Schroder Australian High Yielding Credit Fund - Active ETF (Cboe: HIGH)

Portfolio Review

In February, the Fund returned 0.15% (after fees), behind the benchmark by 0.2% and 6.3%(after fees) over one year which is 2.6% ahead of the benchmark.

At February end, the portfolio is yielding 5.7% with an interest rate duration of 0.3 years.

Market Review

- February saw a sharp supply rebound led by financial issuers (including sizeable Tier 2), while corporates were quieter and REIT issuance picked up late in the month.
- The market absorbed the wave thanks to large maturities and light dealer inventories, though bigger supply pushed new-issue concessions modestly wider.
- Tier 2 supply became congested and several deals softened post-pricing, leaving overall credit spreads broadly flat despite higher running yields from the RBA hiking pivot.
- Corporate earnings were resilient and balance-sheet discipline remained intact, while US–Iran tensions lifted near-term risk-off sentiment with oil-driven inflation the key watchpoint.

February in review:
Following a strong month of credit spread compression in January, we were destined for a supply response and February did not disappoint. While Corporates prepared their reporting updates, Financial issuers set about filling investors' demand, led by Australian major banks ($10b) and Kangaroo Financials ($6b), of which $6.7b came in subordinated form (Tier 2). Corporates were typically quiet through reporting period, but the REITs formed an orderly queue into month end.

Fortunately the local market was well positioned to accommodate the supply wave, with more than $11b of bond maturities (and coupons) ready for redeployment, and a street which was running relatively light inventory levels. Still supply was large enough to bring some balance back to the primary market and new issuance concessions rose a little in response.

Supply indigestion was felt in Tier 2 paper as the month progressed, and deals from early February, such as Westpac and Credit Agricole's long-dated Tier 2 lines struggled to breach reoffer. Consequently, credit spreads were relatively flat this month across the board.

Income however, remains solid and the RBA's pivot to rate hikes has helped lift running yields. We acknowledge credit spreads are relatively tight versus recent history, but we continue to view A$ credit favourably relative to other jurisdictions.

As for Corporate Reporting Season, the results were strong. Earnings growth surprised slightly to the upside and broadly speaking revenue growth supported an unwavering focus on cost control. Any increases in capex, shareholder returns or M&A appetite was measured and within current credit rating tolerances, leaving a clean report card at month end.

Geopolitics reared its head on the last day of the month, resulting in a soft beginning to March. At this point in time, we've observed a modest risk-off as initial response, before sitting in a holding pattern until a clearer

picture can be formed around the duration of the confrontation, given the length and breadth of disruption to global trade will be key inputs to calculating any inflationary impulse.

Inflation is already a sticky topic in Australia, but across the A$ Credit universe, inflation is not a dirty word. Most corporates and financials that issue in this market have revenues which benefit from modest levels of inflation, which help to buffer any negative impacts of subsequent rate hikes. So as long as we don't have a sustained disruption to the Strait of Hormuz, the inflationary impact should not be credit negative.

Late in February, the AREITs joined the issuance stream, with deals from Mirvac and Vicinity Centres, and Charter Hall are road-showing currently. What has brought on this sudden surge of interest from this sector? Prevailing market conditions are ripe for the pickings for the property titans. The market is less focused on fundamentals than ever, partly because there is nothing to really focus on right now. Stabilization in interest rates is good news for property valuations and the transaction market has reopened across all sub-sectors of the commercial real estate market – even office.

Portfolio Update

With all the new supply in February we took the opportunity to trim some exposures which had enjoyed a very strong start to the year, and we were able to add to longer dated Major and Kanga bank Tier 2. The Westpac deal ($1b, 15y at asw+133bps) was comfortably oversubscribed given the reasonable the spread extension on the curve. But this wasn't enough to help performance, as new supply weighed on spreads through the rest of the month, closing 12bps wider than reoffer. Credit Agricole followed up Westpac with another $1b of 15y Tier 2 (asw+172bps), which again saw a decent book build, but was also impacted with softer spread action through February, closing 4bps wide of reoffer.

We expect spreads in subordinated debt from high quality banks to tighten into second half of the year as the supply of subordinated paper from the Australian Major banks slows to a refinancing rate. This contrasts with the additional T2 supply we have seen from the majors in the past few years due to the increase in capital requirements set by the regulator and the replacement for AT1 bank hybrids. We prefer to get set when the opportunity arises on select issuers. The senior to sub ratio backed up to 1.74x from the tights of 1.63x in response to the February supply deluge and by way of context 25% of last year's total AUD financial issuance was issued in the last 2 months!

In M&A, February saw some advancement in the Qube take-private by a Macquarie led consortium. The news led to rating agencies placing Qube on ratings watch negative. We currently have a high conviction that these bonds which traded sub-par on the ratings news will be retired at par on completion of the transaction.

Market Outlook

February ended on a real cliffhanger, as headlines broke of escalating tensions between US and Iran. These escalated over the weekend and as we stand today (~48 hours later), markets remain orderly with credit spreads marginally weaker but minimal selling from investors. Most risk assets have been orderly in response, the biggest mover has unsurprisingly been the oil price.

In the near term, our attention will be focused on 1) gaining clarity on how long the conflict will last and 2) how substantial any disruption to oil supply chains will be. Some commentators have suggested $100/bbl is not out of the realms of possibility if the conflict is prolongued. Ultimately higher oil will have an inflationary impulse, which is the key read through for our markets, and the severity of said impulse depends on our two key areas of focus.

There is limited direct oil exposure in our A$ credit universe, and many of our corporate issuers actually benefit from modest levels of inflation, so at this point in time, we're cautiously watching events unfold.

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