

## **8.5. Investments and Loan Borrowings Held as at 28 February 2021**

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

### **ATTACHMENTS:**

1. Monthly Investment Report - February 2021 [8.5.1 - 19 pages]

### **PURPOSE:**

This report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 28 February 2021.

### **EXECUTIVE SUMMARY:**

#### **Investment Portfolio:**

The Investment portfolio (cash and investments) held as at 28 February 2021 had a market value of \$101.7 million, with an annualised return of 1.72% for the year to date, 1.51% above the reportable BBSW Bank Bill Index of 0.21%. The total funds under investment increased during February by \$3.4 million which included two new Term Deposits. These funds were primarily sourced from the rates instalment that was due at the end of February.

The actual investment returns for the year to date as at 28 February 2021 were \$928,589 which was \$35,499 less than the year to date budgeted estimate. The medium-longer term outlook for financial markets indicate that the RBA's official cash rate will remain unchanged at its emergency level of 0.10% until its objectives of full employment and inflation are reached.

The investment portfolio is managed to ensure liquidity to meet operational requirements, with cashflows being monitored and assessed on a on-going basis.

#### **Borrowings:**

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 28 February 2021 is \$7,468,761.18. Council has made provision for future borrowings of \$31 million to assist in the funding to complete the redevelopment of North Sydney Olympic Pool.

**FINANCIAL IMPLICATIONS:**

The 2020/21 budgeted returns on investments are estimated to be \$1,350,000.00. The estimate was reviewed and reported in the December Budget Review. Investment returns will continue to be monitored and further adjustment made in the March Quarterly Review, if necessary.

**RECOMMENDATION:**

**1. THAT** the report on Investments and Loan Borrowings held as at 28 February 2021 be received.

## LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

### 5. Our Civic Leadership

#### 5.1 Council leads the strategic direction of North Sydney

## 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 February 2021 and annualised for the year to date as at 28 February 2021 (including investments which have matured prior to 28 February 2021).

	February 2021	Annualised YTD as at 28 February 2021
<b>Actual Return</b>	0.11%	1.72%
<b>Benchmark</b>	0.00%	0.21%
<b>Variance</b>	0.11%	1.51%

The strong performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the current interest rate cuts, as well as the FRNs locked in at attractive margins.

<b>Asset Type</b>	<b>Market Value as at 28 February 2021</b>	<b>Portfolio Breakdown as at 28 February 2021</b>
Cash	\$13,677,199.93	13.45%
Term Deposits	\$74,000,000.00	72.74%
Floating Rate Notes (FRN's)	\$8,042,590.55	7.91%
Fixed Bonds	\$6,000,000.00	5.90%
	<b>\$101,719,790.48</b>	<b>100.00%</b>

Two "A" rated term deposit investments, totalling \$4.0 million were transacted during the month. Council's average duration of term deposits which comprise approximately two thirds of the investment portfolio is approximately 372 days, thus reducing the exposure to declining interest rates experienced with investment renewals.

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

Council continues to seek independent advice for all investments and is actively managing the portfolio to ensure that returns are maximised taking into account diversification and risk. A complete analysis of the performance is covered in the Monthly Investment Report prepared by Council's Investment advisor. (refer attachment 1.)

The actual investment returns for the year to date as at 28 February 2021 have been reviewed and are \$35,499 less than the revised budget.

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

<b>Year</b>	<b>Original Annual Budget</b>	<b>Revised Annual Budget</b>	<b>YTD Budget (February)</b>	<b>YTD/Annual Actual (February)</b>	<b>YTD/Annual Actual FV adjustments (February)</b>	<b>YTD Budget to Actual Variance (February)</b>
<b>2020/21</b>	<b>\$1,350,000</b>	<b>\$1,350,000</b>	<b>\$964,088</b>	<b>\$837,222</b>	<b>\$91,367</b>	<b>-\$35,499</b>
2019/20	\$1,500,000	\$1,529,055		\$1,896,660	-\$4,944	\$362,661

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (February)	YTD/Annual Actual (February)	YTD/Annual Actual FV adjustments (February)	YTD Budget to Actual Variance (February)
2018/19	\$1,590,000	\$1,730,000		\$2,253,497	\$91,056	\$614,553

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 at 28 February 2021 the YTD movement of FRN's has been an increase in returns of \$91,367.

### Financial Investment Policy

As at the end of February, all categories were within the Policy limits for credit ratings. 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 at 28 February 2021	Maximum Policy Holding	Distribution as at 28 February 2021
AA Category	\$44,607,689	100.00%	43.85%
A Category	\$28,266,049	60.00%	27.78%
BBB Category	\$28,846,053	35.00%	28.36%
Unrated ADIs (NR)	\$0	10.00%	0.00%

### Loan Borrowings

Council's Debt Management 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 to be 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 of both in order 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.

**The current Debt Facility is as follows:**

The current facility is a fixed loan financing option, fully amortising the drawn down amount of \$9,500,000.00 over 10 years, fixed interest rate with quarterly repayments of interest and principal.

The current loan details are as follows:

<b>Loan amount:</b>	\$ 9,500,000.00			
<b>Loan term:</b>	10 years			
<b>From:</b>	31/07/2018			
<b>To:</b>	31/07/2028			
<b>Interest rate:</b>	4.02%p.a.(fixed)			
<b>Repayment:</b>	<b>Quarterly</b>			
<b>Dates</b>	<b>Principal Outstanding</b>	<b>Interest</b>	<b>Principal</b>	<b>Payment</b>
<b>1/07/2020</b>	\$8,099,526.94			
<b>31/07/2020</b>	\$7,891,956.69	\$82,069.29	\$207,570.25	\$289,639.54
<b>30/10/2020</b>	\$7,681,414.01	\$79,096.87	\$210,542.67	\$289,639.54
<b>29/01/2021</b>	\$7,468,761.18	\$76,986.71	\$212,652.83	\$289,639.54

The next loan instalment is due on 30 April 2021.

#### **Loan Funded Capital Projects as at 28 February 2021:**

##### **Project 1: Upgrading the Car Park in Alexander Street, Crows Nest**

A \$5 million loan has been sourced to fund this project.

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

##### **Project 2: Upgrading of On-Street Parking Management System**

A \$4.5 million loan has been sourced to fund this project.

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


#### **Future Borrowings**

Council has made provision for future borrowings of \$31 million to assist in the funding to complete the redevelopment of North Sydney Olympic Pool. These funds will be negotiated within the next 18 months.



# Monthly Investment Report

## February 2021

 <p><b>IMPERIUM MARKETS</b></p>	<p>Imperium Markets Pty Ltd ABN: 87 616 579 527 Authorised Representative of Libertas Financial Planning Pty Ltd AFSL 429 718 Phone: +61 2 9053 2987 Email: <a href="mailto:michael.chandra@imperium.markets">michael.chandra@imperium.markets</a> Suite 902, 3 Spring Street, Sydney NSW 2000</p>
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### Impact of COVID-19 to Council's Portfolio

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

With regards to financial markets, of importance was the RBA cutting interest rates twice in March 2020, taking the official cash rate down to 0.25%. Shares (equities) experienced a significant correction in March 2020 but recovered substantially due to the unprecedented fiscal and monetary policy support from global central banks and governments. **The RBA cut rates to record lows on 3<sup>rd</sup> November 2020 to 0.10%**. Equities have since, largely rallied with the accelerated rollouts of multiple vaccines and additional fiscal stimulus measures. Longer-term bond yields also rose significantly in February on the prospects of higher inflation. As a result, longer-term fixed interest securities (3-5 years) such as bonds and term deposits also rose during February.

With regards to the medium-longer term outlook for financial markets, of importance is the RBA's outlook and stance on the current situation:

1. The RBA's official cash rate will remain unchanged at its emergency level of 0.10% until its objectives of full employment and inflation are reached. They stressed that reducing unemployment was a "*national priority*" and the development in the labour market as key to the policy outlook;
2. The extension of the Term Funding Facility (TFF) until 30 June 2021, allowing all ADIs to access cheap funding directly from the RBA at a cost of 0.10% for 3 years for new drawings (the facility was previously available at a cost of 0.25% and was increased from an original \$90bn to \$200bn);
3. **The RBA Board is "not expecting to increase the cash rate for at least three years".**

The biggest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits, which accounts for around ~73% of Council's total investment. The biggest risk that Council faces over the medium-longer term in this environment is not the potential loss of capital (given all the banks are well capitalised and regulated by APRA), but the rapid loss of interest income as interest rates have plummeted.

Council's term deposit portfolio was yielding 1.41% p.a. at month-end, with a weighted average duration of around 672 days or ~1.85 years. **This average duration will provide some income protection against the low interest rate environment over the next 12 months.** As existing deposits mature however, they will inevitably be reinvested at much lower prevailing rates.

**Given official rates have fallen to record lows, Council is likely to see a rapid decline in interest income over future financial years. Its budgeted income over the medium-longer term needs to be revised to reflect the low interest rate environment. Returns between 0.50%-0.80% p.a. may potentially be the "norm" over the next few financial years.**

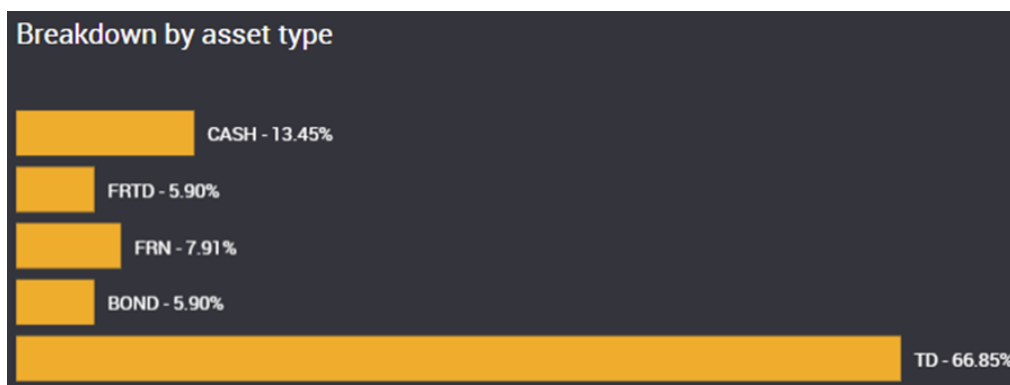


## Council's Portfolio & Compliance

### Asset Allocation

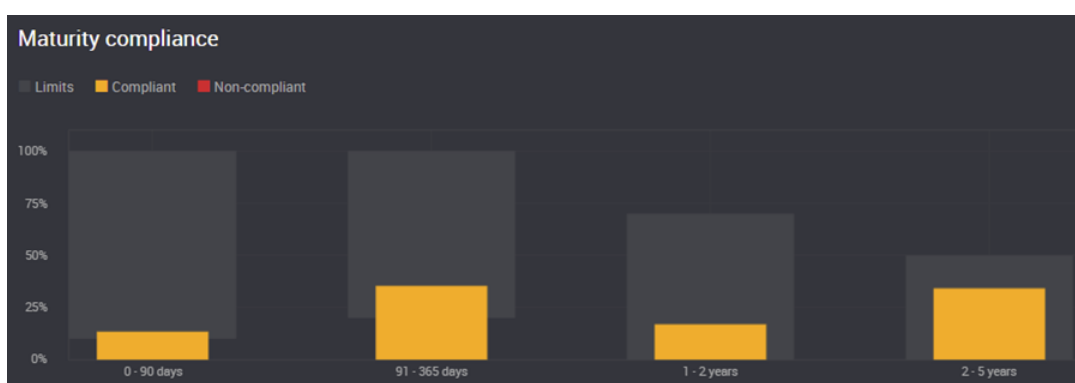
As at the end of February 2021, the portfolio was mainly directed to fixed and floating rate term deposits (72.75%). The remaining portfolio is directed to FRNs (7.91%), fixed bonds (5.90%) and overnight cash accounts (13.45%).

**With the RBA cutting interest rates in November 2020 to 0.10%, the priority should be to lock in any remaining attractive medium-longer dated fixed deposits that may still be available to address reinvestment risk as margins continue to compress.**



### Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 34% of assets is directed to medium-term assets (2-5 years), which is sensible in this low rate environment. There is still high capacity to invest in the medium-term horizon, with approximately \$16m at month-end.



Where liquidity permits, we recommend new surplus funds be directed to 2-5 year horizons given this is where the most attractive value can be found. We suggest this be allocated to any remaining attractive fixed term deposits or fixed bonds to address reinvestment risk.



Compliant	Horizon	Invested (\$)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available (\$)
✓	0 - 90 days	\$13,677,200	13.45%	10%	100%	\$88,042,591
✓	91 - 365 days	\$36,000,000	35.39%	20%	100%	\$65,719,790
✓	1 - 2 years	\$17,260,660	16.97%	0%	70%	\$53,943,193
✓	2 - 5 years	\$34,781,931	34.19%	0%	50%	\$16,077,965
✓	5 - 10 years	\$0	0.00%	0%	25%	\$25,429,948
		<b>\$101,719,790</b>	<b>100.00%</b>			

### Counterparty

As at the end of February, Council did not have an overweight position to any single ADI. 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 (BankWest)	AA-	\$15,568,415	15.31%	30.00%	\$14,947,522
✓	NAB	AA-	\$11,039,274	10.85%	30.00%	\$19,476,663
✓	NTTC	AA-	\$6,000,000	5.90%	30.00%	\$24,515,937
✓	Westpac	AA-	\$12,000,000	11.80%	30.00%	\$18,515,937
✓	Suncorp	A+	\$1,266,049	1.24%	15.00%	\$13,991,920
✓	ICBC Sydney	A	\$12,000,000	11.80%	15.00%	\$3,257,969
✓	ING Bank	A	\$15,000,000	14.75%	15.00%	\$257,969
✓	BOQ	BBB+	\$8,000,000	7.86%	10.00%	\$2,171,979
✓	AMP Bank	BBB	\$3,158,349	3.10%	10.00%	\$7,013,630
✓	Auswide Bank	BBB	\$10,000,000	9.83%	10.00%	\$171,979
✓	Beyond (Nexus)	BBB	\$3,000,000	2.95%	10.00%	\$7,171,979
✓	ME Bank	BBB	\$3,260,660	3.21%	10.00%	\$6,911,319
✓	Newcastle PBS	BBB	\$1,427,044	1.40%	10.00%	\$8,744,935
			<b>\$101,719,790</b>	<b>100.00%</b>		

During September 2020, ratings agency **S&P downgraded AMP Bank by one notch to "BBB"** stating its view that *"the overall creditworthiness of the AMP group is weaker"* and that *"the group is exposed to challenges that may disrupt its overall strategic direction and its ability to effectively execute its strategy."* We have no issues with Council's investments with AMP Bank, given they are super-senior ranked assets, extremely low risk and high up the bank capital structure.

We remain supportive of the regional and unrated ADI sector (and have been even throughout the GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 25-40% more capital than the domestic major banks, and well above the Basel III requirements.

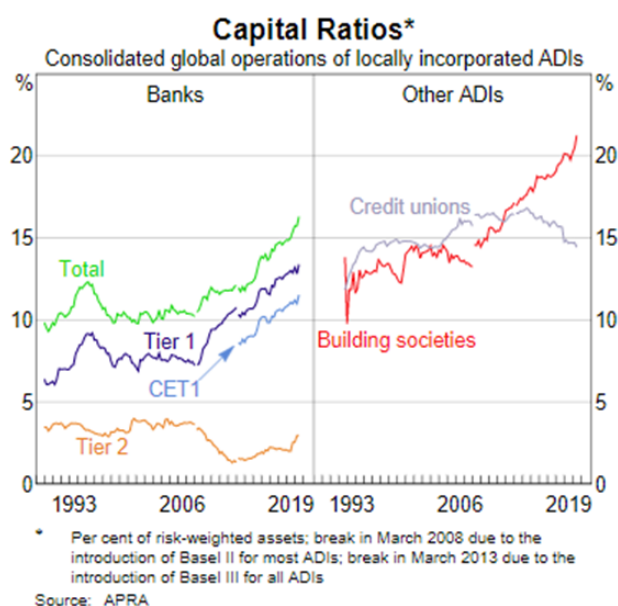


APRA's Chairman affirmed that the banks had satisfactorily moved towards an 'unquestionably strong' capital position and that bank's stress testing contingency plans were now far better positioned than was previously the case years ago. **RBA Governor Lowe has commented that they have not seen any signs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

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). We believe that deposit investments with the lower rated ADIs should be continued going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns.

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

***The biggest single risk that depositors face in the current low interest rate environment is not capital or credit risk, but reinvestment risk. Interest rates are now at their effective lower bound of 0.10%.***





### Credit Quality

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

From a ratings perspective, the BBB (and unrated) banks now generally dominate the number of ADIs issuing deposits within the investment grade space.

However, given most banks are fully liquid during the current pandemic, most of the “BBB” rated and Unrated ADIs are currently not seeking wholesale funding. As such, in the interim, we could see a shift towards a larger proportion of assets being directed towards the higher rated ADIs given the lack of appetite amongst the lower rated ADIs.

As at the end of February 2021, all categories were within the Policy limits:

Compliant	Credit Rating	Invested (\$)	Invested (%)	Max. Limit (%)	Available (\$)
✓	AA Category	\$44,607,689	43.85%	100%	\$57,112,102
✓	A Category	\$28,266,049	27.79%	60%	\$32,765,826
✓	BBB Category	\$28,846,053	28.36%	35%	\$6,755,874
✓	Unrated ADIs	\$0	0.00%	10%	\$10,171,979
		<b>\$101,719,790</b>	<b>100.00%</b>		



### Performance

Council's performance for the month ending 28 February 2021 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.01%	0.02%	0.07%	0.12%	0.20%	0.62%
AusBond Bank Bill Index	0.00%	0.00%	0.03%	0.05%	0.21%	0.75%
Council's T/D Portfolio	0.12%	0.36%	0.76%	1.09%	1.75%	2.12%
Council's FRN Portfolio	0.09%	0.26%	0.54%	0.77%	1.54%	1.97%
Council's Bond Portfolio	0.08%	0.24%	-	-	-	-
<b>Council's Portfolio<sup>^</sup></b>	<b>0.11%</b>	<b>0.34%</b>	<b>0.72%</b>	<b>1.04%</b>	<b>1.72%</b>	<b>2.09%</b>
<b>Outperformance</b>	<b>0.11%</b>	<b>0.34%</b>	<b>0.69%</b>	<b>0.99%</b>	<b>1.51%</b>	<b>1.34%</b>

<sup>^</sup>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	0.10%	0.10%	0.15%	0.18%	0.20%	0.62%
AusBond Bank Bill Index	-0.01%	0.01%	0.06%	0.07%	0.21%	0.75%
Council's T/D Portfolio	1.56%	1.47%	1.54%	1.64%	1.75%	2.12%
Council's FRN Portfolio	1.12%	1.07%	1.08%	1.16%	1.54%	1.97%
Council's Bond Portfolio	1.05%	0.98%	-	-	-	-
<b>Council's Portfolio<sup>^</sup></b>	<b>1.48%</b>	<b>1.39%</b>	<b>1.46%</b>	<b>1.56%</b>	<b>1.72%</b>	<b>2.09%</b>
<b>Outperformance</b>	<b>1.49%</b>	<b>1.38%</b>	<b>1.41%</b>	<b>1.49%</b>	<b>1.51%</b>	<b>1.34%</b>

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

For the month of February, the total investment portfolio (excluding cash) provided a strong return of +0.11% (actual) or +1.48% p.a. (annualised), outperforming the benchmark AusBond Bank Bill Index return of -0.00% (actual) or -0.01% p.a. (annualised). The strong performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the RBA's rate cuts, as well as the FRNs locked in at attractive margins.

We note most of the high-yielding deposits are fast maturing and will be reinvested at lower prevailing rates. With deposit margins tightening over the past few years, the FRN portfolio's performance has narrowed the gap compared to term deposits, although this is likely to reverse following the multiple interest rate cuts over the past year.

**Over the past year, the total portfolio (excluding cash) returned an outstanding +1.72% p.a., outperforming bank bills by 1.51% p.a.** This has been very strong given deposit rates reached their all-time lows and credit margins have generally contracted over the past 3 years.

**We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned (as per our November 2020 Council Rankings).** We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for



many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio. Of the 28 individual deposits North Sydney Council held, 7 are still yielding higher than 1.75% p.a. That is, around a quarter of the outstanding deposits held are currently earning more than the highest rate available in the market from any rated bank out to 5 years.

### Council's Term Deposit Portfolio & Recommendation

As at the end of February 2021, Council's deposit portfolio was yielding an **attractive 1.41% p.a.** (unchanged from the previous month), with an average duration of around 372 days (~1.84 years). We recommend Council extends this average duration. In the low interest rate environment, the biggest collective risk that the local government sector has faced over the post-GFC era has been the dramatic fall in interest rates - from 7¼% to the historical low levels of 0.10%.

As the past decade has highlighted (post-GFC era), we have seen too many portfolios' roll a high proportion of their deposits between 3-6 months, resulting in their deposits being reinvested at lower prevailing rates. That is, depositors have overpaid for liquidity and generally not insured themselves against the low interest rate environment by diversify their funding across various tenors (out to 5 years) but rather placed all their 'eggs in one basket' and kept all their deposits short. **Reinvestment risk has collectively been and continues to be the biggest detriment to depositors' interest income over the post-GFC period.**

At the time of writing, we see value in:

ADI	LT Credit Rating	Term	T/D Rate
ICBC, Sydney	A	5 years	1.50% p.a.
ICBC, Sydney	A	4 years	1.25% p.a.
NAB	AA-	5 years	1.20% p.a.
NAB	AA-	4 years	0.95% p.a.
AMP	BBB	18 months	^0.95% p.a.
ICBC, Sydney	A	3 years	0.95% p.a.
ICBC, Sydney	A	2 years	0.75% p.a.
NAB	AA-	3 years	0.65% p.a.

<sup>^</sup> AMP T/Ds – these are grossed up rates which includes a 0.20% p.a. rebated commission from Imperium Markets

The above deposits are suitable for investors looking to provide some income protection and mitigate reinvestment/rollover risk in the low interest rate environment.

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
AMP	BBB	11-12 months	^0.95% p.a.
AMP	BBB	5, 7-10 months	^0.90% p.a.
AMP	BBB	3-4, 6 months	^0.80% p.a.
ICBC, Sydney	A	12 months	~0.48% p.a.
CBA	AA-	12 months	0.43% p.a.
BoQ	BBB+	9-12 months	0.40% p.a.
NAB	AA-	11-12 months	0.35% p.a.

<sup>^</sup> AMP T/Ds – these are grossed up rates which includes a 0.20% p.a. rebated commission from Imperium Markets





### Senior FRNs Review

Over February, amongst the senior major bank FRNs, physical credit securities remained relatively flat at the longer-end of the curve. Secondary market securities remain expensive on the back of the RBA announcing its \$200bn quantitative easing (QE) package (doubled in Feb 2021). Bid-ask spreads have tightened sharply on the back of excess liquidity and short supply of new issuances.

**A new 5 year senior major bank FRN would now be issued around the +35bp level, appearing expensive on a historical basis.** We expect minimal primary issuance from the domestic banks in the immediate future given the RBA's term funding facility (TFF) to the ADIs, offering a rate of 0.10% (on new drawings) for 3 years, which has been extended to June 2021. The lack of supply from new (primary) issuances amongst the domestic ADIs has also played a major role with the rally in credit markets over recent months.

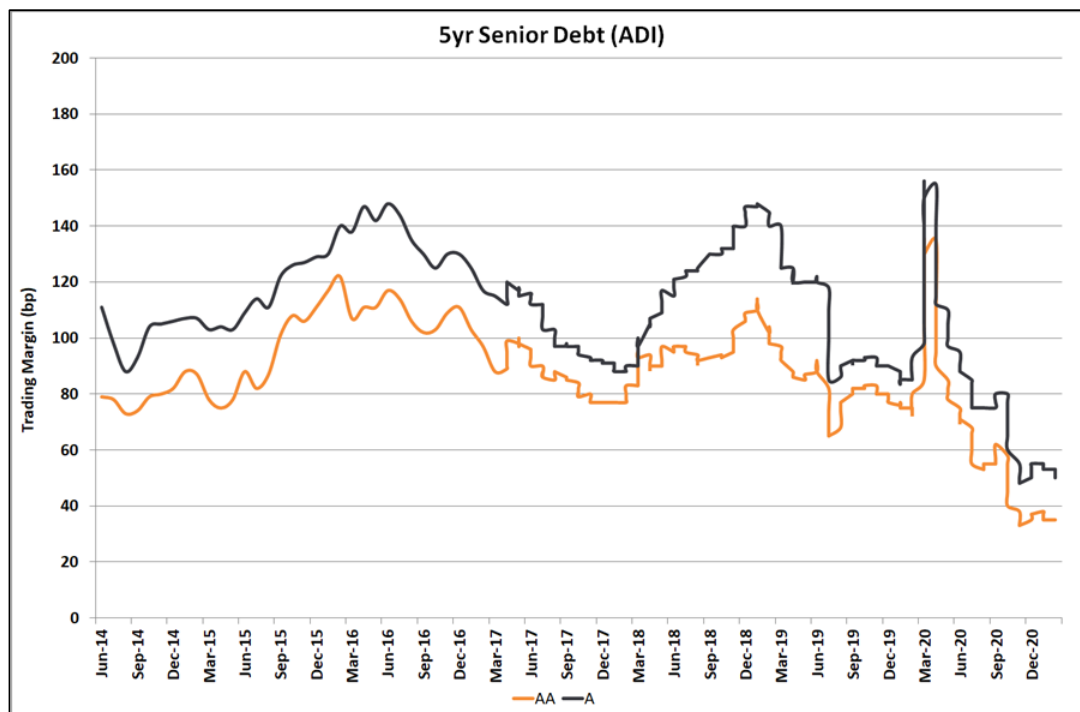
During the month, Suncorp-Metway (A+) issued a new 5 year senior 'benchmark' issue at +45bp, initially tightening from initial guidance of +50bp. The transaction size was \$750m while bids exceeded \$1.85bn i.e. over two times oversubscribed. UBS AG, Australia Branch (A+) also issued a new 5 year deal at +50bp (tightening from +55bp), printing \$1bn with a 70%-30% split between floating and fixed tranches.

Amongst the "A" rated sector, the securities were marked marginally tighter at the long-end of the curve, driven by the new issues from Suncorp and UBS. The "BBB" rated sector remained relatively flat during the month. While turnover in the secondary market is still predominately dominated by commonwealth, semi-government and major bank senior paper, given the lack of supply, we have started to observe that even a handful of regional bank senior paper has sometimes been trading inside "mid" levels over recent months.

Credit margins are now trading very tight on a historical level and look fairly expensive. 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)	26/02/2021	29/01/2021
"AA" rated – 5yrs	+35bp	+35bp
"AA" rated – 3yrs	+20bp	+20bp
"A" rated – 5yrs	+50bp	+53bp
"A" rated – 3yrs	+33bp	+35bp
"BBB" rated – 3yrs	+52bp	+52bp

Source: IBS Capital



Source: IBS Capital

We now generally **recommend switches** ('benchmark' issues only) into new attractive primary issues (or longer-dated alternatives), out of the following senior FRNs that are maturing:

- **On or before early 2024 for the "AA" rated ADIs (domestic major banks);**
- On or before mid-2022 for the "A" rated ADIs; and
- Within 12 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last 1-2 years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current low interest rate environment, any boost in overall returns should be locked in when it is advantageous to do so.



**Council's Senior FRNs Sale/Switch Recommendations**

We now recommend Council switches out of the following FRN:

- \$2.00m CBA (AA-) FRN maturing 11/01/2024 (ISIN: AU3FN0046561) – trading margin marked around **+26.0bp** or capital price of \$102.48 (capital gain ~**\$50,000**).

The above sale would result in capital gains totalling ~**\$50,000** and would most likely be switched into a higher yielding complying asset. Holding the above FRN is now a sub-optimal strategy given it is yielding less than 0.5% p.a. if held to maturity.

At this stage, we prioritise switching into any remaining attractive medium-longer dated fixed deposit given the depressed state of interest rates.

**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. Council received the full rebated commission of 0.25% on the total face value of investments (i.e. \$15,000) in mid-November 2020 as it was introduced by Imperium Markets. We believe this was prudent given the low rate environment.

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.



## Economic Commentary

### International Market

**Global bond yields rose significantly during the month**, driven by increased inflationary concerns amid a rise in energy prices, the prospect of the big US fiscal stimulus package, and the global recovery entering a more solid stage in its vaccine rollouts.

Global equity markets rose on the accelerated vaccine rollout. The S&P 500 Index rose +2.61%, while the NASDAQ gained +0.93%. Across Europe, Germany's DAX rose +2.63%, UK's FTSE +1.19% and France's CAC +5.63%.

**The US House passed the American Rescue Plan stimulus worth US\$1.9 trillion (~9%/GDP)**, which will pay for vaccines and medical supplies, financial aid to households, small businesses and state and local governments. The package includes US\$1,400 direct payments to taxpayers making as much as US\$75,000.

**The US unemployment rate unexpectedly fell to 6.3% from 6.7% in January**, well below the consensus for an unchanged outcome. This was not considered good news given the decline was largely **driven by a pullback in the participation rate (-0.1% to 61.4%), meaning about 405k of workers left the market**, a sign of discouragement.

**US Treasury Secretary Yellen emphasised that if the US\$1.9trn package is approved, the US could return to full employment by 2022** and that without additional stimulus, it could take until 2025 to see unemployment back below 4%.

US core CPI which came in at 0.0% m/m against the +0.2% consensus, taking the annual rate to +1.4%.

The Bank of England meeting outcomes were in line with expectations with no change in policy settings at 0.10% and quantitative easing of £895bn, which included £20bn in corporate bonds.

**Eurozone Q4 GDP came in 0.2% stronger than the consensus estimate of -0.9% at -0.7%q/q**, largely due to better performances by France and Spain, with Germany in line.

Mario Draghi was sworn in as Italy's new PM after two formerly anti-euro parties (The League and Five Star) signalled they would be willing to support him in a national unity government.

Chinese CPI data saw headline CPI miss at -0.3% y/y against 0.0% expected.

The MSCI World ex-Aus Index rose +2.46% for the month of February:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	2.61%	+5.23%	+29.01%	+11.98%	+14.55%	+11.12%
MSCI World ex-AUS	+2.46%	+5.51%	+27.48%	+8.94%	+12.10%	+7.49%
S&P ASX 200 Accum. Index	+1.45%	+3.00%	+6.48%	+7.39%	+10.74%	+7.76%

Source: S&P, MSCI



### Domestic Market

**The RBA surprised to the dovish side in its meeting in February, flagging an early \$100bn extension to the \$100bn QE program**, when the consensus was that the RBA would not decide on this until closer to the end of the current program in late April. **Forward guidance on rates was also tweaked slightly with the Board now not expecting the conditions for a rate hike “until 2024 at the earliest”.**

RBA Board Member Harper indicated *“the tendency of this to produce an asset-price bubble is way off where we’re presently headed”* and that *“there’s still plenty of excess capacity in the economy”*. The comments emphasise the RBA is in no hurry to alter its policy package on the basis of asset prices.

Household deposits rose \$275m in January to \$1.11trn. Compared to pre-pandemic February 2020 levels, total household deposits are now up a cumulative \$123.8bn or 12.5%.

Credit growth remain subdued at +0.2% m/m, taking the annual rate to +1.7%.

New housing loan approvals continued to surge in December, increasing +8.6% m/m to be +31.2% y/y. Residential building approvals continued to see strong gains in December, lifting +10.9% m/m to be +22.8% higher y/y.

**Victoria entered a 5-day Stage 4 lockdown in mid-February** as authorities expected the outbreak of the UK strain of COVID-19 from a hotel quarantine to grow.

**JobSeeker numbers are falling**, reducing concerns that the end of the JobSeeker Supplement and JobKeeper could significantly slow the recovery. The rebound has seen over 553k unemployed Australians back into the workforce.

**Unemployment fell more than expected in January, down to 6.4% from 6.6%**, taking the unemployment rate to its lowest level since April 2020. Underemployment also declined, down 0.4% to 8.1% and is now the lowest since February 2019.

Bank of Queensland announced its acquisition of Members Equity Bank for \$1.325bn, fully funded and underwritten through an equity raise, with the deal likely formalised in coming months.

**The Australian dollar gained another 2.41%, finished the month at US78.29 cents** (from US76.45 cents the previous month).

### Credit Market

The main credit indices tightened over February as investors remained optimistic about the outlook for the global recovery on the back of the accelerated vaccine rollout. The indices now trade back to their levels experienced in late 2019:

Index	February 2021	January 2021
CDX North American 5yr CDS	56bp	56bp
iTraxx Europe 5yr CDS	51bp	52bp
iTraxx Australia 5yr CDS	62bp	63bp

Source: Markit



## Fixed Interest Review

### Benchmark Index Returns

Index	February 2021	January 2021
Bloomberg AusBond Bank Bill Index (0+YR)	-0.00%	+0.00%
Bloomberg AusBond Composite Bond Index (0+YR)	-3.58%	-0.42%
Bloomberg AusBond Credit FRN Index (0+YR)	-0.02%	+0.09%
Bloomberg AusBond Credit Index (0+YR)	-1.65%	+0.04%
Bloomberg AusBond Treasury Index (0+YR)	-4.21%	-0.64%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-4.37%	-0.98%

Source: Bloomberg

### Other Key Rates

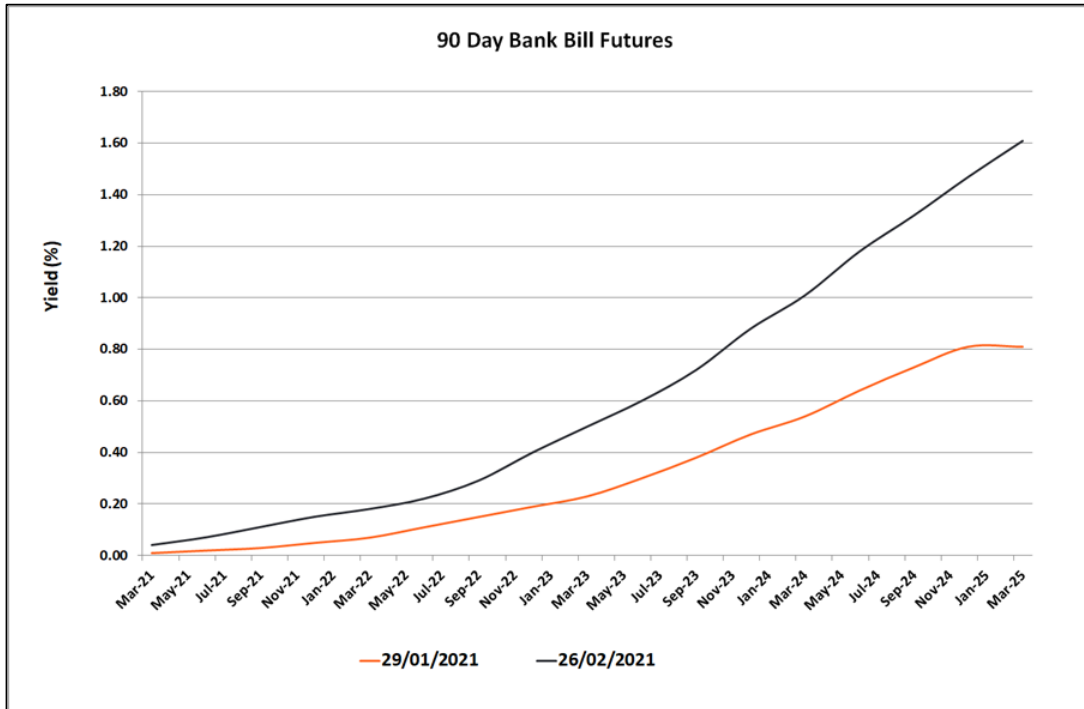
Index	February 2021	January 2021
RBA Official Cash Rate	0.10%	0.10%
90 Day (3 month) BBSW Rate	0.03%	0.01%
3yr Australian Government Bonds	0.12%	0.11%
10yr Australian Government Bonds	1.87%	1.09%
US Fed Funds Rate	0.00%-0.25%	0.00%-0.25%
10yr US Treasury Bonds	1.44%	1.11%

Source: RBA, AFMA, US Department of Treasury



**90 Day Bill Futures**

Over February, bill futures rose significantly at the long-end of the curve as global inflationary pressures caused long-term bond yields to rise dramatically. Overall, bill futures continue to depict a low rate environment over the long-run, despite the steeping curve:



Source: ASX



## Fixed Interest Outlook

Investors continue to focus on the positive medium-term news from multiple vaccine roll-outs, the reduction in daily infection rates and curbing of overwhelmed health systems, amongst the backdrop of unprecedented fiscal stimulus.

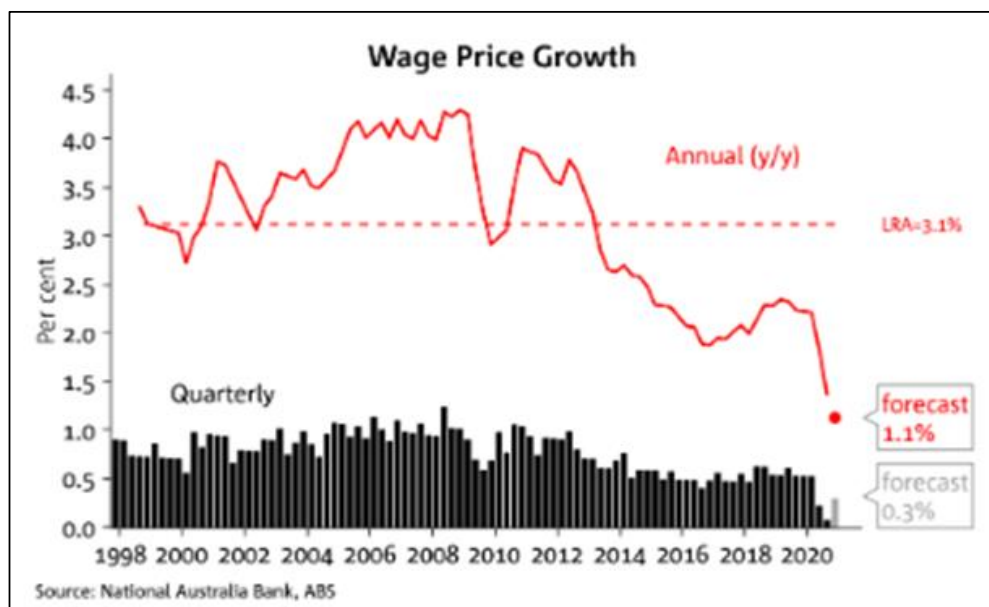
The prospect of stronger fiscal support for the global economy and the evident determination of the new US Biden administration to get pandemic under control and stabilise the economy has aided financial markets.

US Fed Chair Powell stressed the point that the US economy is a long way from a full recovery. He indicated it *“could take more than three years to hit the 2% average inflation target”* while also showing no concerns over asset prices elevation *“by some measures”*.

Domestically, the RBA’s latest forward guidance suggests **they do not expect to increase the official cash rate “until 2024 at the earliest”** given that *“wages growth will have to be materially higher than it is currently”* to see actual inflation sustainably within their 2-3% target range. The RBA’s preferred core trimmed mean measure is forecast to be 1½% at the end of 2022.

The RBA’s focus is now to reduce the unemployment rate, commenting that it was a *“national priority”* to achieve their inflation target range. For inflation to lift sustainably, it will require wages growth to lift substantially and Governor Lowe previously indicated that the unemployment rate may need to fall to 4-point something percent to achieve this objective.

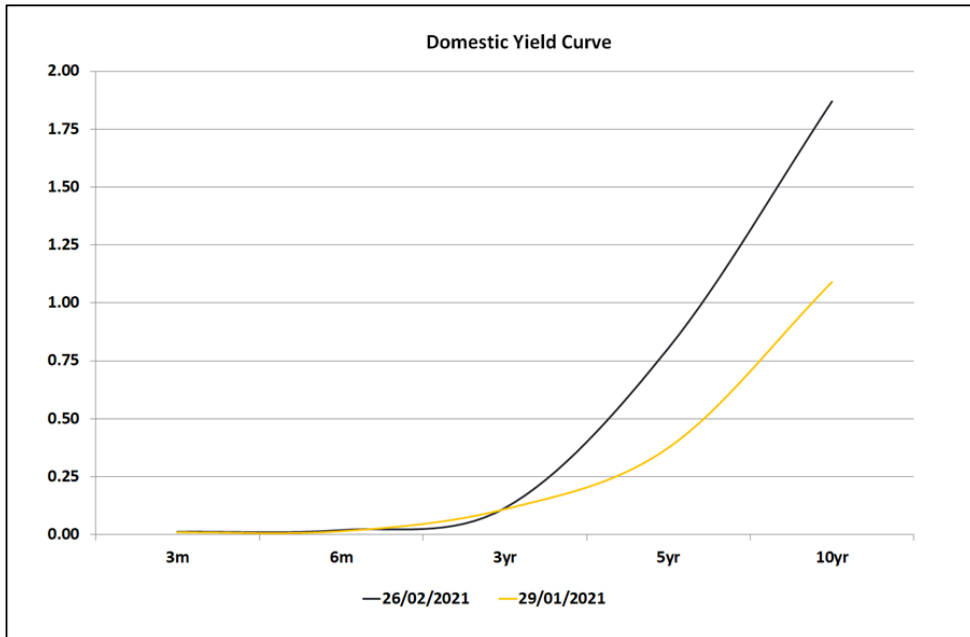
Worryingly on the inflation outlook, the RBA notes that around 25% of recently surveyed firms intend to implement wage freezes in 2021, while 30% already have wage freezes in place. The wage price index (WPI) rose +0.6% in Q4, taking the annual rate to +1.4%, which is well below the 3%+ rate that the RBA states is needed to have inflation sustainably within 2-3% target band.





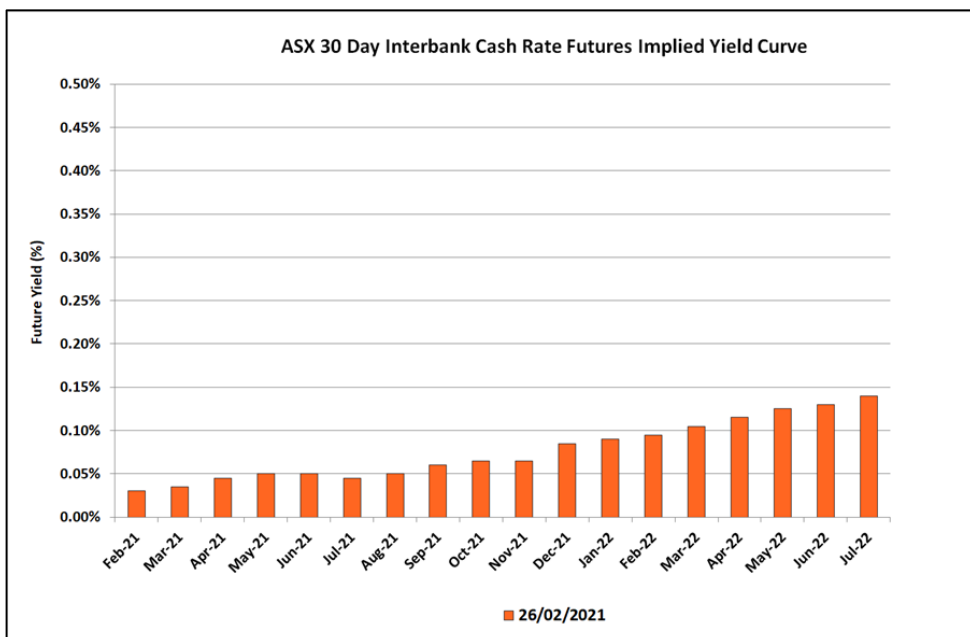


The domestic bond market continues to suggest a prolonged low period of interest rates. Over the month, yields rose over 80bp at the long-end of the curve on rising global inflationary expectations:



Source: AFMA, ASX, RBA

**Despite the RBA’s forward guidance (keep rates unchanged for 3 years), the futures market is still pricing in the possibility of further rate cuts closer to 0% over the next 12 months:**



Source: ASX



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