BetaShares
Exchange Traded Funds

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

Performance[1]	1 Month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Inception[2] % p.a.
Fund Return (net)	0.33%	-1.81%	-1.54%	-4.38%		0.72%
Growth return	*0.22%*	*-2.14%*	*-2.14%*	*-5.43%*		*-0.34%*
Income return	*0.11%*	*0.33%*	*0.60%*	*1.05%*		*1.06%*
Index return	*0.35%*	*-1.78%*	*-1.45%*	*-4.24%*	*3.95%*	*0.89%*

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]	2.18%
Yield to Maturity (% p.a.)[2]	1.85%
Average Maturity (Yrs)[3]	8.87
Modified Duration (Yrs)[4]	8.01
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	$199.64m
Historical Tracking Error	0.18%
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	7.0	Australian Govt 3.25% Apr-29	6.4
Australian Govt 1% Dec-30	6.5	Australian Govt 2.75% Nov-29	6.3
BNG Bank NV 3.3% Apr-29	6.5	Australian Govt 1.25% May-32	5.3
Australian Govt 1% Nov-31	6.5	Australian Govt 4.5% Apr-33	4.5
Australian Govt 1.5% Jun-31	6.4	Intl Finance Corp 3.15% Jun-29	4.3

[1] As at 31 December 2021

Sector exposure	Fund Weight %[1]	Index Weight%[1]
Australian Government	52.1	52.4
Australian State Governments	22.5	22.7
Supranational Banks	11.6	11.7
Government Development Banks/Agencies	13.5	13.2
Regional Authorities	0.0	0.0
Cash	0.2	0.0
TOTAL	100.00	100.00

[1] As at 31 December 2021

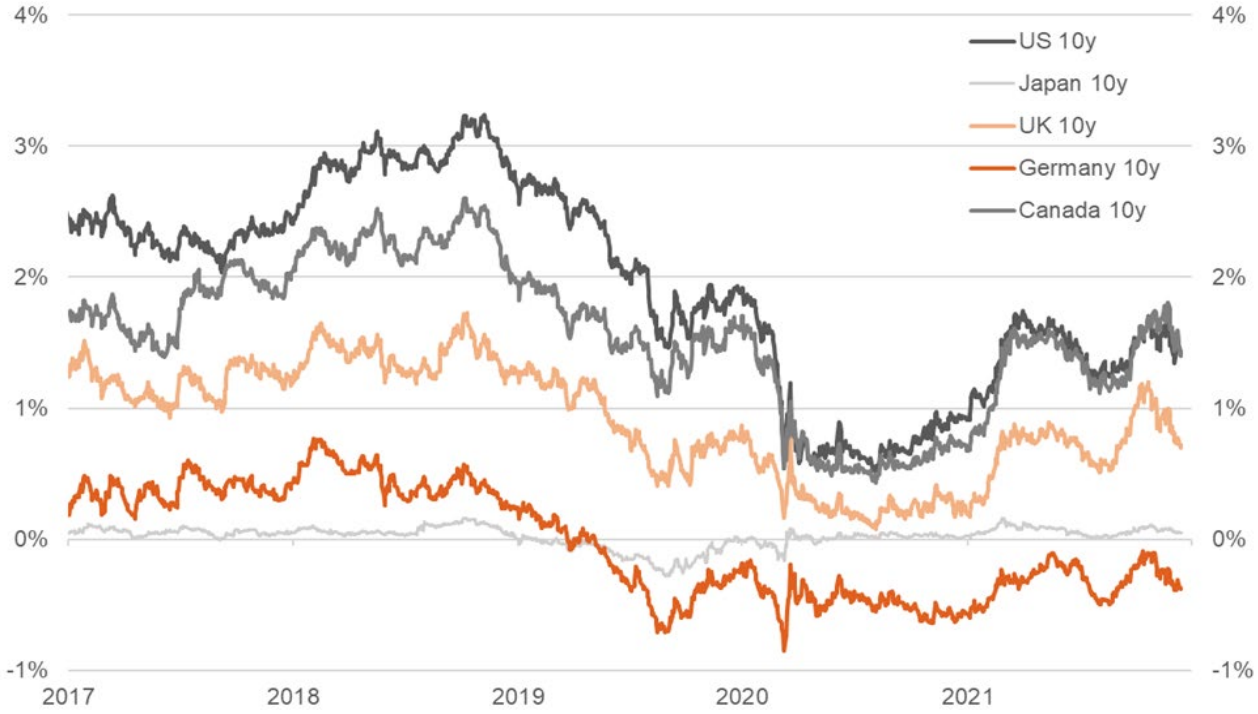
Global macro and rates

The December quarter was characterised by a global curve flattening as markets increasingly priced in more central bank tightening over the medium term, amid ongoing inflation pressures. While long-term benchmark bond yields were little changed over the quarter (often gyrating with COVID-19 developments), short and intermediate tenor yields tended to rise significantly as rate hike expectations were brought forward in several markets.

The Federal Reserve was a big focus during the period, with the December FOMC meeting reinforcing the current hawkish trajectory, with the median member bringing forward rate hike expectations to 3 hikes in 2022 (from 1 hike previously expected in the September meeting). Subsequent minutes from the December FOMC meeting revealed further normalisation intentions, with balance sheet contraction in 2022 also appearing to be favoured by several members.

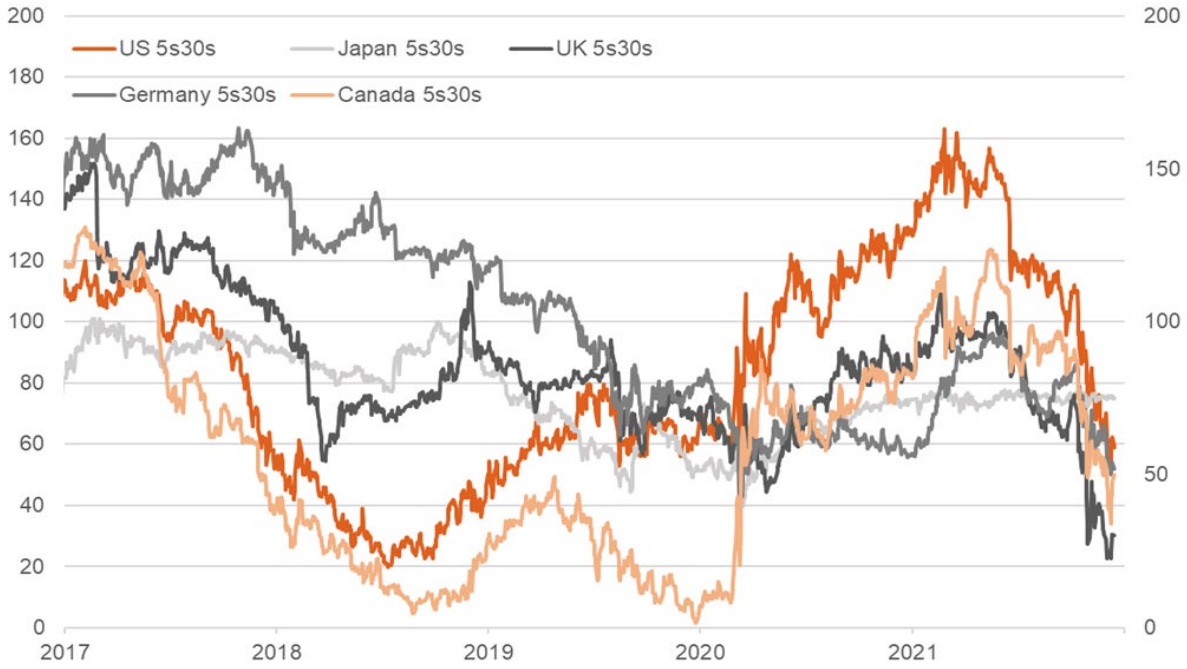
Elsewhere, the Bank of England undertook its first post-pandemic rate hike in December, raising the official Bank Rate to 0.25% (+15bps), while the ECB announced a tapering of its Pandemic Bond Purchase Program (although this was partly offset by expanding the regular asset purchase program).

Chart 1: Global Benchmark 10-year Yields



Source: Bloomberg.

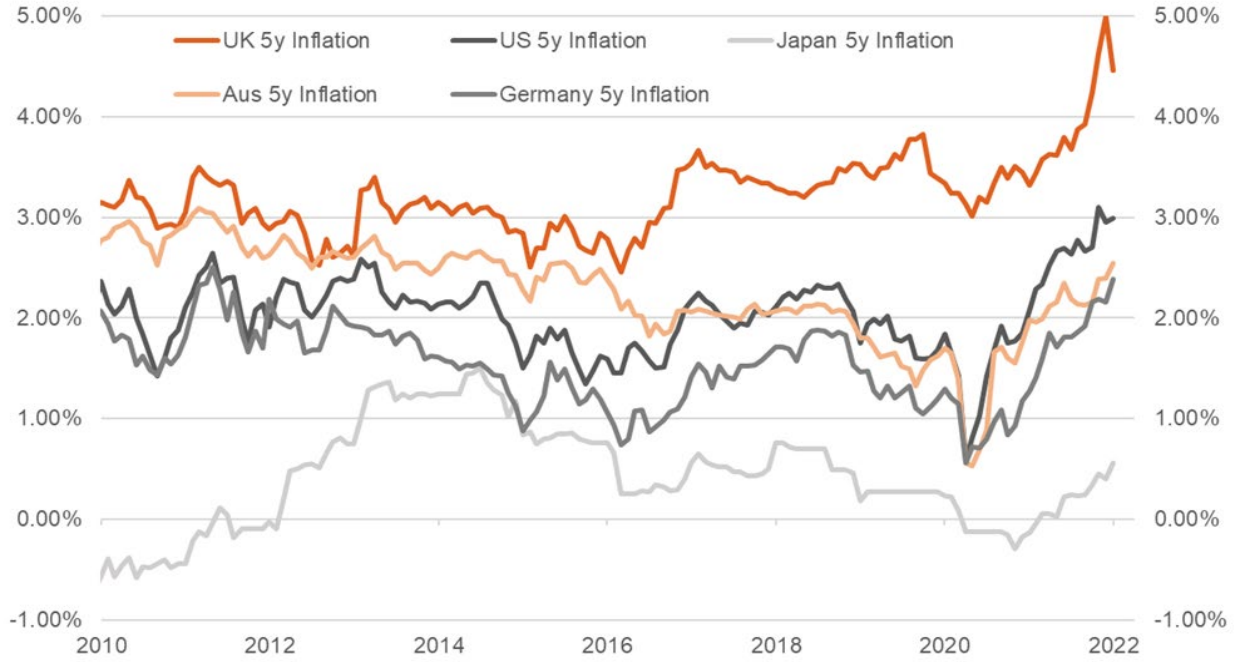
Chart 2: Global 5s30s Yield Spreads, in basis points



Source: Bloomberg.

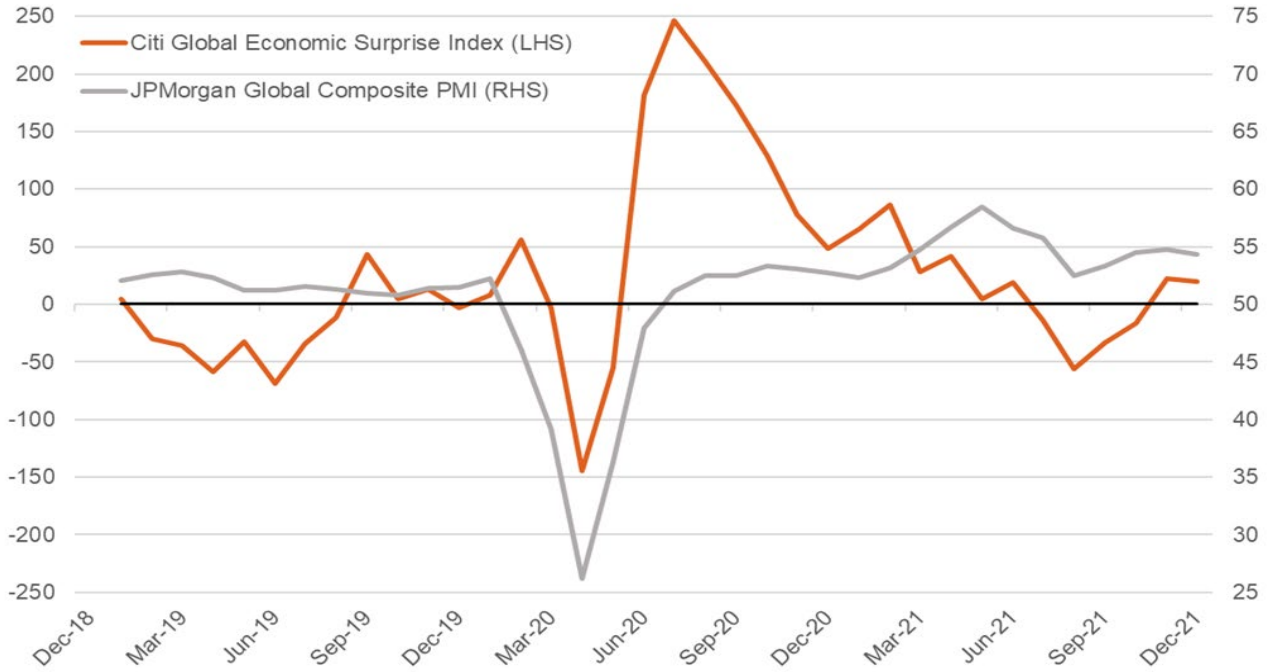
Inflation remained a major area of attention, with several central banks and commentators highlighting the risk of inflation expectations becoming unanchored. Market-implied measures of inflation compensation generally remained elevated globally during the quarter, both relative to trend and central bank targets. In terms of economic activity, the global economy moderated its pace of expansion during the December quarter, with the global composite PMI indicator stabilising around 54, with the emergence of the Omicron COVID-19 variant and the reintroduction of pandemic containment measures in several countries possibly weighing. Overall, economic data generally surprised on the upside, particularly in the Euro Area.

Chart 3: 5-year Inflation Compensation, Zero-Coupon Inflation Swaps



Source: Bloomberg.

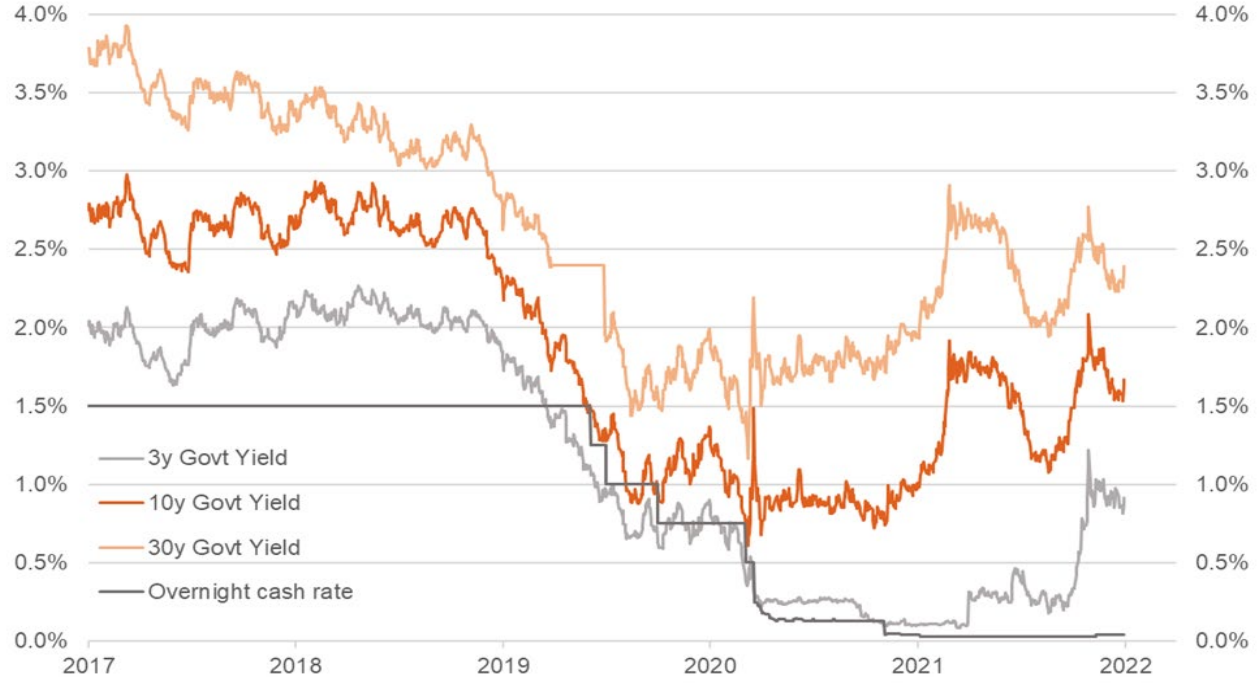
Chart 4: Global Economic Data



Sources: Bloomberg, JPMorgan, Citigroup.

Australian government bonds underperformed global peers, with yields rising across the curve, albeit in a flattening move. Arguably the biggest development was the RBA's abandonment of Yield Curve Control (YCC) in November and the highly erratic price action in front-end yields that preceded it. With liquidity in short-dated paper having thinned over the past year, the repricing of global yields on the back of several hawkish pivots combined with a higher-than-expected Australian Q3 CPI (trimmed mean) release saw the Australian front-end suffer one of the worst bouts of indigestion in recent memory. Despite the RBA's forward guidance that they're unlikely to hike before 2023, markets nevertheless aggressively brought forward rate hike expectations to 2022, with the first rate hike fully priced for July at the time of writing.

Chart 5: Australian Government Bond Yields

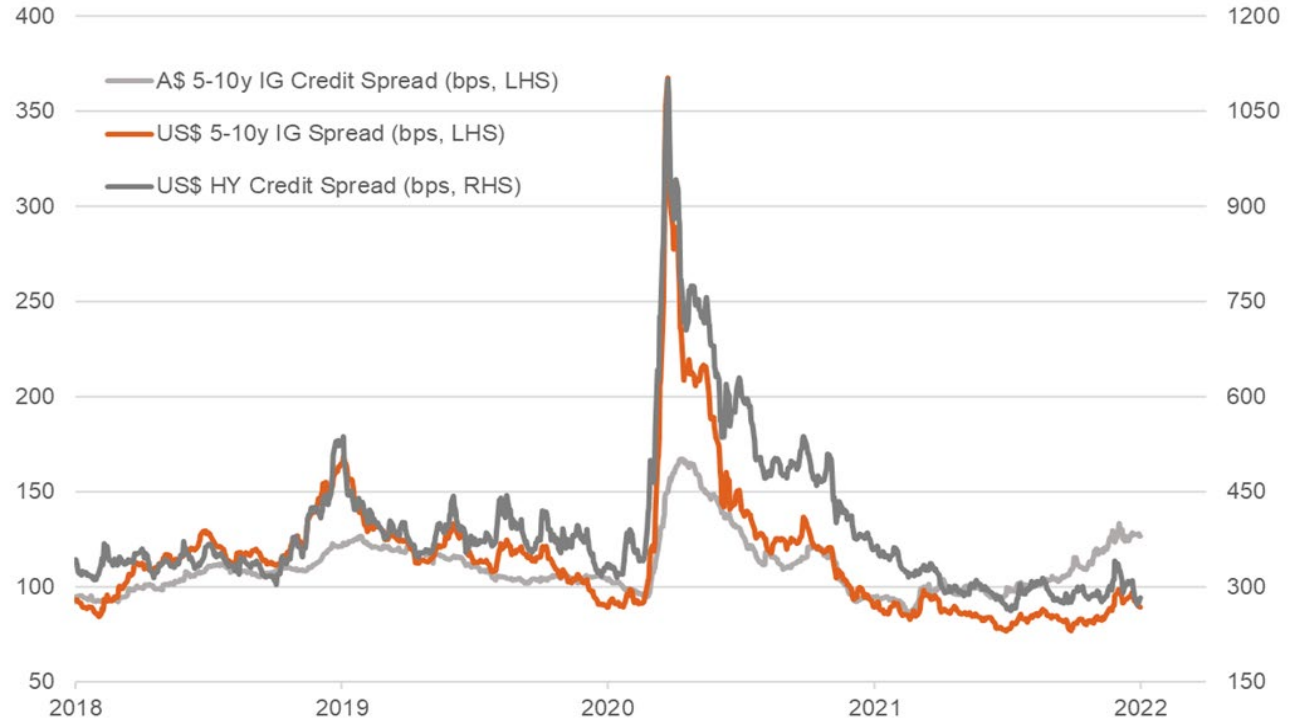


Source: Bloomberg.

Credit Markets

Global investment grade credit spreads drifted wider over the quarter, with the move most pronounced in the Australian dollar market. Potentially contributing were expectations around a removal of global liquidity in 2022 in addition to tighter bank funding markets, with the potential for a wave of senior bank supply also weighing. With global equities buoyant into year-end, U.S. corporate high yield credit erased some initial Omicron-induced weakness, while USD-denominated Chinese high yield credit remained under pressure amid ongoing stress in the property sector.

Chart 6: Credit Spreads



Source: Bloomberg.

Outlook

The new year began with an aggressive repricing higher of global bond yields, led by U.S. real yields on further hawkish rhetoric from the Fed. Specifically, the release of the minutes to the December FOMC meeting suggested the Fed might be looking to commence the balance sheet unwind (quantitative tightening) earlier than previously thought, with March also now considered an 'in-play' meeting for the first post-COVID rate hike. Many commentators have already drawn parallels with 2018 in assessing the outlook for 2022, an environment that saw policy driving financial conditions tighter alongside a deceleration in global growth and inflation. In addition, the negative fiscal impulse will be a headwind, given the reduced likelihood of any major spending bills ahead of the U.S. midterms. If this turns out to be the case, it could set up a volatile year for risk assets, with credit and high-multiple growth stocks particularly sensitive to a repricing higher in real yields and risk premiums.

Although aggressive rate hikes might on the surface be problematic for bonds, a continued curve flattening could see the long end remain resilient, especially if growth and inflation were to materially decelerate. The monetary policy backdrop is quite different in Australia and continued dovishness from the RBA (relative to the Fed) could see a repeat of 2018, where Australian bonds were the standout asset class. Current rate hike expectations appear quite aggressive when compared against the RBA's guidance, while inflation and wage pressures, although rising, still appear contained (especially compared to the U.S.) and appear unlikely to trigger a major short-term policy reversal.