AUSTRALIAN MASTERS
CORPORATE BOND
FUND SERIES

AMCBF Series Quarterly Update

1 OCTOBER 2013 – 31 DECEMBER 2013

Summary

AUSTRALIAN MASTERS CORPORATE BOND FUND SERIES (AMCBF SERIES) HIGHLIGHTS

- The following dividend has been announced:
  - Australian Masters Corporate Bond Fund No 5 (AMCBF5) announced a fully franked dividend of $0.74 per share to be paid on 19 February 2014.
- The following capital return has been announced:
  - Australian Masters Corporate Bond Fund No 5 (AMCBF5) announced a capital return of $7.70 per share to be paid on 19 February 2014.
- All existing fixed income investments held in the AMCBF Series continued to perform as expected.

MARKET HIGHLIGHTS

- **Global markets:** The fourth quarter experienced a rally in risk assets across the globe as a result of better global economic data, signifying that a recovery from the global financial crisis is beginning to gain traction. However, at the time of the US Federal Reserve's (Fed) decision to begin the tapering of their bond purchase program in January 2014, the equity and credit markets reaction was softly positive as Ben Bernanke insisted rates would be near zero for the foreseeable future. Recent data and central bank policy has seen developed government bond yield curves steepen, with the US 10-year government bond yield widening 42bps over the course of the quarter.
- **Australian rates:** Despite leaving the official cash rate unchanged at 2.50%, the Reserve Bank of Australia (RBA) continued to maintain their dovish tone and expressed concerns around the high Australian dollar. Since then, talks around the RBA looking to better manage the currency 's value, waning domestic economic data and the US Fed's taper initiative have seen aggressive selling of the Australian dollar, falling from a six-month high in October of $0.97 to below $0.88 in January.
- **Domestic credit:** Robust volumes of corporate issuance were experienced at tight levels in the back end of 2013. Issuers continued to look at tapping the market, given the uncertainty around the sustainability of the low-interest-rate environment in 2014. The seven-year tenor continued its resurgence as investors sought yield and issuers looked to lock in cheap longer-dated capital. A number of new international issuers, such as Adani Abbot Point Terminal and Anglo American Capital, also launched inaugural Kangaroo issues during the quarter.

AMCBF Activity

AMCBF Series announced the payment of the following quarterly dividends and capital returns:

FUND	DIVIDEND	FRANKED	GROSSED UP	CAPITAL RETURN	EXPECTED PAYMENT DATE
AMCBF5	$0.74	$0.32	$1.06	$7.70	19 February 2014

All existing fixed income securities held within the portfolios of the AMCBF Series continued to perform as expected.

Global Markets Update

After the US government was in shutdown for the first 16 days of October, the last minute Congressional deal to extend the debt ceiling ahead of the 17 October deadline saw risk assets rally to record highs. Data closely monitored by the Fed suggested that the US recovery was well and truly gaining traction, with the third quarter GDP growth figure of 4.1% comfortably beating the expectation of 3.6% and December's unemployment rate falling below 7%. Subsequently, in the December meeting, Ben Bernanke announced that the Fed would commence the unwinding of the monthly asset purchases program by US$10 billion to US$75 billion per month in January 2014 because it saw the improvement in economic activity and labour market conditions as 'consistent with growing underlying strength in the broader economy'. However, investors in developed markets interpreted the removal of liquidity as a positive for the global economic outlook as they placed confidence in earnings growth for 2014, while the Fed emphasised the move need not presage a near-term rate hike. US money markets priced in a rise in interest rates no earlier than late 2015, and the S&P 500 hit an all-time record.

Eurozone equities and peripheral bonds were the beneficiaries of Mario Draghi's decision to cut the European Central Bank's (ECB) main refinancing rate by 25bps to 0.25% as a response to sub-target inflation and economic fragility in early November. The fourth quarter rally in risk assets saw Italian and Spanish 10-year government bond yields crunch in tighter by 30bps and 22bps, respectively. These significantly outperformed the core sovereign 10-year government bond yields on Bunds, Gilts and Treasuries, which rose by 15bps, 32bps and 42bps, respectively. The coalition formation in Germany, the confidence vote for new Italian Prime Minister Enrico Letta, the UK's fastest quarterly growth in three years and Spain's emergence from a two-year recession all coincided with the accommodative monetary policy stance to deliver confidence in consumer and purchasing managers figures for the Eurozone. However, French and Dutch news was not as positive as S&P cut both countries' credit ratings by one-notch to AA and AA+, respectively.

More expansionary policy from the People's Bank of China (PBOC) and China's Third Plenum of the country's top leaders saw a rally in Chinese risk assets. The raft of reforms include the relaxing of the one child policy, welfare system reforms, greater rights for farmers, liberalisation of the financial sector and state-owned enterprise reforms. This movement has been hailed as being as historic as Deng Xiaoping's opening up of the Chinese economy in 1978, and resulted in robust investor sentiment in the quarter.

With the world's central bankers continuing to pursue their expansionary policies and make dovish statements, the recovery from the global financial crisis finally seems to have been validated through positive headline macroeconomic data. The US Fed's next Chair and a noted dove, Janet Yellen is expected to keep interest rates at near zero for the foreseeable future. If the global recovery continues its expected recovery path, global credit and equities are expected to perform well. However, any hiccups in data may see similar volatility as was experienced in June and September 2013.

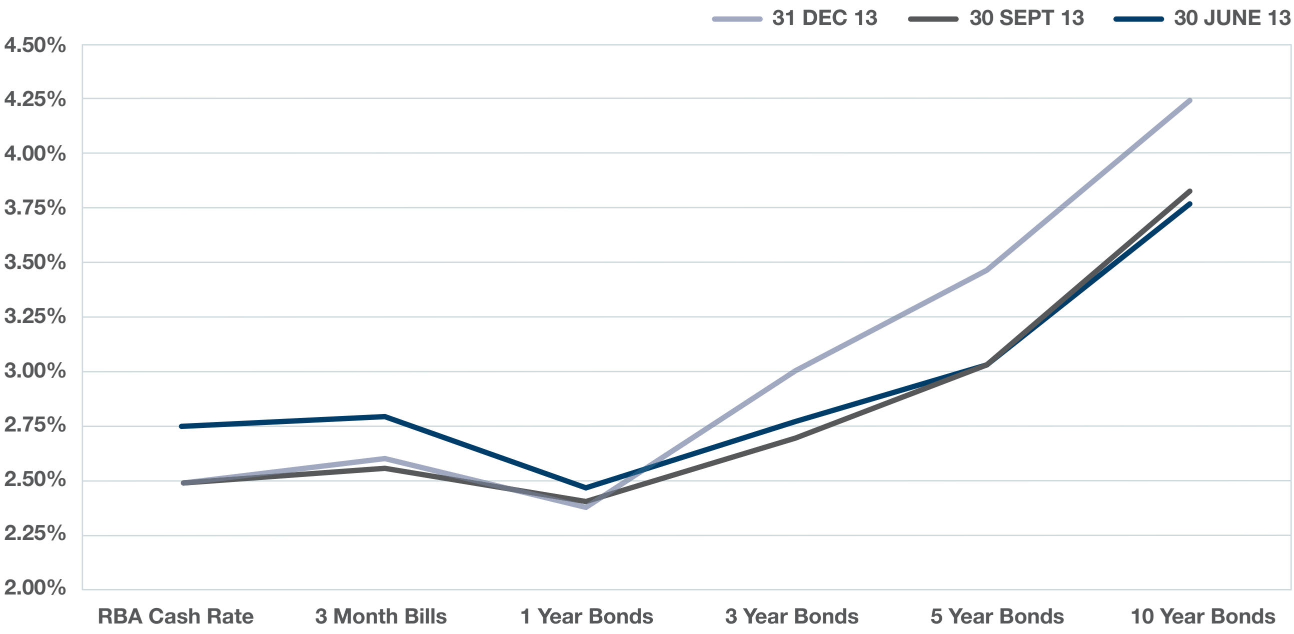
Australian Rates

Despite leaving the official cash rate unchanged at 2.50% over the fourth quarter, Glenn Stevens and the RBA have maintained their dovish stance as they recognise the sub-par growth and rising unemployment rate. While there is a level of uncertainty around the transition away from the mining sector, there has been an improvement in indicators of household and business sentiment in recent times as the full effects of the rate cuts since late 2011 flow through. However, proponents of a rate hike remain concerned over a potential housing bubble, with housing prices increasing at an annualised rate of 15% over the past six months.

While below its level earlier in the year, the RBA believes the Australian dollar is 'still uncomfortably high'. In November, Stevens used his speech to mark 30 years since the dollar was floated to suggest the RBA was open to more active management by managing the Australian dollar down. This saw markets sell off the Australian dollar swiftly in the quarter. With the Fed's announcement of their pullback in asset purchases and the subsequent strengthening of the US dollar, the pressure seems to have been relaxed on the RBA as the cross rate fell from a six month high in October of $0.97 to below $0.90 after the Fed's announcement. Poor domestic data, in particular the fourth quarter unemployment figures, saw aggressive selling of the Australian dollar to below $0.88 in the new year.

The Australian government yield curve was extended out to 20 years with a new 2033 Commonwealth Government bond (CGS) being issued during the quarter. The new line extends the nominal CGS curve by four years, benefiting both investors and issuers.

AUSTRALIAN GOVERNMENT YIELD CURVE



Source: Bloomberg

As displayed by the yield curves at 31 December 2013 (green line) and 30 September 2013 (red line), the focus by the RBA to manage the short-term economic transition away from the mining sector and the high Australian dollar has led to the interest rates at the short end of the curve falling over the past six months. However, with a recovering US economy and a start to the tapering of the US Fed's stimulus program underway, Australian government bond rates from one year to 10 years have steepened over the quarter. The mid and long-end of the curve have spiked with the 10-year government bond yield widening 43bps.

Domestic Credit

ITRAXX AUSTRALIAN CREDIT SPREADS

Australian credit spreads moved in tighter throughout the fourth quarter. Markets took the US Fed's taper of their bond purchase program in their stride as Ben Bernanke and his committee members insist that rates will be at near zero for the foreseeable future. As credit markets become more expensive, the divergence from the historical averages are more apparent; currently 50bps tighter than the 5 year average.

AUSTRALIAN BBB 5YR CORPORATE BOND YIELDS

With the US Fed electing to commence the taper of their bond purchase program on the back of a US economic recovery, Australian credit markets traded in tighter during the quarter. This move tighter exacerbated the variance from the 5 year average, which was 1.76% higher than the Australian corporate bond yields at 31 December 2013. The fourth quarter experienced less volatility than in June and September 2013, as it seemed that financial markets had priced in the commencement of the US Fed taper initiative. However, despite the positive global outlook, the Australian economy has been pressured with a number of hurdles through poor domestic data and structural concerns. This has seen Australian credit spreads begin to widen at the start of 2014.

The quarter continued the trend in seven-year corporate bond issuance as both domestic and offshore corporates look to lock in low rates. The issuers of seven-year debt deals for the quarter included Mirvac Group Finance, Brisbane Airport Corporation, Aurizon Network, Australian Postal Corporation, Airservices Australia, AMT Management, Aquasure and Global Switch Property Australia. Despite the longer tenor and tigher spreads, for the most part, the transactions were well received, as investors continued to hunt for yield.

The latter half of the year consisted of a number of international issuers debuting in the Australian corporate debt market. As these issuers look to raise capital in what seems to be the bottom of an Australian rate cutting cycle, this development presents investors with opportunities to diversify their credit portfolios at very low yields.

Overall, issuance continues to be robust, with over $46.46 billion of domestic corporate bond issuance and $26.96 billion of Kangaroo bond issuance raised in the 2013 calendar year (KangaNews, 2014). Fourth quarter issuance was strong as issuers continued to look to tap the market, given the uncertainty around the sustainability of the low-interest-rate environment in 2014.

HYBRIDS

There was one hybrid deal during the fourth quarter, the NAB CPS II issue. Most of new bank capital issuance continued to come in the form of senior debt, with the big 4 banks coming to market with a number of deals. As the banks continued to improve their overall capital stocks through Tier 2 capital raisings, the subordinated debt structures will take the new Australian Prudential Regulation Authority (APRA) compliant structures including an equity conversion 'non-viability' trigger.

AMCBF#5

ISSUER	MATURITY	FACE VALUE	CONSIDERATION	GICS INDUSTRY	COUPONS RECEIVED		
					OCTOBER	NOVEMBER	DECEMBER
Downer EDI*	29-Oct-13	$11,400,000	$11,624,536	Commercial & Professional Services	-	-	-
Volkswagen Australia*	26-Nov-12	$3,000,000	$2,983,500	Automotive	-	-	-
Stockland*	15-May-13	$500,000	$467,255	Real Estate	-	-	-
GPT Property*	22-Aug-13	$1,000,000	$933,490	Real Estate	-	-	-
Envestra	14-Oct-15	$2,500,000	$2,062,750	Utilities	78,125	-	-
Santos Finance	23-Sep-15	$6,000,000	$5,511,440	Energy	-	-	-
Leightons	28-Jul-14	$6,900,000	$7,229,182	Capital Goods	-	-	-
Melbourne Airport (Fixed)	14-Dec-15	$1,000,000	$863,320	Transportation	-	-	30,000
CFS Retail Property	22-Dec-14	$2,400,000	$2,282,473	Real Estate	-	-	-
AMP Limited	5-Oct-14	$3,500,000	$3,508,330	Insurance	140,000	-	-
Stockland	18-Feb-15	$18,190,000	$18,362,081	Real Estate	-	-	-
Mirvac	15-Mar-15	$2,300,000	$2,349,798	Commercial & Professional Services	-	-	-
Sydney Airport Finance	20-Nov-14	$3,030,000	$2,696,706	Transportation	-	23,446	-
Brisbane Airport*	11-Dec-13	$5,000,000	$4,629,810	Transportation	-	-	39,890
Melbourne Airport (FRN)	14-Dec-15	$3,510,000	$3,056,324	Transportation	-	-	24,765
Goldman Sachs	24-Jun-14	$2,500,000	$2,310,918	Diversified Financials	-	-	39,567
Dexus Finance	28-Jul-14	$2,500,000	$2,701,975	Real Estate	44,939	-	-
		$75,230,000	$73,573,888		263,064	23,446	134,222

*Investment has been redeemed or has matured.

MANAGER

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