Coolabah Floating-Rate High Yield Fund (Managed Fund)

Date: February 2023

Foresight Analytics

Investment Rating Report

Investment Rating: VERY STRONG
Product Complexity: RELATIVELY SIMPLE

Fund Details
Investment Manager: Coolabah Capital Investments (Retail) Pty. Ltd
Investment Structure: Open-ended Australian unit trust
Wholesale/Retail: Both
Category: Fixed Interest
Investment Style: Alternative high yield (geared Australian floating-rate notes)
Inception: 5 December 2022
Management Fee: Investment management fee of 0.75% p.a. plus 0.25% administration fee (Assisted Investor Class)
Performance Fee: Nil
Distribution: Quarterly
Responsible Manager/Entity: Equity Trustees Limited
Investment Objective: to provide investors with exposure to a portfolio of investment-grade Australian floating-rate notes with enhanced yields.

Review Summary

The Coolabah Floating-Rate High Yield Fund (Managed Fund) (the 'Fund') consists of a portfolio of Australian bank senior and subordinated floating-rate notes (FRNs) to which leverage is applied within a permissible range of 50% to 75% (i.e., gross exposure up to 400%). As of 31 January 2023, the portfolio consisted of approximately one-third senior bank FRNs, and two-thirds subordinated bank FRNs with an average credit rating of A-., and the net of fees yield to maturity is currently 9.27% p.a., based on approximately 70% gearing.

The credit default risk of the portfolio is deemed exceptionally low. The Australian bank FRN market has historically exhibited exceptional returns per unit of risk, has minimal negative credit rating risk, and is highly liquid. The underlying portfolio applies gearing cost-effectively, utilising RBA 'back-stopped' repurchase agreements (repos).

The Fund may be viewed as an alternative to high yield sub-investment grade bond strategies, yet with a portfolio that has a substantially higher credit rating and lower default risk. Key points include:

- The Fund has negligible interest-rate risk (being FRN instruments).
- Senior and subordinated Australian bank notes are currently offering attractive yields relative to alternative asset classes on a historic basis. This comparison includes relative to Australian equities, Australian bank stocks, Australian hybrids, and high yield bonds. The yield on these FRNs is further enhanced via the Fund's use of gearing.
- Target returns for the Fund are not fixed and will vary based on credit market conditions specific to the Australian bank FRN market. The key drivers of realised returns are market inflation expectations, movements in the official cash rate, bank bill swap rates (BBSWs), and credit spreads for specific FRNs the Fund invests in.
- The Australian bank FRN market has historically exhibited exceptional returns per unit of risk, has minimal default risk, and is highly liquid. In short, the underlying portfolio is well suited to be geared to enhance returns. However, the high level of leverage does create material mark-to-market volatility / drawdown risk. Historically, on a back-tested basis these risks are not dissimilar to global high yield bonds (albeit back-tested returns on the Fund's strategy were materially higher).
- The Manager is a very adept relative value manager, and will use these techniques in both the selection of individual FRN securities and the dynamic determination of gearing levels.

Investment Rating & Foresight Complexity Indicator

A **VERY STRONG rating** indicates a very strong conviction that the Fund can deliver a risk-adjusted return in line with its investment objectives. The investment manager's support for this strategy is very well-resourced and continues to be enhanced.

Designation as a **RELATIVELY SIMPLE** product reflects the public market liquidity and pricing transparency, simple fee structure, and the standard nature of the underlying asset class of Australian bank bonds. That said, the geared nature of the fund means returns will be amplified both on the upside and downside compared to a similar strategy that is ungeared.

Fund Details

FUND NAME	**COOLABAH FLOATING-RATE HIGH YIELD FUND (MANAGED FUND)**
Dominant Strategy	A portfolio of investment-grade Australian Floating-Rate Notes (FRNs) with enhanced yields.
Fund Type	Alternative High Yield \ Short Duration Fixed Income
Investment Manager	Coolabah Capital Investments (Retail) Pty. Ltd.
Sub-Investment Manager	Coolabah Capital Institutional Investments Pty. Ltd.
Trustee/RE	Equity Trustees Limited
KEY FEATURES	
Fund Inception	5 December 2022
Domicile	Sydney, Australia
Legal Form	Registered Open-ended Australian Unit Trust
APIR Codes	Assisted Investor Class: ETL5010AU; Institutional Class: ETL6855AU
Geographic Mandate	Australian floating-rate notes with a focus on bank issuers.
Open	Yes
Management and Administration Fee	1.00% - 0.75% p.a. management fee + 0.25% administration fee (Assisted Investor Class)
Performance Fee	Nil
Benchmark	Bloomberg AusBond Credit FRN 0+ Yr Index (BAFRN0).
Distributions	Quarterly on 30 June, 30 September, 31 December, 31 March
FUM	~AU$26.56m as of 31 January 2023
Minimum Subscription	AU$1,000 (Assisted Investor Class)
Subsequent Subscription	AU$1,000 (or $100 per month for a regular savings plan)
Entry Fee	No
Exit Fee	0.05% exit spread paid to unitholders in the trust
Fund Term	Open-ended
Reporting	Online 24/7, monthly reports, quarterly/annual distribution and tax statements
Redemptions	Daily
PRIMARY CONTACT	
Name and Title	Gary Walsh, Head of Asset Origination
Email Address	gary.walsh@coolabahcapital.com
Telephone Number	1300 901 711
Website	www.coolabahcapital.com

Investment Profile

BACKGROUND

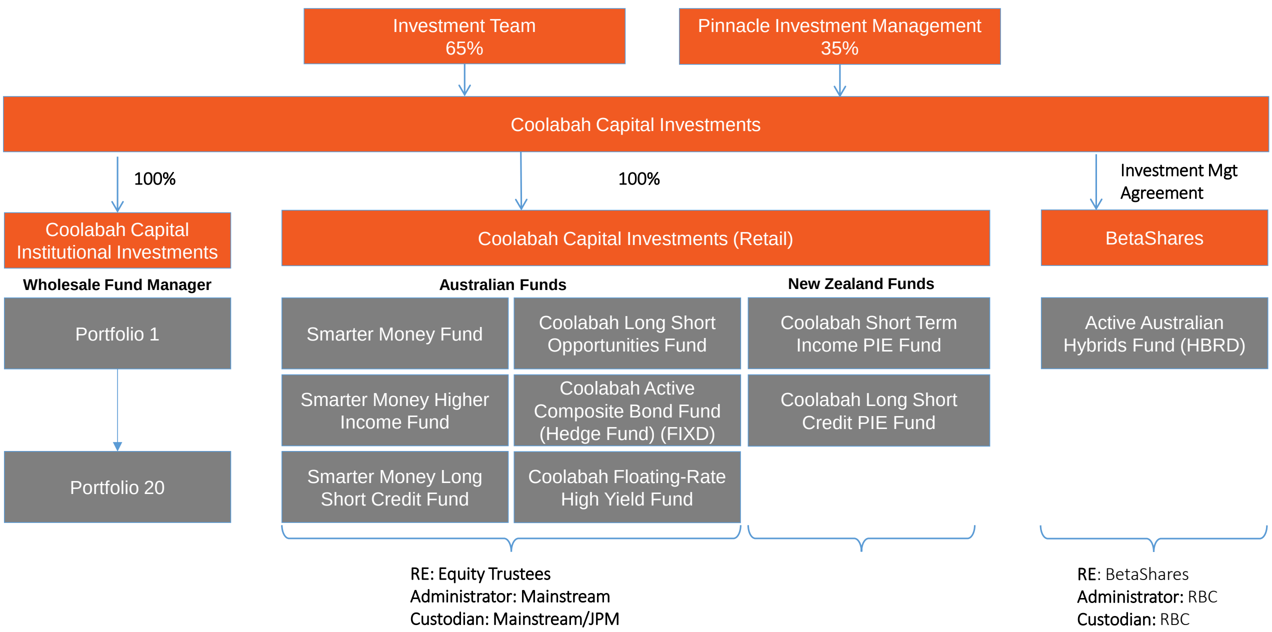
Coolabah Capital Investments Pty. Ltd. ('CCI' or the 'Manager') is 65% owned by its investment team and 35% owned by the Pinnacle Investment Management Group Ltd. (ASX: PNI), an Australia-based multi-affiliate investment firm. Coolabah Capital Investments (Retail) Pty. Ltd. (CCIR) is a wholly-owned subsidiary of CCI and was established to offer investors fixed-income products with a low volatility profile.

CCI was established in 2011 and launched its first fund in February 2012. It currently manages 8 public funds and 20 custom portfolios, with a combined FUM of approximately AU$6.4BN. This includes Australia's fastest growing ETMF, Betashare's Active Australian Hybrids Fund (Managed Fund) (ASX: HBRD), with >AU$1.9BN in FUM. CCI is a fixed-income relative-value house, as opposed to a credit house. Perhaps fittingly, the timing of the Fund corresponds with the attractive relative value status of Australian bank FRNs.

CCI's team currently comprises 34 staff members: 6 portfolio managers; 4 portfolio management, analysis and support staff; 6 credit analysts; and 4 data science team members. The staff collectively have decades of fixed-interest trading, quantitative and credit-research experience. CCI's investment team and their families have invested approximately $10M-$20M of their personal capital into CCI's strategies, which provides for a strong alignment of interests. Profits have been re-invested in the business, mainly in additional staff, systems and technology.

In 2020, CCI opened a London office, in addition to 2 Sydney offices and a Melbourne office. The Manager intends to expand overseas and believes its overall FUM capacity across all the strategies is between $15BN to $20BN. Pinnacle, which has offices in London and New York, is leading CCI's overseas expansion and is exploring the best structures for offering the manager's capabilities in overseas markets.

FUND MANAGEMENT STRUCTURE



Source: Coolabah Capital Investments

OBJECTIVE

The Coolabah Floating-Rate High Yield Fund's objective is to provide investors with exposure to a portfolio of investment-grade Australian floating-rate notes with enhanced yields. The Fund currently has a target running yield and yield to maturity of 9% and 11% p.a. respectively after fees and expenses. This target was published as of 28 November 2022 and will likely vary over time based on the three-month bank bill swap rate (90-day BBSW) and credit spreads applicable to the sector. The target return is a function of two components: 1) coupons over the tenor of the bond (the 'running yield') and, 2) the expected capital uplift based, primarily but not solely, on the discount in primary market issuance and the par value of a bond (creating the higher yield to maturity).

At any given time, the running yield will be a function of the 90-day BBSW. While the interest rate paid on bank bonds can be fixed or floating most domestic issuance pays floating rate interest (floating-rate issuance has the advantage of matching the liability to the floating rate interest received on much of the banks' assets (i.e. variable-rate loans)). In any case, the Fund is a 100% FRN investment strategy. Australian FRNs pay an income set at a margin over the 90-day BBSW (a margin set at the issuance of the bond) that resets on a quarterly basis (based on changes in the 90-day BBSW) and which ensures a very short duration exposure that resets every 90 days.

The net asset value (NAV) of the Fund may vary based on a function of 3 factors: 1) changes in credit spreads applicable to individual FRNs held in the portfolio; 2) credit rating changes to any FRN held in the portfolio (a rare occurence in Australian bank FRNs); and, 3) during extreme market dislocation events, a material widening in FRN bid-ask spreads (which does happen) and assuming the Manager is engaging in portfolio trading in such periods. Of the 3 factors, the first is far and away the most material and persistent. Investors must bear in mind, that while the Australian bank FRN market has an exceptionally low degree of volatility, the application of up to 75% gearing (400% gross exposure) introduces material NAV (but not coupon) risk (see Performance section for an illustration of this risk).

FUNDS UNDER MANAGEMENT

As of December 2022, CCI has FUM of approximately $6.4BN for a predominantly institutional client base. There are approximately 28 portfolios, including retail funds, listed funds and separately managed mandates. According to the Manager, all the strategies use the same underlying 'alpha' engine, with each strategy's portfolio being driven by its specific risk parameters.

INVESTMENT UNIVERSE

The Fund is permitted to invest in senior and subordinated FRNs issued by Australian banks and insurance companies. The interest rates on these bonds are enhanced using gearing of up to 75%, provided via the use of RBA 'back-stopped' repurchase agreements ('repos'). The portfolio has 100% Australian-dollar currency exposure. It is also permitted to invest in cash and cash-equivalent securities for liquidity purposes. The sections below provide an overview of the 2 types of bonds and the Manager's gearing methods.

Senior & Subordinated FRNs - An Overview & Backdrop

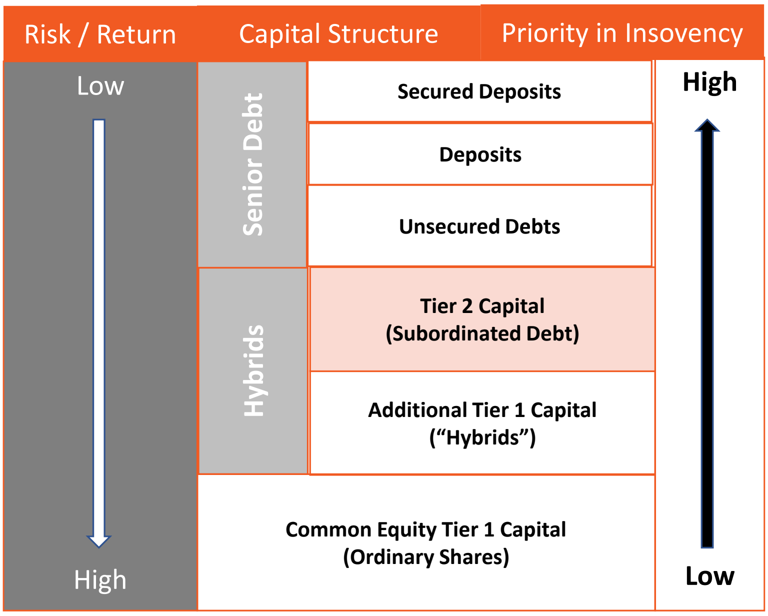
The Australian FRN market comprises investment-grade bonds issued predominantly by domestic and foreign banks and other lending institutions. The Australian FRN market consists of senior and subordinated bonds, with the former being higher on the capital stack.

The diagram below provides a simplified example of the capital structure in a financial institution to illustrate how different securities issued by financial institutions rank in priority of payment in the event of insolvency, including senior and subordinated debt. Priority is given to depositors and senior debt. Shareholders get paid last, if at all.

Secured debt, which is not a part of the Fund's strategy, is the first debt to be repaid in the event of a default and carries the highest ranking, above any other debt issued by a company. The debt is backed with, or secured by, collateral to reduce lending risk. If the borrower defaults, the holder of a secured bond can appropriate this collateral. Assets generally used as collateral include property, cash, receivables, or physical assets owned by the borrower.

Senior (unsecured) debt, one of the two eligible bond holdings of the Fund, has no specific collateral backing from the borrower. In the event of a default, senior unsecured creditors are prioritised ahead of other unsecured creditors to the residual assets of the borrower that have not been used as collateral to satisfy any secured creditors.

Subordinated deb, the second of the two eligible bond holdings of the Fund, ranks behind other debt of the borrower in the event of default. Subordinated debt holders stand behind the senior debt holders in the hierarchy of creditors.



Source: Foresight Analytics, VanEck

SENIOR UNSECURED

Around half of all outstanding Australian non-government bonds are bank bonds. Trends in bank bond issuance are driven by Australia's five largest banks – ANZ, Commonwealth Bank (CBA), National Australia Bank (NAB), Macquarie and Westpac (WBC). These large banks, which together hold about 90 per cent of banking assets, issue around three-quarters of senior unsecured bank bonds, although this varies over time in response to funding needs and market conditions. Senior Australian bank bonds not only have seniority over subordinated debts and hybrids, but as is made evident below these two subordinated classes actually bloster the credit quality of senior bank bonds. We discuss this in greater detail below.

SUBORDINATED BONDS

Subordinated bonds in Australia consists mainly of Tier 2 Capital securities issued by banks and insurers. The debt ranks above ordinary shares and Additional Tier 1 Capital (commonly known as hybrids), but they sit below senior debt, as mentioned. Subordinated bonds are more debt-like than hybrids and, generally, interest payments must be met and principal repaid at maturity while the issuing financial institution is solvent. However, it's important to note that in times of financial stress, subordinated bonds may stop making interest payments indefinitely and they can be converted to equity or written off without resulting in an event of financial default which could trigger the collapse of the institution. This is because the purpose of Tier 2 Capital is that it can be absorbed to prevent the failure of financial institutions which are important to the whole financial system.

For financial institutions, subordinated debt forms part of the buffer they are required to have (by APRA) in order to absorb potential losses in the event of financial distress. This capital protects depositors and policyholders, so they can feel confident their money is safe. It also protects taxpayers from costly bail-outs.

How are subordinated bonds different to traditional bonds?

- **Loss absorption and non-viability.** Subordinated bonds form part of the regulatory capital that banks and insurers are required to hold to protect depositors and policyholders from unexpected losses. For this reason, they are designed to have 'loss-absorbing' features. The result may be that interest and capital payments owing to investors in subordinated bonds may be delayed, converted to equity at a significantly lower value, or completely written off.

- **Higher risk means higher return.** The claims of subordinated bondholders rank below traditional bonds, depositors and other unsecured creditors. If the bank fails, subordinated bondholders will only be paid after all obligations to higher-ranking creditors are paid. As a result, subordinated bonds generally pay higher interest than traditional bonds.

- **Call risks.** Unlike hybrids, subordinated bonds generally have a maturity date at which time the institution must repay the principal. Australian-dollar floating-rate subordinated bonds typically also have a 'call date' at which there is an expectation the institution will repay the securities. Subordinated bonds are typically issued for 10 years with a call date that is 5 years from maturity, and issuers must obtain approval from APRA to call the bond early. The market usually prices the bonds based on the assumption that they will be called at the specified call date. There is a risk that the issuer will not elect to call the securities at that date or that APRA will not grant approval, which could negatively affect the price of the security.

LEVERAGE – REPURCHASE AGREEMENTS

As noted, the Manager utilises repos to implement gearing in the Fund. Repos are frequently used by holders of debt securities to fund their positions. They play an important role in assisting the smooth functioning of debt markets and are the main instrument used by the Reserve Bank to undertake its domestic market operations. A repo is an agreement between 2 parties under which one party sells a security to the other, with a commitment to buy back the security at a later date for a specified price. The difference between the sale and repurchase price reflects the rate of interest to be earned by the cash provider.

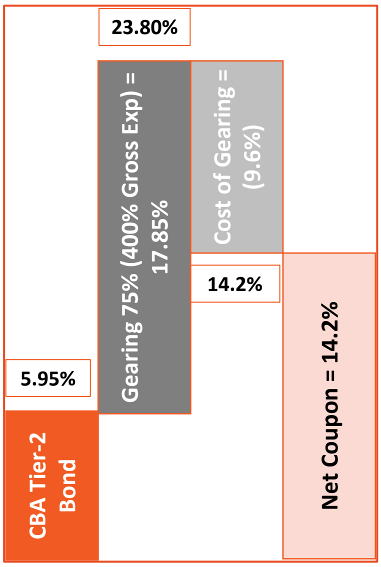
Since the price of the forward (or unwind) leg of a repo transaction is set in advance, the cash provider is only exposed to changes in the security's value if the counterparty defaults on the forward transaction. To limit the potential exposure to counterparty default, the cash provider may demand a margin (or 'haircut') on the security's value. If the securities' values change significantly during the life of a repo, either party may make a margin call or ask for the repo to be repriced, to realign the cash value of the repo with the value of the securities. Within the Australian market, there is no fixed convention on the trigger for making a margin call. In the case of the Reserve Bank, movements in the security's value of more than 1% trigger such a call. For repos contracted on a tri-party basis, it is the responsibility of the tri-party agent to value the securities and determine whether a margin is owed.

The Manager executes repo transactions under Global Master Repurchase Agreements (GMRA), which provide for daily margining processes. The process is the same for all counterparties, though the thresholds for margin calls vary. Margining is done daily on a portfolio basis for each counterparty/fund combination – the loans are revalued to take into account accruing interest, and the securities held as collateral are revalued. If the exposure either way for that fund exceeds a dollar threshold (on average, around AUD $250k), then a margin call is made, typically for payment the following day. The Manager manages this by keeping sufficient cash buffers in all funds which use repo. The cash buffers are sized according to the collateral on repo, current market volatility conditions, and any other factors specific to that fund. Cash buffers are replenished using asset sales if required. Holding a cash buffer does at the margin produce a drag on the overall fund yield, but at typically 5-10% in size, it is not very significant.

We note that the Manager implements repos on a bond-by-bond basis instead of applying them across the entire portfolio. This means the counterparty only has recourse to the bond. On the related issue of risk mitigation, the Manager chooses not to use a prime broker for repo transactions.

Worked Example of Leverage in the Fund

The section below presents a worked example of the application of gearing in the Fund in the determination of the running yield payoff structure for a particular FRN holding in the portfolio. In this case, the underlying FRN is a CBA Tier-2 bond paying 2.9% over the 90-day BBSW (assumed to be 3.05%), and thereby providing a coupon running yield of 5.95%. Assuming the maximum permissable level of gearing of 75% (a gross exposure of 400%), provides a total running yield of 23.80%. The assumed cost of gearing is 15 basis points above the RBA Cash Rate (a level accurately reflects the Manager's actual costs) produces a cost of financing of 9.6%. Deduting this from the gross yield of 23.8% produces a net running yield of 14.2%. This example is illustrated in the waterfall chart below.



Source: Foresight Analytics

BANK FRNs – RATINGS CHANGE HISTORY

Credit spread changes are a persistent risk, both positive and negative. Outside this, rating changes represent an episodic, and is arguably fair to say, a sector-wide risk across the Australian bank issued bonds.

We note that, historically, that ratings have been quite consistent for both senior and subordinated bonds issued by the major banks. The implication of this is that, indeed, credit spread changes does indeed represent the key risk. It also reinforces the point made in this report regarding the complimentarity of the underlying asset class with a gearing overlay.

The current ratings outlook is stable for all agencies. However, S&P has placed a positive risk trend on the Industry Risk Score in the Banking Industry Country Risk Assessment (BICRA) for Australia. If this were to eventually improve the Industry Risk Score by one notch, the credit rating of major bank (and regional bank) subordinated bonds would also improve one notch (i.e. A- for major bank subordinated bonds). This would also upgrade Australia's regional bank senior unsecured paper by one notch from (for BOQ for example) BBB+ to A-.

Historically, for major bank Senior FRNs: S&P rating is AA-, constant since 2011; Moody's rating is Aa3, constant since 2017 (when it was downgraded from Aa2); Fitch rating is A+, constant since 2012.

For major bank Subordinated FRNs: S&P rating is BBB+. This was decreased from BBB+ to BBB in May 2017 and increased back to BBB+ in October 2019 due to movements in Australia's BICRA score; Moody's rating is Baa1, having been lowered from A3 in June 2017; Fitch lowered ratings on major bank Tier 2 from A+ to A- in April 2020.

Allocation Context– Tactical & Strategic Perspectives

Tactical Perspective

From a tactical perspective, we believe the Fund offers 3 key attractions:

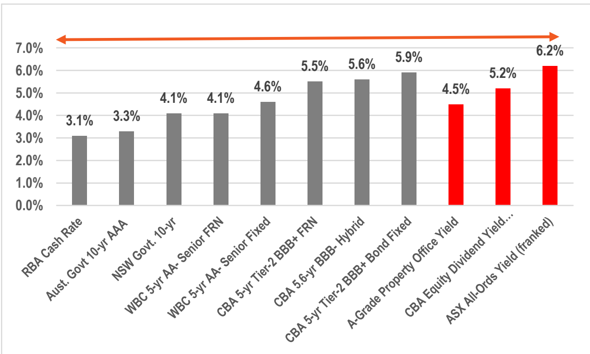
1) A seeming inconsistency in yields relative to capital stack positioning across common asset classes and one favourable to Australian bank FRNs
2) Potential downside protection to the asset class over the foreseeable future based on Australian bank FRN credit spreads being above historical norms (and assuming mean reversion)
3) Historically, during periods of rising rates, floating-rate instruments have outperformed the Australian composite bond asset class

On the first dynamic, the overarching theme driving global financial markets since October 2021 has been the concerted policy normalisation from central banks. The policy pivot across the world resulted in an uptick in volatility and underperformance of global fixed-income markets (investment grade and high-yield bonds as opposed to floating-rate 'leveraged' loans). Supply technicals also turned negative for government bonds globally, as central banks reversed pandemic-era asset purchases (including the removal of AU$4BN of bond purchases per week from the RBA and which had depressed term premia and credit yields).

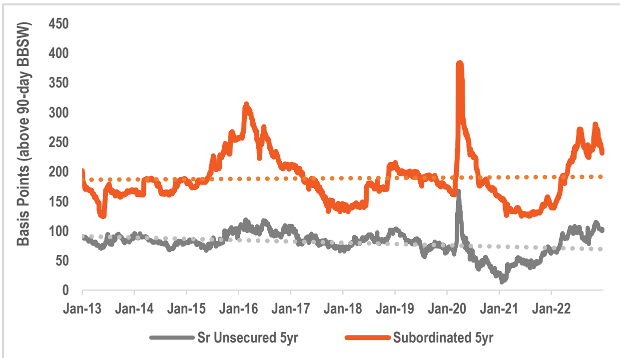
However, the policy normalisation has impacted asset classes differently, reflecting the very different mindsets between debt and equities investment managers. For debt managers, 'debt is a loser's game,' i.e. the payoff profile of debt is asymmetrical, and the debt manager must first and foremost protect the downside. For Wall Street, 'Pessimists (equities bears) seem smart, optimists (equities bulls) make money,' reflecting that over the long-term, equities (at least market-cap weighted equities indices) have recorded material growth. However, there are inflexion point periods during which asset classes reflect different outlooks. The chart below highlights this and illustrates a disparity in yields relative to capital stack positioning.

Regarding this chart, the Manager states, 'When near-riskless government and bank bonds are paying similar/higher yields to equities and commercial property… something is wrong.' 2022 was a year in which investors paid an unprecedented degree of attention to central bank policy. 2023 is expected to be largely about corporate balance sheets. Capital stack positioning may matter.

Yields by Asset Class (31 Dec 2022)

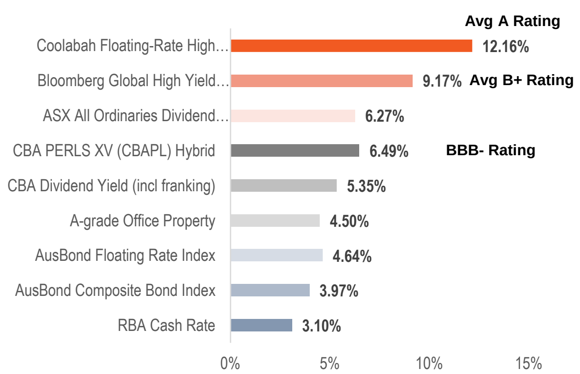


Australian Bank FRNs – Historic Credit Spreads (31 Dec 2022)

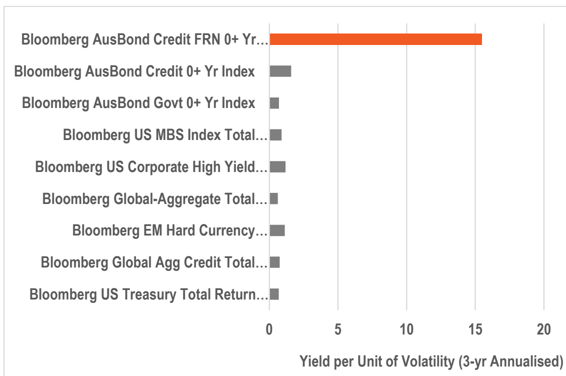


Source: Coolabah Capital Investments

Target Yield vs Other Asset Classes



Bang for Risk Buck



Source: Coolabah Capital Investments

The second chart above speaks to the second dynamic and the notion of downside protection by way of mean reversion (from currently elevated credit spreads) to historical norms. In this regard, the allocation to FRNs is supported by the medium-term structural increase in rates but also on a short-term basis, with current spreads that look relatively attractive. This potentially provides an attractive entry point into the Fund, given the strong underlying fundamentals of banks and the market expectations of at least another 50 basis point increase in the RBA Cash Rate.

Strategic Perspective

In our view, the strategic merit of the Fund relates to the 2 key factors:

1) The financial resilience of the Australian banking sector (i.e. credit rating/default risk)

2) The complementarity, or lack thereof, of the 2 components of the Fund, namely the underlying portfolio and the gearing overlay, the latter of which fundamentally changes the risk-return profile of the underlying portfolio

Regarding the first factor, we point potential investors to the Financial Stability Review (Chapter 3: The Australian Financial System) published by the RBA in October 2022. It concludes, 'The Australian financial system is resilient and well positioned to support the economy through a more challenging period for households and businesses, as interest rates increase to bring inflation back to the target band. Banks have strong capital and liquidity positions.'

Regarding the second factor, we believe the 'Bang for Buck' chart above speaks to the merit and level of gearing. This chart highlights that Australian bank FRNs exhibit an exceptional return per unit of volatility (and that volatility is comparatively low). Furthermore, Australian bank FRNs have historically performed well in periods of rising rates, and have provided stable income and returns. During periods of key downside risk in an asset class where downside risk mitigation is of critical importance, the Australian bank FRNs have historically outperformed. Both these attributes are exceptionally important given the Fund's potentially high levels of gearing exposure.

Investment Philosophy

There are 5 key underlying philosophical/structural components to the creation and timing of the launch of the Fund:

- The Manager views the Fund as an alternative to high-yield investment strategies but with the comparative advantage of lower credit-default risk. Leveraging safer bank bonds carries less credit risk than investing in sub-investment grade instruments. The application of leverage is attractive from a risk-return perspective, given the complementarity of the relatively low-risk underlying a portfolio of Tier 1 and Tier 2 bank floating-rate notes.
- Australian bank FRNs, both Senior (AA-) and Tier 2 (BBB+), currently provide superior yields relative to Australian equities, Australian bank stocks, Australian hybrids, and high-yield bonds, despite being higher on the capital stack (lower risk). This implies that other asset class valuations have been sluggish in reflecting the evolving economic reality.
- Simultaneously, there has been a material increase in credit spreads, with senior FRN spreads increasing from 25 to 120 basis points and Tier-2 spreads increasing from 125 to 280 basis points. These levels are materially above historical norms, implying a source of downside protection should spreads mean-revert.
- The floating-rate portfolio introduces limited interest-rate risk and will reflect any further increases in the official cash rate (RBA Cash Rate and/or the bank bill swap rate).
- Repos are a safe, liquid and highly cost-effective source of leverage, in which bank FRNs are ultimately back-stopped by the RBA.

Investment Strategy

The Fund comprises of 2 components: an underlying portfolio of senior and Tier Two Australian bank floating-rate notes (FRNs) and, secondly, the application of leverage expected to range from 50% to 75% (gross exposure of 275% to 400%). The weighted-average credit rating of the FRN portfolio is currently A- and it has a zero-year interest-duration risk profile. As of the date of this report, approximately a third of the portfolio is Australian bank senior FRNs, and two-thirds are Australian bank Tier 2 FRNs.

The portfolio will be constructed and managed on a credit-spread-relative-value basis, which is very much the Manager's core investment style of seeking mispriced opportunities (the highest spread per unit of risk). Bonds added to the portfolio likely come from primary market issuance (participants typically earn a higher margin in the primary versus secondary market). In many cases, this may involve the divestment of an existing bond portfolio holding, based on relative value assessment. Additionally, as the Fund matures, there will naturally be bond holdings that reach maturity date and are hence repaid.

The emphasis on primary market issuance is higher than may typically be the case in a bond strategy. But this makes inherent sense when considering the discount uplift provided by gearing. For example, what may be a 1.5% discount, becomes 6% with 400% gross exposure.

The portfolio split between senior and subordinated bank notes will vary over time based on where the credit spreads of the 2 note types are trading relative to historical averages. The current predominant weighting to Tier 2 subordinated notes reflects the Manager's assessment that, while senior are attractive, Tier 2 subordinated notes are exceptionally attractive.

The level of leverage will be actively managed between the permitted range on a credit-spread-relative-value basis. That is, how attractive the underlying assets are at any given time. For example, the Manager currently views both senior and Tier-2 bank bonds as extremely attractive relative to historical averages and has applied a level of leverage approaching the maximum limit. Should these notes retreat to fair value, the level of leverage would likely be reduced. As leverage is implemented on a bond-by-bond basis, the level of leverage may also vary from bond to bond, again subject to relative-value assessments.

The Fund's key portfolio limits are tabled below.

Issuers	Net Market Value
Cash and cash equivalents	100%
Government & State Goverments	Unlimited
Any issuer rated AA- to AAA	140%
Any issuer rated A- to A+	60%
Any issuer rated BBB- to BBB+	40%
Maximum absolute exposure to one security	80%

Investment Process

CCI's investment process is singularly focused on identifying mispricing's in liquid, generally investment-grade, credit securities (i.e., in securities paying excess spread after adjusting for risk betas) that have a high probability of normalising or reverting to CCI's modelled fair-value target. The latter is designed to render capital appreciation to augment the income paid by those securities.

CCI uses both top-down and bottom-up analysis as well as qualitative and quantitative valuation analysis. They have created 30 to 40 proprietary quantitative systems/valuation models that can interface directly with Bloomberg. Essentially, the qualitative/quantitative models estimate 'fair value' credit spreads, adjusted for all bond risk factors (rating, maturity, liquidity, default risk, capital stack position, etc.). As credit spreads normalise/mean-revert, CCI generates capital gains on top of the interest paid on the bond.

The Manager attributes most of value added (75%) to quantitative and qualitative fundamental valuation analysis.

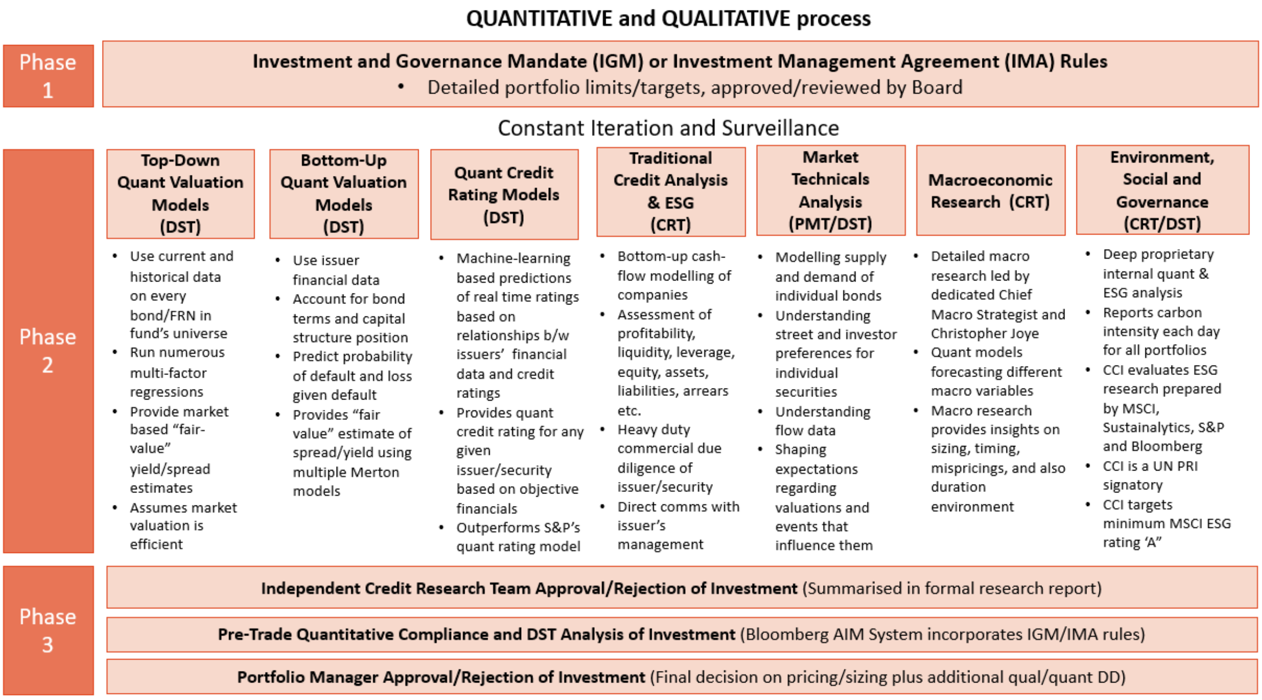
Factor	Contribution
Quantitative and Qualitative Fundamental Valuation	~75%
Supply/Demand Technicals	~12.5%
Macro-Market Sentiment (Behavioural)	~12.5%

The investment process is multi-dimensional and consists of 3 key phases:

- The Investment and Governance Mandate (IGM) determines whether the Fund can acquire an asset or retain an existing asset.
- Potential investments are subject to traditional credit analysis (formalised in a report) and a range of quantitative valuation and credit assessment processes.

- The investment undergoes compliance-and-risk testing, and the portfolio managers accept/reject and, where appropriate, finalise the pricing/sizing of the investment.

The processes and the models are refined continuously. For example, the quantitative credit-rating model has been enhanced by adding a machine-learning-based prediction model. The manager has always been active in price discovery as well as opportunistic on the Australian (buy-side) market-making.



Source: Coolabah Capital Investments

BOTTOM-UP VALUATION

CCI undertakes rigorous bottom-up quantitative asset valuations to price assets based on (a) the issuer's financial characteristics, (b) the asset's capital structure position, and (c) statistical estimates of the probability of default and the expected loss in light of (a) and (b). These bottom-up models include several different state-of-the-art 'Merton' methods. These use option-pricing technology (used by the RBA for monitoring real-time credit risk) and parametric and non-parametric expected-loss models, including techniques that utilise decades of rating-agency data on defaults and recovery rates.

RATINGS ANALYSIS

CCI calculates its own ratings for credit securities. For example, CCI daily calculates default probabilities for the major banks over a 3-year horizon. They have mapped these default probabilities onto implied credit ratings, based on global historical defaults, within different S&P ratings since 1920.

TOP-DOWN VALUATION

CCI has also developed multi-factor, top-down, regression-based valuation models that assume current market prices are correct to price assets based on their individual characteristics: credit rating, maturity, liquidity, capital structure position, industry sector and the terms of the security in question. These top-down statistical valuation models have very high explanatory power and are used to identify day-to-day anomalies in secondary asset pricing and to inform CCI about the expected valuations of new primary issues.

RESPONSIBLE INVESTING

CCI considers environmental, social and governance (ESG) factors to be crucial to its investment process and to have potentially profound consequences for the performance of its investments, including downside risks and upside mispricing potential.

Nuanced ESG factors are often overlooked by the market and credit rating agencies when assessing the creditworthiness and valuations of fixed-income securities. CCI continues to be deeply engaged with its target companies, relevant regulators and government stakeholders, dynamically evaluating the status of different ESG factors and seeking to understand their future path. It is essential that CCI be able to identify and monetise alpha-generating opportunities. ESG is, therefore, a core part of their quantitative and qualitative due diligence and wider investment process.

CCI is cognisant of several benchmarks for assessing ESG issues and is a signatory of the UN-endorsed Principles for Responsible Investment (PRI). CCI actively monitor the development of such principles and their adoption by rating agencies and regulators. CCI also perform deep proprietary research on ESG factors and has published academic research exploring and quantifying the alpha and beta benefits from ESG inputs across different asset classes and countries.

In addition to performing proprietary internal analysis, CCI evaluates ESG research prepared by industry-leading external providers such as MSCI, Sustainalytics, S&P and Bloomberg when assessing a company's resilience to long-term, industry-material ESG risks. Insights provided by these experts assist CCI in identifying risks and opportunities that may not be captured by conventional financial analysis. Furthermore, CCI compiles the MSCI ESG risk rating for each of their exposures and targets a minimum weighted average portfolio MSCI ESG rating of 'A' to help ensure that their portfolios are not exposed to unexpected shocks. Portfolio ESG ratings are reported monthly to investors. The Smarter Money Fund has a weighted average portfolio MSCI ESG rating of "A".

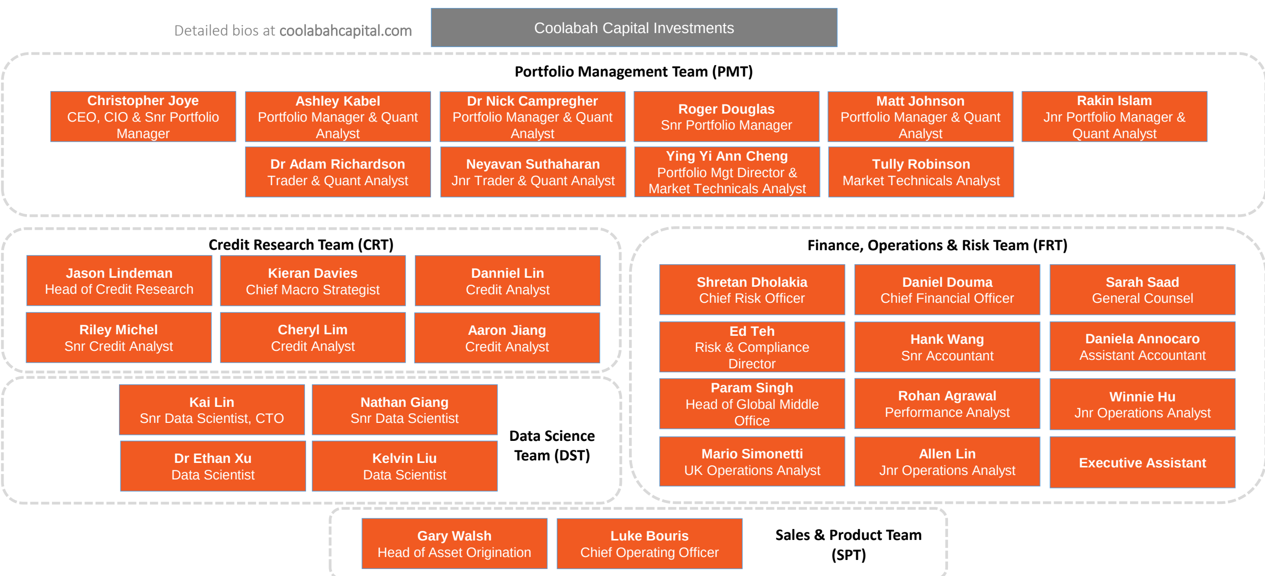
Investment Team

The CCI team has continued to expand over the past year. There are now 34 staff members, including 6 portfolio managers, 4 portfolio management analysis and support staff, 6 credit analysts and 4 data science team members. This includes the London office, led by Dr Nick Campregher, a senior Portfolio Manager and Quant Analyst.

CCI's investment team is large and very well resourced compared to many of its peers, reflecting the highly active and quantitatively complex nature of CCI's investment strategies. The CCI team is managed by Christopher Joye, who is both Chief Investment Officer and Senior Portfolio Manager.

Christopher Joye approves all material OTC trades (one portfolio manager focuses on executing the ASX book on an intra-day basis within agreed delegations), with the other portfolio managers having more limited responsibility, subject to pre-agreed delegations. Hence, there is a high level of key man risk in implementing the strategy.

ORGANISATION CHART



Source: Coolabah Capital Investments

PORTFOLIO MANAGERS

Team Member	Role	Experience
Christopher Joye	CEO, CIO and Senior Portfolio Manager	Christopher is a financial economist and funds management professional and has led the portfolio management team since its inception. His prior experience includes Goldman Sachs (mergers and acquisitions); the RBA in special projects; and he established the quantitative research group Rismark, which also managed asset-backed securities.
Roger Douglas	Senior Portfolio Manager	Roger Douglas joined Coolabah in 2022 as a Senior Portfolio Manager based in our London and Sydney offices. Roger was previously jointly responsible for EUR30 billion in credit strategies at Deutsche Asset Management as a portfolio manager and Co-Head of Fixed-Income Solutions EMEA.
Ashley Kabel	Portfolio Manager and Quant Analyst	Ashley joined CCI in 2017. She was the Director of Quantitative Strategies at The Cambridge Strategy in London between 2012 and 2016, and prior to that, she was an investment analyst with PM responsibilities covering FX, equities and fixed income
Matt Johnson	Portfolio Manager and Quant Analyst	Matt's prior career was mainly at UBS where he was a Managing Director and the Global Head of Rates Strategy. Other roles at UBS included the Head of AUD/NZD Rates Strategy in Sydney and the head of the Asia Pacific Knowledge Network in Singapore.
Dr Nick Campregher	Portfolio Manager and Quant Analyst	Based in London, Nick helps lead Coolabah's offshore trading, investments, execution, and research processes. His previous roles included Senior Trader in the Credit Exotics and Complex Structured Products group at UBS in London between 2013 and 2019, structured credit trader (UBS), and risk management consulting (d-fine Ltd. and Standard Bank).
Rakin Islam	Junior Portfolio Manager & Quant Analyst	Rakin joined Coolabah in 2021 as a Junior Portfolio Manager & Quant Analyst based in London. He was previously a Global Markets Quant at Deutsche Bank in London where he developed semi-systematic trading strategies focussing on securitised products, systematic market making techniques, algorithmic trading, and portfolio construction, amongst other things.

CREDIT / QUANT / RISK / TECHNICAL ANALYSTS

Team Member	Role	Experience
Shretan Dholakia	Chief Risk Officer	Shretan joined Coolabah Capital in 2020. He has over 20 years of experience encompassing trading, portfolio investment and dual risk-compliance subject matter expertise. Prior to joining Coolabah, he advised KPMG and its clients on trade surveillance compliance under the Market Abuse Regulation (MAR) and conducted algorithmic trading model validations for both first and second lines of defence.
Jason Lindeman	Head of Credit Research	Jason's prior experience involved credit analysis, credit trading and portfolio management in Australia and London.
Kieran Davies	Chief Macro Strategist	Kieran was the Chief Markets Economist for NAB and Chief Economist - Australia and New Zealand - for Barclays Bank and ABN Amro Bank/RBS. He also worked as Principal Adviser to the Commonwealth Treasury on the macroeconomy and budget policy.
Ying Yi Ann Cheng	Portfolio Management Director and Market Technical Analyst	Ying specialised in macro-hedge-fund sales at Citibank in London and Sydney and institutional fixed-income sales at RBC.
Kai Lin	Senior Data Scientist and CTO	Kai was a Data Scientist at CBA, building machine learning models.

Performance

The Fund is a newly issued investment strategy, so historical performance data isn't available. Instead, the Manager has 'back-tested' a model portfolio based on the Australian bank bond universe and applied 75% gearing. This back-tested performance serves only as a guide to the potential performance of the Fund.

The table below shows that this strategy would have outperformed all asset classes bar Australian equities. Compared to Australian equities, the strategy would have delivered 75% of the returns with only a third of the risk. The 2 charts below imply the model portfolio has a risk-return profile similar to high-yield bonds, but the nature of the risks is very different. The model portfolio's volatility largely derives from the impact of material leverage on credit spread changes. In contrast, for high-yield bonds, credit deratings and defaults are very much a material risk. Given the economic outlook for 2023, these risks are likely to impact these 2 different strategy types in very different ways.

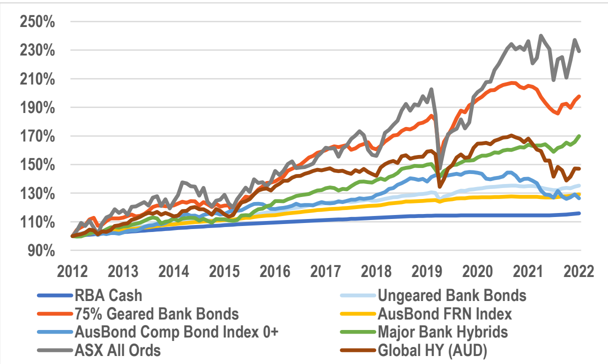
SNAPSHOT

Risk and Return by Asset Class - Jan 2013 – Oct 2022

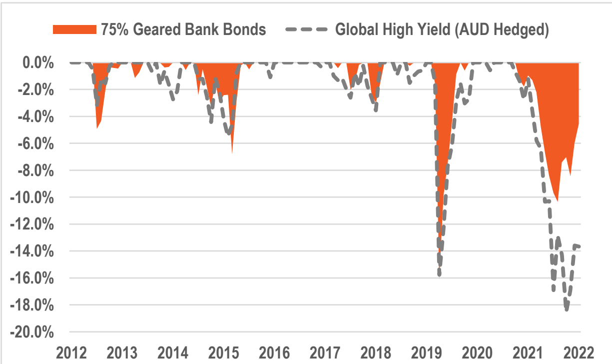
	RBA Cash	Ungeared AU Bank Bonds	75% Geared AU Bank Bonds	Major Bank Hybrids	ASX All Ordinaries	Global HY Index (AUD)	AusBond FRN Index	AusBond Composite Bond Index 0+
Total Return	15.55%	33.75%	**90.54%**	65.29%	135.95%	46.69%	28.56%	28.63%
Return p.a.	1.47%	2.98%	**6.73%**	5.21%	9.06%	3.95%	2.57%	2.58%
Avg Credit Rating	N/A	A	**A**	BBB-	N/A	B+	AA	AA
Excess over RBA Cash		1.51%	**5.26%**	3.74%	7.59%	2.48%	1.10%	1.10%
Volatility p.a.	0.09%	1.33%	**5.29%**	4.15%	15.08%	5.05%	0.24%	3.75%
Sharpe Ratio		1.14	**0.99**	0.90	0.50	0.49	4.61	0.29
Annual Yield to Maturity	2.80%	5.64%	**11.26%**	6.42%	6.14%	9.26%	4.51%	3.70%

Source: Coolabah Capital Investments.

Comparative Returns – 2012 to 2022



Drawdown Profiles – 2012 to 2022



Source: Coolabah Capital Investments, Foresight Analytics.

PORTFOLIO SNAPSHOT

Model Portfolio: 28 November 2022

Average Portfolio Credit Rating	A	**Modified Interest Rate Duration**	<0.1 years
Portfolio Weight to Cash Securities	12.5%	**Number of Notes**	18
Portfolio Weight to Bank Senior Bonds	106.7%	**Gearing**	70%
Portfolio Weight to Bank Tier-2 Bonds	214.2%	**Annual Yield to Maturity**	11.22%
Average Maturity	21/08/26	**Annual Running Yield**	9.10%

Compliance and Risk Management

The Responsible Entity, Equity Trustees Limited, has the primary legal responsibility for monitoring the investment manager's compliance with the Fund's PDS and IGM. The Responsibility Entity has a Compliance Committee and a dedicated Compliance Manager. The Responsible Entity has appointed Apex Fund Services Pty Ltd. (previously known as Mainstream Fund Services Pty. Ltd.) as the administrator for the Fund, responsible for processing investment applications, unit registry, distributions and redemptions, anti-money-laundering monitoring, investor reporting, and investor services. The Fund's assets and unit prices are also independently valued on a daily basis by the fund administrator, using the industry standard administration system, HiPortfolio.

The Fund's assets are held on behalf of the Fund's investors by Apex. As at the date of this report, CCI is insured by Chubb Insurance Australia Limited and includes professional Indemnity insurance ($5 million), directors and officers' insurance ($2 million), and crime insurance ($5 million). There is also a $2 million cyber security policy in place.

CCI RISK GOVERNANCE

CCI has 2 dedicated compliance managers: Risk & Compliance Director, Ed Teh, who is based in Sydney, and Chief Risk Officer, Shretan Dholakia, based in the London office. CCI's Investment Committee and Risk and Compliance Committee also monitor compliance. The Investment Committee comprises Darren Harvey (Chair), Melda Donnelly (Independent), Chris Joye (CIO), Robert Henricks (Independent), John Phokos (Independent) and Colin Roden (Independent). The Risk and Compliance Committee comprises experienced Super Fund Director, Melda Donnelly (Chair), former Super Fund Director, Robert Henricks (independent committee member) and James McNally (risk/compliance expert).

Detailed compliance procedures are in place, which include notification of significant events or breaches to the Compliance Committee and the Board, notification requirements, compliance reviews and audit requirements.

CCI RISK MANAGEMENT SYSTEMS

In 2017, CCI transitioned to the Bloomberg Asset and Investment Manager (AIM) system, which is an industrial-scale, fixed-income order management, portfolio management, compliance, middle-office and back-office asset management system used by over 800 institutions globally. This system represents a significant ongoing cost, but it allows CCI to manage upwards of 20 portfolios using global multi-asset strategies. CCI's Bloomberg AIM system enables the following analytics:

- Live portfolio revaluations and portfolio weights intra-day
- A dashboard view of individual portfolio exposures by security type, issuer and sector
- Pre-trade investment compliance across a large number of mandate rules
- Pre- and post-trade portfolio analytics, including modified duration, spread duration and credit rating distributions

AIM provides real-time position management and portfolio analysis, enabling managers to compare the portfolio to a benchmark, and allowing traders and risk managers to view aggregate risk metrics. CCI's core quantitative valuation models directly interface with Bloomberg and are automatically updated daily.

MIDDLE/BACK-OFFICE

CCI's internal middle office, including a dedicated CFO and an operations analyst, uses Visual Basic to automate settlement processing. CCI's retail funds' accounting, unit registry, tax, general fund administration and back-office services are outsourced to Apex Fund Services, a Sydney-based ASX-listed global fund administrator with operations in 8 countries. Apex Fund Services uses the HiPortfolio system for unit pricing and portfolio valuations.

CCI outsources all Responsible Entity services to Equity Trustees Limited, as well as its own independent compliance systems, and custody to Apex Fund Services.

CCI uses the CompliSpace enterprise-wide risk management, compliance and governance system. CompliSpace services over 600 clients in Australia, including numerous large institutional fund managers. They have offices in Sydney, Melbourne and Perth and staff in Adelaide and Canberra.

Transparency & Reporting

The Coolabah Capital website provides Fund details, documentation, performance, technical papers and – for researchers – detailed company structure and business management.

CCI provides:

- monthly summary performance and strategy reports via email or in the public section of the website;
- monthly portfolio composition files for institutional clients (via email or in a password-protected section of the website); and
- monthly detailed historical performance files for institutional clients (available in the password-protected section of the website.)

THIRD-PARTY & SERVICE ADVISORS

Fund Administrator	Apex Fund Services Pty. Ltd.
AFSL Licensee	Coolabah Capital Institutional Investments Pty. Ltd.
Trustee Services	Equity Trustees Limited
Compliance Services	CompliSpace
Legal Advisor	Corrs Chambers Westgarth
Accounting, Fee and Distribution Calculation	Apex Fund Services Pty. Ltd.
Taxation Advisor	EY Australia
Auditor	EY Australia
Insurance Provider	Chubb Insurance Australia Limited (investment manager policy), Dual Australia Pty. Ltd. (cyber security policy) and Asteron Life (key-man insurance)
Fund Research	Data sources: Bloomberg, FT Interactive, Yieldbroker and S&P Capital IQ
IT Services	Sapphire IT Services
Portfolio Software	Bloomberg AIM System

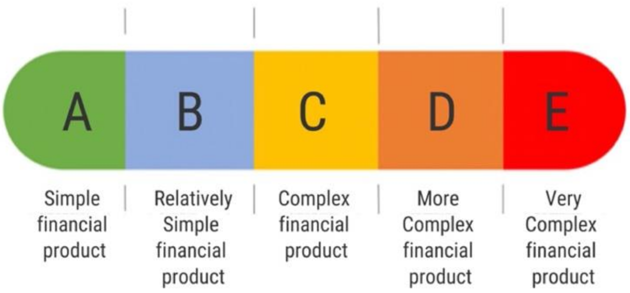
Investment Rating Scale

The Foresight Analytics' Analytics investment rating is an opinion on how well we believe a fund will perform against a range of risks.

Rating	Definition
Superior	Indicates the highest level of confidence that the fund can deliver a risk-adjusted return in line with the investment objectives of the fund.
Very Strong	Indicates a very strong conviction that the fund can deliver a risk-adjusted return line with the investment objective of the fund.
Strong	Indicates a strong conviction that the fund can deliver a risk-adjusted return in line with the investment objective of the fund.
Competent	Indicates that the fund may deliver a return in line with the fund's relevant benchmark.
Weak	Indicates a view that the fund is unlikely to deliver a return in line with the investment objective of the fund and or meet the return of its benchmark.

Foresight Complexity Indicator

Foresight Complexity Indicator (PCI) highlights the complexity of an investment by its terms and conditions' structure and transparency that may affect the investor's return.



Investment Rating & Foresight Complexity Methodology

Foresight Analytics and Ratings' methodology for its investment rating and research can be downloaded from its website.

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