Betashares Active Australian Hybrids Fund (Managed Fund)

ASX: HBRD

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)	0.60%	1.69%	3.04%	6.54%	3.50%	3.81%
Growth return	0.14%	0.23%	0.15%	0.83%	-0.41%	0.20%
Income return	0.46%	1.46%	2.89%	5.71%	3.91%	3.61%
Solactive Australian Hybrid Securities Index (Solactive Index)	0.81%	1.95%	2.91%	6.73%	3.81%	3.99%
Active Return	-0.21%	-0.26%	0.13%	-0.19%	-0.31%	-0.18%

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 13 November 2017.

Yield and portfolio characteristics	
Running Yield (% p.a.)[1]	5.85%
Gross Running Yield (% p.a.)[2]	6.66%
Fund Constituents	95

[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	$2165.16m
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 will invest 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	NAB
ANZ	NABPH
CBAAU	WBCPJ
CBAAU	WBCPM
CBAAU	WSTP

[1] As at 28 March 2024

Sector exposure[1]	Fund Weight %	Index Weight %	Active Weight %
Listed Hybrids	41.8	99.5	-57.7
Capital Notes	0.0	0.5	-0.5
Subordinated Bonds	50.0	0.0	50.0
Senior Bonds	6.5	0.0	6.5
Cash	1.7	0.0	1.7
TOTAL	100.00	100.00	0.00

[1] As at 28 March 2024

Fund performance summary

Over the March 2024 quarter, HBRD returned 1.69% unfranked and after fees, and 1.89% franked after fees. HBRD closed the quarter with a gross running yield of 6.67% pa, and a credit rating of investment grade BBB. Following the upgrade of Standard & Poor's Banking Industry Country Risk Assessment (BICRA) for Australia from 3 to 2, the fund's credit rating improved to BBB+ in early April.

Credit spreads on 5-year investment-grade (BBB- rated) major bank hybrids started the quarter at 258bps above the 3-month Bank Bill Swap Rate (BBSW), before moving wider to 276bps above BBSW, and then rallying to close the period at a tighter 237bps over BBSW rate.

Hybrid yields have benefitted from rising interest rates with the 3-month BBSW rate climbing from 0% in 2021 to 4.34% in March, giving investors greater baseline yields regardless of overall spread levels. In particular, 5-year major bank hybrids paid a running yield of 6.71% (a combination of the 5-year hybrid spread level of 237bps and the 3-month BBSW rate of 434 bps) and a yield-to-call of 6.18% (a combination of the 5-year hybrid spread level of 237 bps and the 5-year quarterly swap rate of 381 bps) at the end of March.

Hybrid market and outlook

During the quarter we saw the issuance of the $1.7bn ANZ Capital Note 9 (AN3PL) hybrid, which was a scheduled roll of their $1.62bn Capital Note 4 (AN3PG). The new line was issued at a spread of 290bps over BBSW, and ended the quarter tighter at 265bps over BBSW.

From the regionals, we saw primary deals from both Bendigo & Adelaide Bank, and Insurance Australia Group. Bendigo launched their new Capital Note 2 (BENPI), which rolled their Callable Preferred Stock 4 (BENPG), with a spread of +320bps above BBSW and rallied to +294bps at quarter end. Soon after, we saw an all-new-money deal from insurer IAG, their Capital Note 3 (IAGPF), which printed at the same +320bps above BBSW, and closed the quarter with a less impressive rally to +300bps. BENPI and IAGPF issued on 25th March and 26th March respectively, with the same tenor, so the spread between them at quarter end implies there has been a shift in market sentiment vis a vis regional banks and insurers, which will make the new issue that Suncorp is considering an interesting prospect, assuming that Suncorp is able to sell its bank business and become a pure-play insurer.

Coming up over the final quarter of the financial year, we have a maturity from CBA, the $1.59bn Capital Note PERLS XI (CBAPH), which is not likely to be rolled. This lack of roll has contributed to the strong AT1 market as investor money looks for a new home in the sector. We also have Suncorp's Capital Note 2 (SUNPG), with first conversion date in June. SUNPG is a $375mn issue allocated within the group $165mn to the insurer, and $210mn to the bank. If the new issue goes ahead, it remains to be seen how Suncorp will size the new issue for the insurance business.

After the end of the quarter, Aussie bank Tier 2 bonds, which represent around 50% of the fund's portfolio, were upgraded by 1 notch from BBB+ to A- by Standard & Poor's due to their lifting of Australia's Banking Industry Country Risk Assessment (BICRA) score.

As Coolabah projected, the improvement in Australia's BICRA score also resulted in credit rating upgrade to non-major bank senior bonds and Aussie bank hybrids. Major bank hybrids had their ratings lifted from BBB- to BBB.

Aussie major bank Tier 2, is now in the "A" band for the first time with all three key global credit rating agencies (CBA will shortly be confirmed for an upgrade with Moody's, based on our research), which will expand the pool of global capital available to be allocated to these assets.

HBRD continued to increase its allocation to Australian bank Tier 2 subordinated bonds from 49% to 50% 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 Tier 2 primary deals from ANZ ($1.435bn) and NAB ($1.1bn), both pricing at +195bps over BBSW, and ending the quarter tighter at around +182.5bps.

Hybrid spreads are currently paying a multiple of 1.29 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 possible 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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