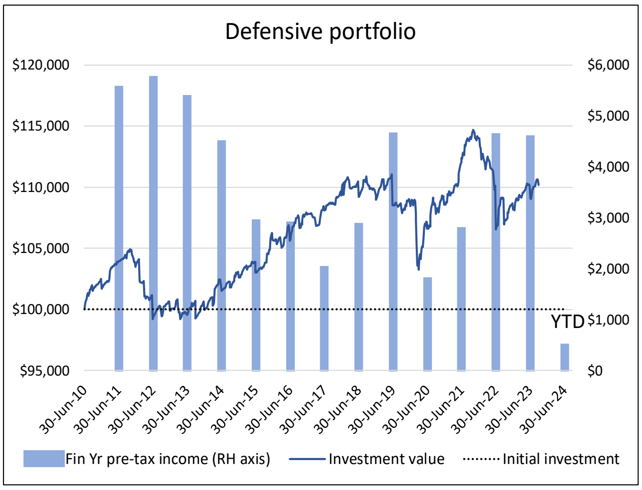
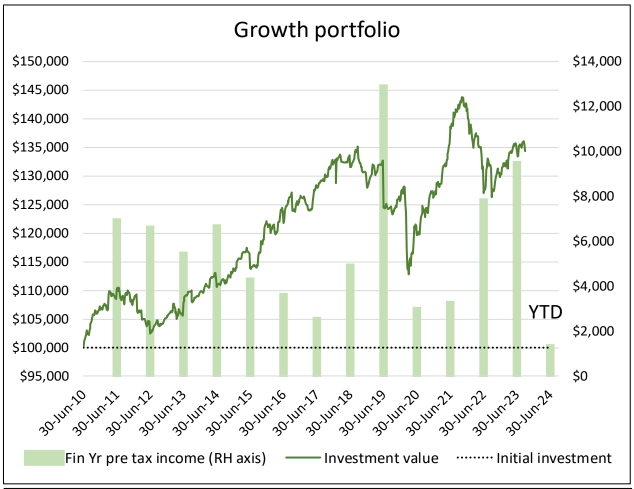
Investment Update

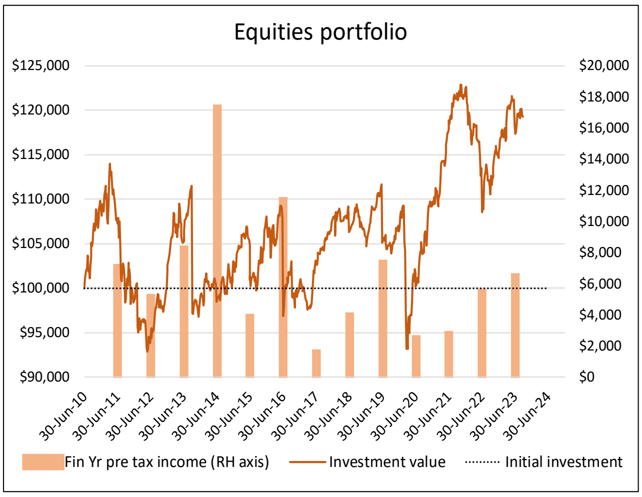
September Quarter 2023

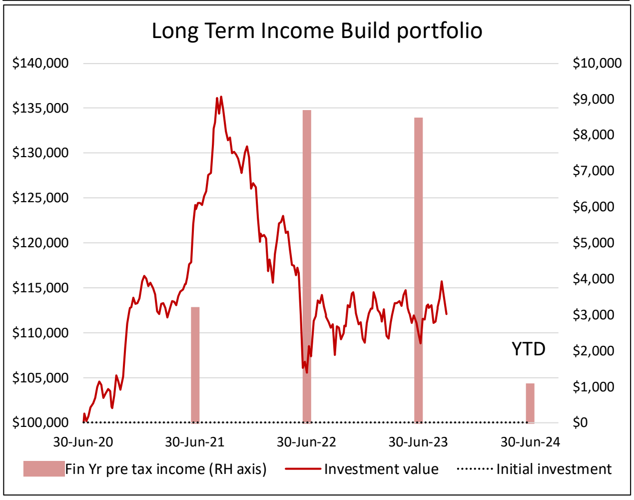
ARA INVESTMENT FUND RETURNS to 30 September 2023						
	3 Months %	1 Year %	3 Years % p.a.	5 Years % p.a.	10 Years % p.a.	Since Inception % p.a.
Defensive	1.3	6.1	4.3	3.4	4.1	4.8 (April 2003)
Growth	0.9	12.2	8.7	6.1	7.0	6.7 (April 2003)
Equities	0.8	13.8	9.0	6.3	6.7	7.6 (August 2003)
Long Term Income Builder	2.9	12.3	9.4	n/a	n/a	9.9 (March 2020)

Illustration of income and capital returns received by an investor from an initial investment of $100,000 since 1/7/2010 (or 1/7/2020 for the Long Term Income Builder)









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Of interest

It seems it's all about interest rates of late, and what they're doing to the cost of living, housing affordability and the economy at large. And while it's not always the case, it's true that rising interest rates in the past have ushered in some of the more challenging times in investment markets. So it's worth spending a bit of time looking at interest rates and what they might mean for your ARA investment.

Some of the older folk in the room who vividly remember double-digit mortgage loan rates might scoff into their pinots noir and think "4%? What's the fuss? Back in my day…….!" But there is a convexity thing happening here. A 2% rise from 2% to 4% is proportionally a far greater interest cost jump than a rise from 11% to 13%.

Most investments don't like interest rate hikes. For businesses (and therefore shares) it raises the expenses column of the Profit & Loss statement, and for property investors it increases the cost of finance, which underpins so much property investment.

And not quite so obviously, interest rates represent the base line return you can expect on "safe" investment - the benchmark against which other opportunities that involve risk are measured, to assess whether the expected incremental return is worth the risk. If the base line moves up, the expected return on the alternative also has to go up, which usually means the buy-in price has to come down.

So stock markets and property investors don't like interest rate hikes. But what about interest-bearing investments themselves. Surely they'd be happy?

Well, maybe, maybe not. Let's think about the "ultra-safe" government bond. If that's not safe - Lord, help us. Let's say you own a 10-year government bond. It pays you 4% interest every year for 10 years, then the borrower – the Government – gives you your money back. Surely they're good for it.

But two years into the contract, rates go up, and when the Government wants to raise some more money because the cost of the North-East link has trebled, the new issue of bonds offers 5% interest. Someone who is in the market for a bond investment would be crazy not to take the new one rather than buy yours. To sell yours, you would have to discount it heavily. So its value falls.

But you're not selling, right? You'll hold it to maturity. But here's the rub. Billions of dollars worth of bonds are traded every day around the world. It's a bigger market than shares. So institutional holders of bonds, like super funds and managed investments, are obliged to "mark to market" – i.e. reflect in their books the value of the bond as if they were about to sell.

Is that bad? Well, right now it ain't good. The market for the global risk-free benchmark, namely US ten-year government bonds, is (or was) about $39 trillion - with a "t". That's 39 with twelve zeros after it. A trillion is a lot. If you stacked just one trillion dollar coins one on top of the other, the pile would reach to the moon and back for three-and-a-half round trips. (Yes, it's true. And yes, it was a slow day).

Bloomberg has calculated that about 46% of the value of bonds with maturities of 10 years or more has been wiped out by recent interest rate rises*1. Bank of America says almost a quarter of the value of **all** bonds on issue has been lost so far*1. That is a crash on par with the stock market plunge during the GFC or the Crash of 1987 (and who knew?).

So times have been tough for "traditional" fixed-interest/bond investors. That tends to include large institutional investment and super funds. Not picking on anyone here, but below is a chart of the Vanguard Global Aggregate Bond Index Fund in $A, as an illustration of the headwinds facing investors in "safe" government bonds.*2

*1 Melbourne Age October 9, 2023
*2 www.Vanguard.com.au

As with any "crash", this really only matters if you have to sell when things are down, and can't sit it out until the market recovers. But by definition, many retirees in pension phase are routinely drawing down on their capital as a matter of course, and having to draw out at such bad times is a sure-fire way to permanently destroy wealth.

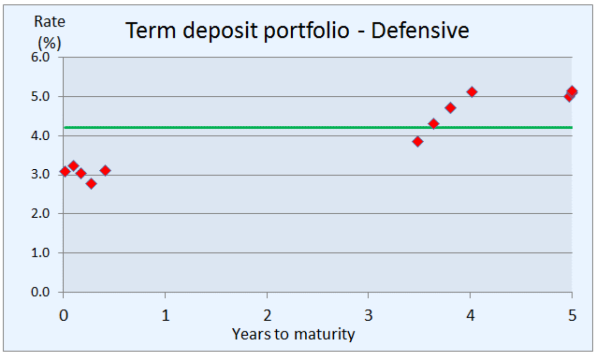
We've written extensively in our Retirement Hub on how we manage this risk, in both the investment strategy of our funds, and advice as to portfolio selection for individuals. See www.araconsultants.com.au/retirement-hub/ for more.

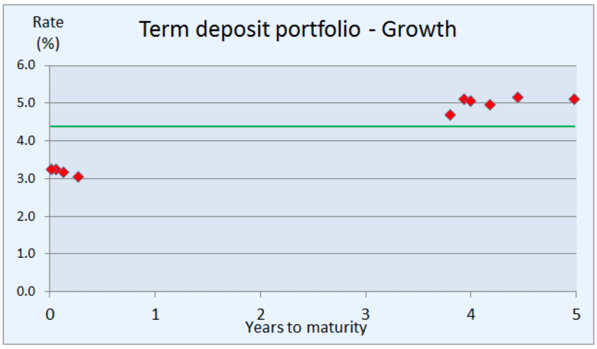
So how does all this gel with the ARA funds?

Firstly, we have had by industry standards very little exposure to the types of fixed-interest investments referred to in the discussion above. A glance at the list of assets in the "Who's got what?" table will show that the bulk of our interest-bearing investments are in bank term deposits and fixed-term annuities. There is no secondary market as such for these, they are not actively traded and so don't cop the "mark-to-market" revaluation phenomenon. We just bank the interest.

The rising rates in fact present us with an opportunity or two. The following charts show the maturity profile for the term deposits and annuities we currently hold – interest rate on the vertical axis, years until they mature on the horizontal.

The upshot is, in each of the Defensive and Growth portfolios, as deposits mature we are able to roll them over at materially higher rates, raising the average yield of the portfolio in the process. And fortuitously, there are several more deposits due to mature over the coming three to six months.





The other opportunity lies in the bond market we have discussed above. Sooner or later the rate rise cycle will peak, and maybe rates start to come down again. If that happens, the value phenomenon then works in investors' favour – the value of an existing bond portfolio goes up. So not only do you pick up the interest payments on an extremely secure investment, but you might also pick up some capital gain as well. This is an appealing risk/reward opportunity if and when it happens, and we have cash with which to take advantage.

Welcome

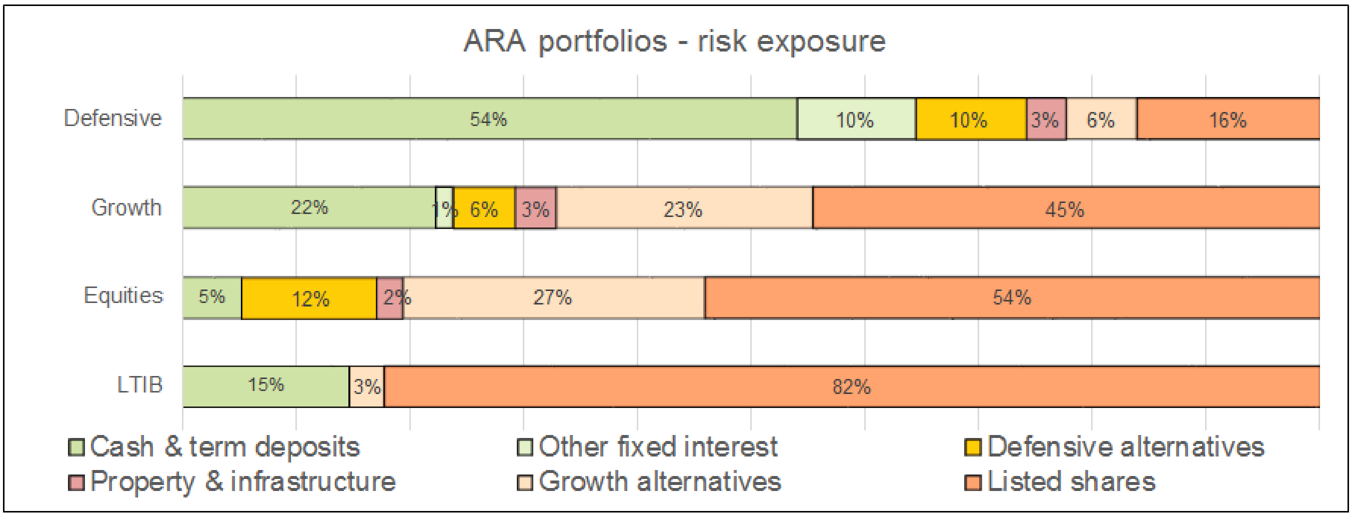
There is a new addition to our service team, one with a familiar surname. Harry Rimmer joined us this month, and in an interesting twist of fate, when Elly returns from maternity leave his big sister will be his boss.

Just like the old days at home, Haz! Welcome to ARA.

So, who's got what?

The table below shows the ARAIF's investments at the time of writing. Please note, the percentages refer to the proportion of each portfolio allocated to that investment, not its rate of return.

	Asset Type	Defensive Portfolio	Growth Portfolio	Equities Portfolio	L/T Income Builder
National Australia Bank Cash account	Cash & Tier 1 Fixed Interest	8.5%	2.0%	5.6%	14.8%
Bank Term Deposits		15.8%	9.0%	0.0%	
Challenger Life Guaranteed Annuities		29.6%	11.5%	0.0%	
Coolabah Active Credit Fund	Other Fixed Interest	10.4%	1.4%	0.0%	
River Capital Growth Fund	Listed Securities	2.0%	5.3%	3.7%	
Sterling Equity		6.5%	8.0%	9.8%	
Anacacia Wattle Fund		6.0%	11.0%	9.6%	
Dimensional Sustainability Aust		0.0%	2.9%	10.4%	
Vanguard World Ex-US ETF		0.9%	7.6%	7.3%	
Anacacia Global Fund		0.6%	1.7%	3.1%	
Dimensional Sustainability Gbl Unhedged		0.0%	4.1%	5.2%	
Dimensional Sustainability Gbl Hedged		0.0%	3.9%	4.9%	
Listed Investment Companies		0.0%	0.0%	0.0%	73.9%
MVB Aust Banks ETF		0.0%	0.0%	0.0%	8.3%
Anacacia Capital	Alternative assets (Growth)	1.6%	14.2%	15.2%	
Polaris Marine		1.6%	2.3%	1.2%	
Morrison Utilities Trust		3.5%	3.5%	2.2%	
Proserpine Resources Trust		0.3%	0.6%	0.2%	
Performance Equity Mgrs Fund 4		2.2%	3.9%	5.8%	
Luxury Escapes		0.7%	1.6%	2.0%	3.0%
Cheesecake Shop		0.0%	0.0%	2.1%	
Infradebt	Alternative assets (Defensive)	0.0%	1.5%	4.6%	
Fortlake Higher Income Fund		3.4%	1.4%	0.0%	
Quota Trust		3.8%	1.0%	0.9%	
BBUS US Bear ETF		1.1%	1.6%	2.2%	
ETF Physical Gold		1.5%	0.0%	4.0%	
		100.0%	**100.0%**	**100.0%**	**100.0%**



Major Holdings – diversified portfolios

Apart from bank deposits and other interest-bearing accounts, Defensive, Growth and Equities portfolios invest in a range of assets through the fund managers listed in the table above. If we drill through to the assets selected and overseen by those managers, there are in fact over a hundred individual securities providing diversification of risk and exposure to a wide range of opportunities.

The table below shows the 20 largest individual holdings and what proportion of each portfolio they represent. These are the investments that will have the biggest impact on the portfolios' returns.

Investment	Type	Principal Activity	Defensive Portfolio Exposure	Growth Portfolio Exposure	Equities Portfolio Exposure
Direct Couriers	Private company	Transport & logistics	0.0%	5.1%	5.8%
RP Infrastructure	Private company	Project Management	0.0%	2.3%	2.6%
Polaris Marine	Private company	Marine services	1.6%	2.3%	1.2%
Sureway	Private company	Employment services	0.0%	1.9%	2.1%
Big River Industries	ASX listed company	Building supplies	1.1%	1.8%	1.4%
Luxury Escapes	Private company	Travel agency	0.7%	1.6%	2.0%
Infradebt	Private trust	Infrastructure lending	0.0%	1.5%	4.6%
Westpac	ASX listed company	Financial services	1.0%	1.4%	1.9%
Schaffer	ASX listed company	Diversified industrial	1.0%	1.3%	1.6%
Opteon	Private company	Property services	0.0%	1.2%	1.5%
Smartpay	ASX listed company	Financial services	0.7%	1.2%	1.1%
Perth Airport	Infrastructure	Transport hub	1.1%	1.1%	0.7%
Gentrack	ASX listed company	Software services	0.6%	1.1%	1.0%
Quota Trust	Private trust	Statutory fishing rights	3.9%	1.0%	0.9%
Data#3 Ltd	ASX listed company	Communications technology	0.5%	1.0%	0.9%
3PLearninhg	ASX listed company	Online education	0.8%	1.0%	1.2%
Force Fire	Private company	Fire safety services	0.5%	0.8%	0.6%
Duncan Technologies	Private company	Parking technology	0.0%	0.8%	0.9%
Transgrid	Infrastructure	Electricity transmission	0.7%	0.7%	0.4%
REA Group Ltd	ASX listed company	Online property advertising	0.5%	0.6%	0.8%

Returns quoted in this report are after all costs, and before the application of management fee rebates. Return figures are pre-tax, and include the value of franking credits from franked dividends. Total return figures assume the re-investment of gross distributions including franking credits. 3-month return figures are for the period to 30 September 2023 and are not annualized.

ARA Consultants Limited provides this update for the information of its clients and associates. If you do not wish to receive this or other information about ARA in future, please contact us on (03) 9853 1688, or enter your name below and return this to PO Box 2273 Kew Vic 3101.

Name (Please print) ____