3.1. Investments and Loan Borrowings Held as at 31 October 2020

AUTHOR: Garry Ross, Manager Financial Services

ENDORSED BY: Margaret Palmer, Director Corporate Services

ATTACHMENTS:
1. Monthly Investment Report - October 2020 [**3.1.1** - 19 pages]

PURPOSE:

This report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 31 October 2020.

EXECUTIVE SUMMARY:

Investment Portfolio:
The Investment portfolio (cash and investments) held as at 31 October 2020 had a market value of $99.97 million, with an annualised return of 1.96% for the year to date,1.45% above the reportable BBSW Bank Bill Index of 0.51%. The total funds under investment decrease during October by $2.5 million. This movement reduced the cash balance of the portfolio as these funds were required to pay contractors for completed works associated with infrastructure improvement.

The actual investment returns for the year to date as at 31 October 2020 were $538,895 which was $9,210 less than the year to date budgeted estimate. During the month, only 2 term deposit matured. These funds will be re-invested at the current interest rate (official cash rate is 0.25% as at 31 October 2020) which will further reduce the performance of the portfolio. Council will see a decline in interest income over the next 12 months, with the RBA indicating interest rates need to be cut and remain low until their objectives of full employment and reduced inflation are reached.

Council's cashflows continue to improve as the COVID-19 pandemic impacts evolves which will in turn provide additional funds available to invest.

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 October 2020 is $7,681,414.01.

FINANCIAL IMPLICATIONS:

The 2020/21 budgeted returns on investments is estimated to be $1,350,000.00. The estimate will be reviewed and reported in the December Budget Review which will identify any changes to the current projections. The investment portfolio is managed to ensure liquidity to meet operational requirements.

Any surplus funds generated in excess of the adopted estimates will be transferred to Council's internally restricted reserves.

RECOMMENDATION:

1. THAT the report on Investments and Loan Borrowings held as at 31 October 2020 be received. (This report was provided to the Governance & Finance Committee on 9 November 2020 for information).

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 October 2020 and annualised for the year to date as at 31 October 2020 (including investments which have matured prior to 31 October 2020).

	October 2020	Annualised YTD as at 31 October 2020
Actual Return	0.13%	1.96%
Benchmark	0.01%	0.51%
Variance	0.12%	1.45%

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

Asset Type	Market Value as at 31 October 2020	Portfolio Breakdown as at 31 October 2020
Cash	$20,922,319.42	20.93%
Term Deposits	$65,000,000.00	65.02%
Floating Rate Notes (FRN's)	$8,049,272.60	8.05%
Fixed Bonds	$6,000,000.00	6.00%
	$99,971,592.02	**100.00%**

During the month, only 2 term deposit matured that were at considerably higher interest rates. The re-investment of these funds at lower rates will have an impact on future interest earnings. Council's average duration of term deposits which comprise two thirds of the investment portfolio is approximately 579 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 October 2020 have been reviewed and are $9,210.00 less than the revised budget.

Summary of Returns from Investments:

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (October)	YTD/Annual Actual (October)	YTD Budget to Actual Variance (October)
2020/21	**$1,350,000**	**$1,350,000**	**$548,104**	**$538,894**	**-$9,210**
2019/20	$1,500,000	$1,529,055		$1,896,660	$367,605
2018/19	$1,590,000	$1,730,000		$2,253,497	$523,497
2017/18	$2,300,000	$2,490,000		$2,589,813	$99,813
2016/17	$2,000,000	$3,000,000		$3,276,518	$276,518

Financial Investment Policy

The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio shall be:

Long Term Rating Range	Invested as at 31 October 2020	Maximum Policy Holding	Distribution as at 31 October 2020
AA Category	$51,867,435	100.00%	51.88%
A Category	$16,264,095	60.00%	16.27%
BBB Category	$30,840,062	35.00%	30.85%
Unrated ADIs (NR)	$1,000,000	10.00%	1.00%

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

Loan Borrowings

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

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

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

a) That the capital cost of infrastructure be recognised over the period during which the benefits will be enjoyed.

b) That loan funds are a resource to fund the replacement and upgrading of existing infrastructure and fund the creation of new infrastructure.

c) That loan funds will be limited to:
   - acquisition or enhancement of income producing assets.
   - construction and/or upgrading of buildings; and
   - infrastructure assets that have a life expectancy of greater than 10 years.

The current Debt Facility is as follows:

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

The current loan details are as follows:

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**
1/07/2019	$ 8,910,951.91			
31/7/2019	$ 8,711,603.51	$ 90,291.14	$ 199,348.40	$ 289,639.54
31/10/2019	$8,510,235.19	$88,271.22	$201,368.32	$ 289,639.54
31/01/2020	$8,306,826.48	$86,230.83	$203,408.71	$289,639.54
30/04/2020	$8,099,526.94	$82,340.00	$207,299.54	$289,639.54
31/07/2020	$7,891,956.69	$82,069.29	$207,570.25	$289,639.54
31/10/2020	$7,681,414.01	$79,096.87	$210,542.67	$289,639.54

The next loan instalment is due on 29 January 2021.

Loan Funded Capital Projects as at 31 October 2020:

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

Monthly Investment Report

October 2020

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 13, 333 George 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, of importance was the RBA cutting interest rates twice in March 2020, taking the official cash rate down to a record low of 0.25%. Shares (equities) experienced a significant correction in March but recovered substantially due to the unprecedented fiscal and monetary policy support from global central banks and governments, as well as pricing in an early distribution of a vaccine. Global equity markets suffered another selloff in September and October as investors remained nervous due to the rising infections in the US and Europe, and the lack of clarity with regards to the timing of additional fiscal stimulus measures in the US.

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 0.25% until its objectives of full employment and inflation are reached;
2. The extension of the Term Funding Facility (TFF) until 30 June 2021, allowing all ADIs to access cheap funding directly from the RBA at a cost of 0.25% for 3 years (the facility was increased from an original $90bn to $200bn);
3. RBA Governor Lowe has commented that he has not seen any signs of stress in the financial system from this crisis because unlike the GFC, the banks have cash and are well capitalised. He also suggested that Australia had "*fantastic fundamentals*" and had so far been effective at containing the virus and providing policy stimulus;
4. The RBA Board expects rates would be low "*for a very long period of time*" and has continued to suggest **they could ease policy further by cutting the cash rate, 3-year yield target and TFF rate by 15bp to 0.10% (from 0.25%), as early as 3rd November**.

The biggest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits, which accounts for around ~65% 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 1.54% p.a. at month-end, with a weighted average duration of around 579 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 0.60%-0.90% p.a. may potentially be the "norm" over the next few financial years.

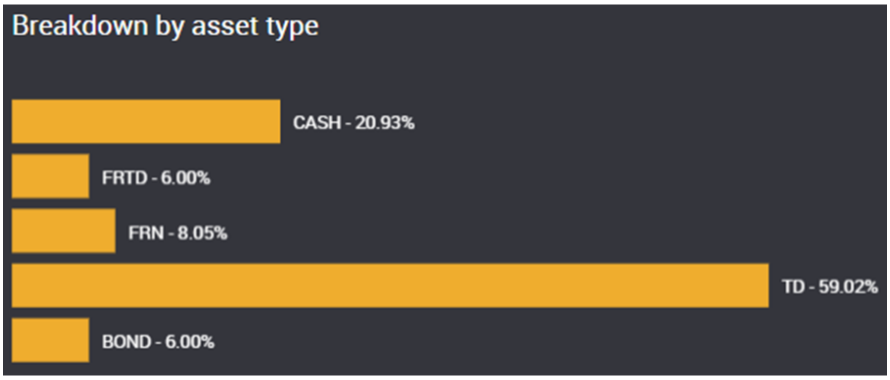
Council's Portfolio & Compliance

Asset Allocation

As at the end of October 2020, the portfolio was mainly directed to fixed and floating rate term deposits (65.02%). The remaining portfolio is directed to FRNs (8.05%), fixed bonds (6.00%) and overnight cash accounts (20.93%).

We would consider increasing the allocation to liquid senior floating rate notes (FRNs), if there are any remaining attractive securities in the primary or secondary market. This will not only offer additional upside with regards to the portfolio's investment returns, but also provide additional liquidity (FRNs are saleable – generally accessible within 2 business days). FRNs are also dominated by the higher rated ADIs which allows Council to maintain a bias towards the higher rated banks.

With the RBA flagging the possibility of a further interest rate cut as early as 3rd November, the priority should be to lock in any attractive medium-longer dated fixed deposits that may still be available to address reinvestment risk.



Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 20% of assets directed to medium-term assets (2-5 years) and an additional 3% is maturing in the long-term (5-10 years). There is still high capacity to invest in the medium-term horizon, with approximately $30m 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 and fixed bonds to address reinvestment risk.

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$23,922,319	23.93%	10%	100%	$76,049,273
✓	91 - 365 days	$21,000,000	21.01%	20%	100%	$78,971,592
✓	1 - 2 years	$32,260,040	32.27%	0%	70%	$37,720,074
✓	2 - 5 years	$19,789,233	19.80%	0%	50%	$30,196,563
✓	5 - 10 years	$3,000,000	3.00%	0%	25%	$21,992,898
		$99,971,592	**100.00%**			

Counterparty

As at the end of October, Council had immaterial overweight positions to ING (A), BoQ (BBB+) and Auswide (BBB), all by less than $5k. This was due to the portfolio's overall balance shrinking over the month. Overall, the portfolio is well diversified across the entire credit spectrum, including some exposure to the unrated ADIs.

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA (BankWest)	AA-	$22,821,267	22.83%	30.00%	$7,170,210
✓	NAB	AA-	$11,046,168	11.05%	30.00%	$18,945,310
✓	NTTC	AA-	$6,000,000	6.00%	30.00%	$23,991,478
✓	Westpac	AA-	$12,000,000	12.00%	30.00%	$17,991,478
✓	Suncorp	A+	$1,264,095	1.26%	15.00%	$13,731,644
X	ING Bank	A	$15,000,000	15.00%	15.00%	**-$4,261**
X	BOQ	BBB+	$10,000,000	10.00%	10.00%	**-$2,841**
✓	AMP Bank	BBB	$3,157,882	3.16%	10.00%	$6,839,277
X	Auswide Bank	BBB	$10,000,000	10.00%	10.00%	**-$2,841**
✓	Beyond (Nexus)	BBB	$3,000,000	3.00%	10.00%	$6,997,159
✓	ME Bank	BBB	$3,260,040	3.26%	10.00%	$6,737,119
✓	Newcastle PBS	BBB	$1,422,140	1.42%	10.00%	$8,575,020
✓	WAW CU	Unrated	$1,000,000	1.00%	5.00%	$3,998,580
			$99,971,592	**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.

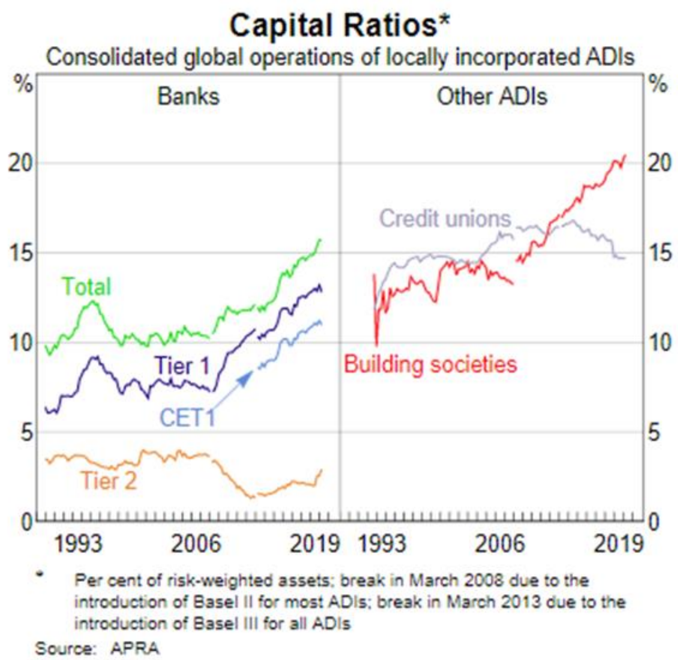
We remain supportive of the regional and unrated ADI sector (and have been even throughout the GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 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 recently 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. Interest rates are now at their effective lower bound of 0.25% and could potentially drop to 0.10% as early 3rd November.



Credit Quality

The portfolio remains well diversified from a credit ratings perspective. As at the end of October 2020, all categories were within the Policy limits.

From a ratings perspective, the BBB rated entities now generally dominate the number of ADIs issuing deposits within the investment grade space. We anticipate more investors will naturally allocate a higher proportion of their assets into this sector (on a historical basis), considering the most attractive assets from senior debt securities are generally offered by these ADIs.

Council may consider lifting the aggregate limit with the BBB and unrated ADI category at its next policy review.

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$51,867,435	51.88%	100%	$48,104,157
✓	A Category	$16,264,095	16.27%	60%	$43,718,860
✓	BBB Category	$30,840,062	30.85%	35%	$4,149,995
✓	Unrated ADIs	$1,000,000	1.00%	10%	$8,997,159
		$99,971,592	**100.00%**		

Performance

Council's performance for the month ending 31 October 2020 is summarised as follows:

Performance	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.02%	0.06%	0.13%	0.08%	0.42%
AusBond Bank Bill Index	0.01%	0.03%	0.05%	0.04%	0.51%
Council's T/D Portfolio	0.13%	0.43%	0.93%	0.60%	1.97%
Council's FRN Portfolio	0.09%	0.28%	0.88%	0.42%	1.85%
Council's Portfolio^	**0.13%**	**0.42%**	**0.93%**	**0.58%**	**1.96%**
Outperformance	**0.12%**	**0.39%**	**0.87%**	**0.54%**	**1.45%**

^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 +0.13% (actual), outperforming the benchmark AusBond Bank Bill Index return of +0.12% (actual). 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 +1.96% p.a., outperforming bank bills by 1.45% 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 August 2020 Council Rankings). We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio. Of the 25 individual deposits North Sydney Council held, 9 are still yielding higher than 1.75% p.a. That is, around 36% 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 October 2020, Council's deposit portfolio was yielding an **attractive 1.54% p.a.** (down 10bp from the previous month), with an average duration of around 579 days (~1.6 years). We recommend Council maintains or even 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 0.25% (and potentially lower).

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	1.20% p.a.
ICBC, Sydney	A	4 years	1.05% p.a.
NAB	AA-	5 years	0.90% p.a.
ICBC, Sydney	A	3 years	0.90% p.a.
BoQ	BBB+	5 years	0.90% p.a.
BoQ	BBB+	4 years	0.85% p.a.
ICBC, Sydney	A	2 years	0.80% p.a.
BoQ	BBB+	3 years	0.75% p.a.
BoQ	BBB+	2 years	0.65% 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 regional ADIs (dependent on daily funding requirements):

ADI	LT Credit Rating	Term	T/D Rate
AMP	BBB	12 months	^0.80% p.a.
AMP	BBB	6-11 months	^0.75% p.a.
BoQ	BBB+	9-12 months	0.60% p.a.
MyState	BBB+	12 months	0.60% p.a.

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

Amongst the higher rated ADIs ("A" rated or higher), the following deposits remain attractive for terms under 12 months:

ADI	LT Credit Rating	Term	T/D Rate
CBA	AA-	12 months	~0.57% p.a.
ICBC, Sydney	A	12 months	~0.55% p.a.
NAB	AA-	12 months	0.54% p.a.
Westpac	AA-	12 months	~0.54% p.a.
NAB	AA-	3-9 months	0.50% p.a.

Senior FRNs & Recommendations

Over October, amongst the senior major bank FRNs, physical credit securities tightened significantly (valuations rose) by around 22bp at the longer-end of the curve, on expectations the RBA would provide more easing measures which includes buying longer-dated bonds. Those investors that require liquidity with a domestic major bank (highly rated) and can roll down the curve should invest in 5 year terms over 3 year terms (or shorter), given the ability to lock in capital gains in subsequent years.

A new 5 year senior major bank FRN would now be issued around +40bp, appearing expensive on a historical basis. We expect minimal primary issuance from the domestic banks in the immediate future given the RBA's $200bn term funding facility (TFF) to the ADIs, offering a rate of 0.25% (which is likely to be reduced to 0.10% shortly) for 3 years, and has now been extended to June 2021. The lack of supply from new (primary) issuances has played a major role with the rally in credit markets over recent months.

During the month, United Overseas Bank (AA-) issued a 5 year benchmark issue at +59bp, initially tightening from guidance of +64bp, printing $750m.

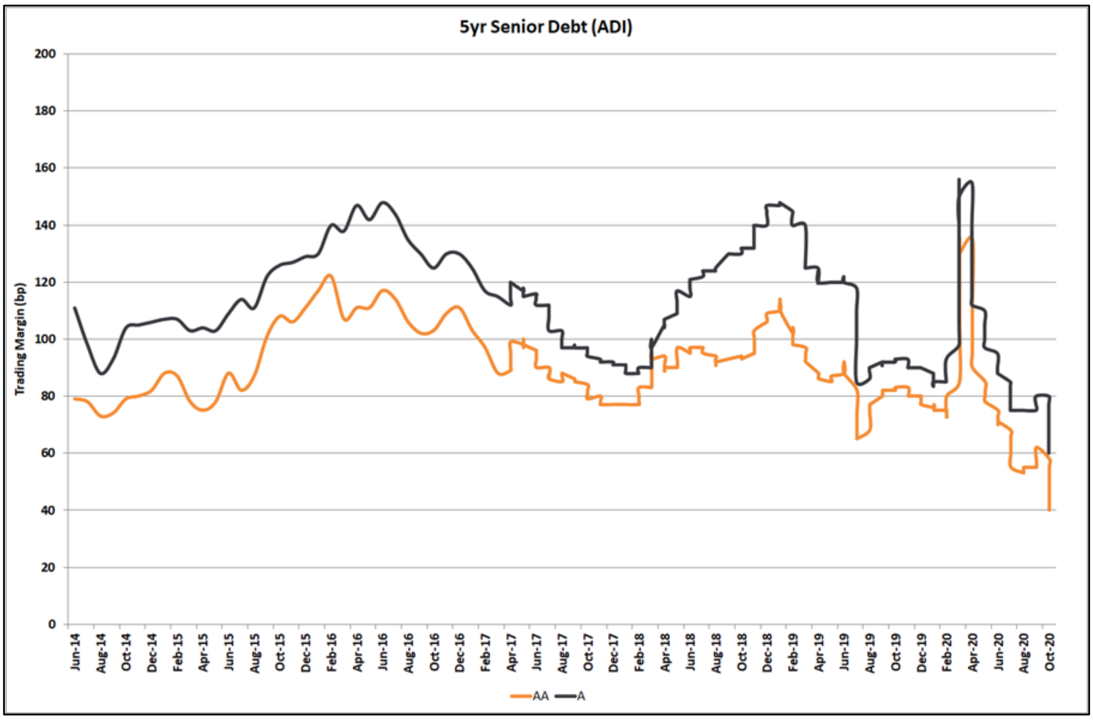
Amongst the "A" and "BBB" rated sector, the senior securities were marked around 13-20bp wider over October. During the month, Mizuho Sydney Branch (A) issued a 3 year benchmark issue at +53bp, initially tightening from guidance of +65bp, reflecting the high demand and minimal issuance. It was over two times oversubscribed with the deal printing $700m. Meanwhile, Bank of China, Sydney Branch (A) and Bank of China (Australia) Ltd (A-) both issued new 3 year deals at +78bp and +83bp respectively.

While turnover in the secondary market is still predominately dominated by the major banks, given the lack of supply, we have started to observe that even a handful of regional bank senior paper has sometimes been trading inside "mid" levels over recent months.

Credit margins are now trading very tight on a historical level and look expensive. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/10/2020	30/09/2020
"AA" rated – 5yrs	+40bp	+62bp
"AA" rated – 3yrs	+22bp	+38bp
"A" rated – 5yrs	+60bp	+80bp
"A" rated – 3yrs	+41bp	+55bp
"BBB" rated – 3yrs	+70bp	+83bp

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 2023 for the “AA” rated ADIs (domestic major banks)**;
- On or before 2021 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.

IMPERIUM MARKETS

Council's Senior FRNs Sale/Switch Recommendations

In early 2021, we recommend Council switches out of the following FRN:

- $2.00m CBA (AA-) FRN maturing 11/01/2024 (ISIN: AU3FN0046561) – trading margin marked around **+23.5bp** or capital price of $102.84 (capital gain **~$56,000**).

The above sale would result in capital gains totalling ~**$56,000** and would most likely be switched into a higher yielding complying FRN or term deposit. At this stage, we prioritise switching into any remaining attractive medium-longer dated fixed deposit given the depressed state of interest rates.

Senior Bonds

During the month, 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 will receive the full rebated commission of 0.25% on the total face value of investments (i.e. $15,000) as it was introduced by Imperium Markets.

We believe this was prudent given the low rate environment. Both parcels are now being offered at a yield of 0.20% p.a. lower in the prevailing marketplace.

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

October saw some risk aversion with global equity markets parring back some of their gains experienced from previous months. Equity markets have almost entirely ignored the coronavirus and its economic impacts, pricing in a rapid V-shaped recovery and an early distribution of a vaccine.

In the US, **the S&P 500 fell -2.77%, while the NASDAQ lost -2.29%**. Across the main European markets, **Germany's DAX plunged -9.44%**, UK's FTSE lost -4.92% and France's CAC by -4.36%.

The US unemployment rate fell by 0.5% to 7.9% in September, which was partially driven by the 0.3% drop in the participation rate. To date, just over half (11.4 million) of the jobs lost since the pandemic first hit the US, have been recovered.

The FOMC Minutes hinted that the Fed is willing to do more if necessary and opens the door to post-election easing if necessary. The Minutes noted that "*many*" participants had "*assumed additional fiscal support and that if future fiscal support was significantly smaller or arrived significantly later than they expected, the pace of the recovery could be slower than anticipated*".

US House Leader Pelosi said stimulus talks had come to an "*impasse*", while Senate Republicans have pushed back on the White House's US$1.8 trillion proposal. A stimulus deal only now appears likely to be completed after the November 3 election.

Tough social restrictions were imposed in many European cities, with the virus infection rates in countries including France, Spain, the Netherlands, Belgium and the UK rising to be above 250 per million, higher than the US during its July peak.

The International Monetary Fund (IMF) upgraded its global growth forecasts, seeing GDP now shrink by "*only*" -4.4% this year compared to the -5.2% projected in June, with the Chief Economist describing the recovery as a "*long, uneven and uncertain ascent*".

China's August industrial profits were reported up a healthy +19.1% versus +19.6% in July (back in March, close to the peak of China's covid-19 lockdowns, they were -35% y/y). **Q3 GDP for China grew by +4.9% on an annual basis (or +2.7% q/q)**, following +3.2% growth in the second quarter. Retail sales grew +3.3% in September from a year earlier, posting the fastest growth since December 2019.

RBNZ's Orr also reiterated the RBNZ is set to ease policy next year and talked up the merits of negative interest rates, saying they "*can be highly effective and highly efficient*".

The MSCI World ex-Aus Index fell -3.20% for the month of October:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-2.77%	-0.04%	+7.65%	+8.29%	+9.48%	+10.70%
MSCI World ex-AUS	-3.20%	-0.48%	+3.02%	+4.22%	+6.20%	+6.74%
S&P ASX 200 Accum. Index	+1.93%	+0.98%	-8.15%	+4.09%	+6.80%	+6.94%

Source: S&P, MSCI

Domestic Market

The RBA kept monetary policy unchanged in its October meeting but strengthened its easing bias, clearing the way for cut on 3rd November. The final paragraph in its statement revealed it **"*continues to consider how additional monetary easing could support jobs as the economy opens up further*".**

The Government delivered its budget with an underlying cash deficit for 2020-21 expected to be appropriately $213.7bn (11.0% of GDP). Gross debt is expected to be $872bn (44.8% of GDP) in 2020-21 and peak at 55% of GDP in 2025-26. Some of the notable highlights from the budget included bringing forward and backdating the Stage 2 Income Tax Cuts to July 2020, which is worth $12.5bn in 2020-21, as well as asset write-offs and tax offsets to businesses with turnover less than $5bn.

Residential building approvals fell -1.6% m/m in August with the level of approvals remaining near 2012 levels. The decline was solely driven by apartments which fell a sharp -11%, while detached housing rose +4.8%.

Retail sales in August fell -4.0% m/m, close to the consensus estimate of -4.2%. Excluding Victoria (which was under lockdown), retail sales fell by a much smaller -1.3% m/m.

Employment fell -29.5k in September with a clear drag from Victoria's second lockdown offsetting the recovery being experienced in other states. **The unemployment rate rose to 6.9% (from 6.8%)**, with the overall participation rate remaining unchanged at 64.8% (although it dropped significantly in VIC).

Headline CPI rose by a sharp +1.6% q/q in Q3, following Q2's record fall of -1.9% q/q. The rise in Q3 was driven by the end of temporary free childcare and other subsidies, and a rebound in petrol prices. Annual inflation is now back into positive territory at +0.7%. **The trimmed mean CPI rose +0.4% in Q3, keeping annual inflation at +1.2% y/y**.

The government announced a $800m digital technology package; around $680m will go to upgrading government IT infrastructure and $120m for helping private businesses digitise.

The Australian dollar finished -0.90% lower at US70.44 cents (from US71.08 cents the previous month).

Credit Market

The main global credit indices were mixed over October, with spreads tightening in the US and Europe on the back of rising infection rates. Conversely, the credit index in Australia tightened. The indices now trade back to their levels experienced earlier this year (February 2020):

Index	October 2020	September 2020
CDX North American 5yr CDS	66bp	59bp
iTraxx Europe 5yr CDS	65bp	59bp
iTraxx Australia 5yr CDS	71bp	76bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	October 2020	September 2020
Bloomberg AusBond Bank Bill Index (0+YR)	+0.01%	+0.01%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.28%	+1.08%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.32%	+0.02%
Bloomberg AusBond Credit Index (0+YR)	+0.56%	+0.48%
Bloomberg AusBond Treasury Index (0+YR)	+0.12%	+1.28%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.09%	+1.39%

Source: Bloomberg

Other Key Rates

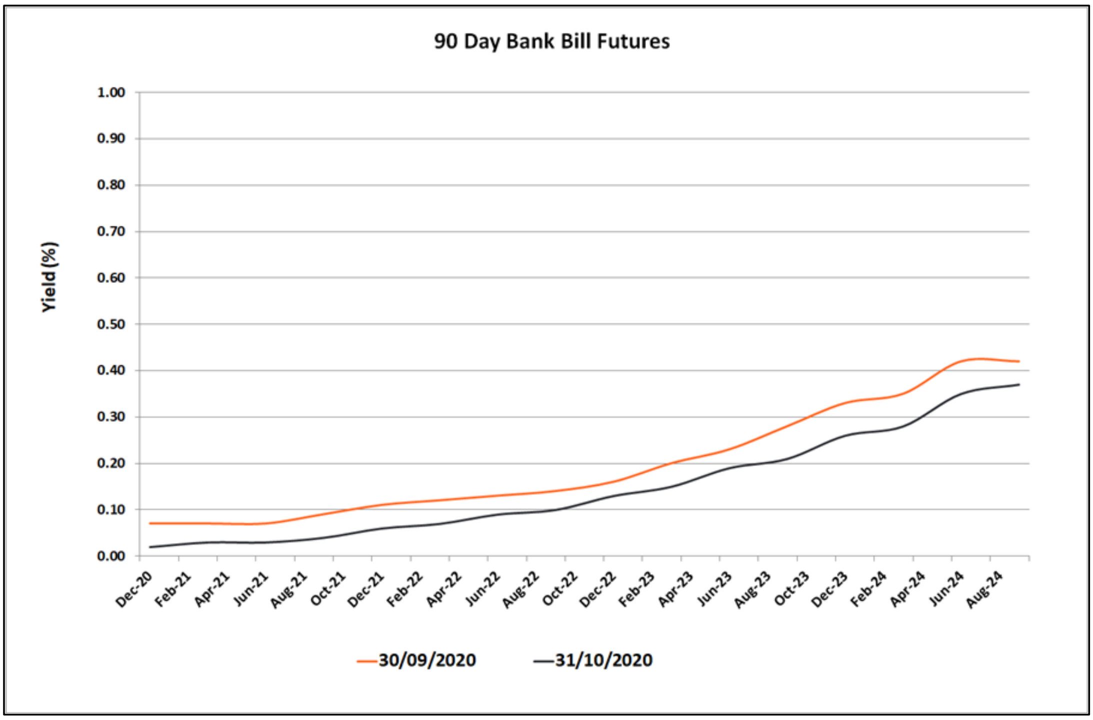
Index	October 2020	September 2020
RBA Official Cash Rate	0.25%	0.25%
90 Day (3 month) BBSW Rate	0.06%	0.09%
3yr Australian Government Bonds	0.13%	0.17%
10yr Australian Government Bonds	0.83%	0.84%
US Fed Funds Rate	0.00%-0.25%	0.00%-0.25%
10yr US Treasury Bonds	0.88%	0.69%

Source: RBA, AFMA, US Department of Treasury

IMPERIUM MARKETS

90 Day Bill Futures

Over October, bill futures fell across the board after the RBA continued to signal further monetary policy easing. This includes cutting the official cash rate, 3 year target yield and the Term Funding Facility (TFF) to 10bp (from 25bp) and additional quantitative easing (QE) measures, likely targeting longer-dated bonds.



Source: ASX

Fixed Interest Outlook

The US Fed has reiterated it is committed to "*using its full range of tools to support the US economy*" and has signalled it is not considering raising interest rates at least until the end of 2023, as highlighted by its latest 'dot plots'. The Fed has indicated it is willing to do more if necessary and opened the door to post-election easing if necessary.

The futures market pushed back expectations of the next Fed rate hike after it announced it aims to achieve a "*moderately above 2% inflation for some time*". The futures market does however continue to price in the possibility that the US Fed may need to take rates into negative territory over the next 6-12 months (factoring in around a 15% chance by end of June 2021, although the Fed remains adamant this is not required).

Domestically, the RBA has signalled it is considering additional policy easing measures. This includes cutting the official cash rate, 3 year target yield and the Term Funding Facility (TFF) to 0.10% (from 0.25%) and potentially quantitative easing (QE), targeted at longer-dated yields.

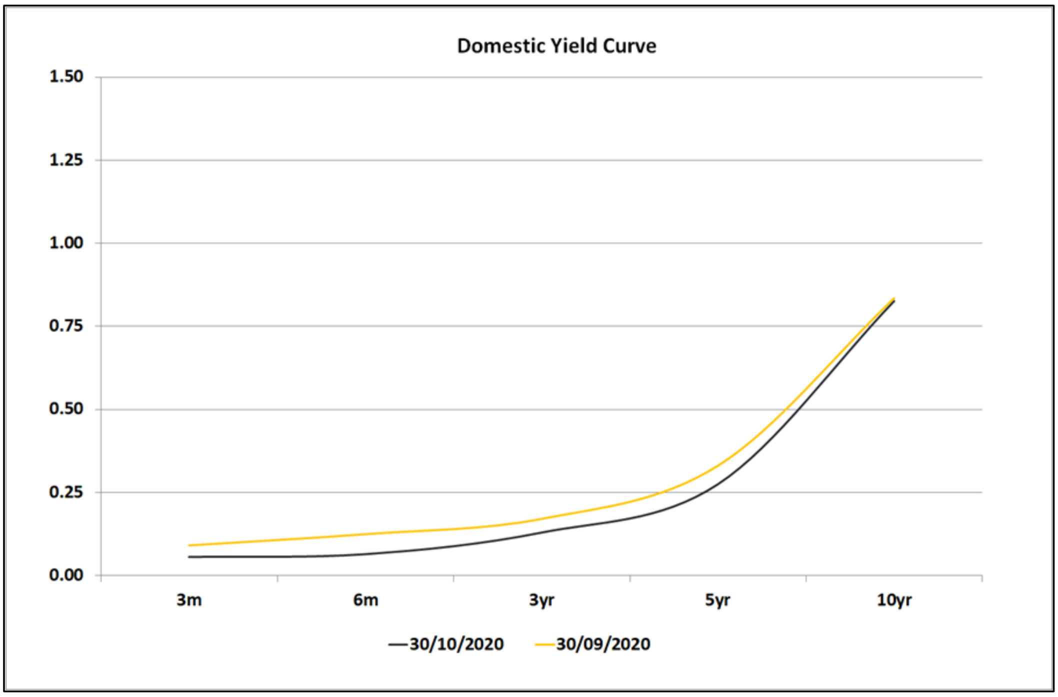
Their longer-term forward guidance is to keep committing the official cash rate unchanged (0.25%) or at potentially lower levels (0.10%) until there is a sustainable recovery and its economic objectives of full employment (unemployment rate of 4.5%-5.0%) and target inflation (2-3%) are on track.

Deputy RBA Governor Debelle has suggested that it would be ***"more than three years before sufficient progress was being made towards full employment to be confident that inflation will be sustainably within the target band"*** and that it is ***"highly unlikely that the cash rate will be raised over that time horizon".***

RBA Governor Lowe has commented that unlike during GFC, **the banks have cash and are well capitalised**, and that they are **not seeing any signs of stress in the financial system**.

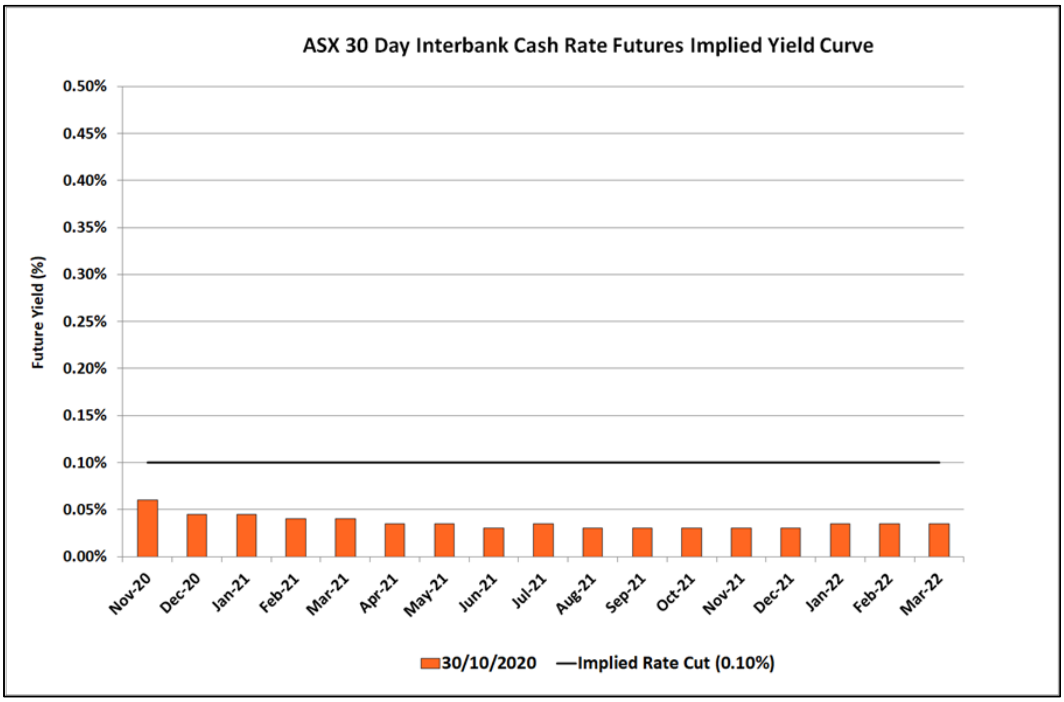
For now, the RBA is not contemplating adopting negative rates, indicating this would be "*extraordinarily unlikely*", citing the mixed empirical evidence on negative rates. In the short-term, it would be effective in lowering the exchange rate, but in the medium term*, "their effectiveness can wane including through the effect on the financial system. Negative rates can also encourage more saving*".

The domestic bond market continues to suggest a 'lower-for-longer' period of interest rates. Over the month, yields fell up to 6bp at the long-end, with 10-year government bond yields finishing at 0.83%:



Source: AFMA, ASX, RBA

The futures market was pricing in around an 84% chance that the RBA would cut interest rates to 0.10% (from 0.25%) on the 3rd November:



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.