10.4. Investment and Loan Borrowings Report as at 30 April 2024

AUTHOR	Christian Menday, Manager Financial Services
ENDORSED BY	Luke Harvey, Director Corporate Services
ATTACHMENTS	1. Arlo Advisory Monthly Investment Report April 2024 [**10.4.1** - 21 pages]
CSP LINK	5. Our Civic Leadership 5.1 Lead North Sydney's strategic direction

PURPOSE:

The purpose of this report is to provide details of the performance of Council's investments and loans for the month ending 30 April 2024.

EXECUTIVE SUMMARY:

- All investments have been made in accordance with the Local Government Act and Regulations and Council's Financial Investments Policy.

- For the month of April, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.30% (actual), or +3.65% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.35% (actual), or +4.37% p.a. (annualised). This is due to Council holding term deposits made in a low inflation environment when interest rate rises were not expected.

- Returns on investments exceed the adjusted YTD budget by $924.35 thousand. The total return for the 2023/2024 financial year to date is approximately $4.59 million. The better-than-expected return is due to payments for the capital works program progressing slower than expected in the first two quarters. The budget will be reviewed in the March Quarterly Budget Review.

RECOMMENDATION:

1. THAT the report on Investments held 30 April 2024, prepared in accordance with clause 212 of the Local Government (General) Regulation 2021, and the information on Loan Borrowings be received.

Background

Clause 212 of Local Government (General) Regulation 2021, states that the Responsible Accounting Officer must provide Council with a monthly report detailing all funds 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, also the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.

It is also prudent to report loan balances and compliance with borrowing orders issued by the Minister for Local Government and Council's Debt Management Policy.

Total Cash and Investment Balance and Reserves

The total cash and investment balance is $131,833,828. Most of this balance is held in reserves to be spent on certain activities and projects. Reserves fall into one of two categories:

- external restrictions (Council is obliged by legislation, or contract, to spend the funds on certain projects and activities); and
- internal allocations (Council has resolved to spend the funds on certain projects and activities).

The following table details the reserves, held as at 30 April 2024. Council holds an unrestricted cash balance of $2.5 million, indicating it has funded all its reserves.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions – general	$50,602,386
Domestic waste management	$14,852,414
Unexpended Special Rates	$906,134
Unspent borrowings - North Sydney Olympic Pool redevelopment	$0
Waste and sustainability improvement funds	$37,646
Specific purpose grants	$5,009,990
Other specific purpose contributions	$2,405,300
Total external restrictions	**$73,813,870**
Internal allocations	
Capital works	$12,382,576
Community housing - capital purchases	$962,601
Community housing - major maintenance	$490,657
Deposits, retentions, and bonds	$14,200,127
Employees leave entitlement	$7,092,831
I.T. hardware and software	$1,211,130
Income producing projects	$782,006
Olympic Pool Redevelopment	$15,486,615
Plant and vehicle replacement	$2,953,179
Total internal allocations	**$55,561,722**

External Restrictions and Internal Allocations	
Total Restrictions and Allocations	**$129,375,592**
Unrestricted Cash and Investments	$2,458,236
Total Cash and Investments	**$131,833,828**

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of April 2024 - and annualised for the year-to-date 30 April 2024 (including investments that have matured prior to that date).

	April 2024	Annualised YTD
Actual Return	0.30%	3.65%
Benchmark	0.35%	4.37%
Variance	-0.05%	-0.72%

The portfolio underperformance, as compared to the benchmark, is due to sharp rises in the RBA official cash rate and long-term investments that were placed when inflation expectations were low and before those increases were made.

Asset Type	Market Value	Portfolio Breakdown
Term Deposits	$107,500,000	81.54%
Cash	$13,932,686	10.57%
Fixed Bonds	$9,000,000	6.83%
Floating Rate Notes (FRNs)	$1,401,142	1.06%
	$131,833,828	**100.00%**

Council's average duration of term deposits, which comprise 81.54% of the investment portfolio, is approximately 240 days. The average duration continues to fall to align maturities with expected outflows on the capital works program.

All funds have been invested in accordance with the Act and the Regulations made thereunder. 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. All investments accord with Council's Financial Investments Policy.

Council continues to seek independent advice for investments and are 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 (Attachment 1) prepared by Council's investment advisor, Arlo Advisory. The report contains advice about optimal investment options, but also notes that Council's scope to act on that advice is limited by its cash flow requirements. Council has considerable requirements for short term investments to fund its Capital Works budget of $94.2 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 30 April 2024 are $924.4 thousand more than the revised year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Apr)	YTD (Mar)	YTD Actual FV adjustments (Apr)	YTD Budget to Actual Variance (Apr)
2023/24	$2,500,000	$4,650,000	$3,666,904	$4,585,477	$5,775	$924,348
Previous Years						
Year	**Original Annual Budget**	**Revised Annual Budget**		**Final Result Interest**	**Final Result FV adjustments**	**Final Budget to Actual Variance**
2022/23	$1,384,350	$3,340,000		$3,685,634	$4,647	$350,281
2021/22	$1,182,500	$1,362,500		$1,302,826	$64,865	$5,191
2020/21	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601

Floating Rate Notes (FRNs) are required to be revalued each month using the Fair Value (FV) method, an estimate of the market value of the investment. The YTD movement of FRN's has seen an increase of $5,775.

Financial Investment Policy

All categories are within the Policy limits for credit ratings. The portfolio remains well diversified, with credit quality rated as BBB, or higher. The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio are:

Long Term Rating Range (Standard & Poors)	Invested	Maximum Policy Holding	Distribution
AA Category	$94,932,686	100.00%	72.00%
A Category	$30,500,000	60.00%	23.14%
BBB Category	$6,401,142	35.00%	4.86%
Unrated ADIs (NR)	$0	10.00%	0.00%

Credit Quality Limits in TCorp Loan Agreement

Council's Loan Agreement with TCorp imposes credit quality limits. The Loan Agreement was varied in February 2024, so that these limits are now the same as those contained in Council's Financial Investment Policy. It is no longer necessary to report compliance with additional TCorp limits.

Loan Borrowings

Council's Loan Borrowing Policy is the framework for Council's borrowing activities. This defines responsibilities and parameters for borrowing and related risk management activities. 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 a risk averse strategy.

Loan borrowings are 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 Street Carpark and On-Street 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**
1/07/2023	$5,456,690.24			
31/07/2023	$5,223,543.14	$56,492.44	$233,147.10	$ 289,639.54
31/10/2023	$4,986,831.69	$52,928.09	$236,711.45	$ 289,639.54
31/01/2024	$4,747,721.74	$50,529.58	$239,109.96	$ 289,639.54
30/04/2024	$4,505,143.18	$47,060.98	$242,578.56	$ 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 February 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 released, as required, to fund project cash outflows. As of April 2024, the loan funds have been fully expended.

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**
01/07/2023	$29,989,374.70			
30/10/2023	$29,467,937.22	$624,720.2	$521,437.78	$1,157,212.52
29/04/2024	$28,935,444.96	$613,431.4	$532,492.26	$1,157,212.52

Consultation requirements

Community engagement is not required.

Financial/Resource Implications

Returns continue to be significantly higher than the year-to-date budget as payments for capital works have been lower than expected. A $1 million upward revision was adopted at the September Quarter Budget Review. The December Quarter Review adopted a further upward revision of $1 million. This report indicates that a further upward revision of $1 million is in order at the March Quarterly Review.

Legislation

Section 625 of the Local Government Act (NSW) allows councils to invest money that is not currently required for any other purpose. It further specifies how councils may invest. It specifies investments must be in accordance with the local government minister's orders.

Clause 212 of the Local Government Regulation (NSW) 2021 requires that the Responsible Accounting Officer must make a monthly report to Council, setting out all details of money invested under Section 625 of the Local Government Act.

Sections 621 to 624 of the Local Government Act give councils the ability to borrow money and specify some further regulations on that borrowing. Council's staff consider it prudent to provide monthly reporting of loans.

Arlo Advisory

Monthly Investment Review

NORTH SYDNEY COUNCIL
CAMMERAYGAL

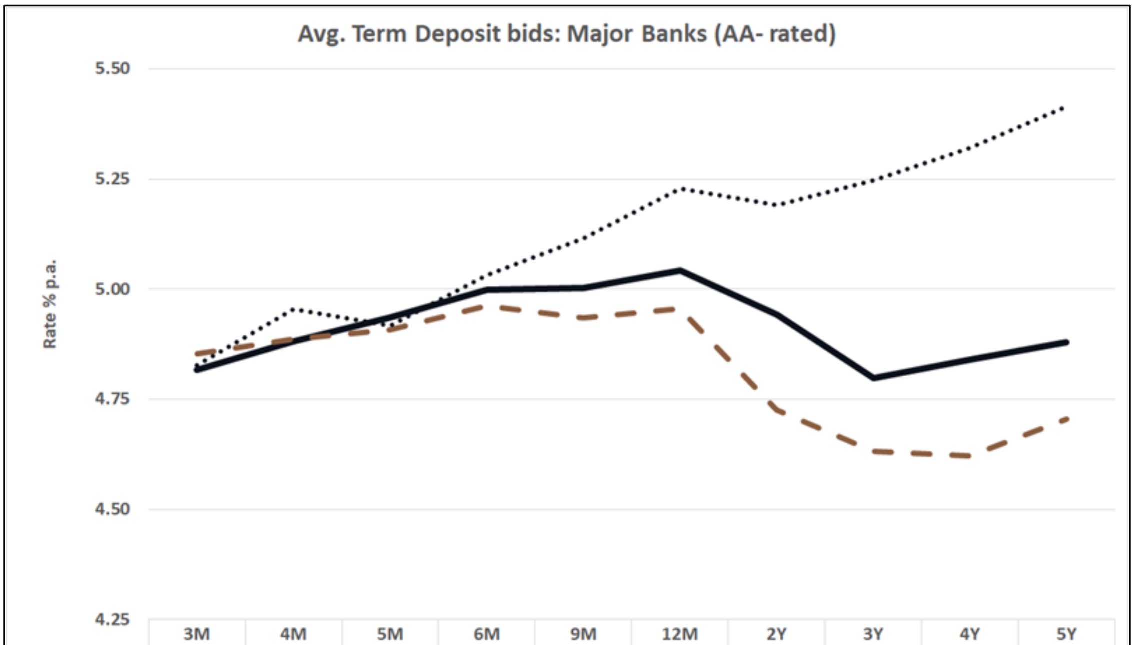
April 2024

Arlo Advisory Pty Ltd
ABN: 55 668 191 795
Authorised Representative of InterPrac Financial Planning Pty Ltd
AFSL 246 638
Phone: +61 2 9053 2987
Email: michael.chandra@arloadvisory.com.au / melissa.villamin@arloadvisory.com.au
125 Middle Harbour Road, East Lindfield NSW 2070

Market Update Summary

In April, risk assets finally parred back some of their strong gains in recent months. Inflation readings in the US have been higher than anticipated, pushing back the US Fed's expectations of when interest rates would fall. Bonds were subsequently sold off, with longer-term yields rising significantly.

Over April, there was a flattening of the deposit curve at the longer-end, reflective of the movement in global bond yields. Markets have seemingly pushed back expectations of the first rate cut to at least late 2024, if not early 2025. On average, major bank deposit rates were around 15-20bp higher at the long-end (2-5 year) part of the curve (compared to March) in response to market movements.



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Apr-2024	4.82	4.88	4.94	5.00	5.00	5.04	4.94	4.80	4.84	4.88
Mar-2024	4.85	4.89	4.91	4.96	4.93	4.96	4.73	4.63	4.62	4.70
Oct-2023	4.83	4.95	4.92	5.03	5.12	5.23	5.19	5.25	5.32	5.42

Source: Imperium Markets

With a global economic downturn and interest rate cuts being priced over the next 12 months, investors should consider diversifying and taking an 'insurance policy' against a potentially lower rate environment by investing across 2-5 year fixed deposits, targeting rates above 5% p.a. (small allocation only).

North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of April 2024, the portfolio was mainly directed to fixed term deposits (82%). The remaining portfolio is directed to FRNs (1%), fixed bonds (7%) and overnight cash accounts (11%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 2 years. New issuances may be considered again on a case by case scenario. In the interim, staggering a mix of fixed deposits between 9-12 months to 2 years remains a more optimal strategy to maximise returns over a longer-term cycle.

With interest rate cuts and a global economic downturn being priced in coming years, investors can choose to allocate a small proportion of longer-term funds and undertake an insurance policy against any potential future rate cuts by investing across 2-5 year fixed deposits, locking in and targeting yields close to or above 5% p.a.

However, noting the significant capital outflows expected in the near term, Council is currently largely restricted to investing into very short-term investments (under 12 months). This is suitable to invest in short-dated fixed term deposits or high yielding cash accounts.

Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 6% of assets is directed to medium-term assets (2-5 years), which has resulted in strong outperformance during the challenging economic environment over longer-term time periods. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $65m at month-end.

Where liquidity permits (once immediate capital projects are finalised), we recommend new surplus funds be directed to 1-3 year horizon given this will help optimise returns over the long-run. We suggest this be allocated to any remaining attractive fixed term deposits.

In the interim, given the large upcoming capital expenditure of $94.1 (as per the September Quarter Budget Review) flagged in the short-term, 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	$57,432,686	43.56%	10%	100%	$74,401,142
✓	91 - 365 days	$39,401,142	29.89%	20%	100%	$92,432,686
✓	1 - 2 years	$27,000,000	20.48%	0%	70%	$65,283,680
✓	2 - 5 years	$8,000,000	6.07%	0%	50%	$57,916,914
✓	5 - 10 years	$0	0.00%	0%	25%	$32,958,457
		$131,833,828	**100.00%**			

Counterparty

As at the end of April, all individual limits comply with the Policy. We remind Council exposures to individual ADIs are driven by the portfolio's movements throughout any month. Overall, the portfolio is lightly diversified across the investment grade spectrum, with no exposure to the unrated ADIs.

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA	AA-	$30,932,686	23.46%	30.00%	$8,617,463
✓	NAB	AA-	$29,000,000	22.00%	30.00%	$10,550,148
✓	NTTC Treasury	AA-	$9,000,000	6.83%	30.00%	$30,550,148
✓	Westpac	AA-	$26,000,000	19.72%	30.00%	$13,550,148
✓	ICBC Sydney	A	$17,000,000	12.90%	15.00%	$2,775,074
✓	BOQ	A-	$11,500,000	8.72%	15.00%	$8,275,074
✓	Bendigo	A-	$2,000,000	1.52%	15.00%	$17,775,074
✓	Heritage	BBB+	$5,000,000	3.79%	10.00%	$8,183,383
✓	Newcastle PBS	BBB+	$1,401,142	1.06%	10.00%	$11,782,240
			$131,833,828	**100.00%**		

In February 2024, ANZ's takeover of Suncorp was given the green light by the Australian Competition Tribunal (ACT), six months after the Australian Competition and Consumer Commission (ACCC) blocked the deal on the grounds that it could lessen competition in the mortgage market. As such, Suncorp's assets are likely to be upgraded to AA- in the near future by S&P (but also, they may be flagged as an ADI lending to the fossil fuel industry in future).

In early April 2024, BoQ and Bendigo-Adelaide were upgraded by S&P from BBB+ to A-. Separately, several other regional banks were upgraded from BBB to BBB+, as well as BBB- to BBB. This has resulted in increased capacity to invest in some of these individual institutions from a counterparty perspective, as well as the aggregate "BBB" rated category (see Credit Quality section).

Credit Quality

The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher). As at the end of April 2024, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$94,932,686	72.01%	100%	$36,901,142
✓	A Category	$30,500,000	23.14%	60%	$48,600,297
✓	BBB Category	$6,401,142	4.86%	35%	$39,740,697
✓	Unrated ADIs	$0	0.00%	10%	$13,183,383
		$131,833,828	**100.00%**		

Performance

Council's performance for the month ending April 2024 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.35%	1.06%	2.15%	3.54%	4.21%	3.30%	2.22%
AusBond Bank Bill Index	0.35%	1.07%	2.17%	3.62%	4.24%	3.30%	2.19%
Council's T/D Portfolio	0.31%	0.94%	1.93%	3.11%	3.59%	2.88%	2.35%
Council's FRN Portfolio	0.51%	1.40%	2.77%	4.58%	5.42%	4.47%	3.40%
Council's Bond Portfolio	0.10%	0.29%	0.58%	0.98%	1.17%	1.17%	1.14%
Council's Portfolio^	**0.30%**	**0.91%**	**1.86%**	**3.00%**	**3.47%**	**2.80%**	**2.29%**
Rel. Performance	**-0.06%**	**-0.16%**	**-0.32%**	**-0.63%**	**-0.77%**	**-0.50%**	**0.10%**

^Total portfolio performance excludes Council's cash account holdings.

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	4.35%	4.35%	4.35%	4.25%	4.21%	3.30%	2.22%
AusBond Bank Bill Index	4.37%	4.40%	4.40%	4.35%	4.24%	3.30%	2.19%
Council's T/D Portfolio	3.80%	3.88%	3.91%	3.73%	3.59%	2.88%	2.35%
Council's FRN Portfolio	6.42%	5.80%	5.64%	5.51%	5.42%	4.47%	3.40%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.14%
Council's Portfolio^	**3.65%**	**3.73%**	**3.76%**	**3.59%**	**3.47%**	**2.80%**	**2.29%**
Rel. Performance	**-0.72%**	**-0.68%**	**-0.65%**	**-0.75%**	**-0.77%**	**-0.50%**	**0.10%**

^Total portfolio performance excludes Council's cash account holdings.

For the month of April, the total investment portfolio (excluding cash) provided a solid return of +0.30% (actual) or +3.65% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.35% (actual) or +4.37% 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 fairly temporary, especially if the RBA is approaching the end of its rate hike cycle.

Note this underperformance is also highly dependent on reinvesting maturing funds at prevailing market rates beyond 6 month tenors. With large capital outflows, maturing funds are largely being spent or kept in low yielding short-dated assets. Council should also remind itself it has consistently 'outperformed' over longer-term time periods (last +10yrs) as demonstrated by the longer-term returns of the overall investment portfolio (e.g. 3 year returns).

We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned. We have been pro-active in our advice about protecting interest income for many years and encouraged to maintain a slightly long duration position as this optimises the overall returns of the portfolio in the long-run.

Recommendations for Council

Term Deposits

As at the end of April 2024, Council's deposit portfolio was yielding **3.64% p.a.** (down 13bp from the previous month), with a weighted average duration of around 240 days (~8 months). We recommend Council slightly increases this weighted average duration, should cash flows allow in future.

In the immediate future, given the significant outflows anticipated from capital projects, short-dated term deposits are suitable for North Sydney Council's purposes.

Please refer to the section below for further details on the Term Deposit market.

Securities

Primary (new) **FRNs** (with maturities between 3-5 years) continue to be appealing (particularly for those investors with portfolios skewed towards fixed assets) and should be considered on a case by case scenario.

Please refer to the section below for further details on the FRN market.

Council's Senior FRNs Sale/Switch Recommendations

We recommend Council retains the Newcastle FRN at this stage (still yielding well above 5¼% p.a.). We will inform Council when there is an opportunity to sell this FRN to boost the overall returns of the investment portfolio. **During the month, Council sold out of the following low yielding FRN to replenish capital reserves**:

Issuer	Rating	Maturity Date	ISIN	Face Value	Trading Margin	Capital Price ($)	Realised Gain ($)
Sunc.	A+	30/07/2024	AU3FN0049144	$1,250,000	+30.0bp	$100.138	$1,725

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 (sister company of Arlo Advisory). We believe these investments were prudent at the time of investment especially after the rate cut delivered in early November 2020 to 0.10% 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.

Term Deposit Market Review

Current Term Deposits Rates

As at the end of April, we see value in the following:

ADI	LT Credit Rating	Term	Rate % p.a.
Rabobank	A	5 years	5.35%
Bank of China, Sydney	A	2-3 years	5.35%
Rabobank	A	4 years	5.25%
Westpac	AA-	5 years	5.20%
NAB	AA-	2 years	5.20%
Westpac	AA-	2 years	5.19%
Westpac	AA-	3 years	5.13%
NAB	AA-	3-5 years	5.10%
ING	A	5 years	5.10%
P&N Bank	BBB+	2 years	5.00%

The above deposits are suitable for investors looking to maintain diversification and lock-in a slight 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 (*we stress that rates are indicative, dependent on daily funding requirements and different for industry segments*):

ADI	LT Credit Rating	Term	Rate % p.a.
ICBC	A	12 months	5.35%
BankVIC	BBB+	12 months	5.31%
Westpac	AA-	12 months	5.30%
NAB	AA-	11-12 months	5.25%
Westpac	AA-	11 months	5.23%
Hume Bank	BBB+	12 months	5.21%
NAB	AA-	8-10 months	5.20%
Bendigo-Adelaide	A-	9 months	5.19%
NAB	AA-	6-7 months	5.15%
Westpac	AA-	6 months	5.15%
BoQ	A-	6-12 months	5.15%
Bendigo-Adelaide	A-	12 months	5.14%
ING	A	12 months	5.10%
NAB	AA-	3 months	5.00%

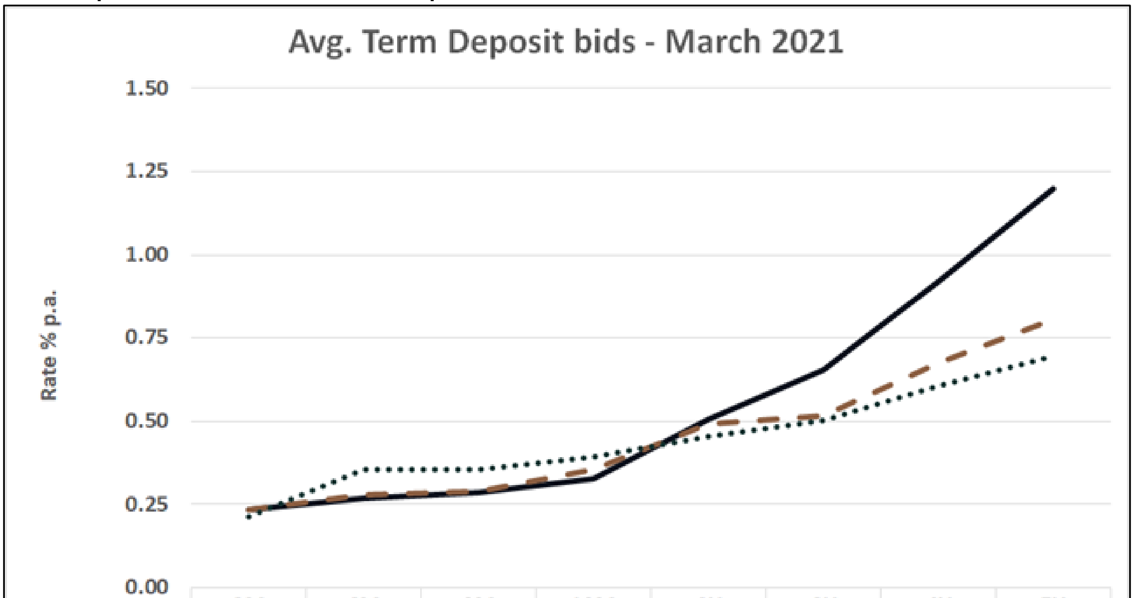
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared to those investors that entirely invest in short-dated deposits (under 6-9 months).

With a global economic slowdown and interest rate cuts being priced over the next 12 months, investors should strongly consider diversifying by allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates close to or above 5% p.a. This will provide some income protection with central banks now looking to cut rates by calendar year-end.

Term Deposits Analysis

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) during mid-2020, 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. 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 three years.

Term Deposit Rates – 12 months after pandemic (March 2021)



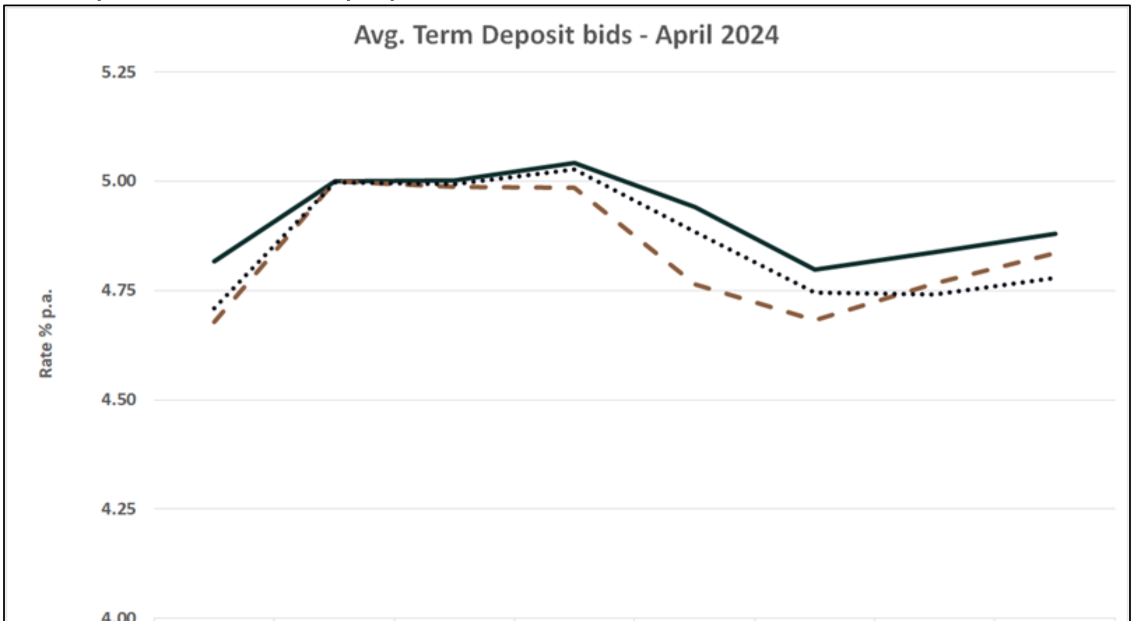
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits slowly increases. In recent months, we have started to periodically see some of the lower rated ADIs ("A" and "BBB" rated) offering slightly higher rates compared to the domestic major banks ("AA" rated) on different parts of the curve (i.e. pre-pandemic environment). Some of this has been attributed to lags in adjusting their deposit rates as some banks (mainly the lower rated ADIs) simply set their rates for the week.

Going forward, Council should have a larger opportunity to invest a higher proportion of its funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry or considered 'ethical'. We are slowly seeing this trend emerge, although the major banks always seem to react to volatility more quickly than the rest of the market, as was the case this month:

Term Deposit Rates – Currently (April 2024)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.82	5.00	5.00	5.04	4.94	4.80	4.84	4.88
A Rated	4.68	5.00	4.99	4.99	4.76	4.68	4.77	4.84
BBB Rated	4.71	5.00	4.99	5.03	4.88	4.75	4.74	4.78

Source: Imperium Markets

Regional & Unrated ADI Sector

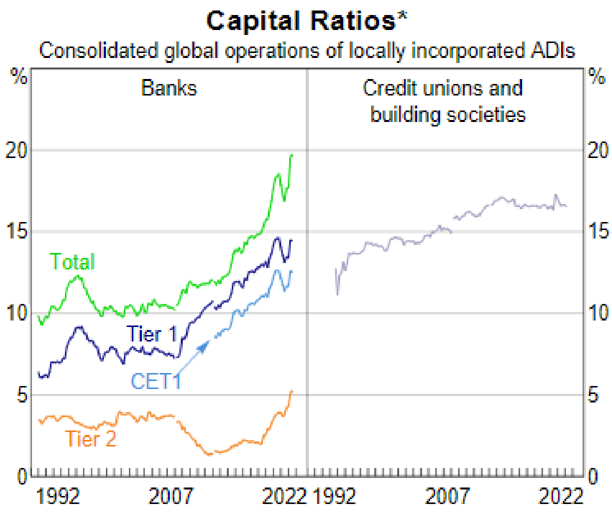
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P expects that consolidation to continue over the next two years.

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). The financial regulator, APRA has 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 decade. 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*".



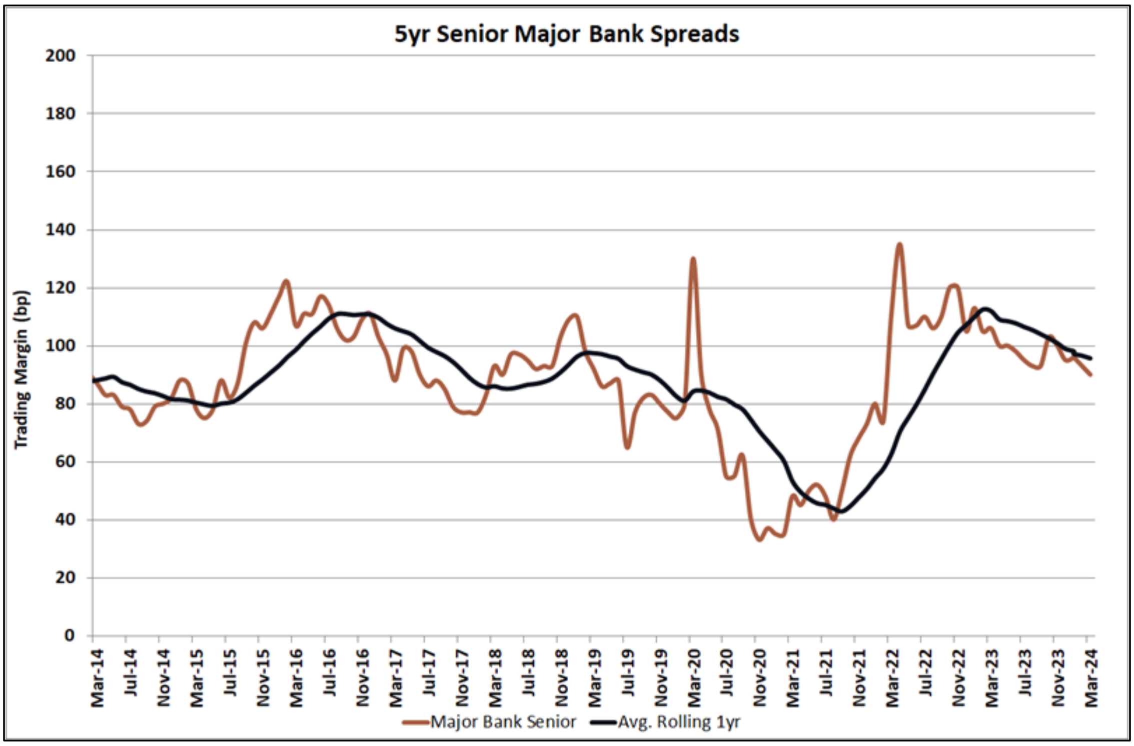
* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

Source: APRA.

Arlo Advisory

Senior FRNs Market Review

Over April, amongst the senior major bank FRNs, physical credit securities widened by around 2-7bp at the long-end of the curve. Major bank senior securities remain at fair value on a historical basis (5yr margins around +97bp level).



Source: IBS Capital

There was very little notable issuances during the month apart from BoQ's (A-) 5 year senior security at +128bp. Amongst the "A" rated sector, the securities widened by around 5-15bp at the longer-end of the curve, whilst the "BBB" rated sector remained flat at the 3 year part of the curve. Overall, credit securities are looking much more attractive given the widening of spreads over the past 2 years and as more primary issuances become available. FRNs will continue to play a role in investors' 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)	30/04/2024	28/03/2024
“AA” rated – 5yrs	+97bp	+90bp
“AA” rated – 3yrs	+66bp	+64bp
“A” rated – 5yrs	+115bp	+100bp
“A” rated – 3yrs	+88bp	+83bp
“BBB” rated – 3yrs	+160bp	+160bp

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-2026 for the “AA” rated ADIs (domestic major banks);
- On or before mid-2025 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.

Senior Fixed Bonds – ADIs (Secondary Market)

With global inflation still high by historical standards, this has seen a significant lift in longer-term bond yields over the past 2 years (valuations have fallen) as markets have reacted sharply.

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
AU3CB0278174	UBS	A+	Senior	26/02/2026	1.83	1.10%	5.45%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.02	1.40%	5.53%
AU3CB0299337	Bendigo	BBB+	Senior	15/05/2026	2.04	4.70%	5.45%
AU3CB0296168	BoQ	BBB+	Senior	27/01/2027	2.75	4.70%	5.52%

Economic Commentary

International Market

In April, risk assets finally parred back some of their strong gains in recent months. Inflation readings in the US have been higher than anticipated, pushing back the US Fed's expectations of when interest rates would fall. Bonds were subsequently sold off, with longer-term yields rising significantly. The ongoing tensions in the Middle East conflict also contributed to financial market volatility during the month.

Across equity markets, the S&P 500 Index fell -4.16% over the month, whilst the NASDAQ lost -4.41%. Europe's main indices also experienced losses, led by Germany's DAX (-3.03%) and France's CAC (-2.69%). UK's FTSE (+2.41%) bucked the global trend, providing a positive return.

The US Core PCE inflation for March came in at +0.32% m/m vs. +0.30% consensus, broadly in line with expectations, despite fears it could print as high as +0.5% m/m. The annual figure was +2.8% y/y, whilst the 6m annualised sits at +3.0% and the 3m annualised more worrying at +4.4%.

US annualised GDP decelerated from +3.4% to +1.6% in Q1, well below market expectations of +2.5%.

The Bank of Canada held official rates at 5.00% as universally expected. Whilst the post-meeting statement says they believed they would be in a position to cut interest rates this year, members apparently disagreed on when inflation would be deemed to have slowed enough to trigger the first move. Employment has weakened in Canada, falling -2.2k in March and the unemployment rate rose from 5.9% to 6.1%.

German inflation fell to +2.3% y/y in March, a tick weaker than expected, following recent data showing falls for France, Italy and Spain. Inflation heading towards target across the region will support the call for the ECB to cut rates in coming months.

UK annual headline and core CPI inflation were +3.2% y/y and +4.2% y/y respectively, which were both slightly above expectations of +3.1% y/y and +4.1% y/y respectively. This "*sticky*" UK inflation also resulted in markets pushing back the timing of interest rate cuts by the UK central bank.

China's GDP grew by +5.3% in the first quarter, exceeding analysts' expectations of +4.8%, and slightly faster than the +5.2% recorded in the previous three months.

The MSCI World ex-Aus Index fell -3.85% for the month of April:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-4.16%	+3.92%	+20.78%	+6.39%	+11.32%	+10.33%
MSCI World ex-AUS	-3.85%	+3.24%	+16.83%	+4.13%	+8.83%	+7.15%
S&P ASX 200 Accum. Index	-2.94%	+1.04%	+9.07%	+7.30%	+8.00%	+7.76%

Source: S&P, MSCI

Domestic Market

The RBA Minutes contained little new information on top of Governor Bullock's post-Meeting press conference. The case for a rate hike was not explicitly discussed and balance of risks "*had become a little more even*".

Australia's unemployment rate increased to 3.8% in March from 3.7% in February as the economy shed 6,600 jobs in March after strong gains of +117,600 in February. The RBA has forecasted the unemployment rate to reach 4.2% by October 2024.

Q1 CPI came in on the high side of expectations, at +1.0% q/q on both the headline and trimmed mean measure. That is stronger than the +0.8% q/q the RBA had pencilled in the February SoMP. On an annual basis, CPI rose to +3.6% to the end of March 2024 (from +3.5% in February).

The most significant contributors to the March quarter rise were education (5.9%), health (2.8%), housing (0.7%), and food and non-alcoholic beverages (0.9%).

Dwelling prices rose +0.6% m/m and +8.8% y/y in March. The +0.6% m/m pace of growth is broadly similar to February, but is certainly a step up on the growth seen in December and January.

The February trade balance narrowed to $7.3bn, its lowest since August, while surpluses recorded in December and January were revised about $1bn lower.

The Australian dollar marginally fell by -0.11%, finishing the month at US65.25 cents (from US65.32 cents the previous month).

Credit Market

The global credit indices remained relatively flat in the US and Europe, whilst they widened in Australia. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	April 2024	March 2024
CDX North American 5yr CDS	52bp	52bp
iTraxx Europe 5yr CDS	55bp	55bp
iTraxx Australia 5yr CDS	73bp	66bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	April 2024	March 2024
Bloomberg AusBond Bank Bill Index (0+YR)	+0.35%	+0.37%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.98%	+1.12%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.48%	+0.50%
Bloomberg AusBond Credit Index (0+YR)	-0.91%	+0.90%
Bloomberg AusBond Treasury Index (0+YR)	-2.03%	+1.15%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-1.82%	+1.34%

Source: Bloomberg

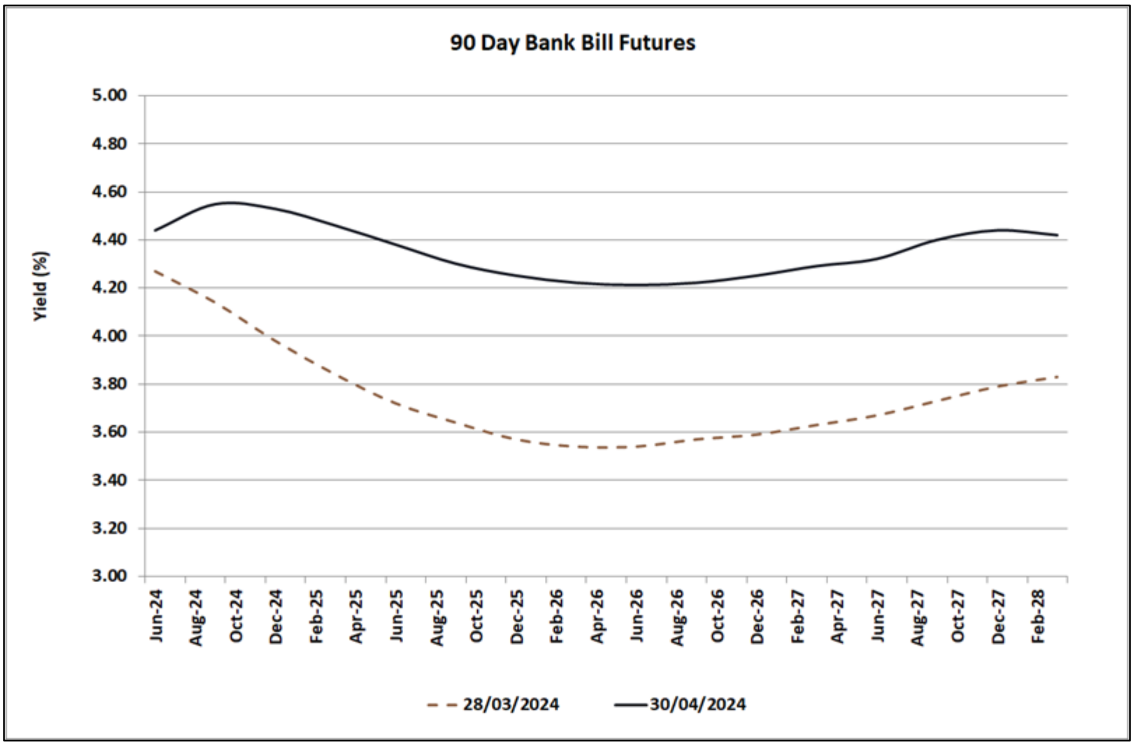
Other Key Rates

Index	April 2024	March 2024
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.41%	4.34%
3yr Australian Government Bonds	4.03%	3.59%
10yr Australian Government Bonds	4.42%	3.97%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	5.04%	4.59%
10yr US Treasury Bonds	4.69%	4.20%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures significantly rose this month, following the movement in the global bond market. Markets have pushed back their expectations of when the first rate cut will be delivered:



Source: ASX

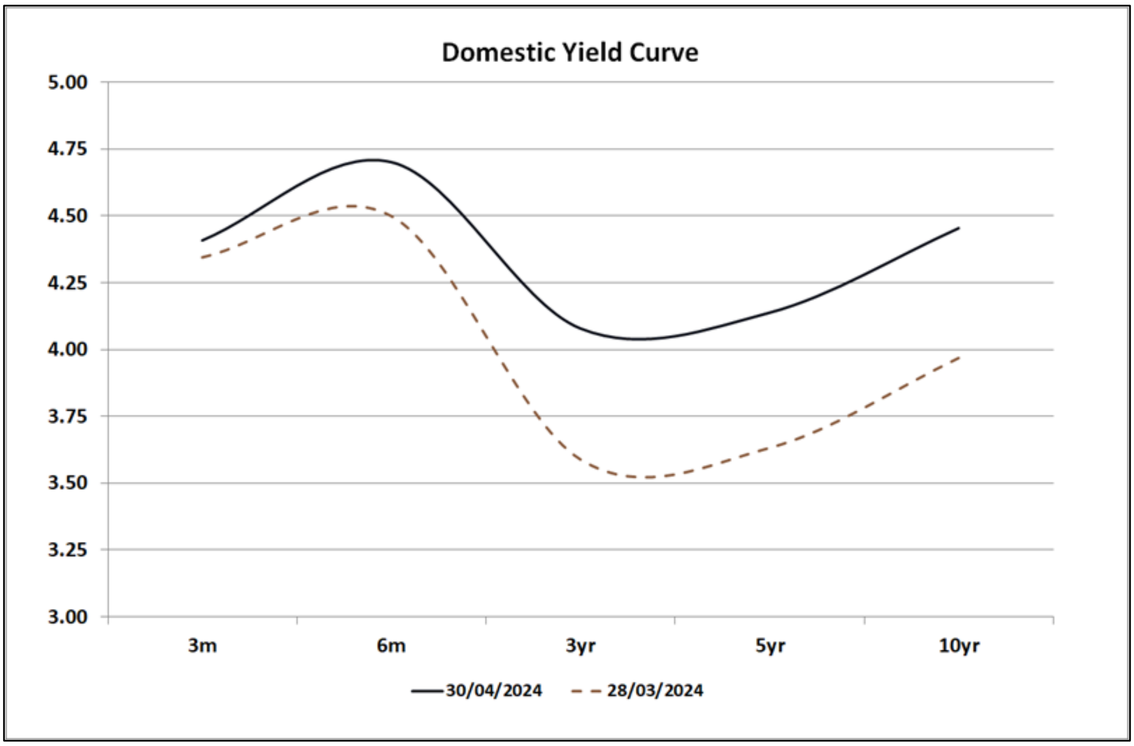
Arlo Advisory

Fixed Interest Outlook

US Fed commentary continued to point towards a cautious FOMC, concerned about the stalling or re-acceleration of inflationary pressures. 10 year Treasury yields hit a year to date high during the month of April, as markets continue to push back expectations for the number and timing of FOMC cuts this year. US Fed pricing for 2024 now stands at around just 34bp of cuts (November 2024 is almost fully priced), noting that at the beginning of April, as much as 67bp was priced.

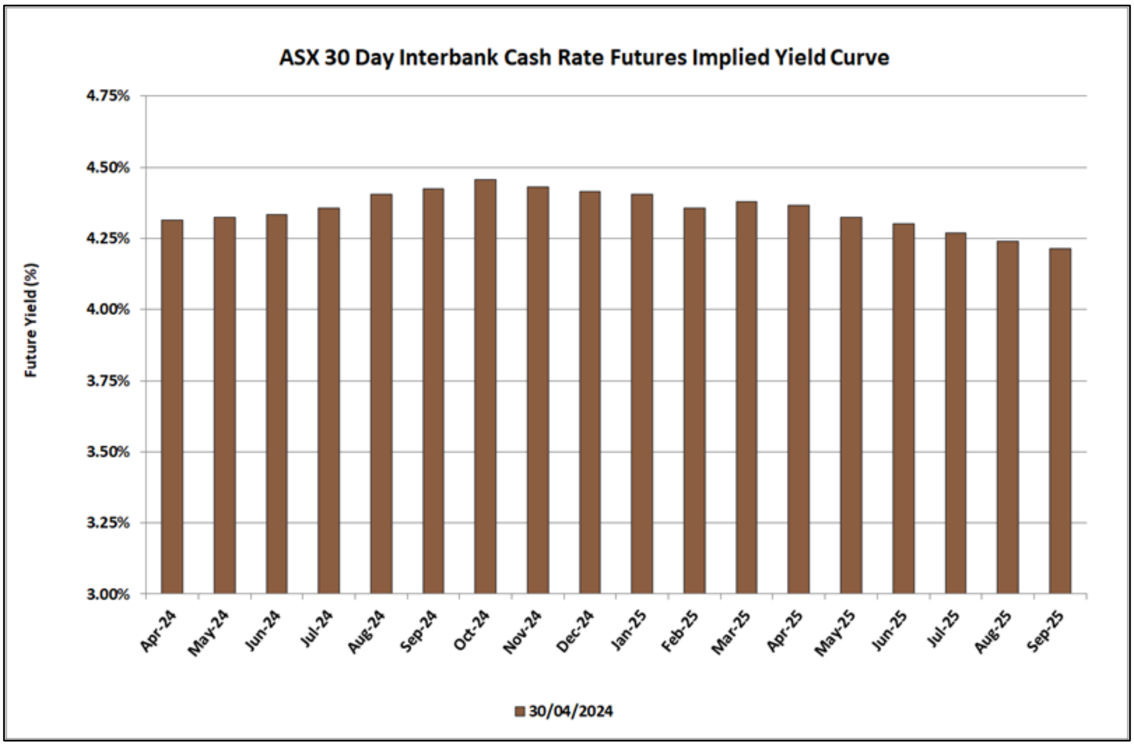
Domestically, Australian inflation is lagging, but expectations is that the RBA is likely to join once the US Fed finally decides to pull the trigger. The RBA is perceived to adopt a slightly more neutral approach to monetary policy; however, the addition of *"the Board is not ruling anything in or out"* in its latest policy statement suggests the Board wants to keep the optionality in the event of future shocks. Additional rate rises are now totally not out of the equation if inflation continues to disappoint.

Over the month, longer-term yields rose up to 50bp at the very long end of the curve (remains an inverse yield curve):



Source: ASX, RBA

For the time being, the consensus from the broader market is that we have reached the peak of the interest rate cycle. Financial markets have pushed back their expectations of the first rate cut to early-mid 2025.



Source: ASX