Betashares Active Australian Hybrids Fund (Managed Fund)

ASX: HBRD

Quarterly Report - June 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)	0.75%	1.75%	3.47%	7.14%	3.68%	3.94%
Growth return	0.25%	0.27%	0.49%	1.19%	-0.51%	0.23%
Income return	0.50%	1.48%	2.98%	5.95%	4.19%	3.71%
Solactive Australian Hybrid Securities Index (Solactive Index)	0.97%	1.42%	3.40%	6.95%	3.81%	4.06%
Active Return	-0.22%	0.33%	0.07%	0.19%	-0.13%	-0.12%

Past performance is not a reliable indicator of future performance.

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

[2] Inception date for the Fund is 13 November 2017.

Yield and portfolio characteristics	
Running Yield (% p.a.)[1]	5.82%
Gross Running Yield (% p.a.)[2]	6.55%
Fund Constituents	110

[1] Average yield (weighted by market value) of the hybrids portfolio, divided by the current market price of the securities. This provides an indication of expected current income from making an investment at market price. This value will vary over time.

[2] Average estimated gross yield (weighted by market values and inclusive of franking credits) of the hybrids in the portfolio, divided by the current market price of the securities. This provides an indication of the expected current income from making an investment at market price. This figure is indicative only and will vary over time. Not all investors will be able to obtain the full value of franking credits.

Investment objective

The Fund provides investors with a convenient way to access attractive income returns, including franking credits, from an actively managed, diversified portfolio of hybrid securities. As the Fund is overseen by a professional investment manager, it actively seeks to reduce the volatility and downside risk that may otherwise be experienced by direct holders of hybrids.

Responsible entity

Betashares Capital Ltd

Investment manager

Coolahbah Capital Institutional Investments Pty Ltd

Distribution frequency

Monthly

Suggested minimum investment timeframe

At least three years

Fund facts	
Inception Date	13-Nov-17
Fund Size	$2193.5m
Historical Tracking Error (annualised)	0.75%
ASX Code	HBRD
Bloomberg Code	HBRD.AU
IRESS Code	HBRD.ASX

Fees	% p.a.
Management fee	0.45
Recoverable expenses	~0.10
Performance fee[1]	15.5

[1] A performance fee may be payable. This fee is 15.5% of the Fund's performance above the performance benchmark in a calendar quarter.

Investment strategy

The Fund invests in an actively managed portfolio of hybrid securities, bonds and cash. If and when the hybrids market is assessed to be overvalued or presents a heightened risk of capital loss, the Fund can allocate more of the portfolio to lower risk securities.

Top 10 positions[1]	
AN3PL	NABPH
WBCPM	CBAAU
ANZ	WBCPJ
NAB	CBAAU
WSTP	CBAAU

[1] As at 28 June 2024

Sector exposure[1]	Fund Weight %	Index Weight %	Active Weight %
Preference Shares	36.4	99.5	-63.1
Capital Notes	0.0	0.5	-0.5
Subordinated	50.8	0.0	50.8
Senior	11.3	0.0	11.3
Cash	1.4	0.0	1.4
TOTAL	100.00	100.00	0.00

[1] As at 28 June 2024

Fund performance summary

Over the June 2024 quarter, HBRD returned 1.75% unfranked and after fees, and 1.95% franked after fees. HBRD closed the quarter with a gross running yield of 6.55% p.a., and a credit rating of BBB+, following the upgrade of Standard & Poor's Banking Industry Country Risk Assessment (BICRA) for Australia from 3 to 2.

Credit spreads on 5-year major bank hybrids started the quarter at 239bps above the 3-month Bank Bill Swap Rate (BBSW), before tightening to 205bps, which coincided with NAB launching their new NABPK issue. Spreads moved wider to 262bps in a sell-off to fund the all-new money deal, and then resumed tightening into quarter end to close at 227bps over the BBSW rate.

Hybrid yields have benefitted from rising interest rates with the 3-month BBSW rate climbing from 0% in 2021 to 4.45% in June, giving investors greater baseline yields regardless of overall spread levels. In particular, 5-year major bank hybrids paid a running yield of 6.72% p.a. (a combination of the 5-year hybrid spread level of 227bps and the 3-month BBSW rate of 445 bps), broadly in line with the running yield paid 3 months ago as the tightening of hybrid spreads above BBSW was offset by an increase in the yield of the BBSW rate, and a yield-to-call of 6.48% p.a. (a combination of the 5-year hybrid spread level of 227bps and the 5-year quarterly swap rate of 421bps), which is 30bps higher than the March quarter end and was driven by swap rates moving wider, which more than offset the spread tightening.

Hybrid market and outlook

During the quarter we saw the issuance of the $1.0bn NAB Capital Note 8 (NABPK) hybrid, which was an all new-money deal. The new line was issued at a record tight spread of 260bps over BBSW. The deal triggered a modest sell-off in hybrids as investors raised capital to fund their participation, and once the deal settled, this trend reversed.

From the regionals, we saw one primary deal from Suncorp, which rolled their $375m Capital Note 2 (SUNPG) into a $360m Capital Note 5 (SUNPJ). The old SUNPG was allocated $260m to their banking business and the balance to their insurance business. With the sale of the banking business to ANZ now approved, SUNPJ will remain a Suncorp Group backed security (note that Suncorp Tier 2 bonds that the fund owns will also remain Suncorp Group backed, while the Suncorp senior bonds that the fund owns will become ANZ-backed securities). The new SUNPJ security was issued at 280bps above BBSW.

Coming up over the next quarter, we have the scheduled call of Westpac's Capital Note 6 (WBCPI), which was previously rolled into their Capital Note 10 (WBCPM) in December 2023, and Bank of Queensland's 350m Capital Note (BOQPE) which is due to be called in mid-August.

In early April, Aussie bank Tier 2 bonds, which represent around 50% of the fund's portfolio, were upgraded by one notch from BBB+ to A- by Standard & Poor's due to it lifting Australia's Banking Industry Country Risk Assessment (BICRA) score.

As Coolabah projected, the improvement in Australia's BICRA score also resulted in credit rating upgrades to non-major bank senior bonds and Aussie bank hybrids. Major bank hybrids had their ratings lifted from BBB- to BBB, and the weighted average credit rating of the fund was upgraded from BBB to BBB+.

HBRD continued to increase its allocation to Australian bank Tier 2 subordinated bonds from 50% to 51% over the quarter, which is a striking increase relative to near-zero allocations in previous years. Tier 2 bonds rank higher in the bank capital structure than hybrids and have superior credit ratings.

During the quarter, the fund participated in a primary deal for the NAB 10 years-to-call 6.342% coupon Tier 2 issue ($1.25bn), and the Westpac 5.1% coupon 5 year senior issue ($1.45bn). These are both fixed-rate bonds, and the fund is maintaining its zero-duration position by interest rate hedging.

Hybrid spreads are currently paying a multiple of 1.37 times Tier 2 spreads, which is well below the long-term average of 1.8 times. This indicates that while hybrids remain attractive due to their overall yields, and Tier 2 bonds have performed well, Tier 2 bonds are still relatively cheaper and remain a source of potential alpha.

There are risks associated with an investment in HBRD, including interest rate risk, credit risk, hybrids complexity risk and sector concentration risk. For more information on risks and other features of HBRD, please see the Product Disclosure Statement.

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