Betashares Sustainability Leaders Diversified Bond ETF - Currency hedged

ASX: GBND

Quarterly Report - September 2024

E: info@betashares.com.au
T: 1300 487 577 (within Australia)
T: +61 2 9290 6888 (outside Australia)

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Performance[1]	1 month %	3 month %	6 month %	1 year %	3 years % p.a.	Inception % p.a.[2]
Fund Return (net)	0.77%	3.61%	2.33%	7.95%	-2.98%	-1.50%
Growth Return	0.77%	2.85%	0.87%	4.88%	-5.28%	-3.48%
Income Return	0.00%	0.76%	1.46%	3.07%	2.30%	1.98%
Index	0.79%	3.77%	2.68%	8.64%	-2.42%	-0.98%

Past performance is not a reliable indicator of future performance.

[1]As at 30 September 2024. Returns are calculated after fees & expenses have been deducted and distributions have been reinvested.

[2]Inception date for the Fund is 26 November 2019.

Yield and portfolio characteristics	
Running Yield (% p.a.)[1]	3.08%
Yield to Maturity (% p.a.)[2]	4.10%
Average Maturity (Yrs)[3]	7.42
Modified Duration (Yrs)[4]	6.31
Average Credit Rating[5]	AA

[1]Average coupon (weighted by market value) of the bonds in the portfolio, divided by the current market price of the bonds. Provides an indication of expected current income from making an investment at market price. This value will vary over time as interest rates change.

[2]Total expected return from the bond portfolio, based on current bond prices and assuming no change in prevailing interest rates.This value will vary over time.

[3]Average (weighted by market value) length of time until the current bonds in the portfolio mature.

[4]A measure of the sensitivity of the portfolio's value to a change in interest rates. For example, a Modified Duration of 7 years implies that a 1% rise in the reference interest rate will reduce the value of the portfolio by 7.00%.

[5]Average credit rating for the bonds in the portfolio. Credit ratings should not be used as a basis for assessing investment merit.

Source: Bloomberg. As at 30 September 2024. Yields shown do not take into account GBND's management costs of 0.49% p.a.

Investment objective

The Fund aims to track the performance of an index (before fees and expenses) that comprises a portfolio of global and Australian bonds screened to exclude issuers with material exposure to fossil fuels or engaged in activities deemed inconsistent with responsible investment considerations. At least 50% of the Fund's portfolio is made up of "green bonds", issued specifically to finance environmentally friendly projects, as defined by the Climate Bonds Initiative.

Responsible entity

Betashares Capital Ltd

Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least three years

Fund facts	
Inception Date	26-Nov-19
Fund Size	$362.12m
Historical Tracking Error (annualised)	0.15%
ASX Code	GBND
Bloomberg Code	GBND.AU
IRESS Code	GBND.AXW

Fees	% p.a.
Management fee	0.39
Recoverable expenses	0.10

Investment strategy

As a summary, the Fund generally invests in a portfolio of bonds that is a representative sample of the constituents of the Solactive Australian and Global Select Sustainability Leaders Bond TR Index – AUD Hedged. Bond issuers may include governments, corporations and supranational bodies.

Issuer eligibility screens: Initial screening includes a fossil fuel screen, which means that bond issuers will be excluded if they are materially involved in the mining, extraction, or burning of fossil fuels, or maintain material fossil fuel reserves or fossil fuels infrastructure. Issuers providing material financing to the fossil fuels industry are also excluded (although green bonds from such issuers may be eligible, subject to materiality thresholds).

The Index methodology also excludes issuers which are exposed to activities considered to carry other significant negative ESG risks (certain materiality thresholds may apply), including:

- Gambling
- Alcohol
- Tobacco
- Junk foods
- Armaments and militarism
- Pornography
- Uranium and nuclear energy
- Human and labour rights
- Destruction of valuable environments
- Chemicals of concern
- Animal cruelty
- Lack of board diversity i.e. no women on the board of directors

These screens apply to all issuers other than sovereign bond issuers. Sovereign bond issuers are screened to remove any issuers that are subject to current sanctions as a result of human rights concerns imposed by bodies such as the U.N. and the E.U.

Green Bonds: At least 50% of the Index at each rebalance will comprise green bonds, issued to fund projects that have positive environmental and/or climate benefits, such as those designed to prevent or reduce pollution, improve the sustainable use of natural resources, or help in the transition to non-fossil fuel-based technologies.

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To be eligible for inclusion on this basis, a bond must have been defined as a green bond by the internationally-recognised not-for-profit organisation, the Climate Bonds Initiative (CBI). The bond issuer must also have passed the screening process outlined above.

All included bonds must be fixed-rate bonds with a minimum investment-grade rating. Bonds are initially market-cap weighted and then scaled so that AUD-denominated bonds make up 50% of the index weight, with the remaining 50% allocated to Euro/US Dollar-denominated bonds at each monthly rebalance. The foreign currency exposure of index constituents is hedged back to the Australian Dollar.

Top 10 positions[1]	Fund Weight %
French Govt OAT 1.75% Jun-39	1.7
Treasury Corp VIC 4.25% Dec-32	1.0
NSW Treasury Corp 3% Mar-28	1.0
Treasury Corp VIC 5.5% Nov-26	1.0
NSW Treasury Corp 4.75% Feb-35	0.9
Treasury Corp VIC 1.5% Sep-31	0.9
NSW Treasury Corp 3% Feb-30	0.9
NSW Treasury Corp 2% Mar-33	0.9
QLD Treasury Corp 3.25% Aug-29	0.9
French Govt OAT 0.5% Jun-44	0.9

[1]As at 30 September 2024

Sector exposure[1]	Fund Weight %
Australian State Government	39.5
Corporate - Financial	14.6
Supranational	13.7
Foreign Sovereign	14.1
Corporate - Non Financial	8.4
Government Special Purpose Bank	5.9
Total	96.15

[1]As at 30 September 2024

Country allocation[1]	%
Australia	41.5
Snat	13.8
Germany	10.4
France	7.8
Netherlands	7.1
United States	3.0
Spain	2.1
Norway	1.3
Belgium	1.8
Other	11.2

[1]As at 30 September 2024

Fund performance summary

GBND returned 3.61% (net of fees) in Q3 of 2024. Attributing GBND's performance; shifts in yield curves added 2.44% to returns: of which AUD (42% contribution to duration), EUR (53% contribution to duration), and USD bonds (5.0% contribution to duration) added 1.01%, 1.21% and 0.21% respectively to returns, with USD bonds outperforming, and EUR bonds slightly underperforming relative to their duration weights. Bond credit spreads compressed over the quarter, adding 0.22% to performance. Combined yield and FX carry contributed 1.07%, with fees subtracting -0.12%.

Global macro and rates

Global developments

Global bond yields declined significantly during the September quarter as central banks around the world transitioned to easing cycles amid a continued moderation in inflation pressures and softer labour markets. The weighted average yield on the Bloomberg Global Treasury Index declined by 51 basis points over the quarter (to finish at 2.85%), while the benchmark US 10-year Treasury yield fell 62 basis points to end the period at 3.78%, with key yield curve measures, such as the 10-year/2-year US Treasury spread ("2s10s"), un-inverting for the first time in two years. Further rate cuts from some central banks (e.g., the Swiss National Bank, European Central Bank, and Bank of Canada), and the initiation of cuts by others, notably the Federal Reserve, Bank of England, and Reserve Bank of New Zealand, was the defining theme of the quarter.

In the United States, the Federal Open Market Committee (FOMC) cut the policy rate by 50 basis points in September, bringing the federal funds target band to 4.75%-5.00%, following an unchanged stance in July. The September rate cut was driven by a sustained moderation in inflation and weaker labour market indicators. The updated Summary of Economic Projections (SEP) showed slight downward revisions to inflation forecasts and slight upward revisions to unemployment projections, though largely maintaining a soft-landing outlook. Additionally, the updated "Dot Plot" revealed a median FOMC expectation for the Fed funds midpoint to end the year at 4.4% and 2025 at 3.4%, showing further expected cuts of 50 basis points over the remaining two meetings this year and a further 100 basis points in 2025. By 2026, the median FOMC member expects the Fed funds rate stabilising around 2.9%, arguably the best estimate of the "neutral rate".

In September, the ECB cut its deposit rate by 25 basis points to 3.5%, continuing the easing cycle that began in June. This move reflected the ECB's concern over subdued growth within the region. Elsewhere, the BoE, BoC, and RBNZ all reduced rates during the quarter. In August, the BoE cut the Bank Rate by 25 basis points to 5.00%, reflecting the easing headline and core inflation, while recognising wage-driven pressures in sectors like services. The BoC followed a similar path, reducing its overnight rate by 25 basis points in both July and September to reach 4.25%, citing a weaker household sector and a softer labour market. Finally, the RBNZ reduced its Official Cash Rate by 25 basis points in August, bringing it to 5.25% (with the RBNZ cutting by 50 basis points again in early October to take the rate to 4.75% at the time of writing), motivated by inflation returning towards its target band and a slowing economy.

The main outlier to the global easing cycle was the Bank of Japan (BoJ), which raised its policy rate from 0.10% to 0.25% in July and held it steady in September. This shift reflected Japan's ongoing economic recovery, supported by rising wages and steady inflation between 2.5% and

[1] https://www.climatebonds.net/2024/06/record-start-year-sustainable-debt

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3.0%. The timing of the BoJ's rate hike coincided with weaker US data and a sharp decline in US bond yields, which triggered an aggressive short-covering rally in the yen and a broader deleveraging event across risk assets in early August. Following market turbulence, the BoJ and Japanese government officials, including the new incoming Prime Minister, made efforts to ease concerns.

Another significant development occurred late in the quarter, with Chinese policymakers announcing various monetary and fiscal measures aimed at stimulating the economy and supporting specific financial markets, including a 20-basis point cut to the PBoC's 7-day repo rate (following a 10bps cut in July to take the rate to 1.5%). While details of the fiscal package are still scarce at the time of writing, the initial market response had been positive, reflecting optimism that the Chinese government is taking concrete steps to bolster economic confidence and aggregate demand. Reflecting a rebound in growth and inflation expectations, Chinese 10-year Government bond yields rose by 30 basis points in the week following the announcement, after hitting a cycle low of 2.04% amid ongoing deflationary pressures.

Finally, geopolitical risks were a focal point as tensions in the Middle East escalated, affecting bond markets largely via inflation expectations, which began to rebound in late September. The rise in TIPS breakevens was mainly due to optimism around a re-acceleration in US growth and higher crude oil prices.

Domestic developments

During the quarter, Australian government bonds largely reflected the global moves, although tended to underperform peers, with the 10-year Commonwealth yield ending the period 34 basis points lower to finish at 3.97%. During the September quarter, the Reserve Bank of Australia (RBA) kept the cash rate target at 4.35%, with the Bank highlighting the persistence of inflationary pressures, particularly in the services sector. Uncertainty in the economic outlook, both domestically and internationally, was acknowledged, as were rising geopolitical risks. The RBA emphasised its commitment to keeping monetary policy restrictive until inflation returns sustainably to target. As a result of the global developments, market pricing largely moved to reflect a high likelihood the RBA would be forced into the global easing cycle, with Cash Rate Futures fully pricing in the first cut by February 2025 and 1-year market implied inflation expectations trading within the RBA's target band.

During the period, domestic economic data was subdued, with inflation staying above the RBA's target, but tended to undershoot expectations. Activity data generally beat expectations on balance, with retail sales data surprisingly robust. The labour market continued to loosen at the margin, with the unemployment rate stabilising around 4.2%. The external sector faced headwinds relating to a slowing global economy and very weak iron ore prices, although base metals staged a rebound towards the end of the month on the back of the latest stimulus announcement from China.

Credit markets

Global credit

Global credit spreads compressed over Q3, with tightening across both investment-grade and high-yield markets. In the US, 5–10-year investment-grade spreads narrowed by 6 basis points to 96 basis points over US Treasuries, while high-yield spreads compressed by 11 basis points to 300 basis points over the benchmark. While briefly interrupted by the August deleveraging event following the "yen carry trade unwind" and volatility in French sovereign spreads following a new coalition government announcement, spreads quickly realigned with broader optimism around central bank easing, supporting demand for corporate credit.

In terms of supply, US dollar corporate bond issuance expanded over the quarter, reflecting improved sentiment on the part of corporate Treasurers amid the start of the US rate cutting cycle, a decline in corporate bond yields, and a still-robust US economy.

Domestic credit

In Australia, 5–10-year investment-grade corporate bond spreads followed a similar trend, tightening 10 basis points to 130 basis points above Commonwealth Government yields, helped by a compression in longer-dated swap spreads. Separately, floating rate spreads across the bank capital structure ended little changed. Domestic corporate bond issuance was robust over the period, led by non-bank financials.

One of the most significant domestic credit developments during the quarter was APRA's announcement and discussion paper outlining its plans to phase out Additional Tier 1 (AT1) bank hybrid instruments. The proposal aims to replace AT1 with Common Equity Tier 1 (CET1) and Tier 2 capital for larger banks, enhancing the framework's ability to absorb losses and support bank resolutions during financial crises. Larger banks, including the four majors and Macquarie, would replace AT1 with 1.25% Tier 2 and 0.25% CET1 capital, while smaller banks can fully substitute AT1 with Tier 2 capital. This change does not affect insurers.

APRA's proposal follows concerns highlighted by international banking crises, which exposed limitations in AT1's loss absorption capabilities, in addition to concerns around the proportion of retail ownership of such instruments in Australia. APRA's proposed timeline for phasing out AT1 capital instruments begins with banks adjusting their capital structures by replacing AT1 with Tier 2 and CET1 by 1 January 2027. From that point onwards, existing AT1 instruments will continue to qualify as regulatory capital until their first call dates and will be treated as Tier 2 capital from the regulator's perspective until they are entirely phased out by 2032, aligning with the final first call dates. A consultation period has begun, with further communication on specific prudential standard changes expected in 2025.

In response to the APRA announcement, AT1 spreads initially compressed aggressively, while Tier 2 spreads widened modestly on expectations of further supply and concerns around ratings implications. However, this inital move was quickly unwound, given the added Tier 2 supply is expected to be easily absorbed given the demand for such debt from a range of sources over the coming years. In addition, later commentary from the ratings agencies suggests the proposed changed would not have any impact.

Outlook

The global easing cycle, which started in the first half of the year, has brought more central banks into its orbit and is now the dominant macro theme. While central banks, including the Fed, have previously focused on combating inflation, the main risk now appears to be shifting towards employment and growth. This shift is clear in the re-emergence of a negative return correlation between US Treasuries and US equities, suggesting duration is once again functioning as a portfolio diversifier.

As we enter the new quarter, the debate centres on how far the Fed will go and where the "neutral" rate might ultimately settle. With recent US labour market data surprising on the upside, rate cut expectations have moderated somewhat. Inflation expectations are also showing signs of recovery, driven by rising crude oil prices amid rising geopolitical tensions. Based on the Fed's dot plot and guidance, most FOMC members still see the nominal neutral Fed funds rate around 2.90%. However, the resilience of the US economy might imply a higher neutral rate. This question over where "neutral" is should be balanced by the momentum long duration bonds typically have during a global rate cutting cycle, in addition to the optionality and convexity such instruments enjoy.

The announcement of new stimulus from Chinese authorities – combining further monetary easing with fiscal measures – was initially met with optimism across risk assets. However, as details have begun to appear in early October, much of the initial euphoria has faded, with the size of the fiscal package falling short of market expectations. Specifics are limited at the time of writing, and further measures could still be announced. A large fiscal stimulus package aimed at boosting domestic demand could be a turning point for the Chinese economy and carry significant global implications. For the past three years, Chinese government bonds (CGBs) have been standout performers, reflecting the economy's fight with deflation, in contrast to the inflation pressures other large economies were dealing with. The true indicator of the success of any fiscal stimulus would be a substantial rise in long-term CGB yields, yet so far, the jump in 10-year yields appears more as a correction within a multi-year trend.

In Australia, the RBA continues to adopt a more hawkish posture compared to other central banks. However, as a medium-sized open economy with significant global linkages, the RBA's policy outlook is often heavily influenced by the Fed and others. Furthermore, "peer economies" like New Zealand and Canada are showing signs of economic stress and it's likely that both the RBNZ and BoC will need to undertake much more aggressive easing measures. Given the similarities with those economies, it's plausible Australia might be subject to the same headwinds but might be at a different stage of the cycle. Ultimately, while trimmed mean inflation remains above the RBA's target band, the broader trend is for a continued moderation given the domestic lag to the global disinflationary impulse. In addition, like other developed economies, the Australian labour market continues to loosen, with unemployment staying low, but broadly trending higher. This backdrop suggests a constructive outlook for Australian fixed-rate bonds from a relative value perspective, particularly given the steeper yield curve and fewer rate cuts priced in compared to global peers.

The soft landing is still our base case for both the US and Australian economies, and continued moderation in inflation is likely to encourage both the Fed and RBA to cut rates and get policy to a "neutral" level relatively quickly. This environment should be supportive for fixed income overall, especially fixed-rate credit, which stands to benefit from a combination of lower yields and spread compression. While a hard landing would likely widen spreads, it would also necessitate further accommodative policy, allowing investment-grade fixed-rate credit to perform from the duration channel offsetting any credit headwinds.

Chart 1: G7 + Australasia Policy Rates, as at 30-September-2024; Implied forward rates from futures or overnight indexed swaps; Source: Bloomberg

Country	Dec-23	Sep-24	Dec-24 implied rate	Expected rate chnage over rest of 2024
United States	5.375%	4.875%	4.178%	-0.697%
Euro Zone	4.000%	3.500%	2.970%	-0.530%
Japan	-0.100%	0.250%	0.318%	+0.068%
United Kindom	5.250%	5.000%	4.623%	-0.377%
Candaa	5.000%	4.250%	3.474%	-0.776%
Australia	4.350%	4.350%	4.267%	-0.083%
New Zealand	5.500%	5.250%	4.358%	-0.892%

Chart 2: 10-year Government bond yields, as at 30-September-2024; Source: Bloomberg

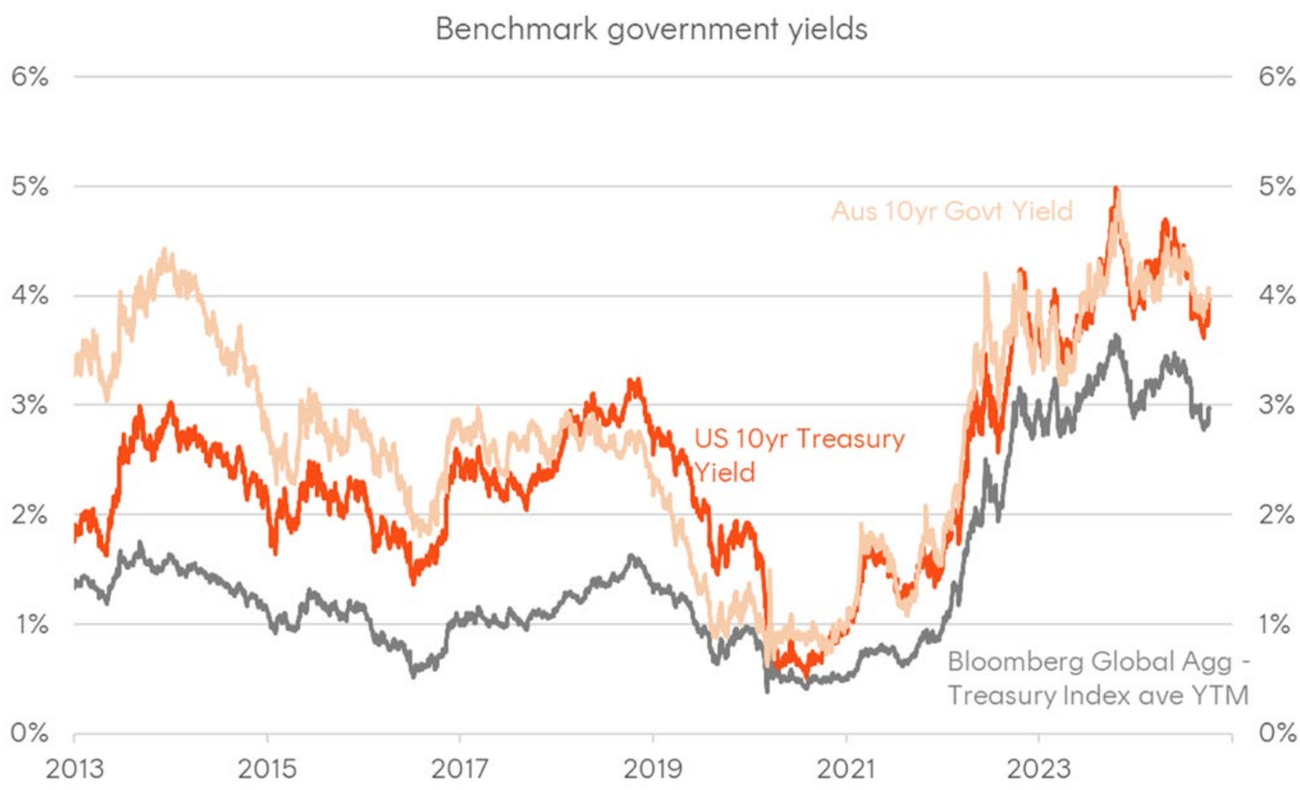

Chart 3: Chinese benchmark interest rates, as at 30-September-2024; Sources: Bloomberg

Chart 4: Measures of US inflation; 1-year expectations inferred from inflation swaps; Sources: BLS, Bloomberg

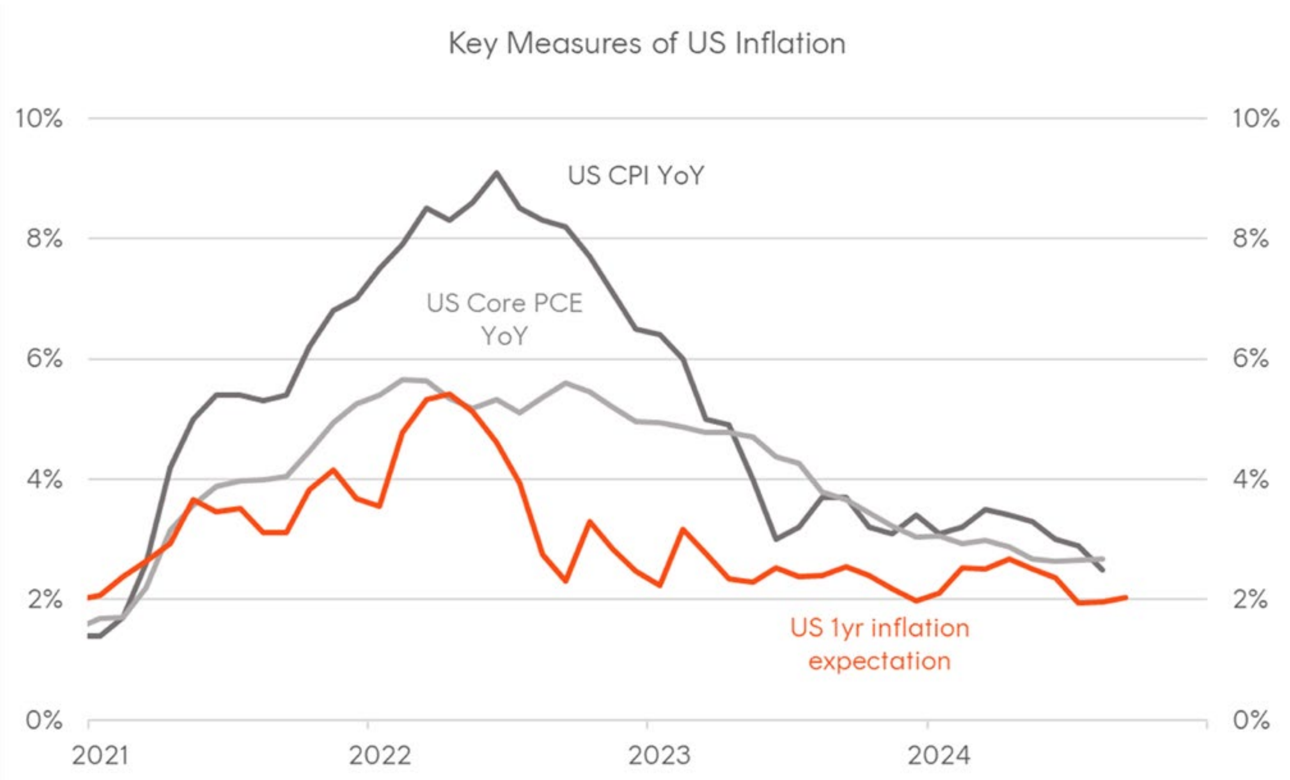

Chart 5: Measures of Australian inflation; quarterly data shown as monthly frequency; 1-year expectations inferred from inflation swaps; Source: ABS, Bloomberg

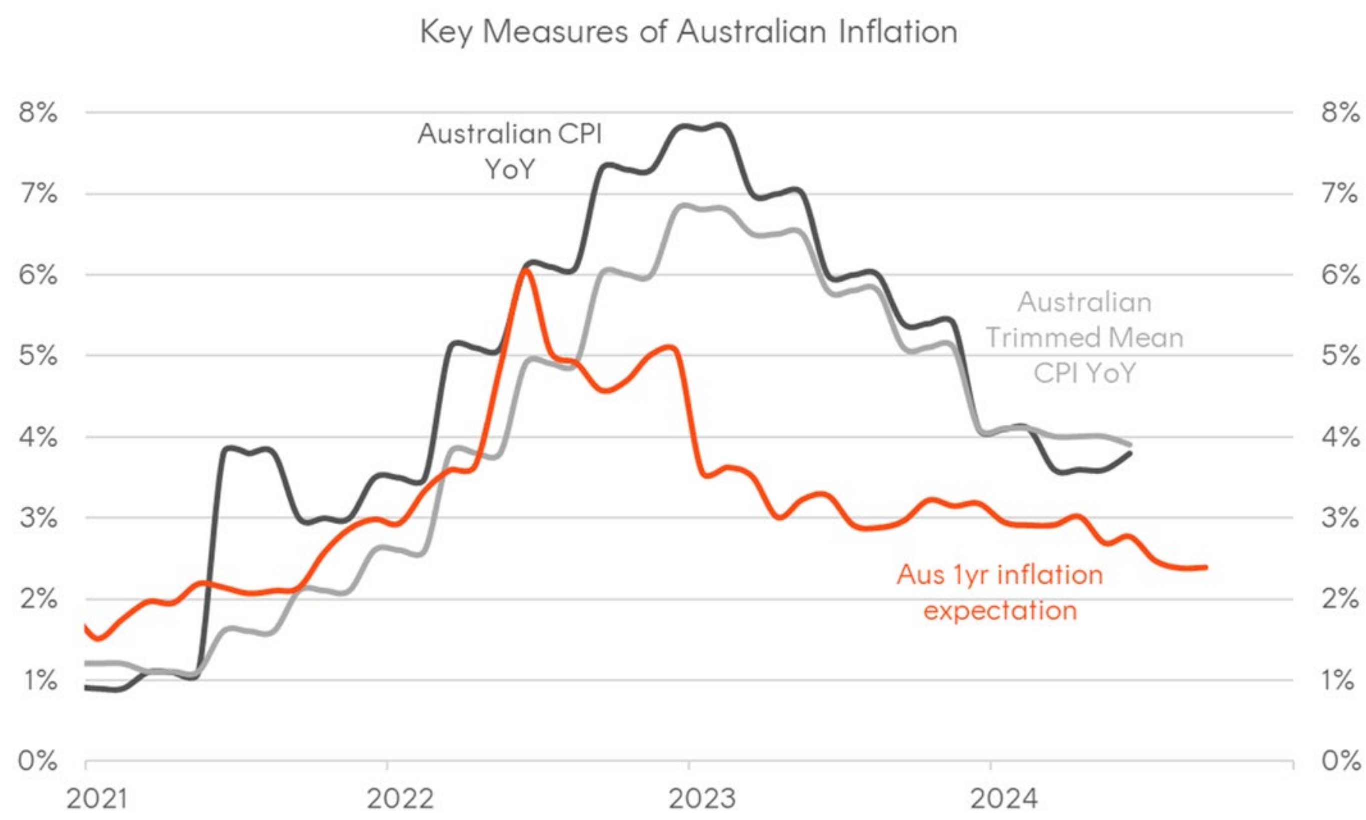

Chart 6: Australian interest rates, as at 30-September-2024; Source: Bloomberg

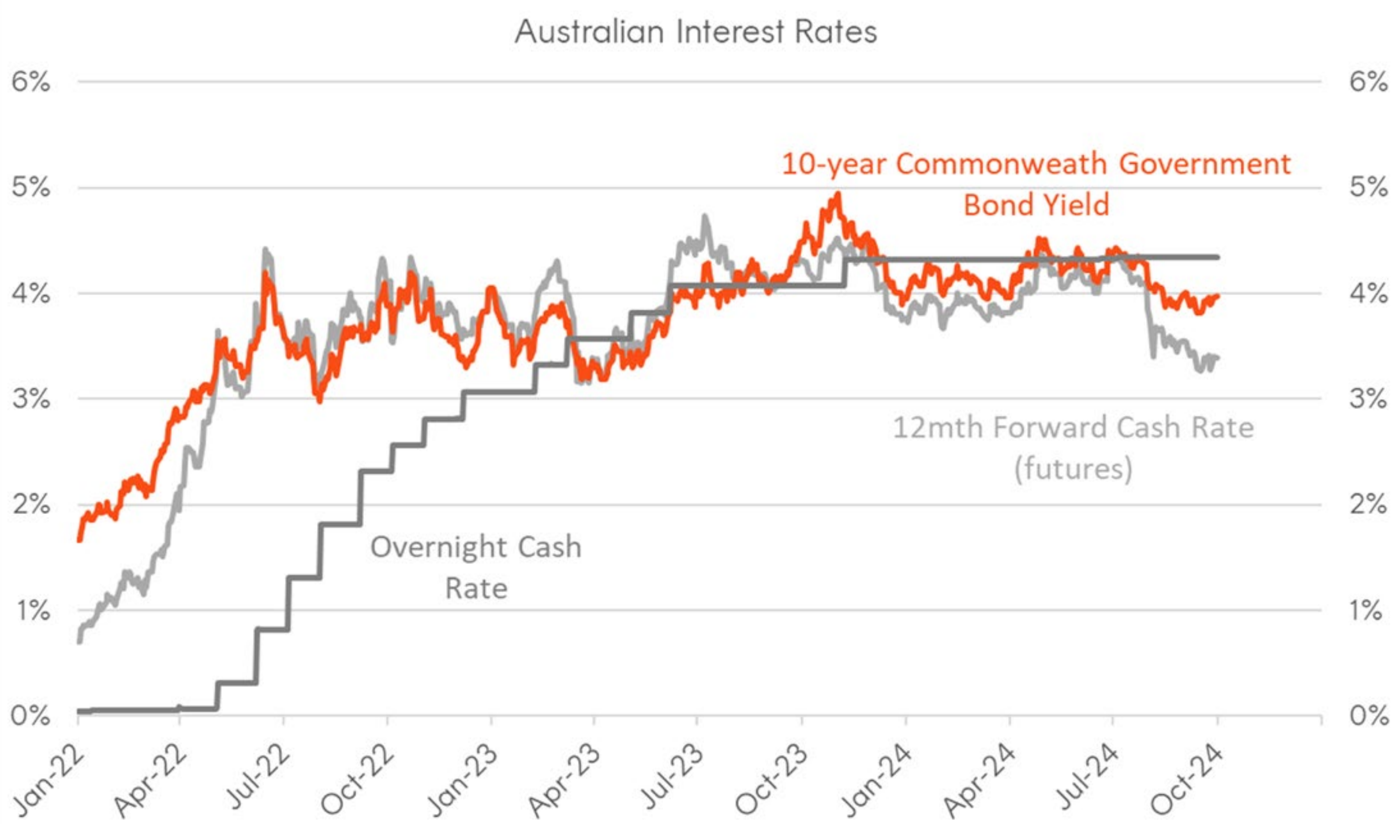

Chart 7: US interest rates, as at 30-September-2024; Source; Bloomberg

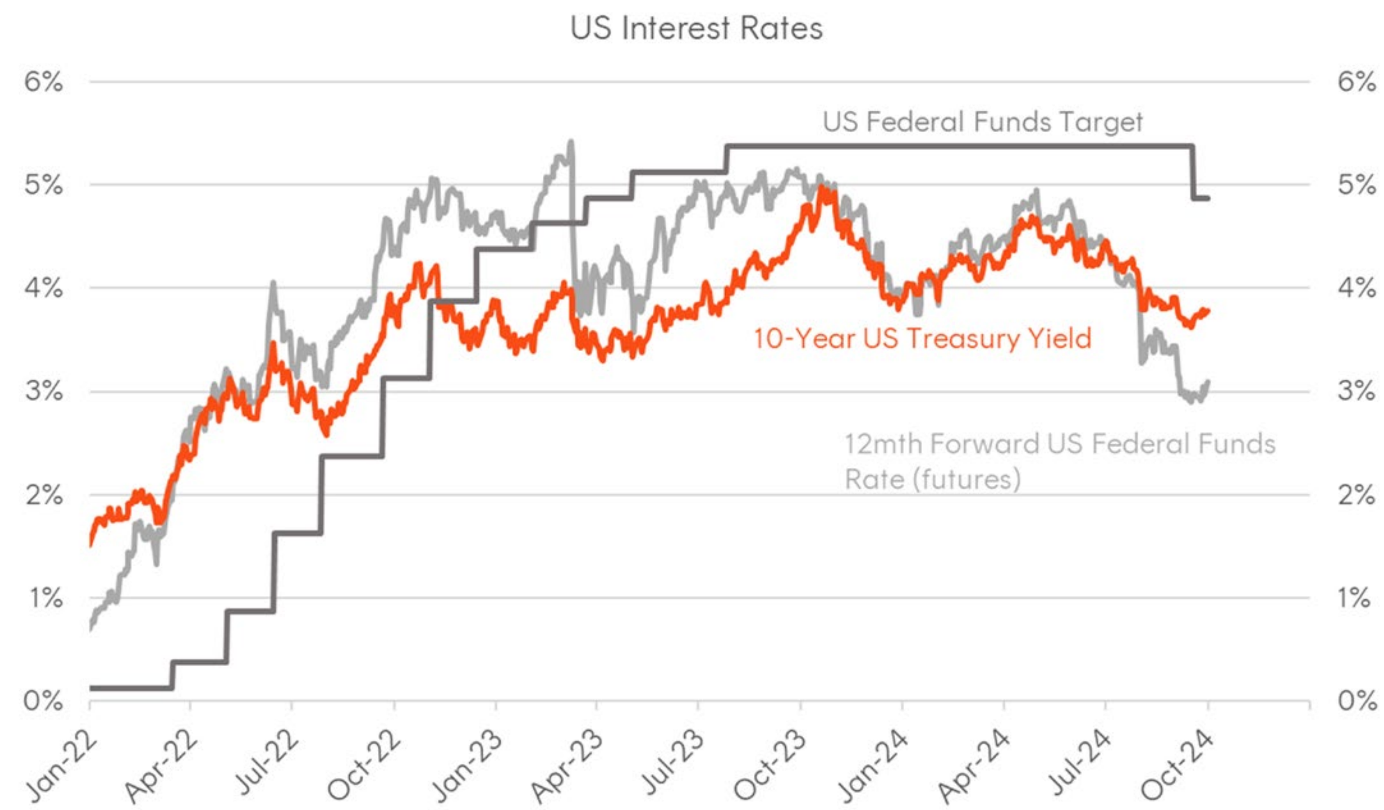

Chart 8: Global economic surprises, as at 30-September-2024; Source: Citi

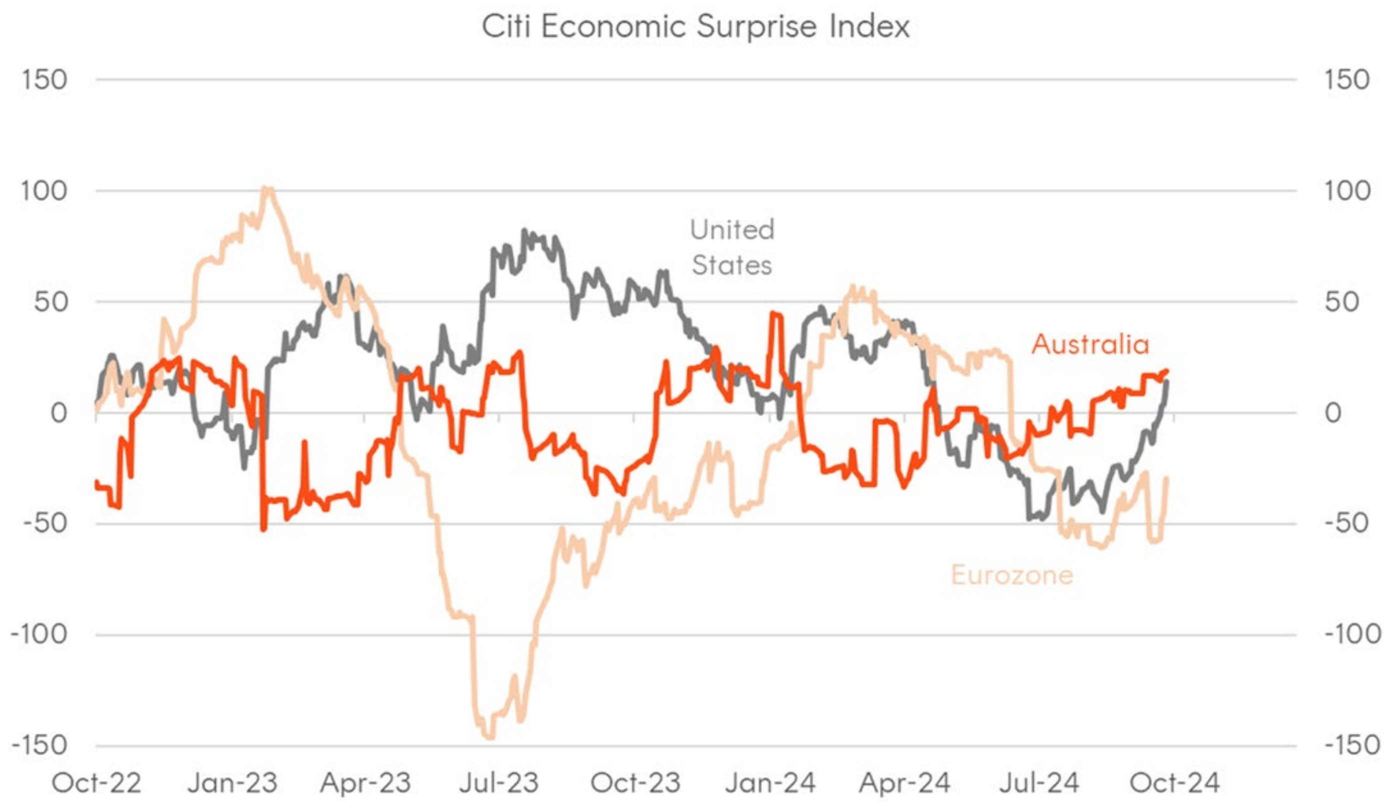

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Chart 9: Global inflation surprises, as at 30-September-2024; Source: Citi

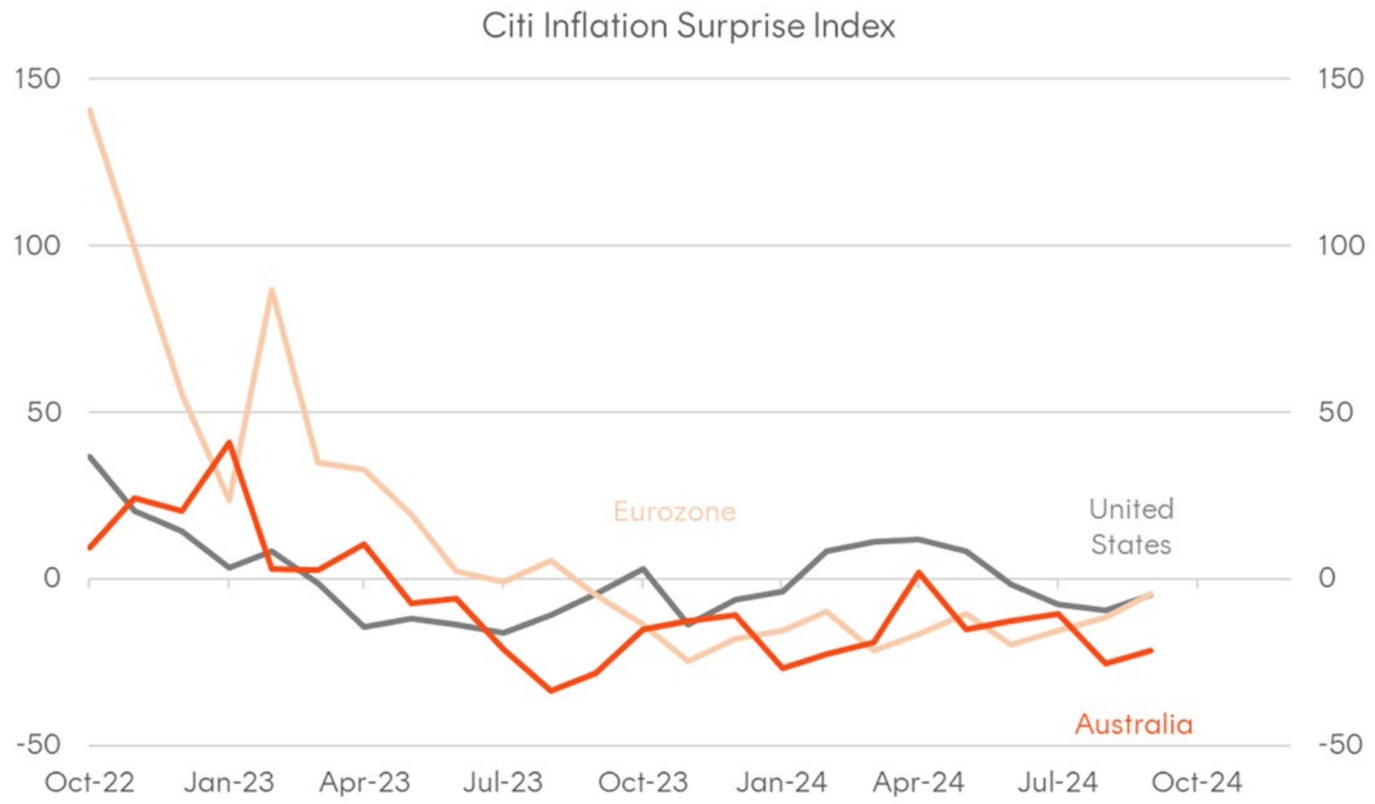

Chart 10: Corporate bond spreads; as at 30-September-2024; Source: Bloomberg

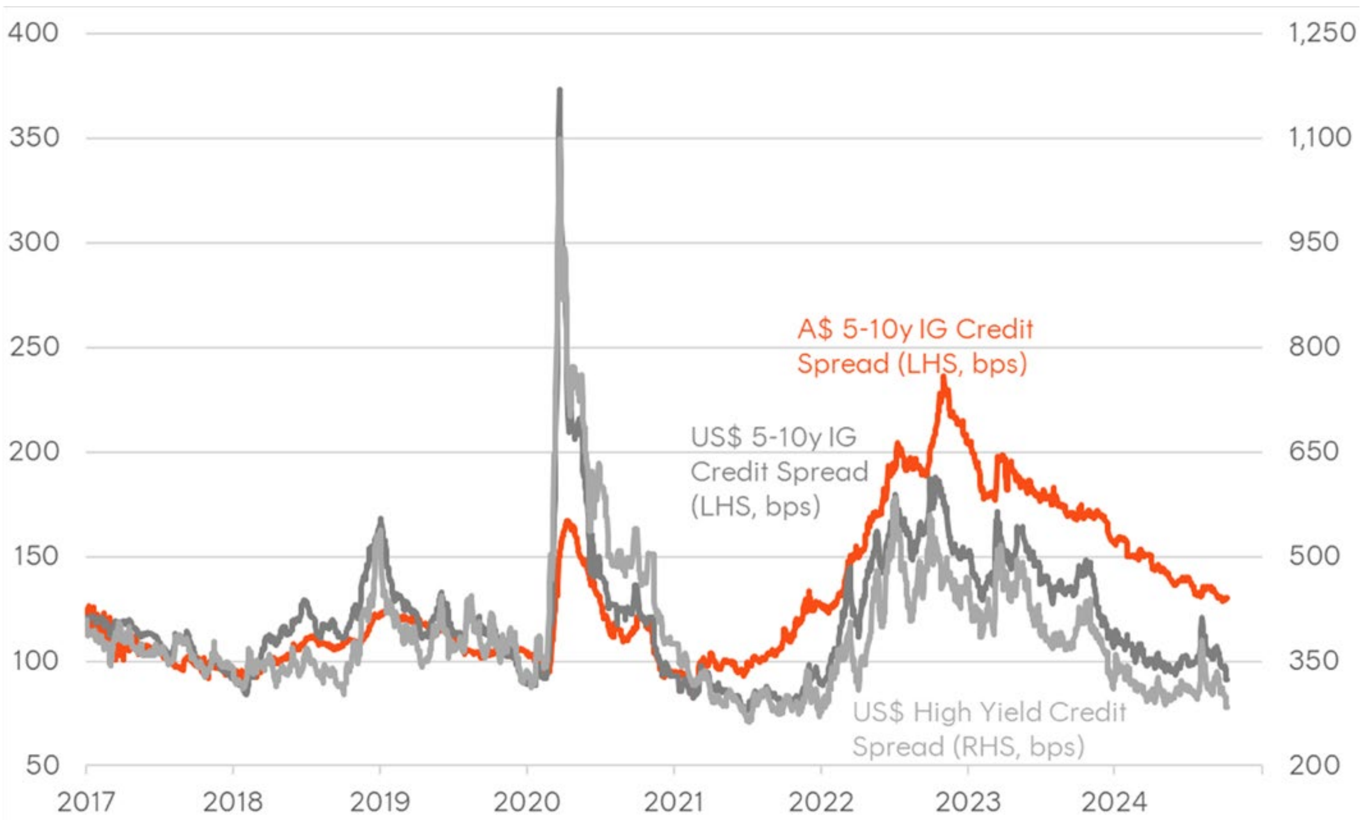

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Chart 11: Australian major bank FRN spreads; as at 30-September-2024; Source: Bloomberg

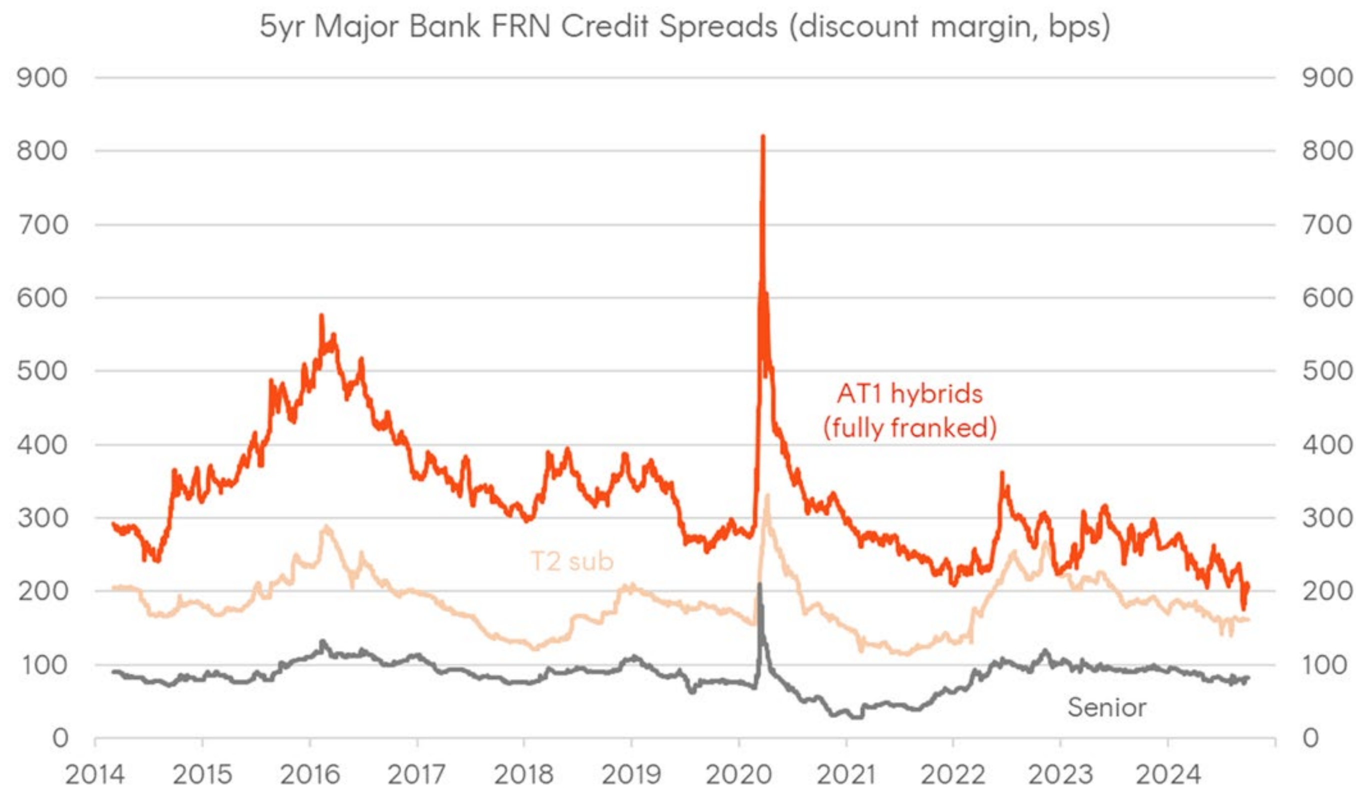

Chart 12: USD corporate bond issuance, breakdown by BICS sectors, as at 30-Sep-2024; Source: Bloomberg

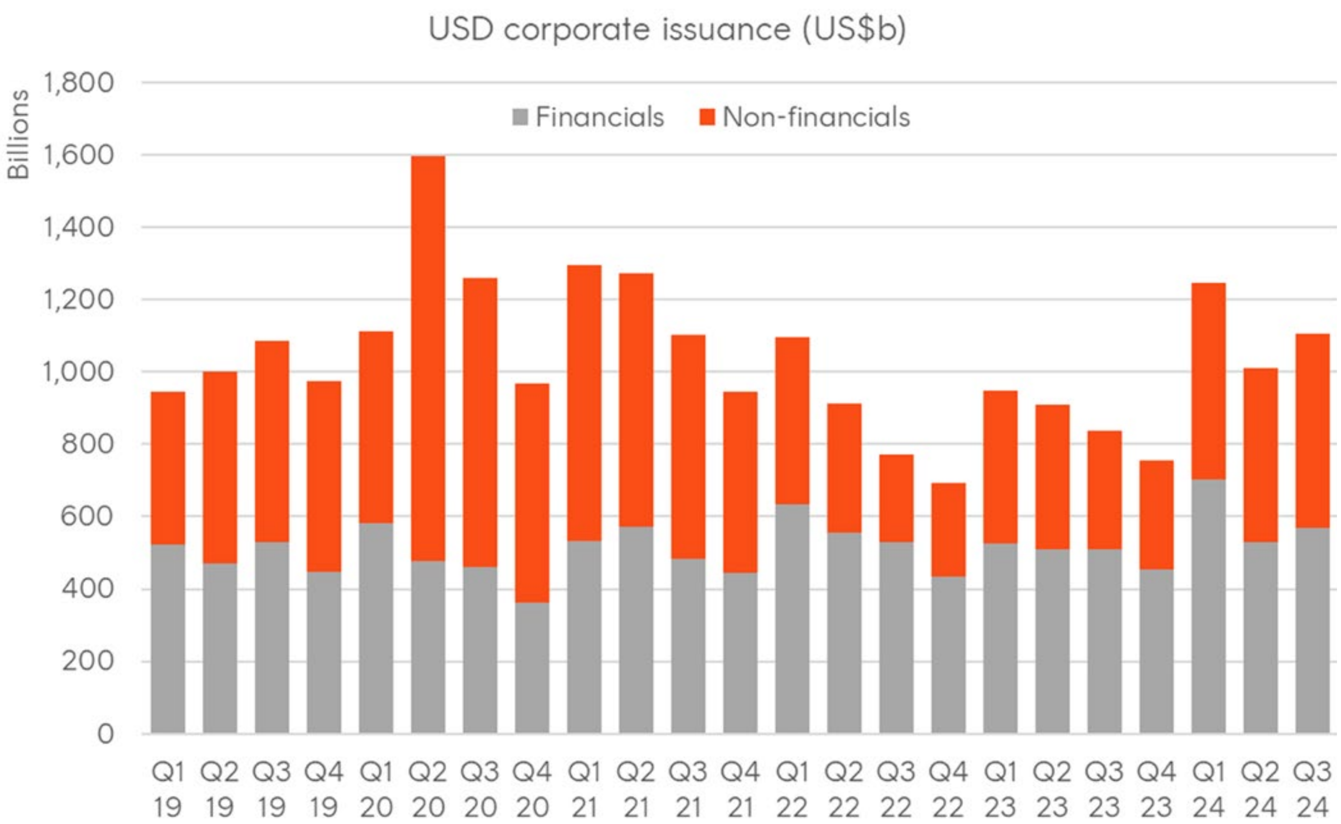

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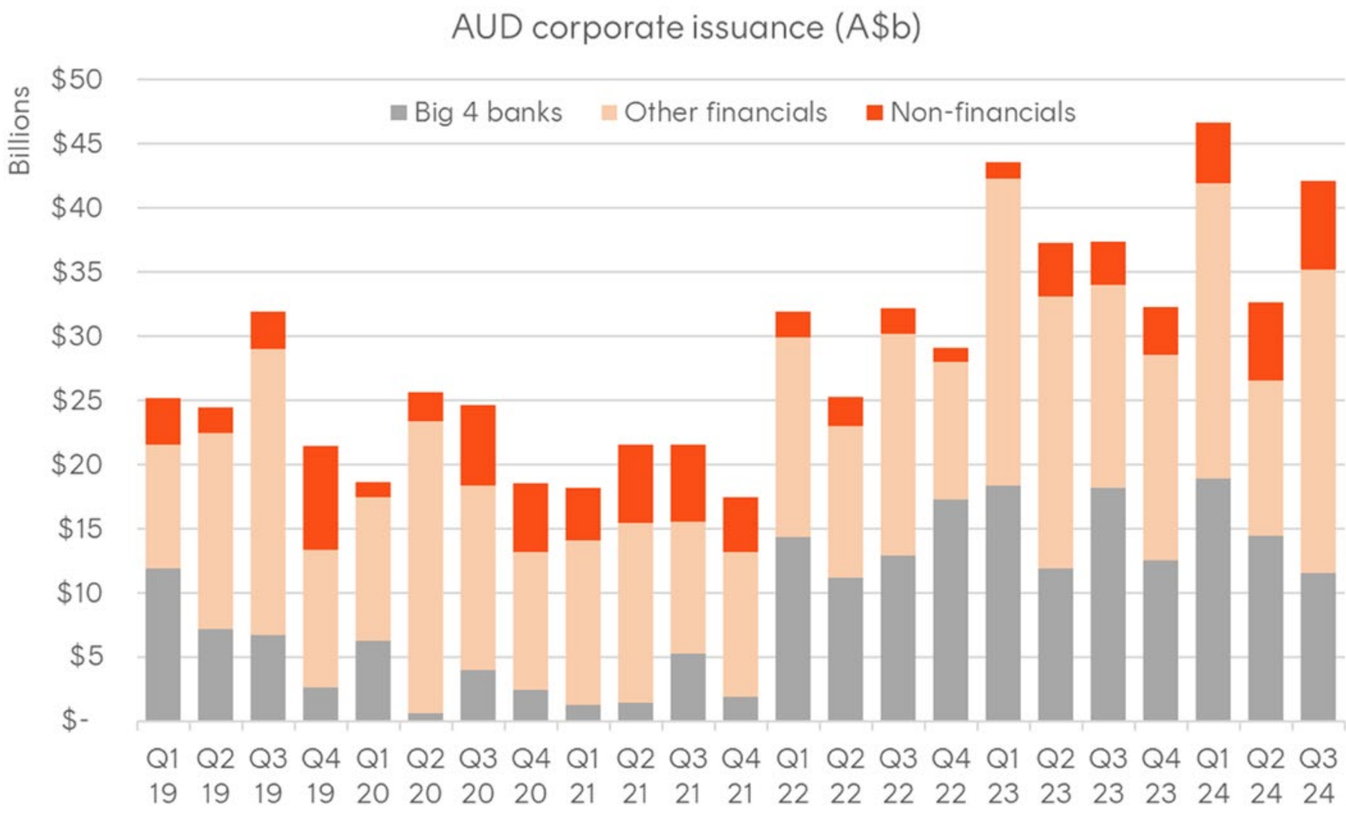
Chart 13: AUD corporate bond issuance, breakdown by BICS sectors, as at 30-September-2024; Source: Bloomberg



There are risks associated with an investment in GBND, including interest rate risk, credit risk, international investment risk and non-traditional index methodology risk. For more information on risks and other features of GBND, please see the Product Disclosure Statement.

CERTIFIED RESPONSIBLE INVESTMENT
CERTIFIED BY RIAA

The Betashares Sustainability Leaders Diversified Bond ETF – Currency Hedged (ASX: GBND) has been certified by the Responsible Investment Association Australasia according to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See www.responsiblereturns.com.au for details.[1]

Important

[1] The Responsible Investment Certification Program does not constitute financial product advice. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed. Appropriate professional advice should be sought prior to making an investment decision. RIAA does not hold an Australian Financial Services Licence.

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T: 1300 487 577 (within Australia)

T: +61 2 9290 6888 (outside Australia)

E: info@betashares.com.au

W: betashares.com.au

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