8.9. Investment and Loan Borrowings Report held as at 31 January 2022

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ENDORSED BY: Margaret Palmer, Director Corporate Services

ATTACHMENTS:
1. Monthly Investment Advisors Report for January 2022 [**8.9.1** - 19 pages]

PURPOSE:

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

EXECUTIVE SUMMARY:

Investment Portfolio:

The Investment Portfolio (excluding cash balances) held for the period ending 31 January 2022 had a market value of $99,928,000. The annualised returns were 1.36%. This return exceeded the Australian bond Bank Bill performance benchmark by 1.33%

Cash deposits at call were $21,025,474 with $19,021,104 of these held in interest bearing accounts. $2,004,370 cash is held in Council's non-interest-bearing transaction account with the Commonwealth Bank to meet day-to-day operational needs.

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

The actual year to date returns for cash and investments for January 2022 was $724,628 compared to a year-to-date budget of $652,166.

The Reserve Bank of Australia (RBA) has indicated that economic data does not warrant an increase in its official cash rate from current historic lows in this Financial Year 2022. It has suggested increases in 2023 are plausible. The RBA is tolerating inflation at the top of its target band of 2-3%

Historically, returns on cash (i.e. "at call" accounts) and short-term investments have been quite strong. With the low official cash rate, market variability in monthly returns may mean the short to medium term investment returns could be flat or potentially slightly negative. The capacity for Council staff to invest in a manner that meets liquidity requirements whilst achieving the "enhanced" benchmark returns (as detailed in the Investment Policy) is increasingly limited. However, the best available returns are still actively sought when surplus funds are invested.

Borrowings:

Loan Facility for Council Projects

Council entered into a fixed interest loan of $9.5 million with quarterly interest and principal payments on 31 July 2018. The principal outstanding as at January 2022 is $6,598,874.

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

North Sydney Olympic Pool Redevelopment

Council has made provision for borrowings of $31 million to partially fund the redevelopment of North Sydney Olympic Pool. At the Extraordinary Council Meeting of 24 January 2022, Council deferred consideration of a report related to this loan.

FINANCIAL IMPLICATIONS:

Council's total investment portfolio performance for the financial year to date is 1.33% above the benchmark (1.36% against 0.03%). The actual returns for cash and investments for the year-to-date are $724,628 compared to year-to-date budget of $652,166.

The budgeted investment returns over the medium term needs to reflect the current low interest rate environment which is likely to continue over the next financial years.

Investment returns will continue to be monitored and reported to ensure the estimate is consistent with the actual returns.

RECOMMENDATION:

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

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

5. Our Civic Leadership
5.1 Council leads the strategic direction of North Sydney

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 January 2022 and annualised for the year to date at 31 January 2022 (including investments which have matured prior to 31 January 2022).

	January 2022	**Annualised YTD as at 31 January 2022**
Actual Return	0.10%	1.36%
Benchmark	0.00%	0.03%
Variance	0.10%	1.33%

The portfolio performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the interest rate cuts of recent years. Council's Floating-Rate Notes (FRNs) were locked in at attractive margins.

Asset Type	Market Value as at 31 January 2022	Portfolio Breakdown as at 31 January 2022
Term Deposits	$82,250,000	68.00%
Cash Interest Bearing	$19,021,104	15.73%
Cash Non-Interest Bearing	$2,004,370	1.66%
Fixed Bonds	$9,000,000	7.44%
FRTD	$6,000,000	4.96%
Floating Rate Notes (FRN's)	$2,678,000	2.21%
	$120,953,474	**100.00%**

Council's average duration of term deposits which comprise approximately 70% of the investment portfolio was approximately 748 days as at 31 January 2022, thus reducing the exposure to declining interest rates experienced with investment renewals.

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

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

The actual investment returns for the year to date as at 31 January 2022 have been reviewed and are $72,512 more than the year-to-date budgeted estimate.

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

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (January)	YTD/Annual Actual (January)	YTD/Annual Actual FV adjustments (January)	YTD Budget to Actual Variance (January)
2021/22	**$1,100,000**	**$1,100,000**	**$652,116**	**$752,219**	**-$27,591**	**$72,512**
2020/21	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601
2019/20	$1,500,000	$1,529,055		$1,896,660	-$4,944	$362,661
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 31 January 2022 the YTD movement of FRN's has been a decrease of $27,591.

Financial Investment Policy

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

Long Term Rating Range	Invested as at 31 January 2022	Maximum Policy Holding	Distribution as at 31 January 2022
AA Category	$57,513,065	100.00%	47.55%
A Category	$43,018,224	60.00%	35.57%
BBB Category	$20,422,185	35.00%	16.88%
Unrated ADIs (NR)	$0	10.00%	0.00%

Loan Borrowings

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

The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating or a combination 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:

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**
1/07/2021	$7,253,977.04			
31/07/2021	$7,037,040.24	$72,702.74	$216,936.80	$ 289,639.54
30/10/2021	$6,817,929.20	$70,528.49	$219,111.04	$ 289,639.54
29/01/2022	$6,598,874.84	$70,585.18	$219,054.36	$ 289,639.54
30/04/2022	$6,373,191.95	$63,956.66	$225,682.88	$ 289,639.54

The next loan instalment is due on 30 April 2022.

Loan Funded Capital Projects as at 31 January 2022:

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

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

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

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

Loan for North Sydney Olympic Pool Redevelopment

Council has made provision for borrowings of $31 million to partially fund the redevelopment of North Sydney Olympic Pool. At the Extraordinary Council Meeting of 24 January 2022, Council deferred consideration of a report related to this loan.

Monthly Investment Report

January 2022

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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.

The RBA cut rates to record lows on 3rd November 2020 to 0.10%, consistent with most global central banks resetting their official rates back to emergency levels. With international borders shut and vaccination rates accelerating, **g**lobal inflationary pressures have emerged. This has resulted in longer-term bond yields to rise in recent months as central banks start to withdraw some of their other stimulatory policy measures (such as quantitative easing), whilst some have already started increasing official interest rates. **Markets are now bracing an environment where central banks will move from their excessively loose policy measures to a tightening cycle**.

Domestically, Governor Lowe has commented that higher Interest rate rises starting later in 2022 were deemed "*a plausible scenario*", but "*it's still quite plausible that the first increase…is a year or longer away*". The RBA's 'patience' to bear higher levels of inflation may well be tested throughout 2022-2023 if wages growth moves closer to its +3% target rate more quickly than anticipated.

The largest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits (fixed and floating), which accounts for around ~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 1.19% p.a. at month-end, with a weighted average duration of around 748 days or ~2 years. **This average duration will provide some income protection against the low interest rate environment over the next 12 months**.

With markets bringing forward expectations of official rate hikes, this has seen a significant shift in longer term deposit rates over recent weeks. Future investments above 1.00% p.a. is now possible if Council can continue to place the majority of its surplus funds for a minimum term of 18 months**.**

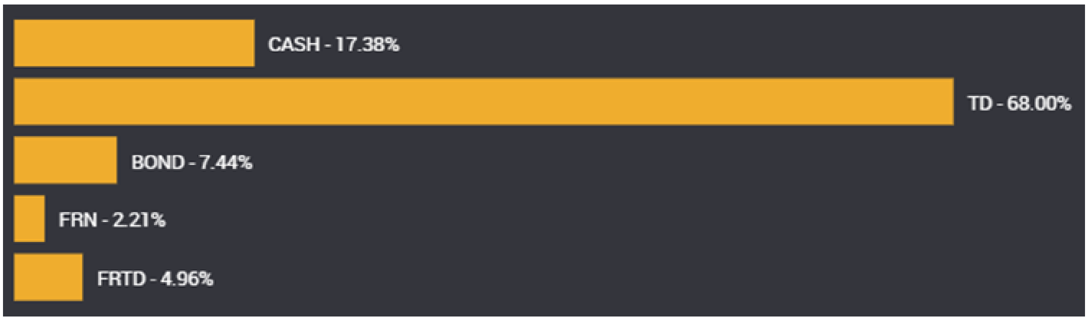
IMPERIUM MARKETS

Council's Portfolio & Compliance

Asset Allocation

As at the end of January 2022, the portfolio was mainly directed to fixed and floating rate term deposits (72.96%). The remaining portfolio is directed to FRNs (2.21%), fixed bonds (7.44%) and overnight cash accounts (17.38%).

While FRNs appear relatively expensive on a historical basis, they are starting to become slightly more attractive as spreads have widened – new issuances should now be considered again on a case by case scenario. In the interim, fixed deposits and secondary market fixed bonds for 2-3 years now appear quite appealing following the spike in longer-term rates in recent months.



Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 43% 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 $8.8m at month-end.

Where liquidity permits, we recommend new surplus funds be directed to 2-3 year horizon given this is where the most attractive value can be found. We suggest this be allocated to any remaining attractive fixed term deposits or secondary market fixed bonds to address reinvestment risk.

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$32,025,474	26.48%	10%	100%	$88,928,000
X	91 - 365 days	$16,000,000	13.23%	20%	100%	$104,953,474
✓	1 - 2 years	$21,250,000	17.57%	0%	70%	$63,417,432
✓	2 - 5 years	$51,678,000	42.73%	0%	50%	$8,798,737
✓	5 - 10 years	$0	0.00%	0%	25%	$30,238,369
		$120,953,474	**100.00%**			

Although the 3-12 month allocation is marginally underweight relative to the min. 20% limit, this is more than offset by the large allocation (26½%) to the 0-3 month horizon (highly liquid).

Counterparty

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

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA	AA-	$5,004,370	4.14%	30.00%	$31,281,672
✓	NAB	AA-	$15,000,000	12.40%	30.00%	$21,286,042
✓	NTTC	AA-	$9,000,000	7.44%	30.00%	$27,286,042
✓	Suncorp	AA-	$1,258,695	1.04%	30.00%	$35,027,347
✓	Westpac	AA-	$27,250,000	22.53%	30.00%	$9,036,042
✓	Macquarie	A+	$15,018,224	12.42%	15.00%	$3,124,797
✓	ICBC Sydney	A	$17,000,000	14.05%	15.00%	$1,143,021
✓	ING Bank	A	$11,000,000	9.09%	15.00%	$7,143,021
✓	BOQ	BBB+	$10,000,000	8.27%	10.00%	$2,095,347
✓	AMP Bank	BBB	$6,002,880	4.96%	10.00%	$6,092,467
✓	Auswide Bank	BBB	$3,000,000	2.48%	10.00%	$9,095,347
✓	Newcastle PBS	BBB	$1,419,305	1.17%	10.00%	$10,676,043
			$120,953,474	**100.00%**		

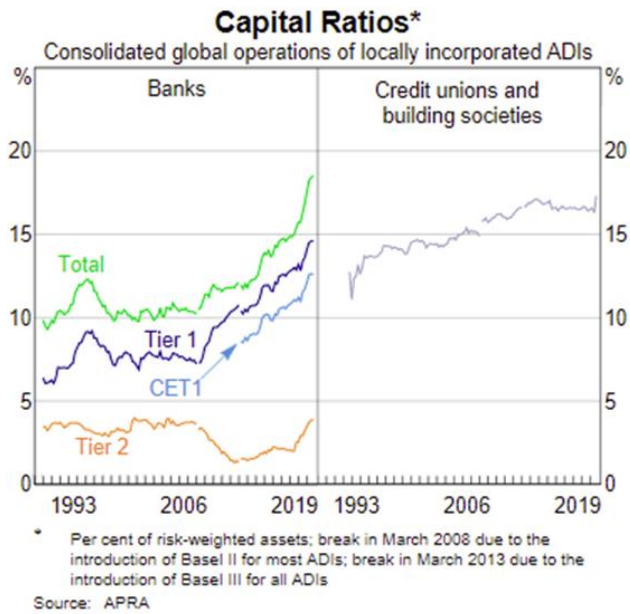
We remain supportive of the regional and unrated ADI sector (and have been even throughout the GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to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

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

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). We believe that deposit investments with the lower rated ADIs should be continued going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns.

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.



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 January 2022, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$57,513,065	47.55%	100%	$63,440,409
✓	A Category	$43,018,224	35.57%	60%	$29,553,860
✓	BBB Category	$20,422,185	16.88%	35%	$21,911,531
✓	Unrated ADIs	$0	0.00%	10%	$12,095,347
		$120,953,474	**100.00%**		

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.01%	0.03%	0.05%	0.06%	0.10%	0.18%
AusBond Bank Bill Index	0.00%	0.01%	0.02%	0.02%	0.03%	0.16%
Council's T/D Portfolio	0.10%	0.32%	0.65%	0.77%	1.37%	1.59%
Council's FRN Portfolio	0.09%	0.53%	0.78%	0.86%	1.61%	1.61%
Council's Bond Portfolio	0.10%	0.29%	0.56%	0.64%	1.05%	-
Council's Portfolio^	**0.10%**	**0.32%**	**0.65%**	**0.76%**	**1.36%**	**1.57%**
Outperformance	**0.10%**	**0.31%**	**0.63%**	**0.75%**	**1.33%**	**1.41%**

^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%	0.10%	0.10%	0.10%	0.18%
AusBond Bank Bill Index	0.06%	0.06%	0.03%	0.03%	0.03%	0.16%
Council's T/D Portfolio	1.22%	1.26%	1.30%	1.32%	1.37%	1.59%
Council's FRN Portfolio	1.02%	2.13%	1.55%	1.47%	1.61%	1.61%
Council's Bond Portfolio	1.13%	1.15%	1.11%	1.09%	1.05%	-
Council's Portfolio^	**1.21%**	**1.29%**	**1.29%**	**1.30%**	**1.36%**	**1.57%**
Outperformance	**1.15%**	**1.23%**	**1.26%**	**1.27%**	**1.33%**	**1.41%**

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

For the month of January, the total investment portfolio (excluding cash) provided a strong return of +0.10% (actual) or +1.21% p.a. (annualised), outperforming the benchmark AusBond Bank Bill Index return of +0.00% (actual) or +0.06% p.a. (annualised). The strong performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the RBA's rate cuts, as well as the FRNs locked in at attractive margins.

Over the past 12 months, the total portfolio (excluding cash) returned an outstanding +1.36% p.a., outperforming bank bills by 1.33% 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 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.

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 October 2021 Council Rankings), earning around $440,000 in additional interest income versus the average NSW Council. We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio. Of the 29 individual deposits North Sydney Council held, 8 are still yielding higher than 1.50% p.a. That is, around 28% of the outstanding deposits held are currently earning more than fifteen times the prevailing cash rate of 0.10%.

Council's Term Deposit Portfolio & Recommendation

As at the end of January 2022, Council's deposit portfolio was yielding an **attractive 1.19% p.a.** (down 6bp from the previous month), with an average duration of around 748 days (~2.05 years). We recommend Council maintains this average duration.

As the past decade has highlighted (post-GFC era), we have seen too many portfolios' roll a high proportion of their deposits less than 6 months (high turnover), 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	2.88% p.a.
ICBC, Sydney	A	4 years	2.69% p.a.
ICBC, Sydney	A	3 years	2.43% p.a.
Westpac	AA-	4 years	2.41% p.a.
Westpac	AA-	3 years	2.18% p.a.
NAB	AA-	3 years	2.10% p.a.
ICBC, Sydney	A	2 years	1.93% p.a.
Westpac	AA-	2 years	1.75% p.a.
NAB	AA-	2 years	1.70% p.a.

The above deposits are suitable for investors looking to provide some income protection and mitigate reinvestment/rollover risk for the next few years.

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 Bank	BBB	11-12 months	1.00% p.a.^
ICBC	A	12 months	1.00% p.a.
Westpac	AA-	12 months	0.98% p.a.
BoQ	BBB+	12 months	0.90% p.a.
NAB	AA-	12 months	0.85% p.a.
CBA	AA-	12 months	0.80% p.a.

^ AMP T/Ds – contact us to receive an additional 0.20% p.a. rebated commission on top of the rate shown above

Amongst the investment grade sector, the majority of short-dated term deposits (maturing less than 12 months) are yielding under 0.95% p.a. Despite the uplift in outright rates since early October, we generally believe there is not much value being offered in short-dated deposits.

In contrast, there is an upward pick-up in yield for investors that can take advantage of 2-3 year fixed T/Ds whilst official rates are stuck at depressed levels at least for the next few years. For those investors that do not require high levels of liquidity and can stagger their investments longer-term, they will be rewarded over coming years if they roll for a minimum term of 2 years, yielding, on average, more than double the return compared to those investors that purely invest in short-dated deposits.

Senior FRNs Review

Over January, amongst the senior major bank FRNs, physical credit securities were marked up to 7bp wider at the long-end of the curve. During the month, WBC (AA-) and CBA (AA-) issued new 5 year 'benchmark' senior FRNs at +70bp. We anticipate the other major banks may follow suit over coming months looking to refinance their upcoming maturities at these historically cheap levels:

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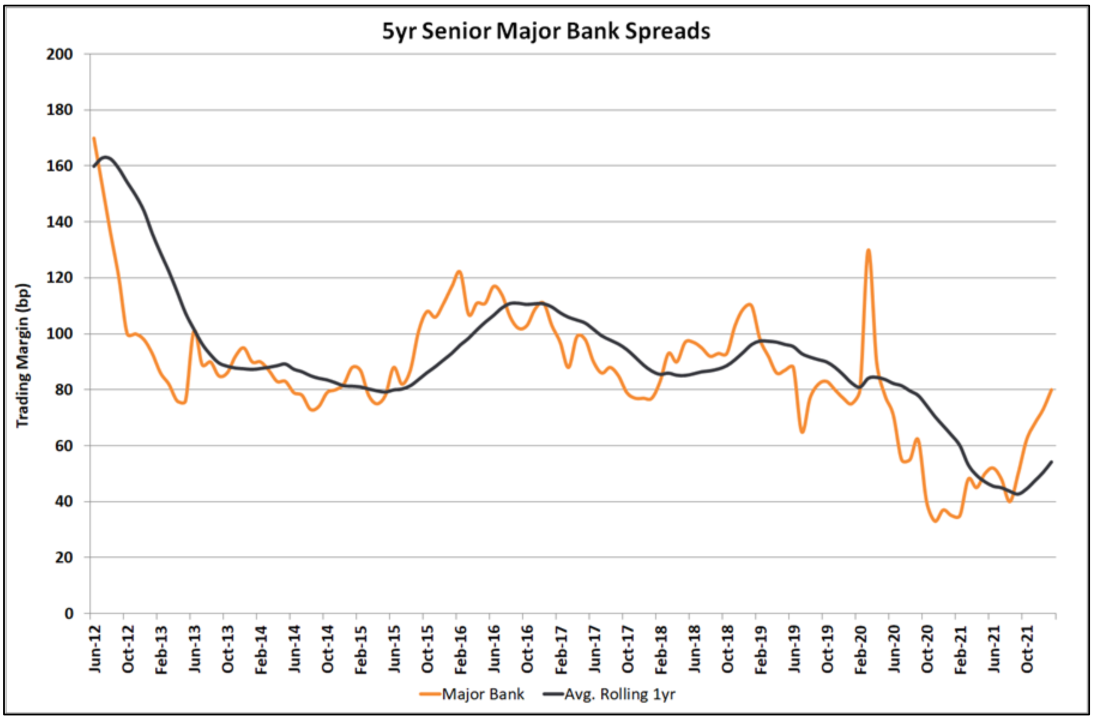


Source: IBS Capital

Amongst the "A" and "BBB" rated sector, the securities were marked relatively flat at the long-end of the curve. There was quite a few number of primary issues in the month, highlighted by:

- Sumitomo (A): dual 3 and 5 year senior FRN at +57bp and +78bp respectively
- Bank of Nova Scotia (A+): dual 1 and 5 year senior FRN deal at +25bp and +87bp respectively
- Suncorp (AA-): 5 year senior FRN at +78bp
- Rabobank Australia Branch (A+): 5 year senior FRN at +73bp

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.

The lack of supply from new (primary) issuances has played a major role with the strong rally in credit markets over 2020. This has now started to reverse as monetary policy easing measures are progressively being withdrawn.

FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/01/2022	31/12/2021
"AA" rated – 5yrs	+80bp	+73bp
"AA" rated – 3yrs	+47bp	+46bp
"A" rated – 5yrs	+90bp	+88bp
"A" rated – 3yrs	+60bp	+62bp
"BBB" rated – 3yrs	+70bp	+70bp

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 2024 for the "AA" rated ADIs (domestic major banks)**;
- On or before early 2023 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 few years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current low interest rate environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

While FRNs appear relatively expensive on a historical basis, they are starting to become slightly more attractive as spreads have widened – new issuances should now be considered again on a case by case scenario. We recommend Council retains its only FRN at this stage.

Council's Senior FRNs Sale/Switch Recommendations

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

Council's Senior Bonds

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

Council received the full rebated commission of 0.25% on the total face value of investments (i.e. $9m x 0.25% = $22,500) as it was introduced by Imperium Markets. We believe 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.

Senior Bonds - Northern Territory Treasury Corporation (NTTC)

Investors should be aware of the following senior retail bond offering from Northern Territory Treasury Corporation (NTTC) effective 4th January 2022:

Maturity Date	Rate % p.a.^	Interest Paid
15/06/2023	0.40%	Annually
15/06/2024	0.90%	Annually
15/06/2025	1.50%	Annually
15/06/2026	1.60%	Annually
15/06/2027	1.90%	Annually

^^The rates offered in the above table can be reviewed and changed at any time from Treasury. The rate for broker sponsored applications will be dropped by 0.20% p.a. effective 1 October 2020.

Any investor interested in this product should avoid placing through the broker channel and contact Imperium Markets to receive the full commission of 0.25% (plus GST) on the face value of the investment, in the form of an additional rebate. If placed through the brokers, they are likely to keep the 0.25% commission (on the face value of the investment).

Overview	Description
Issuer	Northern Territory Government
Credit Rating	Aa3 (Moody's), which is AA- equivalent (S&P)
Type	Fixed senior (retail) bonds
Program	Territory Bonds Issue 112
Date for applications	**01/01/2022 – 31/05/2022**
Liquidity	Weekly redemptions available, subject to the prevailing market rate and administration costs^^

^^ Note given this is a retail bond offering (min. parcel size of $5,000), for wholesale investors, we would not consider this to be a liquid investment (the largest redemptions to date have only been $200-$300k).

The product should be viewed as a hold-to-maturity product, noting there are significant penalty costs including admin fees, the prevailing market interest rate, and factors in any associate commissions that were previously paid. Given the longer-term outlook for official interest rates, any investor interested should invest through Imperium Markets to receive an effectively higher rate, once factoring in the rebated commission. *These offers will need to be compared to other complying assets at the time of investment – term deposits are currently a better alternative.*

Senior Fixed Bonds – ADIs (Secondary Market)

As global inflationary pressures have emerged, this has seen a significant lift in longer-term bond yields (valuations fell) as markets have strongly factored in a tightening of global central bank policy measures (i.e. withdrawal of Quantitative Easing and lifting official interest rates).

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the majority now being marked at a significant discount to par (please note supply in the secondary market may be limited on any day):

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0265403	Suncorp	AA-	Senior	30/07/2024	2.49	1.85%	1.88%
AU3CB0265593	Macquarie	A+	Senior	07/08/2024	2.52	1.75%	1.84%
AU3CB0265718	ING	AAA	Covered	20/08/2024	2.55	1.45%	1.83%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	2.58	1.55%	1.69%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	2.60	1.70%	1.96%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	2.75	2.00%	2.14%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	2.96	1.65%	1.93%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	2.98	1.65%	1.98%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	3.04	1.70%	2.17%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	4.26	1.40%	2.58%
AU3CB0282358	ING	AAA	Covered	19/08/2026	4.55	1.10%	2.32%

Economic Commentary

International Market

Financial markets fell sharply this month as the market readies for the US Fed to raise interest rates to stem inflationary pressures, which is at its highest level in nearly four decades. Geopolitical tensions in Europe between the Ukraine/Russia have also contributed to the broad risk-off environment.

Equity markets fell in the US, with the S&P 500 losing -5.26%, while the NASDAQ plunged -8.98%. Europe's main indices were mixed, with losses led by Germany's DAX (-2.60%) and France's CAC (-2.15%), while UK's FTSE (+1.08%) was the exception.

US inflation rose +0.5% m/m in December, taking the annual rate to +7.0%, the highest record in 40 years. Price increases in housing and used cars and trucks were the largest contributors to the inflation rate, with 0.4% and 3.5% increases in price compared with November, respectively.

US Fed Chair Powell was hawkish in its latest meeting, flagging a rate hike for March and the end of Quantitative Easing (QE). He said the Fed is "*willing to move sooner*" and "*perhaps faster*" than last time in shrinking the balance sheet.

UK headline inflation hit its highest level since the early 1990s, at +5.4% y/y, while core inflation picked up to +4.2%. UK Ministers have flagged the easing of restrictions with virus numbers and hospitalisation having peaked.

In Canada, headline inflation hit a 30-year high of +4.8%, matching expectations. Core inflation came in higher than expected, at +2.9% y/y, also a 30-year high. The Bank of Canada met and delivered a hawkish hold, citing the Omicron variant as one reason not to hike in January as was 70% priced by markets, but signalled a hike at the next meeting in March.

The PBOC cut its 7-day repo rate and one-year medium-term loan rate to banks by 10bp (to 2.1% and 2.85% respectively). Chinese GDP surprised to the upside with quarterly growth of +1.6% q/q against +1.2% expected. That takes 2021 full year growth to +8.1%.

The MSCI World ex-Aus Index fell -5.28% for the month:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-5.26%	-1.95%	+21.57%	+18.64%	+14.66%	+13.15%
MSCI World ex-AUS	-5.28%	-3.50%	+15.36%	+14.93%	+11.51%	+9.70%
S&P ASX 200 Accum. Index	-6.35%	-4.30%	+9.44%	+9.77%	+8.50%	+9.53%

Source: S&P, MSCI

Domestic Market

Headline CPI rose +1.3% q/q and +3.5% y/y. The major contributors to headline inflation in the quarter was new dwelling construction and automotive fuel. New dwelling prices rose +4.2% q/q, contributing around 0.4% to the headline measure.

Core trimmed mean inflation rose +1.0% q/q and +2.6% y/y, well above expectations of +0.7%/+2.3% rise. Importantly this is well above the +0.6%/2¼% the RBA was forecasting back in November, meaning the RBA will need to revise up its inflation track.

In order to lift official interest rates, the RBA has previously said it wants wages growth close to +3% to have confidence inflation will be sustained at target after six years of undershooting the target.

The unemployment rate fell by 0.4% to 4.2% in December (consensus 4.5%). The sharp fall takes the unemployment rate to its lowest levels since August 2008.

Economists have begun to downgrade their Q1 GDP forecasts on the back of Omicron. Estimates have Q1 GDP between +1.3-2.0% q/q, with a downgrade so far of around 0.60%-1.00%.

Retail sales rose +7.3% m/m in November, well above the consensus for a +3.6% rise. That puts retail sales nationally 5.8% above their previous record high in November 2020 and 20.3% above pre-pandemic February 2020 levels.

The trade balance for November was lower than expected at a $9.4bn surplus (consensus $10.6bn) with a strong 6% rise in imports driven by a 7% rise in intermediate imports, offsetting a 2% rise in exports.

The chairman of the prudential regulator, Wayne Byres, is concerned a central bank digital currency (CBDC) might destabilise the financial system by encouraging some customers to hold digital cash directly with the Reserve Bank instead of putting money in bank deposits. Mr Byres said APRA is "*yet to see the clear economic case*" for a CBDC, and it is worried about some customers bypassing banks, if they could hold digital cash in an RBA account.

The Australian dollar fell -3.38%, finishing the month at US70.11 cents (from US72.56 cents the previous month).

Credit Market

The global credit indices widened significantly over January in the risk-off environment. They are back to their levels experienced in mid-2020:

Index	January 2022	December 2021
CDX North American 5yr CDS	60bp	52bp
iTraxx Europe 5yr CDS	59bp	50bp
iTraxx Australia 5yr CDS	75bp	71bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	January 2022	December 2021
Bloomberg AusBond Bank Bill Index (0+YR)	+0.00%	+0.00%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.02%	+0.09%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.01%	+0.04%
Bloomberg AusBond Credit Index (0+YR)	-0.57%	+0.19%
Bloomberg AusBond Treasury Index (0+YR)	-1.03%	-0.03%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-1.20%	+2.21%

Source: Bloomberg

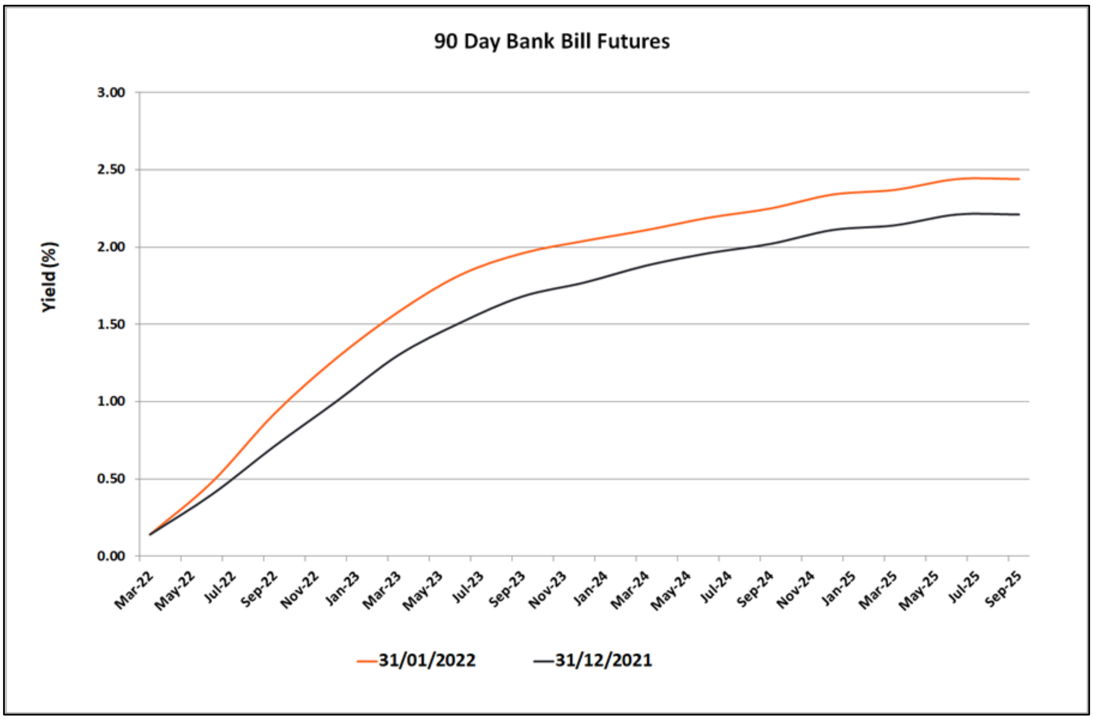
Other Key Rates

Index	January 2022	December 2021
RBA Official Cash Rate	0.10%	0.10%
90 Day (3 month) BBSW Rate	0.08%	0.07%
3yr Australian Government Bonds	1.31%	0.96%
10yr Australian Government Bonds	1.94%	1.67%
US Fed Funds Rate	0.00%-0.25%	0.00%-0.25%
10yr US Treasury Bonds	1.79%	1.52%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over January, bill futures rose across the board as markets reacted to the US Fed accelerating their tightening cycle to control inflation:



Source: ASX

IMPERIUM MARKETS

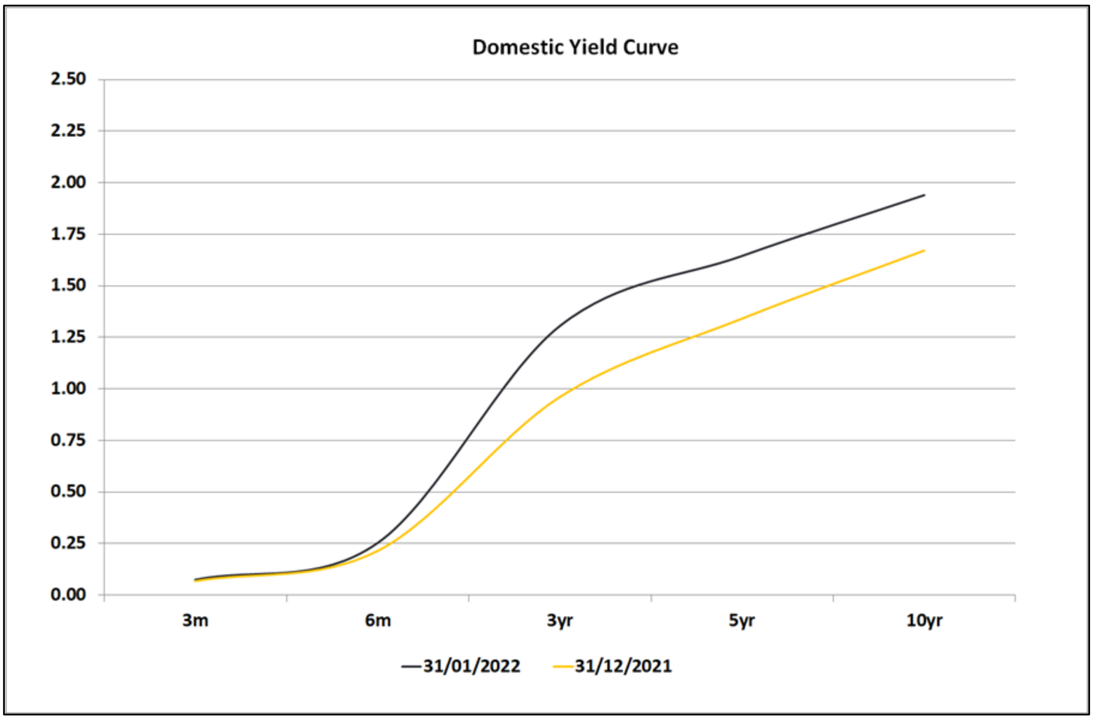
Fixed Interest Outlook

Central bank rate hike expectations continue to be well priced by markets. Money markets are factoring the ECB has a 10bp hike 90% priced by September.

In the US, there is roughly 5 hikes priced for 2022, with the first move in March now almost a certainty following the Fed's latest rhetoric. The Fed's long-term forecast remains unchanged at 2.5%. The Fed acknowledges that it has achieved its target for inflation given that it has "*exceeded 2% for some time*" and commentary suggest that rate hikes will begin once labour market conditions have reached levels consistent with the Committee's assessments of maximum employment.

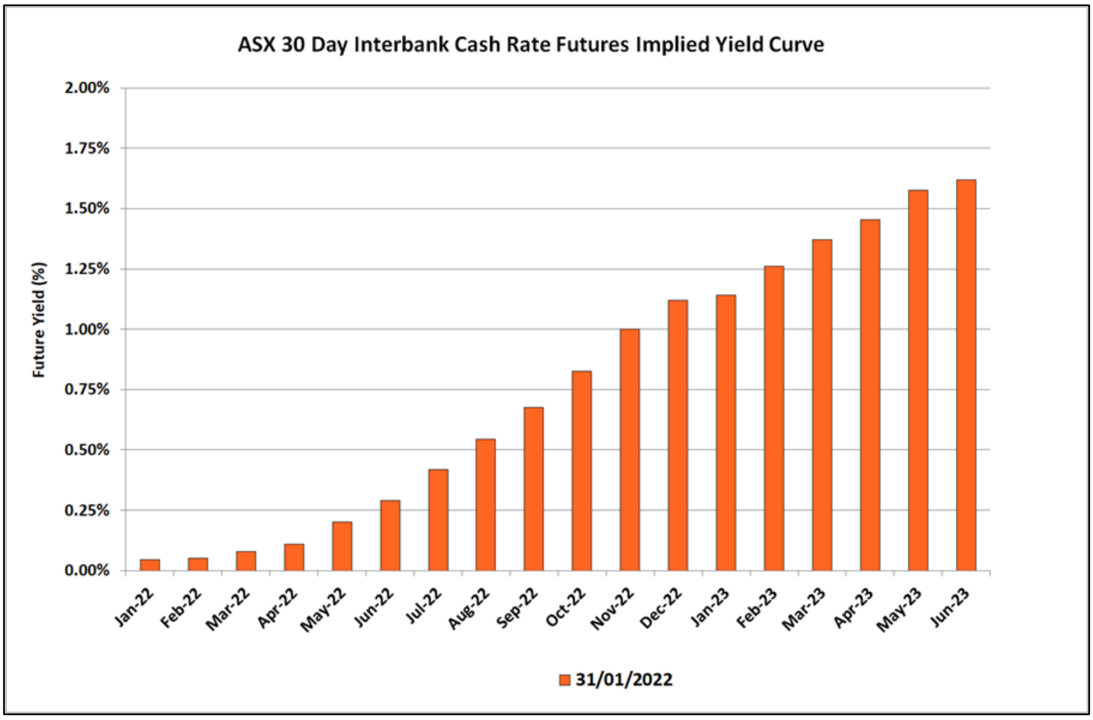
Domestically, Governor Lowe has commented that "*the latest data and forecasts do not warrant an increase in the cash rate in 2022*" but suggested that 2023 was plausible. The RBA's tolerance for inflation at the top of the 2-3% band, or above for a time will be key to understanding how patient the RBA is prepared to be as it waits until wages growth is closer to +3%. After six years of missing its inflation target, the RBA has said it wants to make sure inflation will be sustained at target with wages growth a key input in judging sustainability.

The domestic bond market continues to suggest a prolonged low period of interest rates. Over the month, yields rose up to 35bp at the long-end of the curve:



Source: AFMA, ASX, RBA

Markets have brought forward RBA rate hike pricing following moves offshore with a full rate hike now priced by June 2022 and four hikes priced by December 2022, against the RBA's 'plausible' scenario of not seeing conditions for a hike at least until 2023:


ASX 30 Day Interbank Cash Rate Futures Implied Yield Curve
2.00%
1.75%
1.50%
1.25%
1.00%
0.75%
0.50%
0.25%
0.00%
Future Yield (%)
Jan-22
Feb-22
Mar-22
Apr-22
May-22
Jun-22
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
Dec-22
Jan-23
Feb-23
Mar-23
Apr-23
May-23
Jun-23
31/01/2022

Source: ASX