10.3. Investment and Loan Borrowings Report as at 31 December 2022

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ATTACHMENTS:
1. North Sydney Council Monthly Investment Report December 2022 [**10.3.1** - 19 pages]

PURPOSE:

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

EXECUTIVE SUMMARY:

Investment Portfolio

Independent advice regarding the North Sydney Council's Investments is provided by Imperium Markets. This provides a layer of governance and expert advice in addition to the North Sydney Council's Policy and procedures.

The Investment Portfolio (excluding cash balances) held for the period ending 31 December 2022 had a market value of $140,396,010. The annualised returns were 2.46%.

Cash deposits at call were $12,109,208 with $11,817,507 of these held in interest bearing at-call and notice accounts. $291,701 cash is held in Council's interest-bearing transaction account with the Commonwealth Bank to meet day-to-day operational needs.

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 December 2022 were $1,571,000 compared to a year-to-date budget of $645,000.

The Reserve Bank of Australia (RBA) Board continued to increase the official cash rate to control high inflation. At its December meeting the official rate was increased by 25 basis points to 3.10%. The RBA considers that there are now mixed signals regarding inflation. It will consider a broader range of policy options going forward.

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 December 2022 is $5,921,432.

North Sydney Olympic Pool Redevelopment (NSOP)

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 cash outflows. The principal outstanding as at 31 December 2022 is $30,499,987.

FINANCIAL IMPLICATIONS:

Council's total investment portfolio performance for the financial year to date is 2.46% annualised. The actual year to date returns for cash and investments to 31 December 2022 were $1,566,000 compared to a year-to-date budget of $645,000.

RECOMMENDATION:

1.THAT the report on Investments and Loan Borrowings held on 31 December 2022 be received.

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

5. Our Civic Leadership
5.1 Lead North Sydney's strategic direction
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 December 2022 and annualised for the year-to-date 31 December 2022 (including investments which have matured prior to 31 December 2022).

	December 2022	**Annualised YTD as at 31 December 2022**
Actual Return	0.21%	2.46%
Benchmark	0.25%	2.98%
Variance	-0.04%	-0.52%

The portfolio underperformance as compared to the benchmark is due recent sharp rises in the RBA official cash rate and long-term investments placed when inflation expectations were low before those increases were made. Council's investment advisor, in the attached report, expects this relative underperformance to be temporary. It further notes that North Sydney has amongst the best performing deposits portfolios when ranked against other councils.

Asset Type	**Market Value as at 31 December 2022**	**Portfolio Breakdown as at 31 December 2022**
Term Deposits	$128,750,000	84.42%
Cash	$12,109,208	7.94%
Fixed Bonds	$9,000,000	5.90%
Floating Rate Notes (FRNs)	$2,646,010	1.74%
	$152,505,218	**100.00%**

Council's average duration of term deposits, which comprise 84.42% of the investment portfolio, was approximately 394 days as at 31 December 2022.

All funds have been invested in accordance with the Act and the Regulations made thereunder. The counterparty limit specified by Council's Financial Investment Policy was slightly exceeded for one institution, Suncorp Bank Ltd. 15.57% of the portfolio was placed with Suncorp compared to Policy limit of 15.00%. This was rectified by the withdrawal of $5,000,000 from Suncorp on 4 January 2023. 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. Funds comply with the credit quality conditions contained in Council's loan agreement with TCorp.
Council continues to seek independent advice for investments and is actively managing the portfolio to ensure that returns are maximised, considering 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 December 2022 have been reviewed and are $925,000 more than the year-to-date budgeted estimate. This result is driven by higher than forecast interest rates and a higher-than-expected cash balance due to delays to capital projects caused by wet weather and Covid lockdowns in the 2021/22 Financial Year. The Investment Income budget and forecast cash balances will be closely monitored in the December budget review.

Summary of Returns from Investments (includes Fair Value adjustments)

Year	**Original Annual Budget**	**Revised Annual Budget**	**YTD Budget (December)**	**YTD/Annual Actual (December)**	**YTD/Annual Actual FV adjustments (December)**	**YTD Budget to Actual Variance (December)**
2022/23	**$1,290,000**	**$1,290,000**	**$645,000**	$1,562,000	$4,000	**$921,000**
2021/22	$1,100,000	$1,300,000		$1,244,337	-$64,865	$1,179,472
2020/21	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601
2019/20	$1,350,000	$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 December 2022, the YTD movement of FRN's has been an increase of $4,000.

Financial Investment Policy

As at the end of December, 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 December 2022	Maximum Policy Holding	Distribution as 31 December 2022
AA Category	$97,341,701	100.00%	63.83%
A Category	$40,749,716	60.00%	26.72%
BBB Category	$14,413,801	35.00%	9.45%
Unrated ADIs (NR)	$0	10.00%	0.00%

The counter party limit for one institution, Suncorp Bank, was slightly exceeded. 15.57% of the portfolio was placed with Suncorp, compared to the Policy limit of 15.00%. This was corrected by the maturity of a $5,000,000 Suncorp term deposit on 4 January.

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 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

Loan Funded Capital Projects

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 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

Monthly Investment Report

December 2022

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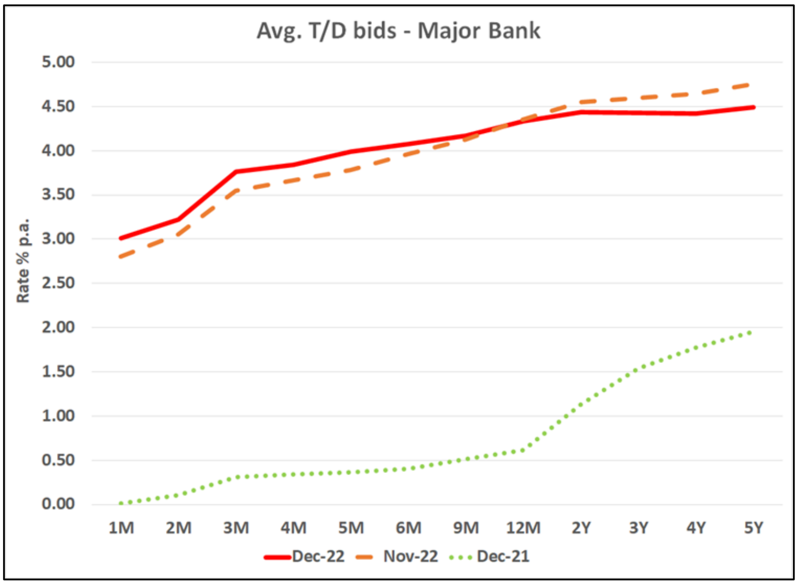
Market Update Summary

Recession fears gathered pace across financial markets in December after hawkish messaging by various global central banks. Hopes for a gentler US Federal Reserve faded amid stubbornly hot inflation with the central bank raising its forecast of how long interest rates have to stay elevated to cool inflation.

Domestically, The RBA's December Board Meeting Minutes contained a mixture of positive and negative developments. On the less hawkish side, the RBA is growing more confident about easing global growth and lower goods price inflation as supply chain disruptions resolve, but on the more hawkish side, the Board notes the balance of risks on Australian wages growth had shifted to the upside. Importantly and perhaps because of these mixed signals - the Board considered a wider range of options for policy at this meeting, including for the first time since interest rates were first increased in May, a pause in the rate rise cycle.

The largest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits, which accounts for around ~84½% of Council's total investment. Despite more rate rises on the horizon, given an upward sloping deposit curve, maintaining a slightly longer duration position will continue to outperform (averaging) shorter durations. The deposit market has largely already factored in the current rate hike cycle, reflected by the flattening of the curve demonstrated by the longer-term tenors (+2yrs) over the past few months (the market is also factoring in a recession over coming years).



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 & Compliance

Asset Allocation

As at the end of December 2022, the portfolio was mainly directed to fixed term deposits (84%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (8%).

Senior FRNs are now becoming more attractive as spreads have widened in 2022 – 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 4½% p.a.

Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 21% of assets is directed to medium-term assets (2-5 years), which has resulted in strong outperformance during the challenging economic environment. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $85m 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.

However in the interim, given the large upcoming capital expenditure of $94.4m flagged for FY2023, Council is likely to invest across shorter-tenors to match the capital program's cash flow requirements.

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$41,609,208	27.28%	10%	100%	$110,896,010
✓	91 - 365 days	$57,250,000	37.54%	20%	100%	$95,255,218
✓	1 - 2 years	$21,249,716	13.93%	0%	70%	$85,503,937
✓	2 - 5 years	$32,396,294	21.24%	0%	50%	$43,856,315
✓	5 - 10 years	$0	0.00%	0%	25%	$38,126,305
		$152,505,218	**100.00%**			

Counterparty

As at the end of December, all individual limits comply with the Policy, except for Suncorp (A+), which was marginally over by around $874k. 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-	$34,091,701	22.35%	30.00%	$11,659,864
✓	NAB	AA-	$33,000,000	21.64%	30.00%	$12,751,565
✓	NTTC Treasury	AA-	$9,000,000	5.90%	30.00%	$36,751,565
✓	Westpac	AA-	$21,250,000	13.93%	30.00%	$24,501,565
X	Suncorp	A+	$23,749,716	15.57%	15.00%	**-$873,933**
✓	ICBC Sydney	A	$17,000,000	11.15%	15.00%	$5,875,783
✓	BOQ	BBB+	$10,000,000	6.56%	10.00%	$5,250,522
✓	AMP Bank	BBB	$3,017,507	1.98%	10.00%	$12,233,015
✓	Newcastle PBS	BBB	$1,396,294	0.92%	10.00%	$13,854,228
			$152,505,218	**100.00%**		

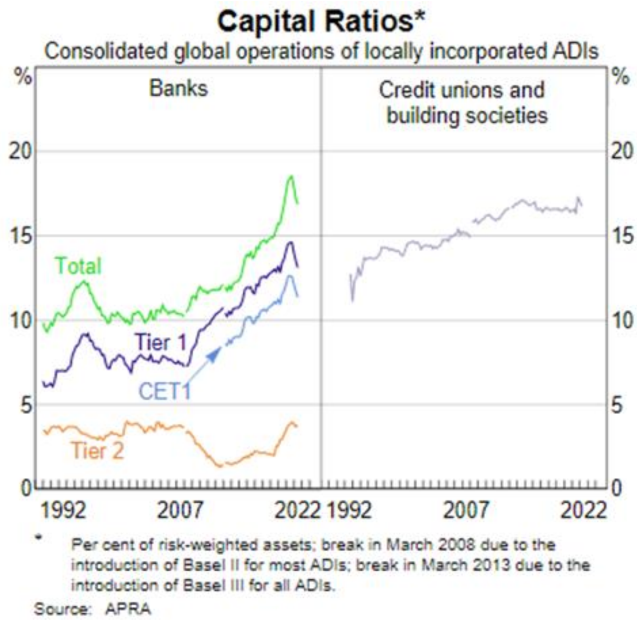
In late June 2022, Standard & Poor's downgraded Suncorp-Metway from AA- to A+ (negative watch). Suncorp recently announced that it is undertaking a strategic review of its banking operations. The downgrade reflects S&P's view that the Suncorp Group's likelihood of support for the bank had "*slightly*" 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 ~$3.9bn. 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 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*".**



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 December 2022, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$97,341,701	63.83%	100%	$55,163,517
✓	A Category	$40,749,716	26.72%	60%	$50,753,415
✓	BBB Category	$14,413,801	9.45%	35%	$38,963,026
✓	Unrated ADIs	$0	0.00%	10%	$15,250,522
		$152,505,218	**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 December 2022 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.26%	0.71%	1.18%	1.18%	1.31%	0.70%
AusBond Bank Bill Index	0.25%	0.74%	1.17%	1.17%	1.25%	0.64%
Council's T/D Portfolio	0.21%	0.60%	1.09%	1.09%	1.69%	1.54%
Council's FRN Portfolio	0.35%	0.99%	1.74%	1.74%	2.39%	2.00%
Council's Bond Portfolio	0.10%	0.29%	0.59%	0.59%	1.16%	1.10%
Council's Portfolio^	**0.21%**	**0.59%**	**1.07%**	**1.07%**	**1.67%**	**1.52%**
Outperformance	**-0.04%**	**-0.16%**	**-0.10%**	**-0.10%**	**0.41%**	**0.88%**

^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	3.10%	2.85%	2.35%	2.35%	1.31%	0.70%
AusBond Bank Bill Index	2.98%	2.98%	2.33%	2.33%	1.25%	0.64%
Council's T/D Portfolio	2.52%	2.39%	2.17%	2.17%	1.69%	1.54%
Council's FRN Portfolio	4.16%	4.00%	3.49%	3.49%	2.39%	2.00%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.16%	1.10%
Council's Portfolio^	**2.46%**	**2.34%**	**2.13%**	**2.13%**	**1.67%**	**1.52%**
Outperformance	**-0.52%**	**-0.64%**	**-0.20%**	**-0.20%**	**0.41%**	**0.88%**

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

For the month of December, the total investment portfolio (excluding cash) provided a strong return of +0.21% (actual) or +2.46% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.25% (actual) or +2.98% 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.

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 September 2022 Council Rankings), earning around $367,000 in additional interest income versus the average NSW Council. We have been pro-active in our advice about protecting interest income 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 December 2022, Council's deposit portfolio was yielding **2.49% p.a.** (up 17bp from the previous month), with a weighted average duration of around 394 days (~13 months). We recommend Council maintains an average duration above 12 months, if 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 ½-1% 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:

	LT Credit Rating	Term	T/D Rate
ICBC, Sydney	A	3 years	4.95% p.a.
ICBC, Sydney	A	2 years	4.90% p.a.
P&N Bank	BBB	3 years	4.90% p.a.
P&N Bank	BBB	2 years	4.85% p.a.
CBA	AA-	2 years	4.80% p.a.
Westpac	AA-	2 years	4.78% p.a.
Suncorp	A+	2 years	4.75% p.a.
NAB	AA-	2 years	4.65% p.a.
AMP Bank	BBB	2 years	4.55% p.a.^
BoQ	BBB+	2 years	4.50% p.a.

^Contact us for an additional 0.20% p.a. rebated commission. Rate changes daily. Current limit of $10m in aggregate.

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	4.71% p.a.
P&N Bank	BBB	12 months	4.65% p.a.
Westpac	AA-	12 months	4.63% p.a.
Suncorp	A+	12 months	4.55% p.a.
NAB	AA-	12 months	4.50% p.a.
BoQ	BBB+	12 months	4.45% p.a.
AMP	BBB	12 months	4.40% p.a.^
BoQ	BBB+	6 months	4.35% p.a.
NAB	AA-	6 months	4.30% p.a.

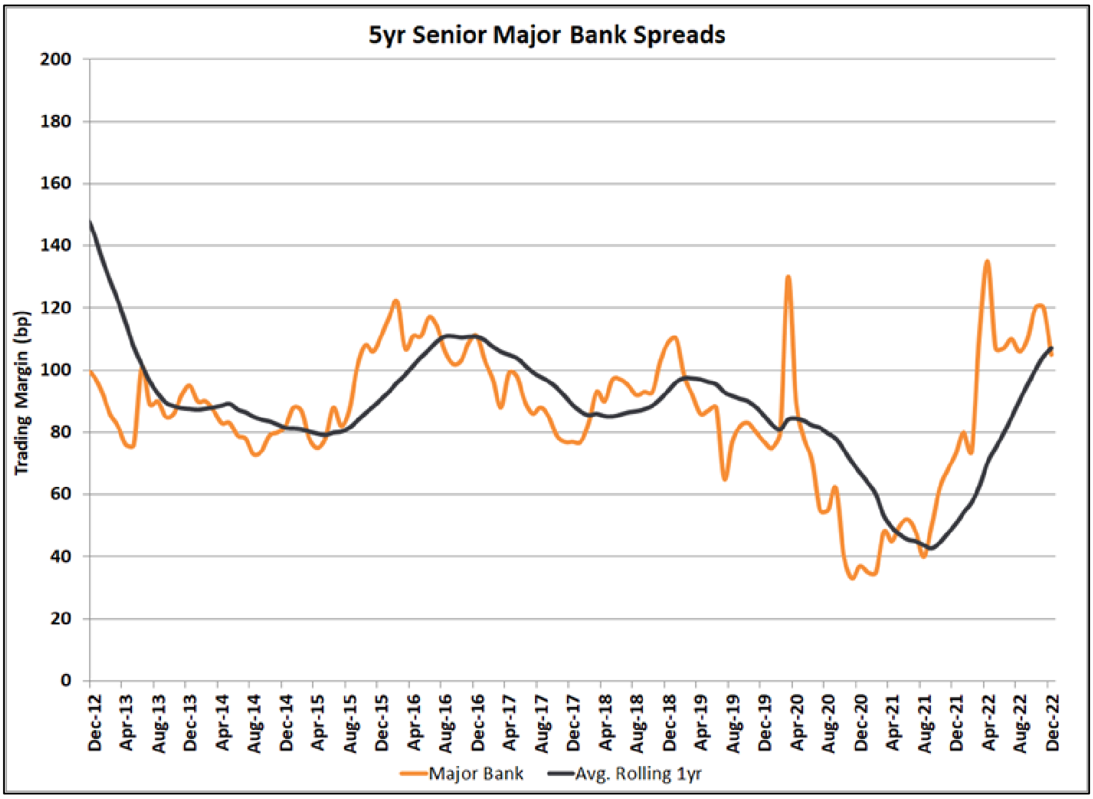
^Contact us for an additional 0.20% p.a. rebated commission. Rate changes daily. Current limit of $10m in aggregate

If Council does not require high levels of liquidity and can stagger its investments slightly 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 current value), yielding, on average, up to ½% p.a. higher compared to those investors that entirely invest in short-dated deposits (under 9 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 4½% p.a.

Senior FRNs Review

Over December, amongst the senior major bank FRNs, physical credit securities tightened between 10-15bp 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 +100-105bp level):



Source: IBS Capital

During December, there were noticeable new primary issuances from:

- WBC (AA- rated) senior FRN for 1 year at +50bp
- Suncorp (A+) senior FRN for 3 years at +125bp

Amongst the "A" rated sector, the securities were marked up to 20bp tighter at the 3-5 year part of the curve, whilst the "BBB" rated sector was marked up to 5bp wider 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)	31/12/2022	30/11/2022
"AA" rated – 5yrs	+105bp	+120bp
"AA" rated – 3yrs	+82bp	+92bp
"A" rated – 5yrs	+125bp	+145bp
"A" rated – 3yrs	+105bp	+115bp
"BBB" rated – 3yrs	+165bp	+158bp

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 late 2024 for the "AA" rated ADIs (domestic major banks)**;
- On or before late 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 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.

Primary (new) FRNs are now looking more appealing and should be considered on a case by case scenario.

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 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	0.68	3.00%	4.34%
AU3CB0258465	Westpac	AA-	Senior	16/11/2023	0.89	3.25%	4.26%
AU3CB0265403	Suncorp	AA-	Senior	30/07/2024	1.59	1.85%	4.76%
AU3CB0265593	Macquarie	A+	Senior	07/08/2024	1.63	1.75%	4.84%
AU3CB0265718	ING	AAA	Covered	20/08/2024	1.63	1.45%	4.67%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	1.67	1.55%	4.54%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.70	1.70%	4.80%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.84	2.00%	4.97%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	2.06	1.65%	4.62%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	2.06	1.65%	4.63%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	2.13	1.70%	4.98%
AU3CB0287415	Westpac	AA-	Senior	17/03/2025	2.22	2.70%	4.57%
AU3CB0291508	Westpac	AA-	Senior	11/08/2025	2.62	3.90%	4.63%
AU3CB0291672	CBA	AA-	Senior	18/08/2025	2.64	4.20%	4.63%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	3.34	1.40%	5.37%
AU3CB0282358	ING	AAA	Covered	19/08/2026	3.64	1.10%	4.94%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.83	2.10%	5.38%
AU3CB0286037	Westpac	AA-	Senior	25/01/2027	4.08	2.40%	4.93%

Economic Commentary

International Market

Recession fears gathered pace across financial markets in December after hawkish messaging by various global central banks. Hopes for a gentler US Federal Reserve faded amid stubbornly hot inflation with the central bank raising its forecast of how long interest rates have to stay elevated to cool inflation.

Across equity markets, the S&P 500 Index fell -5.90%, while the NASDAQ lost -8.73%. Europe's main indices also fell, led by France's CAC (-3.93%), Germany's DAX (-3.29%) and UK's FTSE (-1.60%).

The US Fed lifted the funds rate by 0.50% to a range between 4.25-4.50%, a level not seen since 2007. The 50bp increase was a downshift following four consecutive hikes of 75bp. The new dot plot revealed the majority of Fed officials now expect the Funds rate to end next year at 5.125% (5% to 5.25% range), 50bp higher relative to the median projection in September. Fed Chair Powell reiterated the message that policy will need to remain tight for "*some time*" in order to restore price stability.

US CPI came in at +0.1% m/m for November and +7.1% y/y, two tenths below expectations and the smallest increase since August 2021. Core CPI came in at +0.2% and +6.0% y/y, one tenth below consensus.

The Bank of England hiked by 50bp to 3.50%, as expected. UK GDP for October came in at +0.5% against the +0.4% consensus.

The ECB delivered the anticipated 50bp hike in the deposit rate to 2.0%, dialled down from 75bp at each of the previous two meetings. Inflation in the eurozone in the year to November fell for the first time in 17 months, easing to +10.0% from +10.6%.

The Bank of Canada increased official rates by 50bp to 4.25%, but signalled openness to pausing in January. Canada's employment growth matched expectations with +10k job growth but the unemployment rate fell to 5.1% (expectations for a rise to 5.3%), near its lowest levels since the 1970s.

The Bank of Japan somewhat took the market by surprise by the expansion of the tolerance band around its Yield Curve Control (YCC) target to +/-0.5% from +/-0.25%, something that Governor Kuroda has been suggesting was not under consideration, since it would, he said, be equivalent to a rate rise.

China's soundings around its Covid situation also aided markets, hinting towards a pro-growth strategy instead of their ongoing strict zero-Covid strategy.

The MSCI World ex-Aus Index fell -4.39% for the month of December:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-5.90%	+7.08%	-19.44%	+5.92%	+7.51%	+10.41%
MSCI World ex-AUS	-4.39%	+9.30%	-19.67%	+3.41%	+446%	+7.09%
S&P ASX 200 Accum. Index	-3.21%	+9.40%	-1.08%	+5.55%	+7.11%	+8.66%

Source: S&P, MSCI

Domestic Market

As widely expected, the RBA raised the cash rate by 25bp for the third consecutive Board meeting in December to 3.10%. The important final paragraph again notes that "*the Board expects to increase interest rates further over the period ahead*", but importantly added "*it is not on a pre-set course*" and concludes with the reaffirmation "*the Board remains resolute in its determination to return inflation to target and will do what is necessary to achieve that*".

The RBA's December Board Meeting Minutes contained a mixture of positive and negative developments. On the less hawkish side, the RBA is growing more confident about easing global growth and lower goods price inflation as supply chain disruptions resolve, but on the more hawkish side, the Board notes the balance of risks on Australian wages growth had shifted to the upside.

Importantly and perhaps because of these mixed signals - the Board considered a wider range of options for policy at this meeting, including for the first time since interest rates were first increased in May, a pause in the rate rise cycle.

Australia's GDP rose by +0.6% q/q (+5.9% y/y) and continues to reflect a strong economy where GDP is now 6.5% above pre-pandemic levels – stronger than most major economies.

The unemployment rate for November was unchanged at 3.4%, as the participation rate rose 0.2% to 66.8%, returning to its record high.

October's trade data saw the trade surplus coming in at $12.2bn, just $0.2bn below the previous month.

Australian dwelling prices fell -1.0% m/m in November, the seventh consecutive month of decline. The residential auction clearance rate dipped to its lowest level in almost five months as homebuyers factored in the impact of another jump in interest rates.

The Australian dollar gained +1.15%, finishing the month at US67.75 cents (from US66.98 cents the previous month).

Credit Market

The global credit indices widened over December as financial markets lost some of their recent (positive) momentum. They are now back to their levels earlier this year:

Index	December 2022	November 2022
CDX North American 5yr CDS	86bp	77bp
iTraxx Europe 5yr CDS	98bp	92bp
iTraxx Australia 5yr CDS	91bp	91bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	December 2022	November 2022
Bloomberg AusBond Bank Bill Index (0+YR)	+0.25%	+0.25%
Bloomberg AusBond Composite Bond Index (0+YR)	-2.06%	+1.55%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.34%	+0.42%
Bloomberg AusBond Credit Index (0+YR)	-0.62%	+1.35%
Bloomberg AusBond Treasury Index (0+YR)	-2.37%	+1.43%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-2.74%	+2.48%

Source: Bloomberg

Other Key Rates

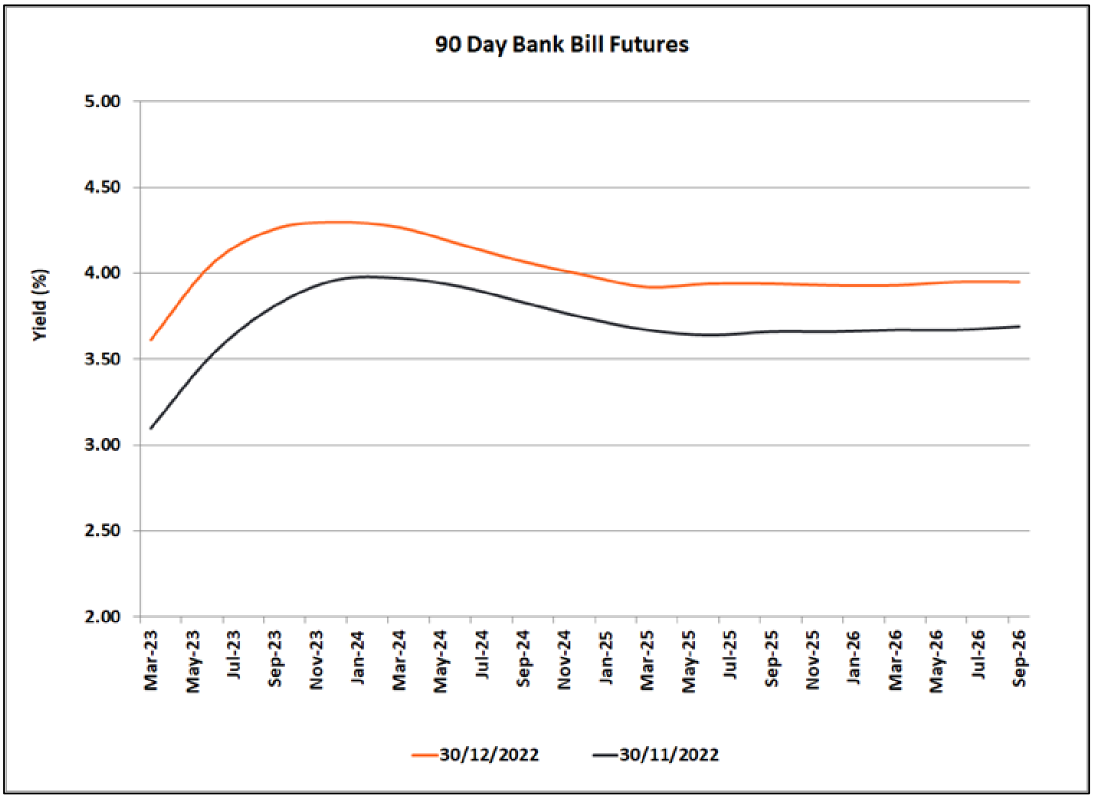
Index	December 2022	November 2022
RBA Official Cash Rate	3.10%	2.85%
90 Day (3 month) BBSW Rate	3.26%	3.09%
3yr Australian Government Bonds	3.51%	3.17%
10yr Australian Government Bonds	4.05%	3.53%
US Fed Funds Rate	4.25%-4.50%	3.75%-4.00%
3yr US Treasury Bonds	4.22%	4.13%
10yr US Treasury Bonds	3.88%	3.68%

Source: RBA, AFMA, US Department of Treasury

IMPERIUM MARKETS

90 Day Bill Futures

Over December, bill futures rose across the board, with the market reacting to the US Fed's guidance about how long official rates are likely to remain elevated, erasing hopes of a potential drop in rates in 2023. 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

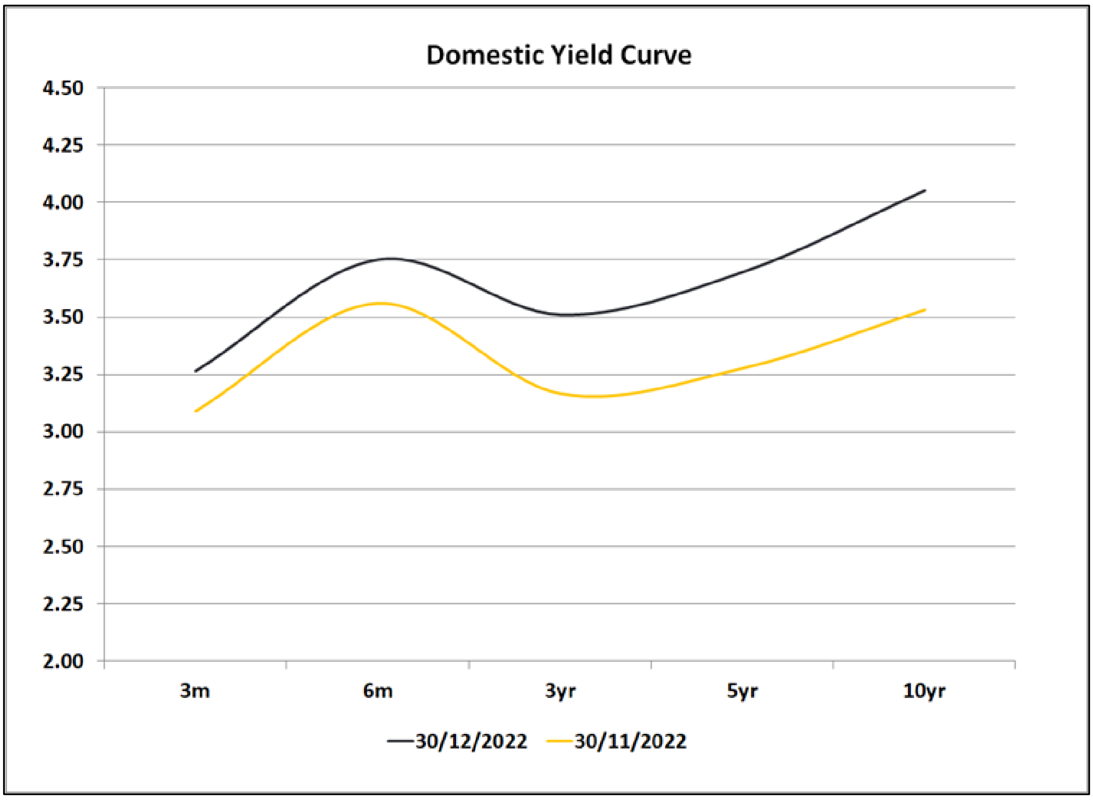
Fixed Interest Outlook

Markets have remained volatile as hopes for a gentler US Fed vanished amid stubbornly hot inflation. The central bank recently raised its forecast of how long interest rates have to stay elevated to cool inflation that has been hurting businesses and threatening spending. Markets are now factoring the peak of interest rate cycle in the US to be in the 5.25%-5.50% range (up from 5.00%-5.25%).

Domestically, the latest RBA minutes for the December meeting revealed the Board considered a wide range of options for policy, including a 50bp rate rise and, for the first time since interest rates were first increased in May, a pause in the rate rise cycle. The Board concluded that the arguments for the three different courses of action (no change, +25bp or +50bp) were strongest for increasing the Cash Rate by a further 25bp. The very fact that a pause in the rate rise cycle entered the RBA's thinking in December suggest that one may not be too far off.

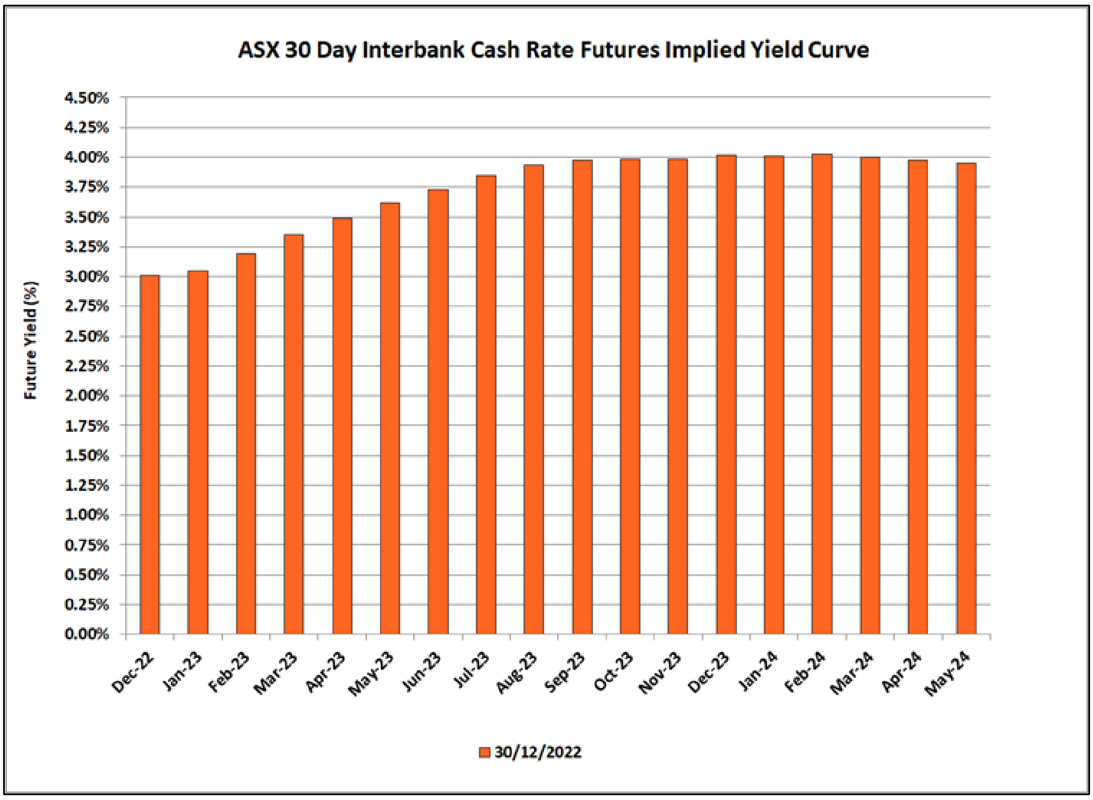
The RBA continues to signal that it expects to increase interest rates further over the period ahead, with an additional two to three 25bp hikes already largely priced into the market by Q2 2023, taking the cash rate up to 3.60%-3.85%. Thereafter, noting the lags in monetary policy, a pause around the end of Q1 or in Q2 is likely whilst the RBA monitors the economic data.

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



Source: AFMA, ASX, RBA

Markets are currently pricing in around 4 additional rate rises into 2023 (up to 4%). 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