14.7 Statement of Investments - October 2023

CSP Objective: Outcome 12: Public funds and assets are managed strategically, transparently and efficiently

CSP Strategy: 12.1 Manage Public Funds in accordance with Financial Management Standards and the Local Government Act

Delivery Program: 12.1.1 Improved financial reporting and legislative compliance through reporting, scrutiny and oversight processes.

Summary

This report provides an overview of Council's cash and investment portfolio and investment performance on 31 October 2023 and endorsement of the restricted funds position.

Financial Implication

Investments are undertaken based upon the best rate on the day and after consideration of spreading Council's Investment risk across various institutions as per the Investment Policy and section 625 of the Local Government Act 1993. The distinction between restricted and unrestricted funds is a key operational and financial understanding.

Risk Implication

The risk related to this information is non-compliance with Council's Investment Policy and Office of Local Government guidelines for appropriate monitoring and reporting of changes and the position of restricted funds.

Policy

Clause 625 of the *Local Government Act 1993*

Clause 212 of the Local Government (General) Regulation 2021

Kiama Municipal Council – Investment Policy

Kiama Municipal Council – Restricted Funds Policy

Consultation (internal)

Chief Executive Officer

Chief Financial Officer

Financial Accountant

Communication/Community engagement

N/A

Attachments

1 October 2023 Investment Report⇩

Enclosures

Nil

RECOMMENDATION

That Council:

1. Receives the information relating to the Statement of Investments as at 31 October 2023.
2. Approves the transfer of $2,174,773 from the Land Development Reserve to Unrestricted Funds and endorses the restricted funds position outlined in the report.

Background

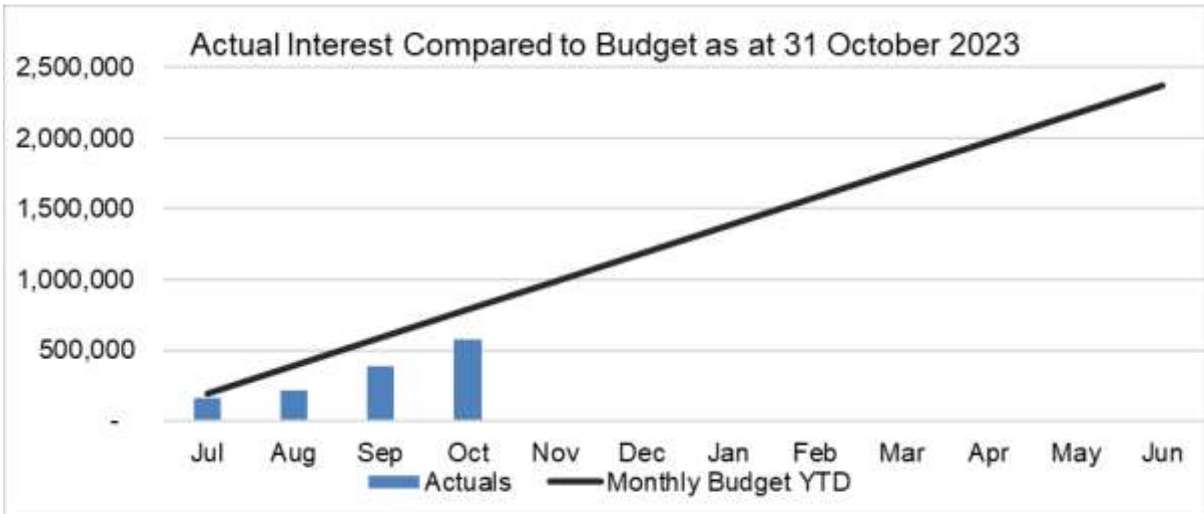
Council is required to invest its surplus funds in accordance with the Ministerial Investment Order and Office of Local Government guidelines. The Order reflects a conservative approach and restricts the investment types available to Council. In compliance with the Order and Office of Local Government guidelines, Council adopted an Investment Policy in August 2021. The Investment Policy provides a framework for the credit quality, institutional diversification, and maturity constraints that Council's portfolio can be exposed to. Council's investment portfolio was controlled by Council's Finance Department during the period to ensure compliance with the Investment Policy. External investment advisor advice is also considered at the time.

Return on Investments

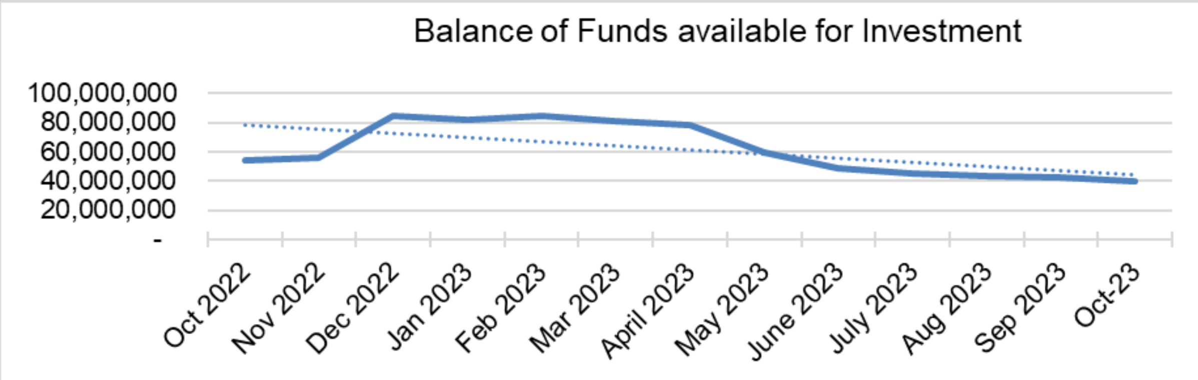
Council's average weighted return for October was 5.02%. The 90 Day Bank Bill Swap Rate (BBSW) benchmark monthly average return was 4.21% as at 31 October 2023. As such, Council outperformed the benchmark by 0.81%.

For the month of October, excluding cash, the total portfolio provided a return of 5.14%. The attached investment advisor report compares Council's performance against AusBond Bank Bill Index rate of 4.01% for October (page 7 of the report attached).

The improved monthly performance was driven by the investment of $8M of term deposits during October, which had a weighted average rate of 5.25%.



Movement in Investments
Over the past 12 months, Council's investments portfolio has decreased by $14.2M. Repayment of TCorp loan tranches of $30M being key outflows, offset by property sales inflows and the other operational cash flows.



Matured trades for October:

Issuer	Rating	Type	Interest	Purchase	Maturity	Rate	Value
BOQ	BBB+	TD	At Maturity	11/08/2023	11/10/2023	4.44	2,000,000
Heritage and People's Choice Limited	BBB+	TD	At Maturity	15/08/2023	16/10/2023	4.70	2,000,000
Heritage and People's Choice Limited	BBB+	TD	At Maturity	21/08/2023	23/10/2023	4.70	2,000,000
Bendigo and Adelaide	BBB+	TD	At Maturity	28/08/2023	30/10/2023	4.60	2,000,000
Totals							8,000,000

New trades entered under delegation, during October:

Issuer	Rating	Type	Interest	Purchase	Maturity	Rate	Value
Suncorp	A+	TD	At Maturity	11/10/2023	13/05/2024	5.15	2,000,000
ING Direct	A	TD	At Maturity	16/10/2023	16/10/2024	5.23	2,000,000
Commonwealth Bank	AA-	TD	At Maturity	23/10/2023	23/10/2024	5.26	2,000,000
Suncorp	A+	TD	At Maturity	30/10/2023	30/07/2024	5.35	2,000,000
Total							8,000,000

Portfolio Summary:

Issuer	Rating	Type	Interest	Purchase	Maturity	Rate %	Value
NAB	AA-	TD	At Maturity	15/08/2023	15/11/2023	4.98	2,000,000
NAB	AA-	TD	At Maturity	21/08/2023	21/11/2023	4.94	3,000,000
NAB	AA-	TD	At Maturity	28/08/2023	28/11/2023	4.90	2,000,000
NAB	AA-	TD	At Maturity	04/09/2023	04/12/2023	4.90	3,000,000

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Issuer	Rating	Type	Interest	Purchase	Maturity	Rate %	Value
Commonwealth Bank	AA-	TD	At Maturity	15/08/2023	13/12/2023	5.09	2,000,000
Commonwealth Bank	AA-	TD	Semi-Annual	16/12/2022	18/12/2023	4.67	3,000,000
Commonwealth Bank	AA-	TD	At Maturity	15/08/2023	16/01/2024	5.19	2,000,000
Commonwealth Bank	AA-	TD	At Maturity	21/08/2023	22/01/2024	5.15	2,000,000
Commonwealth Bank	AA-	TD	At Maturity	28/08/2023	29/01/2024	5.09	2,000,000
Commonwealth Bank	AA-	TD	At Maturity	28/08/2023	26/02/2024	5.27	2,000,000
Commonwealth Bank	AA-	TD	At Maturity	18/09/2023	18/03/2024	5.09	2,000,000
Commonwealth Bank	AA-	TD	At Maturity	25/09/2023	25/03/2024	5.13	2,000,000
NAB	AA-	TD	At Maturity	11/09/2023	11/04/2024	5.10	2,000,000
Suncorp	A+	TD	At Maturity	11/10/2023	13/05/2024	5.15	2,000,000
Suncorp	A+	TD	At Maturity	30/10/2023	30/07/2024	5.35	2,000,000
AMP Bank	BBB	TD	Annual	27/09/2022	26/09/2024	4.95	750,000
ING Direct	A	TD	At Maturity	16/10/2023	16/10/2024	5.23	2,000,000
Commonwealth Bank	AA-	TD	At Maturity	23/10/2023	23/10/2024	5.26	2,000,000
Westpac	AA-	CASH	Monthly	31/10/2023	31/10/2023	4.01	4,986,321
Totals							**42,736,321**

Restricted Funds Movements

The restricted fund movement for this month and balance is presented in the table below.

Cash and Investments Held	Sep-23	Movement	Oct-23
Cash at Bank - Transactional Account	6,135,592	(1,149,271)	4,986,321
Other Cash and Investments	37,750,000	-	37,750,000
Total Portfolio Balance (agrees to Arlo Advisory report)	**43,885,592**	**(1,149,271)**	**42,736,321**
Cash on Hand	6,110		6,110
Bank Reconciliation items	(1,197,149)	(1,694,983)	(2,892,132)
Book Value of Cash and Investments	**42,694,553**	**(2,844,254)**	**39,850,298**
Developer Contributions	12,199,772	143,179	12,342,951
Unexpended Grants	1,455,511	(297,000)	1,158,511
Domestic Waste	4,104,551	(127,747)	3,976,804
Blue Haven Terralong ILU Maintenance Levy	1,873,322		1,873,322
Blue Haven Bonaira ILU Maintenance Levy	312,035		312,035
Blue Haven RAC Prudential Liquidity Management	5,000,000		5,000,000
Blue Haven Community Transport Vehicle	315,000		315,000
Blue Haven Home Care Client credit Balance	193,817		193,817
Crown Holiday parks	1,962,547	220,913	2,183,460
Leisure Centre Unspent Loan Funding	500,000		500,000
Stormwater Levy	228,947		228,947

Cash and Investments Held	**Sep-23**	**Movement**	**Oct-23**
Security Bonds, Deposits & Retentions	1,973,838	25,025	1,998,863
Externally Restricted	**30,119,341**	**(35,629)**	**30,083,711**
Council Elections	49,776		49,776
Employee Leave Liabilities	4,000,000	(633,000)	3,367,000
Land development	2,702,000	(2,174,773)	527,227
Plant replacement	-		-
Risk Improvement Incentive	99,097		99,097
Waste Business Unit	865,308		865,308
Waste and Sustainability	558,180		558,180
Blue Haven ILU Prudential Cover	4,300,000		4,300,000
Internally Restricted	**12,574,360**	**(2,807,773)**	**9,766,587**
Unrestricted Funds	**851**	**(851)**	**(0)**
Receivable – Expenditure on Grant Funded Projects yet to be reimbursed			**2,650,000**
Projected Unrestricted Cash Balance Including Grants AR			**2,650,000**

As a part of preparation of 2022/23 Financial Statements, management has completed calculation of employee leave liability balance. The reserve balance was adjusted accordingly after consideration of employee establishment, leave balances and period of tenure. This resulted in a reduction of $633K.

The waste business unit and domestic waste management reserves are currently under review. Grants reserve balance is also under review with the 30 June 2023 balances yet to be finalised as a part of financial statements preparation process. Part of the grants review has revealed $2.65M in expenditure to be received in acquittal processes – Landslide Disaster Recovery Funding $2.4M and Blue Haven RAC Covid Outbreak Funding $250K.

These funds have impacted unrestricted funds balance and an alternative unrestricted funds balance was added to the table above to reflect these findings. As mentioned, the grants review in upcoming months will provide a complete position and reconciliation.

Other Movements in reserves include transfer of $297K from Unexpended Grants and $128K from Domestic Waste to reflect relevant expenditures. Developer Contributions, Crown Holiday Parks and Security Bonds, Deposits and Retentions had reserve increases of $143K, $221K and $25K respectively.

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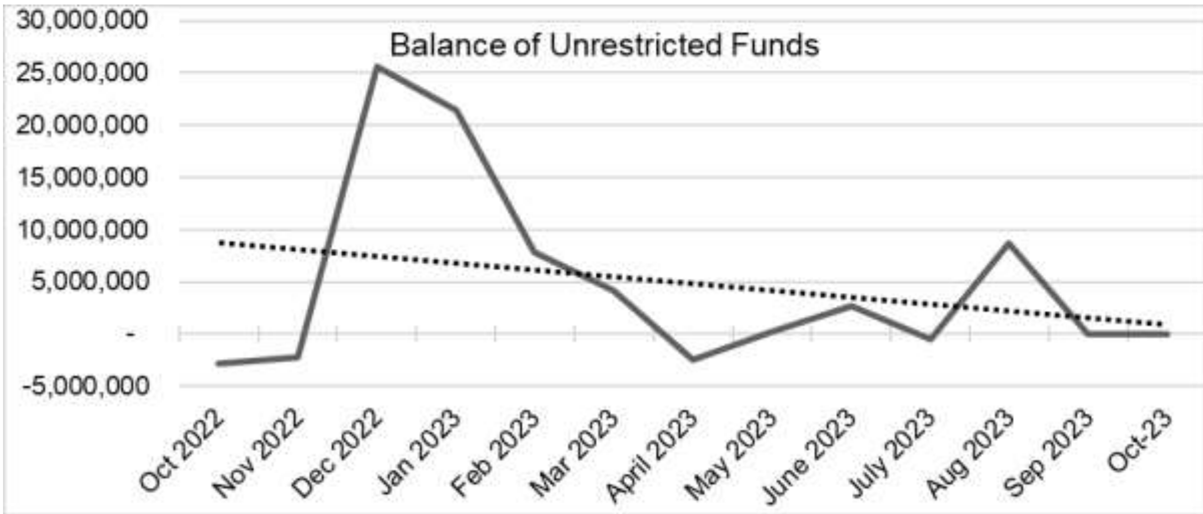
Unrestricted Funds for Future Strategic or Operational Expenditure



Council adopted an unbalanced 2023-24 Budget with an estimated unrestricted cash deficit of $8M. In other words, the budget anticipates an average monthly reduction in unrestricted cash of $667K. As outlined in 2023-24 budget and LTFP, this unrestricted cash deficit will be offset by proceeds from sale of assets in line with the divestment strategy.

The unrestricted funds balance as at 31 October 2023 was negative $2,807,773. This reduction in unrestricted cash is explained by the following:

- Landslide repair works (DRFA) – Council is yet to be reimbursed by Transport NSW for capital works delivered and RAC Covid Outbreak funding claim awaiting reimbursement.
- expected budgeted monthly unrestricted cash reduction of $667K.
- Net outflow of Blue Haven Residential Accommodation refunds of $1.28M. A review back to July 2022 shows that the net position over the 16 months period to October 2023 is positive $2.3M, however, this compares unfavourably to forecasted $5.3M. Note any movement has a direct corresponding movement in the balance sheet liability.

In order to attain a positive unrestricted cash position, it is recommended that $2.175 million be transferred from the Internally Restricted Land Development Reserve in accordance with section 6 of Council's Restricted Funds Policy which states:

"Council may decide to review its internal restrictions at any time to meet financial obligations and requirements of Council's Long Term Financial Plan.

A Council resolution is required to return funds no longer required to unrestricted cash. If an urgent, unplanned or emergency need arises during the year to access internally restricted funds Council may resolve to do so outside of the annual review process."

This transfer does not prevent Council from utilising the funds transferred to unrestricted cash for the purposes of the Land Development Reserve, should the need arise.

Next month should see cash inflow from the settlement proceeds of recent divestment of Akuna Street (South), Blue Haven (new resident) accommodation payments and additional grants received in November. These should counter or offset the outflow noted above. Occupancy fluctuations across Blue Haven can have a notable impact on cash reserves.

The summary of transfers from internal reserves in order to replenish unrestricted cash as per previous Council resolutions is summarised below:

Reference	Date Effective	Reserve	Amount	Reason
23/126OC	30/04/2023	Land Development Reserve	-5,000,000	insufficient unrestricted cash balance
23/195OC	31/07/2023	Land Development Reserve	-500,000	insufficient unrestricted cash balance
23/256OC	31/08/2023	Land Development Reserve	-1,800,000	insufficient unrestricted cash balance
	Total:		**-7,300,000**	

Consolidated Cash Position and Cash Flow Forecast

The recent 2 Year cash flow and Financial Sustainability Strategy are key documents that note Council's plans to progress through its current financial position. The chart below shows a comparison of actual total cash reserves against the forecast as presented in February 2023 and an updated cash flow forecast.

The Cash flow forecast will be updated to reflect quarterly budget review and updated cash position. This updated forecast will be presented next month.

Note a longer term view of the cash flow forecast and chart will be presented and discussed with the Financial Advisory Committee in November.

Certification – Responsible Accounting Officer

I hereby certify that the investments listed in this report have been made in accordance with Section 625 of the *Local Government Act 1993*, clause 212 of the Local Government (General) Regulation 2021 and Council's Investment Policy.

Olena Tulubinska
Chief Financial Officer

09/11/2023

Arlo Advisory

Monthly Investment Review

KIAMA MUNICIPAL COUNCIL
your council, your community

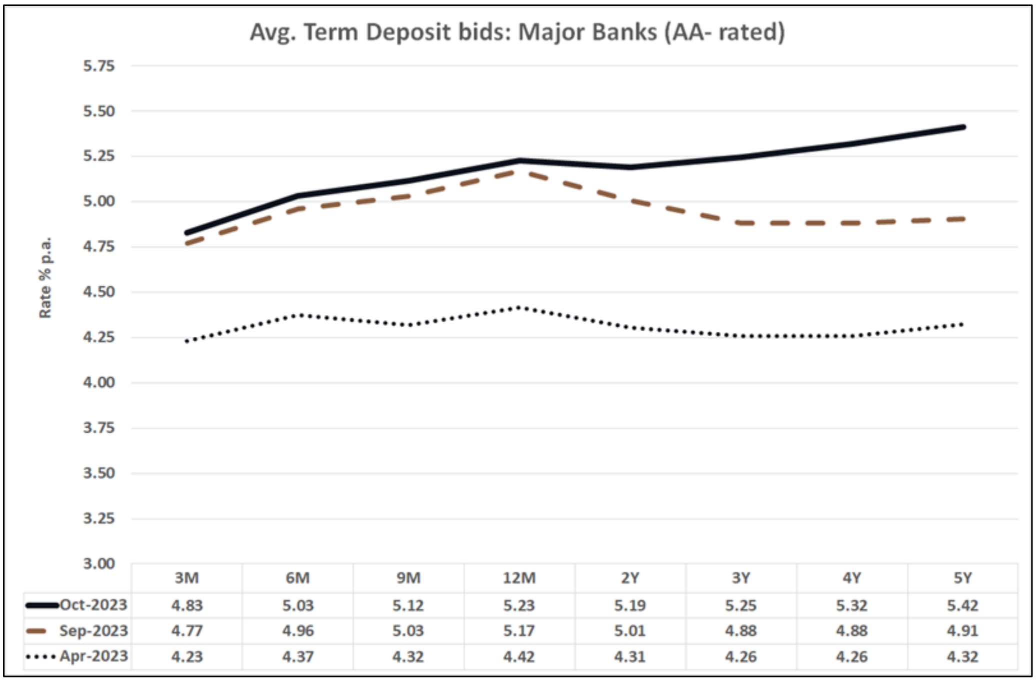
October 2023

Arlo Advisory Pty Ltd
ABN: 55 668 191 795
Authorised Representative of InterPrac Financial Planning Pty Ltd
AFSL 246 638
Phone: +61 2 9053 2987
Email: michael.chandra@arloadvisory.com.au / melissa.villamin@arloadvisory.com.au
125 Middle Harbour Road, East Lindfield NSW 2070

Market Update Summary

Financial markets reacted to expectations that central banks could keep interest rates higher for longer than previously envisaged, as they fight to curb inflation that remains stubbornly high across many countries. The sell-off in global bonds continued with fresh cycle highs being set for longer-term yields. Domestically, the RBA's tolerance for the current elevated levels of inflation is waning. They have maintained their tightening bias and likely to hike rates again as early as November 7th (Melbourne Cup).

Over the month of October, major bank deposit rates increase significantly (~40-50bp) at the long-end (3-5 year) part of the curve, reacting to the higher than expected inflation number. Interesting, deposit rates offered by the major banks are now slightly higher at the very long end (3-5 years) compared to the shorter-end (6 month-2 years), which has not been the case in recent months. Rates remain relatively flat across the longer-tenors (only a ~20bp range between 1-5 year rates), reflective of the major banks believing that we are approaching the peak of the interest rates cycle and potentially, future rate cuts may need to be delivered should inflation be returning back to target.



Source: Imperium Markets

With a global economic downturn being priced in coming years, investors may take an 'insurance policy' against a potentially lower rate environment by investing across 2-5 year fixed deposits, targeting rates above or close to 5¼-5½% p.a. (small allocation only).

Kiama Municipal Council's Portfolio & Compliance

Asset Allocation

The majority of the portfolio is directed to term deposits (88%), with the remainder in cash (12%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 12-18 months. New issuances may be considered again on a case by case scenario. In the interim, staggering a mix of fixed deposits between 9-12 months to 3 years remains a more optimal strategy to maximise returns over a longer-term cycle.

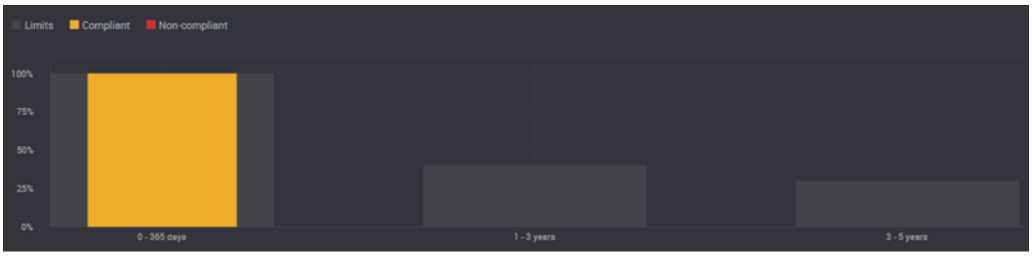
With a global economic downturn being priced in coming years, investors can choose to allocate a small proportion of longer-term funds and undertake an insurance policy against any potential future rate cuts by investing across 2-5 year fixed deposits, locking in and targeting yields close to or above 5¼-5½% p.a.

Term to Maturity

The portfolio is highly liquid with the majority maturing under 3 months. We recommend a more diversified maturity profile to optimise the overall returns of the portfolio in the long-run.

All the maturity policy allocations are compliant, with substantial capacity to invest in 1-3 year terms particularly amongst the higher rated ADIs. Where ongoing liquidity requirements permit, we recommend Council to invest a higher proportion in deposits with a minimum term of 6-12 months, with a smaller allocation to 2 year deposits.

Council is currently implementing a strategy to stagger deposits maturing within 3-6 months. Over time, once comfortable with cash flow forecasts, we recommend incrementally staggering deposits with a spread of maturities between 6-12 months.



Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 365 days	$42,736,321	100.00%	0%	100%	$0
✓	1 - 3 years	$0	0.00%	0%	40%	$17,094,528
✓	3 - 5 years	$0	0.00%	0%	30%	$12,820,896
✓	5 - 10 years	$0	0.00%	0%	30%	$12,820,896
		$42,736,321	**100.00%**			

Counterparty

As at the end of October, all individual counterparties are within limits and compliant. Overall, the portfolio is well diversified across the investment grade credit spectrum with zero exposure to the unrated ADI sector.

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA	AA-	$19,000,000	44.46%	100%	$23,736,321
✓	Westpac	AA-	$4,986,321	11.67%	100%	$37,750,000
✓	NAB	AA-	$12,000,000	28.08%	100%	$30,736,321
✓	Suncorp	A+	$4,000,000	9.36%	30%	$8,820,896
✓	ING	A	$2,000,000	4.68%	30%	$10,820,896
✓	AMP	BBB	$750,000	1.75%	5%	$1,386,816
			$42,736,321	**100.00%**		

Fossil Fuel Investments

What is Council's current exposure to institutions that fund fossil fuels?

Using the following link http://www.marketforces.org.au/banks/compare, based on the Council's investment portfolio balance as at 31/10/2023 ($42.7m), we can roughly estimate that ~91% of the institutions invested have some form of exposure. Note this is purely based on the institution/counterparty and not the actual underlying investments themselves.

Council's exposure is summarised as follows:

Counterparty	Rating	Funding Fossil Fuel
CBA	AA-	Yes
WBC	AA-	Yes
NAB	AA-	Yes
Suncorp	A+	No
ING	A	Yes
AMP Bank	BBB	Yes

Source: https://www.marketforces.org.au/info/compare-bank-table/

Summary	Amount	Invested %
Yes	$38,736,321	91%
No	$4,000,000	9%
	$42,736,321	**100%**

Transition to investments without major exposure to fossil fuels

Council has not made a formal decision to divest from the current portfolio of investments which have exposure to fossil fuels. To do so would have unfavourable implications to the credit quality, rating and interest income forecasts.

However, where possible, and within the ministerial and policy guidelines, Council will continue to favour newly issued fossil fuel free investment products, providing it does not compromise the risk and return profile.

In time, it is Councils intention to move to a more balanced portfolio which has less exposure to fossil fuels, providing it is prudent to do so.

What would be implications on our portfolio credit rating?

By adopting a free fossil fuel policy or an active divestment strategy, this would eliminate the major banks rated "AA-" as well as some other potential "A" rated banks (e.g. Macquarie and ING). Council would be left with a smaller sub-sector of banks to choose to invest with.

What would be risks and implications on Council's portfolio performance?

Some implications include:

- High concentration risk – limiting Council to a selected number of banks;

- Increased credit/counterparty risk;
- May lead to a reduction in performance (e.g. should Council choose to invest in securities, most of the senior FRN issues are with the higher rated ADIs);
- Underperformance compared to other Councils which could result in a significant loss of income generated – could be in excess of hundreds of thousands of dollars per annum.

It may actually be contrary to Council's primary objective to preserve capital as the investment portfolio's risk would increase (all things being equal). Council may not be maximising its returns – this is one of the primary objectives written in the Investment Policy.

Credit Quality

The portfolio is diversified from a credit ratings perspective, with exposure down to the BBB category. All ratings categories are within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AAA Category	$0	0.0%	100%	$42,736,321
✓	AA Category	$35,986,321	84.2%	100%	$6,750,000
✓	A Category	$6,000,000	14.0%	100%	$36,736,321
✓	BBB Category	$750,000	1.8%	30%	$12,070,896
✓	Unrated Category	$0	0.0%	10%	$4,273,632
		$42,736,321	**100.0%**		

Performance

Council's performance (excluding cash holdings) for the month ending October 2023 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.34%	1.02%	2.03%	1.36%	3.66%
AusBond Bank Bill Index	0.33%	1.04%	2.02%	1.42%	3.66%
Council's Portfolio^	**0.43%**	**1.20%**	**2.14%**	**1.53%**	**3.62%**
Outperformance	**0.09%**	**0.16%**	**0.11%**	**0.12%**	**-0.04%**

^Total portfolio performance excludes Council's cash account holdings.

Performance (Annualised)	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	4.10%	4.10%	4.06%	4.10%	3.66%
AusBond Bank Bill Index	4.01%	4.19%	4.05%	4.27%	3.66%
Council's Portfolio^	**5.14%**	**4.86%**	**4.29%**	**4.62%**	**3.62%**
Outperformance	**1.13%**	**0.66%**	**0.23%**	**0.35%**	**-0.04%**

^Total portfolio performance excludes Council's cash account holdings.

For the month of October, excluding cash, the total portfolio provided a return of +0.43% (actual) or +5.14% p.a. (annualised), outperforming the benchmark AusBond Bank Bill Index return of +0.33% (actual) or +4.01% p.a. (annualised). The improved monthly performance was driven by the investment of $8m of term deposits during October, which had a weighted average rate of 5.25% p.a.

Although there has been some 'underperformance' over the past year, this has been due to the unexpected and aggressive rate hike cycle delivered by the RBA. We do anticipate this to be temporary, particularly given the high level of turnover and hopes that the RBA is approaching the peak of its rate hike cycle.

Recommendations for Council

Term Deposits

Over this financial year, Council may consider altering its longer-term strategy by placing a slightly larger proportion of deposits and stagger investments across 12-24 months terms. Over a cycle and in a normal market environment, this may earn up to ¼-½% p.a. higher compared to purely investing in shorter tenors. There is a growing belief that a global economic downturn is not too far away and so locking in rates above or close to 5¼-5½% p.a. across 2-3 year tenors may provide some income protection against a lower rate environment.

As at the end of October 2023, Council's deposit portfolio was yielding around 5.14% p.a. (up 21bp from the previous month), with a weighted average duration of 125 days (~4 months). ***We commend Council for improving its weighted average duration in recent months, and we continue to recommend Council to increase this closer to 6-9 months incrementally over the current financial year (with a view to extending closer to 12 months in the medium-term).***

Please refer to the section below for further details on the Term Deposit market.

Securities

Primary (new) **FRNs** (with maturities between 3-5 years) continue to be appealing (particularly for those investors with portfolios skewed towards fixed assets) and should be considered on a case by case scenario.

Please refer to the section below for further details on the FRN market.

Term Deposit Market Review

Current Term Deposits Rates

As at the end of October, we see value in:

Index	LT Credit Rating	Term	Rate % p.a.
ANZ	AA-	5 years	5.89%
ING	A	5 years	5.67%
ANZ	AA-	4 years	5.58%
ING	A	4 years	5.58%
ING	A	2-3 years	5.49%
Westpac	AA-	2 years	5.41%
NAB	AA-	2 years	5.40%
BoQ	BBB+	2 years	5.35%
CBA	AA-	2 years	5.29%

The above deposits are suitable for investors looking to maintain diversification and lock-in a slight premium compared to purely investing short-term.

For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (*we stress that rates are indicative, dependent on daily funding requirements and different for industry segments*):

Index	LT Credit Rating	Term	Rate % p.a.
ING	A	12 months	5.47%
CBA (>$2m)	AA-	12 months	5.45%
Westpac	AA-	12 months	5.43%
Suncorp	A+	12 months	5.42%
ING	A	11 months	5.37%
NAB	AA-	12 months	5.40%
BoQ	BBB+	12 months	5.35%
NAB	AA-	9 months	5.30%
BoQ	BBB+	6-9 months	5.30%
CBA (>$2m)	AA-	6 months	5.22%
NAB	AA-	6 months	5.20%
NAB	AA-	3 months	5.00%

If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared to those investors that entirely invest in short-dated deposits (under 6-9 months).

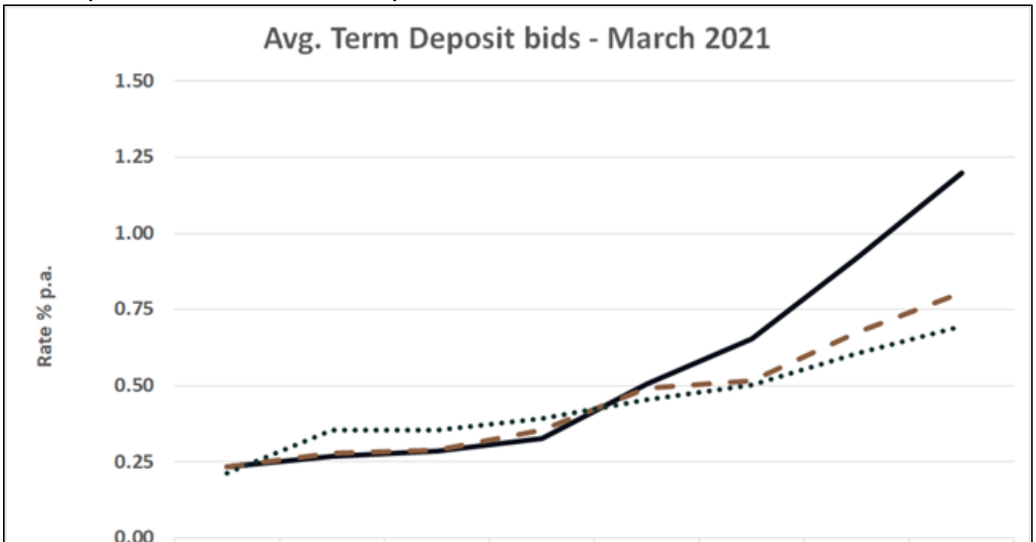
With a global economic slowdown being priced in coming years, investors should consider allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates close to or above 5¼-5½% p.a. This will provide some income protection if central banks decide to cut rates in future years, assuming inflation has stabilised.

Arlo Advisory

Term Deposits Analysis

Pre-pandemic (March 2020), a 'normal' marketplace meant the lower rated ADIs (i.e. BBB category) were offering higher rates on term deposits compared to the higher rated ADIs (i.e. A or AA rated). But due to the cheap funding available provided by the RBA via their Term Funding Facility (TFF) during mid-2020, allowing the ADIs to borrow as low as 0.10% p.a. fixed for 3 years, those lower rated ADIs (BBB rated) did not require deposit funding from the wholesale deposit. Given the higher rated banks had more capacity to lend (as they have a greater pool of mortgage borrowers), they subsequently were offering higher deposit rates. In fact, some of the lower rated banks were not even offering deposit rates at all. As a result, most investors placed a higher proportion of their deposit investments with the higher rated (A or AA) ADIs over the past three years.

Term Deposit Rates – 12 months after pandemic (March 2021)



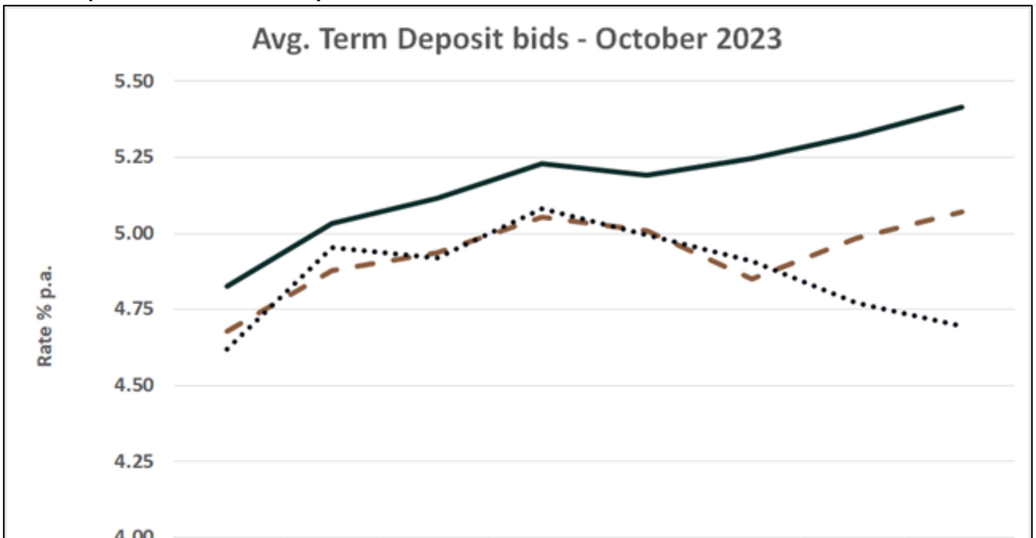
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits slowly increases. In recent months, we have started to periodically see some of the lower rated ADIs ("A" and "BBB" rated) offering slightly higher rates compared to the domestic major banks ("AA" rated) on different parts of the curve (i.e. pre-pandemic environment). Some of this has been attributed to lags in adjusting their deposit rates as some banks (mainly the lower rated ADIs) simply set their rates for the week.

Going forward, Council should have a larger opportunity to invest a higher proportion of its funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry. We are slowly seeing this trend emerge, although the past three months have been an exception, with the major banks repricing more rapidly to the movement in the bond market than their lower rated counterparts:

Term Deposit Rates – Currently (October 2023)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.83	5.03	5.12	5.23	5.19	5.25	5.32	5.42
A Rated	4.68	4.88	4.94	5.05	5.01	4.85	4.99	5.07
BBB Rated	4.62	4.95	4.92	5.08	4.99	4.91	4.77	4.70

Source: Imperium Markets

Regional & Unrated ADI Sector

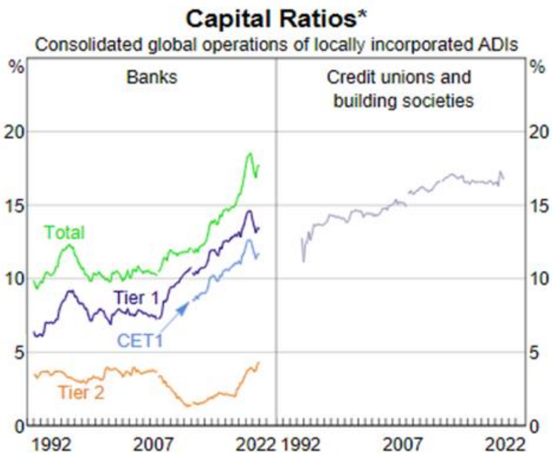
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P expects that consolidation to continue over the next two years.

We remain supportive of the regional and unrated ADI sector (and have been even throughout the post-GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 25-40% more capital than the domestic major banks, and well above the Basel III requirements.

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). The financial regulator, APRA has noted that the Common Equity Tier 1 capital of Australian banks now exceeds a quarter of a trillion dollars. It has increased by $110 billion, or more than 70%, over the past nine years. Over the same time, banks' assets have grown by 44%. Some of the extra capital is supporting growth in the banking system itself but clearly, there has been a strengthening in overall resilience and leverage in the system is lower.

We believe that deposit investments with the lower rated ADIs should be considered going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities are generally deemed to be the more 'ethical' ADIs compared to the higher rated ADIs.

In the current environment of high regulation and scrutiny, all domestic (and international) ADIs continue to carry high levels of capital. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC and the pandemic period. APRA's mandate is to "*protect depositors*" and provide "*financial stability*".

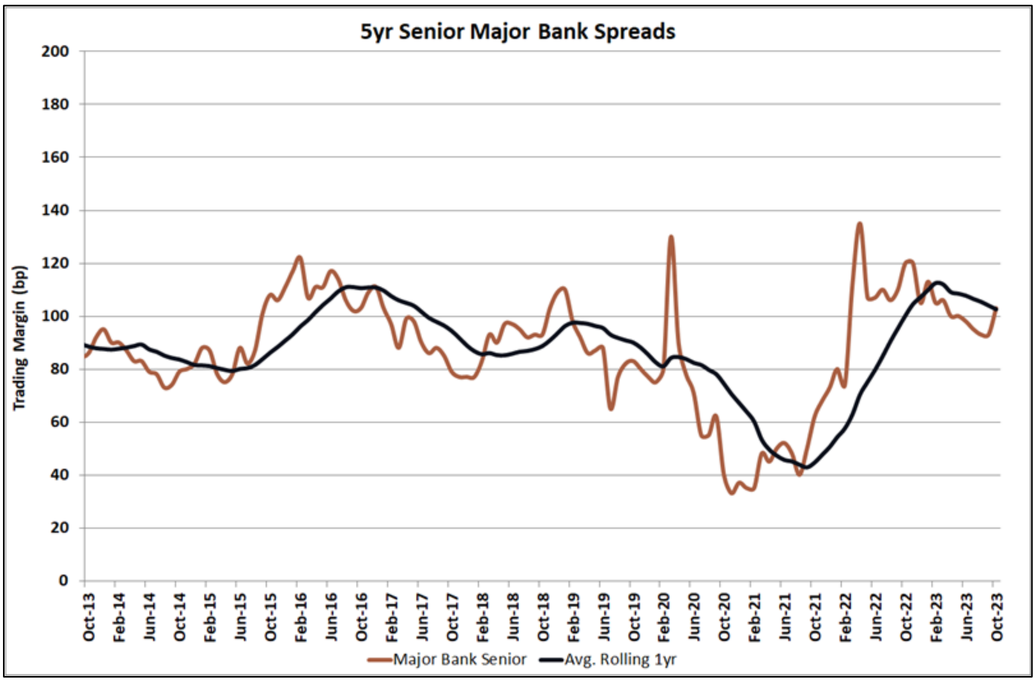


* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

Source: APRA

Senior FRNs Market Review

Over October, amongst the senior major bank FRNs, physical credit securities widened by around 6-10bp at the long-end of the curve. Major bank senior securities remain at fair value in the rising rate environment (5yr margins above +100bp level).



Source: IBS Capital

During the month, there were a handful of other new (primary) issuances:

- 3 & 7yr SMBC (A) senior FRN at +90bp and +137bp respectively
- 3 & 5yr Bank of America (A) senior FRN at +105bp and +125bp respectively
- 3yr Bank Australia (BBB) senior FRN at +150bp

Amongst the "A" and "BBB" rated sector, the securities widened by around 10-15bp and 35bp respectively at the longer-end of the curve. Credit securities are looking much more attractive given the widening of spreads over the past ~18 months. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over future years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/10/2023	30/09/2023
"AA" rated – 5yrs	+103bp	+93bp
"AA" rated – 3yrs	+80bp	+74bp
"A" rated – 5yrs	+125bp	+115bp
"A" rated – 3yrs	+105bp	+90bp
"BBB" rated – 3yrs	+150bp	+115bp

Source: IBS Capital

We now generally recommend switches ('benchmark' issues only) into new primary issues, out of the following senior FRNs that are maturing:

- On or before 2025 for the "AA" rated ADIs (domestic major banks);
- On or before 2024 for the "A" rated ADIs; and
- Within 6-9 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last few years are now generally holding sub optimal investments and are not maximising returns by foregoing realised capital gains. In the current challenging economic environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

Senior Fixed Bonds – ADIs (Secondary Market)

With global inflation remaining elevated, this has seen a significant lift in longer-term bond yields over the past 18 months (valuations fallen) as markets have reacted sharply.

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the majority now being marked at a significant discount to par (please note supply in the secondary market may be limited on any day):

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0273407	UBS	A+	Senior	30/07/2025	1.76	1.20%	5.62%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.53	1.40%	5.85%
AU3CB0299337	Bendigo	BBB+	Senior	15/05/2026	2.55	4.70%	5.76%
AU3CB0296168	BoQ	BBB+	Senior	27/01/2027	3.26	4.70%	5.92%
AU3CB0302404	ANZ	AA-	Senior	11/09/2028	4.89	4.90%	5.54%
AU3CB0302735	WBC	AA-	Senior	19/09/2028	4.90	4.95%	5.55%

Economic Commentary

International Market

Financial markets reacted to expectations that central banks could keep interest rates higher for longer than previously envisaged, as they fight to curb inflation that remains stubbornly high across many countries. The sell-off in global bonds continued with fresh cycle highs being set for longer-term yields.

Across equity markets, the S&P 500 Index fell -2.20%, whilst the NASDAQ dropped -2.78%. Europe's main indices also experienced losses, led by UK's FTSE (-3.76%), Germany's DAX (-3.75%) and France's CAC (-3.50%).

The US core PCE deflator rose at +2.4% y/y, 0.1% below the consensus of +2.5%. The +2.4% increase in core PCE is the smallest since Q4 2019, ignoring the initial Covid distortions. US headline retail sales came in at +0.7% m/m vs. +0.3% expected, and the core control measure which feeds into GDP was +0.6% m/m vs. +0.1% expected.

US payrolls for September beat expectations, with payroll jobs up +336k against +170k expected. The participation rate remained high at 62.8%, and the unemployment rate remained at 3.8% against expectations for a dip to 3.7%.

The ECB kept rates on hold as widely expected and there was little initial market reaction. The statement reported that interest rates are at levels that, if maintained for a sufficiently long duration, will bring inflation back to its target. That reinforced market expectations that the tightening cycle may now be finished.

Canada's CPI figures for September slightly undershot expectations, with the headline rate falling to +3.8%. Meanwhile, Canada's labour market data was strong, with employment up +64k jobs in September (+20k expected). The unemployment rate was unchanged at 5.5%.

China's CPI remained flat year-on-year in September while producer prices declined -2.5% amid lingering concerns about weak demand.

The RBNZ left the Official Cash Rate unchanged at 5.50%, with the accompanying statement suggesting there is little change in the Bank's assessment from the August Monetary Policy Statement. New Zealand's Q3 CPI report showed notably lower annual inflation of +5.6% compared to the RBNZ's estimate of +6.0%.

The MSCI World ex-Aus Index fell -2.92% for the month of October:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-2.20%	-8.61%	+8.31%	+8.65%	+9.11%	+9.09%
MSCI World ex-AUS	-2.92%	-9.58%	+8.87%	+6.58%	+6.61%	+5.82%
S&P ASX 200 Accum. Index	-3.78%	-7.19%	+2.95%	+8.88%	+7.18%	+6.60%

Source: S&P, MSCI

Domestic Market

As widely expected, the RBA kept rates unchanged in October for the four consecutive month. The RBA's October Board Minutes was more hawkish than recent communications. Key was the statement, "*the Board has a low tolerance for a slower return of inflation to target than currently expected*", which was inserted into the concluding paragraph. Even if the RBA hikes in November, they may still retain a tightening bias given the "*low tolerance*" for a slower return of inflation to target.

RBA Governor Bullock remained bullish in her follow-up comments during the month, saying "*there's a few things that are suggestive that it's going to be difficult to get inflation down" and "services inflation - inflation in things like takeaways, hairdressers, restaurants, those sorts of things - that inflation is running at a bit over 4%...so it's above our target and it's pretty sticky. And that's what we're observing overseas as well*". She also commented, "*the Board will not hesitate to raise the cash rate further if there is a material upward revision to the outlook for inflation*".

Q3 trimmed mean CPI came in at +1.2% q/q (+1.16% unrounded) and +5.2% y/y. That was marginally higher than consensus for +1.0% q/q. Most importantly, it is meaningfully higher than the +0.9% q/q outcome the RBA had pencilled in the August SoMP. The RBA appears to have been overly optimistic in its near term forecast for disinflation.

The unemployment rate fell 0.1% to 3.6% in September. This was largely due to the fall in the participation rate by 0.2% to 66.7%, with employment only rising by +6.7k (softer than consensus).

Retail sales rose a strong +0.9% m/m in September (consensus +0.3%) or +3.4% on an annual basis, which is 0.5% above its pre-pandemic growth rate. Very elevated population growth is a key tailwind to the aggregate consumer spending growth.

Residential auction clearance rates have held firm at 70.8%, in a sign the property market is shifting to the middle ground between buyers and sellers, as increased auction volumes temper vendor dominance.

The Australian dollar fell -1.73%, finishing the month at US63.46 cents (from US64.58 cents the previous month).

Credit Market

The global credit indices widened again over November in the 'risk-off' environment. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	October 2023	September 2023
CDX North American 5yr CDS	81bp	73bp
iTraxx Europe 5yr CDS	89bp	80bp
iTraxx Australia 5yr CDS	98bp	89bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	October 2023	September 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.33%	+0.34%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.85%	-1.53%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.37%	+0.37%
Bloomberg AusBond Credit Index (0+YR)	-0.77%	-0.58%
Bloomberg AusBond Treasury Index (0+YR)	-1.85%	+1.88%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-1.35%	-2.20%

Source: Bloomberg

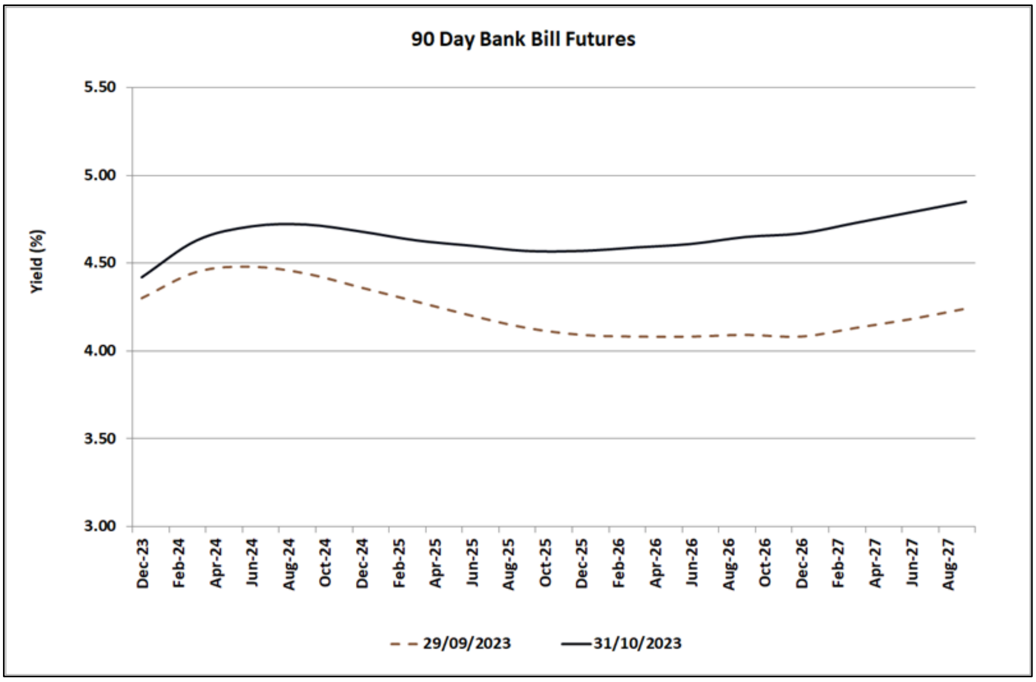
Other Key Rates

Index	October 2023	September 2023
RBA Official Cash Rate	4.10%	4.10%
90 Day (3 month) BBSW Rate	4.35%	4.14%
3yr Australian Government Bonds	4.41%	4.08%
10yr Australian Government Bonds	4.93%	4.48%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	5.07%	5.03%
10yr US Treasury Bonds	4.88%	4.59%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures rose across the board this month, following the higher than anticipated inflation number. The RBA is now expected to lift official rates again on Melbourne Cup Day (7th November). The bills market continues to factor in the possibility of an economic downturn over the next few years, highlighted by the drop in the futures pricing by the beginning of 2024:



Source: ASX

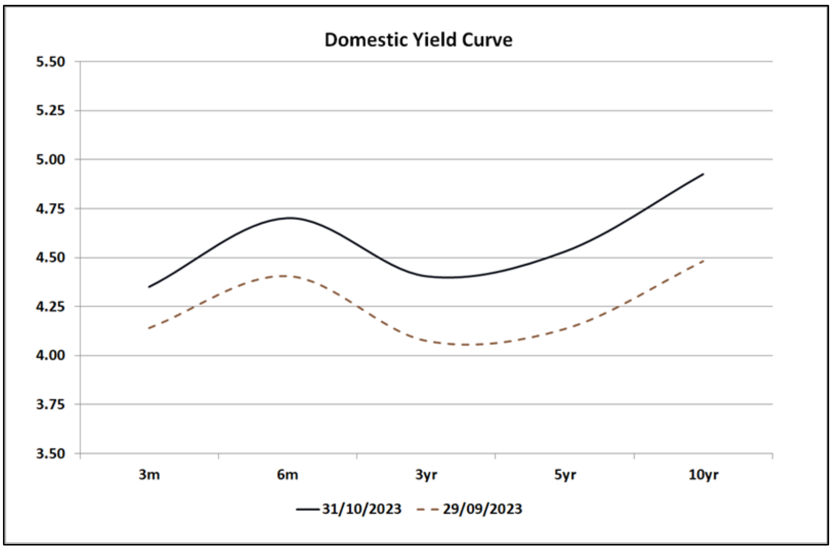
Fixed Interest Outlook

Global inflation has accelerated in recent months – ending the trend of disinflation exhibited in early to mid-2023. Certain sectors in most advance economies have remained sticky, with rising energy prices remaining a significant risk to headline inflation. The near-term outlook around monetary policy is still firmly to the upside. There is considerable uncertainty when central banks will start to cut official rates – markets continue to push back their expectations, factoring a 'higher for longer' sustained period of interest rates, resulting in the ongoing sell-off in bonds (yields rising).

US Fed Chair Powell commented that the FOMC is "*proceeding carefully*" and that "*additional evidence of persistently above-trend growth, or that tightness in the labour market is no longer easing, could put further progress on inflation at risk and could warrant further tightening of monetary policy*". US fed funds pricing universally expects the Fed to be on hold in November. Pricing of cuts though has expanded slightly with around 80bp priced for 2024.

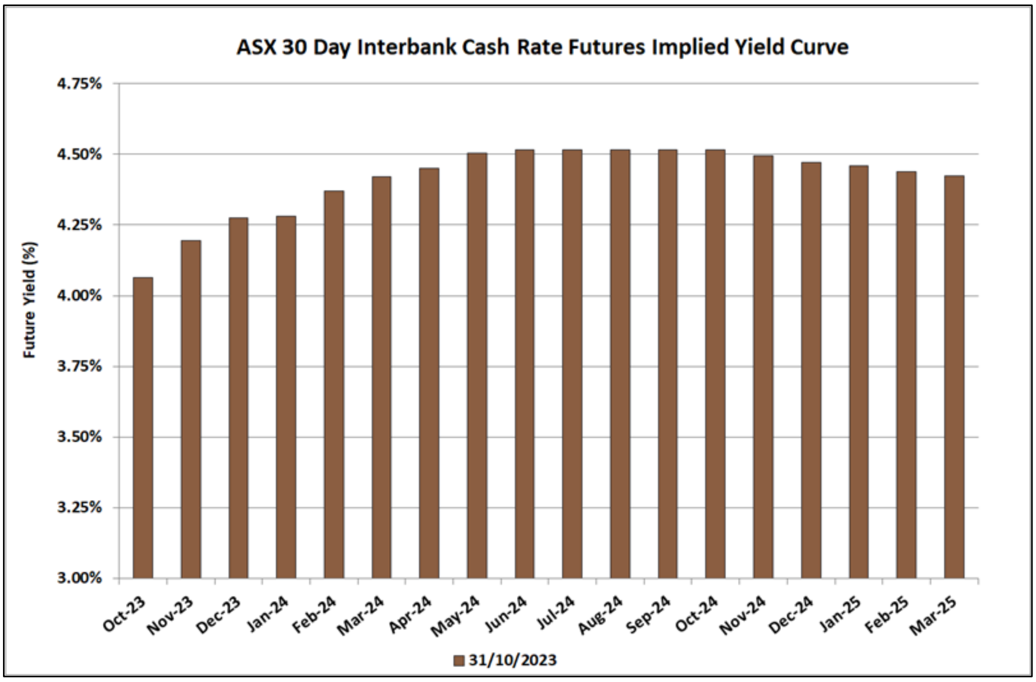
Domestically, the RBA remains committed to tightening further if required, again warning that some further tightening may be required to ensure that inflation returns to target in a reasonable timeframe, and that this will continue to depend upon the data and the evolving assessment of risks. Governor Bullock has commented that services inflation is the worry ("*although services inflation is declining, it's still higher than we're comfortable with. And it's also reasonably persistent*"). The Board's tolerance for the ongoing elevated levels of inflation is waning and the market believes this will force its hand with another rate hike in November.

Over the month, yields rose up to 44bp at the long end of the curve:



Source: ASX, RBA

Markets have been quick to revise their interest rate forecasts with one more rate hike fully priced this cycle. Rate cuts are still being forecasted, but not at least until 2025:



Source: ASX