

10.7. Investment and Loan Borrowings Report as at 31 May 2024

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ATTACHMENTS	1. Arlo Advisory Monthly Investment Report May 2024 [10.7.1 - 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 31 May 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 May, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.29% (actual), or +3.51% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.37% (actual), or +4.50% 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 \$103,950. The total return for the 2023/2024 financial year to date is approximately \$5 million. The better-than-expected return is due to payments for the capital works program progressing slower than expected in the first two quarters.

RECOMMENDATION:

1. THAT the report on Investments held 31 May 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 the 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 \$132,681,744. 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 31 May 2024. Council holds an unrestricted cash balance of \$7.6 million, indicating it has funded all its reserves.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions – general	\$49,751,150
Domestic waste management	\$15,411,954
Unexpended Special Rates	\$476,711
Unspent borrowings - North Sydney Olympic Pool redevelopment	\$0
Waste and sustainability improvement funds	\$37,646
Specific purpose grants	\$4,885,028
Other specific purpose contributions	\$2,407,518
Total external restrictions	\$72,970,007
Internal allocations	
Capital works	\$10,857,024
Community housing - capital purchases	\$962,601
Community housing - major maintenance	\$490,657
Deposits, retentions, and bonds	\$14,202,338
Employees leave entitlement	\$7,092,831
I.T. hardware and software	\$1,250,727
Income producing projects	\$782,006
Olympic Pool Redevelopment	\$13,796,672
Plant and vehicle replacement	\$3,147,198
Total internal allocations	\$52,582,054

External Restrictions and Internal Allocations	
Total Restrictions and Allocations	\$125,552,061
Unrestricted Cash and Investments	\$7,129,683
Total Cash and Investments	\$132,681,744

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of May 2024 - and annualised for the year-to-date 31 May 2024 (including investments that have matured prior to that date).

	May 2024	Annualised YTD
Actual Return	0.29%	3.51%
Benchmark	0.37%	4.50%
Variance	-0.08%	-0.99%

The portfolio underperformance, as compared to the benchmark, is due to 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	\$110,000,000	82.91%
Cash	\$12,280,616	9.26%
Fixed Bonds	\$9,000,000	6.78%
Floating Rate Notes (FRNs)	\$1,401,128	1.06%
	\$132,681,744	100.00%

Council's average duration of term deposits, which comprise 82.91% of the investment portfolio, is approximately 237 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 \$92.6 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 May 2024 are \$103,950 more than the revised year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (May)	YTD (May)	YTD Actual FV adjustments (May)	YTD Budget to Actual Variance (May)
2023/24	\$2,500,000	\$5,490,000	\$4,874,400	\$4,972,585	\$5,761	\$103,946
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 \$5,761.

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	\$95,780,616	100.00%	72.19%
A Category	\$30,500,000	60.00%	22.99%
BBB Category	\$6,401,128	35.00%	4.82%
Unrated ADIs (NR)	\$0	10.00%	0.00%

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 May 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 are significantly higher than the original budget as payments for capital works were lower than expected in the first two quarters. \$1 million upward budget revisions were adopted each of the September, December, and March Quarterly Budget Reviews.

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.



Monthly Investment Review



May 2024

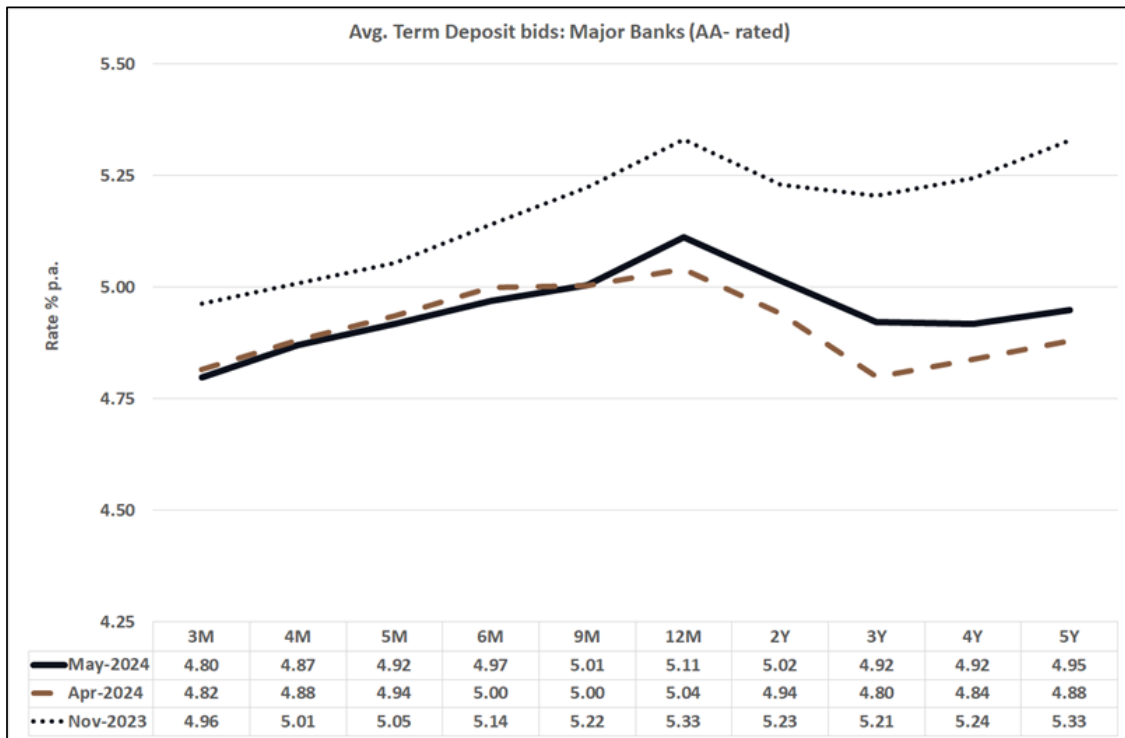
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Market Update Summary

In May, risk assets rebounded despite inflation data continuing to challenge expectations for when central banks will begin easing monetary policy. In response, global bond yields remain elevated and have been volatile in recent months.

Over May, the average deposit rates offered by the major banks at the short-end (up to 9 months) remained relatively flat. In the medium-term (1-3 years), the average bids from the major banks rose between 7-12bp, reflective of the market positioning a ‘higher-for-longer’ period where official interest rates may remain stagnant for the foreseeable future. The deposit curve still remains inverse with markets still factoring in rate cuts in future years.



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 May 2024, the portfolio was mainly directed to fixed term deposits (83%). The remaining portfolio is directed to FRNs (1%), fixed bonds (7%) and overnight cash accounts (9%).

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 \$63m 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	\$55,780,616	42.04%	10%	100%	\$76,901,128
✓	91 - 365 days	\$39,401,128	29.70%	20%	100%	\$93,280,616
✓	1 - 2 years	\$29,500,000	22.23%	0%	70%	\$63,377,221
✓	2 - 5 years	\$8,000,000	6.03%	0%	50%	\$58,340,872
✓	5 - 10 years	\$0	0.00%	0%	25%	\$33,170,436
		\$132,681,744	100.00%			



Counterparty

As at the end of May, 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-	\$29,280,616	22.07%	30.00%	\$10,523,907
✓	NAB	AA-	\$34,000,000	25.63%	30.00%	\$5,804,523
✓	NTTC Treasury	AA-	\$9,000,000	6.78%	30.00%	\$30,804,523
✓	Westpac	AA-	\$23,500,000	17.71%	30.00%	\$16,304,523
✓	ICBC Sydney	A	\$17,000,000	12.81%	15.00%	\$2,902,262
✓	BOQ	A-	\$11,500,000	8.67%	15.00%	\$8,402,262
✓	Bendigo	A-	\$2,000,000	1.51%	15.00%	\$17,902,262
✓	Heritage	BBB+	\$5,000,000	3.77%	10.00%	\$8,268,174
✓	Newcastle PBS	BBB+	\$1,401,128	1.06%	10.00%	\$11,867,046
			\$132,681,744	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 May 2024, all categories were within the Policy limits:

Compliant	Credit Rating	Invested (\$)	Invested (%)	Max. Limit (%)	Available (\$)
✓	AA Category	\$95,780,616	72.19%	100%	\$36,901,128
✓	A Category	\$30,500,000	22.99%	60%	\$49,109,047
✓	BBB Category	\$6,401,128	4.82%	35%	\$40,037,482
✓	Unrated ADIs	\$0	0.00%	10%	\$13,268,174
		\$132,681,744	100.00%		



Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.36%	1.08%	2.16%	3.91%	4.26%	3.47%	2.34%
AusBond Bank Bill Index	0.37%	1.10%	2.20%	4.01%	4.32%	3.48%	2.32%
Council's T/D Portfolio	0.31%	0.94%	1.93%	3.43%	3.67%	2.99%	2.42%
Council's FRN Portfolio	0.47%	1.45%	2.81%	5.08%	5.49%	4.64%	3.53%
Council's Bond Portfolio	0.10%	0.29%	0.58%	1.08%	1.17%	1.17%	1.15%
Council's Portfolio [^]	0.29%	0.90%	1.85%	3.30%	3.53%	2.90%	2.35%
Rel. Performance	-0.08%	-0.20%	-0.35%	-0.71%	-0.79%	-0.58%	0.03%

[^]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%	4.26%	4.26%	3.47%	2.34%
AusBond Bank Bill Index	4.50%	4.43%	4.43%	4.36%	4.32%	3.48%	2.32%
Council's T/D Portfolio	3.69%	3.79%	3.89%	3.73%	3.67%	2.99%	2.42%
Council's FRN Portfolio	5.71%	5.87%	5.68%	5.53%	5.49%	4.64%	3.53%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.15%
Council's Portfolio [^]	3.51%	3.62%	3.73%	3.59%	3.53%	2.90%	2.35%
Rel. Performance	-0.99%	-0.81%	-0.70%	-0.78%	-0.79%	-0.58%	0.03%

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

For the month of May, the total investment portfolio (excluding cash) provided a solid return of +0.29% (actual) or +3.51% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.50% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA over the past two years. 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 ongoing period of 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 May 2024, Council's deposit portfolio was yielding **3.68% p.a.** (up 4bp from the previous month), with a weighted average duration of around 237 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, most likely over the next 3–4 months.

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 May, we see value in the following:

ADI	LT Credit Rating	Term	Rate % p.a.
ING	A	5 years	5.35%
ING	A	4 years	5.26%
ING	A	2 years	5.25%
ING	A	3 years	5.20%
Westpac	AA-	2 years	5.13%
Bank of Us	BBB+	2 years	5.12%
Suncorp	A+	2 years	5.11%
Australian Military	BBB+	2 years	5.11%
NAB	AA-	2 years	5.05%
Suncorp	A+	3 years	5.03%

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.
P&N Bank	BBB+	12 months	5.40%
Rabobank	A	12 months	5.37%
ING	A	12 months	5.31%
Bank of Us	BBB+	12 months	5.25%
NAB	AA-	12 months	5.25%
BankVIC	BBB+	12 months	5.25%
Westpac	AA-	12 months	5.24%
Suncorp	A+	12 months	5.23%
Suncorp	A+	9 months	5.21%
NAB	AA-	10-11 months	5.20%
NAB	AA-	6-9 months	5.15%
BoQ	A-	6-12 months	5.10%
NAB	AA-	3-4 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).

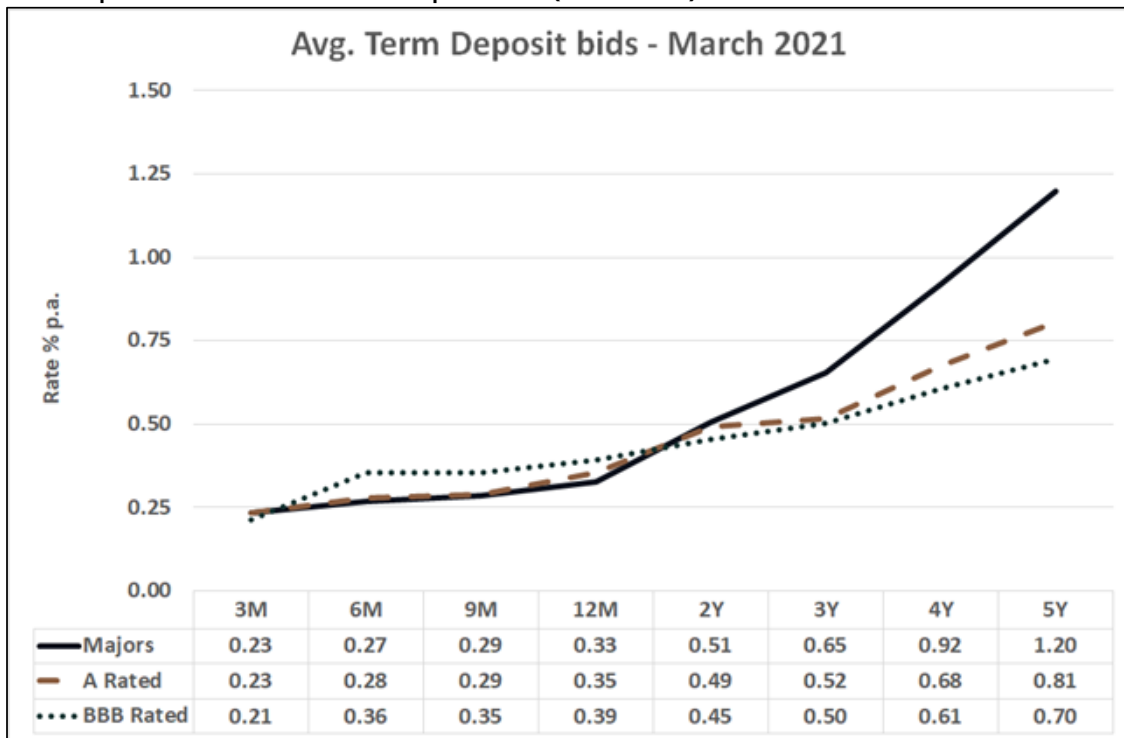
With a global economic slowdown and interest rate cuts being priced over the next few years, investors should strongly consider diversifying by allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates above 5% p.a. This will provide some income protection with central banks now potentially looking to cut rates in 2025.



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)



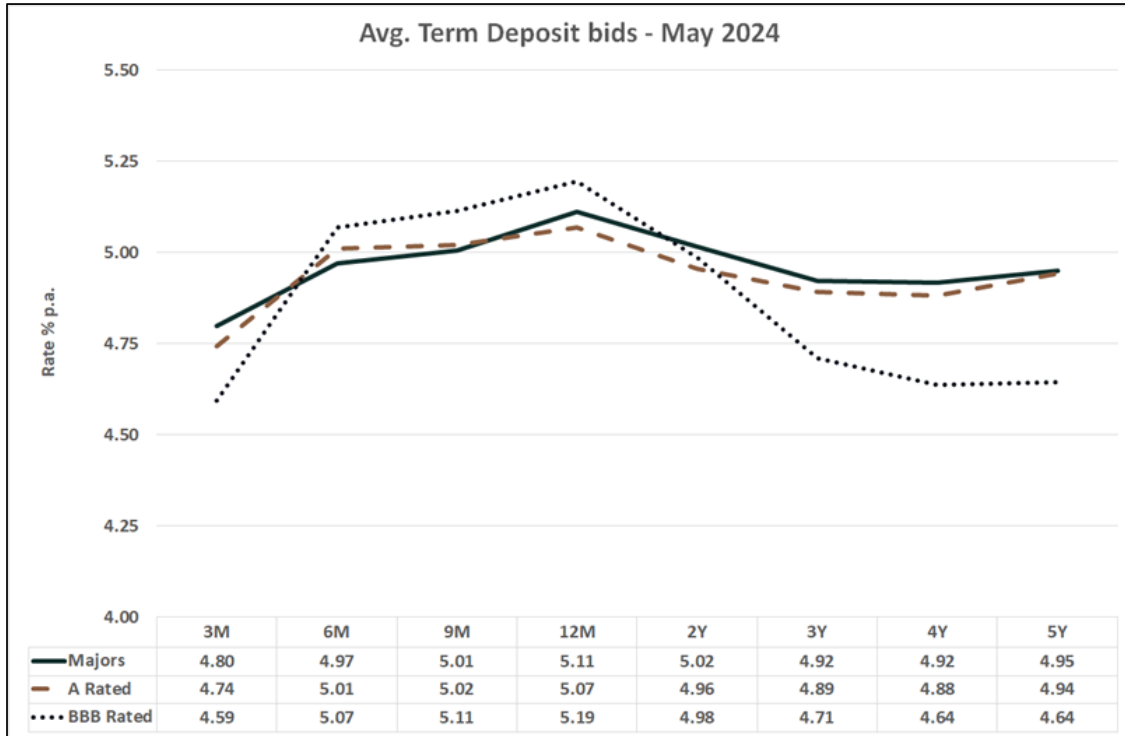
Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits slowly increases, partially driven by the RBA’s term funding facility coming to an end. 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 again this month:

Term Deposit Rates – Currently (May 2024)



Source: Imperium Markets

Regional & Unrated ADI Sector

Ratings agency S&P has commented that "*mergers remain compelling for mutual 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.

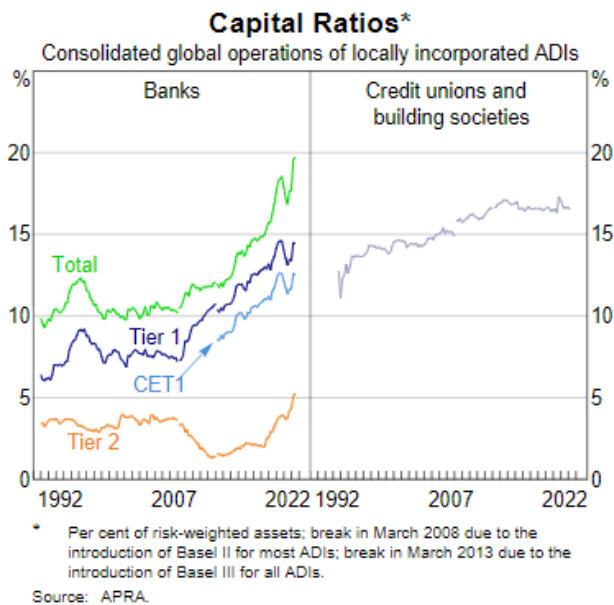
Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position than they have been historically (see the Capital Ratio figure below). The financial regulator, APRA has noted that



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.

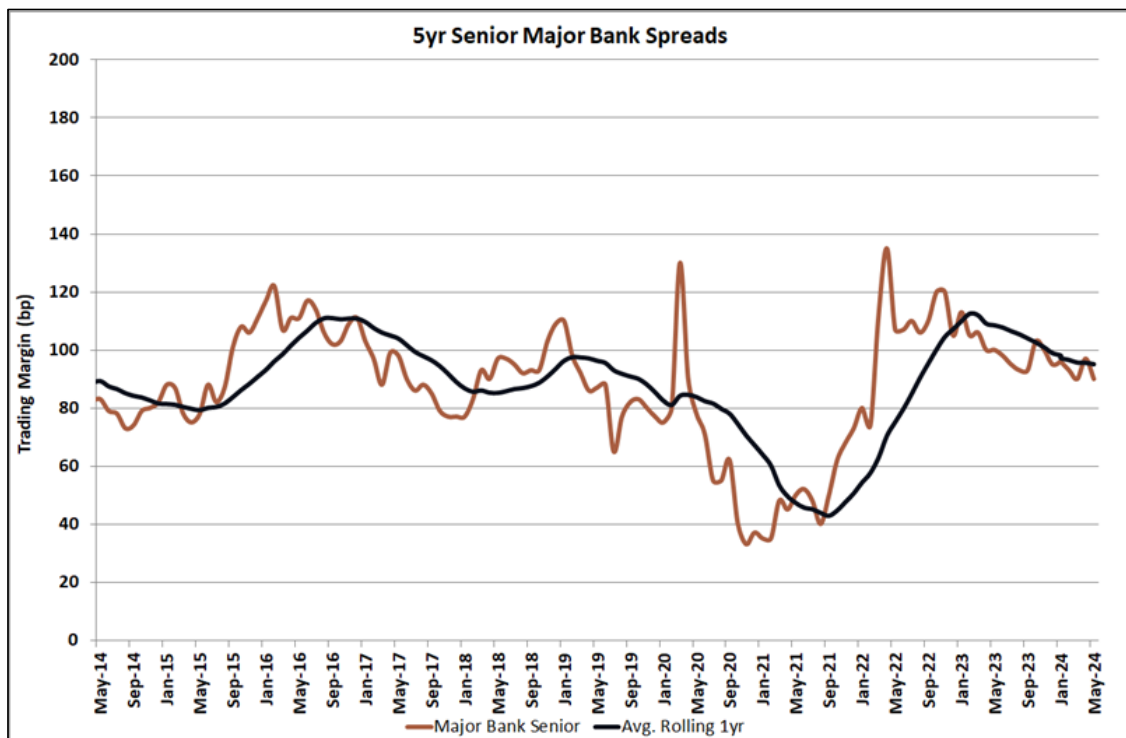
In the current environment of high regulation and scrutiny, all domestic (and international) ADIs continue to carry high levels of capital. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC and the pandemic period. APRA's mandate is to "protect depositors" and provide "financial stability".





Senior FRNs Market Review

Over May, amongst the senior major bank FRNs, physical credit securities tightened by around 7bp at the 5 year part of the curve. During the month, NAB (AA-) issued a 3 year senior deal at +70bp, whilst WBC (AA-) issued a 5 year senior issue at +88bp. Major bank senior securities remain at fair value on a historical basis (5yr margins around +90bp level).



Source: IBS Capital

There was very little notable issuances during the month apart from Bendigo & Adelaide’s (A-) 3 year senior security at +100bp and a small private placement from Bank of Us (BBB+) for 1 year at +95bp. Amongst the “A” rated sector, the securities tightened by around 3-10bp 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)	31/05/2024	30/04/2024
"AA" rated – 5yrs	+90bp	+97bp
"AA" rated – 3yrs	+68bp	+66bp
"A" rated – 5yrs	+105bp	+115bp
"A" rated – 3yrs	+85bp	+88bp
"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	1.74	1.1000%	5.22%
AU3CB0280030	BoQ	A-	Senior	06/05/2026	1.93	1.4000%	5.35%
AU3CB0299337	Bendigo	A-	Senior	15/05/2026	1.95	4.7000%	5.27%
AU3CB0296168	BoQ	A-	Senior	27/01/2027	2.66	4.7000%	5.34%
AU3CB0308955	BoQ	A-	Senior	30/04/2029	4.92	5.3580%	5.45%



Economic Commentary

In May, risk assets rebounded despite markets pushing back their expectations with regards to the timing of the easing cycle by central banks.

Across equity markets, the S&P 500 Index rose +4.80% over the month, whilst the NASDAQ surged +6.88%. Europe's main indices also experienced gains, led by Germany's DAX (+3.16%), UK's FTSE (+1.61%) and France's CAC (+0.10%).

The US Fed kept rates on hold for the sixth meeting in a row, warning that there had been a lack of further progress towards their 2% inflation target. Fed Chair Powell also commented however *"it's unlikely that the next policy rate move will be a hike"*. US Fed Chair Powell repeated his view that he and most Fed officials do not anticipate having to resume interest rate rises but that patience is required before they can be cut, saying *"we're just going to have to see where the inflation data fall out"*.

US core CPI for April came in at +0.3% m/m as expected, with headline a touch lower at +0.3% vs +0.4% expected. On an annual basis, core CPI ticked down to +3.6% y/y, down from +3.8% y/y in March. The annual headline rate also fell to +3.4% y/y in April, from +3.5% y/y in March.

Canada CPI came in at +2.7% y/y in April (which was lower than market expectations) and was down from +2.9% y/y in March.

UK headline CPI was +2.3% y/y in April, decreasing from +3.3% y/y in March. Core inflation also slowed to +3.9% y/y in April from +4.2% y/y in March.

European Q1 GDP surprised a little stronger, while April inflation was broadly in line. Q1 GDP growth rose +0.3% q/q (+0.1% expected) for annual growth of +0.4% y/y.

As expected, the RBNZ left the Official Cash Rate unchanged at 5.50% at its May meeting. The central bank flagged it now expects to keep rates high for longer amid some signs of sticky inflation.

Sweden's Riksbank cut rates by 25bp as expected as markets going into the meeting were 64% priced for a cut.

The MSCI World ex-Aus Index rose +4.26% for the month of May:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+4.80%	+3.56%	+26.26%	+7.87%	+13.91%	+10.62%
MSCI World ex-AUS	+4.26%	+3.27%	+23.23%	+5.16%	+11.16%	+7.42%
S&P ASX 200 Accum. Index	+0.92%	+1.16%	+12.93%	+6.80%	+7.83%	+7.78%

Source: S&P, MSCI



Domestic Market

The RBA kept rates on hold at 4.35% in its meeting in May, as universally expected. They still see trimmed mean inflation at +2.6% y/y by mid-2026. Staff still assess policy as being “restrictive” based on financial indicators and ongoing easing in growth of aggregate demand.

The monthly CPI Indicator for April printed higher than expected at +3.6% y/y (consensus +3.4%) and +3.5% in March. Importantly, core measures also printed higher than expected. The CPI excluding volatile items and holiday travel was +4.1% y/y.

The Q1 wage price index (WPI) growth was 0.1% below expectations at +0.8% q/q and +4.1% y/y (consensus +0.9%/+4.2%). By sector, private sector wages growth was +0.8% q/q, and public sector wages growth was just +0.5% after +1.4% q/q in Q4.

The seasonally adjusted unemployment rate rose by 0.2% to 4.1% in April, up from a revised 3.9% in March. Employment rose by around 38,000 people and the number of unemployed grew by 30,000 people, leading to an uplift in the participation rate, increasing to 66.7% (by 0.1%).

April retail sales rose +0.1% m/m (consensus +0.2% m/m).

The February trade balance narrowed to \$5.0bn, its lowest since November 2020. The February surplus was revised down to \$6.6bn from \$7.3bn. In the month, exports were little changed (+0.1%) while imports rose +4.2%.

Dwelling approvals were +1.9% higher in March, but private house and apartment approvals were a bit stronger, up +3.8% and +3.6%.

The Australian dollar rose +1.72%, finishing the month at US66.37 cents (from US65.25 cents the previous month).

Credit Market

The global credit indices marginally tightened across the board in May. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	May 2024	April 2024
CDX North American 5yr CDS	51bp	52bp
iTraxx Europe 5yr CDS	52bp	55bp
iTraxx Australia 5yr CDS	65bp	73bp

Source: Markit



Fixed Interest Review

Benchmark Index Returns

Index	May 2024	April 2024
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.35%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.39%	-1.98%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.50%	+0.48%
Bloomberg AusBond Credit Index (0+YR)	+0.70%	-0.91%
Bloomberg AusBond Treasury Index (0+YR)	+0.35%	-2.03%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.30%	-1.82%

Source: Bloomberg

Other Key Rates

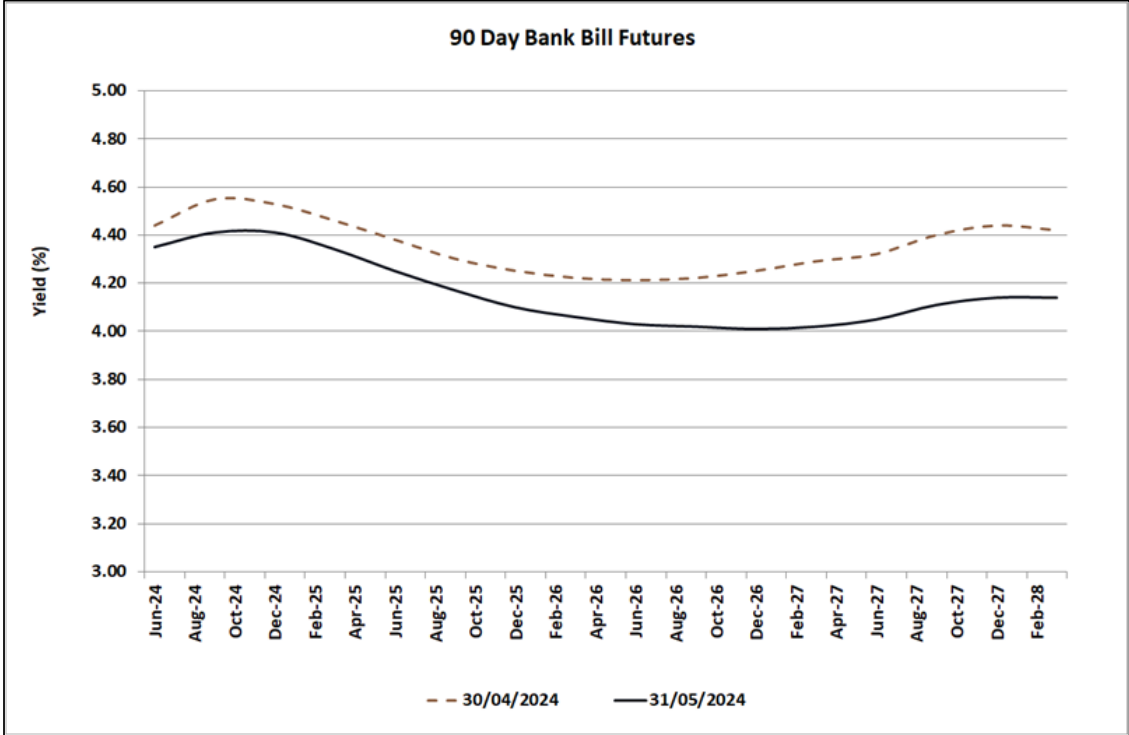
Index	May 2024	April 2024
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.35%	4.41%
3yr Australian Government Bonds	4.05%	4.03%
10yr Australian Government Bonds	4.41%	4.42%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.89%	5.04%
10yr US Treasury Bonds	4.51%	4.69%

Source: RBA, ASX, US Department of Treasury



90 Day Bill Futures

Bill futures fell across the board this month, following the movement in bond markets. Markets continue to push back their expectations of when the first rate cut will be delivered, resulting in a flattening of the curve.



Source: ASX

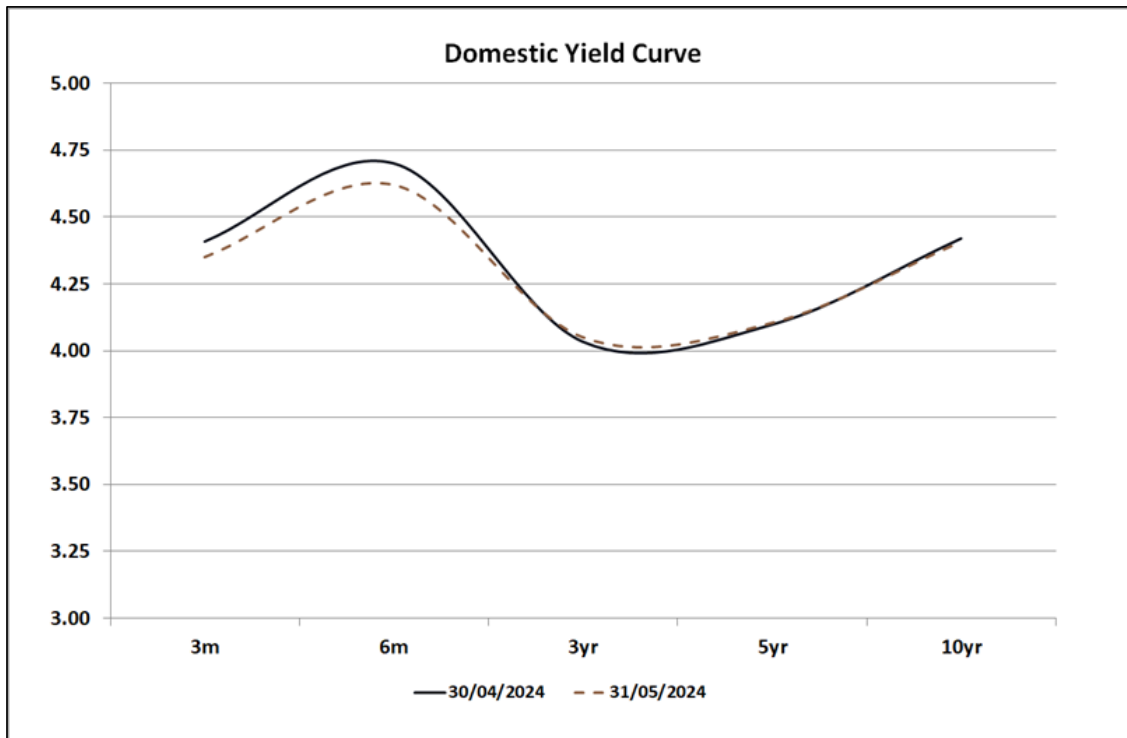


Fixed Interest Outlook

As per the minutes of the US Fed May meeting, policymakers concluded recent data had not increased their confidence that inflation was moving sustainably toward the 2% target to begin cutting rates. Monetary policy is currently considered “well-positioned” and further tightening is only required if inflation surprises to the upside.

Domestically, the RBA May meeting minutes stated inflation had eased more slowly than anticipated and that “risks around inflation had risen somewhat...Given this, members agreed that it was difficult either to rule in or rule out future changes in the cash rate target.” As is the case with most central banks at the moment, the RBA is waiting for current economic data to show a clear trend before taking any decisive action.

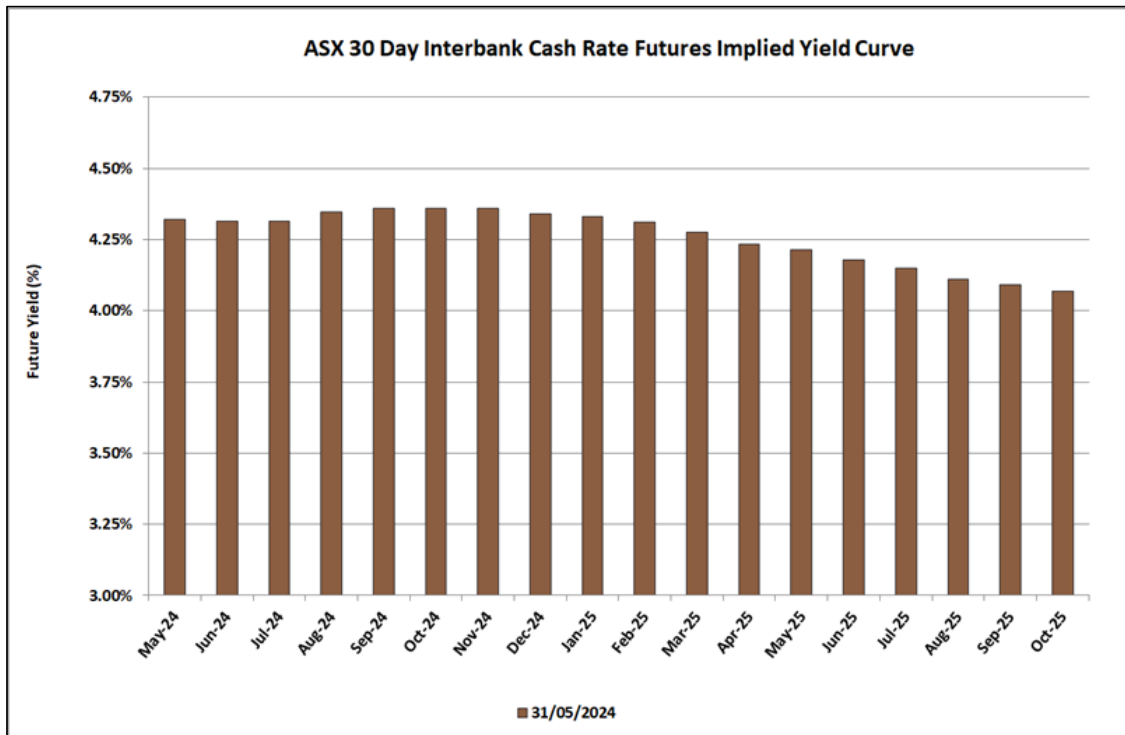
Over the month, longer-term yields remained relatively flat at the very long end of the curve (remains an inverse yield curve):



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. With inflation remaining sticky, financial markets have pushed back their expectations of rate cuts, with the first cut pencilled in for early-mid 2025.



Source: ASX

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