BetaShares Exchange Traded Funds

BETASHARES AUSTRALIAN GOVERNMENT BOND ETF
ASX: AGVT
Quarterly Report - September 2021

Performance[1]	1 Month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Inception[2] % p.a.
Fund Return (net)	-2.43%	0.28%	2.54%	-2.88%		1.63%
Growth return	*-2.53%*	*0.00%*	*1.99%*	*-3.83%*		*0.58%*
Income return	*0.10%*	*0.28%*	*0.55%*	*0.95%*		*1.05%*
Index return	*-2.38%*	*0.36%*	*2.68%*	*-2.71%*	*5.73%*	*1.81%*

Past performance is not a reliable indicator of future performance.

[1] Returns are calculated after fees & expenses have been deducted and distributions have been reinvested.

[2] Inception date for the Fund is 5 July 2019.

Yield and portfolio characteristics

Running Yield (% p.a.)[1]	2.15%
Yield to Maturity (% p.a.)[2]	1.53%
Average Maturity (Yrs)[3]	8.92
Modified Duration (Yrs)[4]	8.04
Average Credit Rating[5]	AAA

[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 7 years implies that a 1% rise in the reference interest rate will reduce the value of the portfolio by 7.00%.

[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. Yields shown do not take into account AGVT's management costs of 0.22% p.a.

Investment objective

The Fund aims to track the performance of an index that provides exposure to a portfolio of high-quality bonds issued by Australian federal and state governments, and with a component also issued by supranationals and sovereign agencies.

Responsible entity

BetaShares Capital Ltd

Distribution frequency

Monthly

Fund Facts	
Inception Date	5-Jul-19
Fund Size	$173.59m
Historical Tracking Error	0.40%
ASX Code	AGVT
Bloomberg Code	AGVT.AU
IRESS Code	AGVT.AXW

Fees	% p.a.
Management fees	0.19
Recoverable expenses	0.03

Investment strategy

The Fund's Index is designed to provide exposure to Australian Dollar denominated fixed rate bonds issued primarily by Australian federal and state governments, and with a component issued by supranationals, sovereign agencies and similar issuers. To be eligible for inclusion in the Index, amongst other requirements, each bond must be an Australian Dollar denominated fixed rate bond, have a term to maturity between 7-12 years and meet a minimum issuance size requirement. Securities are market capitalisation weighted, and will be adjusted at rebalance date to ensure that 75% of the Index is comprised of Australian federal and state government bonds; and 25% of the Index comprises of supranationals, sovereign agencies, government-related development banks and non-Australian governments/regional authorities.

Top 10 positions	%		%
Australian Govt 2.5% May-30	6.9	Australian Govt 1.5% Jun-31	5.9
Australian Govt 3.25% Apr-29	6.3	Australian Govt 2.75% Nov-28	5.7
Australian Govt 1% Dec-30	6.3	Australian Govt 1% Nov-31	5.6
Australian Govt 2.75% Nov-29	6.1	Australian Govt 1.25% May-32	4.5
BNG Bank NV 3.3% Apr-29	6.0	Intl Finance Corp 3.15% Jun-29	3.6

[1] As at 30 September 2021

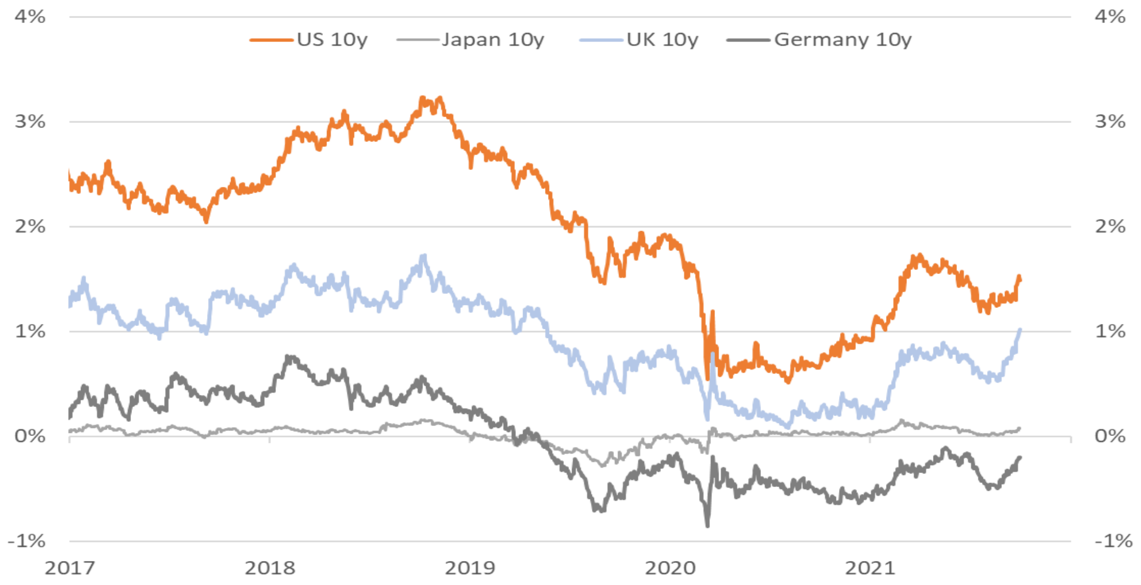
Sector exposure	Fund Weight %[1]	Index Weight%[1]
Australian Government	53.7	53.9
Australian State Governments	21.2	21.0
Supranational Banks	11.2	11.2
Government Development Banks/Agencies	13.7	13.9
Regional Authorities	0.0	0.0
Cash	0.2	0.0
TOTAL	100.00	100.00

[1] As at 30 September 2021

Global macro and rates

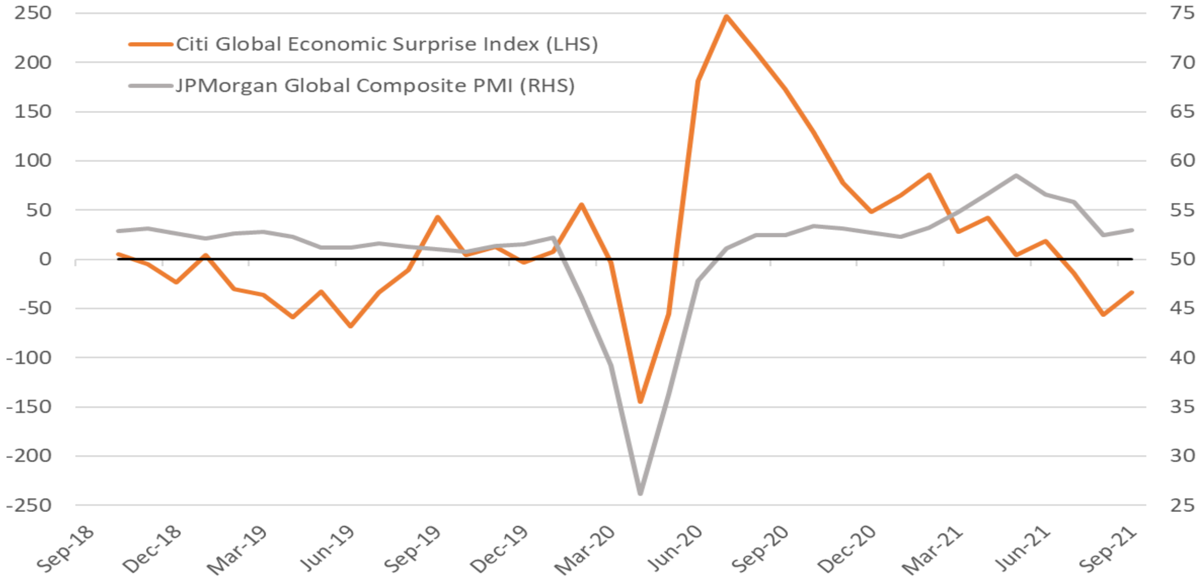
Global bond yields were little changed over the September quarter, although curves tended to flatten at the back end as the market increasingly priced in the prospect of monetary and fiscal accommodation being withdrawn. This was against a backdrop of various crosscurrents, including continued inflation concerns amid higher energy prices and lingering supply chain problems, improved optimism around COVID-19 and the Delta variant, and acute stress in Chinese credit markets. Economic indicators were generally consistent with expansion over the quarter, although surprises were generally tilted to the downside, particularly in the U.S. and Euro area.

Chart 1: Global Benchmark 10-year Yields



Source: Bloomberg.

Chart 2: Global Composite PMI and Economic Surprises



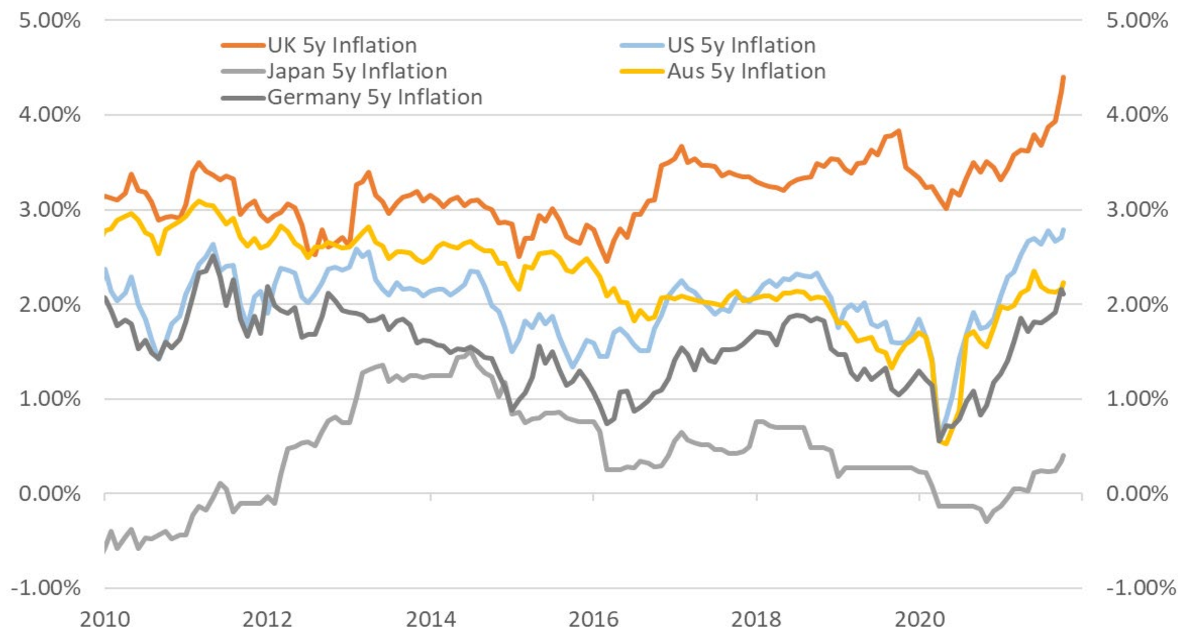
Sources: Bloomberg, JPMorgan, Citigroup.

10-year U.S. Treasury yields ended the quarter 2 basis points higher, while the spread between 30-year and 5-year Treasuries ("5s30s") compressed by 12 basis points, owing to a continuation of the relatively hawkish Fed posture assumed back in June. The September Federal Open Market Committee (FOMC) meeting saw members upgrading economic forecasts and bringing forward rate hike expectations in response to rising inflationary pressures, with the median member now expecting rate hikes to commence next year. Although a formal tapering was not announced, the Fed signalled that a commencement this year is likely. The immediate market response was a flattening of the back end of the curve and higher real yields in the intermediate sectors (3-7yrs), consistent with historical patterns of normalisation and the pricing of tighter financial conditions over the policy horizon. Compounding the flattening impulse was increasing political dysfunction in the U.S., with expectations of meaningful fiscal stimulus being pared back.

Chinese credit market stress came into focus as multiple property developers either failed to make debt repayments or their bonds were increasingly priced for a default. Initial fears about a global financial market contagion quickly receded, although longer-term implications on Chinese growth remain. Chinese authorities on the surface appear to be committed to a deleveraging drive in a possible attempt to rebalance the economy away from a fixed-asset investment-drive growth model, which would have implications for not only demand for commodities, but global growth more generally.

Concerns around spiralling energy costs, particularly in Europe, have begun to dominate macro narratives in recent weeks, adding steepening pressures to global yield curves. Surging power prices amid severe supply constraints in the natural gas market combined with broader supply chain and logistical bottlenecks have seen market-implied measures of UK inflation expectations rise to their highest levels in the post-crisis era. In response to inflation expectations potentially becoming unanchored, the Bank of England has signalled near-term rate hikes, which sponsored a repricing higher across the UK yield curve. Capacity constraints against the backdrop of improving demand have prompted smaller G10 central banks to commence rate hikes, including the central banks of Norway (in late September) and New Zealand (in early October), confirming the idea that global monetary accommodation will increasingly be withdrawn over the coming months.

Chart 3: Global Inflation Pricing (5-year zero coupon inflation swaps)

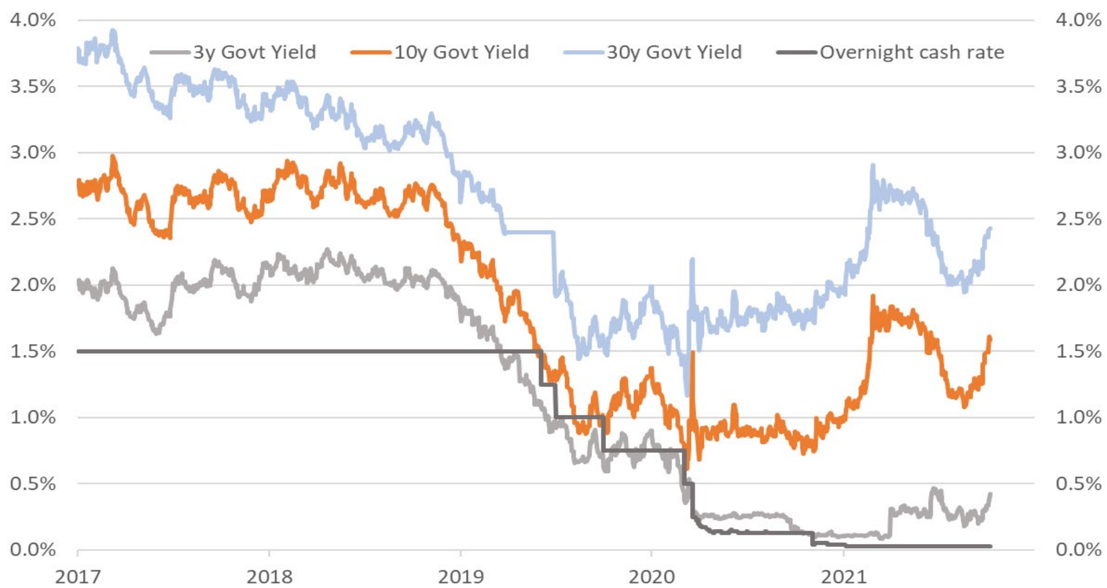


Source: Bloomberg.

Australian benchmark yields were largely captive to global developments during the September quarter, with the economic data generally surprising despite the major population centres subject to lockdown restrictions for much of the period. 10-year Australian government yields ended the quarter 4 basis points lower, although in contrast to other sovereign markets, the Australian curve steepened, with the 5s30s spread widening 15 basis points. A large part of this is due to the RBA defying the increasing global trend of central banks assuming a more hawkish posture, with the RBA reaffirming its forward guidance of keeping rates unchanged until 2024.

As expected, the RBA announced it would reduce the pace of QE-related purchases (to $4 b/week from $5b/week) at the August meeting and this took effect in September. Also, of note domestically was APRA's announcement that the Committed Liquidity Facility (CLF) would be removed, which will force the governments to increasingly buy High Quality Liquid Assets (HQLA) outright to meet Basel III Liquidity Coverage Ratio (LCR) requirements. Aside from deposits at the RBA, HQLA primarily consists of Commonwealth and state government bonds, whereas previously banks were able to access an RBA liquidity facility by providing credit instruments (including self-securitised RMBS) as collateral in lieu of outright HQLA holdings.

Chart 4: Australian Government Bond Yields

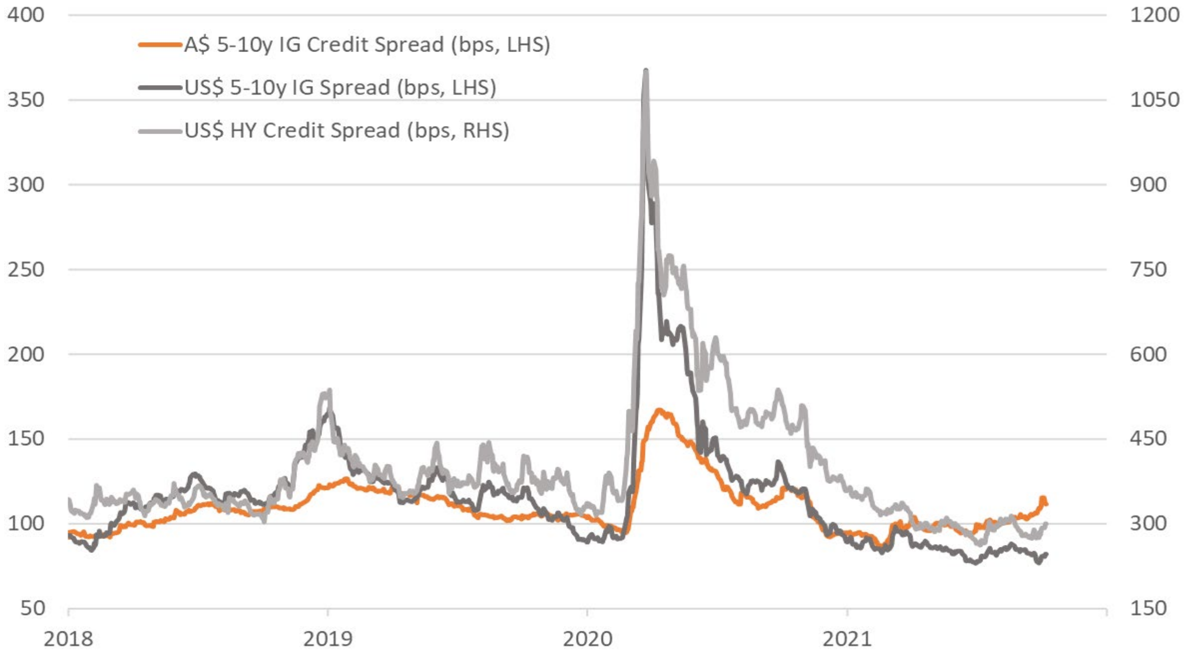


Source: Bloomberg.

Credit Markets

Despite the credit stress among Chinese property developers and heightened expectations of a withdrawal of global monetary stimulus, credit markets globally were generally resilient during the quarter. Credit spreads on 5–10-year U.S. dollar investment grade bonds were 4 basis points wider over Q3, while credit spreads on U.S. corporate high yield securities widened 20 basis points. This is in sharp contrast to the ratcheting higher on Asian U.S. dollar high yield spreads, particularly Chinese U.S. dollar high yield bonds, as default probabilities surged, and estimated recovery rates fell. An index capturing the universe of Asian (Ex-Japan) high yield corporate bonds (primarily Chinese issuers) saw its average credit spread widen by 650 basis points over the quarter to finish at almost 1600 basis points over maturity-matched U.S. Treasuries.

Chart 5: Benchmark credit spreads



Source: Bloomberg.

In Australia, the main development was APRA's announcement to unwind the CLF, which immediately saw credit spreads on senior bank debt widen, while spreads on state government bonds compressed. In addition to LCR and Net Stable Funding Ratio (NSFR) requirements, elevated issuance will be needed over the coming years to meet APRA's loss absorbing capital requirements (primarily via T2 subordinated securities) and to repay debt relating to the Term Funding Facility (TFF), with maturities to commence in 2023. Spreads on non-financial AUD corporate bonds were also slightly wider over the quarter.

Outlook

Energy prices remain in focus at the time of writing, in addition to U.S. budget negotiations, raising global policy uncertainty into Q4. For much of 2021, central banks were firm in the view that inflation pressures would likely prove transitory, but as COVID-related supply chain disruptions (particularly in transportation and logistics) have persisted longer than expected, the price pressures created by rising energy costs have been compounded. As several central banks view inflation expectations as a key driver of inflation pressures, and with market-implied and survey-based measures of inflation expectations now running well above inflation targets in the UK and U.S., it's likely that central banks will persist with hawkish signalling over the coming months. However, central banks will need to walk a fine line between managing inflation expectations and not tightening financial conditions too aggressively, given the elevated levels of corporate debt globally. Wage growth globally hasn't yet accelerated materially in a broad-based fashion, and price pressures remain concentrated in selected sectors dealing with supply-side bottlenecks.

BetaShares Exchange Traded Funds

Outlook continued.

Domestically, inflation pressures are still subdued, with core inflation still below the RBA's target. The RBA remains focused on wage growth picking up, which they see as a necessary condition for core inflation to sustainably persist in the 2-3 per cent target band. Despite this, the Australian yield curve remains hostage to global developments and already market implied forward rates have risen sufficiently to be at odds with RBA forward guidance on the back of a steepening in the yield curve. In addition, Australian government bonds are likely to receive a tailwind from favourable net supply dynamics as banks are increasingly forced to buy HQLA outright, more than offsetting any RBA tapering effects. Finally, the re-introduction of macro prudential measures from APRA (to enforce more restrictive mortgage lending requirements on the banks) will arguably enable the RBA to remain relatively accommodative with its rate setting policy.