BetaShares
Exchange Traded Funds

BETASHARES AUSTRALIAN BANK SENIOR FLOATING RATE BOND ETF
ASX: QPON
Quarterly Report - March 2022

Performance[1]	1 Month %	3 Months %	6 Months %	1 Year %	3 Years % p.a.	Inception[2] % p.a.
Fund Return (net)	-0.51%	-0.59%	-0.83%	-0.74%	1.26%	1.93%
Growth return	*-0.56%*	*-0.75%*	*-1.16%*	*-1.62%*	*0.05%*	*0.24%*
Income return	*0.05%*	*0.16%*	*0.33%*	*0.88%*	*1.21%*	*1.69%*
Index return	*-0.53%*	*-0.55%*	*-0.71%*	*-0.54%*	*1.48%*	*2.12%*

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 1 June 2017*

Investment objective
The Fund aims to track the performance of an index (before fees and expenses) that provides exposure to a portfolio of some of the largest and most liquid senior floating rate bonds issued by Australian banks.

Responsible entity
BetaShares Capital Ltd

Distribution frequency
Monthly

Fund Facts	
Inception Date	1-Jun-17
Fund Size	$645.47m
Historical Tracking Error	0.08%
ASX Code	QPON
Bloomberg Code	QPON.AU
IRESS Code	QPON.ASW

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

Investment strategy
The Fund will generally invest in a portfolio of bonds that comprise the Index in proportion to the weightings of these bonds in the Index.

In order to be eligible for inclusion in the Index, each bond must be a senior floating rate debt security denominated in AUD and issued by an eligible Australian bank. In addition, eligible bonds must have amounts outstanding of at least $500 million and a term to maturity ("TTM") of between one to five years. Current eligible banks are classified into two bands as follows:

- **Band 1**: ANZ Bank, Commonwealth Bank of Australia, National Australia Bank, Westpac
- **Band 2**: AMP Bank, Bank of Queensland, Bendigo & Adelaide Bank, Macquarie Bank, Members Equity

Eligible bonds with the longest TTM are selected with up to two bonds selected from each Band 1 bank, and one bond from each Band 2 bank. Bonds from Band 1 are given a total weight of at least 80% based on market value, with each bond equal weighted. Bonds from Band 2 are given a total weight of up to 20% based on market value, with each bond equal weighted (with no Band 2 bond allowed to have a weight in excess of 5%).

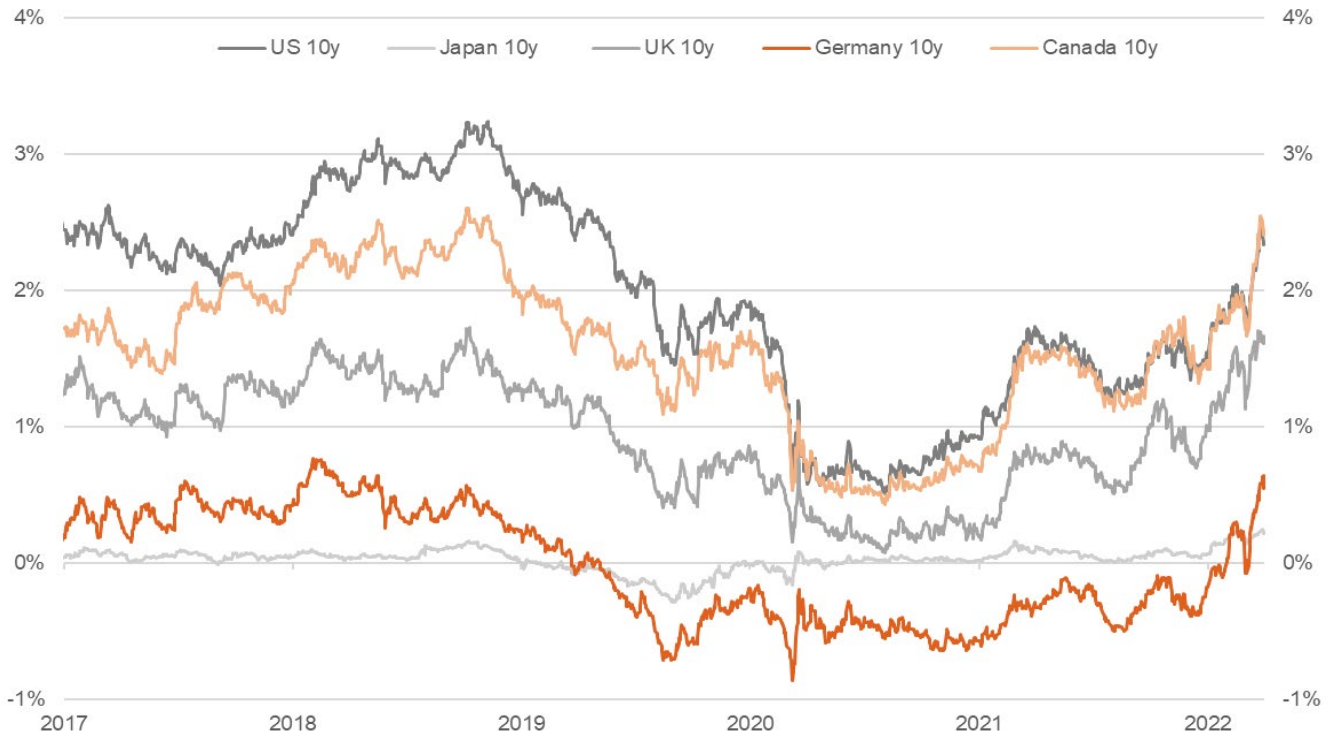
Top 10 Exposures[1]	%		%
CBA Frn Jan-24	10.7	NAB Frn Feb-27	8.1
NAB Frn Aug-26	10.6	CBA Frn Jan-27	6.0
ANZ Frn Jan-25	10.5	WBC Frn Mar-25	5.7
ANZ Frn Aug-24	9.9	BOQ Frn Oct-26	5.6
WBC Frn Jan-27	9.0	Macquarie Group Frn Dec-25	5.3

[1] As at 31 March 2022

Global macro and rates

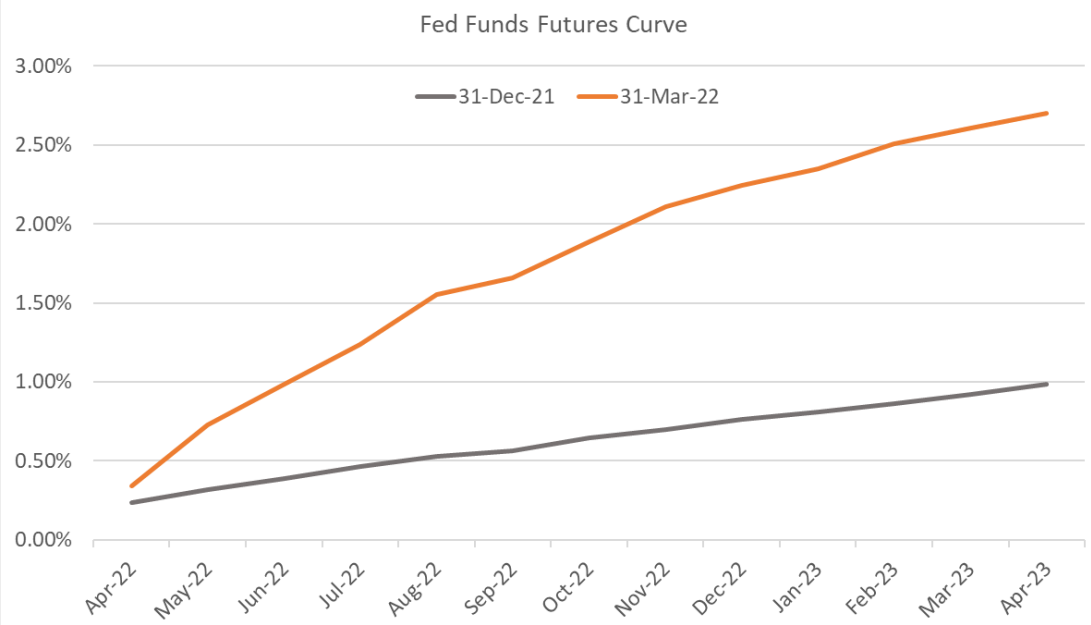
Q1 was a tumultuous quarter for fixed income, with historically large drawdowns incurred across benchmark indices as yields surged globally, with losses broad based across most segments. Over the period, the market was forced to digest a more aggressive rate hiking outlook from global central banks, a tightening of U.S. financial conditions, and the inflationary implications from the war in Ukraine and sanctions imposed on Russia. Inflation pressures remained in focus, with disruptions to global commodity supplies feeding through to higher inflation expectations, forcing a much more aggressive posture from central banks. Yield curves continued to “bear flatten” globally amid the acceleration in near-term rate hike expectations, with many segments of the U.S. curve ending the quarter inverted, spurring a debate around recession risks over the medium term and whether the Fed can engineer a “soft landing”.

Chart 1: Global 10-year Yields



Source: Bloomberg.

Chart 2: Change in Fed Funds Futures over the quarter

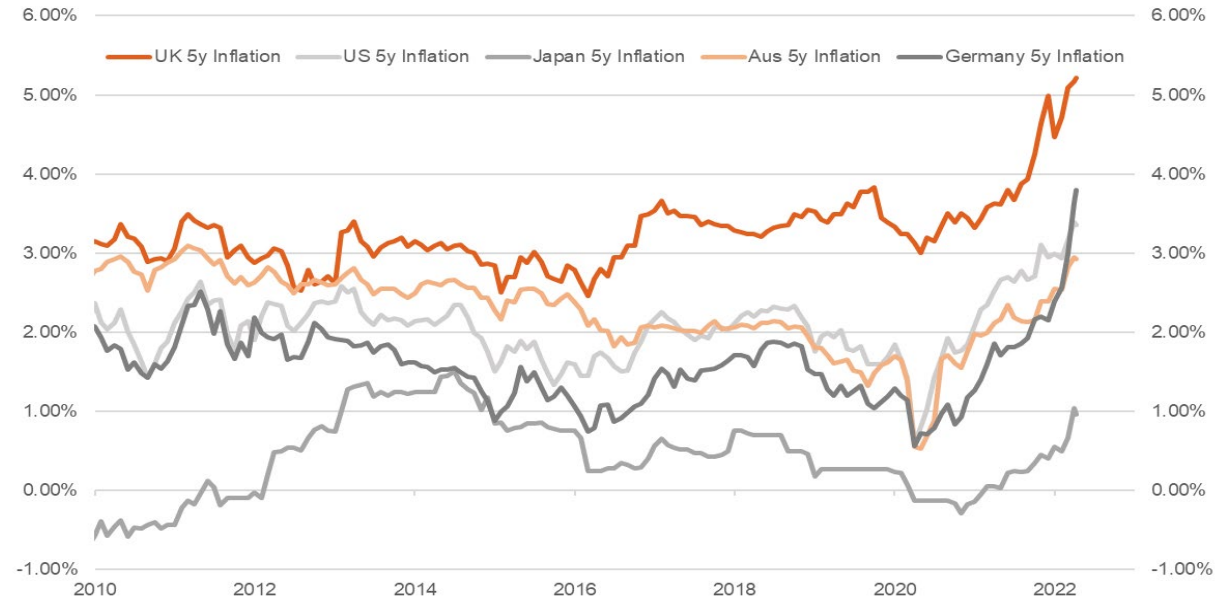


Source: Bloomberg, BetaShares.

The March Federal Open Market Committee (FOMC) and subsequent speeches from Fed officials signalled a much greater willingness to curb inflation pressures and anchor inflation expectations, with the dot plot shifting in a much more hawkish direction over the medium term. Chair Powell also emphasised the role of financial conditions in monetary policy transmission, which will need to be tightened indirectly via a combination of a faster hiking cycle and an accelerated balance sheet runoff, with quantitative tightening (QT) likely to formally commence in Q2.

The European Central Bank (ECB) also moved in a similar direction, as the euro area contends with surging energy prices and outsized inflation pressures. At the March meeting, the Governing Council signalled an end to its quantitative easing (QE) programme and brought forward rate hike expectations amid upward revisions to inflation in 2022. The Bank of England raised the key policy rate twice during the quarter, although resisted calls by some in the MPC to be even more aggressive. Despite some initial speculation to the contrary, the Bank of Japan affirmed its commitment to yield curve control, preventing a disorderly sell-off in Japanese government bonds, but spurring a precipitous decline in the yen.

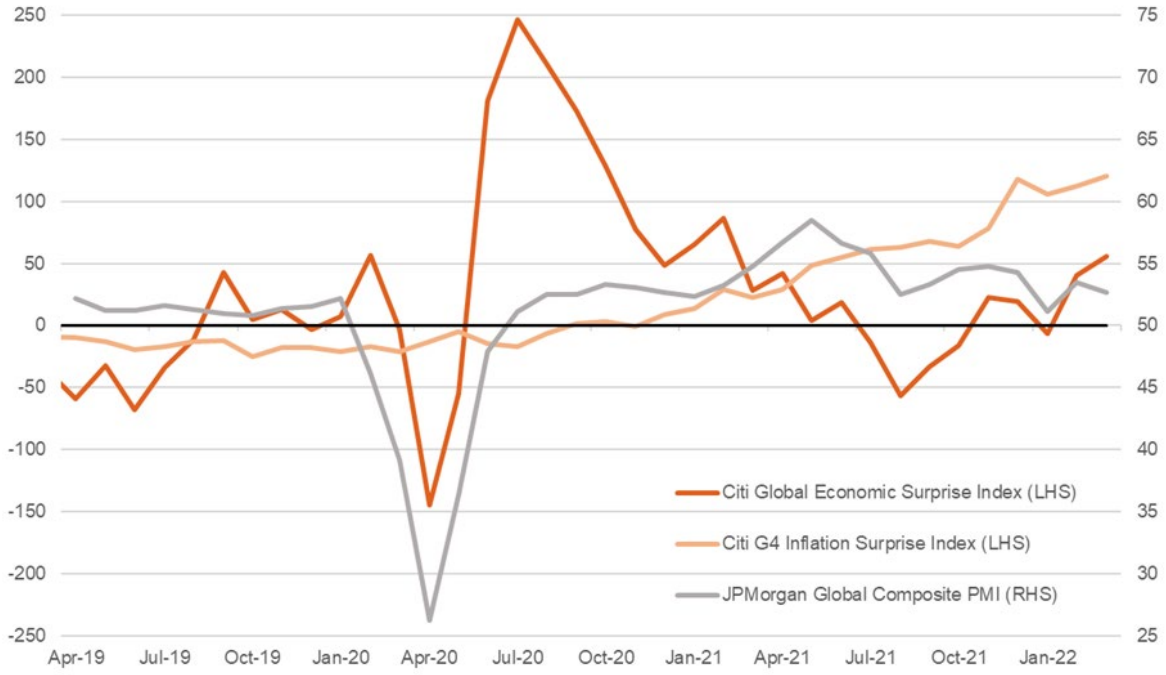
Chart 3: Global inflation pricing from 5-year zero coupon inflation swaps



Source: Bloomberg.

Global economic data generally remained robust, albeit with inflation prints and inflation surprise gauges reaching the highest levels in decades. Leading indicators of economic activity remained in expansionary territory, although moderated in recent months. Global growth more broadly is seen as likely to slow down over the coming quarters amid a combination of base effects, a reduced fiscal impulse, and a tightening of financial conditions. The Chinese economy remained a headwind for global growth as ongoing woes in the property sector continued to weigh, and the recent Covid outbreak triggered a series of lockdowns in major economic zones, with Chinese PMI data recently moving back to contractionary levels.

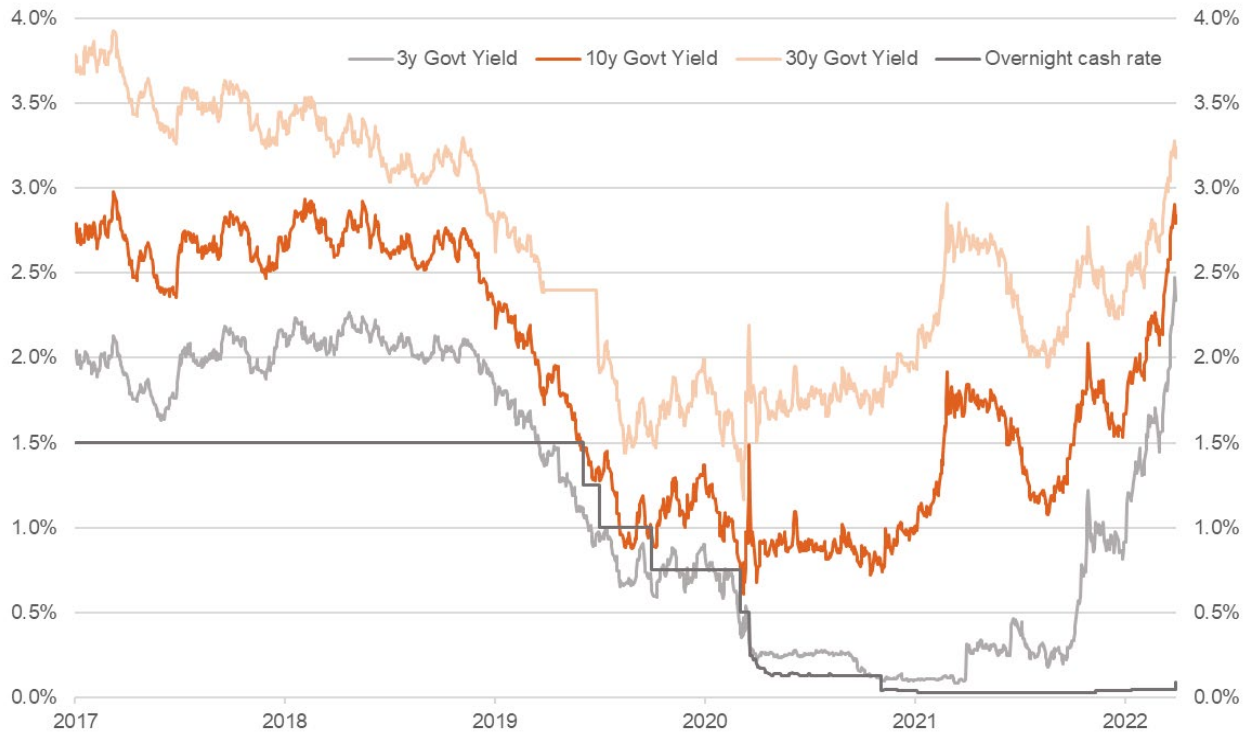
Chart 4: Global Economic Data



Sources: Bloomberg.

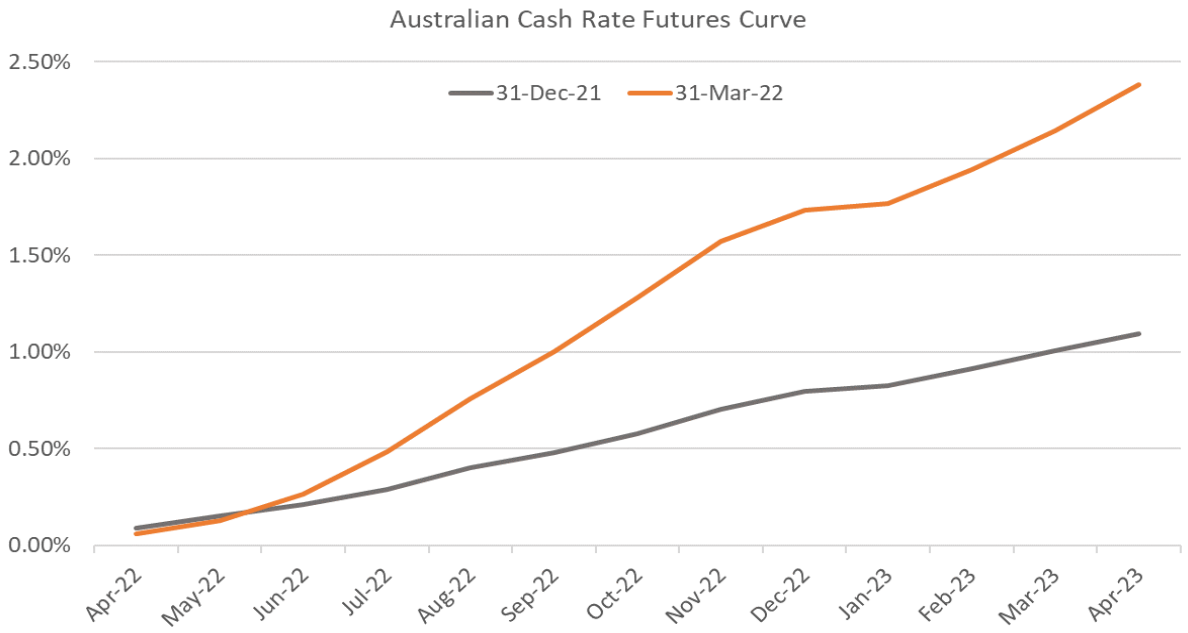
Australian government bonds underperformed over the quarter, as traders increasingly priced in an aggressive near-term hiking cycle, despite relatively dovish signalling from the RBA during the quarter. The most aggressive moves were seen at the front of the curve, with the 3-year yield reaching a 7-year high after trading at an all-time low only 12 months prior. Inflation pressures moved modestly higher, with Q1 headline CPI printing at 3.5% y/y and trimmed mean CPI printing at 2.6%, moving into the upper end of the RBA's target band. Wages growth inched upwards, reflecting a relatively tight labour market, although remained below the RBA's informal 3% target. The war in Ukraine and impact on commodity prices, particularly coal, wheat, and natural gas, have generated expectations of a positive terms of trade shock, which supported the Australian dollar and possibly weighed on bonds at the margin, as cross-asset risk premiums rose on the heightened policy uncertainty.

Chart 5: Australian Government Bond Yields



Source: Bloomberg.

Chart 6: Change in Australian Cash Rate Futures over the quarter



Source: Bloomberg, BetaShares.

The degree of Australian fixed income underperformance was notable, seen across nominal government bonds, inflation-linked bonds (higher real yields), and corporate bonds (wider credit spreads against U.S. dollar equivalents), despite the inflationary backdrop being among the most benign in the developed world. Market participants have argued the highly aggressive rate hike pricing is partly a function of the increased risk premium following the RBA's unscheduled exit of yield curve control last year, in addition to other market structure factors heading into the Japanese financial year end (31 March), with elevated fixed income and cross-asset volatility tending to weigh heavily on the Australian rates complex.

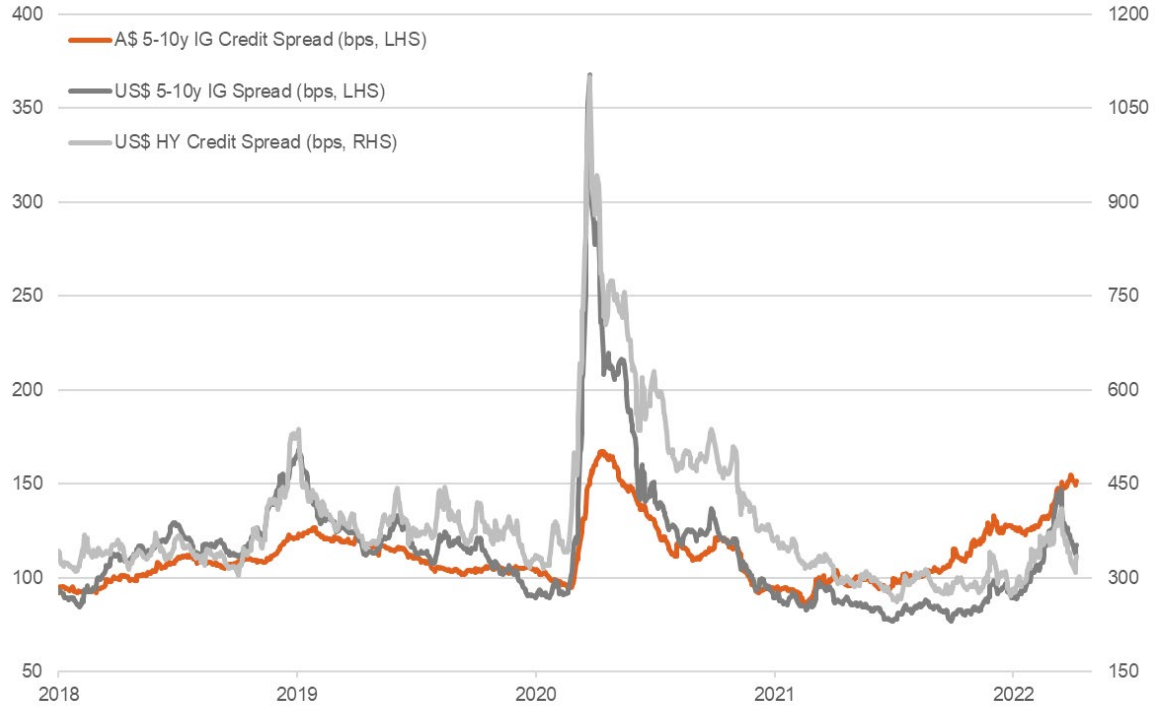
Credit

Credit spreads continued to move wider over the March quarter, as the full implications of the global policy normalisation was digested. U.S. dollar credit traded erratically in between the commencement of the war in Ukraine and the FOMC, with a significant volume of hedging via options reported across investment grade and high yield U.S.-listed ETFs. With volatility moderating following the FOMC, U.S. dollar spreads retraced sharply into quarter-end. European peripheral sovereign spreads widened as the ECB signalled that its own QE program will be unwound and brought forward rate hike expectations, with Italian 10-year spreads to Germany widening as much as 35 basis points during the quarter.

The Russian invasion of Ukraine and subsequent sanctions introduced a fresh round of credit and funding-related concerns, with the market increasingly expecting a sovereign default from the Russian state. Furthermore, volatility and dislocations across commodities markets created unique funding pressures, with several commodity-related entities seeing spreads on their corporate bonds and credit default swaps surge.

Australian dollar credit spreads exhibited less volatility than U.S. dollar equivalents, but continued to widen over the period. Local bank funding spreads to risk-free equivalents also moved wider, reflecting a combination of increased wholesale issuance needs and a more general tightening of financial conditions on the back of the global policy normalisation. Spreads on senior bank credit repriced higher following new issues from CBA, Westpac and NAB, the first round of significant local wholesale issuance in the post-Covid era.

Chart 7: Credit Spreads

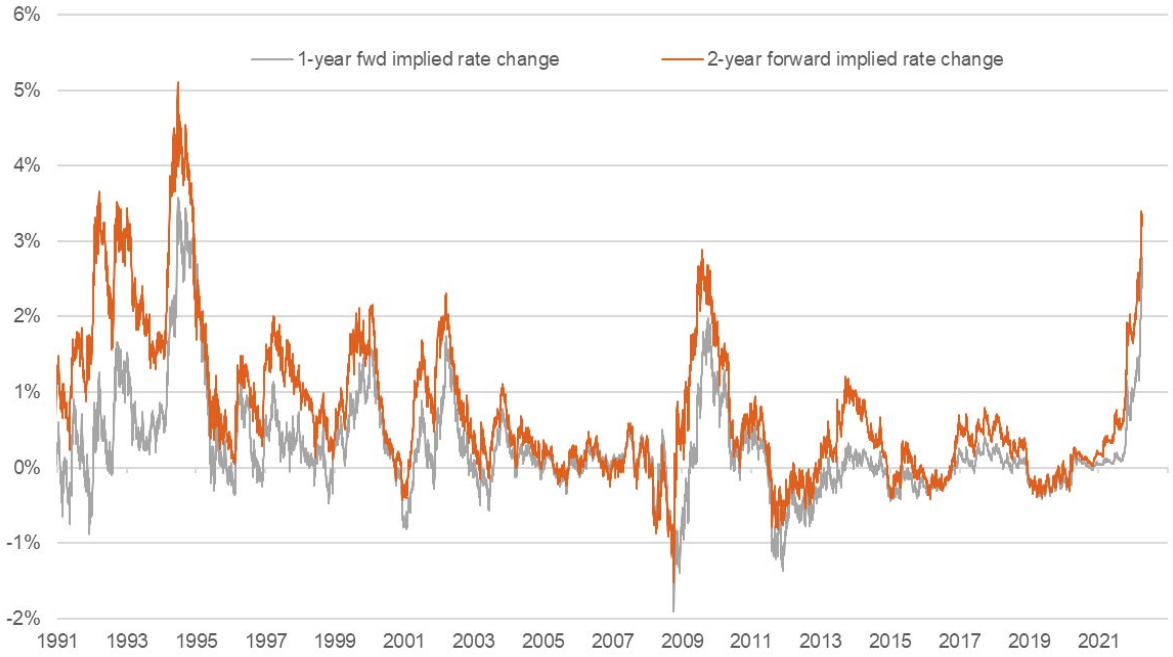


Source: Bloomberg, BetaShares.

Outlook

Although the April RBA meeting saw a hawkish pivot, with the Board signalling an intention to commence rate hikes in June, it doesn't fundamentally change the trajectory of rate hike expectations. Rather, it shifts forward guidance slightly closer to where market pricing has been for some time. Australian rate hike expectations appear overly aggressive at the time of writing, given the leverage and sensitivity of the household sector to short-term rates. Furthermore, the bond market has historically over-estimated rate hikes relative to what was ultimately delivered, presenting a constructive backdrop for Australian fixed rate debt.

Chart 8: Bank bill futures-implied 1-year and 2-year rate change



Source: Bloomberg, BetaShares.

Complicating matters, however, is that the Fed may need to still be more hawkish in its forward guidance, given inflation expectations over the medium term are still running well above target. Although broad indicators of financial conditions have tightened over the past 12 months, they are still not restrictive by historical standards. Comments from Fed officials since the March FOMC have raised the need to accelerate QT, which should intensify the drain in global liquidity over the coming months. Key indicators of financial conditions include real yields and credit spreads, and we expect both to drift higher as the Fed tries to anchor inflation expectations, which may present major challenges to risk assets over the remainder of the year.