14.4 Statement of Investments: May 2024

CSP Objective: Outcome 5.1: Public funds and assets are managed strategically, transparently, and efficiently

CSP Strategy: 5.1.1 Public funds are managed in accordance with Financial Management Standards and the Local Government Act.

Delivery Program: 5.1.1.1 Improved financial reporting and legislative compliance through reporting, scrutiny oversight and processes

Summary

This report provides an overview of Council's cash and investment portfolio and investment performance as at May 2024 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 May 2024 Investment Report⇩

Enclosures

Nil

Item 14.4

RECOMMENDATION

That Council:

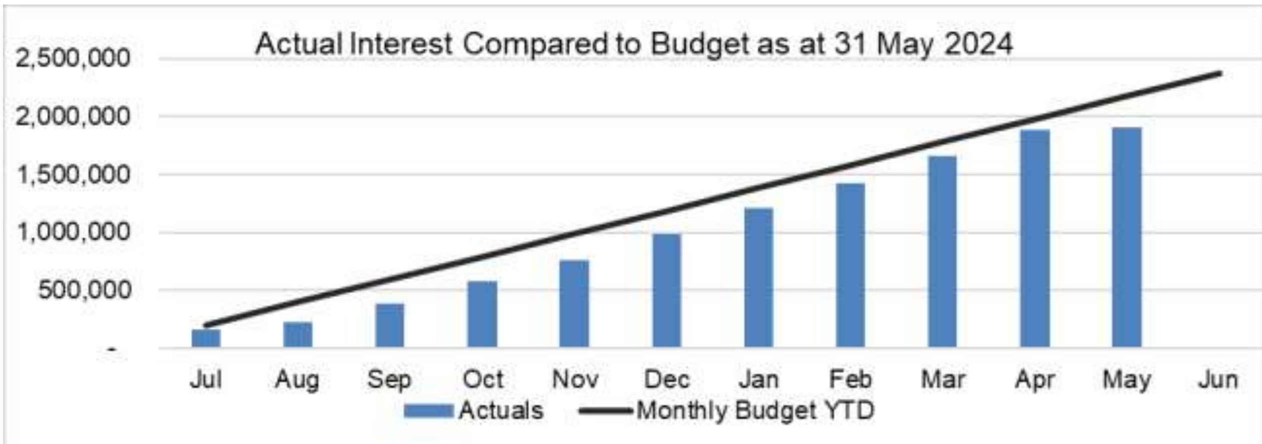
1. Receives the information relating to the Statement of Investments as at 31 May 2024.
2. Approves the transfer of $3,900,000 from the Land Development Reserve to Unrestricted Funds and endorses the restricted funds position outlined in the report

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. Council's 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.

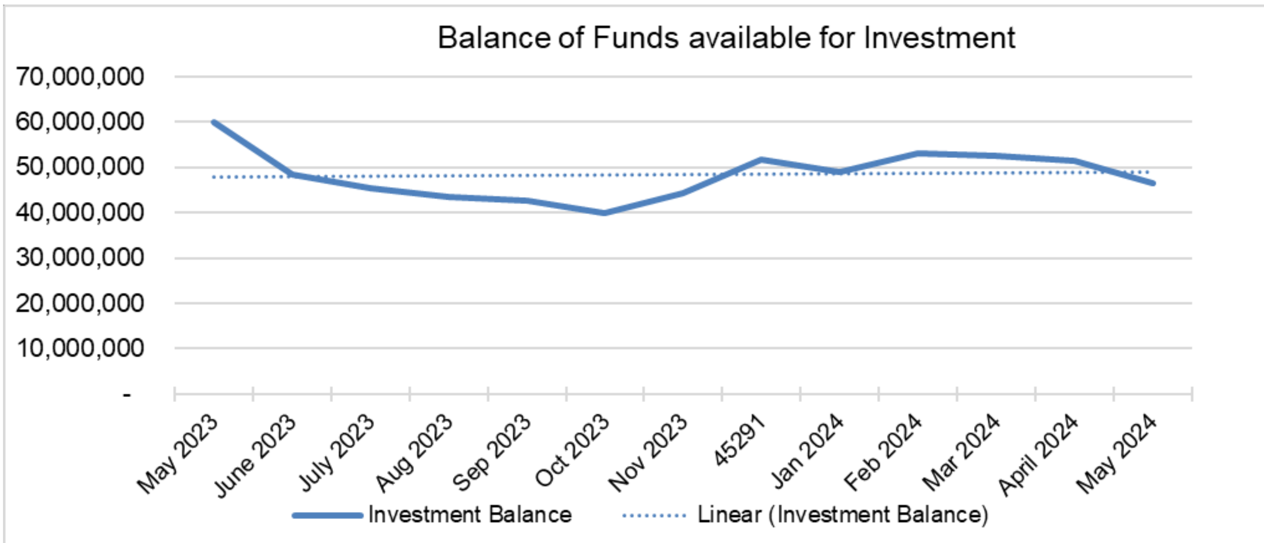
Return on Investments

For the month of May, excluding cash, the total portfolio provided a return of +0.45% (actual) or +5.37% p.a. (annualised), outperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.50% p.a. (annualised). All previously held low yielding deposits coming out of the pandemic period have all matured and have been reinvested with higher prevailing rates. This brings Council's all time period investments above the one year benchmark returns.



Movement in Investments

Compared to May 2023 Council's investments portfolio decreased by $38M. Repayment of TCorp loan tranches of $30M (excluding interest payments) being the key outflows.



Matured trades for May:

Issuer	Rating	Type	Interest	Purchase	Maturity	Rate %	Value
Suncorp	A+	TD	At Maturity	11/10/2023	13/05/2024	5.15	2,000,000
Total							**2,000,000**

No new trades were entered into during May.

Portfolio Summary:

Issuer	Rating	Type	Interest	Purchase	Maturity	Rate %	Value
Suncorp	A+	TD	At Maturity	04/12/2023	03/06/2024	5.28	1,000,000
NAB	AA-	TD	At Maturity	10/01/2024	12/06/2024	5.10	4,000,000
NAB	AA-	TD	At Maturity	26/02/2024	26/06/2024	5.05	2,000,000
NAB	AA-	TD	At Maturity	06/03/2024	10/07/2024	5.10	2,000,000
Suncorp	A+	TD	At Maturity	30/10/2023	30/07/2024	5.35	2,000,000
NAB	AA-	TD	At Maturity	11/03/2024	07/08/2024	5.10	1,000,000
BOQ	A-	TD	At Maturity	21/11/2023	21/08/2024	5.40	1,000,000
NAB	AA-	TD	Annual	18/12/2023	18/09/2024	5.13	1,000,000
AMP Bank	BBB+	TD	Annual	27/09/2022	26/09/2024	4.95	750,000
ING Bank (Australia) Ltd	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
ING Bank (Australia) Ltd	A	TD	At Maturity	15/11/2023	15/11/2024	5.48	2,000,000
Suncorp	A+	TD	At Maturity	21/11/2023	21/11/2024	5.40	1,000,000
Suncorp	A+	TD	At Maturity	28/11/2023	28/11/2024	5.50	2,000,000
Suncorp	A+	TD	At Maturity	04/12/2023	04/12/2024	5.35	1,000,000
Suncorp	A+	TD	At Maturity	13/12/2023	13/12/2024	5.30	2,000,000
ING Bank (Australia) Ltd	A	TD	Annual	21/12/2023	18/12/2024	5.23	2,000,000
ING Bank (Australia) Ltd	A	TD	At Maturity	10/01/2024	09/01/2025	5.22	1,000,000
NAB	AA-	TD	At Maturity	26/02/2024	26/02/2025	5.08	2,000,000
Suncorp	A+	TD	At Maturity	06/03/2024	12/03/2025	5.14	1,000,000
BankVic	BBB+	TD	At Maturity	25/03/2024	26/03/2025	5.15	2,000,000
ING Bank (Australia) Ltd	A	TD	At Maturity	16/04/2024	02/04/2025	5.13	1,000,000
ING Bank (Australia) Ltd	A	TD	At Maturity	22/11/2023	23/09/2025	5.35	1,000,000
Suncorp	A+	TD	At Maturity	21/11/2023	21/11/2025	5.36	1,000,000
ING Bank (Australia) Ltd	A	TD	At Maturity	04/12/2023	04/12/2025	5.25	1,000,000
ING Bank (Australia) Ltd	A	TD	Annual	18/12/2023	18/12/2025	5.20	2,000,000
ING Bank (Australia) Ltd	A	TD	Annual	10/01/2024	14/01/2026	4.96	1,000,000
Bank of Us	BBB+	TD	At Maturity	06/03/2024	11/03/2026	4.96	1,000,000
ING Bank (Australia) Ltd	A	TD	At Maturity	11/04/2024	08/04/2026	4.92	2,000,000
Westpac	AA-	CASH	Monthly	31/05/2024	31/05/2024	4.24	7,232,708
Total 51,982,708							

Restricted Funds Movements

The restricted funds movement for this month and balances are presented in the table below.

Cash and Investments Held	Apr-24	Movement	May-24
Cash at Bank - Transactional Account	5,878,737	1,353,972	7,232,708
Other Cash and Investments	46,750,000	(2,000,000)	44,750,000
Total Portfolio Balance (agrees to Arlo Advisory report)	**52,628,737**	**(646,028)**	**51,982,708**
Cash on Hand	6,110		6,110
Bank Reconciliation items	(1,332,154)	(4,088,680)	(5,420,834)
Book Value of Cash and Investments	**51,302,692**	**(4,734,709)**	**46,567,984**
Developer Contributions	12,764,954	12,361	12,777,315
Unexpended Grants	2,677,144		2,677,144
Domestic Waste	5,727,549		5,727,549
Blue Haven Terralong ILU Maintenance Levy	2,023,322		2,023,322
Blue Haven Bonaira ILU Maintenance Levy	395,562		395,562
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	4,802,733	(108,838)	4,693,895
Closed Roads	-		-
Leisure Centre Unspent Loan Funding	500,000		500,000
Stormwater Levy	228,947		228,947
Security bonds, Deposits & Retentions	1,998,343	(7,215)	1,991,128
Externally Restricted	**36,627,371**	**(103,692)**	**36,523,679**
Council Elections	49,776		49,776
Employee Leave Liabilities	3,367,000		3,367,000
Land development	4,646,565	(3,900,000)	746,565
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	**13,885,926**	**(3,900,000)**	**9,985,926**
Unrestricted Funds	**789,396**	**(731,016)**	**58,379**

Note the Disaster Recovery Funding grant request of $3.8M which is outstanding as referred in the Monthly Financial Report.

May's reserve movements include:

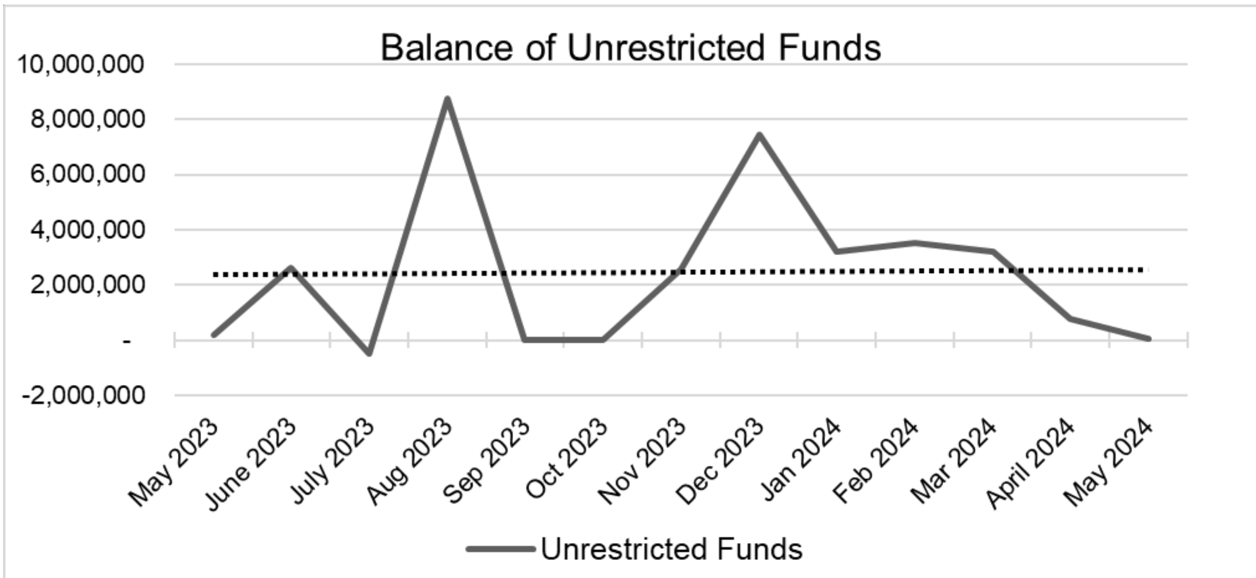
- An increase in the Developer Contribution reserve of $12K
- A decrease in the Crown Holiday Parks reserve of $109K
- A decrease in the Security and Bonds, Deposits and Retentions reserve of $7K
- A decrease in the Land Development reserve of $3.9M

Some reimbursement of the land development reserve is expected to occur next month through receipt of rate instalments and $1.8M of the $3.8M Disaster Recovery Funding in June.

The public exhibition period of the 2022/23 Draft Financial Statements has ended. However, due to the continual work in resolving the historic underlying issues relating to reserve balances, the final adjustments to the reserve opening balances has not been reflected in this month's Investment report.

Overall decrease in cash is explained in the unrestricted cash section of this report.

Unrestricted Funds



Council's overall cash balance decreased during May from $51.3M to $46.6M. This $4.7M decrease is mainly associated with the net outflow of Residential Accommodation Deposit and ILU refunds of $2.2M. These are timing matters based on resident departure and also probate processes. The additional works at Terralong ILU are slowing the refurbishment process which is also impacting.

Legal costs and capital expenditure were some $1M higher than expected. Other operating expenses such as loan repayments and Audit Office fees also contributed.

The unrestricted funds balance as at 31 May decreased from $789K to $58k.

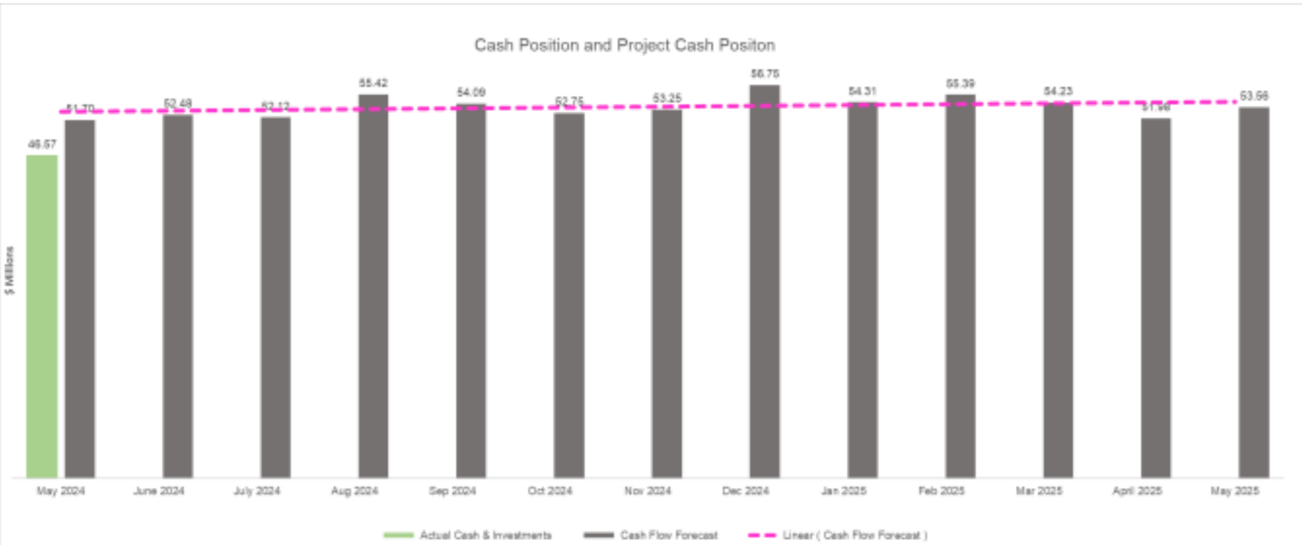
The summary of transfers from internal reserves in order to replenish unrestricted cash as per previous Council resolutions is summarised below:

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
23/329OC	31/10/2023	Land Development Reserve	-2,174,773	insufficient unrestricted cash balance
23/365OC	30/11/2023	Land Development Reserve	2,000,000	transfer to increase reserve
24/018OC	29/02/2024	Land Development Reserve	1,000,000	transfer to increase reserve
	Total:		**-6,474,773**	

Consolidated Cash Position and Cash Flow Forecast

Council's Forecasted Cashflow was reviewed, updated, and presented to the Financial Advisory Committee in early June. .

The below graph depicts the revised cash forecast for the coming 12 months, whilst comparing the current cash reserve balance to the predicted cash reserve balance.



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.

Debbie Webb
Acting Chief Financial Officer

07/06/2024

Arlo Advisory

Monthly Investment Review

KIAMA MUNICIPAL COUNCIL
your council, your community

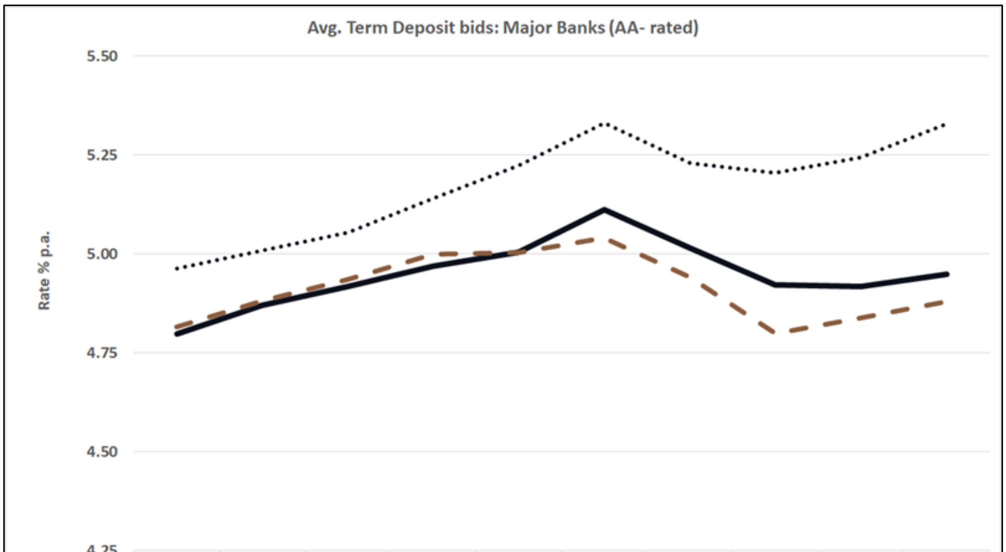
May 2024

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

In May, risk assets rebounded despite inflation data continuing to challenge expectations for when central banks will begin easing monetary policy. In response, global bond yields remain elevated and have been volatile in recent months.

Over May, the average deposit rates offered by the major banks at the short-end (up to 9 months) remained relatively flat. In the medium-term (1-3 years), the average bids from the major banks rose between 7-12bp, reflective of the market positioning a 'higher-for-longer' period where official interest rates may remain stagnant for the foreseeable future. The deposit curve still remains inverse with markets still factoring in rate cuts in future years.



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
May-2024	4.80	4.87	4.92	4.97	5.01	5.11	5.02	4.92	4.92	4.95
Apr-2024	4.82	4.88	4.94	5.00	5.00	5.04	4.94	4.80	4.84	4.88
Nov-2023	4.96	5.01	5.05	5.14	5.22	5.33	5.23	5.21	5.24	5.33

Source: Imperium Markets

With a global economic downturn and interest rate cuts being priced over the next 12 months, investors should consider diversifying and taking an 'insurance policy' against a potentially lower rate environment by investing across 2-5 year fixed deposits, targeting rates above 5% p.a. (small allocation only).

Kiama Municipal Council's Portfolio & Compliance

Asset Allocation

The majority of the portfolio is directed to term deposits (86.1%), with the remainder in cash (13.9%).

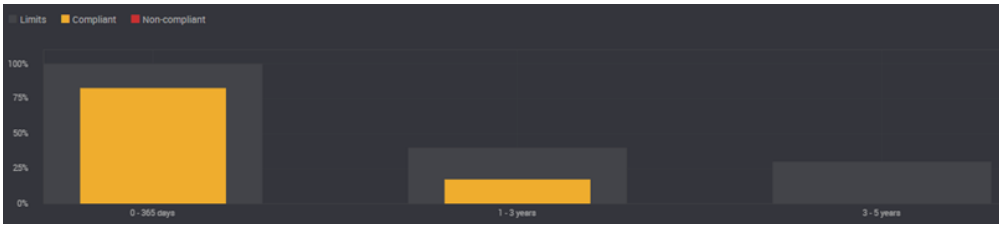
Senior FRNs remain relatively attractive as spreads have generally widened over the past 2 years. New issuances may now be considered again on a case by case scenario. In the interim, staggering a mix of fixed deposits between 9-12 months to 2 years remains a more optimal strategy to maximise returns over a longer-term cycle.

With interest rate cuts and 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 above 5% p.a.

Term to Maturity

The portfolio is highly liquid with the majority maturing within 1 year (~83%). 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 9-12 months, with a smaller allocation to 2-3 year deposits.



Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 365 days	$42,982,708	82.69%	0%	100%	$7,441,790
✓	1 - 3 years	$9,000,000	17.31%	0%	40%	$9,751,294
✓	3 - 5 years	$0	0.00%	0%	30%	$12,894,812
✓	5 - 10 years	$0	0.00%	0%	30%	$12,894,812
		$51,982,708	**100.00%**			

Counterparty

As at the end of May, all individual counterparties are within limits and compliant. Overall, the portfolio is lightly 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-	$2,000,000	3.85%	40%	$18,793,083
✓	Westpac	AA-	$7,232,708	13.91%	40%	$13,560,375
✓	NAB	AA-	$12,000,000	23.08%	40%	$8,793,083
✓	Suncorp	A+	$11,000,000	21.16%	30%	$4,594,812
✓	ING	A	$15,000,000	28.86%	30%	$594,812
✓	BoQ	A-	$1,000,000	1.92%	30%	$14,594,812
✓	AMP	BBB+	$750,000	1.44%	15%	$7,047,406
✓	Bank of Us	BBB+	$1,000,000	1.92%	15%	$6,797,406
✓	BankVic	BBB+	$2,000,000	3.85%	15%	$5,797,406
			$51,982,708	**100.00%**		

In February 2024, ANZ's takeover of Suncorp was given the green light by the Australian Competition Tribunal (ACT), six months after the Australian Competition and Consumer Commission (ACCC) blocked the deal on the grounds that it could lessen competition in the mortgage market. As such, Suncorp's assets are likely to be upgraded to AA- in the near future by S&P, potentially within 6 months (but also, they may be flagged as an ADI lending to the fossil fuel industry in future).

In early April 2024, BoQ was upgraded by S&P from BBB+ to A-. Separately, several other regional banks were upgraded from BBB to BBB+ (including AMP). This has resulted in increased capacity to invest in some of these individual institutions from a counterparty perspective, as well as the aggregate "BBB" rated category (see "Credit Quality" section).

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 31/05/2024 (~$51.98m), we can roughly estimate that ~71% 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
BoQ	A-	No
AMP Bank	BBB+	Yes
Bank of Us	BBB+	No
BankVIC	BBB+	No

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

Summary	Amount	Invested %
Yes	$36,982,708	71%
No	$15,000,000	29%
	$51,982,708	**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%	$51,982,708
✓	AA Category	$21,232,708	40.8%	100%	$30,750,000
✓	A Category	$27,000,000	51.9%	70%	$9,387,896
✓	BBB Category	$3,750,000	7.2%	30%	$11,844,812
✓	Unrated Category	$0	0.0%	0%	$0
		$51,982,708	**100.0%**		

There is now much higher capacity to invest with the "BBB" rated ADIs following the recent ratings upgrade for BoQ (moved up from BBB to A category range). From a ratings perspective, the "BBB" rated banks still generally dominate the number of ADIs issuing deposits within the investment grade space. There has been some signs of appetite growing in the wholesale deposit market as additional lower rated ("BBB" and unrated) ADIs have come to market to raise 'new' money.

Performance

Council's performance (excluding cash holdings) for the month ending May 2024 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	0.36%	1.08%	2.16%	3.91%	4.26%
AusBond Bank Bill Index	0.37%	1.10%	2.20%	4.01%	4.32%
Council's Portfolio^	**0.45%**	**1.30%**	**2.60%**	**4.58%**	**4.89%**
Outperformance	**0.07%**	**0.20%**	**0.40%**	**0.57%**	**0.57%**

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

Performance (Annualised)	1 month	3 months	6 months	FYTD	1 year
Official Cash Rate	4.35%	4.35%	4.35%	4.26%	4.26%
AusBond Bank Bill Index	4.50%	4.43%	4.43%	4.36%	4.32%
Council's Portfolio^	**5.37%**	**5.26%**	**5.24%**	**4.99%**	**4.89%**
Outperformance	**0.87%**	**0.84%**	**0.81%**	**0.62%**	**0.57%**

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

For the month of May, excluding cash, the total portfolio provided a return of +0.45% (actual) or +5.37% p.a. (annualised), outperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.50% p.a. (annualised). All time periods are now above benchmark returns up to 1 year as the previously held low yielding deposits coming out of the pandemic period have all matured and been reinvested at higher prevailing rates.

Recommendations for Council

Term Deposits

Going forward, 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 growing belief that interest rate cuts and a global economic downturn is forthcoming and so locking in rates above 5% p.a. across 1 5 year tenors may provide some income protection against a lower rate environment.

As at the end of May 2024, Council's deposit portfolio was yielding around 5.20% p.a. (unchanged from the previous month), with a weighted average duration of 231 days (~8 months). ***We commend Council for improving its weighted average duration in recent months reflective of investments in high yielding term deposits in 1 and 2 year tenors. We continue to recommend Council to increase the portfolio's duration closer to 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 May, we see value in the following:

ADI	LT Credit Rating	Term	Rate % p.a.
ING	A	5 years	5.35%
ING	A	4 years	5.26%
ING	A	2 years	5.25%
ING	A	3 years	5.20%
Westpac	AA-	2 years	5.13%
Bank of Us	BBB+	2 years	5.12%
Suncorp	A+	2 years	5.11%
Australian Military	BBB+	2 years	5.11%
NAB	AA-	2 years	5.05%
Suncorp	A+	3 years	5.03%

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*):

ADI	LT Credit Rating	Term	Rate % p.a.
P&N Bank	BBB+	12 months	5.40%
Rabobank	A	12 months	5.37%
ING	A	12 months	5.31%
Bank of Us	BBB+	12 months	5.25%
NAB	AA-	12 months	5.25%
BankVIC	BBB+	12 months	5.25%
Westpac	AA-	12 months	5.24%
Suncorp	A+	12 months	5.23%
Suncorp	A+	9 months	5.21%
NAB	AA-	10-11 months	5.20%
NAB	AA-	6-9 months	5.15%
BoQ	A-	6-12 months	5.10%
NAB	AA-	3-4 months	5.00%

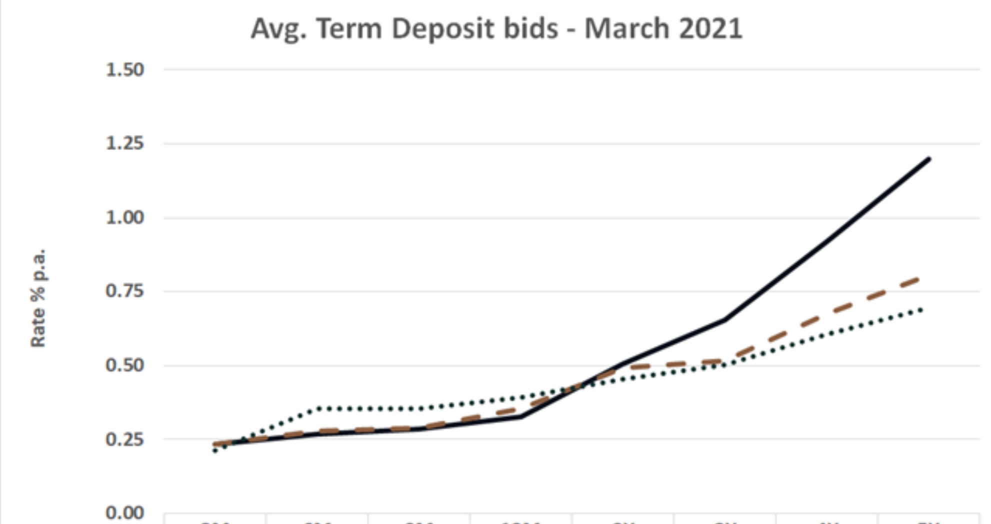
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared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

With a global economic slowdown and interest rate cuts being priced over the next few years, investors should strongly consider diversifying by allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates above 5% p.a. This will provide some income protection with central banks now potentially looking to cut rates in 2025.

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)



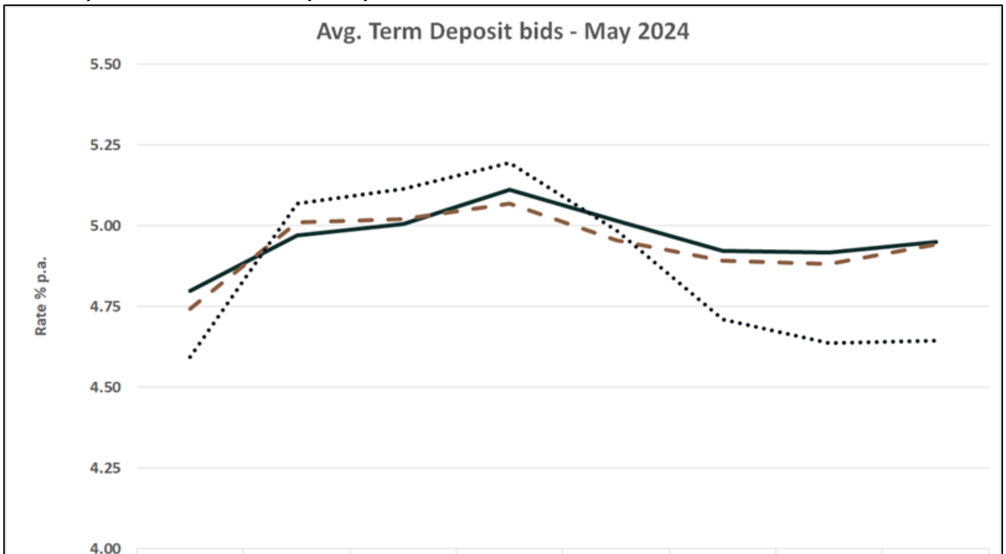
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits slowly increases, partially driven by the RBA's term funding facility coming to an end. 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 or considered 'ethical'. We are slowly seeing this trend emerge, although the major banks always seem to react to volatility more quickly than the rest of the market, as was the case again this month:

Term Deposit Rates – Currently (May 2024)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.80	4.97	5.01	5.11	5.02	4.92	4.92	4.95
A Rated	4.74	5.01	5.02	5.07	4.96	4.89	4.88	4.94
BBB Rated	4.59	5.07	5.11	5.19	4.98	4.71	4.64	4.64

Source: Imperium Markets

Regional & Unrated ADI Sector

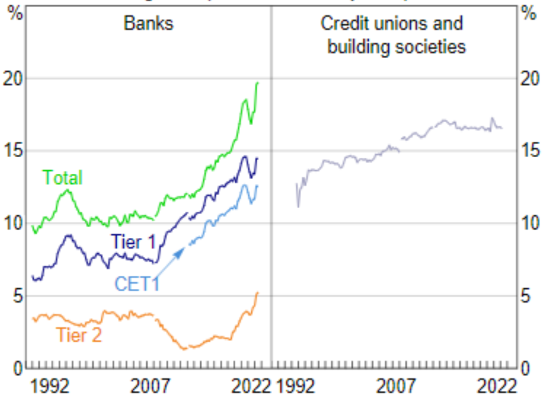
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P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

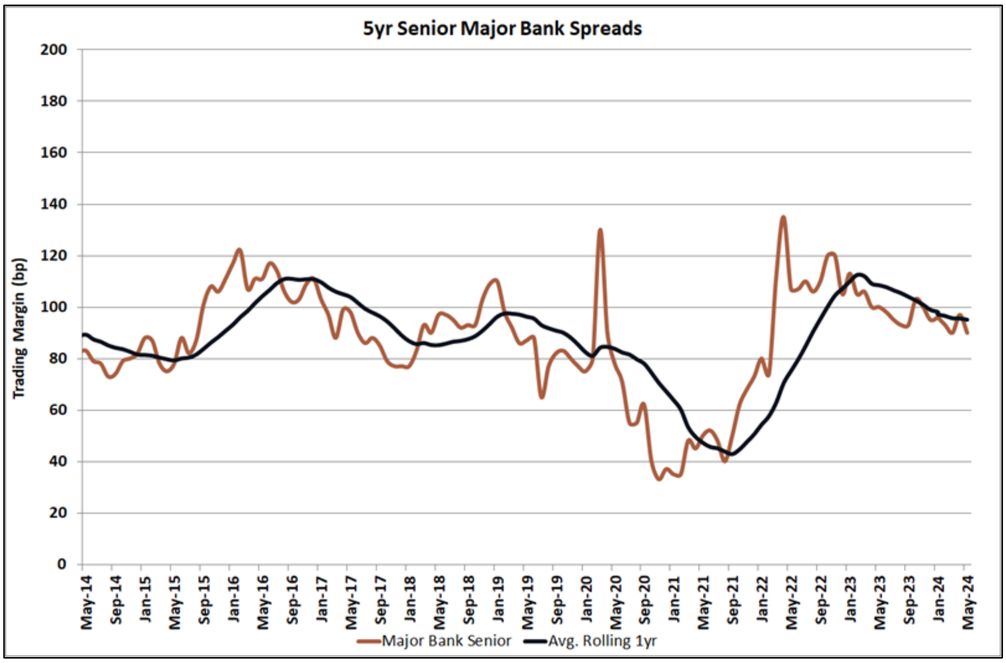


* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

Source: APRA.

Senior FRNs Market Review

Over May, amongst the senior major bank FRNs, physical credit securities tightened by around 7bp at the 5 year part of the curve. During the month, NAB (AA-) issued a 3 year senior deal at +70bp, whilst WBC (AA-) issued a 5 year senior issue at +88bp. Major bank senior securities remain at fair value on a historical basis (5yr margins around +90bp level).



Source: IBS Capital

There was very little notable issuances during the month apart from Bendigo & Adelaide's (A-) 3 year senior security at +100bp and a small private placement from Bank of Us (BBB+) for 1 year at +95bp. Amongst the "A" rated sector, the securities tightened by around 3-10bp at the longer-end of the curve, whilst the "BBB" rated sector remained flat at the 3 year part of the curve. Overall, credit securities are looking much more attractive given the widening of spreads over the past 2 years and as more primary issuances become available. FRNs will continue to play a role in investors' portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/05/2024	30/04/2024
"AA" rated – 5yrs	+90bp	+97bp
"AA" rated – 3yrs	+68bp	+66bp
"A" rated – 5yrs	+105bp	+115bp
"A" rated – 3yrs	+85bp	+88bp
"BBB" rated – 3yrs	+160bp	+160bp

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 mid-2026 for the "AA" rated ADIs (domestic major banks);
- On or before mid-2025 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 still high by historical standards, this has seen a significant lift in longer-term bond yields over the past 2 years (valuations have 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
AU3CB0278174	UBS	A+	Senior	26/02/2026	1.74	1.1000%	5.22%
AU3CB0280030	BoQ	A-	Senior	06/05/2026	1.93	1.4000%	5.35%
AU3CB0299337	Bendigo	A-	Senior	15/05/2026	1.95	4.7000%	5.27%
AU3CB0296168	BoQ	A-	Senior	27/01/2027	2.66	4.7000%	5.34%
AU3CB0308955	BoQ	A-	Senior	30/04/2029	4.92	5.3580%	5.45%

Economic Commentary

In May, risk assets rebounded despite markets pushing back their expectations with regards to the timing of the easing cycle by central banks.

Across equity markets, the S&P 500 Index rose +4.80% over the month, whilst the NASDAQ surged +6.88%. Europe's main indices also experienced gains, led by Germany's DAX (+3.16%), UK's FTSE (+1.61%) and France's CAC (+0.10%).

The US Fed kept rates on hold for the sixth meeting in a row, warning that there had been a lack of further progress towards their 2% inflation target. Fed Chair Powell also commented however "*it's unlikely that the next policy rate move will be a hike*". US Fed Chair Powell repeated his view that he and most Fed officials do not anticipate having to resume interest rate rises but that patience is required before they can be cut, saying "*we're just going to have to see where the inflation data fall out*".

US core CPI for April came in at +0.3% m/m as expected, with headline a touch lower at +0.3% vs +0.4% expected. On an annual basis, core CPI ticked down to +3.6% y/y, down from +3.8% y/y in March. The annual headline rate also fell to +3.4% y/y in April, from +3.5% y/y in March.

Canada CPI came in at +2.7% y/y in April (which was lower than market expectations) and was down from +2.9% y/y in March.

UK headline CPI was +2.3% y/y in April, decreasing from +3.3% y/y in March. Core inflation also slowed to +3.9% y/y in April from +4.2% y/y in March.

European Q1 GDP surprised a little stronger, while April inflation was broadly in line. Q1 GDP growth rose +0.3% q/q (+0.1% expected) for annual growth of +0.4% y/y.

As expected, the RBNZ left the Official Cash Rate unchanged at 5.50% at its May meeting. The central bank flagged it now expects to keep rates high for longer amid some signs of sticky inflation.

Sweden's Riksbank cut rates by 25bp as expected as markets going into the meeting were 64% priced for a cut.

The MSCI World ex-Aus Index rose +4.26% for the month of May:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+4.80%	+3.56%	+26.26%	+7.87%	+13.91%	+10.62%
MSCI World ex-AUS	+4.26%	+3.27%	+23.23%	+5.16%	+11.16%	+7.42%
S&P ASX 200 Accum. Index	+0.92%	+1.16%	+12.93%	+6.80%	+7.83%	+7.78%

Source: S&P, MSCI

Domestic Market

The RBA kept rates on hold at 4.35% in its meeting in May, as universally expected. They still see trimmed mean inflation at +2.6% y/y by mid-2026. Staff still assess policy as being "*restrictive*" based on financial indicators and ongoing easing in growth of aggregate demand.

The monthly CPI Indicator for April printed higher than expected at +3.6% y/y (consensus +3.4%) and +3.5% in March. Importantly, core measures also printed higher than expected. The CPI excluding volatile items and holiday travel was +4.1% y/y.

The Q1 wage price index (WPI) growth was 0.1% below expectations at +0.8% q/q and +4.1% y/y (consensus +0.9%/+4.2%). By sector, private sector wages growth was +0.8% q/q, and public sector wages growth was just +0.5% after +1.4% q/q in Q4.

The seasonally adjusted unemployment rate rose by 0.2% to 4.1% in April, up from a revised 3.9% in March. Employment rose by around 38,000 people and the number of unemployed grew by 30,000 people, leading to an uplift in the participation rate, increasing to 66.7% (by 0.1%).

April retail sales rose +0.1% m/m (consensus +0.2% m/m).

The February trade balance narrowed to $5.0bn, its lowest since November 2020. The February surplus was revised down to $6.6bn from $7.3bn. In the month, exports were little changed (+0.1%) while imports rose +4.2%.

Dwelling approvals were +1.9% higher in March, but private house and apartment approvals were a bit stronger, up +3.8% and +3.6%.

The Australian dollar rose +1.72%, finishing the month at US66.37 cents (from US65.25 cents the previous month).

Credit Market

The global credit indices marginally tightened across the board in May. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	May 2024	April 2024
CDX North American 5yr CDS	51bp	52bp
iTraxx Europe 5yr CDS	52bp	55bp
iTraxx Australia 5yr CDS	65bp	73bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	May 2024	April 2024
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.35%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.39%	-1.98%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.50%	+0.48%
Bloomberg AusBond Credit Index (0+YR)	+0.70%	-0.91%
Bloomberg AusBond Treasury Index (0+YR)	+0.35%	-2.03%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.30%	-1.82%

Source: Bloomberg

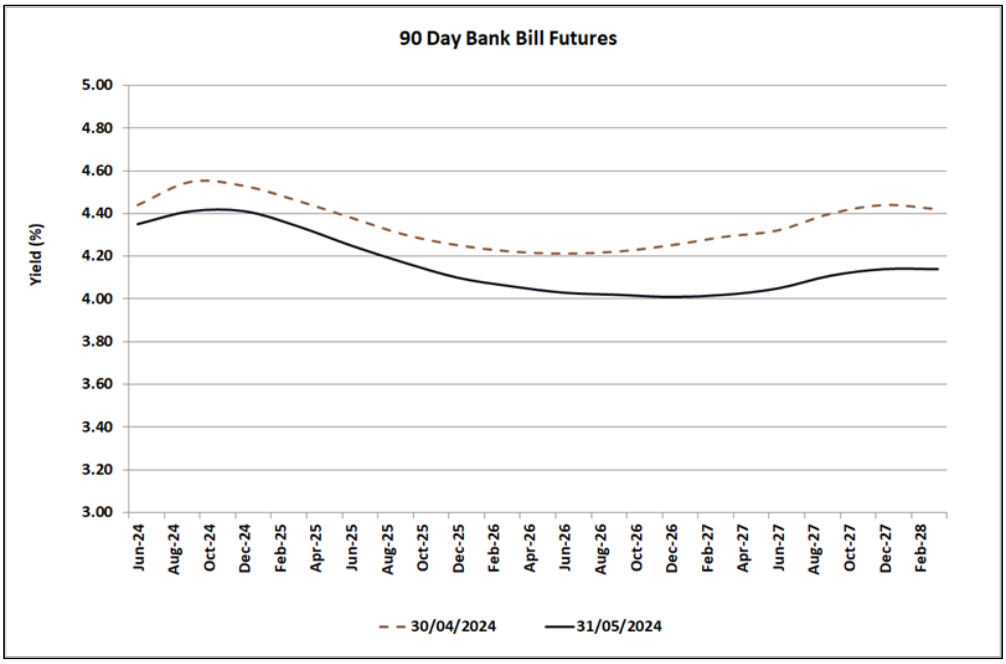
Other Key Rates

Index	May 2024	April 2024
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.35%	4.41%
3yr Australian Government Bonds	4.05%	4.03%
10yr Australian Government Bonds	4.41%	4.42%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.89%	5.04%
10yr US Treasury Bonds	4.51%	4.69%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures fell across the board this month, following the movement in bond markets. Markets continue to push back their expectations of when the first rate cut will be delivered, resulting in a flattening of the curve.



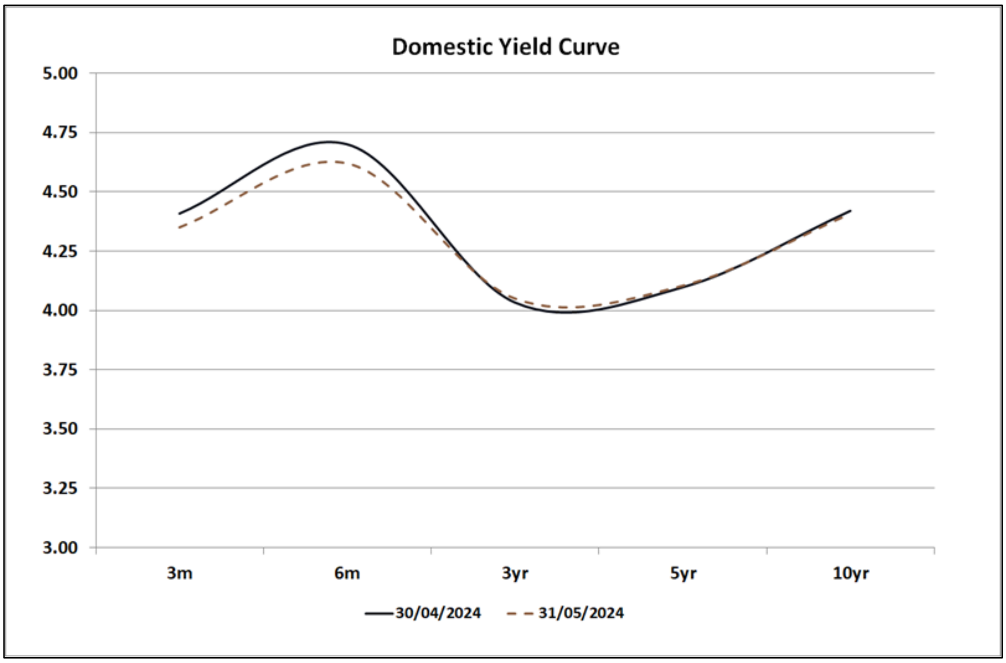
Source: ASX

Fixed Interest Outlook

As per the minutes of the US Fed May meeting, policymakers concluded recent data had not increased their confidence that inflation was moving sustainably toward the 2% target to begin cutting rates. Monetary policy is currently considered "*well-positioned*" and further tightening is only required if inflation surprises to the upside.

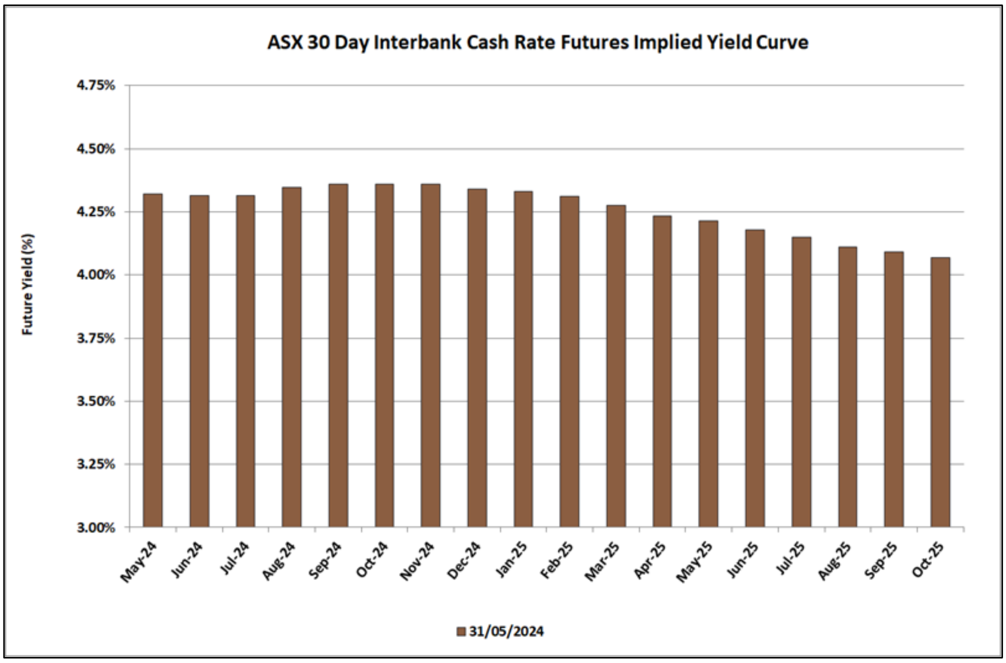
Domestically, the RBA May meeting minutes stated inflation had eased more slowly than anticipated and that "*risks around inflation had risen somewhat…Given this, members agreed that it was difficult either to rule in or rule out future changes in the cash rate target.*" As is the case with most central banks at the moment, the RBA is waiting for current economic data to show a clear trend before taking any decisive action.

Over the month, longer-term yields remained relatively flat at the very long end of the curve (remains an inverse yield curve):



Source: ASX, RBA

For the time being, the consensus from the broader market is that we have reached the peak of the interest rate cycle. With inflation remaining sticky, financial markets have pushed back their expectations of rate cuts, with the first cut pencilled in for early-mid 2025.



Source: ASX

DISCLAIMER

This document has been prepared by Arlo Advisory Pty Ltd ("Arlo"), ABN 55 668 191 795, an authorised representative of InterPrac Financial Planning Pty Ltd (ABN 14 076 093 680) AFS Licence No. 246638. Arlo provides fixed income investment advisory services to wholesale investors only. The information in this document is intended solely for your use. This document may not otherwise be reproduced and must not be distributed or transmitted to any other person or used in any way without the express approval of Arlo.

General Advice Warning

The information contained in this document is general in nature and does not take into account your individual investment objectives and adopted policy mandate. Arlo monitors the fixed income market and recommends the best rates currently available to the investors. You are responsible for deciding whether our recommendations are appropriate for your particular investment needs, objectives and financial situation and for implementing your decisions.

Accuracy & Reliability of Information

Arlo sources and uses information provided by third parties from time to time, including from Imperium Markets Pty Ltd ABN 87 616 579 527, a sister company of Arlo. Although every effort has been made to verify the accuracy of the information contained in this document, Arlo, its officers, employees and agents disclaim all liability (except for any liability which by law cannot be excluded), for any error, inaccuracy in, or omission from the information contained in this document or any loss or damage suffered by any person directly or indirectly through relying on this information.