8.6. Investments and Loan Borrowings Held as at 31 May 2021

AUTHOR: Garry Ross, Manager Financial Services

ENDORSED BY: Margaret Palmer, Director Corporate Services

ATTACHMENTS:
1. Investment Report - May 2021 [**8.6.1** - 18 pages]
2. Investment Portfolio Valuations - May 2021 [**8.6.2** - 3 pages]

PURPOSE:

This report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 31 May 2021.

EXECUTIVE SUMMARY:

Investment Portfolio:

The Investment portfolio (excluding cash balances) held as at 31 May 2021 had a market value of $86.0 million, with an annualised return of 1.60% for the year to date,1.54% above the reportable BBSW Bank Bill Index of 0.06%. Cash deposits at call total $16.0 million which enables liquidity for day-to-day operational availability and the increased end of financial year liabilities for completed Capital projects

The actual returns for cash and investments for the year to date as at 31 May 2021 were $1,223,317 which was $32,205 less than the year-to-date budgeted estimate. The medium-longer term outlook for financial markets indicate that the RBA's official cash rate will remain unchanged at its emergency level of 0.10% until its objectives of full employment and inflation are reached and that rate rises are not expected until at least 2024.

Borrowings:

Council entered into a fixed interest loan of $9.5 million with quarterly interest and principal payments on 31 July 2018. The principal outstanding as at 31 May 2021 is $7,253,977.04. Council has made provision for future borrowings of $31 million to assist in the funding to complete the redevelopment of North Sydney Olympic Pool.

FINANCIAL IMPLICATIONS:
The 2020/21 budgeted returns on investments are estimated to be $1,350,000.00. The 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 year.

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 as at 31 May 2021 be received.

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

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

BACKGROUND

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

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

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

CONSULTATION REQUIREMENTS

Community engagement is not required.

DETAIL

Investment Portfolio

The following table provides details of the performance of Council's investment portfolio (excluding cash deposits) against the benchmark for the month of May 2021 and annualised for the year to date as at 31 May 2021 (including investments which have matured prior to 31 May 2021).

	May 2021	Annualised YTD as at 31 May 2021
Actual Return	0.11%	1.60%
Benchmark	0.00%	0.06%
Variance	0.11%	1.54%

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

Asset Type	Market Value as at 31 May 2021	Portfolio Breakdown as at 31 May 2021
Cash	$16,096,909.73	15.76%
Term Deposits	$74,000,000.00	72.49%
Floating Rate Notes (FRN's)	$5,991,681.10	5.87%
Fixed Bonds	$6,000,000.00	5.88%
	$102,088,590.83	**100.00%**

Council's average duration of term deposits which comprise approximately two thirds of the investment portfolio is approximately 580 days, thus reducing the exposure to declining interest rates experienced with investment renewals.

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

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

The actual investment returns for the year to date as at 31 May 2021 have been reviewed and are $30,205 less than the revised budget.

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

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (May)	YTD/Annual Actual (May)	YTD/Annual Actual FV adjustments (May)	YTD Budget to Actual Variance (May)
2020/21	**$1,350,000**	**$1,350,000**	**$1,253,522**	**$1,132,560**	**$90,757**	**-$30,205**
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 May 2021 the YTD movement of FRN's has been an increase in returns of $90,757.

Financial Investment Policy

As at the end of May, 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 May 2021	Maximum Policy Holding	Distribution as at 31 May 2021
AA Category	$44,977,509	100.00%	44.06%
A Category	$28,265,217	60.00%	27.69%
BBB Category	$28,845,865	35.00%	28.25%
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 to be carried out.

The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating or a combination of both in order to maintain its risk averse strategy.

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

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

The current Debt Facility is as follows:

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

The current loan details are as follows:

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**
1/07/2020	$8,099,526.94			
31/07/2020	$7,891,956.69	$82,069.29	$207,570.25	$289,639.54
30/10/2020	$7,681,414.01	$79,096.87	$210,542.67	$289,639.54
29/01/2021	$7,468,761.18	$76,986.71	$212,652.83	$289,639.54
30/04/2021	$7,253,977.04	$74,855.40	$214,784.14	$289,639.54

The next loan instalment is due on 30 July 2021.

Loan Funded Capital Projects as at 31 May 2021:

Project 1: Upgrading the Car Park in Alexander Street, Crows Nest
A **$5 million** loan has been sourced to fund this project.

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

Project 2: Upgrading of On-Street Parking Management System
A **$4.5 million** loan has been sourced to fund this project.

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

Future Borrowings

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

As per Council’s resolution of the September 2020 meeting, prior to accessing these funds, comparative loan rates will be obtained from TCorp and the major banks to ensure market competitiveness.

Monthly Investment Report

May 2021

IMPERIUM MARKETS

Imperium Markets Pty Ltd ABN: 87 616 579 527
Authorised Representative of Libertas Financial Planning Pty Ltd AFSL 429 718
Phone: +61 2 9053 2987
Email: michael.chandra@imperium.markets
Level 9 Suite 02, 3 Spring Street, Sydney NSW 2000

Impact of COVID-19 to Council's Portfolio

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

With regards to financial markets, shares (equities) experienced a significant correction in March 2020 but have since, recovered substantially due to the unprecedented fiscal and monetary policy support from global central banks and governments. **The RBA cut rates to record lows on 3rd November 2020 to 0.10%.** Equities have continued their rally over the course of 2021 with the accelerated rollout of multiple vaccines and ongoing fiscal stimulus. Longer-term bond yields have also risen over the past few months on the prospects of higher inflation over coming years.

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

1. The RBA's official cash rate will remain unchanged at its emergency level of 0.10% until its objectives of full employment and inflation are reached.
2. They suggested the NAIRU could be in the low 4s, or even the high 3s, well below the current unemployment rate of ~5½%;
3. **The Board does not expect the conditions for a rate hike "*to be met until 2024 at the earliest*".**

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 ~72% of Council's total investment. The biggest risk that Council faces over the medium-longer term in this environment is not the potential loss of capital (given all the banks are well capitalised and regulated by APRA), but the rapid loss of interest income as interest rates have plummeted.

Council's term deposit portfolio was yielding 1.41% p.a. at month-end, with a weighted average duration of around 580 days or ~1.6 years. **This average duration will provide some income protection against the low interest rate environment over the next 12 months**. As existing deposits mature however, they will inevitably be reinvested at much lower prevailing rates.

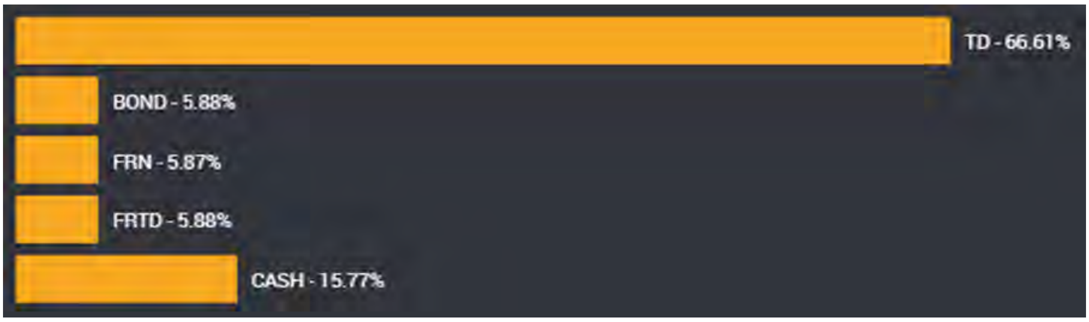
Given official rates have fallen to record lows, Council is likely to see a rapid decline in interest income over future financial years. Its budgeted income over the medium-longer term needs to be revised to reflect the low interest rate environment. Returns between 0.40%-0.80% p.a. may potentially be the "norm" over the next few financial years, especially if rolling the majority of surplus funds for terms less than 2-3 years. Yields may in fact be lower if electing to invest for terms under 12 months.

Council's Portfolio & Compliance

Asset Allocation

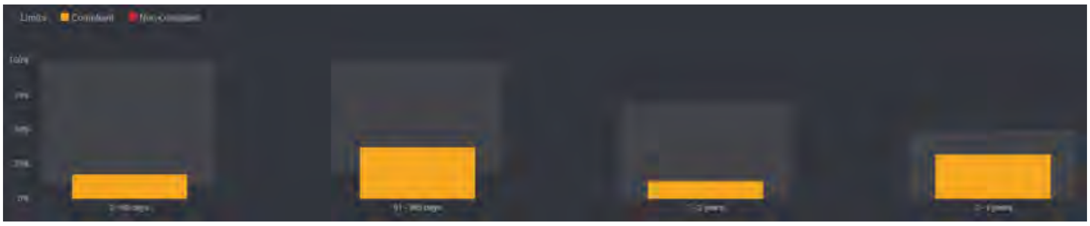
As at the end of May 2021, the portfolio was mainly directed to fixed and floating rate term deposits (72.49%). The remaining portfolio is directed to FRNs (5.87%), fixed bonds (5.88%) and overnight cash accounts (15.77%).

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



Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 32% 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 $18m at month-end.



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

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$18,096,910	17.73%	10%	100%	$83,991,681
✓	91 - 365 days	$38,000,000	37.22%	20%	100%	$64,088,591
✓	1 - 2 years	$13,260,025	12.99%	0%	70%	$58,201,989
✓	2 - 5 years	$32,731,656	32.06%	0%	50%	$18,312,639
✓	5 - 10 years	$0	0.00%	0%	25%	$25,522,148
		$102,088,591	**100.00%**			

Counterparty

As at the end of May, all individual limits comply with the Policy. Limits to ING (A) and Auswide (BBB) remain close to the maximum limits, helped this month by the increase in the total portfolio's balance by around $5m. Exposures to individual ADIs are driven by the portfolio's movements throughout any month. Overall, the portfolio is well diversified across the investment grade spectrum, with no exposure to the unrated ADIs.

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA (BankWest)	AA-	$15,938,257	15.61%	30.00%	$14,688,320
✓	NAB	AA-	$11,039,252	10.81%	30.00%	$19,587,325
✓	NTTC	AA-	$6,000,000	5.88%	30.00%	$24,626,577
✓	Westpac	AA-	$12,000,000	11.75%	30.00%	$18,626,577
✓	Suncorp	A+	$1,265,218	1.24%	15.00%	$14,048,071
✓	ICBC Sydney	A	$12,000,000	11.75%	15.00%	$3,313,289
✓	ING Bank	A	$15,000,000	14.69%	15.00%	$313,289
✓	BOQ	BBB+	$8,000,000	7.84%	10.00%	$2,208,859
✓	AMP Bank	BBB	$3,158,653	3.09%	10.00%	$7,050,206
✓	Auswide Bank	BBB	$10,000,000	9.80%	10.00%	$208,859
✓	Beyond (Nexus)	BBB	$3,000,000	2.94%	10.00%	$7,208,859
✓	ME Bank	BBB	$3,260,025	3.19%	10.00%	$6,948,834
✓	Newcastle PBS	BBB	$1,427,187	1.40%	10.00%	$8,781,672
			$102,088,591	**100.00%**		

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

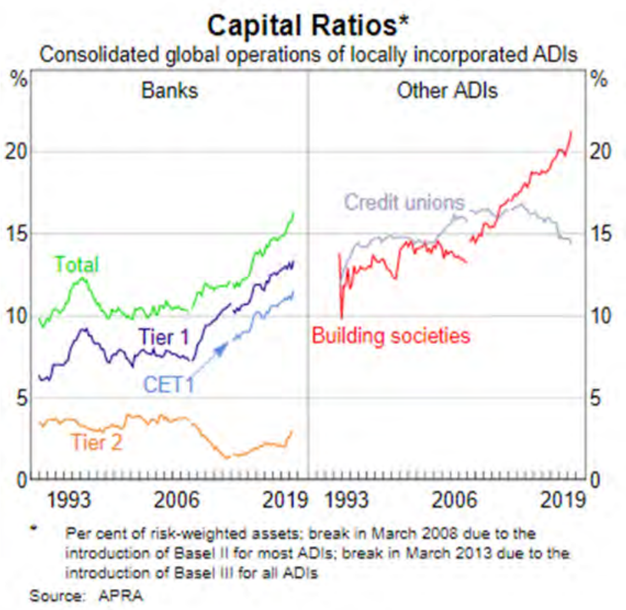
We remain supportive of the regional and unrated ADI sector (and have been even throughout the GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to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

APRA's Chairman affirmed that the banks had satisfactorily moved towards an '*unquestionably strong*' capital position and that bank's stress testing contingency plans were now far better positioned 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. <u>Interest rates are now at their effective lower bound of 0.10%.</u>



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 May 2021, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$44,977,509	44.06%	100%	$57,111,082
✓	A Category	$28,265,218	27.69%	60%	$32,987,937
✓	BBB Category	$28,845,864	28.26%	35%	$6,885,142
✓	Unrated ADIs	$0	0.00%	10%	$10,208,859
		$102,088,591	**100.00%**		

Performance

Council's performance for the month ending 31 May 2021 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%	0.14%	0.16%	0.45%
AusBond Bank Bill Index	0.00%	0.01%	0.01%	0.06%	0.06%	0.52%
Council's T/D Portfolio	0.12%	0.36%	0.72%	1.45%	1.61%	1.94%
Council's FRN Portfolio	0.08%	0.57%	0.83%	1.35%	1.69%	1.87%
Council's Bond Portfolio	0.08%	0.24%	0.48%	-	-	-
Council's Portfolio^	**0.11%**	**0.37%**	**0.71%**	**1.41%**	**1.60%**	**1.91%**
Outperformance	**0.11%**	**0.36%**	**0.70%**	**1.35%**	**1.54%**	**1.39%**

^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%	0.16%	0.16%	0.45%
AusBond Bank Bill Index	0.05%	0.04%	0.02%	0.06%	0.06%	0.52%
Council's T/D Portfolio	1.41%	1.42%	1.44%	1.58%	1.61%	1.94%
Council's FRN Portfolio	0.99%	2.27%	1.67%	1.47%	1.69%	1.87%
Council's Bond Portfolio	0.95%	0.96%	0.97%	-	-	-
Council's Portfolio^	**1.34%**	**1.46%**	**1.43%**	**1.53%**	**1.60%**	**1.91%**
Outperformance	**1.30%**	**1.42%**	**1.40%**	**1.47%**	**1.54%**	**1.39%**

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

For the month of May, the total investment portfolio (excluding cash) provided a strong return of +0.11% (actual) or +1.34% p.a. (annualised), outperforming the benchmark AusBond Bank Bill Index return of +0.00% (actual) or +0.05% p.a. (annualised). The strong performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the RBA's rate cuts, as well as the FRNs locked in at attractive margins.

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

Over the past year, the total portfolio (excluding cash) returned an outstanding +1.60% p.a., outperforming bank bills by 1.54% p.a. This has been very strong given deposit rates reached their all-time lows and credit margins have generally contracted over the past 3 years.

We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned (as per our January 2021 Council Rankings). We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio. Of the 28 individual deposits North Sydney Council held, 7 are still yielding higher than 1.75% p.a. That is, around a quarter of the outstanding deposits held are currently earning more than the highest rate available in the market from any rated bank out to 5 years.

Council's Term Deposit Portfolio & Recommendation

As at the end of May 2021, Council's deposit portfolio was yielding an **attractive 1.41% p.a.** (unchanged from the previous month), with an average duration of around 580 days (~1.6 years). We recommend Council extends this average duration. In the low interest rate environment, the biggest collective risk that the local government sector has faced over the post-GFC era has been the dramatic fall in interest rates - from 7¼% to the historical low levels of 0.10%.

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

At the time of writing, we see value in:

ADI	LT Credit Rating	Term	T/D Rate
ICBC, Sydney	A	5 years	1.40% p.a.
NAB	AA-	5 years	1.30% p.a.
ICBC, Sydney	A	4 years	1.12% p.a.
NAB	AA-	4 years	1.00% p.a.
ICBC, Sydney	A	3 years	0.85% p.a.
NAB	AA-	3 years	0.80% p.a.
ICBC, Sydney	A	2 years	0.60% p.a.
NAB	AA-	2 years	0.60% p.a.

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

For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (dependent on daily funding requirements):

ADI	LT Credit Rating	Term	T/D Rate
ME Bank	BBB	12 months	~0.50% p.a.
BoQ	BBB+	6 months	0.45% p.a.
BoQ	BBB+	9-12 months	0.40% p.a.
CBA	AA-	12 months	~0.38% p.a.
AMP Bank	BBB	9-12 months	0.35% p.a.^
NAB	AA-	12 months	0.35% p.a.
Westpac	AA-	12 months	~0.35% p.a.
Bendigo	BBB+	9-12 months	0.35% p.a.

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

Amongst the investment grade sector, short-dated term deposits (maturing less than 12 months) are yielding under 0.50% p.a. (most are under 0.40% p.a.). We 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 2-5 year fixed T/Ds whilst official rates are stuck at depressed levels for the foreseeable future. If Council does not require high levels of liquidity and can stagger its investments longer-term, it will be rewarded over coming years if it can roll for a minimum term of 2 years (rolling for 3-5 years is even better, where possible), potentially yielding, on average, more than double or triple the return compared to those investors that purely invest in short-dated deposits.

Senior FRNs Review

Over May, amongst the senior major bank FRNs, physical credit securities widened by around 5bp at the long-end of the curve. Secondary market securities remain relatively expensive on the back of the RBA announcing its $200bn quantitative easing (QE) package (doubled in Feb 2021).

A new 5 year senior major bank FRN would now be issued around the +50bp, which remains tight on a historical basis. We may finally see some primary issuances in Q3-Q4 this year from the major banks as the RBA's term funding facility (TFF) ends as of 30 June 2021. The lack of supply from new (primary) issuances has played a major role with the rally in credit markets over the past year.

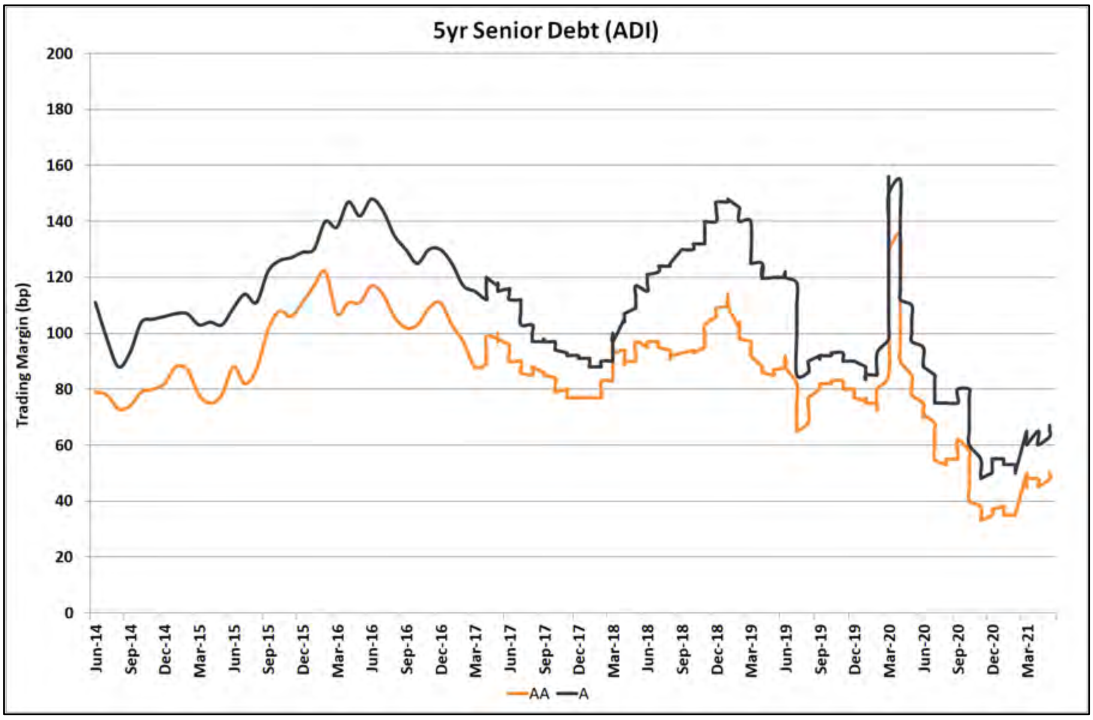
During the month, HSBC Sydney Branch (AA-) issued a new 3 year senior FRN at +42bp, printing $500m, tightening from initial guidance of +50bp, after receiving orders in excess of $1.4bn. While it tightened 8bp from initial guidance, relative to where the domestic major banks were being marked, we thought this was issued at a relatively fair level. Separately, China Everbright Bank, Sydney Branch (BBB+) issued a 3 year senior FRN deal at +68bp, tightening from +73bp and printed $300m.

Amongst the "A" and "BBB" rated sector, the securities were also marked around 2-5bp wider at the long-end of the curve. While turnover in the secondary market is still predominately dominated by commonwealth, semi-government and major bank senior paper, given the lack of supply, we have started to observe that even a handful of regional bank senior paper has sometimes been trading inside "mid" levels over recent months.

Credit securities remain tight on a historical level but are looking slightly more attractive following the widening experienced over the past few 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 ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/05/2021	30/04/2021
"AA" rated – 5yrs	+50bp	+45bp
"AA" rated – 3yrs	+27bp	+27bp
"A" rated – 5yrs	+67bp	+60bp
"A" rated – 3yrs	+45bp	+42bp
"BBB" rated – 3yrs	+55bp	+52bp

Source: IBS Capital



Source: IBS Capital

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

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

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

Council's Senior FRNs Sale/Switch Recommendations

In the next few months, we recommend Council sells out of the following FRNs given yielding a low rate of return, if held to maturity (less than 0.4% p.a.):

- $2.00m NAB (AA-) FRN maturing 19/06/2024 (ISIN: AU3FN0048724) – trading margin at **+27.0bp** or capital price of $101.96 (capital gain **~$39,000**);
- $1.25m ME Bank (BBB) FRN maturing 18/07/2022 (ISIN: AU3FN0048948) – trading margin at **+27.0bp** or capital price of $100.80 (capital gain **~$10,000**).

The above sales would result in capital gains totalling **$49,000.** Council can easily switch into a higher yielding complying asset which is returning much higher than 0.40% p.a., namely 2-5 year fixed term deposits. *At this stage, we recommend holding Council's remaining senior FRNs with a view of selling the above two FRNs over Q3 2021*.

Senior Bonds

During October 2020, Council placed two parcels of $3m (totalling $6m) with the Northern Territory Treasury Corporation (NTTC), locking in yields of 0.90% p.a. and 1.00% p.a. for a 4 and 5 year term respectively. Council received the full rebated commission of 0.25% on the total face value of investments (i.e. $15,000) in mid-November 2020 as it was introduced by Imperium Markets. We believe this was prudent given the low rate environment.

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

Economic Commentary

International Market

Despite ongoing concerns regarding inflation and higher commodity prices, equity markets continued their positive momentum in May, providing positive returns across most major markets.

In the US, the S&P 500 Index gained +0.55%, while the tech-heavy NASDAQ Index fell -1.53%. Equities finished positively across Europe's main indices, led by France's CAC (+2.83%), Germany's DAX (+1.88%) and UK's FTSE (+0.76%).

The US payroll numbers in April disappointed, coming in at 266k against expectation of 1 million. **The unemployment rate unexpectedly ticked up from 6.0% to 6.1%** against expectations of a fall to 5.8%.

The US April core PCE deflator rose to +3.1% from +1.9%, its highest annual rate since 1992 and a little above the 2.9% expected.

President Biden outlined his Budget plan for FY22, proposing US$6 trillion of spending that would significantly boost discretionary spending and sharply raise taxes on corporates and high-income households.

European GDP data confirmed their recession with Q1 GDP at -0.6% q/q. With the vaccination programme back on track in the region and restrictions likely to ease, Q2 is expected to be much better.

The UK economy contracted by -1.5% q/q in Q1, but the monthly track showed a decent pick-in in growth in March, confirming that a strong rebound is underway as lockdown restrictions ease. The Bank of England kept all its policy settings unchanged, including its £875bn government bond buying target.

China's monthly activity data did not provide any support to risk appetite, with retail sales coming in weaker than expected (17.7% y/y vs 25% expected). The unemployment rate fell to 5.1% (the lowest since November 2019), while new home prices were up +0.5% m/m in April.

The RBNZ surprised the market by re-introducing its forecasts for their Official Cash Rate (held steady at 0.25%) into their Monetary Policy statement. **OCR forecasts point to a sequence of hikes from the Q3 of 2022**.

The MSCI World ex-Aus Index rose +1.22% for the month of May:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+0.55%	+10.31%	+38.10%	+15.83%	+14.93%	+12.07%
MSCI World ex-AUS	+1.22%	+9.15%	+38.37%	+12.59%	+12.31%	+8.42%
S&P ASX 200 Accum. Index	+2.34%	+8.48%	+28.23%	+9.95%	+10.11%	+8.82%

Source: S&P, MSCI

Domestic Market

The RBA kept its rates and guidance unchanged at its meeting in May, however it upgraded its baseline forecasts for economic growth and substantially reduced its unemployment forecasts. The RBA has lowered its unemployment rate forecasts to 4.5% by the end of 2022 (previously 5.5%), which is at the bottom end of model-based NAIRU estimates (NAIRU is pegged around 4.5-5.0%).

The RBA indicated it will not extend their 3yr yield target from the April 2024 bond to the November 2024 bond, which could signal their intention to announce a tapered QE3.

The underlying cash deficit for 2020-21 was revised almost $40bn lower to $161bn (7.8% of GDP) from $213.7bn (11%) at the previous budget in October 2020, on the back of the better-than-expected labour market recovery and elevated iron ore price. Deficits are forecast all the way to 2031-32. Gross debt is expected to be $829bn (40.2% of GDP) in 2020-21 before stabilising at around 51% of GDP in the medium term.

In terms of spending, the largest item was the Government's aged care package – at around $17.7bn over the forward estimates. But there were other big spends in the areas of Infrastructure ($15bn) and NDIS ($13.2bn). The Low and Middle-Income tax offset was extended a year ($7.8bn) and the Investment Asset Write Off was also extended.

Headline employment fell -30.6k in April, well below expectations of +20k. The unemployment rate fell by 0.2% to 5.5% from an upwardly revised 5.7%, partially driven by falling participation from 66.3% to 66.0%. Interestingly, youth unemployment fell 1.1% to 10.6%, its lowest since 2009. Underemployment also fell by 0.2% to 7.8%, its lowest level since May 2014.

The Wage Price Index (WPI) rose +0.6% q/q and +1.5% y/y in March, one-tenth higher than the consensus.

The trade surplus fell by $2.0bn to $5.6bn in March, driven mostly by higher imports (+4% m/m or $1.3bn).

Australia has now administered vaccine doses equivalent to 14.9% of the population, while only 2% of the population is now fully vaccinated.

The Australian dollar fell -0.66%, finishing the month at US77.25 cents (from US77.76 cents the previous month).

Credit Market

The main credit indices remained flat over May. The indices now trade back to their levels experienced in late 2020:

Index	May 2021	April 2021
CDX North American 5yr CDS	51bp	50bp
iTraxx Europe 5yr CDS	50bp	50bp
iTraxx Australia 5yr CDS	59bp	61bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	May 2021	April 2021
Bloomberg AusBond Bank Bill Index (0+YR)	+0.00%	+0.00%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.26%	+0.56%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.07%	+0.07%
Bloomberg AusBond Credit Index (0+YR)	+0.22%	+0.54%
Bloomberg AusBond Treasury Index (0+YR)	+0.30%	+0.57%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+0.90%	+1.61%

Source: Bloomberg

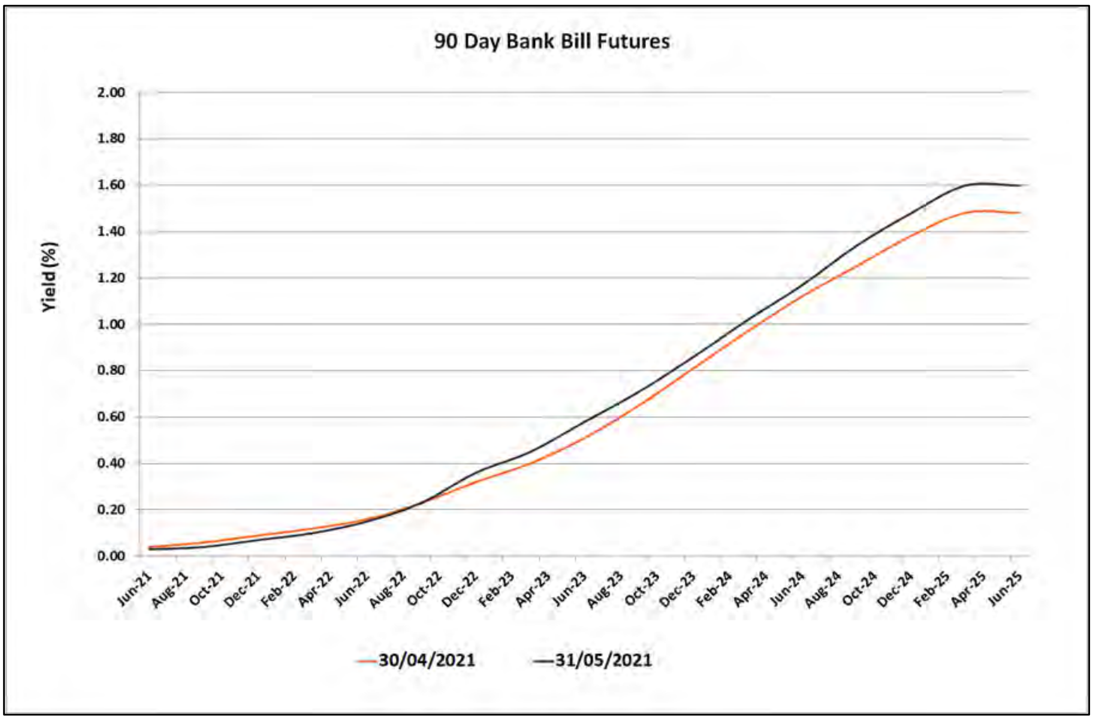
Other Key Rates

Index	May 2021	April 2021
RBA Official Cash Rate	0.10%	0.10%
90 Day (3 month) BBSW Rate	0.04%	0.04%
3yr Australian Government Bonds	0.10%	0.10%
10yr Australian Government Bonds	1.61%	1.65%
US Fed Funds Rate	0.00%-0.25%	0.00%-0.25%
10yr US Treasury Bonds	1.58%	1.65%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over May, bill futures marginally rose across the board on anticipation of a tapering in QE programs and rising inflationary expectations. Overall, bill futures continue to depict a low rate environment over the long-run, despite the steeping curve in recent months:



Source: ASX

Fixed Interest Outlook

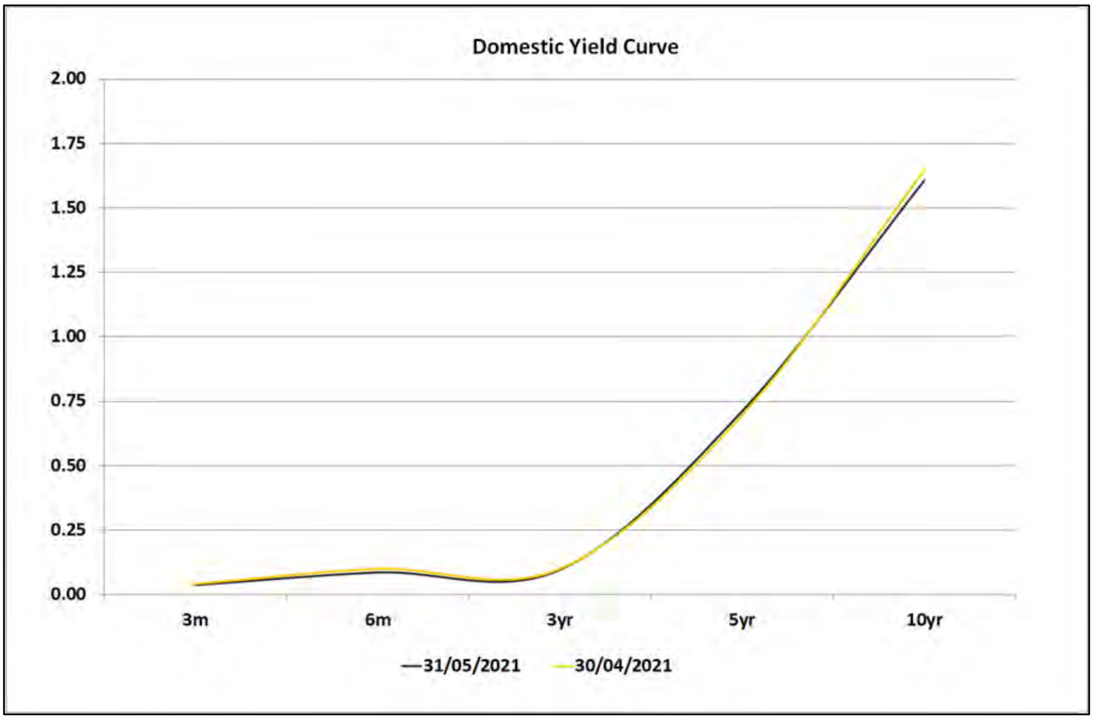
The unprecedented fiscal support for the global economy and the accelerated vaccine rollout in countries such as the US and the UK has aided financial markets. Further significant stimulus packages are also being proposed in the US, with President Biden announcing a $US2.25 trillion infrastructure plan – about half of it for physical infrastructure and the other half for social infrastructure.

US Fed Chair Powell appeared to be more optimistic on the outlook, saying "*we feel like we're at a place where the economy's about to start growing much more quickly and job creation coming much more quickly*". Powell remains cautious and has made it clear that it was "*not time yet*" to have a conversation about tapering its US$120bn monthly QE bond buying programme. He emphasised that the US was "*not close to*" the substantial progress toward its employment and price stability goals that has been set as the condition for contemplating its first steps of tapering.

Global central banks (including the RBA) have stressed that they will look through temporary increases in inflation from base effects and supply chain disruptions.

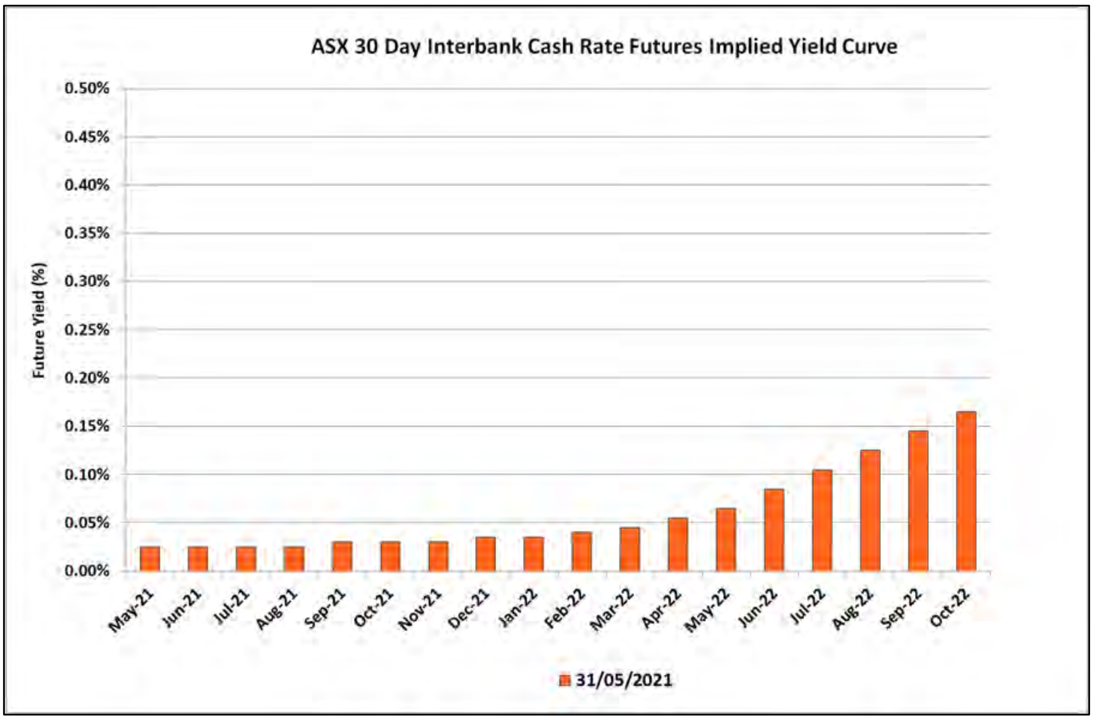
Domestically, the RBA is of the view that "*a materially lower unemployment rate*" (NAIRU of low 4s or even 3s) is needed to generate wages growth in excess of 3%, which is the level the RBA thinks is needed to deliver inflation sustainably within the 2-3% inflation target. The Bank does not see this occurring "***until 2024 at the earliest***", which underpins their rates guidance.

The domestic bond market continues to suggest a prolonged low period of interest rates. Over the month, yields fell around 4bp at the long-end of the curve:



Source: AFMA, ASX, RBA

<u>RBA Governor Lowe has pushed back on market pricing of rate hikes as early as late 2022. Dr Lowe reiterated his 'best guidance' was that it is "*unlikely to see wages growth consistent with the inflation target before 2024. This is the basis for our assessment that the cash rate is very likely to remain at its current level until at least 2024*":</u>



Source: ASX

Disclaimer

Imperium Markets provides fixed income investment advisory services and a financial market platform through which clients and fixed income product providers may transact with each other.

The information in this document is intended solely for your use. The information and recommendations constitute judgements as of the date of this report and do not consider your individual investment objectives and adopted policy mandate.

Imperium Markets monitors the entire fixed income investible universe and recommends the best rate available to us, regardless of whether a product provider uses our market platform. You are responsible for deciding whether our recommendations are appropriate for your particular investment needs, objectives and financial situation and for implementing your decisions. You may use our platform to transact with your chosen product providers.

Imperium Markets charges a flat fee for our investment advice. Any commissions received are rebated to clients in full. If you choose a product provider who uses our market platform, the product provider pays us 1bp p.a. funding fee of the value of the investments transacted.

Investment Report

01/05/2021 to 31/05/2021

Portfolio Valuation as at 31/05/2021

Issuer	Rating	Type	Alloc	Interest	Purchase	Maturity	Rate	Value	Accrued	Accrued MTD
Members Equity Bank	BBB	TD	GENERAL	Annual	29/07/2019	29/07/2021	1.8000	2,000,000.00	30,279.45	3,057.53
NAB	AA-	TD	GENERAL	At Maturity	31/08/2020	31/08/2021	0.8000	4,000,000.00	24,021.92	2,717.81
NAB	AA-	TD	GENERAL	At Maturity	31/08/2020	31/08/2021	0.8000	3,000,000.00	18,016.44	2,038.36
Auswide Bank	BBB	TD	GENERAL	At Maturity	05/09/2019	06/09/2021	1.8000	3,000,000.00	93,945.21	4,586.30
Auswide Bank	BBB	TD	GENERAL	Annual	15/10/2019	15/10/2021	1.6500	2,000,000.00	20,704.11	2,802.74
Westpac	AA-	TD	GENERAL	Quarterly	31/10/2019	29/10/2021	1.6100	6,000,000.00	8,469.04	8,204.38
Auswide Bank	BBB	TD	GENERAL	At Maturity	31/10/2019	29/10/2021	1.6500	1,000,000.00	26,173.97	1,401.37
Nexus Mutual	BBB	TD	GENERAL	Annual	29/11/2019	29/11/2021	1.8000	3,000,000.00	27,073.97	4,586.30
Auswide Bank	BBB	TD	GENERAL	At Maturity	29/11/2019	29/11/2021	1.7000	1,000,000.00	25,616.44	1,443.84
ING Direct	A	TD	GENERAL	Annual	21/01/2020	21/01/2022	1.6500	4,000,000.00	23,687.67	5,605.48
ING Direct	A	TD	GENERAL	Annual	17/02/2020	17/02/2022	1.6000	6,000,000.00	27,353.42	8,153.42
ING Direct	A	TD	GENERAL	Annual	28/02/2020	28/02/2022	1.6000	1,000,000.00	4,164.38	1,358.90
ING Direct	A	TD	GENERAL	Annual	02/03/2020	02/03/2022	1.5000	4,000,000.00	14,958.90	5,095.89
Members Equity Bank	BBB	FRN	GENERAL	Quarterly	18/07/2019	18/07/2022	1.0241	1,260,025.00	1,508.09	1,087.23
Auswide Bank	BBB	TD	GENERAL	At Maturity	12/08/2019	12/08/2022	1.9500	3,000,000.00	105,620.55	4,968.49
AMP Bank	BBB	TD	GENERAL	Annual	31/08/2020	31/08/2022	0.8000	3,000,000.00	18,016.44	2,038.36
Westpac	AA-	FRTD	GENERAL	Quarterly	31/08/2017	31/08/2022	1.0860	2,000,000.00	59.51	59.51
Westpac	AA-	FRTD	GENERAL	Quarterly	31/08/2017	31/08/2022	1.0860	2,000,000.00	59.51	59.51

Issuer	Rating	Type	Alloc	Interest	Purchase	Maturity	Rate	Value	Accrued	Accrued MTD
Westpac	AA-	FRTD	GENERAL	Quarterly	18/09/2017	19/09/2022	1.0350	2,000,000.00	4,253.42	1,758.08
BOQ	BBB+	TD	GENERAL	Annual	06/09/2019	06/09/2023	1.9000	2,000,000.00	27,797.26	3,227.40
BOQ	BBB+	TD	GENERAL	Annual	21/01/2020	22/01/2024	1.9500	2,000,000.00	13,997.26	3,312.33
NAB	AA-	FRN	GENERAL	Quarterly	19/06/2019	19/06/2024	0.9493	2,039,252.00	3,849.22	1,612.51
Suncorp	A+	FRN	GENERAL	Quarterly	30/07/2019	30/07/2024	0.8200	1,265,217.50	898.63	870.55
BOQ	BBB+	TD	GENERAL	Annual	29/10/2020	29/10/2024	0.9500	3,000,000.00	16,787.67	2,420.55
ICBC Sydney Branch	A	TD	GENERAL	Annual	10/11/2020	11/11/2024	1.0800	2,000,000.00	12,013.15	1,834.52
Northern Territory Treasury	AA-	BOND	GENERAL	Annual	30/10/2020	16/12/2024	0.9000	3,000,000.00	12,427.40	2,293.15
Newcastle Permanent	BBB	FRN	GENERAL	Quarterly	04/02/2020	04/02/2025	1.1620	1,427,186.60	1,247.96	1,247.96
ICBC Sydney Branch	A	TD	GENERAL	Annual	23/02/2021	24/02/2025	1.2000	2,000,000.00	6,443.84	2,038.36
BOQ	BBB+	TD	GENERAL	Annual	28/02/2020	28/02/2025	2.0000	1,000,000.00	5,205.48	1,698.63
NAB	AA-	TD	GENERAL	Annual	30/10/2020	29/10/2025	0.9600	2,000,000.00	11,256.99	1,630.68
ICBC Sydney Branch	A	TD	GENERAL	Annual	10/11/2020	10/11/2025	1.2500	4,000,000.00	27,808.22	4,246.58
ICBC Sydney Branch	A	TD	GENERAL	Annual	11/12/2020	11/12/2025	1.2000	2,000,000.00	11,309.59	2,038.36
Northern Territory Treasury	AA-	BOND	GENERAL	Annual	29/10/2020	15/12/2025	1.0000	3,000,000.00	13,808.22	2,547.95
ICBC Sydney Branch	A	TD	GENERAL	Annual	23/02/2021	23/02/2026	1.4500	2,000,000.00	7,786.30	2,463.01
Commonwealth Bank	AA-	CASH	GENERAL	Monthly	31/05/2021	31/05/2021	0.0000	15,938,256.97	-	-
AMP Bank	BBB	CASH	GENERAL	Monthly	31/05/2021	31/05/2021	0.5500	158,652.76	74.11	74.11
TOTALS								**102,088,590.83**	**646,693.73**	**94,580.13**