

10.5. Investment and Loan Borrowings Report as at 31 October 2023

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ATTACHMENTS	1. Arlo Advisory North Sydney Monthly Investment Review October 2023 [10.5.1 - 21 pages]
CSP LINK	5. Our Civic Leadership 5.2 Strong civic leadership and customer focussed services

PURPOSE:

The purpose of this report is to provide Council with the details of the performance of Council's investments and details of loans for the month ending 31 October 2023.

EXECUTIVE SUMMARY:

- All investments have been made in accordance with the Local Government Act, Regulations, Council's Investment Policy, and the specific conditions of the TCorp Loan Agreement.
- For the month of October, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.30% (actual), or +3.54% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.33% (actual), or +4.01% p.a. (annualised). This is due to recent interest rate rises and Council holding term deposits made in a low inflation environment, when rises were not expected.
- Returns on investments exceed the YTD budget by \$884,000. The total return for the 2023/2024 financial year to date is approximately \$1.7 million. The better-than-expected return is due to the payments for the capital works program progressing slower than expected in the first quarter. Interest income will be addressed in the September Quarter Budget Review, also presented to this meeting. The total original budget for 2023/2024 is \$2.5 million.

RECOMMENDATION:

1. THAT the report on Investments held on 31 October 2023, prepared in accordance with clause 212 of the Local Government (General) Regulation 2021, and information on Loan Borrowings be received.

Background

Clause 212 of Local Government (General) Regulation 2021, states that The Responsible Accounting Officer must provide Council with a monthly report detailing all funds invested under Section 625 of the Local Government Act 1993. This report must include certification that the investments have been made in accordance with the Act and the Regulations made thereunder, also the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.

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

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of October 2023 and annualised for the year-to-date 31 October 2023 (including investments that have matured prior to that date).

	October 2023	Annualised YTD
Actual Return	0.30%	3.54%
Benchmark	0.33%	4.01%
Variance	-0.03%	-0.07%

The portfolio underperformance, as compared to the benchmark, is due to sharp rises in the RBA official cash rate and long-term investments that were placed when inflation expectations were low, before those increases were made. Council's investment advisor (Arlo Advisory – formerly known as Imperium Markets), as per the attached report, expects this relative underperformance to be temporary. The advice is that the portfolio will return to overperformance when the RBA ends its interest rate raising cycle, which they expect will be in the next six months. Arlo Advisory further notes that North Sydney Council's deposits portfolio rank amongst the best performing when compared to other NSW councils.

Asset Type	Market Value	Portfolio Breakdown
Term Deposits	\$125,250,000	79.37%
Cash	\$20,896,693	13.24%
Fixed Bonds	\$9,000,000	5.70%
Floating Rate Notes (FRNs)	\$2,649,549	1.68%
	\$157,796,242	100.00%

Council's average duration of term deposits, which comprise 79.37% of the investment portfolio, is approximately 343 days.

All funds have been invested in accordance with the Act and the Regulations made thereunder. Council's investment portfolio complies with the revised Investment Order issued by the Minister for Local Government, which places restrictions on the type of investments permitted. Funds invested also comply with the credit quality conditions contained in Council's loan agreement with TCorp.

Council continues to seek independent advice for investments and is actively managing the portfolio to ensure that returns are maximised, considering diversification and risk. A complete analysis of the performance is covered in the Monthly Investment Report (Attachment 1) prepared by Council’s investment advisor, Arlo Advisory. The report contains advice about optimal investment options, but also notes that Council’s scope to act on that advice is limited by its cash flow requirements. Council has considerable requirements for short term investments to fund its Capital Works original budget of \$79.4 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 October 2023 are \$884,000 more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Oct)	YTD (Oct)	YTD Actual FV adjustments (Oct)	YTD Budget to Actual Variance (Oct)
2023/24	\$2,500,000	\$2,500,000	\$830,000	\$1,711,000	\$3,000	\$884,000
Previous Years						
Year	Original Annual Budget	Revised Annual Budget		Final Result Interest	Final Result FV adjustments	Final Budget to Actual Variance
2022/23	\$1,290,000	\$3,340,000		\$1,244,337	-\$64,865	\$1,179,472
2021/22	\$1,350,000	\$1,350,000		\$1,222,664	\$93,735	-\$33,601
2020/21	\$1,350,000	\$1,529,055		\$1,896,660	-\$4,944	\$362,661

Floating Rate Notes (FRNs) are required to be revalued each month using the Fair Value (FV) method, an estimate of the market value of the investment. The YTD movement of FRN’s has seen an increase of \$3,000.

Financial Investment Policy

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

Long Term Rating Range (Standard & Poors)	Invested	Maximum Policy Holding	Distribution
AA Category	\$108,143,214	100.00%	68.53%
A Category	\$23,251,180	60.00%	14.73%
BBB Category	\$26,401,848	35.00%	16.73%
Unrated ADIs (NR)	\$0	10.00%	0.00%

Credit Quality Limits in TCorp Loan Agreement

Council's Loan Agreement with TCorp imposes credit quality limits additional to Council's Financial Investment Policy. In cases where the loan agreement imposes a credit quality limit more conservative than the Financial Investment Policy, Council's contractual obligations prevail, and the more conservative limit will be applied. 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 (Standard and Poors/Moody's)	Invested	Maximum Allowed	Distribution
AA+ to AA-/Aa1 to Aa3 Category	\$108,143,214	100%	68.53%
A+ to A/A1 to A2 Category	\$23,251,180	100%	14.73%
A-/A3 Category	\$0	40%	0.00%
BBB+/Baa1 Category	\$18,000,000	20%	11.41%
BBB/Baa2 Category	\$8,401,848	10%	5.32%
BBB-/Baa3 Category	\$0	5%	0.00%
Unrated	\$0	0%	0.00%

The maximum counterparty limits and the allowed limits are as per the following table:

Institution	Long Term Rating Range (Standard and Poors/Moody's)	Invested	Maximum Allowed	Distribution
AMP Bank Ltd	BBB/Baa2 Category	\$7,003,479	5%	4.44%
Bendigo and Adelaide Bank Ltd	BBB+/Baa1 Category	\$2,000,000	10%	1.27%
BOQ Ltd	BBB+/Baa1 Category	\$6,000,000	10%	3.80%
Commonwealth Bank of Australia	AA+ to AA-/Aa1 to Aa3 Category	\$41,893,214	100%	26.55%
Heritage and People's Choice Limited	BBB+/Baa1 Category	\$10,000,000	10%	6.34%
ICBC Sydney Branch	A+ to A/A1 to A2 Category	\$17,000,000	100%	10.77%
NAB Ltd	AA+ to AA-/Aa1 to Aa3 Category	\$31,000,000	100%	19.65%
Newcastle Greater Mutual Group	BBB/Baa2 Category	\$1,398,369	5%	0.89%
Northern Territory Treasury	AA+ to AA-/Aa1 to Aa3 Category	\$9,000,000	100%	5.70%
Suncorp Bank Ltd	A+ to A/A1 to A2 Category	\$6,251,180	100%	3.96%
Westpac Bank Ltd	AA+ to AA-/Aa1 to Aa3 Category	\$26,250,000	100%	16.64%

Loan Borrowings

Council's Loan Borrowing Policy is the framework for Council's borrowing activities. This defines responsibilities and parameters for borrowing and related risk management activities. The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating, or a combination thereof, to maintain a risk averse strategy.

Loan borrowings are in line with the following principles:

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

Council has two debt facilities:

Alexander Street Carpark and On-Street Carparking Management System Loan

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

Loan amount:	\$ 9,500,000.00			
Loan term:	10 years			
From:	31/07/2018			
To:	31/07/2028			
Interest rate:	4.02%p.a.(fixed)			
Repayment:	Quarterly			
Dates	Principal Outstanding	Interest	Principal	Payment
1/07/2023	\$5,456,690.24			
31/07/2023	\$5,223,543.14	\$56,492.44	\$233,147.10	\$ 289,639.54
31/10/2023	\$4,986,831.69	\$52,928.09	\$236,711.45	\$ 289,639.54
31/01/2023	\$4,747,721.74	\$50,529.58	\$239,109.96	\$ 289,639.54
30/04/2023	\$4,505,143.18	\$47,060.98	\$242,578.56	\$ 289,639.54

Loan Funded Capital Projects:

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

\$5 million loan was sourced to fund project.

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

Project 2: Upgrading of On-Street Parking Management System

\$4.5 million loan was sourced to fund project.

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

Loan for North Sydney Olympic Pool Redevelopment

In 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 are being released, as required, to fund project cash outflows. As of 30 June 2023, \$17.8 million was unspent.

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

Loan amount:	\$ 31,000,000.00			
Loan term:	20 years			
From:	28/04/2022			
To:	28/04/2042			
Interest rate:	4.24%p.a.(fixed)			
Repayment:	Semi-Annual			
Dates	Principal Outstanding	Interest	Principal	Payment
01/07/2023	\$29,989,374.70			
30/10/2023	\$29,467,937.22	\$624,720.2	\$521,437.78	\$1,157,212.52
29/04/2024	\$28,935,444.96	\$613,431.4	\$532,492.26	\$1,157,212.52

Consultation requirements

Community engagement is not required.

Financial/Resource Implications

Returns are significantly higher than year to date budget as payments for capital works have been lower than expected. This will be addressed in the September Quarter Budget Review.

Legislation

Section 625 of the Local Government Act (NSW) allows councils to invest money that is not currently required for any other purpose. It further specifies how councils may invest. It specifies investments must be in accordance with the local government minister's orders. Clause 212 of the Local Government Regulation (NSW) 2021 requires that the Responsible Accounting Officer must make a monthly report to Council, setting out all details of money invested under Section 625 of the Local Government Act.

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



Monthly Investment Review



October 2023

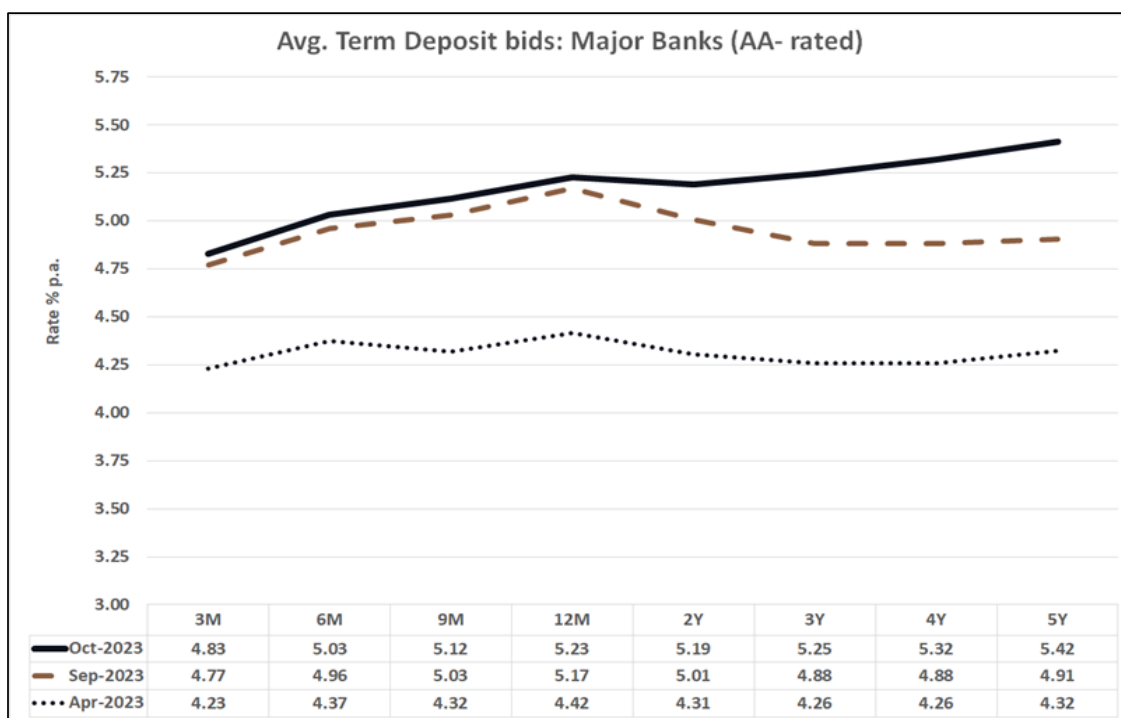
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Market Update Summary

Financial markets reacted to expectations that central banks could keep interest rates higher for longer than previously envisaged, as they fight to curb inflation that remains stubbornly high across many countries. The sell-off in global bonds continued with fresh cycle highs being set for longer-term yields. Domestically, the RBA’s tolerance for the current elevated levels of inflation is waning. They have maintained their tightening bias and likely to hike rates again as early as November 7th (Melbourne Cup).

Over the month of October, major bank deposit rates increased significantly (~40–50bp) at the long-end (3–5 year) part of the curve, reacting to the higher than expected inflation number. Interestingly, deposit rates offered by the major banks are now slightly higher at the very long end (3–5 years) compared to the shorter-end (6 months–2 years), which has not been the case in recent months. Rates remain relatively flat across the longer-tenors (only a ~20bp range between 1–5 year rates), reflective of the major banks believing that we are approaching the peak of the interest rates cycle and potentially, future rate cuts may need to be delivered should inflation be returning back to target.



Source: Imperium Markets

With a global economic downturn being priced in coming years, investors may take an ‘insurance policy’ against a potentially lower rate environment by investing across 2–5 year fixed deposits, targeting rates above or close to 5¼–5½% p.a. (small allocation only).



North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of October 2023, the portfolio was mainly directed to fixed term deposits (79%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (13%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 12-18 months. New issuances may be considered again on a case by case scenario. In the interim, staggering a mix of fixed deposits between 9-12 months to 2 years remains a more optimal strategy to maximise returns over a longer-term cycle.

With a global economic downturn being priced in coming years, investors can choose to allocate a small proportion of longer-term funds and undertake an insurance policy against any potential future rate cuts by investing across 2-5 year fixed deposits, locking in and targeting yields close to or above 5¼-5½% p.a.

However, noting the significant capital outflows expected in the near term, Council is currently largely restricted to investing into very short-term investments (under 6-12 months). This is suitable to invest in short-dated fixed term deposits.





Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 12% of assets is directed to medium-term assets (2-5 years), which has resulted in strong outperformance during the challenging economic environment over longer-term time periods. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately \$72m at month-end.

Where liquidity permits (once immediate capital projects are finalised), we recommend new surplus funds be directed to 1-2 year horizon given this will help optimise returns over the long-run. We suggest this be allocated to any remaining attractive fixed term deposits.

In the interim, given the large upcoming capital expenditure of \$74.4m flagged in the short-term, Council is likely to invest across shorter-tenors to match the capital program's cash flow requirements.

Compliant	Horizon	Invested (\$)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available (\$)
✓	0 - 90 days	\$45,146,693	28.61%	10%	100%	\$112,649,549
✓	91 - 365 days	\$55,251,180	35.01%	20%	100%	\$102,545,062
✓	1 - 2 years	\$38,398,369	24.33%	0%	70%	\$72,059,000
✓	2 - 5 years	\$19,000,000	12.04%	0%	50%	\$59,898,121
✓	5 - 10 years	\$0	0.00%	0%	25%	\$39,449,061
		\$157,796,242	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-	\$41,893,214	26.55%	30.00%	\$5,445,659
✓	NAB	AA-	\$31,000,000	19.65%	30.00%	\$16,338,873
✓	NTTC Treasury	AA-	\$9,000,000	5.70%	30.00%	\$38,338,873
✓	Westpac	AA-	\$26,250,000	16.64%	30.00%	\$21,088,873
✓	Suncorp	A+	\$6,251,180	3.96%	15.00%	\$17,418,256
✓	ICBC Sydney	A	\$17,000,000	10.77%	15.00%	\$6,669,436
✓	BOQ	BBB+	\$6,000,000	3.80%	10.00%	\$9,779,624
✓	Bendigo	BBB+	\$2,000,000	1.27%	10.00%	\$13,779,624
✓	Heritage	BBB+	\$10,000,000	6.34%	10.00%	\$5,779,624
✓	AMP	BBB	\$7,003,479	4.44%	10.00%	\$8,776,145
✓	Newcastle PBS	BBB	\$1,398,369	0.89%	10.00%	\$14,381,255
			\$157,796,242	100.00%		

In early August 2023, ANZ's takeover of Suncorp was blocked by the Australian Competition and Consumer Commission (ACCC), with the watchdog saying it was unconvinced the deal would deliver the public benefits claims put forward by ANZ (although ANZ has since appealed the decision).

Credit Quality

The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher). As at the end of October 2023, all categories were within the Policy limits:

Compliant	Credit Rating	Invested (\$)	Invested (%)	Max. Limit (%)	Available (\$)
✓	AA Category	\$108,143,214	68.53%	100%	\$49,653,028
✓	A Category	\$23,251,180	14.73%	60%	\$71,426,565
✓	BBB Category	\$26,401,848	16.73%	35%	\$28,826,837
✓	Unrated ADIs	\$0	0.00%	10%	\$15,779,624
		\$157,796,242	100.00%		



Performance

Council's performance for the month ending October 2023 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.34%	1.02%	2.03%	1.36%	3.66%	2.24%	1.52%
AusBond Bank Bill Index	0.33%	1.04%	2.02%	1.42%	3.66%	2.20%	1.47%
Council's T/D Portfolio	0.31%	0.90%	1.63%	1.15%	2.93%	2.21%	1.95%
Council's FRN Portfolio	0.45%	1.33%	2.58%	1.76%	4.78%	3.46%	2.75%
Council's Bond Portfolio	0.10%	0.29%	0.59%	0.39%	1.17%	1.17%	1.11%
Council's Portfolio [^]	0.30%	0.87%	1.58%	1.12%	2.85%	2.17%	1.91%
Rel. Performance	-0.04%	-0.18%	-0.44%	-0.30%	-0.80%	-0.03%	0.44%

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

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	4.10%	4.10%	4.06%	4.10%	3.66%	2.24%	1.52%
AusBond Bank Bill Index	4.01%	4.19%	4.05%	4.27%	3.66%	2.20%	1.47%
Council's T/D Portfolio	3.67%	3.60%	3.26%	3.47%	2.93%	2.21%	1.95%
Council's FRN Portfolio	5.39%	5.37%	5.18%	5.32%	4.78%	3.46%	2.75%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.11%
Council's Portfolio [^]	3.54%	3.48%	3.16%	3.35%	2.85%	2.17%	1.91%
Rel. Performance	-0.48%	-0.72%	-0.89%	-0.91%	-0.80%	-0.03%	0.44%

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

For the month of October, the total investment portfolio (excluding cash) provided a solid return of +0.30% (actual) or +3.54% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.33% (actual) or +4.01% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be fairly temporary (within the next 6 months), especially if the RBA is approaching the end of its rate hike cycle. Council should also remind itself it has consistently 'outperformed' over longer-term time periods (last +10yrs) as demonstrated by the longer-term returns of the overall investment portfolio (e.g. 3 year returns).

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



Recommendations for Council

Term Deposits

As at the end of October 2023, Council's deposit portfolio was yielding **3.60% p.a.** (up 1bp from the previous month), with a weighted average duration of around 343 days (~11½ months). We recommend Council maintains this weighted average duration, should cash flows allow in future.

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

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

Securities

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

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

Council's Senior FRNs Sale/Switch Recommendations

We recommend Council retains the Newcastle FRN at this stage (still yielding well above 5¼% p.a.). We will inform Council when there is an opportunity to sell this FRN to boost the overall returns of the investment portfolio. We now recommend Council switch/sell out of the following FRN over the next few months given it is now yielding a low rate of return, if held to maturity:

Issuer	Rating	Maturity Date	ISIN	Face Value	Trading Margin	Capital Price (\$)	~Unrealised Gain (\$)
Sunc.	A+	30/07/2024	AU3FN0049144	\$1,250,000	+61.5bp	\$100.094	\$1,180

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 to 0.10% and the RBA's forward guidance on official interest rates (no rate rises "until at least 2024").

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



Term Deposit Market Review

Current Term Deposits Rates

As at the end of October, we see value in:

Index	LT Credit Rating	Term	Rate % p.a.
ANZ	AA-	5 years	5.89%
ING	A	5 years	5.67%
ANZ	AA-	4 years	5.58%
ING	A	4 years	5.58%
ING	A	2-3 years	5.49%
Westpac	AA-	2 years	5.41%
NAB	AA-	2 years	5.40%
BoQ	BBB+	2 years	5.35%
CBA	AA-	2 years	5.29%

The above deposits are suitable for investors looking to maintain diversification and lock-in a slight premium compared to purely investing short-term.



For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (we stress that rates are indicative, dependent on daily funding requirements and different for industry segments):

Index	LT Credit Rating	Term	Rate % p.a.
ING	A	12 months	5.47%
CBA (>\$2m)	AA-	12 months	5.45%
Westpac	AA-	12 months	5.43%
Suncorp	A+	12 months	5.42%
ING	A	11 months	5.37%
NAB	AA-	12 months	5.40%
BoQ	BBB+	12 months	5.35%
NAB	AA-	9 months	5.30%
BoQ	BBB+	6-9 months	5.30%
CBA (>\$2m)	AA-	6 months	5.22%
NAB	AA-	6 months	5.20%
NAB	AA-	3 months	5.00%

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

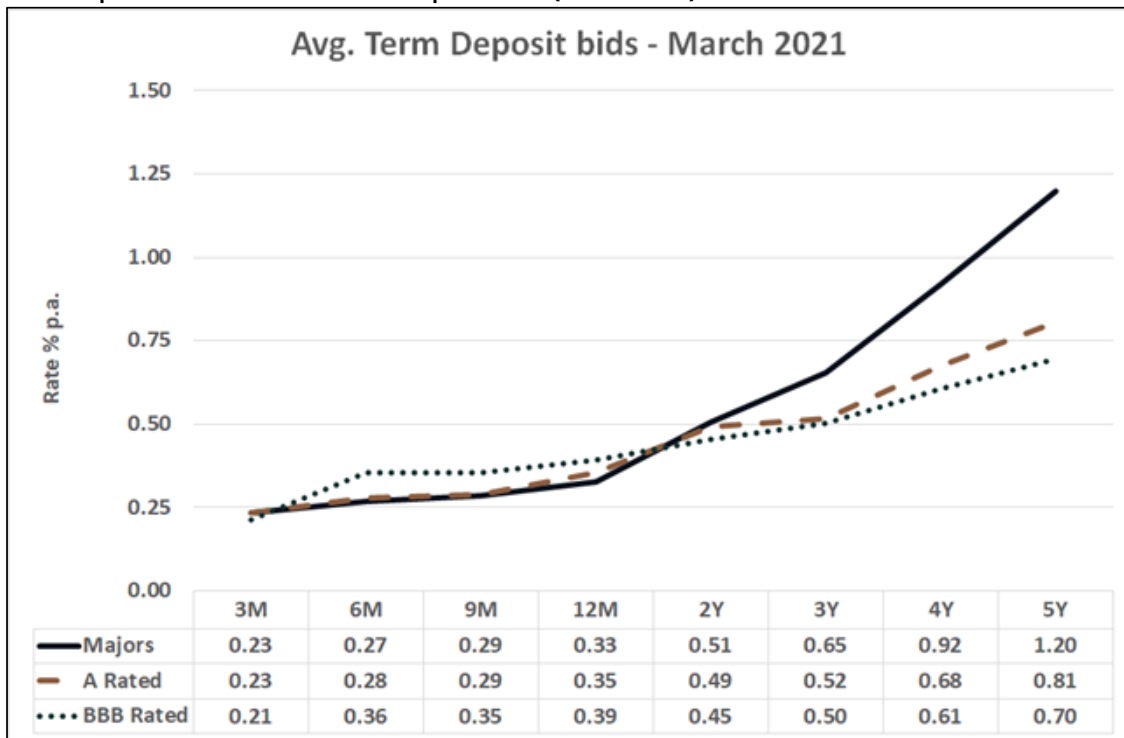
With a global economic slowdown being priced in coming years, investors should consider allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates close to or above 5¼-5½% p.a. This will provide some income protection if central banks decide to cut rates in future years, assuming inflation has stabilised.



Term Deposits Analysis

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

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



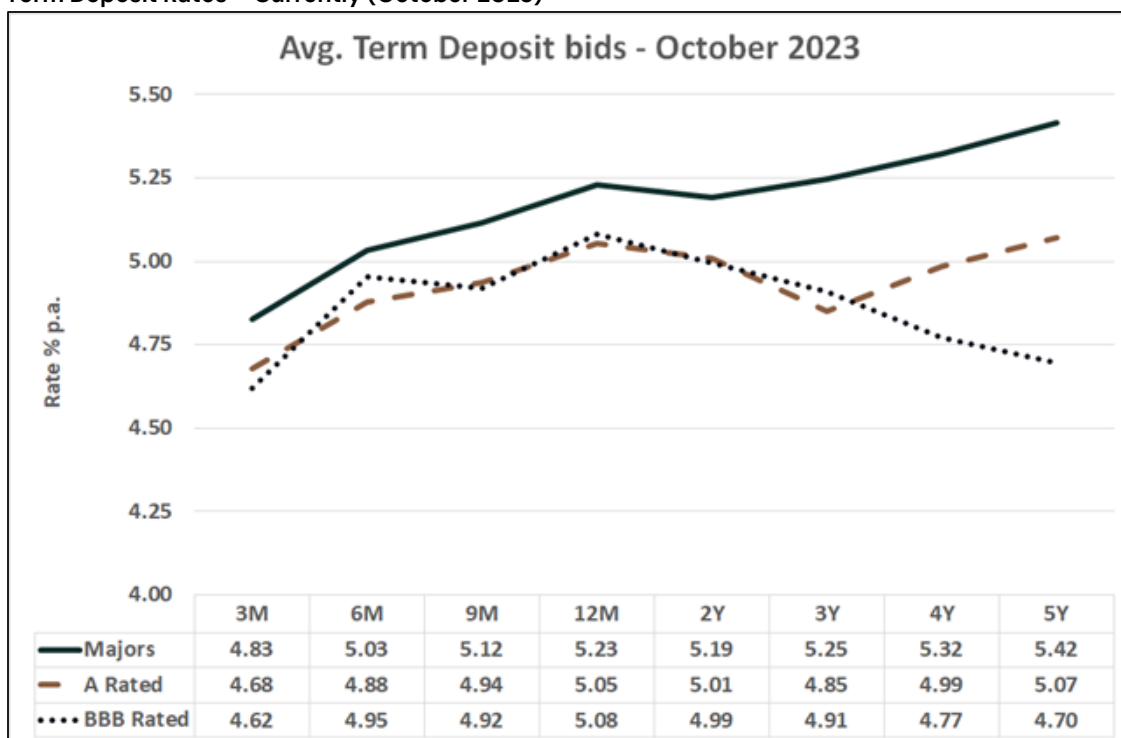
Source: Imperium Markets

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



Going forward, Council should have a larger opportunity to invest a higher proportion of its funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry. We are slowly seeing this trend emerge, although the past three months have been an exception, with the major banks repricing more rapidly to the movement in the bond market than their lower rated counterparts:

Term Deposit Rates – Currently (October 2023)



Source: Imperium Markets

Regional & Unrated ADI Sector

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

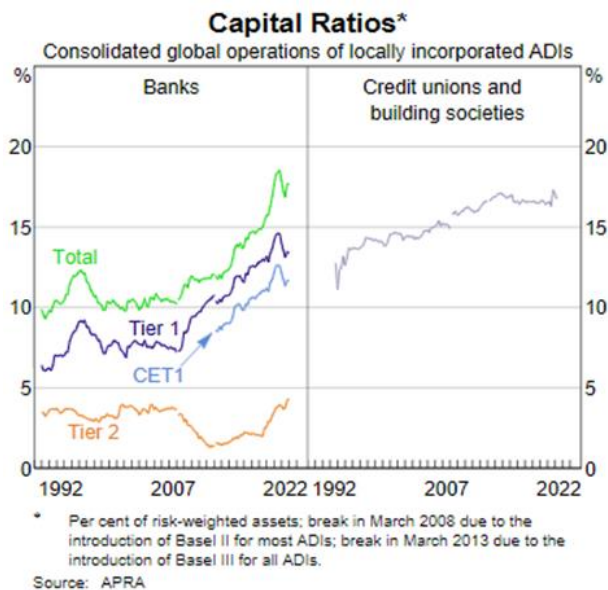
We remain supportive of the regional and unrated ADI sector (and have been even throughout the post-GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have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



Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position than they have been historically (see the Capital Ratio figure below). The financial regulator, APRA has noted that the Common Equity Tier 1 capital of Australian banks now exceeds a quarter of a trillion dollars. It has increased by \$110 billion, or more than 70%, over the past nine 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.

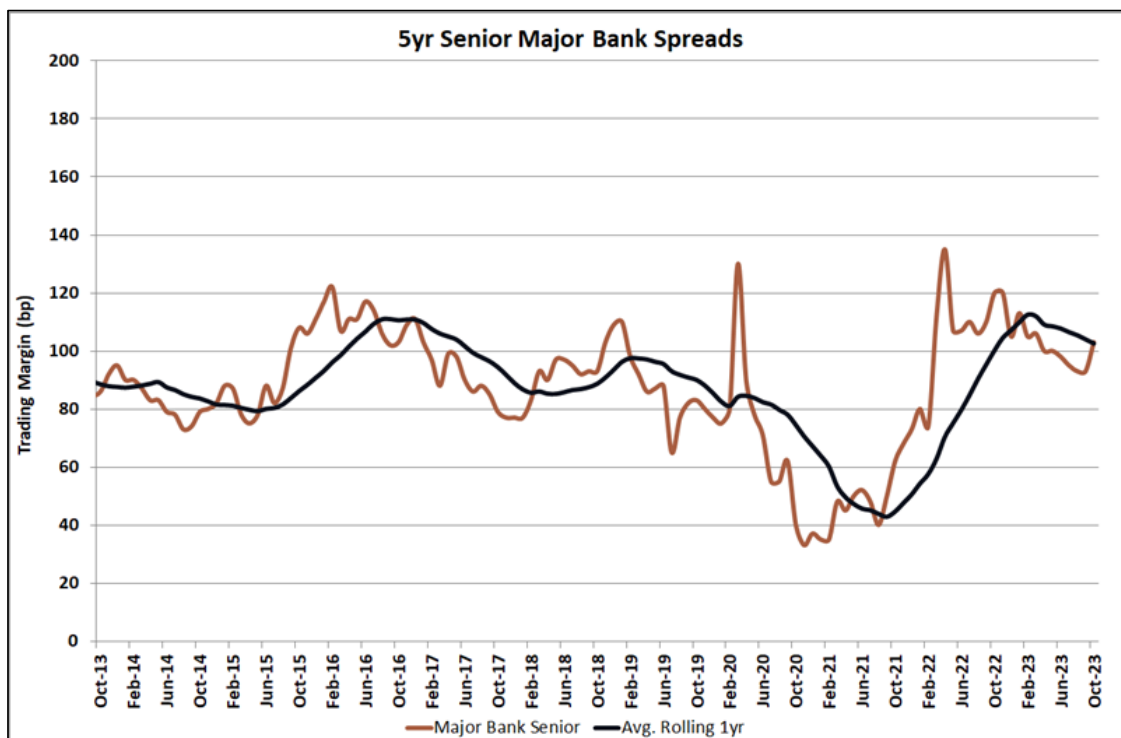
In the current environment of high regulation and scrutiny, all domestic (and international) ADIs continue to carry high levels of capital. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC and the pandemic period. APRA's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





Senior FRNs Market Review

Over October, amongst the senior major bank FRNs, physical credit securities widened by around 6–10bp at the long-end of the curve. Major bank senior securities remain at fair value in the rising rate environment (5yr margins above +100bp level).



Source: IBS Capital

During the month, there were a handful of other new (primary) issuances:

- 3 & 7yr SMBC (A) senior FRN at +90bp and +137bp respectively
- 3 & 5yr Bank of America (A) senior FRN at +105bp and +125bp respectively
- 3yr Bank Australia (BBB) senior FRN at +150bp

Amongst the "A" and "BBB" rated sector, the securities widened by around 10–15bp and 35bp respectively at the longer-end of the curve. Credit securities are looking much more attractive given the widening of spreads over the past ~18 months. 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 future years (in a relatively stable credit environment).



Senior FRNs (ADIs)	31/10/2023	30/09/2023
"AA" rated – 5yrs	+103bp	+93bp
"AA" rated – 3yrs	+80bp	+74bp
"A" rated – 5yrs	+125bp	+115bp
"A" rated – 3yrs	+105bp	+90bp
"BBB" rated – 3yrs	+150bp	+115bp

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 2025 for the "AA" rated ADIs (domestic major banks);
- On or before 2024 for the "A" rated ADIs; and
- Within 6–9 months for the "BBB" rated ADIs (consider case by case).

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



Senior Fixed Bonds – ADIs (Secondary Market)

With global inflation remaining elevated, this has seen a significant lift in longer-term bond yields over the past 18 months (valuations fallen) as markets have reacted sharply.

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

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0273407	UBS	A+	Senior	30/07/2025	1.76	1.20%	5.62%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.53	1.40%	5.85%
AU3CB0299337	Bendigo	BBB+	Senior	15/05/2026	2.55	4.70%	5.76%
AU3CB0296168	BoQ	BBB+	Senior	27/01/2027	3.26	4.70%	5.92%
AU3CB0302404	ANZ	AA-	Senior	11/09/2028	4.89	4.90%	5.54%
AU3CB0302735	WBC	AA-	Senior	19/09/2028	4.90	4.95%	5.55%



Economic Commentary

International Market

Financial markets reacted to expectations that central banks could keep interest rates higher for longer than previously envisaged, as they fight to curb inflation that remains stubbornly high across many countries. The sell-off in global bonds continued with fresh cycle highs being set for longer-term yields.

Across equity markets, the S&P 500 Index fell -2.20%, whilst the NASDAQ dropped -2.78%. Europe's main indices also experienced losses, led by UK's FTSE (-3.76%), Germany's DAX (-3.75%) and France's CAC (-3.50%).

The US core PCE deflator rose at +2.4% y/y, 0.1% below the consensus of +2.5%. The +2.4% increase in core PCE is the smallest since Q4 2019, ignoring the initial Covid distortions. US headline retail sales came in at +0.7% m/m vs. +0.3% expected, and the core control measure which feeds into GDP was +0.6% m/m vs. +0.1% expected.

US payrolls for September beat expectations, with payroll jobs up +336k against +170k expected. The participation rate remained high at 62.8%, and the unemployment rate remained at 3.8% against expectations for a dip to 3.7%.

The ECB kept rates on hold as widely expected and there was little initial market reaction. The statement reported that interest rates are at levels that, if maintained for a sufficiently long duration, will bring inflation back to its target. That reinforced market expectations that the tightening cycle may now be finished.

Canada's CPI figures for September slightly undershot expectations, with the headline rate falling to +3.8%. Meanwhile, Canada's labour market data was strong, with employment up +64k jobs in September (+20k expected). The unemployment rate was unchanged at 5.5%.

China's CPI remained flat year-on-year in September while producer prices declined -2.5% amid lingering concerns about weak demand.

The RBNZ left the Official Cash Rate unchanged at 5.50%, with the accompanying statement suggesting there is little change in the Bank's assessment from the August Monetary Policy Statement. New Zealand's Q3 CPI report showed notably lower annual inflation of +5.6% compared to the RBNZ's estimate of +6.0%.

The MSCI World ex-Aus Index fell -2.92% for the month of October:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-2.20%	-8.61%	+8.31%	+8.65%	+9.11%	+9.09%
MSCI World ex-AUS	-2.92%	-9.58%	+8.87%	+6.58%	+6.61%	+5.82%
S&P ASX 200 Accum. Index	-3.78%	-7.19%	+2.95%	+8.88%	+7.18%	+6.60%

Source: S&P, MSCI



Domestic Market

As widely expected, the RBA kept rates unchanged in October for the four consecutive month. The RBA's October Board Minutes was more hawkish than recent communications. Key was the statement, "*the Board has a low tolerance for a slower return of inflation to target than currently expected*", which was inserted into the concluding paragraph. Even if the RBA hikes in November, they may still retain a tightening bias given the "*low tolerance*" for a slower return of inflation to target.

RBA Governor Bullock remained bullish in her follow-up comments during the month, saying "*there's a few things that are suggestive that it's going to be difficult to get inflation down*" and "*services inflation – inflation in things like takeaways, hairdressers, restaurants, those sorts of things – that inflation is running at a bit over 4%...so it's above our target and it's pretty sticky. And that's what we're observing overseas as well*". She also commented, "*the Board will not hesitate to raise the cash rate further if there is a material upward revision to the outlook for inflation*".

Q3 trimmed mean CPI came in at +1.2% q/q (+1.16% unrounded) and +5.2% y/y. That was marginally higher than consensus for +1.0% q/q. Most importantly, it is meaningfully higher than the +0.9% q/q outcome the RBA had pencilled in the August SoMP. The RBA appears to have been overly optimistic in its near term forecast for disinflation.

The unemployment rate fell 0.1% to 3.6% in September. This was largely due to the fall in the participation rate by 0.2% to 66.7%, with employment only rising by +6.7k (softer than consensus).

Retail sales rose a strong +0.9% m/m in September (consensus +0.3%) or +3.4% on an annual basis, which is 0.5% above its pre-pandemic growth rate. Very elevated population growth is a key tailwind to the aggregate consumer spending growth.

Residential auction clearance rates have held firm at 70.8%, in a sign the property market is shifting to the middle ground between buyers and sellers, as increased auction volumes temper vendor dominance.

The Australian dollar fell -1.73%, finishing the month at US63.46 cents (from US64.58 cents the previous month).

Credit Market

The global credit indices widened again over November in the 'risk-off' environment. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	October 2023	September 2023
CDX North American 5yr CDS	81bp	73bp
iTraxx Europe 5yr CDS	89bp	80bp
iTraxx Australia 5yr CDS	98bp	89bp

Source: Markit



Fixed Interest Review

Benchmark Index Returns

Index	October 2023	September 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.33%	+0.34%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.85%	-1.53%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.37%	+0.37%
Bloomberg AusBond Credit Index (0+YR)	-0.77%	-0.58%
Bloomberg AusBond Treasury Index (0+YR)	-1.85%	+1.88%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-1.35%	-2.20%

Source: Bloomberg

Other Key Rates

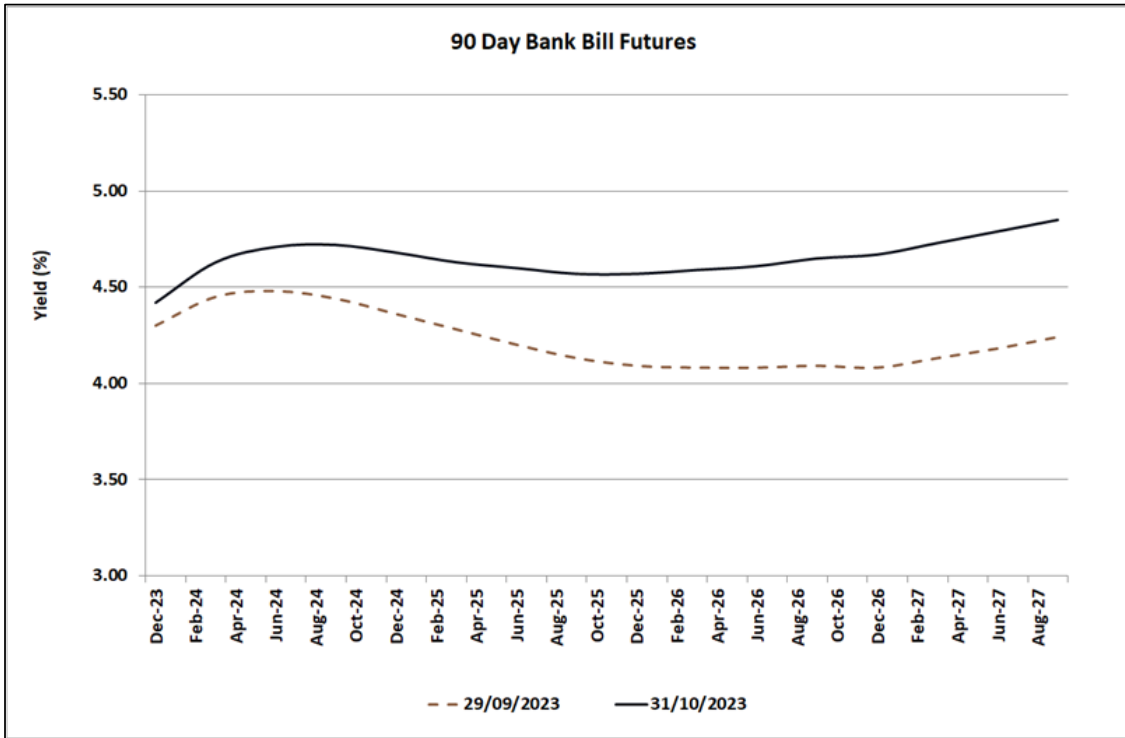
Index	October 2023	September 2023
RBA Official Cash Rate	4.10%	4.10%
90 Day (3 month) BBSW Rate	4.35%	4.14%
3yr Australian Government Bonds	4.41%	4.08%
10yr Australian Government Bonds	4.93%	4.48%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	5.07%	5.03%
10yr US Treasury Bonds	4.88%	4.59%

Source: RBA, ASX, US Department of Treasury



90 Day Bill Futures

Bill futures rose across the board this month, following the higher than anticipated inflation number. The RBA is now expected to lift official rates again on Melbourne Cup Day (7th November). The bills market continues to factor in the possibility of an economic downturn over the next few years, highlighted by the drop in the futures pricing by the beginning of 2024:



Source: ASX



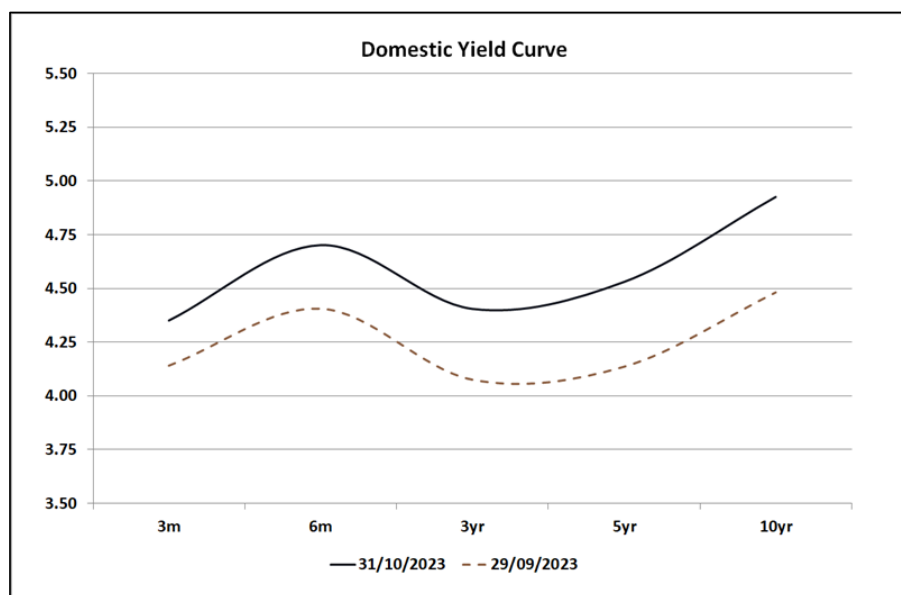
Fixed Interest Outlook

Global inflation has accelerated in recent months – ending the trend of disinflation exhibited in early to mid-2023. Certain sectors in most advanced economies have remained sticky, with rising energy prices remaining a significant risk to headline inflation. The near-term outlook around monetary policy is still firmly to the upside. There is considerable uncertainty when central banks will start to cut official rates – markets continue to push back their expectations, factoring a ‘higher for longer’ sustained period of interest rates, resulting in the ongoing sell-off in bonds (yields rising).

US Fed Chair Powell commented that the FOMC is “proceeding carefully” and that “additional evidence of persistently above-trend growth, or that tightness in the labour market is no longer easing, could put further progress on inflation at risk and could warrant further tightening of monetary policy”. US fed funds pricing universally expects the Fed to be on hold in November. Pricing of cuts though has expanded slightly with around 80bp priced for 2024.

Domestically, the RBA remains committed to tightening further if required, again warning that some further tightening may be required to ensure that inflation returns to target in a reasonable timeframe, and that this will continue to depend upon the data and the evolving assessment of risks. Governor Bullock has commented that services inflation is the worry (“although services inflation is declining, it’s still higher than we’re comfortable with. And it’s also reasonably persistent”). The Board’s tolerance for the ongoing elevated levels of inflation is waning and the market believes this will force its hand with another rate hike in November.

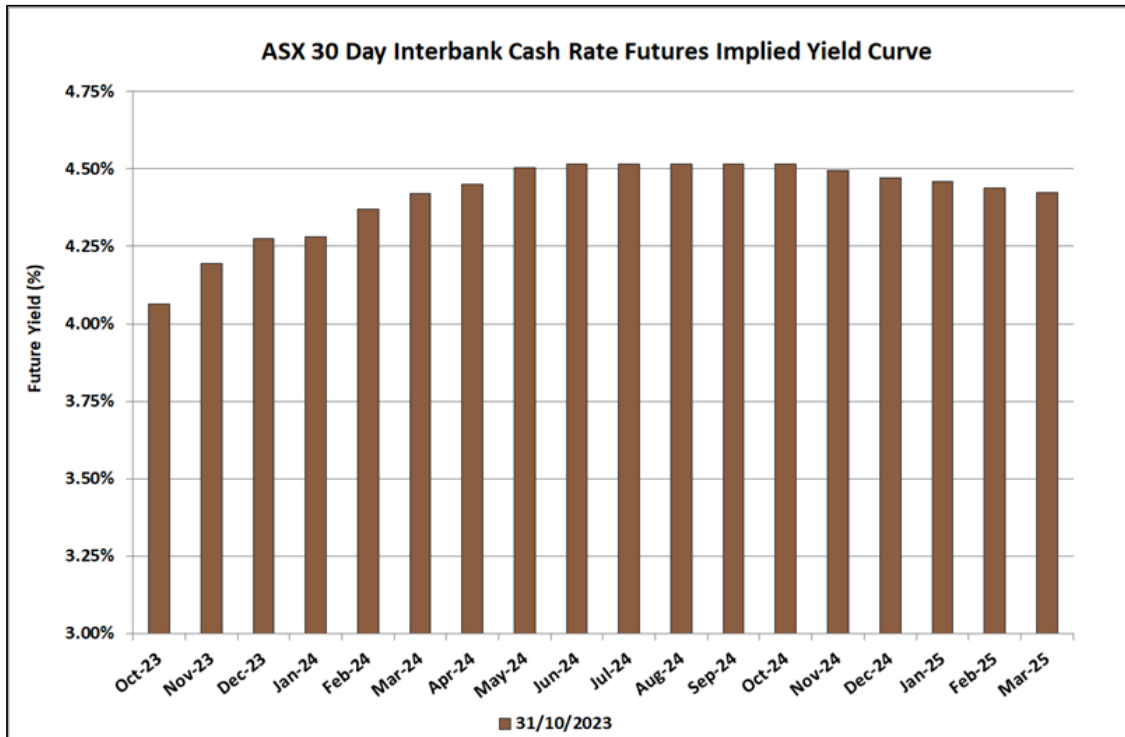
Over the month, yields rose up to 44bp at the long end of the curve:



Source: ASX, RBA



Markets have been quick to revise their interest rate forecasts with one more rate hike fully priced this cycle. Rate cuts are still being forecasted, but not at least until 2025:



Source: ASX

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