SEED FUNDS MANAGEMENT

Hybrid Income Fund

Monthly Report – December 2024

Fund Dashboard

31 December 2024

6.47%
% Yield to Call
(Portfolio as bought)

6.25%
Running Yield

4.5 Years
Weighted Average
Term to Call

98%
Portfolio Floating Rate

0.53 Years
Interest Rate Duration^

31%
Top 5 Holdings
As % of Fund*

44
Number of Holdings*

BBB+
Weighted Average
Portfolio Rating

$336 million
Current FUM

Source: Seed Funds Management.
As at 31 December 2024.

*Excluding cash.
^Maximum duration of 1.

Hybrid Income Fund Strategy Net Performance

31 December 2024

FIGURE 1.

	1 Month	3 Months	6 Months	1 Year	3 Years Annualised	5 Years Annualised	SI (Sep 15) Annualised
HYBRID INCOME FUND STRATEGY	**0.76%**	**2.16%**	**4.23%**	**8.23%**	**6.02%**	**5.34%**	**6.45%**
Hybrid Benchmark (Solactive*)	0.47%	1.24%	3.36%	6.88%	4.33%	3.98%	4.87%
RBA Cash Rate	0.36%	1.09%	2.19%	4.44%	3.21%	2.00%	1.78%

Figures to 31 December 2024. The performance table above represents The Hybrid Income Fund Strategy ("Strategy"). The Strategy commenced in September 2015 and has been continuously operated with identical investment parameters and processes by its portfolio manager, Nicholas Chaplin. The Strategy began in 2015 as the Paraclete Investment Fund until June 2022. The Hybrid Income Fund commenced in June 2022 operating under Evolution Trustees Limited as trustee. Investment management services were novated to Seed Funds Management Pty Ltd in March 2024. Accordingly, Seed Funds Management Pty Ltd receives a management fee for managing the Fund. Performance figures for the Strategy have been reviewed in accordance with ASRS 4400 "Agreed-Upon Procedures Engagements" by Hall Chadwick Corporate (NSW) Limited.

Monthly Commentary

Our portfolio's investment objective is to outperform the hybrid index while investing in lower risk securities. In acknowledging this, 2024 concluded on a high note, with the portfolio outperforming the index despite its more conservative allocation. With over half of the portfolio invested in Tier 2 subordinated bonds, a robust primary market in recent months significantly bolstered performance throughout the year. The availability of substantial new issue premia has been a key driver of these results.

We anticipate this positive trend will carry into 2025, especially as banks increasingly focus on Tier 2 bonds following APRA's decision to phase out bank hybrids. This transition means no rollovers in the bank hybrid market, with ANZ and CBA set to call their hybrids in March and April, respectively. Consequently, we expect banks to respond with increased issuance of wholesale subordinated bonds.

The fund delivered a return of 8.23% for the 2024 calendar year (inclusive of franking credits), outperforming the index (all hybrids), which returned 6.88%. This was achieved while maintaining an investment-grade weighted-average portfolio rating (currently BBB+) and a balanced mix of subordinated and senior bonds alongside hybrid securities.

Key Portfolio Moves in December

With the primary bond market winding down early in December ahead of the Christmas and New Year period, our trading activity focused entirely on the secondary market.

Listed hybrid prices exhibited significant volatility throughout the month, which we leveraged to trade out of overvalued major bank issues. However, we identified opportunities within CBA's listed hybrids, selectively swapping into better-valued issues when conditions were favourable.

We extended our exposure to BOQ through both subordinated and senior bonds during a rare lull in secondary market activity, securing excellent entry prices. Similarly, we capitalised on attractive valuations in senior and subordinated bonds issued by Westpac and Suncorp, increasing our holdings in both.

In addition, we identified continued value in QBE's subordinated bonds on the secondary market. We expanded our position in this insurance issuer through two separate purchases during the month, efficiently deploying newly received funds.

*Solactive Australian Hybrid Securities Index (Net)

Increased Debt Issuance

In 2024, Australia's debt capital markets experienced significant growth, with proceeds from raisings surpassing $US193.6 billion across 340 issues—a 16% increase compared to the previous year.

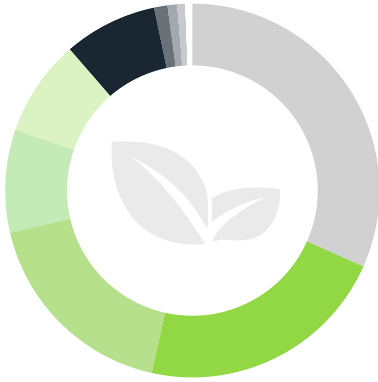
This growth was largely driven by issuers seeking to refinance debt under more favourable conditions, with some activity also supporting mergers and acquisitions. The top four Australian banks dominated the issuance landscape, and this trend is expected to continue into 2025 as they fund growth and adapt to evolving prudential regulations.

Changes to bank capital requirements are expected to occur gradually, with only a limited number of bank hybrids due for call each year. The final hybrid issue is anticipated to be called in 2032.

Portfolio Holdings

(as at 31 December 2024)

FIGURE 2.



- Wholesale Bank Tier 2 – 31.66%
- Wholesale Insurance Tier 2 – 21.81%
- Listed Bank Tier 1 – 17.89%
- Wholesale Non-Bank Senior – 8.90%
- Wholesale Bank Senior – 8.38%
- Wholesale Bank Tier 1 – 8.06%
- Listed Non-Bank Tier 1 – 1.15%
- Listed Insurance Tier 1 – 0.84%
- Listed Non-Bank Senior – 0.68%
- Cash – 0.63%

We Will Continue To Actively Adjust Our Portfolio Exposures As Markets Change

As Australia's prudential capital requirements for banks evolve, we are making subtle but strategic adjustments to our portfolio to align with these changes. With bank hybrids set to be phased out commencing in 2027 and the final issues expected to be called by 2032, we will be gradually reducing our exposure to bank hybrids in line with the call timetable while increasing allocations to Tier 2 subordinated notes and senior bonds. Our portfolio remains focused exclusively on financial issuers, ensuring a targeted approach that leverages our deep understanding of the sector.

We expect the volume of Tier 2 subordinated notes to grow steadily as they replace bank hybrids over time. Additionally, the Tier 2 market is likely to diversify further, with new issuers entering as mergers and structural changes within the financial sector take shape. This diversification will create a broader range of opportunities while enhancing the resilience of the subordinated bond market. The potential inclusion of 'Upper Tier 2 capital ' is also a potentially interesting alternative for the market albeit this may not be an imminent development and would require APRA's blessing.

Insurance and non-Bank hybrids are currently anticipated to continue to be available.

Senior bonds continue to provide a highly liquid and reliable component of our portfolio, offering flexibility for deploying new cash when opportunities arise. Their ready availability ensures we can maintain our disciplined approach to managing liquidity while capturing attractive yield opportunities.

By proactively adjusting the portfolio mix to reflect these dynamics, we are well-positioned to navigate the transition away from bank hybrids and adapt to the increasing prominence of Tier 2 instruments. These measures reinforce our commitment to delivering competitive returns while preserving stability and resilience.

Market Volatility Amid Economic Indicators

The Reserve Bank of Australia's (RBA) softened stance in December heightened expectations of interest rate cuts as early as February 2025. This shift impacted bond yields throughout December, which trended lower in anticipation of monetary policy easing. The RBA's growing confidence in inflation converging towards its target has further reinforced this sentiment in the market.

While there is speculation of a target cash rate reduction next month, it is more likely that the RBA will act in May, allowing time to assess multiple quarters of CPI data for a clearer economic picture.

With our portfolio consisting of 98% floating-rate instruments, we are well-positioned to continue executing our investment strategies with minimal sensitivity to the exact timing of RBA rate changes. Nonetheless, any adjustment will be closely observed, given that the last cash rate movement by the RBA occurred over a year ago, in November 2023.

SEED FUNDS MANAGEMENT

Expert Management

The HIF provides access to highly skilled specialist management, with extensive expertise in regulated capital products including hybrids, subordinated debt and mutual equity.

Senior Portfolio Manager

Nicholas Chaplin is an authority in the Hybrid and capital issuance market having structured, originated, distributed, and educated on many issues since 1998.

Over his career he has originated over $200 billion in hybrid & capital issues. From 2009 to 2021, Nick was Head of Hybrid & Structured Capital at NAB and prior to that he was Head of Hybrid Origination at Westpac.

Portfolio Manager
Chair, Investment Committee

John Corr has worked in the finance industry for 40 years and is a highly regarded authority in portfolio risk management. He has experience in banking, broking, proprietary trading and funds management.

John was a founder and CIO of Aurora Funds Management.

Unit Pricing:	Daily
Applications:	Daily
Distributions:	Monthly
APIR Code:	EVO3184AU
Management Fee:	0.55% per annum
Performance Fee:	Not Applicable
Website:	Click here
Offer Document:	Click here
How to Apply:	Click here
Contact Details:	Click here

Fund Information

The Hybrid Income Fund strategy was established in September 2015.

Hybrid Income Fund (HIF) actively invests in a diversified portfolio of financial capital with a heavy weighting to Australian-regulated capital instruments. The underlying securities include hybrids (Tier 1 capital notes and convertible preference shares), Tier 2 bonds, subordinated debt, senior debt, mutual capital instruments and cash. The Fund typically holds ~40 positions whose underlying issuers are banks, insurance companies and non-bank lenders.

Fund Objective

HIF aims to provide returns that exceed the Hybrid Benchmark on a net basis over the suggested investment timeframe (five+ years). The Fund has a meaningful track record of exceeding its target after fees through active management with low volatility and access to franking credits.

Our Product Universe

The universe for the Hybrid Income Fund portfolio includes prudential capital instruments issued by Banks, Insurers, and non-bank financial corporations as well as other instruments from these issuers such as senior bonds. Prudential capital includes hybrids and subordinated bonds (sometimes referred to as Tier 1 and Tier 2 securities respectively). Senior bonds add significant additional liquidity to the portfolio as well as adding important product diversity.

The Investment Strategy

The investment manager intends to apply a tactical approach in terms of which securities it invests in and the timing of such investments with a focus on delivering a robust risk adjusted yield through market and interest rate cycles.

The investment manager will:

- Manage interest rate risk by holding predominantly floating rate instruments;
- Provide portfolio diversity by security type, credit risk, duration and issuer;
- Aim to distribute franking credits;
- Aim to provide regular income.

Platform Availability

HUB24 · FNZ · Mason Stevens · netwealth · Australian Money Market · Powerwrap · Apex · praemium · connexion

Unit Price and Core Data

The unit price on 31 December 2024 was $1.0802. This is inclusive of the December distribution which will be paid in early January. The unit price is published daily on our website here.

Franking credits provide an additional return which will depend on the investor's own tax situation. Currently, 15% of the portfolio is receiving full franking value. The remainder is receiving full cash returns. Franking credit exposure is reduced with additional investment in Tier 2 securities or senior bonds as these are debt instruments for tax purposes.

Fund returns are made up of three key aspects: 1) regular distributions (either taken as cash or reinvested according to your preference, 2) franking credits associated with these distributions, and 3) changes in the capital value (unit price) over time.

We continually measure the relative value of the prime asset classes of the fund and adjust weightings actively. On 31 December, the fund was holding 27.9% Tier 1 instruments (including both listed and wholesale), 53.5% Tier 2 instruments, 18.0% senior bonds, and 0.6% cash. Figure 2 on Page 2 depicts these current allocations.

The average credit rating of the portfolio is investment grade at BBB+.

Glossary

The following details are provided to assist in understanding of terms used in this report:

Credit Spread Duration: Measures the sensitivity of a bond's price to changes in its credit spread. This measure reflects the potential change in the bond's value in response to a 100-basis point (1%) change in the credit spread. For example, if credit spreads tighten by 100 bps for a portfolio with a credit spread duration of 2.5 years, it will result in a + 2.5% return assuming all else is equal.

Interest Rate Duration: The weighted maturity of a fixed-income investment's cash flows, considering all coupon interest payments and the maturity date - used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates i.e. shorter duration bonds are less sensitive to interest rate movements than long bonds.

Running Yield: The ratio of interest to the current market price of the bond, stated as a percentage. For example, a bond with a current market price of $100 that pays $6 per year in interest would have a running yield of 6%.

Yield to Call: A yield on a security calculated by assuming that interest payments will be paid until the call date, when the security will be redeemed at the call price.

Yield to Maturity: A yield on a security calculated by assuming that interest payments will be made until the final maturity date, at which point the principal will be repaid by the issuer. Yield to maturity is essentially the discount rate at which the present value of future payments (investment income and return of principal) equals the price of the security.

General Disclosures

The material contained within this Report (The Report) has been prepared by Seed Funds Management Pty Limited (ABN 25 675 247 506) (Seed), a Corporate Authorised Representative (no 001308397) of its related body corporate, Seed Partnerships Pty Ltd (ABN 32 606 230 639) the holder of AFSL No. 492973. It is issued by the Responsible Entity of the Fund, Evolution Trustees Limited (ABN 29 611 839 519, AFSL 486217) (Evolution). Seed receives a management fee for managing the Fund.

Figures referred to in The Report are unaudited.

The Report is not intended to provide advice to investors or take into account an individual's financial circumstances or investment objectives. This is general investment advice only and does not constitute advice to any person. Neither Evolution nor Seed guarantee repayment of capital or any particular rate of return from the Fund. Neither Evolution nor Seed gives any representation or warranty as to the reliability, completeness or accuracy of the information contained in The Report.

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