AUSTRALIAN MASTERS
CORPORATE BOND
FUND SERIES

AMCBF Series Quarterly Update

1 January – 31 March 2015

Summary

AUSTRALIAN MASTERS CORPORATE BOND FUND NO. 5 (AMCBF5 OR FUND) HIGHLIGHTS

- The following dividends have been announced:
  - AMCBF5 announced an unfranked dividend of $0.35 per share to be paid on 12 May 2015.
- The following capital return has been announced:
  - AMCBF5 announced a capital return of $26.47 per share to be paid on 12 May 2015.
- All existing fixed income investments held in AMCBF5 performed as expected.

MARKET HIGHLIGHTS

- **Global markets:** The Minutes from the latest Federal Open Market Committee meeting show that the US Federal Reserve (Fed) is split several ways on when to raise interest rates. Some members advocated for a move as early as June while others wanted to wait until 2016. The European Central Bank's (ECB) Quantitative Easing (QE) program is now in full swing which has led many European central banks, outside of the Eurozone, to cut their respective cash rates to below zero.
- **Australian rates:** In February, The Reserve Bank of Australia (RBA) reduced rates to 2.25%, with the market already predicting a further rate cut in May 2015. The RBA continues to be concerned about growth prospects for the Australian economy.
- **Domestic credit:** Primary issuance continues to be strong, with both domestic and offshore issuers coming to market at record-low rates. While the situation in Greece has caused some global volatility in the credit markets, the low-interest rate environment and investors chasing yield has meant spreads on corporate bonds have continued to tighten.

AMCBF5 Activity

AMCBF5 announced the following quarterly dividend and capital return:

FUND	DIVIDEND	FRANKED	GROSSED UP	CAPTIAL RETURN	EXPECTED PAYMENT DATE
AMCBF5	$0.35	$0.00	$0.35	$26.47	12 May 2015

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All existing fixed income securities held within the portfolio of AMCBF5 performed as expected. The manager is proactively managing the cash balances of the funds and will consider returning capital to shareholders when it is practical to do so.

As this Fund is coming to its maturity with its final investment expect to mature in December 2015, distributions will be less frequent and reflect the lower amount still held in the portfolio. $52.85 per share has been returned to investors (not including the capital return announced for payment on 12 May 2015).

Global Markets Update

The Fed is showing divergence amongst its members as to when it is appropriate to lift rates. In the most recent Federal Open Market Committee (FOMC) meeting, the Fed dropped its pledge to be ‘patient’, stating they would raise rates when they are ‘reasonably confident’ inflation will move back to its target. Despite this, the Fed’s economic, inflation and interest rate projections were all downgraded; interest rate projections dropped 0.50%. The FOMC minutes and the official comments from the Fed both suggest that the first rate hike could come as early as June, but possibly later, and the tightening will be at a gradual pace as the US economy continues to recover.

According to the minutes, ‘Several participants judged that the economic data and outlook were likely to warrant beginning normalisation at the June meeting. However, others anticipated that the effects of energy price declines and the dollar’s appreciation would continue to weigh on inflation in the near term, suggesting that conditions likely would not be appropriate to begin raising rates until later in the year, and a couple of participants suggested that the economic outlook likely would not call for liftoff until 2016.’

In the Eurozone, the ECB is starting to act more aggressively, having delivered its long-awaited QE program in January. The ECB plans to inject at least €1.14 trillion into the euro area’s bond markets and charge banks less under its funding for lending scheme. The ECB hopes these measures will stabilise the Eurozone, spurring growth and reducing the risk of deflation. Commentators suggest that the open-ended structure of the QE program demonstrates the ECB’s commitment to achieve its inflation and growth targets.

However, with QE leading to further weakening of the Euro currency and strengthening of non-Eurozone currencies, the non-Eurozone economies are set to face increased deflationary pressures. This has led a number of central banks to lower their interest rates to below zero, effectively taxing the money that banks hold instead of lending it out into the real economy. Sweden’s Riksbank cut the repo rate to -0.25% and announced its own QE program in March. The Danish central bank lowered its main deposit rate four times this year to -0.75% and heavily intervened in the foreign currency market to defend the krone’s peg to the euro. The Swiss National Bank also cut its deposit rate to -0.75%, after removing the exchange rate cap on the franc at CHF1.20/EUR. Furthermore, by the end of March over a quarter of all debt issued by Eurozone Governments had negative yields. This means that investors who bought these government bonds with negative yields, and held them to maturity, would not get all their money back. For example, a two year Swiss Government bond is currently yielding -1.04%. If an investor purchased $10,000 of these bonds, they would only receive roughly $9,973 back in two years, effectively loosing $207.

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While banks are reluctant to pass on negative rates for fear of losing retail customers, UBS have noted that its earnings are shrinking in light of negative interest rates, and Julius Baer a private Swiss bank has begun to charge large depositors for holding their cash. If banks make customers pay to hold their money, retail clients may choose to hold cash instead. However, when banks absorb the costs of negative rates themselves, it squeezes the profit margin between their lending and deposit rates, and may even make them less willing to lend out to the real economy.

The decline in global bond yields is being closely watched by bond investors and the major central banks, which had previously assumed that the effective lower bound of interest rates was close to zero. Those that thought long bond yields would not go negative have had a rude awakening. During the financial crash, central banks held rates just above zero. The Fed stopped cutting at 0-0.25% and Bank of England at 0.5%. Both were quoted at the time saying rates could fall no further.

The political and economic situation in Greece remains uncertain after the anti-austerity party, Syriza, won the election in January. The new Prime Minister Alexis Tsipras attempted to renegotiate the terms of Greece's debt with the major euro-area creditors. However, due to liquidity concerns in the banking system and domestic outflows from deposits, Greece had to back down from their initial hostile stand. In February, Greece negotiated a four-month extension to the existing bailout agreement, giving them a brief reprieve until June 2015.

Liquidity concerns for Greece heighten as they face large debt obligations maturing in May and June this year, when their existing bailout agreement ends. At this time they will rely solely on the release of new bailout cash. It has been reported that the Greek Government is rapidly running out of funds to pay public sector salaries and state pensions. One government official noted, 'We have come to the end of the road… If the Europeans won't release bailout cash, there is no alternative [to a default]'.

Negotiations are underway between Greece, the European Commission, ECB and the International Monetary Fund (IMF) on a 'cash for reform' basis covering budget targets, fiscal measures and privatisations. Until a clear resolution is reached, increased volatility in Europe and the credit markets will continue.

Australian Financial Market Update

In Australia, house prices, the Australian Dollar (AUD), domestic growth, weakening business confidence, and unemployment; remain the key areas of focus for the RBA. Non-mining growth in Australia has been slow to pick up and is nowhere near offsetting the expected slowdown in mining investment. Furthermore, household consumption remains sluggish due to low consumer confidence. The subdued recovery is expected to keep the RBA in easing mode in 2015, with many market commentators predicting further rate cuts in the near future.

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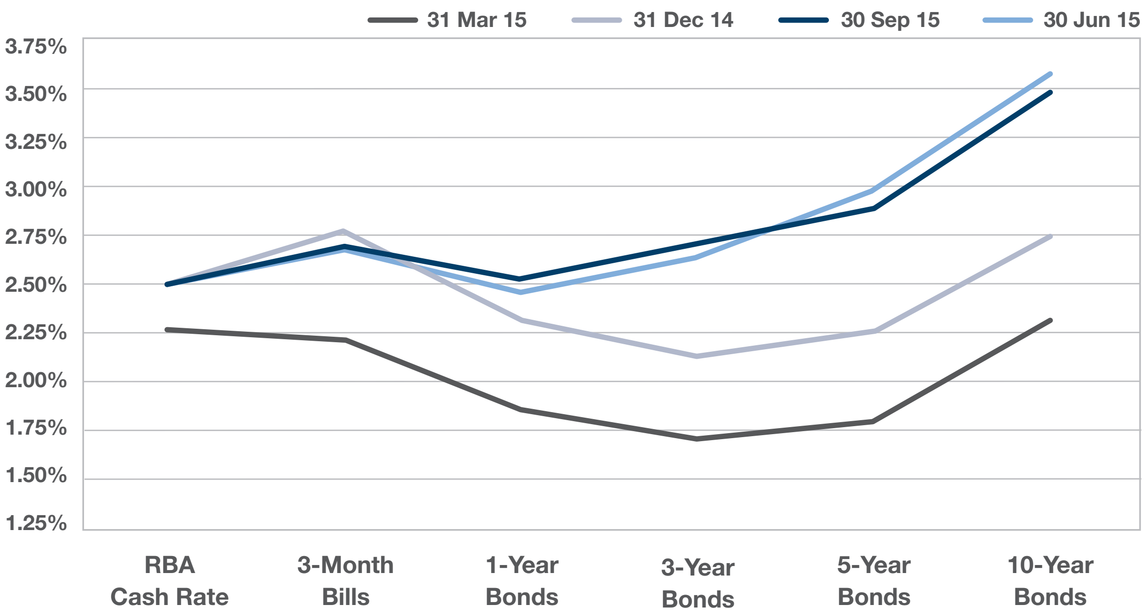
Domestic Rates

Driven by disinflationary pressures, unemployment concerns and a lack of economic growth, the RBA joined a growing number of world banks when it cut the cash rate in February this year to 2.25%. The February minutes of the RBA monetary policy meeting showed a bias towards further rates cuts that 'might emerge'. Historically, the RBA has tended to move in cycles, rather than cutting in isolation, and a number of market measures have now priced in a further 0.25% rate cut expected for May.

The buoyant property market is regarded as the RBA's main consideration against further rate cuts. Although the risk has eased, with the Australian Prudential Regulation Authority (APRA) introducing measures to constrain investor participation in the property market. In February's monetary policy statement, the RBA acknowledged that it is continuing to work with APRA to manage this risk and dispel fears of a bubble in domestic house prices.

The RBA has noted that the AUD has fallen substantially against the U.S. dollar in the past three months, but less so against a broader basket of currencies with central banks globally predominantly being in easing mode. Weakening commodity prices, expectations of rate hikes in the United States, and less mining investment will continue to exert downward pressure on the AUD in 2015 and support the transition to non-mining activity. The transition away from mining investment to the manufacturing and export sectors is forecast to take longer than initially expected and may require further monetary easing, and a lower AUD.

AUSTRALIAN GOVERNMENT YIELD CURVE



Source: Bloomberg

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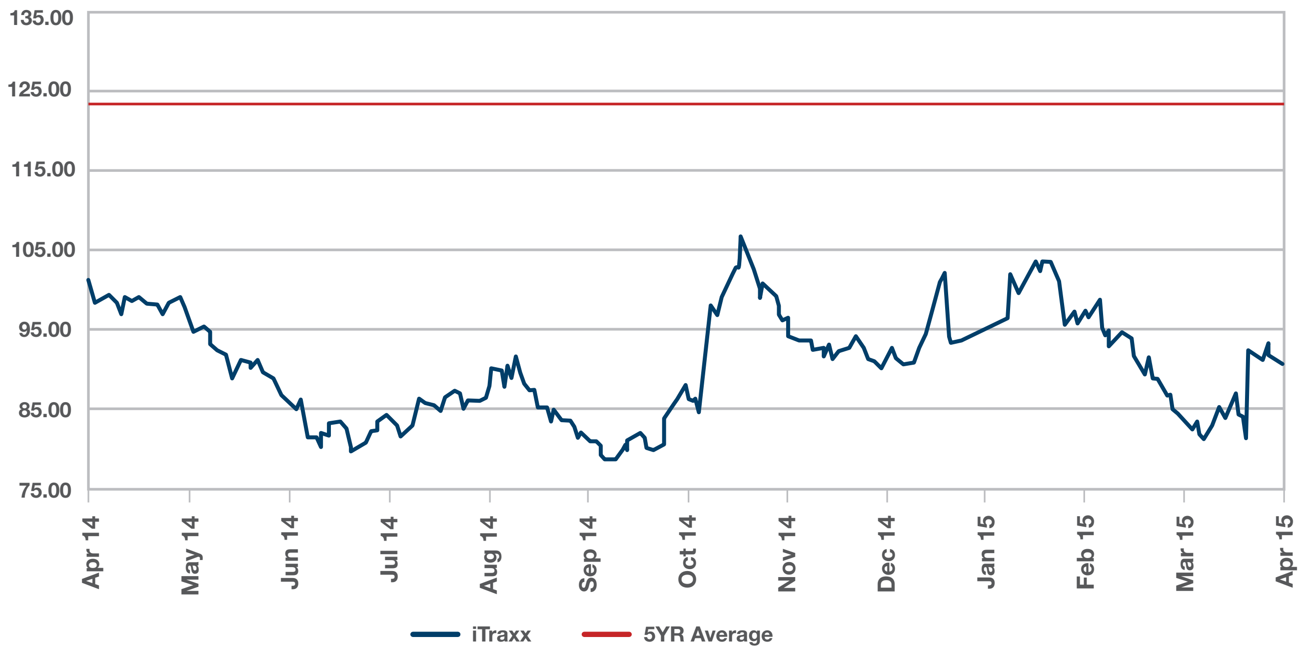
Domestic Credit

Australian credit spreads finished the quarter at a lower level relative, to their position in December. Headline risk from Greece, and its potential exit from the European Union, created some volatility in the market, but accommodative monetary policy continued to dampen volatility.

ITRAXX AUSTRALIAN CREDIT SPREADS



Source: Bloomberg

Australian bonds continued to be bought well in the March quarter, aided by record-low interest rates. But as prices continue to increase, bond yields fell to a record lows, with the market anticipating a further rate cut amid weakening economic data and softening commodity prices.

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AUSTRALIAN BBB 5YR CORPORATE BOND YIELDS

Source: Bloomberg

During the March quarter, the domestic debt issuance totaled $17.9 billion, largely dominated by financial institutions. Foreign financials issued $7.47 billion or 42% of total issuance, closely followed by domestic majors with $7.4 billion or 41% of the total issuance. Corporate issuances were subdued during the period, totaling $2.6 billion across six issues.

BHP Billiton raised $1 billion in March, taking advantage of the all-time low interest rates, paying an annual coupon of 3.0% on a five-year senior note.

HYBRID MARKET UPDATE

The first quarter of 2015 saw National Australia Bank (NAB) and, Australia and New Zealand Bank (ANZ) issue ASX listed Tier 1 capital in an effort to maintain their capital requirements in line with the APRA regulations. These new hybrids were issued at higher yields compared to prior issuances in 2014; with the market having re-priced the risk on these Tier 1 securities.

Due to strong investor demand, NAB raised $1.34 billion in Tier 1 capital after originally planning to raise $750 million. ANZ issued $970 million Capital Notes 3 after initially planning to raise $850 million.

Crown Resort's issued the first corporate hybrid in Australia for 2015, initially announcing an intention to issue $400 million, but latter increasing it to $600 million due to heightened global demand. The tenor on the Crown hybrid was set at 60 years with a call at 5 years. The Crown hybrid, however, does not have the regulatory oversight of APRA like the banks, and as such corporate hybrids are seen by the market to carry increased risk.

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	DECEMBER QUARTER DIVIDENDS & CAPITAL RETURNS			
FUND	CASH	FULLY FRANKED	CAPITAL RETURNS**	FUND MATURITY*
AMCBF#5	$0.35	$0.35	$26.47	31-Dec-15

* Anticipated end date
** Captital Return up to this amount

AMCBF#5

ISSUER	MATURITY	FACE VALUE	CONSIDERATION	GICS INDUSTRY	COUPONS RECEIVED JANURARY	FEBRUARY	MARCH
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	-	-	-
Brisbane Airport*	11-Dec-13	$5,000,000	$4,629,810	Transportation	-	-	-
Goldman Sachs*	24-Jun-14	$2,500,000	$2,310,918	Diversified Financials	-	-	-
Dexus Finance*	28-Jul-14	$2,500,000	$2,701,975	Real Estate	-	-	-
Leightons*	28-Jul-14	$6,900,000	$7,229,182	Capital Goods	-	-	-
AMP Limited*	5-Oct-14	$3,500,000	$3,508,330	Insurance	-	-	-
Sydney Airport Finance*	20-Nov-14	$3,030,000	$2,696,706	Transportation	-	-	-
CFS Retail Property*	22-Dec-14	$2,400,000	$2,282,473	Real Estate	-	-	-
Stockland*	18-Feb-15	$18,190,000	$18,362,081	Real Estate	-	773,075	-
Mirvac*	15-Mar-15	$2,300,000	$2,349,798	Commercial & Professional Services	-	-	94,875
Santos Finance	23-Sep-15	$6,000,000	$5,511,440	Energy	-	-	187,500
Envestra	14-Oct-15	$2,500,000	$2,062,750	Utilities	-	-	-
Melbourne Airport (Fixed)	14-Dec-15	$1,000,000	$863,320	Transportation	-	-	-
Melbourne Airport (FRN)	14-Dec-15	$3,510,000	$3,056,324	Transportation	-	-	26,253
		$75,230,000	$73,573,888		-	773,075	308,628

* Investment has been redeemed or has matured
** Figures may not reconcile due to rounding

MANAGER

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