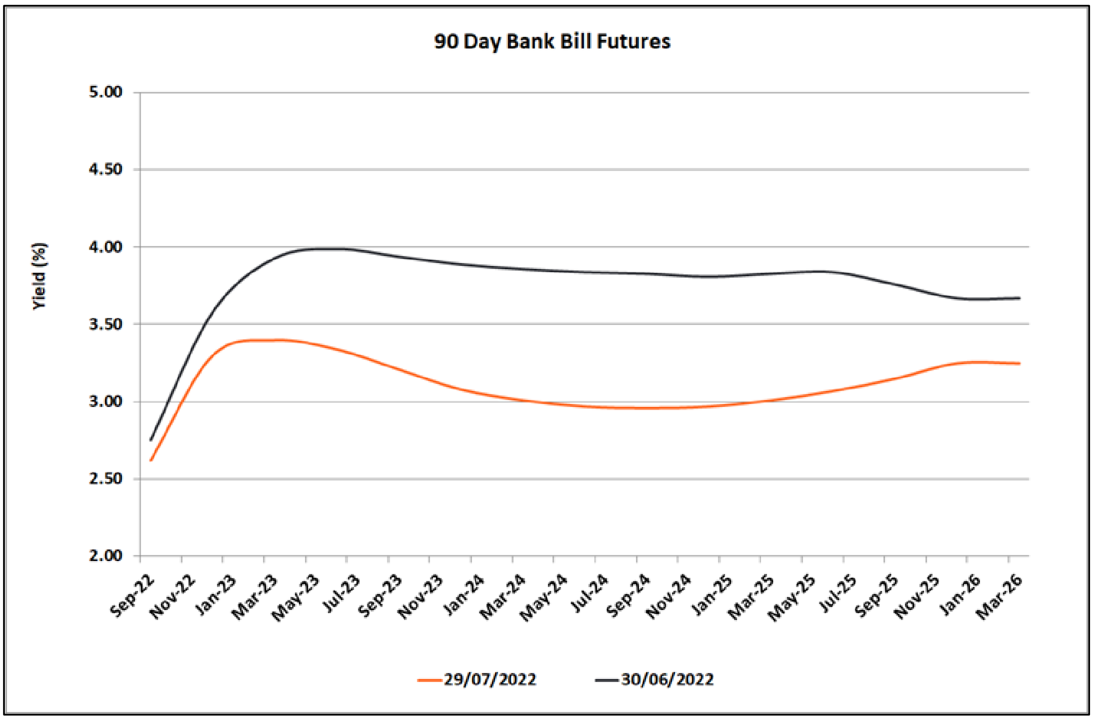
## *Other Key Rates*

| Index | July 2022 | June 2022 |
|---|---|---|
| RBA Official Cash Rate | 1.35% | 0.85% |
| 90 Day (3 month) BBSW Rate | 2.12% | 1.81% |
| 3yr Australian Government Bonds | 2.70% | 3.16% |
| 10yr Australian Government Bonds | 3.05% | 3.66% |
| US Fed Funds Rate | 2.25%-2.50% | 1.50%-1.75% |
| 3yr US Treasury Bonds | 2.83% | 2.99% |
| 10yr US Treasury Bonds | 2.67% | 2.98% |

*Source: RBA, AFMA, US Department of Treasury*

***90 Day Bill Futures***

Over July, bill futures fell sharply at the long-end of the curve as the market factors in a higher probability of a global recession over the next few years, highlighted by the drop in the futures pricing in 2023-2024:




*Source: ASX*

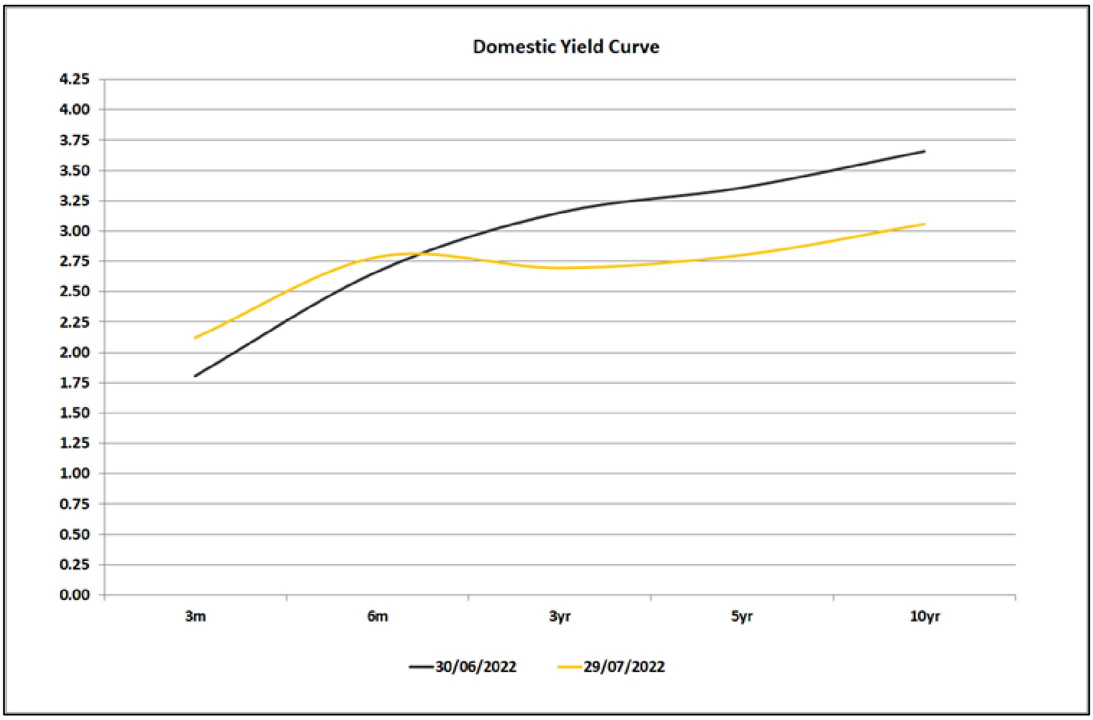
# Fixed Interest Outlook

After the US Fed hiked rates by 75bp in July, the accompanying statement gave the impression of less urgency in future rate rises, noting that "*indicators of spending and production have softened*" and a prior reference to supply disruptions from China lockdowns was removed. US Fed Chair Powell said further moves will depend be data dependent. With the target rate now back at neutral, slowing of rate hikes would become appropriate, although the June '*dot plots*' were still a valid guide.

Domestically, the latest headline CPI came in at +1.8% q/q and +6.1% y/y. The more closely watched core trimmed mean measure rose +1.5% q/q which was exactly in line with consensus. There was an upward revision to the past quarter helping push the core annual rate to +4.9%. This should keep the pressure on the RBA to continue to move quickly towards a more neutral setting of policy. The market reaction suggested markets are braced for an upside surprise.

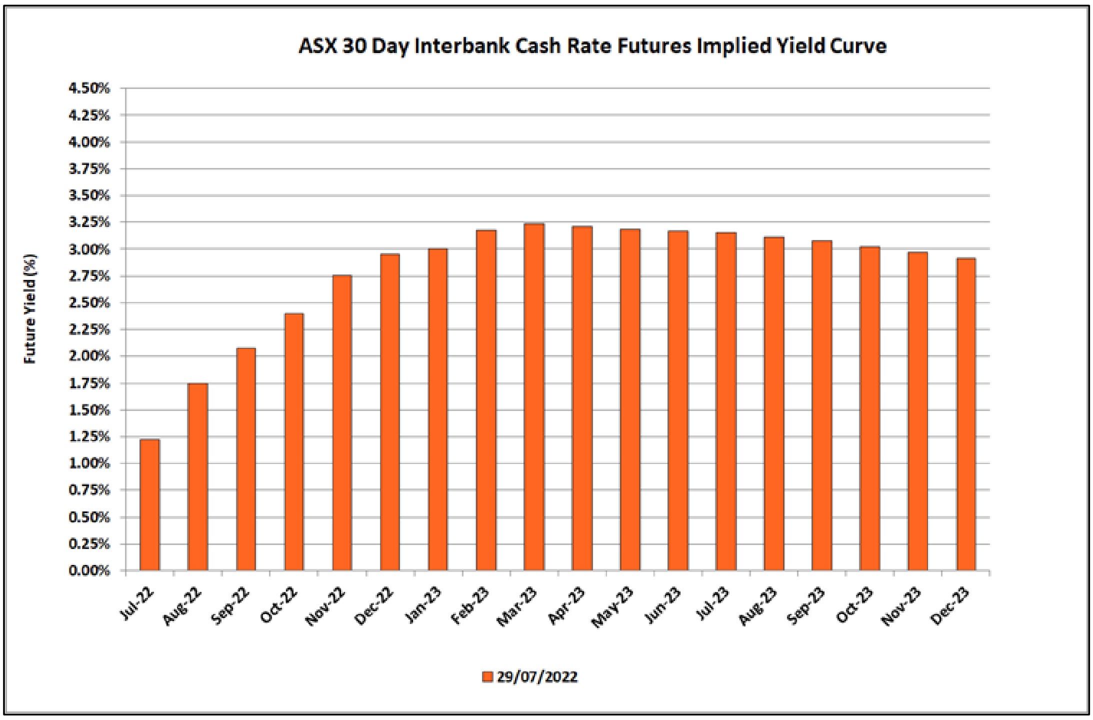
The RBA states "*we do need to chart a credible path back to 2-3%. We are seeking to do this in a way in which the economy continues to grow and unemployment remains low*". That suggests the RBA is still prioritising a soft landing as long as inflation expectations remain anchored as they currently are.

The domestic bond market continues to suggest a prolonged low period of interest rates on a historical basis (10-year government bond yields still just over 3%). Over the month, yields fell around 60bp at the long-end of the curve:




*Source: AFMA, ASX, RBA*

Markets are currently pricing in around 8 additional rate rises over the next year (up to 3¼%), against the RBA's neutral setting of 2½%. Fears of a looming global recession have actually seen rate cuts start to be priced in towards the second half of 2023**:**




*Source: ASX*

## Disclaimer

Imperium Markets provides fixed income investment advisory services and a financial market platform through which clients and fixed income product providers may transact with each other.

The information in this document is intended solely for your use. The information and recommendations constitute judgements as of the date of this report and do not consider your individual investment objectives and adopted policy mandate.

Imperium Markets monitors the entire fixed income investible universe and recommends the best rate available to us, regardless of whether a product provider uses our market platform. You are responsible for deciding whether our recommendations are appropriate for your particular investment needs, objectives and financial situation and for implementing your decisions. You may use our platform to transact with your chosen product providers.

Imperium Markets charges a flat fee for our investment advice. Any commissions received are rebated to clients in full. If you choose a product provider who uses our market platform, the product provider pays us 1bp p.a. funding fee of the value of the investments transacted.