Alexander Funds

The Alexander Perspective

Quarterly Update
June 2022

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CEO's Update

Welcome to our June 2022 quarterly update.

The term "unprecedented" is possibly one of the most overused words in financial markets in recent years but, perhaps now more than ever, it has merit. Inflation and interest rates continue to rise, as does global political turmoil and its effect on financial markets. Credit markets have not been immune to these events, but as you will discover throughout this report, our active approach to risk management and investing have kept our funds well positioned over the past year.

While the 2022 financial year was a challenging one for all investors, I am incredibly proud of the results we were able to achieve for our clients in both the Credit Opportunities Fund and Credit Income Fund. Both portfolios closed out the financial year with positive net returns and significantly outperformed their respective benchmarks.

Alexander Funds experienced significant growth in funds under management this year, mirroring the growth and development of our team and expertise. We have been working hard with external ratings agencies and investment platforms in order to increase accessibility for advisers and investors and are encouraged by the positive independent ratings we have received from Foresight Analytics, Lonsec Research, SQM Research and Zenith Investment Partners.

The Credit Opportunities Fund was also recognised by a number of Financial Publications, winning the Fixed Income – Credit category at the Financial Standard Investment Leadership Awards in June and receiving a nomination for the upcoming Financial Newswire Fund Manager of the Year awards.

This year has seen an increased focus on our Environmental, Social and Governance (ESG) and Responsible Investment framework. Among our notable accomplishments is the extension of our procedures to formalise responsible investment practices, in particular the development of our Responsible Investment Policy and formation of the Alexander Funds ESG Committee. We're dedicated to engaging with investors in this area and you can now view our ESG related policies on our website. In addition, we have committed to the United Nations' Principles of Responsible Investment and will begin reporting on our progress in 2023. At a time when political uncertainty and environmental values are at the forefront of global investors' concerns, we believe that these factors are crucial for maintaining the quality and longevity of our portfolios.

In the following pages our investment team provides more in-depth comments on the Funds' performance and overall economic landscape. As always, thank you to all our investors' support throughout the 2022 financial year, and I look forward to providing future updates as we continue through this unprecedented environment into 2023.

Warm Regards

Rachel Shirley
CEO

Market Commentary

The Interest Rate Bear Market and its Implications for Credit

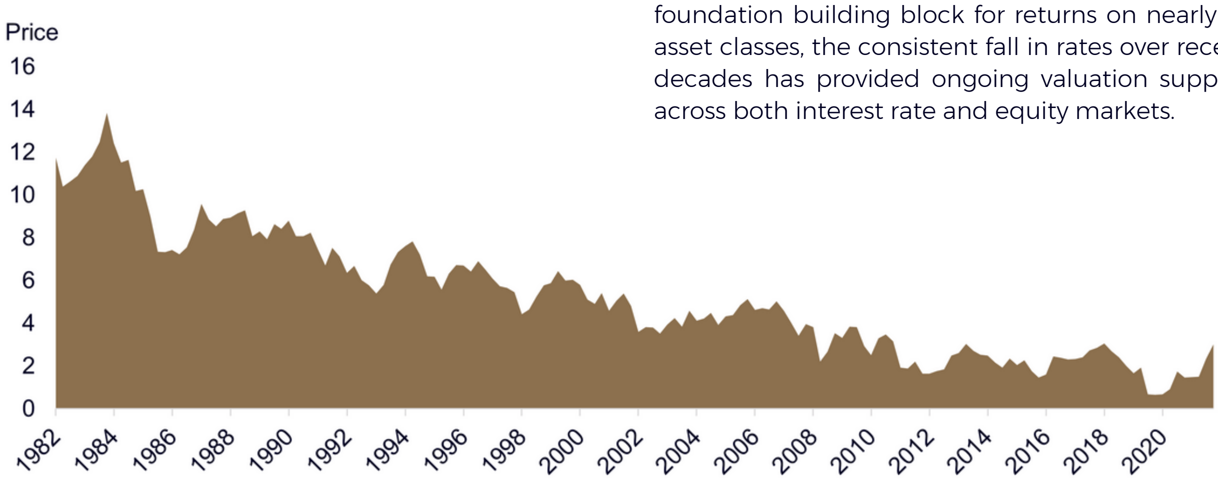
Adam Scully, Senior Portfolio Manager

As the 2022 Financial Year draws to a close, the domestic and global economy sits in a dramatically different position compared to the same time 12 months earlier.

As the acute phase of the COVID pandemic has faded, the world has moved from one in which deflationary forces generally prevailed and remained at the forefront of investors' minds to an environment of rising inflation with prices increasing at levels not seen in close to 40 years. This is a profound shift in the world we live in and the operating environment for financial markets.

Whilst the ongoing effect of this change in inflationary regime will likely play out in markets over several years, the impact in FY 2022 has already been substantial. This effect has been magnified because the starting position 12 months ago was for a world teetering on the brink of a deflationary recession due the impact of COVID.

Chart 1 - US 10 Year 1982 - 2022



Source: Bloomberg

Over FY 2022 the risk asset that has undergone the largest adjustment is the interest rate market. Whilst Alexander Funds is a credit specialist and does not take any active position in interest rate risk, as the level and direction of interest rates is central to valuation in almost all asset classes it is worth exploring the change, why it's occurred and its implications for the Alexander Funds portfolios and the credit markets we invest in.

The long-term trend in interest rates prior to the last 12 months has been lower, albeit with intermittent periods of rising rates. This dynamic has its cause in a number of different factors including:

- Globalisation driving lower production prices
- An ageing of populations within most developed world economies with older citizens generally consuming less than younger citizens (outside of some specific industries such as healthcare)
- A willingness by central banks to use monetary policy more aggressively to combat growth related downturns in financial markets (particularly equities)

As the level of prevailing interest rates provides the foundation building block for returns on nearly all asset classes, the consistent fall in rates over recent decades has provided ongoing valuation support across both interest rate and equity markets.

Market Commentary

In many ways, the increasing level of central bank support to markets reached its zenith in response to COVID, with policy rates being immediately shifted to zero and several other market support mechanisms created. In Australia, the RBA launched the Term Funding Facility (TFF) which effectively provided banks with near zero rate, 3 year money for them to on-lend to consumers. Combined with a program to cap 3 year government bond interest rates at 0.25%, interest rates in Australia reached their lowest level in history.

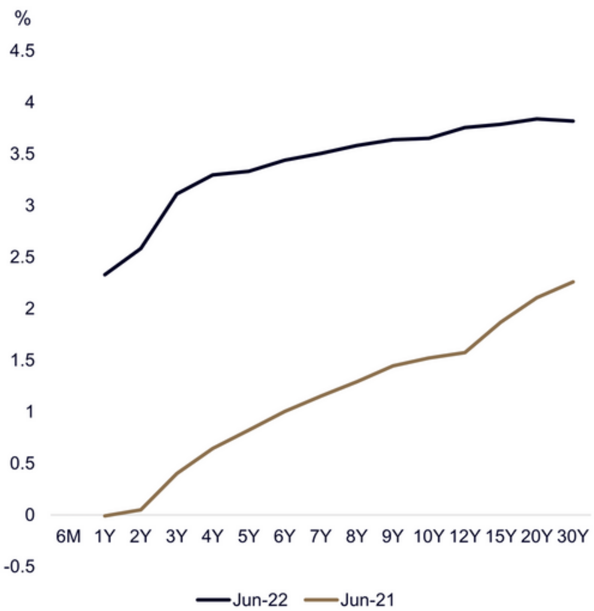
However, over the last 6 months of CY 2021 things began to change, the TFF ceased as planned on 30 June 2021 and in late October, the RBA stepped back (unbeknownst to the market) from its promise to protect the 0.25% level in 3-year government bonds. The impact was immediate, with the Bloomberg AusBond Govt 0+ Yr Index (an index measuring the market of Australian government bonds) producing its second worst month (-3.7%) since inception (July 1998). The government bond market was able to recover some of that loss in the following month but the respite was short lived as unfolding economic data continued to demand higher rates despite the RBA's protest that it expected to leave cash rates near zero for another 2 years.

Geopolitics, supply chain disruptions, a lack of immigration and an economy generally awakening from a COVID slumber had began to put increasing pressure on price levels within the economy. While there was a reasonable argument that some of this pressure was "transitory", over the last 9 months evidence has continued to build that rising inflation has a structural element to it and maintaining emergency policy rates was no longer appropriate.

In response, the RBA raised rates for the first time since 2010 in May (and again in June) and the government bond market has continued to raise its estimate of where it thinks interest rates will settle. The impact to returns on government bonds has been substantial with the Bloomberg AusBond Govt 0+ Yr index down 11.5% for the year ending 30 June 2022.

The RBA raised its official cash rate by 0.5% to 1.35% in July and the market is expecting further rate rises to follow with an additional 0.5% by September and close over 2% by the end of the calendar year. Whilst many market commentators argue that the interest rate market has become too aggressive in its future expectation for further hikes, there is no dissent that they will be higher by the end of the calendar year.

Chart 2 - Australian Sovereign Yield Curve



Source: Bloomberg

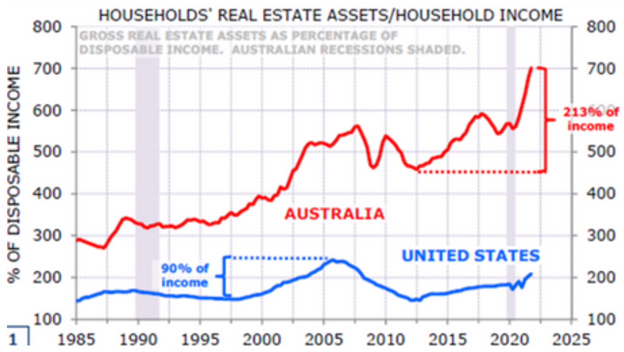
While there have been some elements of this change unique to Australia, the broad trend is similar across other developed world markets, including the US.

As a result the key questions for financial markets from 12 months ago (what does the path back to growth after COVID look like? When will central banks be in a position to begin monetary policy normalisation?) have shifted to concerns around how monetary policy will find a balance between taming inflation without needlessly suppressing growth and potentially causing recession?

In the US and Australia, the answer to this question has seen both equites and interest rate markets suffer over FY 2022 as the market increases its probability of a looming recession brought on by persistently rising inflation and the consequent rise in rates required to bring it back under control.

While the market has dramatically lifted its probability of a recession in the US in the next 12 months on the back of rising rates, in Australia the potential impact is more dramatic given the significant amount of leverage carried by households.

Chart 3 - Household Real Assets / Household Income: Australia vs US

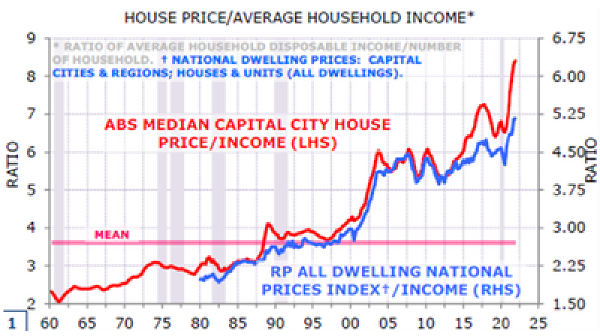


Source: Minack Advisors

In addition, in comparison to the US where residential mortgages are offered in a 30 year, fixed rate format – Australian mortgages are floating rate (albeit some may have a fixed coupon initially) and as such any rise in interest rates flows much more efficiently into household budgets.

Rising rates lowers potential borrowing capacity which (all else being equal) creates a deflationary impact to asset prices. Specifically in domestic housing, some of this impact should be offset by wage inflation but given the already stretched ratio of domestic housing price/household income it will unlikely be significant enough to offset the impact of rising rates.

Chart 4 - House Price/Income Ratio : Australia



Source: Minack Advisors

What does this mean for our portfolios and credit markets?

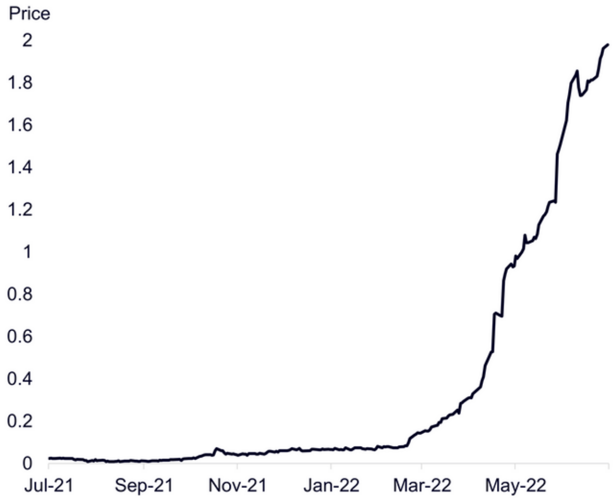
Alexander Funds investment process takes no active position on interest rates and as a result our portfolios have been immune from the direct impact on capital value suffered in the fixed rate bond market due to rising rates. However, there are secondary implications for our funds and the markets we invest in, including;

The overall yield of the funds

Floating rate credit securities reset the coupon they're paid to reflect changes in the interest rate index on which the coupon is based. This index is typically the bank bill swap rate (which is set as the rate banks are willing to lend to each other). In line with rising rates, this number has also increased over the course of FY 2022. Whilst there is some lag in impact of this change as generally credit securities reset quarterly, over time this will (all else being equal) lift the yield on the funds

Market Commentary

Chart 5 - 3 month BBSW

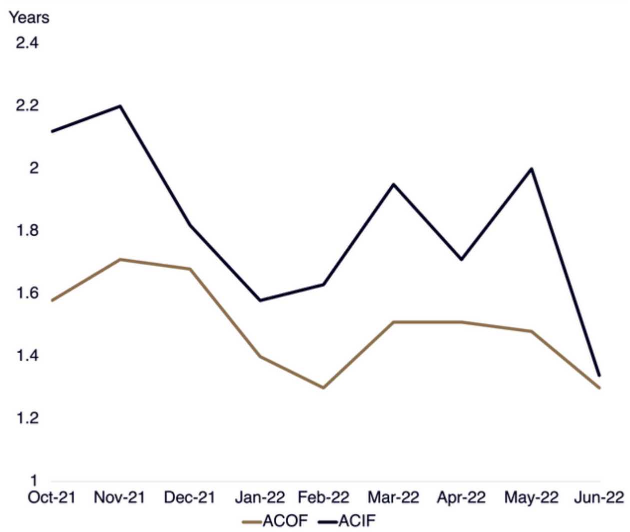


Source: Bloomberg

Growth expectations and valuations

In an environment of lower (or potentially negative) growth, the market will demand a higher return from most asset classes to compensate for the additional risk associated with investing. Whilst the impact of lower growth is more muted in credit versus other asset classes (such as equites) it is not completely immune.

Chart 6 - Historical Credit Duration



This dynamic has already impacted credit markets both domestically and abroad with credit spreads (the extra yield the market demands from a credit security in compensation for the risk) drifting consistently wider over the course of the last 12 months. This increase in credit spread is more impactful to capital value the longer a security has till maturity. In anticipation of a more challenging market environment, Alexander Funds has maintained a portfolio with more shorter dated securities to minimise this risk, helping mitigate what has generally been a difficult 12 months in credit markets.

Fundamental Credit Risk

An environment of rising rates can potentially challenge the credit fundamentals of securities we invest in. For example a company may be caught between rising input costs with no meaningful ability to raise prices with its customers. Often these fundamental challenges are company specific, however, there is a broad based fundamental risk in credit markets relating to how rising rates impact the Australian residential property market.

Whilst a dramatic fall in residential property prices has the potential to permeate through all parts of the Australian economy, in the credit space it would be most felt in the banks and RMBS market, particularly if it's combined with a large rise in unemployment which in turn drives a rise in defaults.

While the Alexander Funds portfolios has steadily reduced its RMBS holdings over the past 3 years, this change has been more a reflection of superior return for risk available in other segments of the credit market rather than a wholesale fear of RMBS credit losses.

Market Commentary

Why can we be relatively sanguine about the impact of falling property prices on RMBS assets that are directly invested in residential mortgages? The detail here is vital to assessing the risk.

- RMBS securities naturally reduce in leverage over time as people pay back their loans both through monthly mortgage repayments and selling houses – these funds all work towards lowering the leverage within the RMBS.
- In the Alexander Funds portfolio, the average loan-to-value ratio of the individual mortgages that make up our RMBS securities is 63% and have an average life (called seasoning) of ~2.5 years. That means that the 63% LVR figure hasn't been adjusted to the current value of the housing market. Over the past 2.5 years Australian house prices have risen by ~25% implying that the average LVR within our RMBS holdings based on current market value is closer to 50%.
- The expected average maturity of our RMBS portfolio is less than 1.3 years across both portfolios and each investment is reducing in size and risk monthly.

For these reasons, we're comfortable holding our portfolio of RMBS assets despite a view that Australian house prices are potentially under threat from an environment of rising rates.

Chart 7- Credit Opportunities Fund Historical Allocation to RMBS

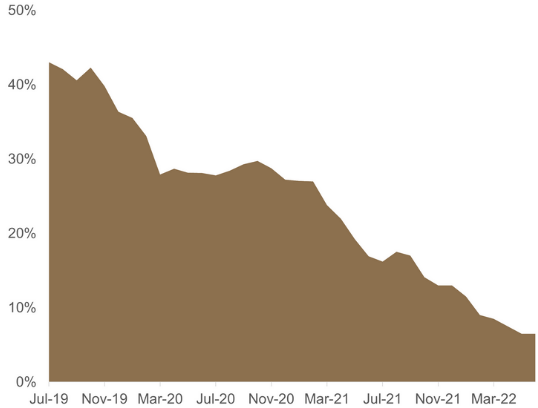
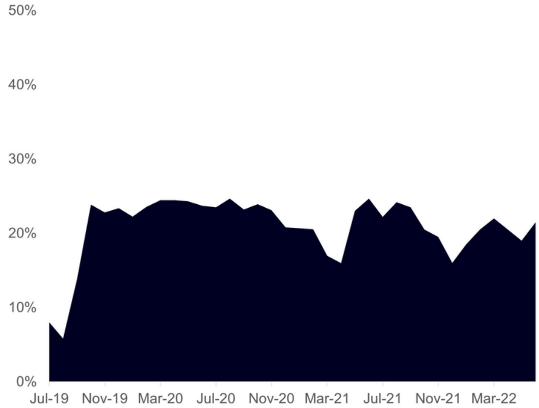


Chart 8 - Credit Income Fund Historical Allocation to RMBS



Sector Performance & Fund Positioning

Debt Capital Markets

Over the quarter Debt Capital Markets were weaker in line with investment markets generally. The impact was felt across the credit spectrum with both investment grade and high yield CDS spreads rising to levels well in excess of their 10 year averages.

Chart 9 - Australian iTraxx / US CDX High Yield Spread: Last 3 Years

Source: Bloomberg

With most of the major banks coming through their earnings reporting period in May, they stepped back into primary markets which added further pressure to spreads as the market digested elevated supply with a challenging economic backdrop.

Over the quarter we generally reduced our exposure to Debt Capital Markets both in portfolio weight and risk level. With 3 of the 4 major banks reporting earnings in early May, several issued new bonds in primary markets with each new deal pushing spreads wider as the market tone grew more cautionary.

Structured Credit

Structured credit markets were also under pressure as investors repriced the space relative to the moves in Debt Capital Markets. Whilst initially the higher rated traches within each transaction were to first to be impacted, over the quarter the lower rated notes also adjusted.

Despite the price moves, primary transaction volumes remained healthy as Non-Bank lenders need to issue new RMBS/ABS deals after writing large volumes of new loans in the last 18 months. We anticipate this dynamic will persist over the remainder of the calendar year and keep the Structured Credit pricing generally constrained.

The Funds overall exposure to Structured Credit was slightly lower over the quarter, mostly due to not fully replacing maturing securities. In addition, any participation in new issues was focused on the highest rated (AAA), short average life (~ 6 months) note within each deal. This has allowed the Fund's to access higher spreads versus 6 months ago and the income benefit of rising yields whilst being exposed to immaterial market and credit risk.

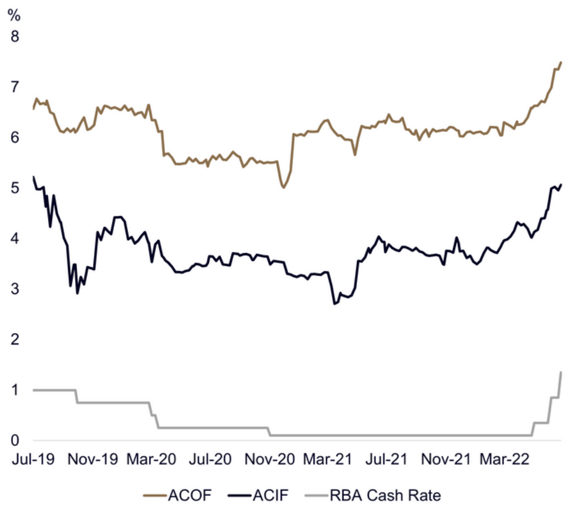
Sector Performance & Fund Positioning

Private Assets

Across the our entire investment universe within credit, private funding warehouses to support the growing Non-Bank Financial Institution space has been a clear standout in terms of value for the past 24 months. Even with the reset in Debt Capital Market and Structured Credit pricing, the warehouse market still offers, those investors able access it, a superior risk adjusted return outcome.

Supply of new opportunities in this space remains healthy and our expectation is it will continue to be a key contributor to portfolio return over the next 12 months.

Chart 10 - Historical Running Yield (before fees)



Fund Positioning & Activity

In light of the changing economic outlook over FY 2022, Alexander Funds has retained a cautious perspective on portfolio composition, this is reflected in the low credit duration of both funds. Our ability to access high quality, low duration assets within the warehouse funding market has meant that both portfolios could carry lower market risk without sacrificing yield.

As we begin a new financial year, the Fund strategy remains the same given our expectation that the market volatility of FY 2022 is likely to continue as investors grapples with how successful central bank policy is at curbing inflation without badly impairing growth.

Fund Performance

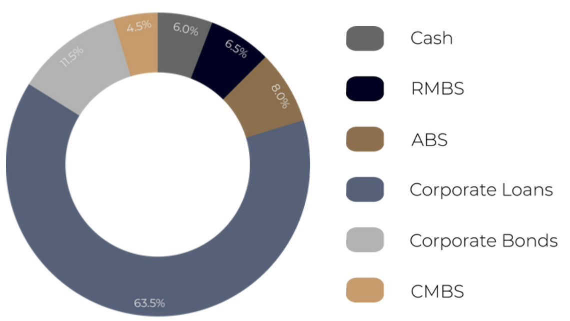
Credit Opportunities Fund

The Alexander Credit Opportunities Fund has a benchmark of the AusBond Bank Bill Index +2% pa. The Fund achieved a return of 0.97% for the quarter ended 30 June 2022 for an annualised return over the previous 12 months of 4.31%, and paid a distribution for the quarter of 4.4246 cents per unit.

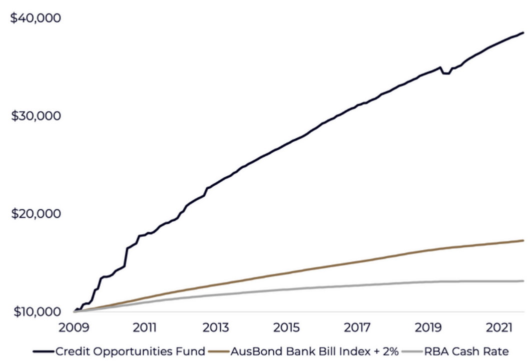
Returns as at 30 June 2022

	Fund	Benchmark
1 Month*	0.32%	0.22%
3 Month	0.97%	0.57%
6 Month	1.95%	1.08%
12 Month	4.31%	2.12%
3 Year (pa)	4.36%	2.23%
Since Inception (pa)	11.23%	4.41%

Portfolio˜ as at 30 June 2022



Performance of $10k Invested Since Inceptionˆ



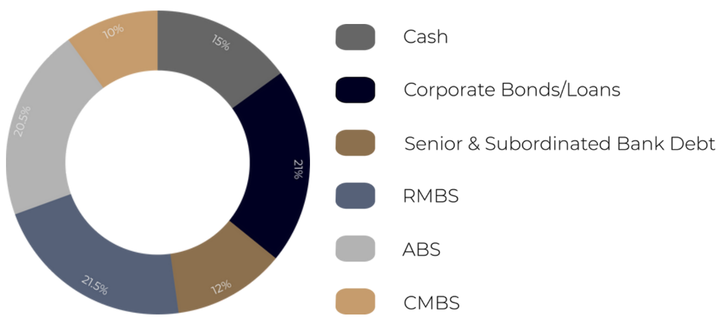
Credit Income Fund

The Alexander Credit Income Fund has a benchmark of the AusBond Bank Bill Index + 1% pa. The Fund achieved a return of 0.36% for the quarter ended 30 June 2022 for an annualised return over the previous 12 months of 2.35%, and paid a distribution for the quarter of 1.2567 cents per unit.

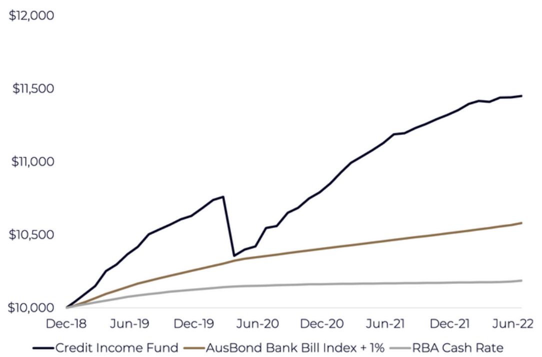
Returns as at 30 June 2022

	Fund	Benchmark
1 Month*	0.09%	0.13%
3 Month	0.36%	0.32%
6 Month	0.85%	0.58%
12 Month	2.35%	1.10%
3 Year (pa)	3.20%	1.34%
Since Inception (pa)	3.85%	1.59%

Portfolio˜ as at 30 June 2022



Performance of $10k Invested Since Inceptionˆ



Alexander Funds

Notices & Disclaimers

* The monthly return is an actual return net of all fees, costs and taxes generated by dividing the redemption unit price by the previous month's redemption unit price. Past performance is not a reliable indicator of future performance.
~ Portfolio Composition is net of hedges
^ Assumes reinvestment of all distributions

Alexander Funds Management Pty Ltd (ABN 77 136 871 924) (AFSL 476697) ("Alexander Funds") is the Investment Manager of the Alexander Credit Opportunities Fund (ARSN 156 026 514) ("ACOF" or "Fund") and the Alexander Credit Income Fund (ARSN 629 915 199) ("ACIF" or "Fund"). Equity Trustees Limited ('Equity Trustees) (ABN 46 004 031 298) AFSL 240975 is the Responsible Entity for the Fund. Equity Trustees is a subsidiary of EQT Holdings Limited ABN 22 607 797 615, a publicly listed company on the Australian Securities Exchange (ASX: EQT).

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ACIF's PDS and TMD can also be found at
https://www.alexanderfunds.com.au/alexander-credit-income-fund
ACOF's PDS and TMD can also be found at
https://www.alexanderfunds.com.au/alexander-credit-opportunities-fund

A Target Market Determination is a document which is required to be made available from 5 October 2021. We recommend that you read this document as it describes who this financial product is likely to be appropriate for (i.e. the target market), and any conditions around how the product can be distributed to investors. It also describes the events or circumstances where the Target Market Determination for this financial product may need to be reviewed.

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