March 2024
Quarterly Report

EQT DIVERSIFIED FIXED INCOME FUND (INSTITUTIONAL CLASS)

PORTFOLIO OBJECTIVE

The Fund aims to provide investors with exposure to high-quality income-yielding investments. The Fund aims to outperform the benchmark over rolling three-year periods, after taking into account fees and expenses.

FUND PERFORMANCE

PERFORMANCE[1]	3 MONTHS	1 YEAR	3 YEARS (P.A.)	5 YEARS (P.A.)	SINCE INCEPTION (P.A.)[2]
Total net return	0.97%	1.19%	-1.62%	-0.18%	1.73%
Benchmark return[3]	1.03%	1.47%	-1.29%	0.17%	2.23%
Active return	-0.06%	-0.28%	-0.33%	-0.35%	-0.49%

Table 1
Source: Equity Trustees as at 28/03/2024

[1] Performance: Total net return is the return after the deduction of ongoing fees and expenses. Results greater than one year are annualised.

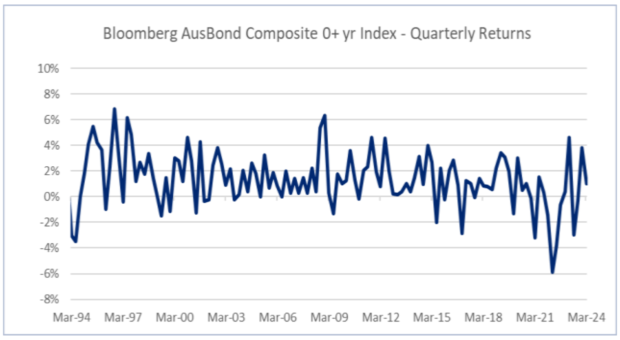
[2] Inception date is 14 October 2014.

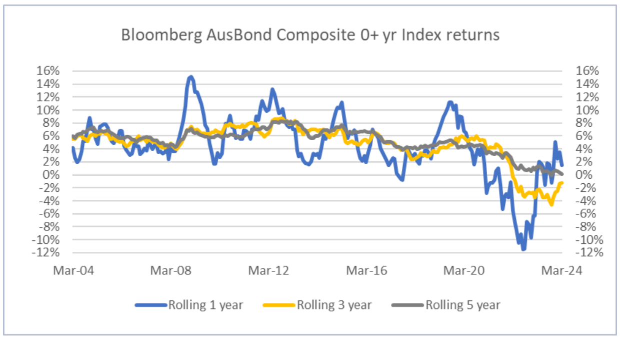
[3] Benchmark is the Bloomberg AusBond Composite 0+ Year Index.

Past performances should not be taken as an indicator of future performance.

PERFORMANCE SUMMARY

The Fund recorded a total net return of 0.97% for the March 2024 quarter, underperforming the Bloomberg AusBond Composite 0+ year Index. Over the last 12 months the Fund recorded a total net return of 1.19%, underperforming the Index by 28bps. The total net return since inception is 1.73% p.a., underperforming the benchmark over the same period.





Source: Bloomberg, Equity Trustees as at 28/03/2024

MARKET SUMMARY

The March quarter delivered a positive return to domestic bond investors as Australian bonds outperformed global peers.

Softer domestic inflation data released late January saw markets respond by sending 3-year bond yields 15bps lower on the day, which in turn helped support the benchmark deliver a positive 0.21% return for the month. February economic data releases were also generally softer with employment, CPI and retails sales all printing lower than expected, however stronger data out of the US drove global yields higher and the local bond market was not immune to offshore moves, ending February down 0.30%. In March, a raft of soft US data early in the month saw yields fall again and with the RBA maintaining the target cash rate at 4.35%, but striking a less hawkish tone on monetary policy, domestic bond prices held on to small gains, delivering a solid 1.12% monthly return to domestic investors.

Economic data out of the US provided little evidence of a faltering economy, making the next step down in inflation (to 2%) a more challenging objective. Against this backdrop and combined with the recent easing in US financial conditions, it is not surprising that the Fed has recently looked to dial back its previous dovish messaging and in doing so, the market has responded by removing some of the rate cuts it had priced in 2024. As at now stands, the market expects 69bps of easing versus the Fed Dots, which reflected 75bps of easing at the time of the FOMC March meeting. Any further signs of strength in the US economy are likely to place upward pressure on yields.

In other jurisdictions, most major central banks held policy rates steady, challenged by a similar inflation story. One exception was the Bank of Japan, which finally lifted its target rate, the first rise since 2007 and in doing so ended its negative interest rate policy. Yield curve control was also scrapped which means the BOJ will not be required to buy bonds to maintain a certain level of yield. The market reaction was muted with negligible impact to Australian bonds.

In terms of market movements, the yield on the Australian 3-year generic bond opened the quarter at 3.61% and rose to 3.86% by mid-January, before falling sharply to 3.57% in late January following the softer-than expected CPI data, eventually closing the quarter at 3.62%. The yield on the 10-year generic bond opened at 3.96% and moved as high as 4.29% before falling to close the quarter unchanged at 3.96%. Given the small moves at quarter end, the 3s/10s spread remained relatively unchanged at 34bps. The spread between the Australian 10-year government bond and US 10-year treasury note fell by 32bps, to close the quarter at -24bps.

GLOBAL BOND MARKET MOVES

	DEC QUARTER	MAR QUARTER	MOVE	QUICK COMMENT
US 10-year note	3.88%	4.20%	0.32	Economic data supports higher for longer rates narrative
German 10-year bund	2.02%	2.30%	0.28	ECB holds policy rate steady, wary of wage growth
UK 10-year gilt	3.53%	3.93%	0.40	BOE on hold, UK Gilts follow global sell-off
Japanese 10-year bond	0.61%	0.71%	0.10	BOJ hikes policy rate for the first time since 2007
Australian 3-year bond	3.61%	3.62%	0.01	RBA seen as less hawkish on lower inflation
Australian 10-year bond	3.96%	3.96%	-	Long-dated bonds outperform global moves

Table 2
Source: Equity Trustees as at 28/03/2024

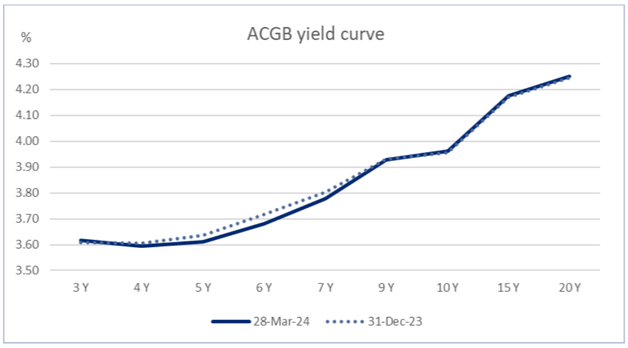
PORTFOLIO ACTIVITY AND ATTRIBUTION

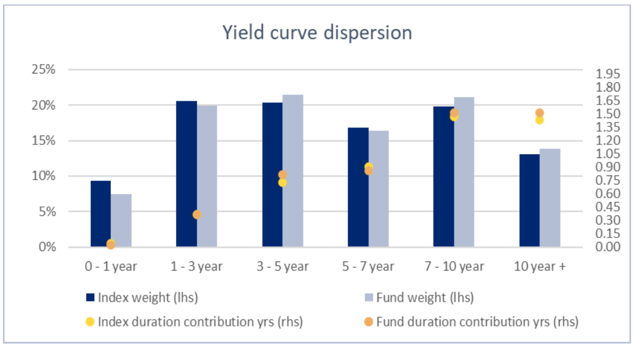
DURATION

We maintained a neutral duration position through January. Around the middle of February and following a small sell-off which saw long-dated bond yields move approx. 25bps higher, we added duration and maintained a slight, long bias until the end of the quarter. By the end of March, the domestic 10-year bond yield had fallen back below 4%, prompting us to move back to a neutral duration position for the start of the new quarter.

YIELD CURVE

The AUD yield curve saw mild bull-steepening over the quarter as short-dated yields fell slightly, whilst longer-dated yields held broadly steady.





Source: Bloomberg, Equity Trustees as at 28/03/2024

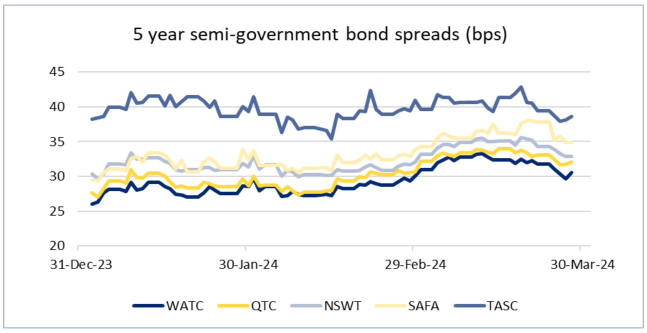
Our curve positioning added slightly to performance as we maintained a small overweight position around the 3–5-year part of the curve.

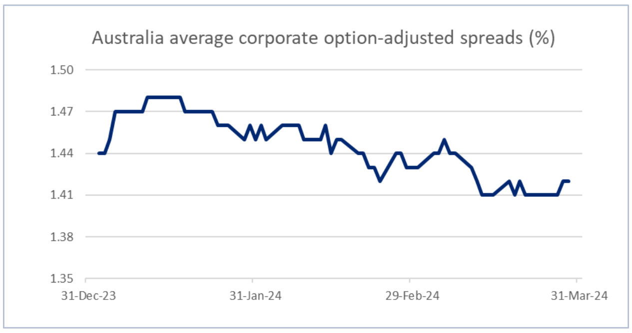
SECTOR ALLOCATION

Corporate bond spreads tightened over the quarter with new issues easily absorbed by investors. Positive fundamentals continue to support corporate demand and we were comfortable adding to our corporate bond exposure. In particular, recent news on the possible sale of the Optus business in Australia and subsequent spread widening due to an anticipated downgrade in credit rating provided an opportunity for us to add to our holdings at more attractive levels.

Semi-government bond spreads saw some widening as issuance continues to be a negative factor, along with the prospect of weakening demand from bank balance sheets.

From a benchmark perspective, the credit component performed best, delivering a 1.37% return for the quarter, followed by supranational bonds at 1.14%. The longer duration components underperformed, with semi-government bonds delivering 1.01% and government bonds returning 0.95%.





Source: Bloomberg, Equity Trustees as at 28/03/2024

Our sector allocations made a positive contribution to performance, mostly due to our higher allocation to corporate bonds. However, security selection detracted, as certain longer-dated corporate bonds outperformed our shorter-dated holdings.

Sector allocation as of 28 March 2024

	BENCHMARK		PORTFOLIO		
SECTORS	BENCHMARK WEIGHTS	DURATION CONTRIBUTION	PORTFOLIO WEIGHTS	DURATION CONTRIBUTION	DIFFERENCE
Commonwealth Govt bonds	51.7%	2.71	36.1%	2.63	-0.08
State (semi) Govt bonds	29.8%	1.65	26.4%	1.51	-0.14
Supranational/sovereign/other	5.4%	0.18	6.7%	0.21	0.03
Corporate bonds	13.1%	0.40	29.9%	0.74	0.34
Cash and related	0%	0.00	0.9%	0.00	0.00
	100%	**4.94**	**100%**	**5.09**	**0.15**

Source: Bloomberg, Equity Trustees as at 28/03/2024
Note: Numbers taken from our Portfolio Management System may vary slightly from accounting or index reports. Numbers may not add precisely due to rounding.

Global outlook

United States

February employment data showed the US added 275,000 jobs against an expected increase of 200,000. The participation rate remained unchanged at 62.5%, while unemployment rate rose from 3.7% to 3.9% and average hourly earnings rose by 0.1% MoM, below the expected 0.2%.

The March US ISM manufacturing index printed at 50.3 from 47.8 in February with strong gains in both Prices Paid and New Orders. Factory orders (ex-transport) rose 1.1%, and durable goods orders increased by 1.3% in February. US Manufacturing PMI came in softer at 51.9, while Services PMI remained unchanged at 51.7 in March. The March ISM services index printed softer at 51.4, below market expectations of 52.8.

US headline inflation edged higher to 3.2% YoY in February from 3.1% in January, and core CPI came in at 3.8% from 3.9%, above the expected 3.7%. Core PCE deflator came as a mild relief at 2.8% after an upward revision to January's number from 2.8% to 2.9%. Headline printed at 2.5% YoY from 2.4% in previous month.

The Q4 GDP final release came in above expectations at 3.4% vs forecast 3.2%. Personal consumption was also revised up again to 3.3% from 3.0%.

During the March meeting, the FOMC decided to hold the Federal Funds Rate unchanged. The Fed's 'dot plot' retained three cuts for 2024 but removed a cut from its forecast for 2025.

China

Economic data provided a small upside surprise in March. The Caixin manufacturing PMI Index improved from 50.9 to 51.1 and the services PMI Index also showed a slight uptick from 52.5 to 52.7 in March. Industrial production was up 7.0 % YoY in February. Fixed asset investment growth improved to 4.2%. Retail sales rose 5.5% YoY, below market expectations of 5.6%. The People's Bank of China maintained the medium-term lending facility rate at 2.50% as widely expected.

China's gloomy economic outlook has led to a severe stock-market decline in Q1 2024. Multiple factors, including a struggling post-pandemic recovery, a distressed real estate market, mounting debt, unprecedented youth unemployment, and the flight of foreign capital have weighed on the economy.

The recent decision by Chinese lenders to reduce their five-year loan prime rate (LPR) by 25 bps to 3.95% reflects a significant shift in policy direction by the People's Bank of China. This marks the first rate cut since June and the most substantial adjustment since the introduction in 2019. The move underscores a growing emphasis on addressing the challenges posed by the property crisis, which has been exerting considerable pressure on the overall economy.

Europe

PMI data suggest services sector activity rose to 51.1 in March from 50.2 in February, and the manufacturing sector improved from 45.7 to 46.1. Industrial production decreased 3.2% in January, while retail sales rose 0.1% MoM, taking the YoY to -1.0%. The final read of Q4 GDP printed the same from advance and preliminary read at 0% QoQ and 0.1% YoY, seeing stagnation in Euro Zone. Of note, UK Q4 GDP fell 0.3% in Q4 following the 0.1% contraction in Q3 suggesting a technical recession in H2 2023.

The annual headline rate of inflation for Europe is expected to print at 2.4% YoY in March, a decline from the 2.6 % YoY level in February. Core inflation also fell from 3.1% YoY to 2.9% YoY. UK inflation printed lower than expected for February, where the headline held at 3.4% against an expectation of 3.5% as did core at 4.5% versus 4.6% expected.

The ECB kept its deposit facility rate at 4.0% at the March meeting as universally expected and stated that it needed to be maintained for a 'sufficiently long time. The BOE maintained the bank rate at 5.25% in March as well. Of note, the Swiss National Bank became the first major developed central bank to ease policy, surprising the market with a 25bps cut in its policy rate to 1.5% in March. The market now has 90 bps of rate cuts priced in for the ECB and 94 bps for the BOE in 2024.

Australia

Employment rose by 116,500 in February, fully reversing the weakness seen in December/January. The monthly outcome was well above consensus of 40,000. The unemployment rate fell to 3.7% from 4.1%, the lowest since September 2023.

Manufacturing and service sector PMI indicators printed at 47.3 and 54.4, respectively. Business conditions improved three points to +10, back above its long run average of +6. Business confidence fell one point to zero.

Retail sales rose 0.3% MoM in February, close to the 0.4% expectation. House prices continue to rise despite the significant lift in mortgage rates, gaining 0.6% MoM in March. Consumer confidence levels fell 1.8% MoM to 84.4 from 86.0.

The February monthly CPI data was steady at 3.4%, with elevated housing inflation offset by goods discounting, lower fuel, and a fall in international travel prices.

Fourth quarter GDP came in at 0.2% QoQ and 1.5% YoY as expected. The softness in GDP growth over the past four quarters reflects a broader slowing in the economy to a below trend pace of growth.

The RBA left the target cash rate unchanged at 4.35% in March, and the statement reads less hawkish with the comment that "the Board is not ruling anything in or out." Current market pricing has priced in less than two rate cuts in this year.

SUMMARY

Recent economic data suggests the US economy is growing at above trend growth, affording the Fed more time to assess current monetary policy settings. The market has responded by removing some of the previously expected rate cuts from the 2024 profile, which has seen bond yields edge higher in early April.

Domestic policy rates are in restrictive territory, as evidenced by a slowdown in consumer spending and sub trend GDP growth. Despite the below trend growth, the RBA is likely to maintain the policy rate at 4.35% until it sees further evidence of inflation returning to target. Services inflation remains key.

We continue to view the outlook for bonds as favourable, but our inhouse models suggest longer-dated yields are trading close to fair value and we are therefore neutral on duration.

Our preferred portfolio construction is:

- Duration: We will look to add duration as opportunities present.
- Yield curve: We expect to add to our 3–5-year maturities in the forthcoming period as that part of the curve is expected to outperform upon the commencement of an anticipated rate easing cycle.

- Sector/credit mix: The current backdrop continues to support high quality investment grade credit. We will look to diversify our holdings, maintaining a preference to invest in non-cyclical defensive sectors.