



Betashares Australian Investment Grade Corporate Bond ETF

ASX: CRED

Quarterly Report - March 2024

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Performance ¹	1 month %	3 month %	6 month %	1 year %	3 years % p.a.	Inception % p.a. ²
Fund Return (net)	1.53%	2.04%	8.01%	6.12%	-0.94%	2.62%
Growth Return	1.14%	0.81%	5.44%	1.20%	-5.31%	-1.55%
Income Return	0.39%	1.23%	2.57%	4.92%	4.37%	4.17%
Index Return	1.54%	2.04%	7.93%	6.02%	-0.84%	2.94%

Past performance is not a reliable indicator of future performance.

¹ As at 28 March 2024. Returns are calculated after fees & expenses have been deducted and distributions have been reinvested.

² Inception date for the Fund is 31 May 2018.

Yield and portfolio characteristics	
Running Yield (% p.a.) ¹	4.52%
Yield to Maturity (% p.a.) ²	5.57%
Average Maturity (Yrs) ³	7.07
Modified Duration (Yrs) ⁴	5.79
Average Credit Rating ⁵	A-

¹ Average coupon (weighted by market value) of the bonds in the portfolio, divided by the current market price of the bonds. Provides an indication of expected current income from making an investment at market price. This value will vary over time as interest rates change.

² Total expected return from the bond portfolio, based on current bond prices and assuming no change in prevailing interest rates. This value will vary over time.

³ Average (weighted by market value) length of time until the current bonds in the portfolio mature.

⁴ A measure of the sensitivity of the portfolio's value to a change in interest rates. For example, a Modified Duration of 6 years implies that a 1% rise in the reference interest rate will reduce the value of the portfolio by 6.00%.

⁵ Average credit rating for the bonds in the portfolio. Credit ratings should not be used as a basis for assessing investment merit.

Source: Bloomberg. As at 28 March 2024. Yields shown do not take into account CRED's management costs of 0.25% p.a.

Investment objective

The Fund aims to track the performance of an index (before fees and expenses) that provides exposure to a portfolio of investment grade fixed-rate Australian corporate bonds.

Responsible entity

Betashares Capital Ltd

Distribution frequency

Monthly

Suggested minimum investment timeframe

At least three years

Fun facts	
Inception Date	31-May-18
Fund Size	\$711.31m
Historical Tracking Error (annualised)	0.35%
ASX Code	CRED
Bloomberg Code	CRED.AU
IRESS Code	CRED.AXW
Fees	
	% p.a.
Management fee	0.22
Recoverable expenses	0.03

Investment strategy

The Fund will generally seek to invest in a portfolio of bonds that comprises the Index in proportion to the weightings of these bonds in the Index.

The Index is designed to provide exposure to corporate bonds in Australia, with each bond having a minimum investment grade credit rating. In order to be eligible for inclusion in the Index, each bond must be a senior, fixed rate, investment grade debt security denominated in Australian dollars, issued by companies listed on the ASX or other eligible entities.

In addition, eligible bonds must have amounts outstanding of at least \$250 million and a term to maturity ("TTM") of between 5.25 to 10.25 years.

Eligible bonds are ranked by yield above benchmark (being a Commonwealth Government bond of similar maturity), with up to a maximum of 50 bonds selected, with each bond assigned an equal weight as at each rebalance date. To aid with issuer diversification, no single issuer shall have a weight in excess of 7% at each rebalance date.

By selecting bonds based upon expected returns rather than debt outstanding, the Index methodology seeks to avoid shortcomings of traditional debt-weighted indices and provide relatively higher returns.

Top 10 positions	% ¹
Deutsche Bahn Fin Gmbh 6.016% Nov-33	2.4
Coles Group 6.208% Nov-33	2.3
Contact Energy Ltd 6.398% Nov-30	2.3
Auckland Intl Airport 6.482% Nov-33	2.2
Australian Unity Healthc 6.781% Nov-29	2.2
Contact Energy 6.398% Nov-30	2.2
Woolworths Group 2.75% Nov-31	2.2
Westconnex Finance 3.15% Mar-31	2.2
Verizon Comms 2.65% May-30	2.2
NSW Electricity 2.543% Sep-30	2.2

¹ As at 28 March 2024

Sector exposure	Fund Weight % ¹	Index Weight % ¹
Financial	36.5	38.9
Communications	12.7	10.1
Consumer, Non-cyclical	15.5	14.3
Utilities	15.3	14.3
Industrial	15.7	16.4
Consumer, Cyclical	4.4	6.1
Technology	0.0	0.0
Basic Materials	0.0	0.0
TOTAL	100.00	100.00

¹ As at 28 March 2024

Global macro and rates

Global developments

Global bond yields drifted modestly higher in the March quarter of 2024, as rate cut expectations were partially unwound from forward rate markets amid stronger-than-expected economic activity data and a relatively sticky US inflation backdrop. The average yield on the Bloomberg Global Treasury Index rose by 24 basis points over the quarter, with US Treasuries leading the move. Ten-year note yields increased by 32 basis points, with the movement largely evenly split between higher real yields (implied by TIPS) and inflation break-evens. The shape of the US yield curve remained broadly unchanged, with the spread between 10-year and 2-year yields recording its seventh consecutive quarter of inversion.

There were two FOMC meetings during the quarter (no changes to interest rates), with the January meeting striking a neutral tone regarding the statement and Chair Powell's responses in the Q&A, arguing that the Fed would need to see more evidence of inflation moderating before commencing cuts. The highly anticipated March meeting saw Powell adopt a more dovish tone in his rhetoric, considering the economic resilience of the US economy over the preceding months, although the dot plot saw some hawkish revisions at the margin. Specifically, the median FOMC member projected fewer rate cuts for 2025 compared to the December forecasts, in addition to increasing the estimate for the long-run Fed funds rate, marking the first such move in several years. This presented the first clear evidence of the Committee revising their estimates of the so-called "neutral rate" higher.

The other major global policy development of note was the Bank of Japan (BoJ) raising interest rates for the first time in 17 years, following the strongest and most enduring domestic inflation pressures in over 30 years (albeit modest by global standards in the post-Covid era). In addition to rate hikes, the BoJ also formally ended its Yield Curve Control (YCC) programme and announced an end to purchases of ETFs and J-REITs. The BoJ stopped short of formally ending Quantitative Easing, however, and pledged to maintain the current pace of JGB purchases.

Key economic data globally tended to print above expectations, with the Citi US Economic Surprise Index remaining in positive territory, while the Euro area index returned to positive territory as leading indicators turned higher. Specifically, global and US manufacturing PMI indices returned to levels consistent with an economic expansion, indicating a bottoming out of the manufacturing cycle alongside a belated pickup in Chinese economic activity. US economic activity more broadly remains well above trend levels, in both real and nominal terms, and continues to outperform the rest of the developed world. Inflation data globally was mixed, with inflation tending to surprise on the upside in the US and key inflation gauges appearing to bottom out at levels well above the Fed's 2% target. A rise in commodity prices was also recorded during the period, coinciding with forward-looking US inflation indicators turning higher, including the "prices paid" sub-component of the most recent Manufacturing ISM report.

Measures of global liquidity during the quarter were mixed, with central bank balance sheet changes consistent with a tightening, while market-based measures of financial conditions indicated liquidity remains abundant. The largest central banks – the Fed, ECB, BoJ, and People's Bank of China (PBoC) – collectively reduced the size of their balance sheets, although any major liquidity impact was possibly tempered by the contraction being a result of maturities rather than outright asset sales. In addition, much of the tightening from the Fed's balance sheet runoff was possibly offset by the existence of the Fed's Reverse Repo facility, which helped sterilise increased Treasury bill issuance, which might have otherwise created a liquidity drain at the margin.

Domestic developments

In Australia, 10-year Commonwealth Government Bond yields ended the quarter unchanged, outperforming most global peers amid a benign policy backdrop and mixed economic data. Market pricing of cash rate expectations over the medium term were also little changed, with 12-month forward cash rate futures ending the quarter 8 basis points higher (in interest rate terms), a move much smaller than the 52bps rise in equivalent fed funds pricing.

On the policy front, the RBA adopted a new schedule (of 8 meetings 6 weeks apart instead of the monthly meeting schedule previously) outlined following last year's review, although both the February and March meetings were largely inconsequential for markets (with no changes to the cash rate target), with the forward rates market largely of the view the RBA would remain data dependent.

Inflation data during the period affirmed the trend of moderation in price pressures, and the Q4 quarterly CPI print in addition to the monthly readings for January and February printed below expectations. However, the magnitude of the downside surprises was modest and was seen as unlikely to materially alter the RBA's own inflation forecasts, although it arguably supported local bond markets relative to global peers. In contrast to the relatively dovish inflation data, labour market data remained robust, with the unemployment rate recording an unexpected drop in February (to 3.7% from 4.1% previously), upending the consensus among economists that the labour market was now trending in a looser direction. However, despite the surprise February jobs print, other measures of economic activity tended to fall short of expectations, and GDP growth remained below trend levels.

In terms of domestic liquidity developments, the size of the RBA's balance sheet was largely unchanged over the quarter, while the stock of exchange settlement (ES) balances declined by approximately A\$19 billion (-5.5%). The next major liquidity event domestically will be the final round of Term Funding Facility (TFF) maturities, which will conclude by 30 June, totalling approximately A\$95 billion. Also of note, the RBA announced plans to transition towards a so-called "Ample reserves regime" from the "excess reserves regime" adopted following the covid response. This would involve the RBA's balance sheet remaining flexible to ensure the overnight cash rate trades at the target (floor), but in practice would likely result in

a much smaller balance sheet than at present (following maturities of the remaining TFF loans and outright holdings purchased during QE) and a much smaller footprint in the local bond market.

Credit markets

Global credit markets were characterised by positive risk sentiment and elevated issuance. Despite the highest volume of bond sales since 2021, USD 5-10-year investment-grade spreads to US Treasuries ended the quarter 8 basis points tighter, while high-yield spreads compressed by 20 basis points. Driving the movement was a constructive macroeconomic backdrop for credit, strength in global equity markets, in addition to yield-sensitive investors still being attracted to elevated outright yields as expectations of a US recession over the medium term continued to recede. The increase in bond issuance was widely attributed to a moderation in policy uncertainty from the Fed, with realised and implied levels of US interest rate volatility declining over the quarter. This, combined with the US Treasury recently shifting its issuance focus away from longer-dated bonds and notes to bills, provided a window for corporate treasurers to access an outright-yield-focused investor base in size.

In Australia, AUD 5-10 year corporate bond spreads (to Commonwealth Government bond yields) compressed by 6 basis points, largely in line with global developments. In the floating-rate bank credit space, spreads on senior major bank FRNs were largely unchanged over the period amid issuance ahead of the RBA's final round of TFF maturities. Spreads on Tier 2 major bank subordinated notes widened marginally as new issuance entered indices with concessionary pricing, while spreads on listed AT1 bank hybrids compressed by 25 basis points on a fully franked basis alongside outperformance from ordinary bank shares. Major banks issued approximately A\$19 billion during the quarter in the domestic market across the capital structure (from A\$12.5 billion last quarter), while other financials also increased the level of issuance (A\$22 billion from A\$16 billion in the December quarter). Issuance from non-financial corporates remained the smallest part of local bond market issuance, although there was a modest increase in the amount and number of individual deals coming to market over the quarter.

A key development for domestic credit markets was the ratings actions from both Moody's and S&P, which upgraded several Australian banks across various parts of the capital structure. Specifically, Moody's upgraded senior bonds for NAB, WBC, and ANZ and Tier 2 ratings for all the majors by one notch (to AA equivalent from AA- previously), while S&P upgraded tier 2 (to A- from BBB+) and AT1 ratings (to BBB from BBB-) for all four majors.

Outlook

Although the outlook for fixed income remains uncertain, volatility across the bond market continues to moderate as the range of policy outcomes from both the Fed and RBA narrows. Although the market is still pricing in an easing cycle to begin this year and the Fed appears sanguine regarding the economic backdrop, much of the cuts initially priced in have been removed as the US economy continues to surprise with its resilience.

It should also be noted that the aggressive rally in global bonds at the end of last year was likely exacerbated by short covering from the systematic community, with a sequence of more benign Treasury Refinancing Announcements (TRAs) in H2 2023 acting as the initial catalyst for the reversal. However, with fiscal policy still in play and the US budget deficit still running at 6% of GDP, there's a high likelihood that issuance – both absolute dollar volume and the duration supplied to the market – will increase over the coming quarters. Elevated issuance at a time when the inflation cycle is re-accelerating could lead to a further move higher in yields. The US yield curve also continues to confound many by remaining inverted, although this is largely due to the market still being of the view that the neutral fed funds rate is roughly around the Fed's latest long-run dot plot estimate of 2.625%. If the market were to revise higher its assessment (which may require continued above-trend growth and inflation remaining above 3%), we'd likely see an aggressive "bear steepening" of the US yield curve (long-term yields rising by more than short-term yields to reflect a repricing higher in medium-term forward interest rates). That said, without further upward revisions to the Fed's own neutral rate assessment, the current stance of policy would be viewed as highly restrictive, and their current framework would likely be prescribing cuts. Indeed, Chair Powell has already stated that inflation does not actually need to print 2% (annualised) for the Fed to commence easing, and such an outcome might initially drive a "bull steepening" (short-term yields falling by more than long-term yields) of the curve.

While the picture for rates remains complicated, the environment for credit appears more constructive, supported by a moderation in interest rate volatility, financial conditions remaining accommodative, and the US and global economy showing surprising resilience to higher rates. Investment grade credit remains an attractive choice for outright yield-focused investors, although USD spreads are arguably already discounting a soft-landing outlook for the US economy, in addition to saddling Australian investors with high FX hedging costs. In contrast, AUD investment grade spread potentially offer compelling relative value, trading well above USD equivalents and above prior cycle "tights". Specifically, both fixed rate corporate bonds and high quality supranational and government-related entities continue to offer a relatively favourable risk-return profile compared to Commonwealth government securities, and investors might consider getting their domestic duration exposure outside the traditional route of Treasuries.

Within the floating rate space, major bank credit offers potential upside across the capital structure following the latest round of ratings upgrade. However, senior FRNs are potentially the most interesting segment, with spreads continuing to trade wider than historical averages and above similarly rated globally systematically important peers amid elevated issuance ahead of the unwind of the RBA's TFF. Once the programme formally ends on 30 June and if global credit conditions remain favourable, it's possible that discount margins on 'major bank senior' compress to much tighter levels.

Chart 1: G7 + Australasia Policy Rates, as at 31-March-2024; Source: Bloomberg

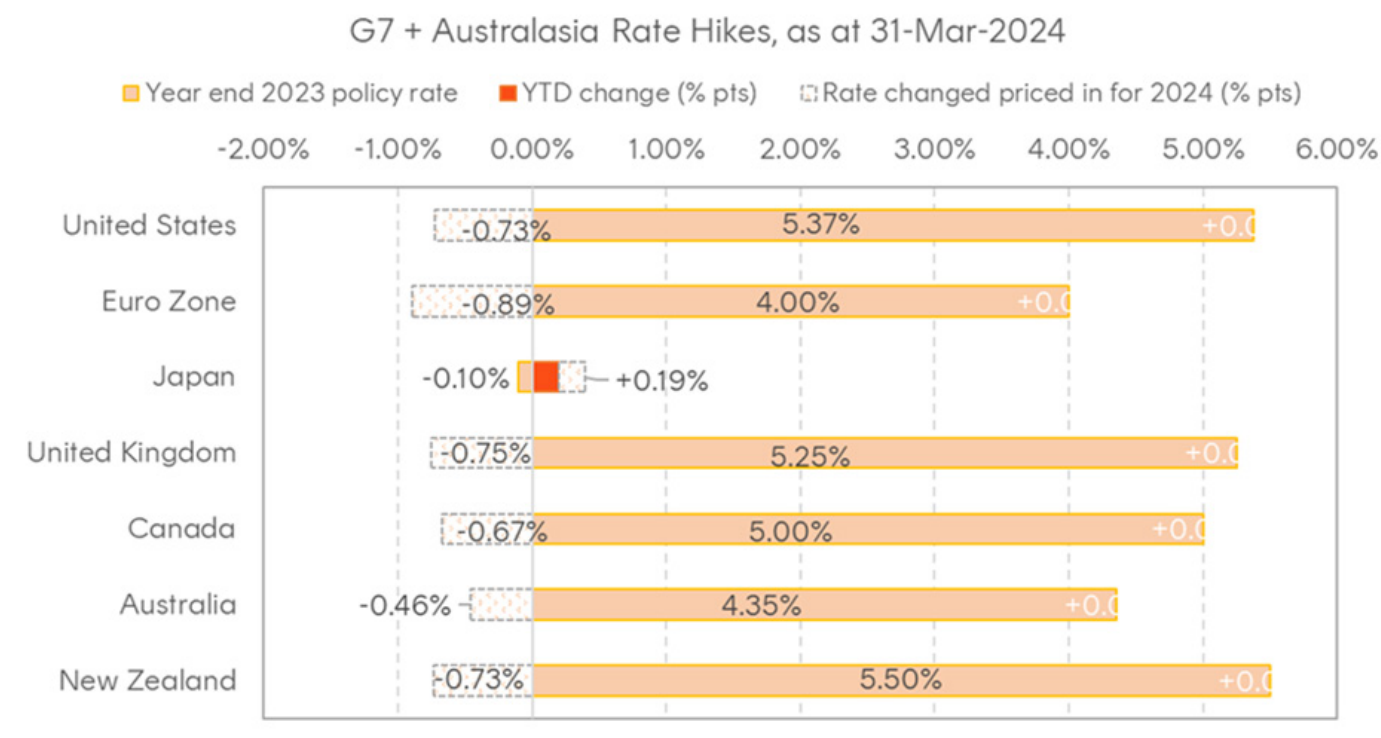


Chart 2: 10-year Government bond yields, as at 31-March-2024; Source: Bloomberg

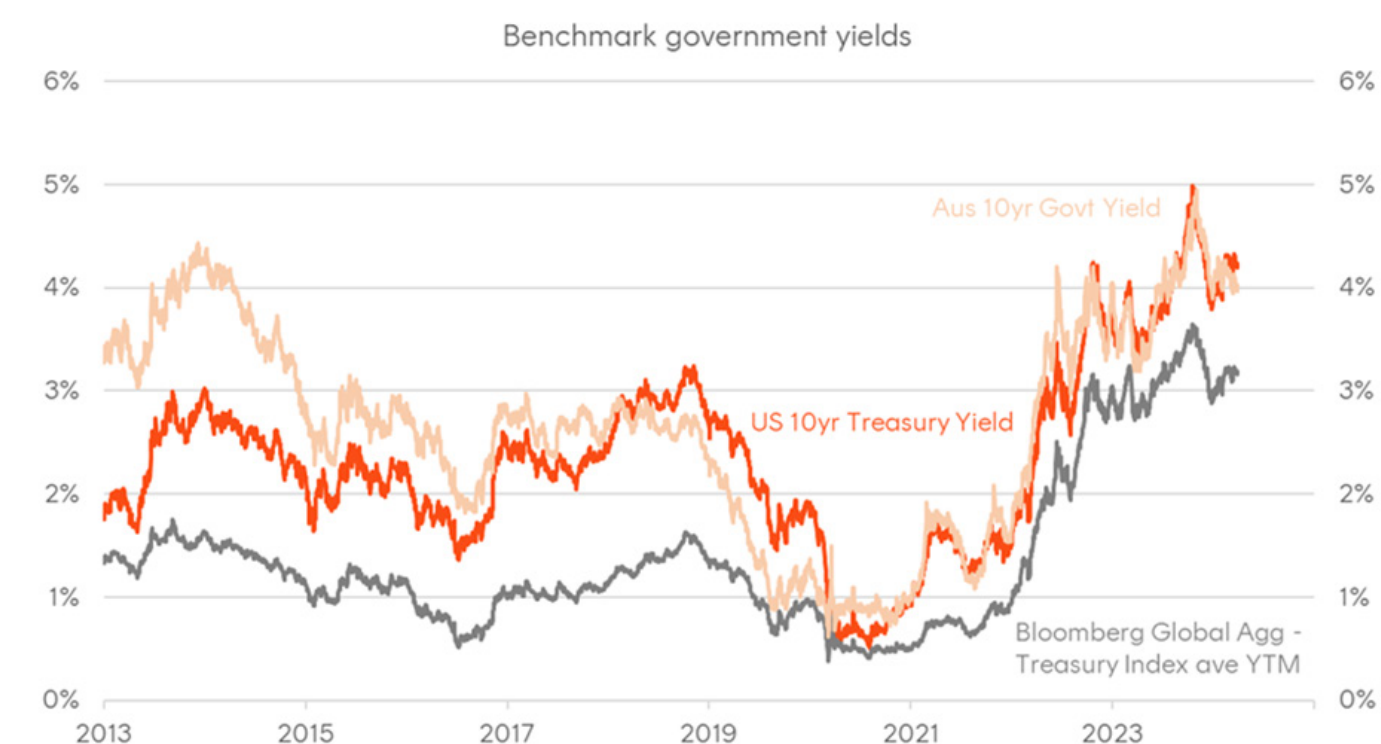


Chart 3: Quarterly change in balance sheets from selected central banks (US\$b); as at 31-March-2024; Sources: Bloomberg, Fed, ECB, BoJ, PBoC

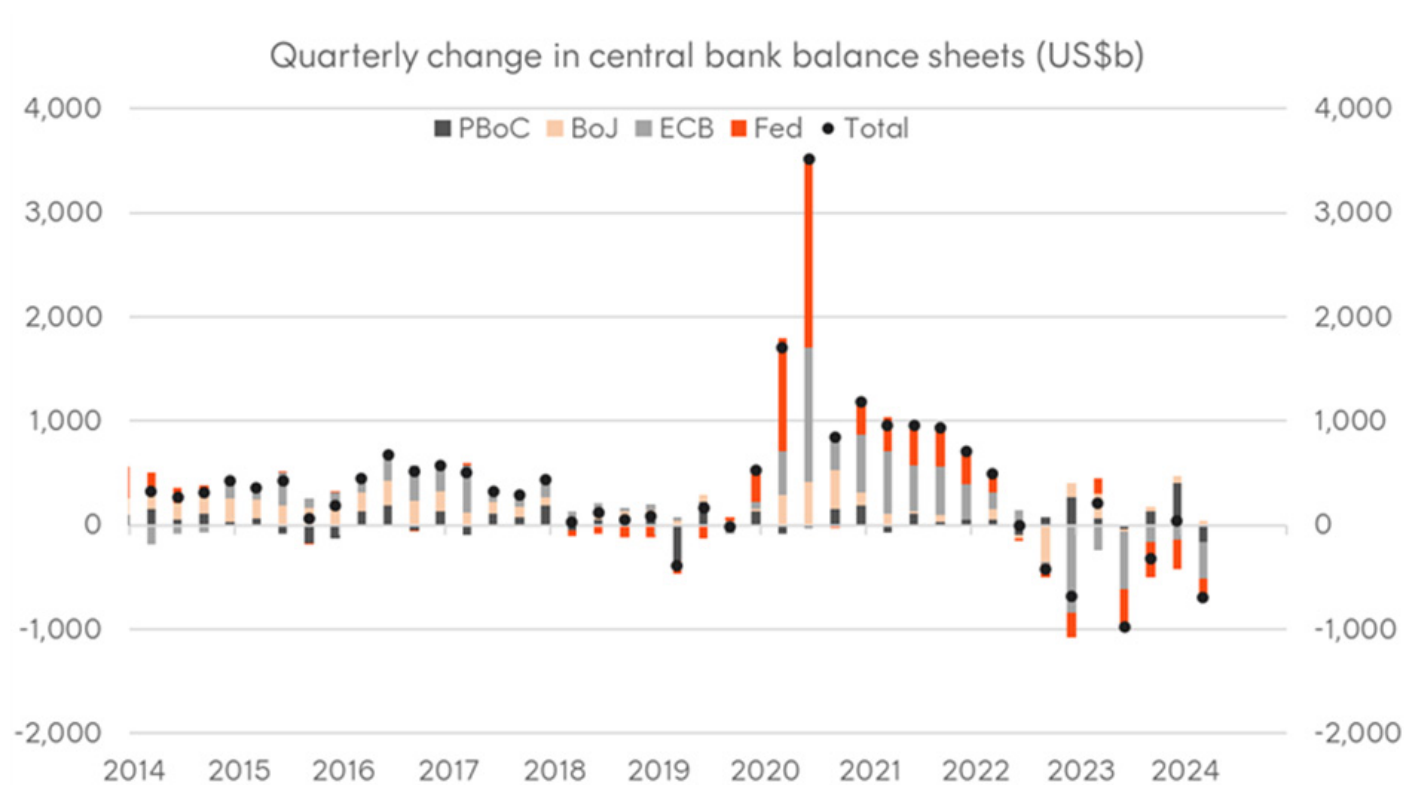


Chart 4: USD corporate bond issuance, breakdown by BICS sectors, as at 31-March-2024; Source: Bloomberg

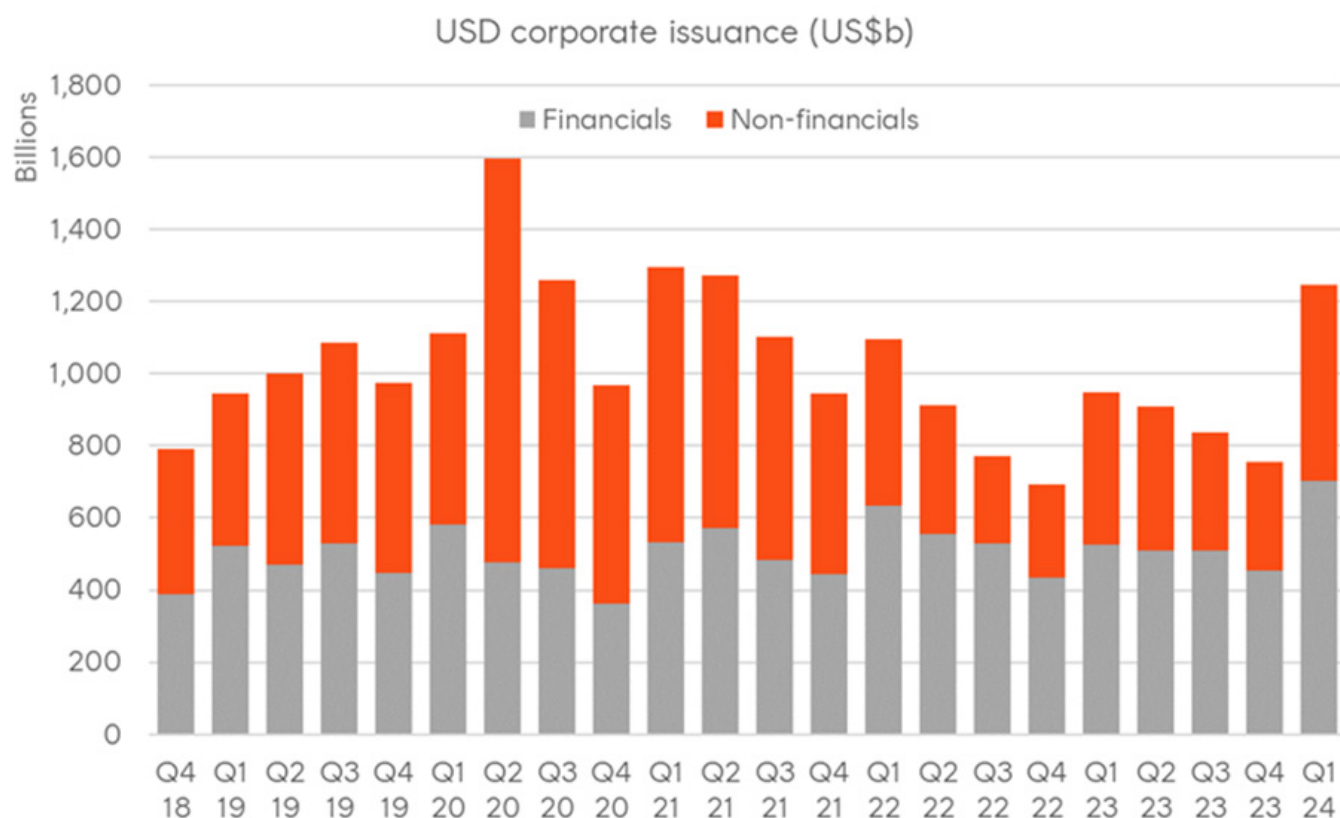


Chart 5: AUD corporate bond issuance, breakdown by BICS sectors, as at 31-March-2024;
Source: Bloomberg

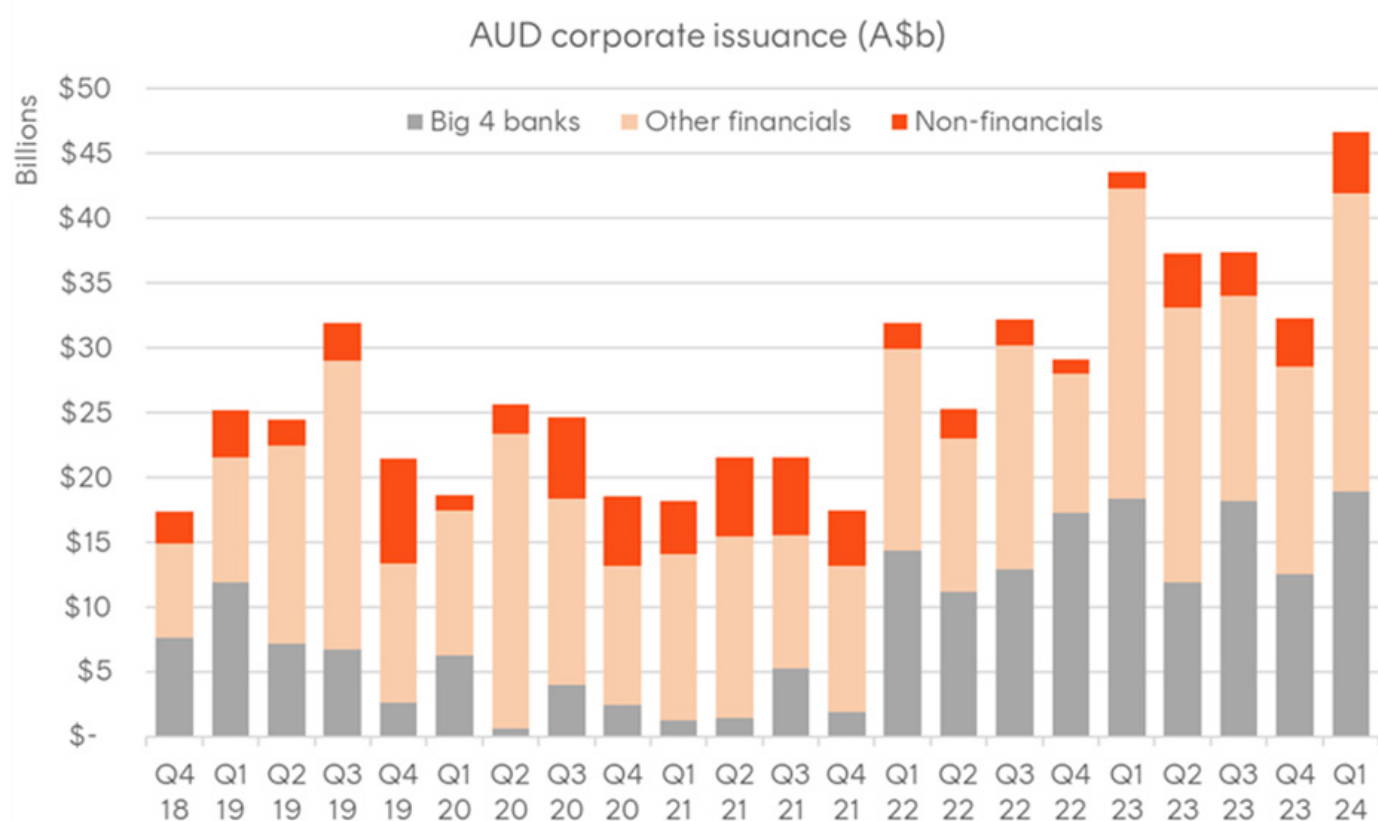


Chart 6: US interest rates, as at 31-March-2024; Source: Bloomberg

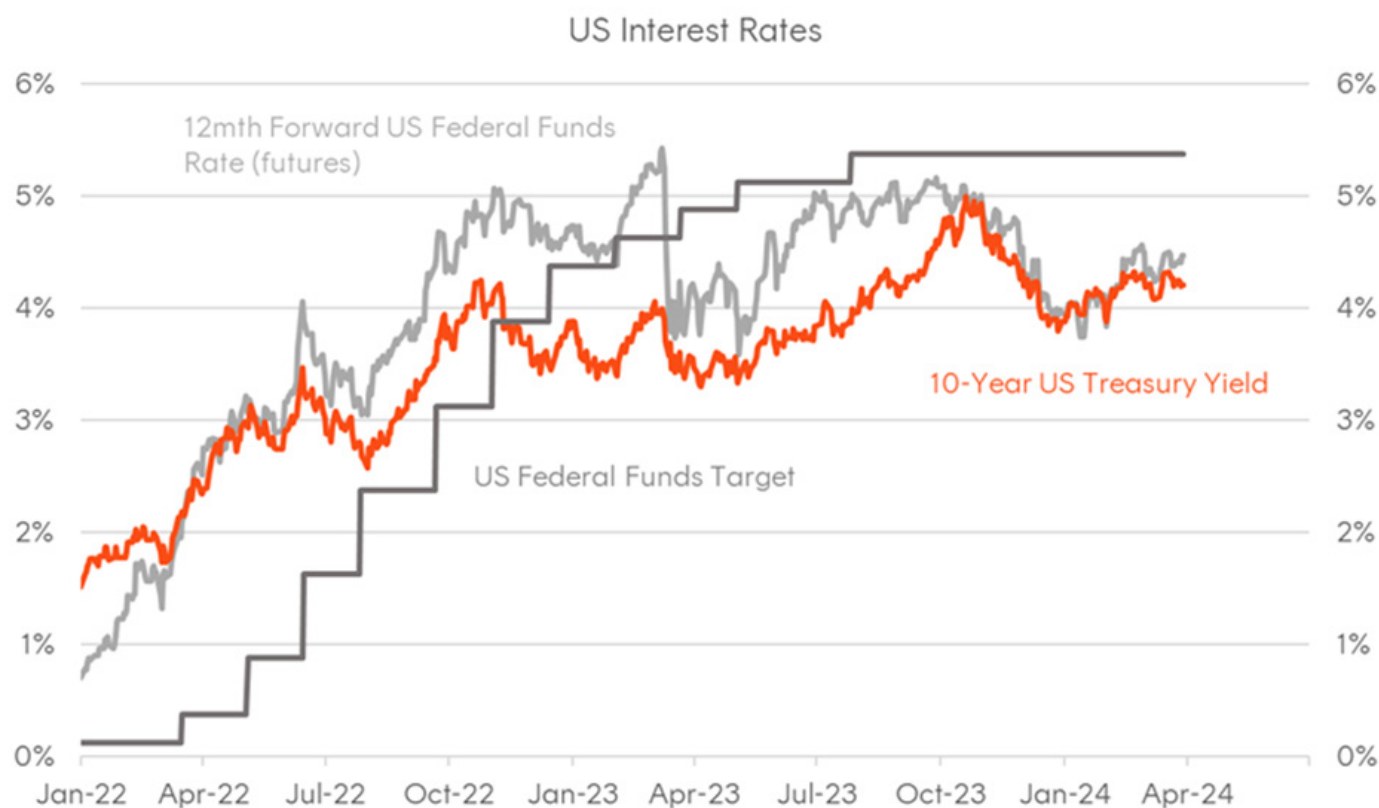


Chart 7: Australian interest rates, as at 31-March-2024; Source; Bloomberg

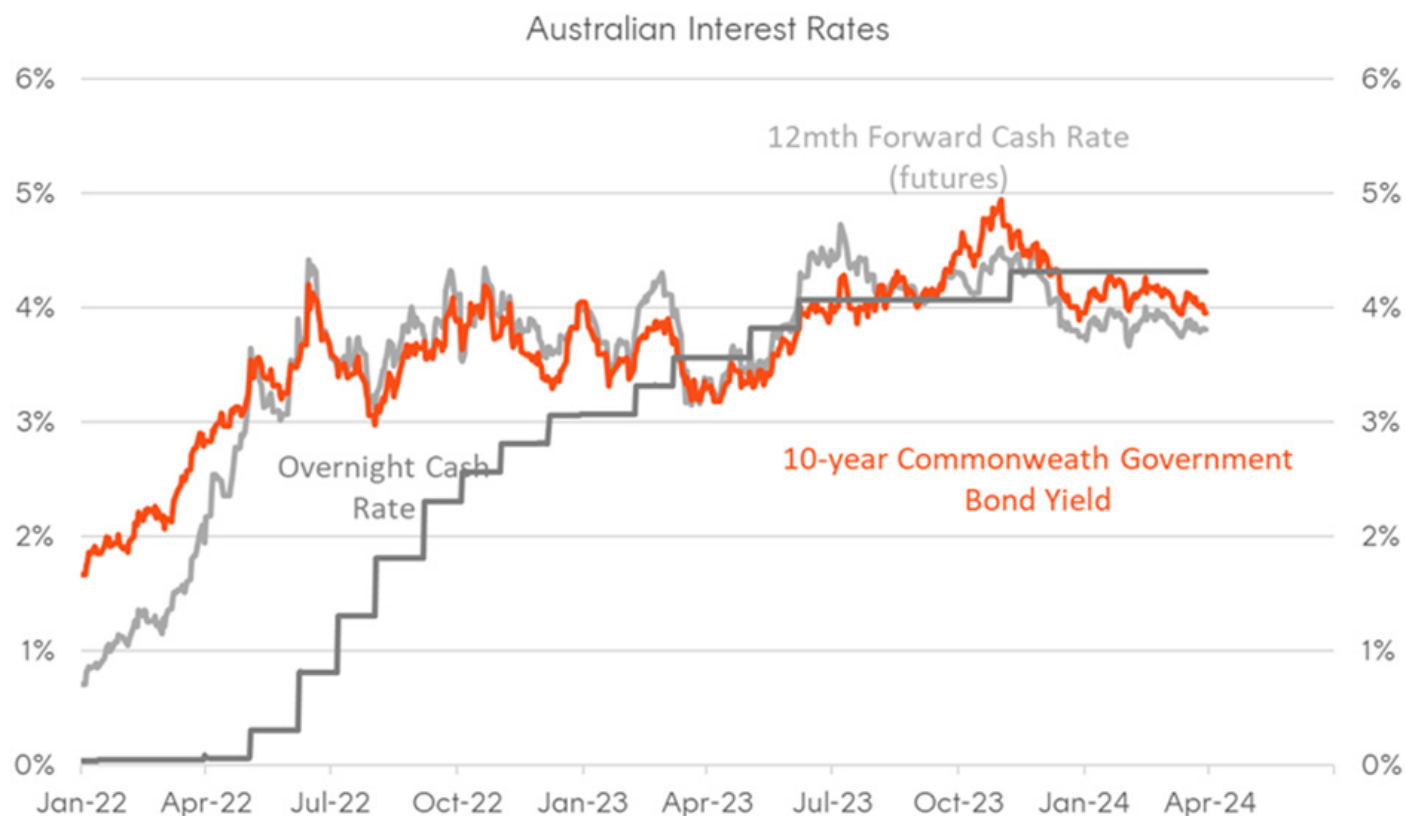


Chart 8: Global economic surprises, as at 31-March-2024; Source: Citi

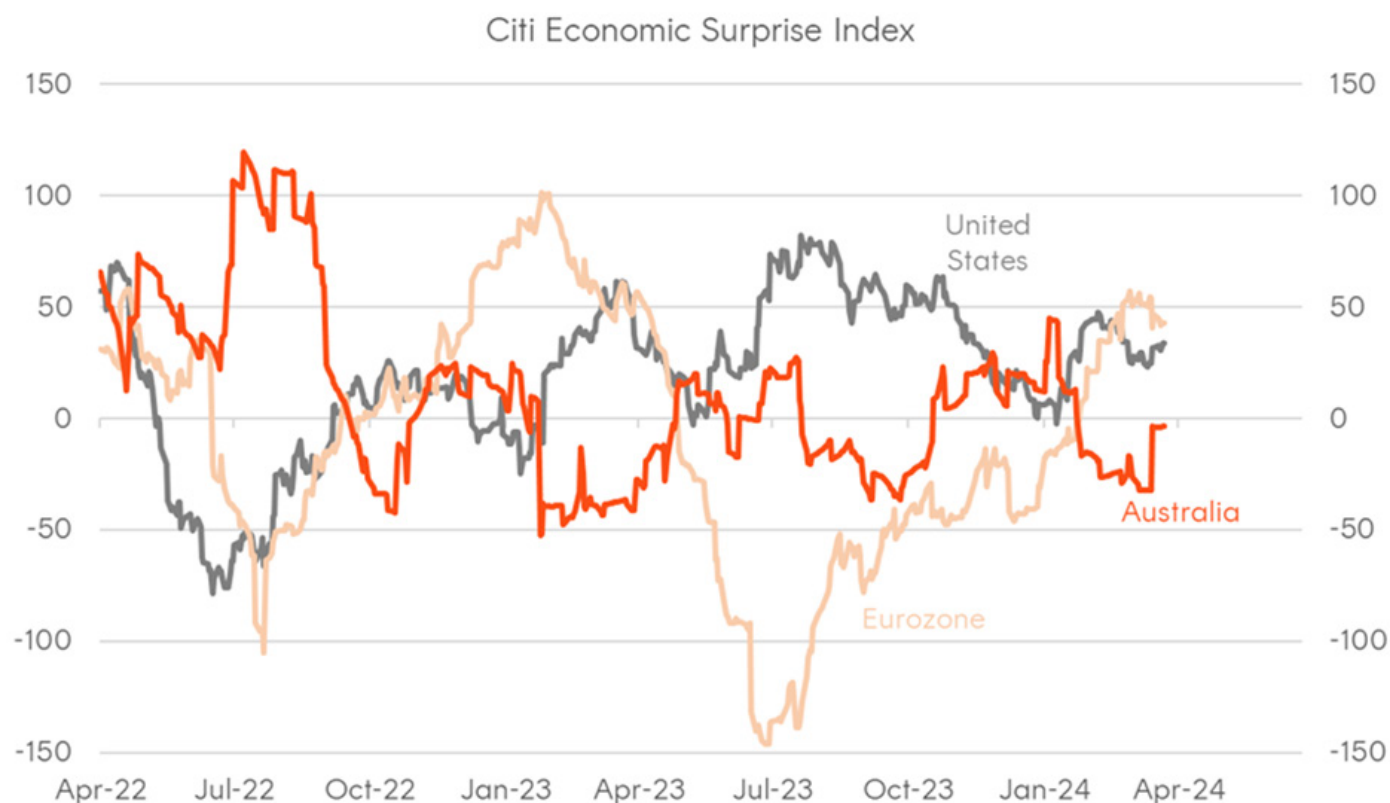


Chart 9: Global inflation surprises, as at 31-March-2024; Source: Citi

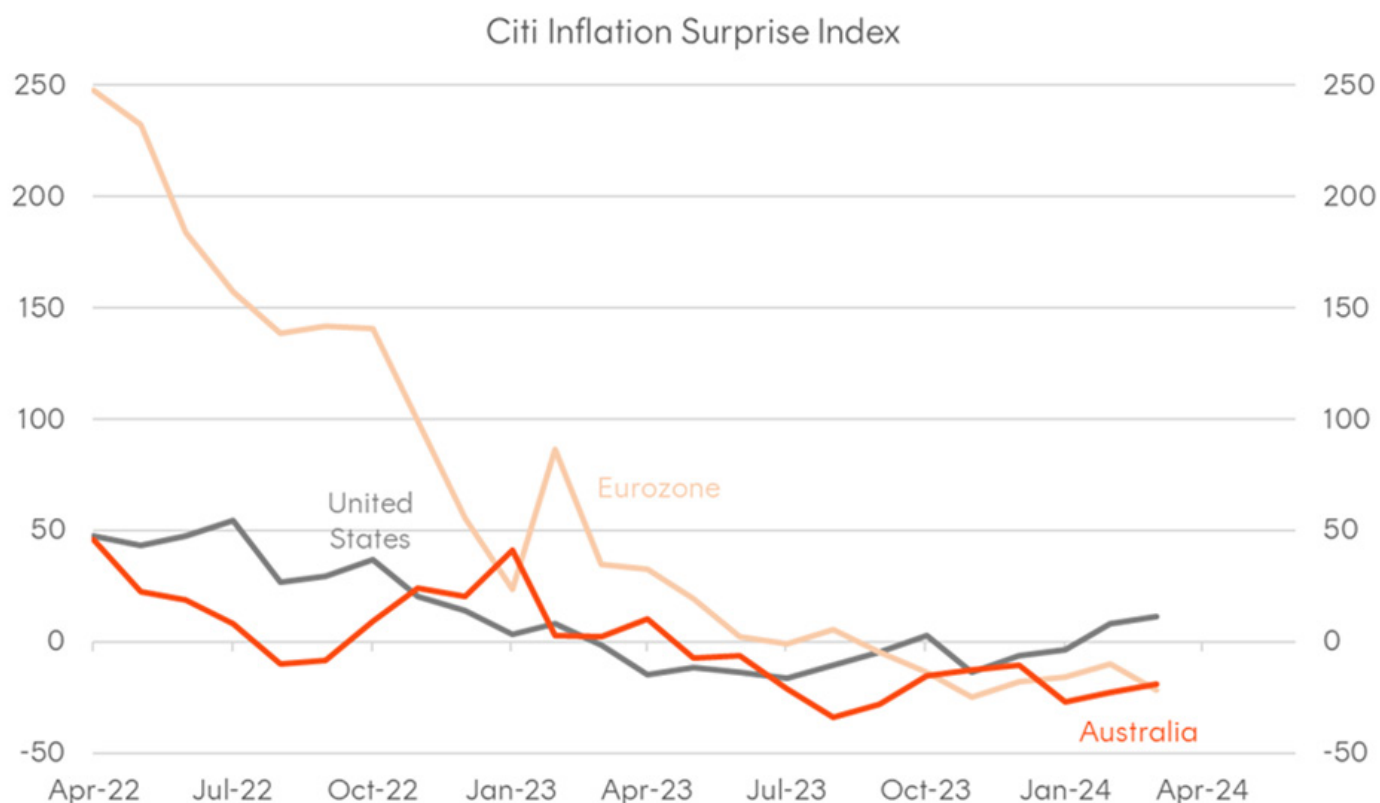


Chart 10: Corporate bond spreads; as at 31-March-2024; Source: Bloomberg

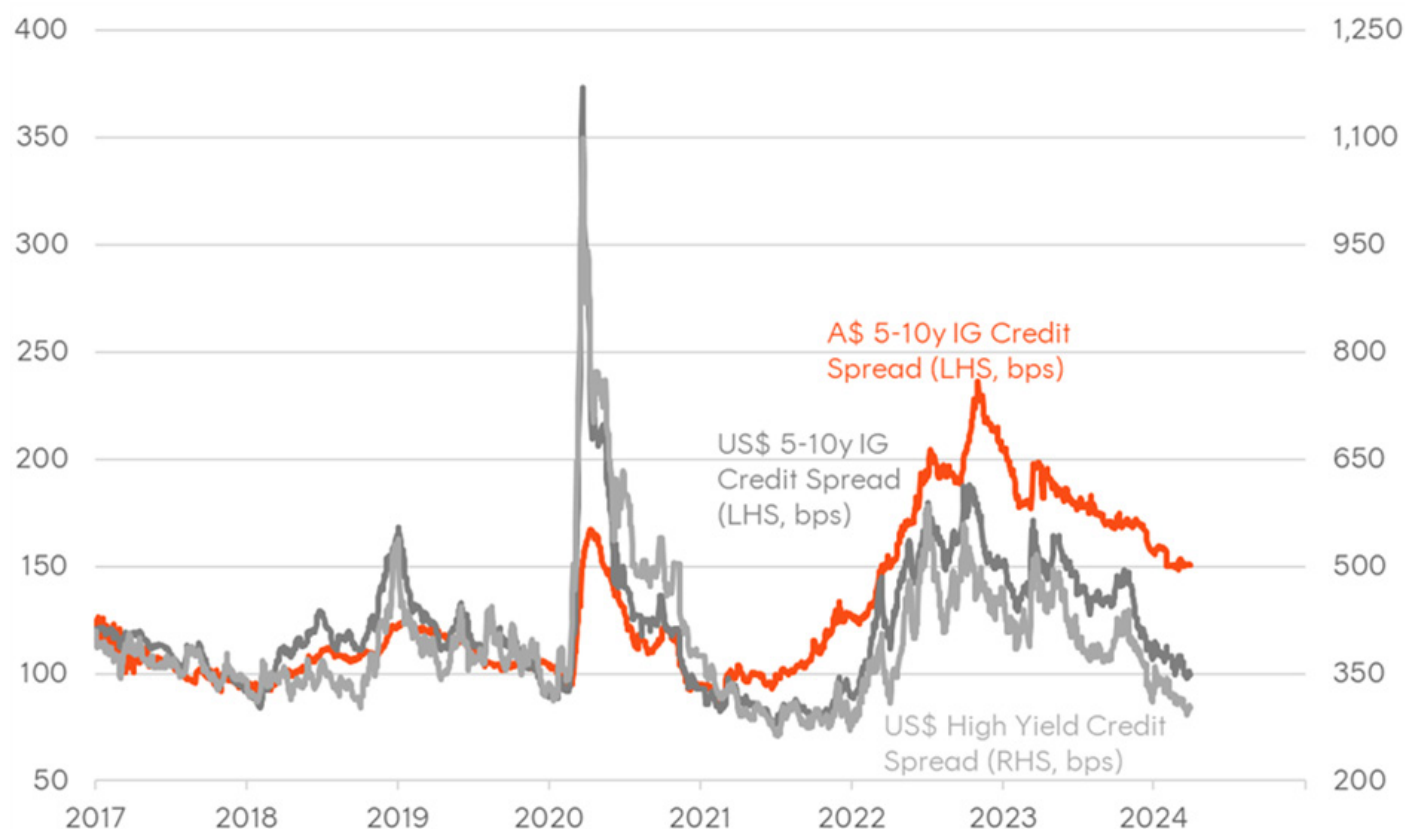
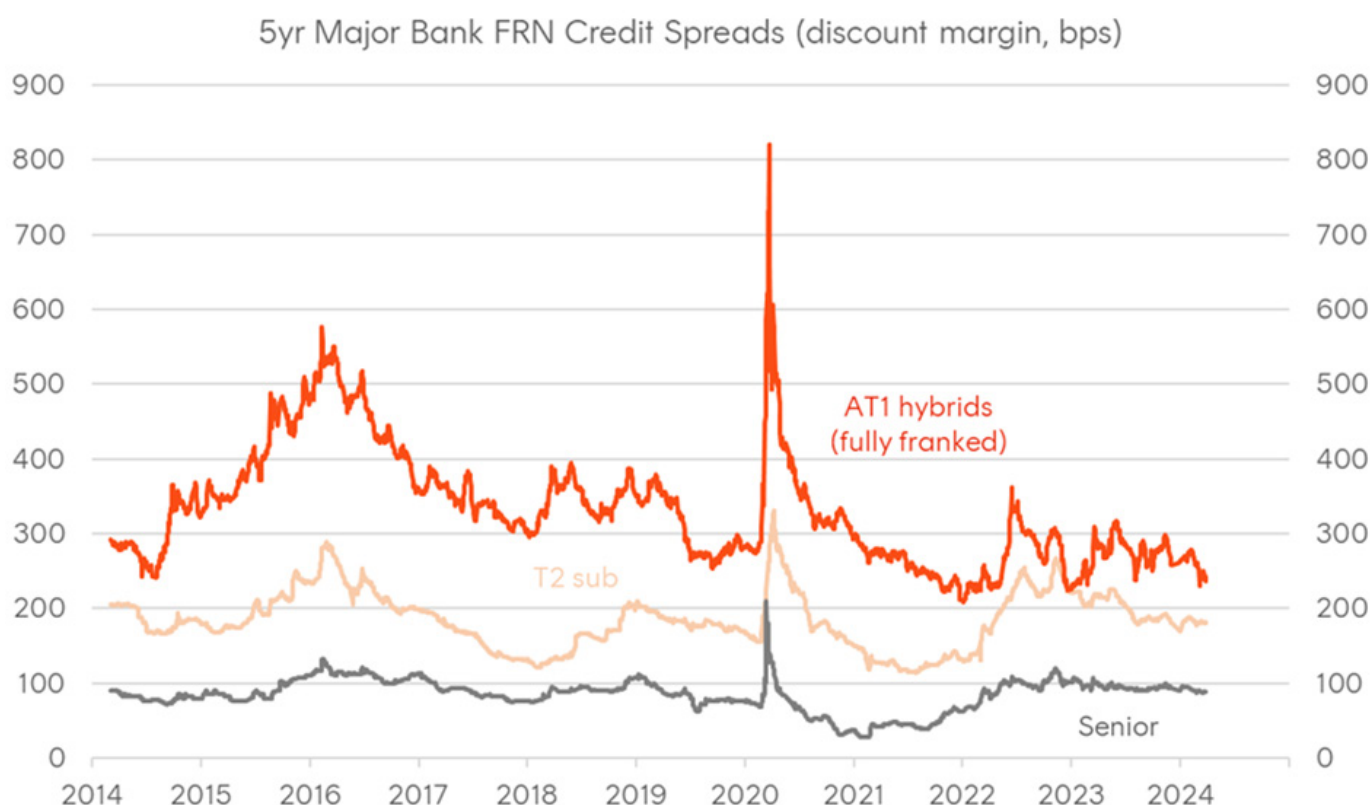


Chart 11: Australian major bank credit spreads history, as at 31-March-2024; Source: Bloomberg



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