Mutual Limited

Security with Performance
Investment Update - May 2024
MCF - Mutual Credit Fund

All figures as at 31 May 2024

Fund Performance

	3 months %	6 months %	12 months %	3 years % p.a.	Inception % p.a.
MCF (pre-fees)	2.27	4.92	9.55	4.92	4.55
MCF (post-fees)	2.14	4.68	9.06	4.42	4.05
BBerg AusBond Bank Bill Index	1.10	2.20	4.32	2.32	1.68
Relative Performance (Net)	1.04	2.48	4.74	2.10	2.37

Investment Objective and Investment Strategy

Mutual's objective for the Mutual Credit Fund is to source and actively manage a portfolio of fixed interest credit assets across APRA regulated institutions, corporates and structured assets. Targeted portfolio construction is to hold assets with a shorter credit duration to ameliorate periods when risk assets sell-off.

Mutual manages interest rate risk by predominately investing in assets that reset their reference rate every 30 or 90 days.

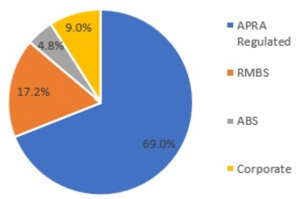
Portfolio

Liquidity
Up to 5 days

Fund Statistics

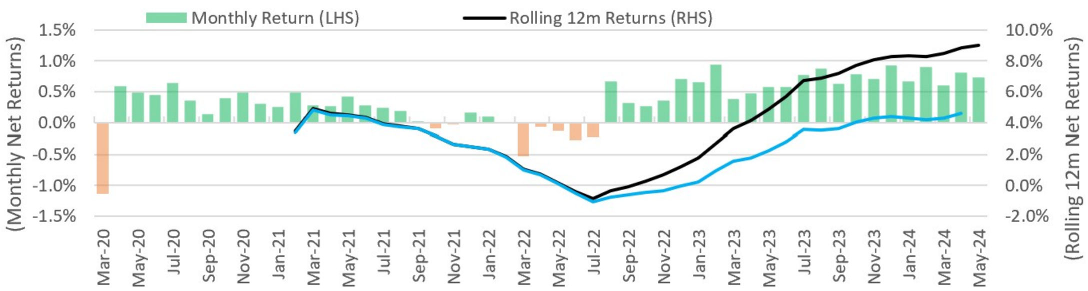
Running Yield:	7.20%
Yield to Maturity:	6.80%
Credit Duration (years):	2.40
Interest Duration (years):	0.09

Current Portfolio Diversification



Month in Review

Performance: MCF returned 0.74% (net) in May. The 6 month net return was 4.68% and the 12 month net return was 9.06% at the end of May. Over the past 12 months the fund has returned 4.74% (net) above the Ausbond Bank Bill Index, versus a target of +2.20%.



Overview: Core themes evolved a touch over May with ebb and flow in markets around macro data prints and corresponding central bank policy expectations. Locally, inflation is moderating, but doubts are building on whether it is moderating fast enough. Consequently, RBA signalling – via meeting statements and minutes – took a hawkish turn in recent weeks.

Domestic labour market conditions are cooling. The unemployment rate ticked up to 4.1% from 3.8%, a surprise versus consensus estimates, which expected a more modest increase to 3.9%. Nevertheless, the unemployment rate remains well below post GFC averages (5.6%) and well into expansionary territory. The monthly annual CPI data series surprised to the high side, +3.6% YoY vs +3.4% YoY consensus, and up on the prior reading of +3.5%. Trending in the wrong direction and presenting a headwind to investor hopes of RBA rate cuts this year. Rent, finance, education and insurance costs remain core headwinds. Beyond these core data series, Home Loan values rose +3.1% YoY vs +1.5% YoY prior, with Investor Loans +3.8% YoY vs +1.2% YoY prior. Building Approvals (-0.3% MoM) again weaker than consensus (+1.8% MoM) and down on the prior month (+2.7% MoM), but the series is notoriously volatile. On a net basis, there are insufficient dwellings being built to meet demand, which is causing upward pressure on house prices. Retail sales (+0.1% MoM) remain subdued, while credit growth advanced a touch (+0.5% MoM vs +0.4% MoM prior).

Outlook

Market pricing for the end of year cash rate was largely unchanged through May, with no rate cuts priced in until well into 2025, likely around mid-year at this stage. The recent inflation data has further cemented the growing belief that rate cuts are not imminent. While markets are not pricing in rate cuts for 2024, median consensus expectations are for one cut by year end, either at the November or December meeting. However, confidence in this view is not high. Of the 36 economists

Portfolio Manager
Mutual Limited

Inception
21 February 2020

Fund Size
$668.9 million

Month End Price
$1.038763

Benchmark
Bloomberg AusBond Bank Bill Index

Distribution Frequency
Quarterly

Minimum Investment
$1 through IDPS
$20,000 for Retail & Wholesale Investors

Minimum Investment Term
Longer than 5 days (suggested)

Management Fees
0.4930% p.a. (inclusive of GST)

Buy / Sell Spread
Nil / Nil

APIR Code
PRM8256AU

ISIN
AU60PRM82564

Ratings
Lonsec
Zenith

Platforms
Asgard
BT Panorama
Centric
Colonial First State
Hub 24
Netwealth
Powerwrap

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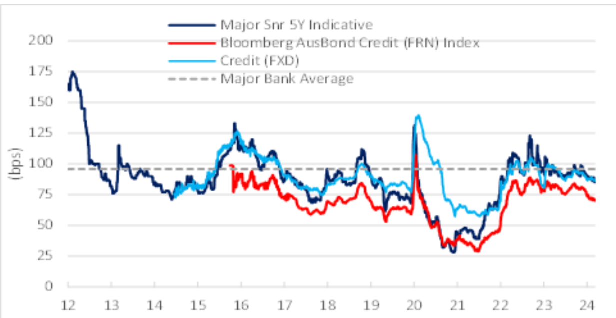
surveyed by Bloomberg, 42% expect a cut (at least one) by year end, while 36% expect no cuts. A smaller 22% expect at least two cuts by year end.

The RBA's next meeting is June 17 - 18th, at which point the board is expected to leave the cash rate unchanged, at 4.35%. Our expectations around the timing and scale of rate cuts this year varies to consensus. We expect no rate cuts this calendar year, whereas consensus expect one in Q4. Markets are more in line with our thinking, with no full rate cut priced in until June 2025. We see risk of a rate hike as being very minor, but not zero.

A$ credit remained strong in May with both senior and subordinated spreads at the 5 year tenor now trading inside long run averages. This is in part due to the technical backdrop where all 4 of the majors have ventured overseas to raise new funding, giving domestic markets a break from new issuance. NAB did buck this trend with a 15NC10 year fixed rate tranche only Tier 2 priced during the month. In a sign of accelerating private client type demand for anything yielding above 6%, the book build topped $3.5bn. NAB issued $1.25bn, which left plenty of unmet demand, driving a strong performance of this bond on the break. In MCF we do not buy fixed rate assets, and 10 years to call is challenging to fit into our overall credit duration limit of 2.5 years. Pricing was also tight compared to a 10NC5 bond, offering only around 5bps a year payable from 5 to 10 years versus the 15bps per annum payable from 2 to 5 years. That being said, the performance of the 15NC10 year was exceptionally strong, highlighting underlying demand for any higher yielding AUD credit.

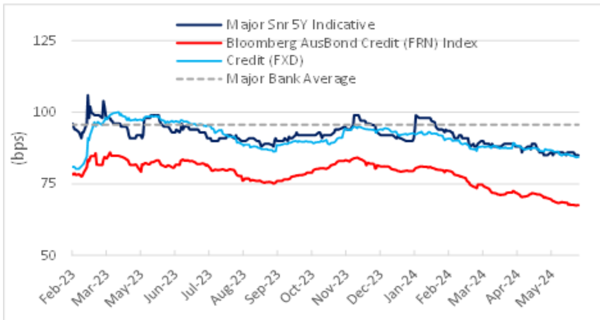
Tier 2 has been on a remarkable run lately, taking us back to the performance of this asset class seen during COVID. The shortest dated calls traded as low as +60bps during 2021. Today, the short calls are now in the low +80bps region. The 2025 calls are now around +100bps and the early 2026 calls around +110bps. All these levels are 50bps tighter than 1Q24. With the additional issuance of Tier 2 by the major banks to achieve APRAs targets now largely complete, supply is expected to normalise and be more predictable. With global markets also attractive to Bank Treasurers, the mega A$ deals seen over the past 12 months may not be repeated.

Credit Spreads – long run history



Source: Bloomberg, Mutual Limied

Credit Spreads – short run history

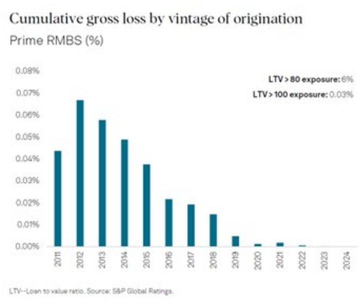


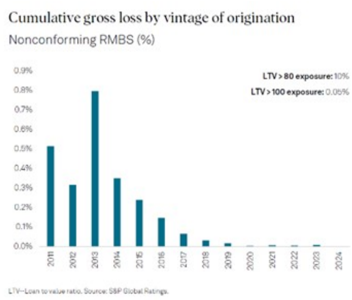
Source: Bloomberg, Mutual Limited

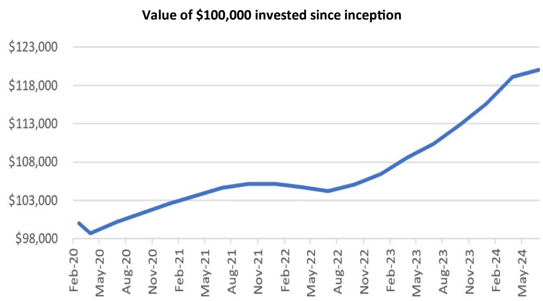
Structured credit has also experienced a period of strong performance, most notably in the A to BBB rated notes across both RMBS and ABS pools. The senior notes are starting to find a base level, with new deals either printing at launch pricing or having to revise pricing slightly wider (spread higher) in order to find investors. Ongoing new issuance looks to be the driver. As an example, non-conforming RMBS loan balances increased from $49.3bn to $51.2bn between February and April this year. The size of non-conforming RMBS outstanding is now equal to ~25% of the Bloomberg AusBond Credit (FRN) index, highlighting the growth and relevance of the asset class in A$ credit markets.

The latest arrears commentary from S&P covering Q1 highlights arrears remain low, albeit rising. In their commentary they highlight low unemployment remains the key to low arrears, something likely to continue given commentary in May from the RBA around their dual mandate of managing inflation and achieving the best employment outcomes. Other commentary from S&P included a reference to borrowers being prudent in curtailing expenses to service their debts.

As an investor in RMBS we focus beyond just arrears. Losses are the end of the road for investors, but even then it's not just one loss that sends the fund returns into negative territory. With mechanisms built into structures to cover losses, an RMBS transaction needs a lot of individual loans to lose money in a short period of time before an investor sees any write downs. The latest S&P data highlights low loan to value ratios and continued property price growth as two key factors to limit losses. The below charts show this in real time, with cumulative gross losses across both Prime and Non-Conforming RMBS virtually non-existent since 2020. We expect this trend to continue, supporting the returns of the fund.







If you would like more information on MCF please visit www.mutualltd.com.au or contact Mutual on + 61 3 8681 1900