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

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ENDORSED BY: Margaret Palmer, Director Corporate Services

ATTACHMENTS:
1. Monthly Investment Report October 2022 [**10.3.1** - 19 pages]

PURPOSE:

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

EXECUTIVE SUMMARY:

Investment Portfolio:

The Investment Portfolio (excluding cash balances) held for the period ending 31 October 2022 had a market value of $139,398,172. The annualised returns were 2.26%.

Cash deposits at call were $11,643,725 with $11,317,576 of these held in interest bearing at-call and notice accounts. $326,149 cash is held in Council's interest-bearing transaction account with the Commonwealth Bank to meet day-to-day operational needs.

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

The actual year to date returns for cash and investments to 31 October 2022 were $964,000. compared to a year-to-date budget of $431,000.

The Reserve Bank of Australia (RBA) Board continues to increase the official cash rate to control high inflation. At its October meeting the official rate was increased by 25 basis points to 2.60%. Official interest rates were increased by a further 25 basis points to 2.85% at its November meeting. The RBA indicated that it is "resolute in its determination to return inflation to its target and will do what is necessary to achieve that".

Borrowings:

Loan Facility for Council Projects

Council entered into a fixed interest loan of $9.5 million with quarterly interest and principal payments on 31 July 2018. The principal outstanding as at 31 October 2022 is $5,921,432.

North Sydney Olympic Pool Redevelopment (NSOP)

In January 2022 Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The drawdown rate is 4.24%. The funds were restricted and will be released as required to fund cash outflows.

FINANCIAL IMPLICATIONS:

Council's total investment portfolio performance for the financial year to date is 2.26% annualised. The actual year to date returns for cash and investments to 31 October 2022 were $964,000 compared to a year-to-date budget of $431,000.

RECOMMENDATION:

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

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

5. Our Civic Leadership
5.1 Lead North Sydney's strategic direction
5.2 Council is well governed, and customer focused

BACKGROUND

The Responsible Accounting Officer must provide Council with a monthly report detailing all funds:

a. Invested under Section 625 of the Local Government Act 1993. This report must include certification that the investments have been made in accordance with the Act and the Regulations made thereunder, the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.

b. Borrowed under Section 624 of the Local Government Act. This report must comply with the borrowings Order issued by the Minister for Local Government and Council's Debt Management Policy.

CONSULTATION REQUIREMENTS

Community engagement is not required.

DETAIL

Investment Portfolio

The following table provides details of the performance of Council's investment portfolio (excluding cash deposits) against the benchmark for the month of October 2022 and annualised for the year-to-date 31 October 2022 (including investments which have matured prior to 31 October 2022).

	October 2022	Annualised YTD as at 31 October 2022
Actual Return	0.19%	2.26%
Benchmark	0.24%	2.89%
Variance	-0.05%	-0.63%

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

Asset Type	**Market Value as at 31 October 2022**	**Portfolio Breakdown as at 31 October 2022**
Term Deposits	$127,750,000	84.58%
Cash	$11,643,725	7.11%
Fixed Bonds	$9,000,000	5.96%
Floating Rate Notes (FRNs)	$2,648,171	1.75%
	$151,041,896	**100.00%**

Council's average duration of term deposits, which comprise 84.48% of the investment portfolio, was approximately 422 days as at 31 October 2022.

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. Funds also comply with the credit quality conditions contained in Council's loan agreement with TCorp.

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 31 October 2022 have been reviewed and are $533,000 more than the year-to-date budgeted estimate. This result is driven by a higher-than-expected cash balance due to delays to capital projects caused by wet weather and Covid lockdowns in the 2021/22 Financial Year. For further details please refer to report to Meeting of 14 November 2022, 10.12 Unspent funds to be carried over from 2021/22 to 2022/23

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

Year	**Original Annual Budget**	**Revised Annual Budget**	**YTD Budget (October)**	**YTD/Annual Actual (October)**	**YTD/Annual Actual FV adjustments (October)**	**YTD Budget to Actual Variance (October)**
2022/23	**$1,290,000**	**$1,290,000**	**$431,000**	$958,000	$6,000	**$533,000**
2021/22	$1,100,000	$1,300,000		$1,244,337	-$64,865	$1,179,472
2020/21	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601
2019/20	$1,350,000	$1,529,055		$1,896,660	-$4,944	$362,661

Floating Rate Notes (FRN's) are required to be revalued each month using the Fair Value (FV) method which is an estimate in time of the potential market value of the investment. As of 31 October 2022, the YTD movement of FRN's has been an increase of $6,000.

Financial Investment Policy

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

Long Term Rating Range	Invested as 31 October 2022	Maximum Policy Holding	Distribution as 31 October 2022
AA Category	$107,876,149	100.00%	71.42%
A Category	$25,755,488	60.00%	17.05%
BBB Category	$17,410,259	35.00%	11.53%
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 thereof to maintain its risk averse strategy.

Loan borrowing will be undertaken in line with the following principles:

a) That the capital cost of infrastructure be recognised over the period during which the benefits will be enjoyed.
b) That loan funds are a resource to fund the replacement and upgrading of existing infrastructure and fund the creation of new infrastructure.
c) That loan funds will be limited to:
    - acquisition or enhancement of income producing assets.
    - construction and/or upgrading of buildings; and
    - infrastructure assets that have a life expectancy of greater than 10 years.

Council has two debt facilities

Alexander Avenue Carpark and Onstreet Carparking Management System Loan

This loan is a fixed loan financing option, fully amortising the drawn down amount of $9,500,000 over 10 years, fixed interest rate with quarterly repayments of interest and principal.

The loan details are:

Loan amount:	$ 9,500,000.00			
Loan term:	10 years			
From:	31/07/2018			
To:	31/07/2028			
Interest rate:	4.02%p.a.(fixed)			
Repayment:	**Quarterly**			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
1/07/2022	$6,373,191.95			
29/07/2022	$6,147,427.51	$63,875.10	$225,764.44	$ 289,639.54
28/10/2022	$5,921,431.53	$63,643.56	$225,995.98	$ 289,639.54
27/01/2023	$5,691,791.50	$59,999.51	$229,640.03	$ 289,639.54
28/04/2023	$5,456,690.24	$54,538.28	$235,101.26	$ 289,639.54

Loan Funded Capital Projects

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

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

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

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

Loan for North Sydney Olympic Pool Redevelopment

In January 2022 Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The funds were restricted and will be released as required to fund project cash outflows.

This loan is a fixed loan financing option, fully amortising the drawn down amount of $31,000,000 over 20 years, fixed interest rate with semi-annual repayments of interest and principal.

The loan details are:

Loan amount:	$ 31,000,000.00			
Loan term:	20 years			
From:	28/04/2022			
To:	28/04/2042			
Interest rate:	4.24%p.a.(fixed)			
Repayment:	**Semi-Annual**			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
01/07/2022	$31,000,000			
28/10/2022	$30,499,987	$657,200	$500,013	$1,157,213
28/04/2023	$29,989,375	$646,600	$510,613	$1,157,213

Monthly Investment Report

October 2022

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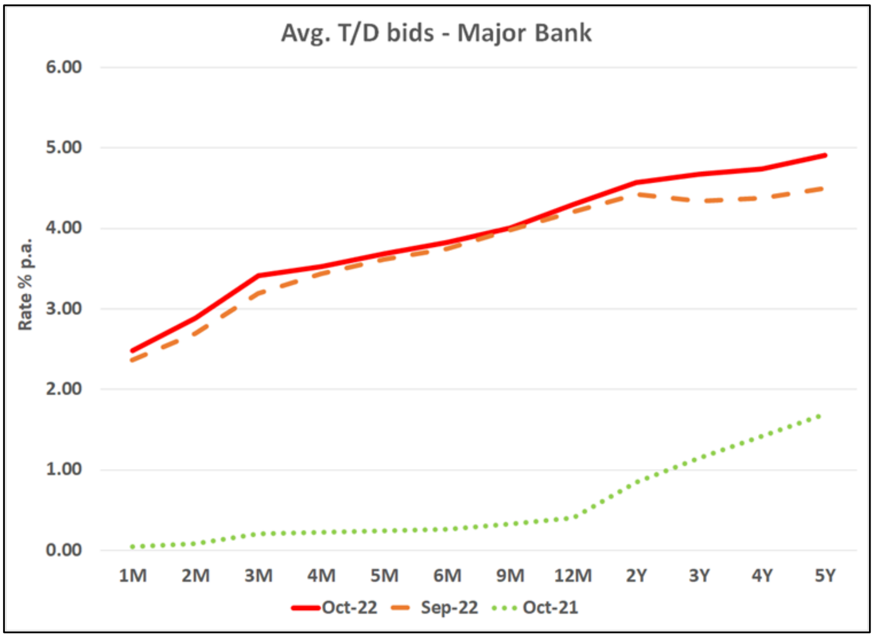
Market Update Summary

Despite global central banks continuing their interest rate hike cycle to combat mounting inflationary pressures, the market is now focusing on the possibility of a 'soft pivot' by global central banks. Financial markets are now starting to factor in the peak of the rate hike cycle, which may be approaching slightly earlier than previously anticipated. **Domestically, the RBA increased the official cash rate by 25bp in October to 2.60%, which somewhat took the market by surprise given a 50bp hike was the ongoing consensus.** The move to increase the cash rate by a lower increment, however, should not be interpreted as dovish - the RBA, like other global central banks, remains "*resolute in its determination to return inflation to target and will do what is necessary to achieve that*", suggesting there are still more rate rises to follow. **It subsequently lifted rates by another 25bp on 1st November to 2.85%**.

The largest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits, which accounts for around ~84% of Council's total investment. Despite more rate rises on the horizon, given an upward sloping deposit curve, maintaining a slightly longer duration position will continue to outperform (averaging) shorter durations. The deposit market has largely already factored in the current rate hike cycle, reflected by the flattening of the curve demonstrated by the longer-term tenors (+2yrs) over the past few months (the market is also factoring in a recession over coming years). Deposit yields remained relatively flat over the past month across most tenors:



Source: Imperium Markets

'New' investments above 4¼-4½% p.a. now appears likely if Council can continue to place the majority of its surplus funds for terms of 12 months to 2 years. *With recessionary fears being priced in coming years, investors may take an insurance policy by investing across 3-5 year fixed deposits and locking in rates above 4½% p.a. (small allocation only).*

Council's Portfolio & Compliance

Asset Allocation

As at the end of October 2022, the portfolio was mainly directed to fixed term deposits (84%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (9%).

Senior FRNs are now becoming more attractive as spreads have widened in 2022 – new issuances should now be considered again on a case by case scenario. In the interim, fixed deposits for 12 months to 3 years appear quite appealing following the spike in medium-to longer-term yields in recent months.

With recessionary fears being priced in coming years, those investors that can allocate longer-term surplus funds may take an insurance policy by investing across 3-5 year fixed deposits and locking in rates above 4½% p.a.

Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 26% of assets is directed to medium-term assets (2-5 years), which has resulted in strong outperformance during the challenging economic environment. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $83m at month-end.

Where liquidity permits, we recommend new surplus funds be directed to 1-2 year horizon given this is where the most attractive value can be found. We suggest this be allocated to any remaining attractive fixed term deposits.

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

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$47,203,938	30.93%	10%	100%	$105,398,171
✓	91 - 365 days	$42,500,000	27.85%	20%	100%	$110,102,109
✓	1 - 2 years	$23,499,802	15.40%	0%	70%	$83,321,674
✓	2 - 5 years	$39,398,369	25.82%	0%	50%	$36,902,685
✓	5 - 10 years	$0	0.00%	0%	25%	$38,150,527
		$152,602,109	**100.00%**			

Counterparty

As at the end of October, 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-	$35,186,362	23.06%	30.00%	$10,594,271
✓	NAB	AA-	$44,000,000	28.83%	30.00%	$1,780,633
✓	NTTC Treasury	AA-	$9,000,000	5.90%	30.00%	$36,780,633
✓	Westpac	AA-	$21,250,000	13.93%	30.00%	$24,530,633
✓	Macquarie	A+	$5,687	0.00%	15.00%	$22,884,630
✓	Suncorp	A+	$8,749,802	5.73%	15.00%	$14,140,514
✓	ICBC Sydney	A	$17,000,000	11.14%	15.00%	$5,890,316
✓	BOQ	BBB+	$10,000,000	6.55%	10.00%	$5,260,211
✓	AMP Bank	BBB	$6,011,889	3.94%	10.00%	$9,248,322
✓	Newcastle PBS	BBB	$1,398,369	0.92%	10.00%	$13,861,842
			$152,602,109	**100.00%**		

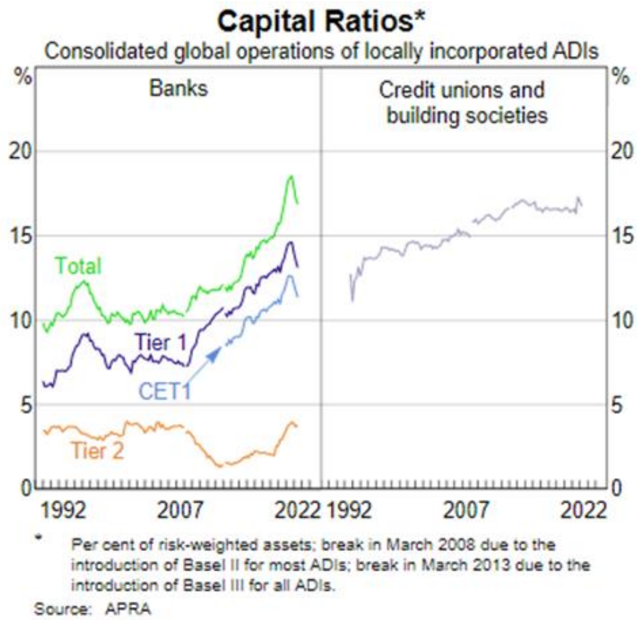
In late June 2022, Standard & Poor's downgraded Suncorp-Metway from AA- to A+ (negative watch). Suncorp recently announced that it is undertaking a strategic review of its banking operations. The downgrade reflects S&P's view that the Suncorp Group's likelihood of support for the bank had "*slightly*" diminished and that it was no longer a core part of the Group. In July 2022, ANZ (AA-) announced it was putting a bid to buy Suncorp's banking division for ~$3.9bn. Should that takeover be formalised, Suncorp-Metway's (A+) current credit rating is likely to be upgraded to ANZ's (AA-).

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

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). APRA's outgoing Chair Wayne Byres recently noted that the Common Equity Tier 1 capital of Australian banks now exceeds a quarter of a trillion dollars. It has increased by $110 billion, or more than 70%, over the past eight years. Over the same time, banks' assets have grown by 44%. Some of the extra capital is supporting growth in the banking system itself but clearly, there has been a strengthening in overall resilience and leverage in the system is lower.

We believe that deposit investments with the lower rated ADIs should be considered going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities are generally deemed to be the more 'ethical' ADIs compared to the higher rated ADIs.

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



Credit Quality

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

Pre-pandemic (March 2020), a 'normal' marketplace meant the lower rated ADIs (i.e. BBB category) were offering higher rates on term deposits compared to the higher rated ADIs (i.e. A or AA rated). But due to the cheap funding available provided by the RBA via their Term Funding Facility (TFF) since mid-2020[1], allowing the ADIs to borrow as low as 0.10% p.a. fixed for 3 years, those lower rated ADIs (BBB rated) did not require deposit funding from the wholesale deposit from the likes of Council. Given the higher rated banks had more capacity to lend (as they have a greater pool of mortgage borrowers), they subsequently were offering higher deposit rates. In fact, some of the lower rated banks were not even offering deposit rates at all. As a result, most investors placed a higher proportion of their deposit investments with the higher rated (A or AA) ADIs over the past two years.

Going forward, with the RBA now removing these cheap borrowing facilities, this has meant the lower rated banks (BBB rated) have started to become more competitive as the market starts to 'normalise'. Investors should have a larger opportunity to start investing a higher proportion of their surplus funds with the lower rated institutions (within Policy limits), from which the majority are considered to be the more ‘ethical’ ADIs as they generally do not lend to the Fossil Fuel industry.

As at the end of October 2022, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$109,436,362	71.71%	100%	$43,165,747
✓	A Category	$25,755,489	16.88%	60%	$65,805,777
✓	BBB Category	$17,410,259	11.41%	35%	$36,000,480
✓	Unrated ADIs	$0	0.00%	10%	$15,260,211
		$152,602,109	**100.00%**		

[1] The RBA’s Term Funding Facility (TFF) allowed the ADI to borrow as low as 0.10% fixed for 3 years: https://www.rba.gov.au/mkt-operations/term-funding-facility/overview.html

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.22%	0.57%	0.78%	0.68%	0.83%	0.46%
AusBond Bank Bill Index	0.24%	0.54%	0.75%	0.67%	0.76%	0.39%
Council's T/D Portfolio	0.19%	0.55%	0.87%	0.68%	1.49%	1.46%
Council's FRN Portfolio	0.31%	0.84%	1.34%	1.05%	2.15%	1.74%
Council's Bond Portfolio	0.10%	0.29%	0.58%	0.39%	1.16%	1.08%
Council's Portfolio^	**0.19%**	**0.54%**	**0.87%**	**0.67%**	**1.49%**	**1.44%**
Outperformance	**-0.05%**	**-0.01%**	**0.11%**	**0.00%**	**0.73%**	**1.05%**

^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	2.60%	2.27%	1.55%	2.03%	0.83%	0.46%
AusBond Bank Bill Index	2.89%	2.18%	1.50%	1.99%	0.76%	0.39%
Council's T/D Portfolio	2.31%	2.20%	1.74%	2.04%	1.49%	1.46%
Council's FRN Portfolio	3.68%	3.37%	2.68%	3.15%	2.15%	1.74%
Council's Bond Portfolio	1.17%	1.17%	1.16%	1.17%	1.16%	1.08%
Council's Portfolio^	**2.26%**	**2.15%**	**1.72%**	**2.01%**	**1.49%**	**1.44%**
Outperformance	**-0.63%**	**-0.02%**	**0.22%**	**0.01%**	**0.73%**	**1.05%**

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

For the month of October, the total investment portfolio (excluding cash) provided a strong return of +0.19% (actual) or +2.26% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.24% (actual) or +2.89% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be temporary. Council should also remind itself it has consistently 'outperformed' over longer-term time periods as demonstrated by the longer-term returns of the overall investment portfolio.

We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned (as per our August 2022 Council Rankings), earning around $430,000 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.

Council's Term Deposit Portfolio & Recommendation

As at the end of September 2022, Council's deposit portfolio was yielding **2.27% p.a.** (up 1bp from the previous month), with a weighted average duration of around 422 days (~1.16 years). We recommend Council maintains an average duration above 12 months, if possible.

As the past decade or so has highlighted (post-GFC era), we have seen too many portfolios overpay for liquidity and generally not insured themselves by diversify their funding across various tenors. Those investors that can maintain a weighted average duration of +12-18 months are likely to yield, on average, up to ½-1% p.a. higher than those investors who maintain a weighted average duration of less than 6-9 months.

At the time of writing, we see value in:

	LT Credit Rating	Term	T/D Rate
ICBC, Sydney	A	5 years	5.30% p.a.
ICBC, Sydney	A	4 years	5.15% p.a.
ICBC, Sydney	A	3 years	5.00% p.a.
ICBC, Sydney	A	2 years	4.90% p.a.
ING	A	2 years	4.90% p.a.
AMP Bank	BBB	2 years	4.90% p.a.^
Westpac	AA-	2 years	4.67% p.a.
BoQ	BBB+	2 years	4.60% p.a.
CBA	AA-	2 years	4.58% p.a.
Suncorp	A+	2 years	4.55% p.a.
NAB	AA-	2 years	4.50% p.a.

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

The above deposits are suitable for investors looking to maintain diversification and lock-in a premium compared to purely investing short-term. For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (dependent on daily funding requirements):

ADI	LT Credit Rating	Term	T/D Rate
AMP	BBB	12 months	4.70% p.a.^
Westpac	AA-	12 months	4.47% p.a.
ING	A	12 months	4.45% p.a.
CBA	AA-	12 months	4.42% p.a.
Suncorp	A+	12 months	4.40% p.a.
BoQ	BBB+	12 months	4.40% p.a.
NAB	AA-	12 months	4.40% p.a.
Bendigo-Adelaide	BBB+	12 months	4.30% p.a.
Suncorp	A+	6 months	4.26% p.a.
BoQ	BBB+	6 months	4.20% p.a.

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

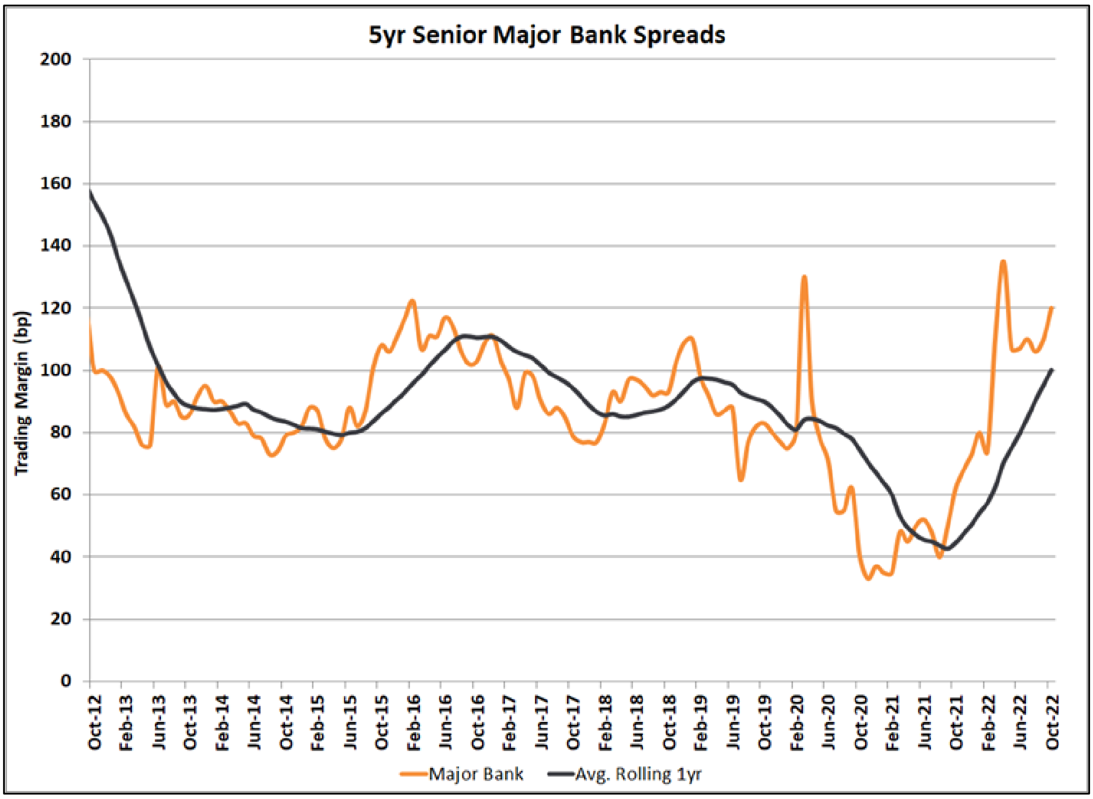
If Council does not require high levels of liquidity and can stagger its investments slightly longer-term, it will be rewarded over coming years if it can roll for an average min. term of 12 months-2 years (this is where we current value), yielding, on average, up to ½% p.a. higher compared to those investors that entirely invest in short-dated deposits.

With recessionary fears being priced in coming years, those investors that can allocate longer-term surplus funds may take an insurance policy by investing across 3-5 year fixed deposits and locking in rates above 4½% p.a.

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

Senior FRNs Review

Over October, amongst the senior major bank FRNs, physical credit securities widened by up to 10bp at the long-end of the curve. The widening was partially driven by ANZ's (AA-) dual 3 and 5 year senior issue at +92bp and +120bp respectively, printing $4.75bn. Major bank senior securities are now looking fairly attractive again in a rising rate environment (5 year margins around the +120bp level):



Source: IBS Capital

Apart from ANZ (AA-), over October, there were noticeable new primary issuances from:

- Suncorp (AAA rated) covered security for 3 years at +88bp
- Teachers Mutual Bank (BBB) senior FRN for 3 years at +150bp
- Bank of Nova Scotia (AAA rated) covered security for 3 years at +90bp
- Bank of Montreal (AAA rated) covered security for 3 years at +90bp

Amongst the "A" and "BBB" rated sectors, the securities were marked between 10-15bp wider at the 3-5 year part of the curve.

Credit securities are looking much more attractive given the widening of spreads in 2022. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/10/2022	30/09/2022
“AA” rated – 5yrs	+120bp	+110bp
“AA” rated – 3yrs	+92bp	+85bp
“A” rated – 5yrs	+135bp	+125bp
“A” rated – 3yrs	+110bp	+100bp
“BBB” rated – 3yrs	+135bp	+120bp

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-late 2024 for the “AA” rated ADIs (domestic major banks)**;
- On or before mid-late 2023 for the “A” rated ADIs; and
- Within 6-9 months for the “BBB” rated ADIs (consider case by case).

Investors holding onto the above senior FRNs (‘benchmark’ issues only) in their last few years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current challenging economic environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

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

Council's Senior FRNs Sale/Switch Recommendations

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

Council's Senior Bonds

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

Council received the full rebated commission of 0.25% on the total face value of investments (i.e. $9m x 0.25% = $22,500) as it was introduced by Imperium Markets. We believe these investments were prudent at the time of investment especially after the rate cut delivered in early November 2020 and the RBA's forward guidance on official interest rates (no rate rises "*until at least 2024*").

The NTTC bonds are a 'retail' offering and not 'wholesale' issuances. Given the lack of liquidity and high penalty costs if they were to be sold/redeemed prior to the maturity date, they are considered to be a hold-to-maturity investment and will be marked at par value ($100.00) throughout the term of investment.

Senior Fixed Bonds – ADIs (Secondary Market)

As global inflationary pressures have escalated, this has seen a significant lift in longer-term bond yields (valuations fell) as markets have reacted accordingly.

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

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0255776	ING	AAA	Covered	07/09/2023	0.85	3.00%	4.33%
AU3CB0258465	Westpac	AA-	Senior	16/11/2023	1.04	3.25%	4.33%
AU3CB0265403	Suncorp	AA-	Senior	30/07/2024	1.74	1.85%	4.69%
AU3CB0265593	Macquarie	A+	Senior	07/08/2024	1.78	1.75%	4.73%
AU3CB0265718	ING	AAA	Covered	20/08/2024	1.80	1.45%	4.64%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	1.82	1.55%	4.56%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.84	1.70%	4.82%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	2.00	2.00%	4.95%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	2.21	1.65%	4.62%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	2.21	1.65%	4.73%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	2.28	1.70%	4.99%
AU3CB0287415	Westpac	AA-	Senior	17/03/2025	2.37	2.70%	4.75%
AU3CB0291508	Westpac	AA-	Senior	11/08/2025	2.77	3.90%	4.49%
AU3CB0291672	CBA	AA-	Senior	18/08/2025	2.79	4.20%	4.65%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	3.49	1.40%	5.26%
AU3CB0282358	ING	AAA	Covered	19/08/2026	3.79	1.10%	4.66%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.98	2.10%	5.34%
AU3CB0286037	Westpac	AA-	Senior	25/01/2027	4.23	2.40%	4.94%

Economic Commentary

International Market

The mere suggestion of the US Fed stepping down from 75bp to a 50bp incremental rate hike in coming months resulted in the rebound in equities, as well as a partial reversal of the recent surge in global bond yields. Yields fell globally on growing expectations that future central bank tightening is likely to be trimmed back further.

Across equity markets, the S&P 500 Index surged +7.99%, while the NASDAQ rebounded +3.90%. Europe's main indices also gained, led by Germany's DAX (+9.41%%), France's CAC (+8.75%%), and UK's FTSE (+2.91%%).

Both headline and core CPI readings in the US surprised to the upside. The headline print came at +8.2% y/y (vs +8.1% expected), while the more important core reading came in at +6.6% y/y (vs +6.5% expected). The core CPI print was the highest in 40 years.

The US unemployment rate fell two tenths to 3.5% vs. 3.7% expected, and the participation rate fell 0.1% to 62.3% (vs. 62.4% expected).

Canada's inflation data provided no relief from a string of recent global inflation upside surprises, coming at +6.9% from +7.0% and against +6.7% expected. However, the Bank of Canada surprised markets by lifting rates by 50bp, against expectations of a 75bp hike.

The Bank of England (BoE) extended support targeted at pension funds, offering to buy up to £5b a day of inflation-linked government bonds, out of the expanded £10b daily envelope announced previously. UK GDP data showed a -0.3% m/m contraction in August, making the UK on track to record a negative Q3 outcome. UK inflation was +10.1% y/y in September from +9.9% in August and against expectations for a +10.0% rise. The UK is on the lookout for another Prime Minister after Liz Truss announced her resignation.

Europe's preliminary CPI data for September came in hot at +10.0% y/y from +9.1% in August and +9.7% expected. That was the first double digit read in the blocs history.

China's GDP came in at +3.9% y/y vs +3.3% y/y expected. Retail sales though slowed to +2.5% y/y from +5.4% and +3.0% expected.

The RBNZ raised the OCR by 50bp as expected, taking the cash rate to 3.50% to continue tightening monetary policy "*at pace*".

The MSCI World ex-Aus Index rose +7.15% for the month of October:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+7.99%	-6.25%	-15.92%	+8.43%	+8.50%	+10.61%
MSCI World ex-AUS	+7.15%	-7.18%	-19.77%	+4.63%	+4.71%	+7.18%
S&P ASX 200 Accum. Index	+6.04%	+0.67%	-2.01%	+4.82%	+7.18%	+8.73%

Source: S&P, MSCI

Domestic Market

The RBA surprised most market participants by raising the cash rate by a smaller than expected 25bp to 2.60% in October. This was the sixth successive interest rate rise but broke a string of four successive 50bp increases. The accompanying commentary again signalled that the Board expects to increase interest rates further over the period ahead.

The move to increase the cash rate by a lower increment, however, should not be interpreted as dovish - the RBA, like other global central banks, remains "*resolute in its determination to return inflation to target and will do what is necessary to achieve that*".

Australia's Q3 inflation data surprised to the upside. Headline inflation was +1.8% q/q (consensus +1.6% q/q) and +7.3% y/y. The closely watched core trimmed mean measure accelerated sharply to +1.8% q/q (consensus +1.5%) and +6.1% y/y, its highest quarterly pace since December 1990.

Employment growth surprised to the downside in September, coming in broadly unchanged at +1k against expectations for a +25k gain. The unemployment rate remained at 3.5% and the participation rate also remained unchanged 66.6%.

The Federal Budget delivered fully on Labor's election commitments, but major reform/action to resolve medium-term pressures on the Budget was postponed to at least the next May Budget. The 2022-23 deficit is expected to come in at $36.9bn (1.5% of GDP) less than half the $78bn forecast at the pre-election budget in March this year.

House prices in nearly two out of five Sydney suburbs have already plummeted by more than 10% since the RBA started raising interest rates in May, with more areas likely to follow suit as the downturn intensifies.

The trade surplus surprised lower in August falling $643m to $8.3bn (consensus $10bn). Exports rose 2.6% (+1.4bn) helped by a rebound in coal export volumes after weather related disruptions in July.

The Australian dollar depreciated by -1.26%, finishing the month at US64.20 cents (from US65.02 cents the previous month).

Credit Market

The global credit indices tightened significantly over October as risk markets rebounded. They remain back to their levels experienced during the start of the pandemic (Q1 2020):

Index	October 2022	September 2022
CDX North American 5yr CDS	90bp	107bp
iTraxx Europe 5yr CDS	114bp	138bp
iTraxx Australia 5yr CDS	130bp	148bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	October 2022	September 2022
Bloomberg AusBond Bank Bill Index (0+YR)	+0.24%	+0.15%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.93%	-1.36%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.16%	+0.12%
Bloomberg AusBond Credit Index (0+YR)	+0.39%	-1.01%
Bloomberg AusBond Treasury Index (0+YR)	+1.22%	-1.42%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+4.06%	-3.85%

Source: Bloomberg

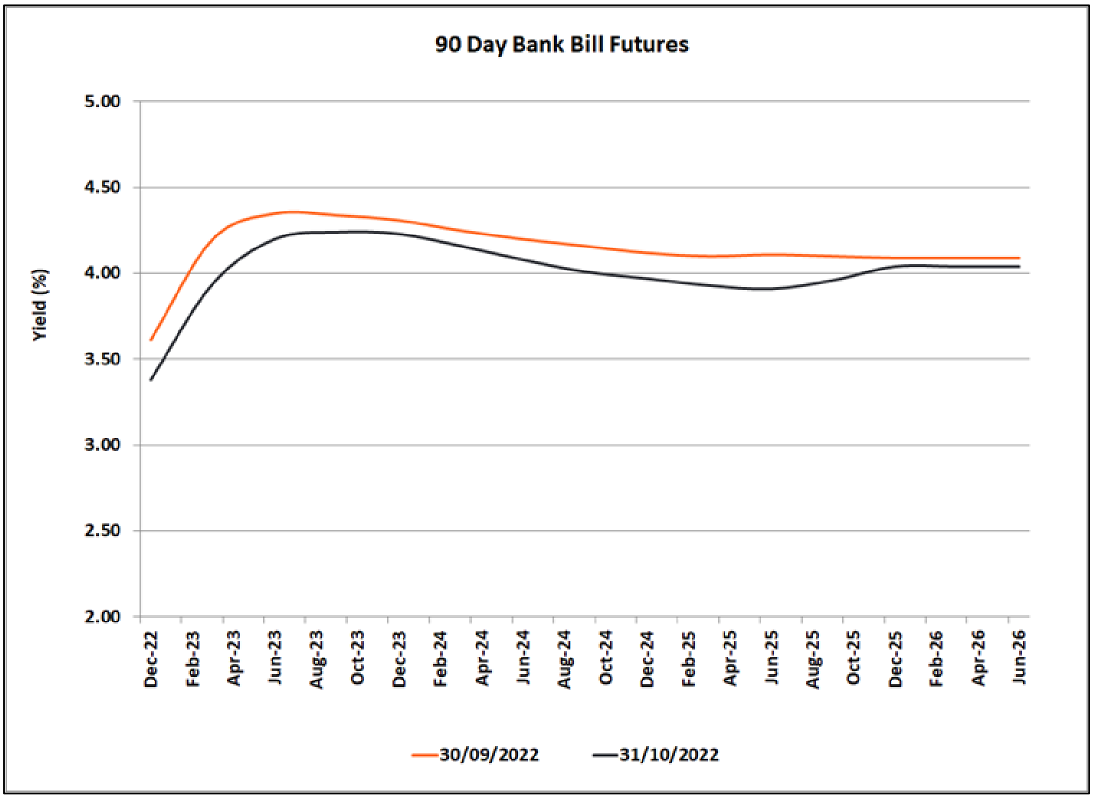
Other Key Rates

Index	October 2022	September 2022
RBA Official Cash Rate	2.60%	2.35%
90 Day (3 month) BBSW Rate	3.08%	3.06%
3yr Australian Government Bonds	3.29%	3.57%
10yr Australian Government Bonds	3.76%	3.90%
US Fed Funds Rate	3.00%-3.25%	3.00%-3.25%
3yr US Treasury Bonds	4.45%	4.25%
10yr US Treasury Bonds	4.10%	3.83%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over October, bill futures fell across the board following the movement in the bond market, with the market reacting to the possibility of a pivot by global central banks. The markets continue to factor in the possibility of a global recession over the next few years, highlighted by the drop in the futures pricing in early 2024:



Source: ASX

Fixed Interest Outlook

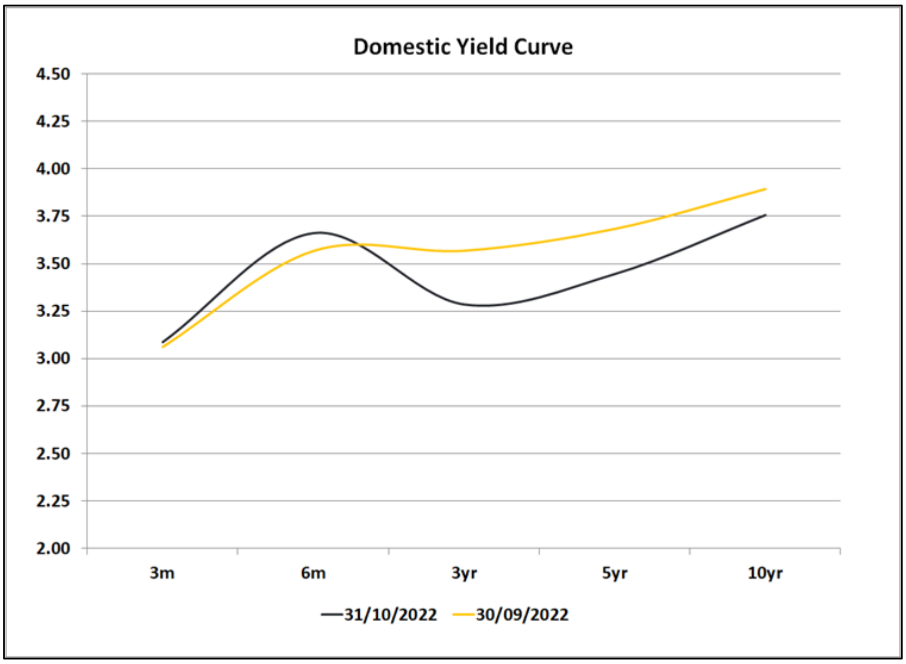
The terminal US Fed Funds pricing has lifted to 5.00% by March 2023 and continues to price a 75bp hike at the upcoming 2nd November meeting and 50bp at the 14th December FOMC meeting. The US Fed dot plots sees no cut(s) before 2024 (end of 2024 shows a median dot of 3.875%). The message from US Fed Chair Powell was loud and clear. Powell repeated the Fed will move rates purposefully until rates are at a sufficiently restrictive stance to ensure their price stability objective is achieved.

Domestically, after lifting rates by 25bp to 2.60% in October, the RBA's evolution to a slower pace of interest rate rises likely reflects a combination of:

- The lags in the impact of monetary policy;
- The substantial tightening already put in place;
- That interest rates are now estimated to be somewhere close to neutral or even in slightly restrictive territory;
- The considerable uncertainties about the global economic outlook; and
- The RBA's desire to try to keep the economy on an even keel.

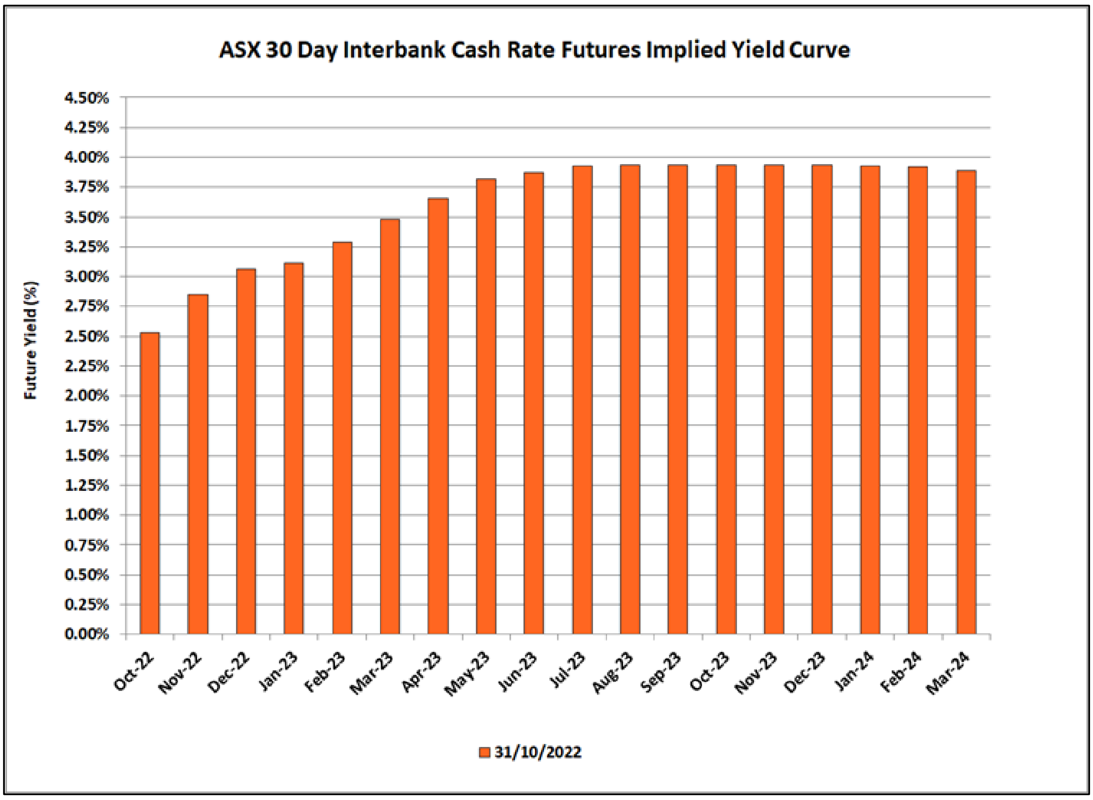
The move, however, should not be interpreted as dovish - the RBA, like other global central banks, remains "*resolute in its determination to return inflation to target and will do what is necessary to achieve that*". A shift back to larger rate rises or a higher peak for interest rates cannot be ruled out either if the RBA's assertion that "*the potential for inflation to subside quickly*" is disproven.

The domestic bond market continues to suggest a prolonged low period of interest rates on a historical basis (10-year government bond yields under 4%). Over the month, yields fell up to 30bp at the long-end of the curve:



Source: AFMA, ASX, RBA

Markets are currently pricing in around 6 additional rate rises into 2023 (up to 4%). Fears of a looming global recession have actually seen rate cuts start to be priced in towards the end of 2023, although this seems unlikely for now**:**



Source: ASX

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