



BOND MARKETS
**Global threat or local
opportunity?**

GLOBAL STRENGTH, LOCAL EXPERTISE

BGC Fixed Income Solutions is a dynamic fixed income business staffed by industry experts and backed by the global strength of BGC Partners.

- The global strength of BGC has attracted some of the most experienced fixed interest executives in the market
- Pure fixed income focus – bonds and hybrids
- Wholesale investors only

BGC Partners (parent):

- NASDAQ listed financial services company – Market cap >US\$6 billion
- Also in commercial real estate, acquiring Newmark Knight Frank in 2011
- World's largest inter-dealer broker, regulated in 22 countries, 8500 staff
- Formerly known as Cantor Fitzgerald, which was formed in 1945.
- BGC stands for Bernard Gerald Cantor.

ANNUAL CHARITY DAY

BGC has a strong affiliation with charities and not-for-profit organisations.

Cantor Fitzgerald tragically lost 658 staff in the September 11 terrorist attack on the World Trade Centre. BGC Charity Day was subsequently founded in 2005 to raise money for the Cantor Fitzgerald Relief Fund and other not-for-profits as a way to honor the victims of the September 11 attacks.

Each year on or near September 11, BGC Charity Day brings in celebrities, athletes and politicians to man the phones and speak with clients, with 100% of global revenues from the day donated to the Relief Fund and many other charities.

Since its inception, Charity Day has raised approximately US\$150 million.

For further information or enquiries see:

www.bgcpartners.com/charity-day/





BOND BASICS

WHAT IS A BOND?

- A security that pays a defined distribution (interest) for a given period of time (term) and repays the principal value of the security at maturity. In short, a bond is a loan from an investor to a government or company

MARKET DEPTH

- The global bond market is 4-5 times the size of the global share market
- The Australian bond market is approximately AUD \$1.5 trillion in size

TYPES OF BONDS AND STRUCTURES AVAILABLE

- Fixed, Floating or Inflation-linked options
- Senior secured, unsecured, subordinated and hybrids

WHO ARE THE ISSUERS AND INVESTORS?

Issuers: Governments, Banks, ASX 200 corporates, Supranationals (e.g. World Bank), Public Private Partnerships (PPP) and unrated smaller institutions

Investors: sovereign funds, industry super funds, family offices, middle market investors (councils, credit unions, NFPs and aged care providers) and individuals (SMSFs)

BONDS VS SHARES

Bonds:

- IOU
- Guaranteed coupon
- Defined maturity date
- Rank higher in liquidation

Shares:

- Ownership in company
- Dividends at issuer's discretion
- Must be sold to realise cash
- First loss position

Lowest
Risk

SENIOR SECURED BONDS (Covered bonds)

TERM DEPOSITS

CORPORATE BONDS

SUBORDINATED DEBT

HYBRIDS – Bond like / Equity Like

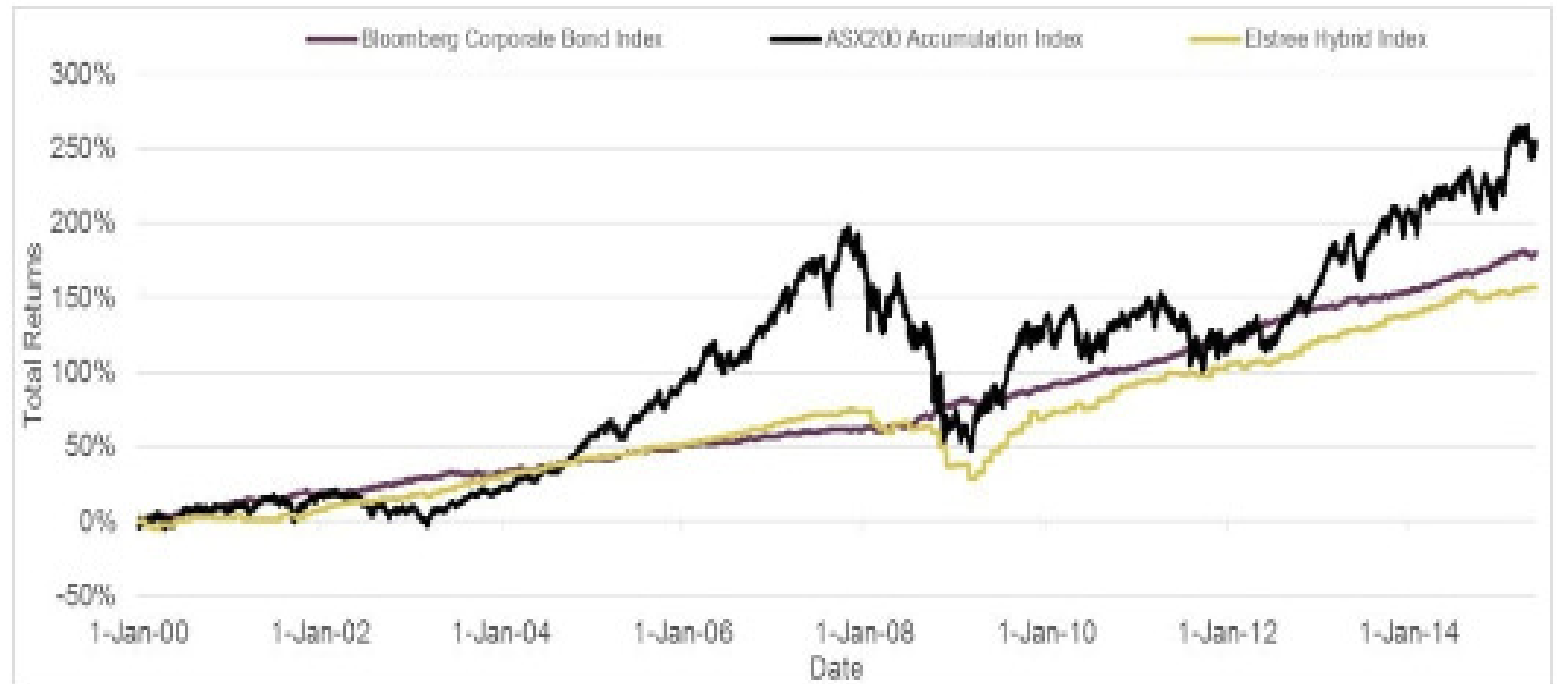
Highest
Risk

EQUITY

Priority of Payment in Liquidation

BONDS VS SHARES & HYBRIDS – VOLATILITY

Volatility of bonds, shares and hybrids



LIQUIDITY

- Generally speaking bonds are highly liquid
- Can vary in line with credit quality and deal size

MARKET PERFORMANCE

- The Australian bond market has outperformed cash and global shares over the last 10yrs, averaging just over 6%
- Global bonds have outperformed cash and global shares by nearly 2% over the same period

RISKS

- Credit risk
- Liquidity risk (inability to liquidate, stick to predominately HQLA)
- Duration / interest rate risk – offset by allocating to FRNs
- Default scenario

BENEFITS

- Bonds are inherently less risk than shares
- Capital guarantee from issuer
- Traded in a deeply liquid market
- Provides income certainty and cash flow planning
- Effective asset/liability matching tool for middle market investors
- Low volatility compared to shares

KEY BOND TERMS

- Yield
- Coupon
- Maturity
- Capital Price
- Running Yield
- Credit Rating
- Capital Structure
- Fixed Coupon, Floating Rate Notes (FRNs) or Inflation Linked

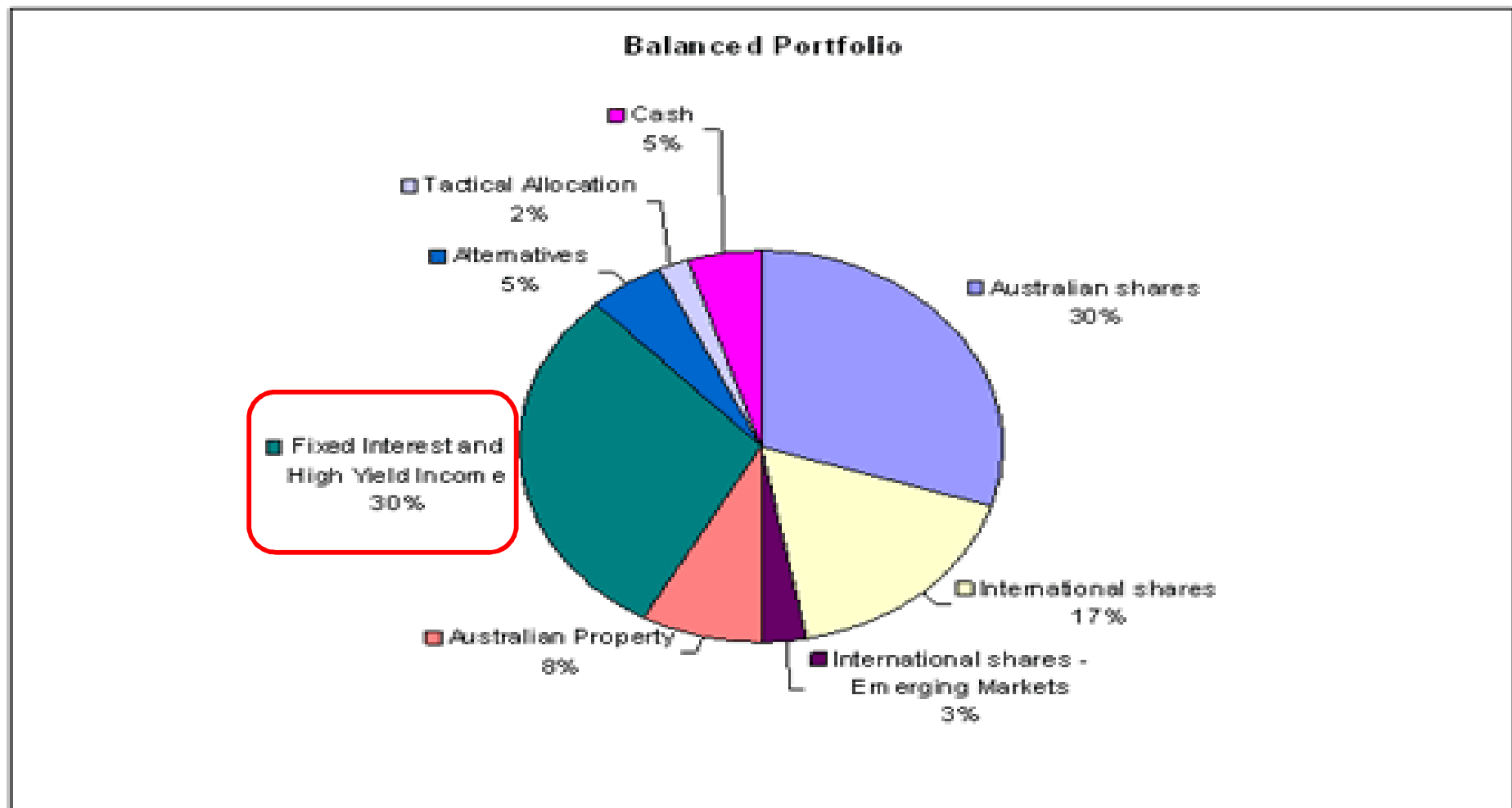
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AUSTRALIAN SMSF LANDSCAPE

A broad market....with familiar names



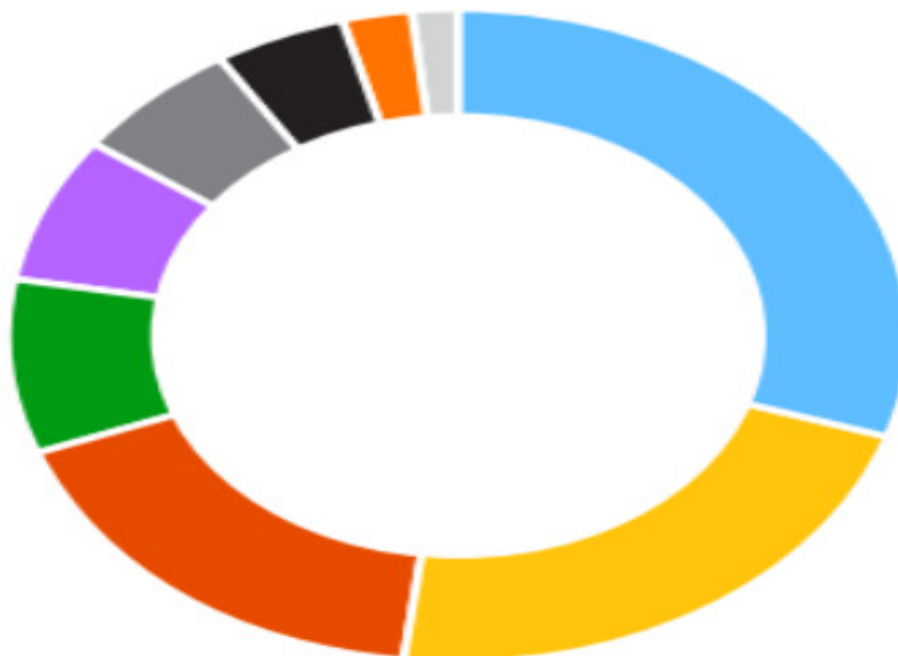
The ASX outlines five different SMSF asset strategies, ranging from 'high growth' through to 'conservative'. This one is the middle of the road, and suggests a 30% allocation to 'fixed interest and high yield income' (*high growth suggests zero allocation and conservative suggests 50%*)



Average Australian SMSF asset allocation at 30/6/17 (source – Cuffelinks)

- Fixed income does not even get its own category!
- Must be included in the 'all other assets', which comprises just 7.2% in total

SMSF Asset Allocation
30 June 2017



Listed shares:	29.0%
Cash and term deposits:	22.2%
Unlisted trusts:	17.7%
Non-residential real property:	8.6%
All other assets:	7.2%
Residential real property:	6.3%
Listed trusts:	4.7%
Limited recourse borrowing arrangements:	2.8%
Other managed investments:	1.4%

OECD PENSION FUNDS (source: Financial Services Council of Australia)

- Consolidated in to 3 main asset classes, rounded to nearest 5%
- Australia has lowest fixed interest allocation @ 25%
- Average allocation is 52.91%

Table 4: A summary of pension fund asset allocation around the world

Country	Equities	Fixed interest	Property and other
Australia	50%	25%	25%
Canada	35%	40%	25%
Chile	40%	45%	15%
China	20%	80%	-
Denmark	20%	65%	15%
Hong Kong	65%	35%	-
Japan	30%	50%	20%
Korea (South)	5%	95%	-
Netherlands	20%	70%	10%
Switzerland	35%	45%	20%
UK	40%	45%	15%
USA	45%	40%	15%

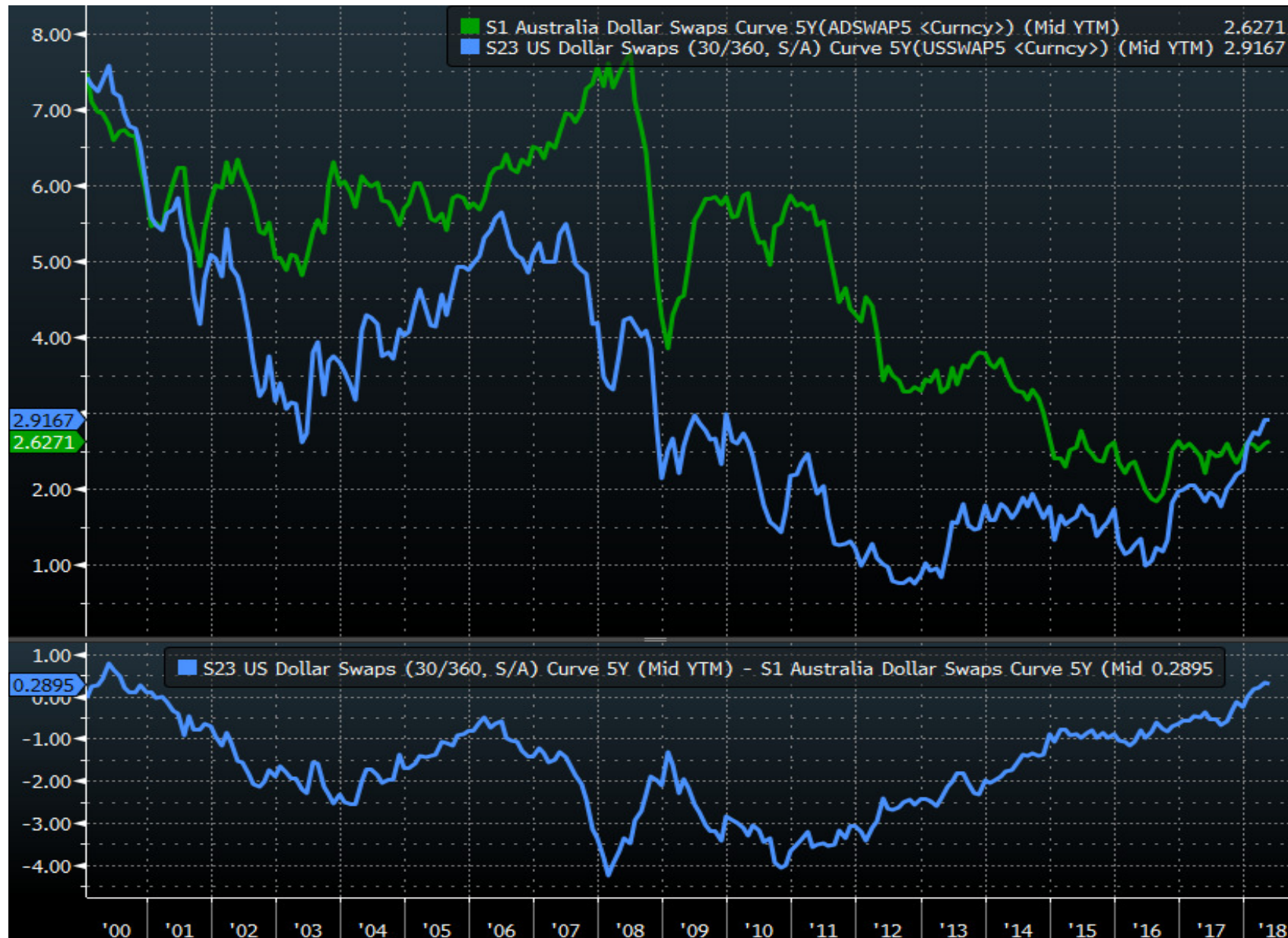
The background of the slide is a dark, out-of-focus image of city lights at night, creating a bokeh effect with various colored circles (blue, yellow, red, green) and light streaks. A semi-transparent dark rectangle with a fine grid pattern is centered on the slide, containing the title text.

GLOBAL CREDIT TRENDS

2 - CDX IG vs. CDX High Yield



AUD Yields (Green) Lower Than US (Blue) - First Time Since Late 2000



The background of the image is a dark, out-of-focus scene filled with colorful bokeh lights in shades of blue, yellow, orange, and red. A semi-transparent dark rectangle with a fine grid pattern is centered over the image, containing the text.

STRATEGIES AND TRADE IDEAS

New Issue Premiums

- **New issue premium**
 - NAB Subdebt (BBB) +240bps – see NABPE example
- **New name premium**
 - Verizon Senior (A-) +185bps – 10x size of Telstra & 2x size of CBA; 20bps wide of USD lines
 - Heartland Bank Subdebt (BBB-) +415bps
- **New structure premium**
 - Members Equity Bank AT1 Hybrid +525bps
 - MoneyMe +1,150bps
 - Barclays TLAC/Tier 3 +235bps

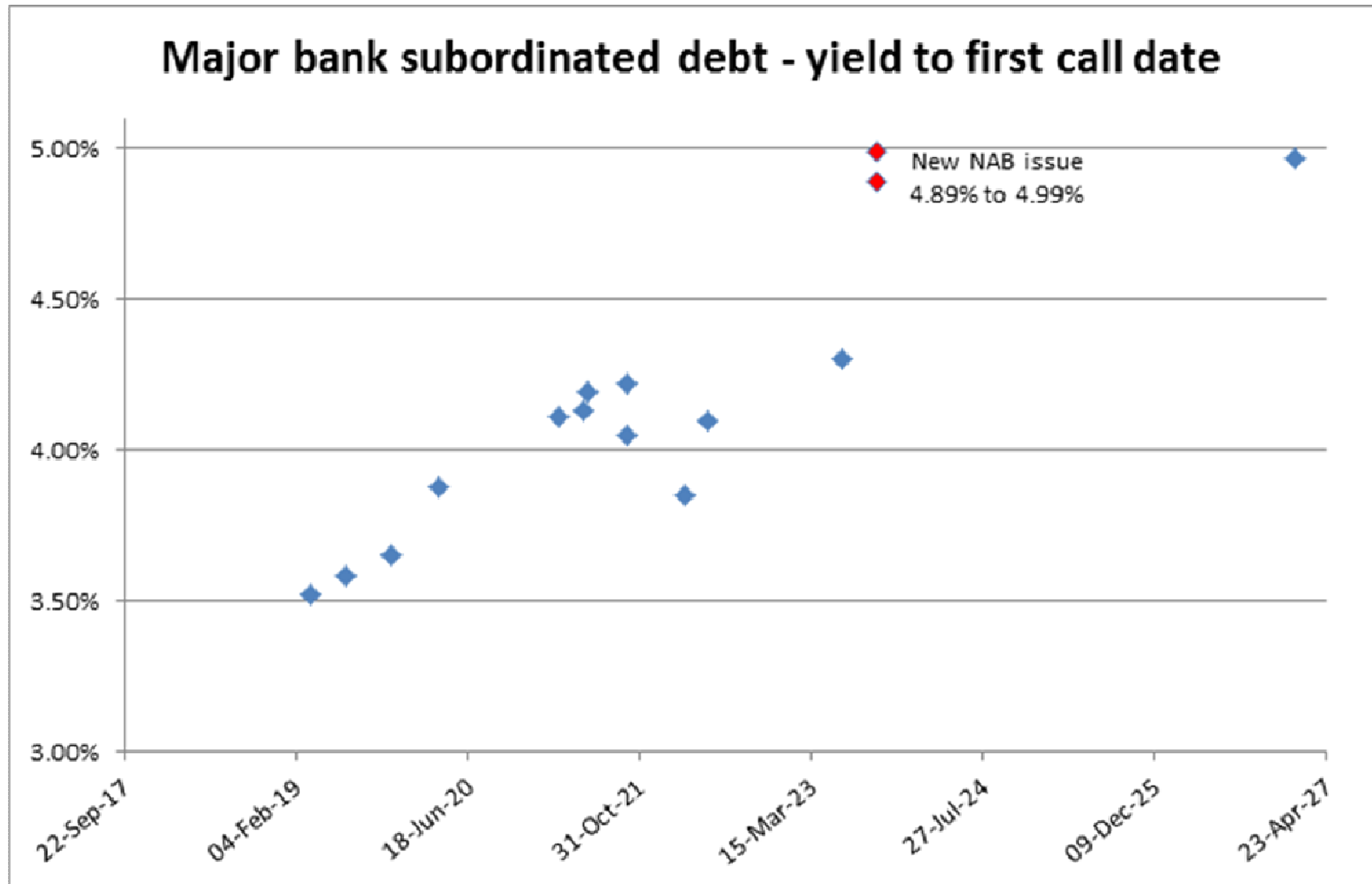
Multiple Originators and Vast Array of Choice

- Access to new issues from **multiple originators** due to size and standing of BGC
- Pick and choose the deals we like - listed and OTC
 - **Involved in 19 listed and 85+ OTC new issues in past 2 years** – majority investment grade; best of breed companies; large & liquid issues
- **Buy at par**
- **Multiple source of liquidity**

Recycling Capital and 'Rollover' Trades

- Recycle capital in and out of new issues – this strategy in 2017 produced >20% returns
- Strong technicals; demand>supply, especially for 'rollover' trades

New Issue Premium Example – NABPE 40bps x 6 Years = \$2.40



Regulatory Arbitrage

- Focus on 'old style' or 'legacy' / non-compliant / pre-Basel III capital securities
 - Weighting to capital falling rapidly until they no longer count from 1-Jan-2022
 - Expect regulators to push for clean up as they complicate order of priority
- **Examples:** NABHA, MBLHB, Major Bank Discount USD perps, Citigroup TruPS (US\$)
 - **10%+ returns expected from investment grade issues**

Changing Regulation

- Any change in regulation brings winners and losers...**and opportunities**
 - Regulation is constantly changing
 - Royal Commission has and will continue to force change

Property Opportunities

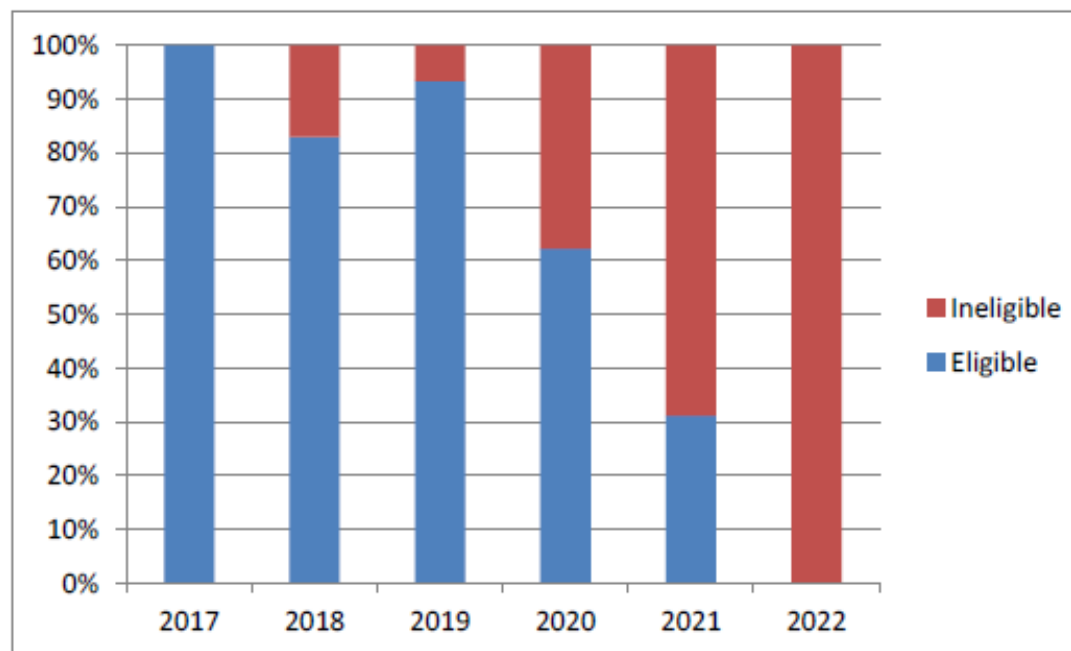
- Short term (1 – 2 yr) development or property funding – filling the gap left by the banks
- **Examples:** Wealth Pi, Capital Alliance, ASCF (launching in August)

Non-bank/Fintech Opportunities

- Quality and/or high margin loans being pushed out of traditional banking sector due to:
 - Increased regulatory, capital, reputational, internal compliance burden on banks
 - Slow approval times
 - Lack of digital channels/engagement with 'Millennials' (I want it now)
 - However, banks happy to fund them/fund pools of receivables = lower funding costs (**'virtuous cycle'**)
- Expect a lot of opportunities – SME loans; Property Development; Non-Resident Mortgages
- **Examples:** AfterPay, MoneyMe, CML, AxsessToday, ASCF

Trade Idea #1 – NABHA (Regulatory Arbitrage)

- 'Old style' or 'legacy' pre-Basel III capital securities
- Highly rated: BBB/Baa1
- Running yield over 4% (elevated BBSW a boost)
- No franking (which also makes it expensive)
- Liquid - \$2bn issue and trades ~avg \$2m per day
- Very strong dividend stopper (incentive to call)
- No point of non-vitality clause/conversion
- Very expensive senior debt if not called
- Weighting to capital falling rapidly until they no longer count from 1-Jan-2022 and starts to bite in 2020 (see chart)
- Good precedent from recent NAB US\$ Libor +15bps Perps buy-backs
- No precedent for any Aussie major or regional bank to keep a capital security outstanding if it does not count towards capital ratios
- Expect call/rollover into a new Basel III compliant issue around 2021 (may do on-market buyback in 2019/2020)
- Trades ~\$82, so the earlier the call the better. Base case assumes early 2021 call. **YTC ~10-15% (our #1 trade idea)**



Trade Idea #2 – US\$ Citigroup TruPS (Regulatory Arbitrage)



- Truly unique bond – ‘legacy’ Trust Preferred Security (TruPS) which has been granted Tier 1 capital treatment for life
- High yielding USD floater – 3 month US Libor + 6.37% (last quarterly reset 8.72%) so very high running yield
- ‘Grandfathered’ as was originally owned by The Fed
- One of the few remaining TruPS – tax deductible whereas replacement issues are not
- Rated BB+/Ba1/BBB- and issued by one of the world’s largest banks
- USD\$880m loss for Citigroup if called early due to the treatment when the Fed sold it back to Citi in 2010
- CFO stated in July 2017 “never say never”, but can’t see a scenario in which they call in near future
- However, the risk is that improbable early call as it trades at a premium to par and it can be called at any time
- Call assessment:
 - 5% before 2020
 - 40% in the early to mid 2020s (**yield of ~7.0%**)
 - 10% late 2020s to late 2030s (**yield of ~8.25%**)
 - 45% at maturity in 2040 (**yield of ~ 8.5%**)
- Income play, not one for price appreciation. Good switch from USD fixed into FRN

SUGGESTED PORTFOLIO - \$500K



Security	Issuer	Rating	Call / Maturity	Position	Yield	RY	Cap Price	Purch Gross Val (AUD)
Fixed Coupon Bond								
ATGL- 7.25% -27APR22	Afterpay Touch Group Limited	NR	27-Apr-20	50,000	6.01%	7.11%	102.000	\$51,941.00
CGRAU 7.95% 30MAY22	CML Group Ltd	NR	30-May-22	50,000	7.27%	7.78%	102.250	\$51,816.30
LBRFI 5.10% 09Apr21	Liberty Financial Pty Ltd	BBB-	09-Apr-21	50,000	4.71%	5.05%	100.959	\$51,267.00
CAIG 11% 11JUN21	Capital Alliance Holdings P/L	NR	12-Jul-21	50,000	10.60%	10.89%	101.000	\$50,839.51
CYBGLN 8% PERP	CYBG PLC	BB-	08-Dec-22	25,000	7.11%	7.75%	103.250	\$47,458.40
Totals: Fixed Coupon Bond					7.13%	7.71%		\$253,322.21
Floating Rate Note								
MONME-1MTHBBSY+11.5%-16NOV20	Moneyme Fin. Group P/L	NR	16-Nov-20	50,000	11.23%	12.91%	104.750	\$52,653.00
NXTAU BBSW+3.75% 09JUN22	NEXTDC Ltd	NR	09-Jun-22	50,000	5.81%	5.74%	101.000	\$50,674.50
NABHA BBSW+1.25% Perpetual	National Australia Bank Ltd	BBB	15-Nov-21	600	9.24%	3.76%	83.795	\$50,676.00
CITI TRUST PREF L+6.37% 30Oct40	Citigroup Inc	BBB-	30-Oct-40	1,300	8.27%	8.02%	27.500	\$48,972.60
Totals: Floating Rate Note					8.66%	7.65%		\$202,976.10
Capital Indexed Bond								
SYDAU CIB 3.12% 20Nov30	SYDAU Finance Co P/L	BBB+	20-Nov-30	35,000	5.20%	3.00%	137.422	\$48,301.36
Totals: Capital Indexed Bond					5.20%	3.00%		\$48,301.36
Portfolio Totals:					7.57%	7.24%		\$504,599.67

DIRECT INVESTMENT VERSUS MANAGED SERVICE



PORTFOLIO MANAGEMENT - DIRECT

- Direct bonds – individual selection of bonds by investor (\$50K mins)
- Provision of custody and reporting services by BGC
- Investor has full discretion over portfolio design and management
- No fees chargeable
- BGC revenue derived from bid-offer spread or new issue placement fee

PORTFOLIO MANAGEMENT - MANAGED

- Full management of portfolio facilitated by BGC portfolio manager
- Investment policy and portfolio governance captured in an Investment Management Agreement (IMA)
- Benchmark target yield agreed to, full reporting and custodial services
- Investor pays manager (BGC) an agreed management fee
- **Discounted management fee of just 0.50%pa for all AIA members**

NEXT STEPS

- BGC is pleased to offer AIA members a complimentary follow up consultation to review your existing investment policy and investment portfolio
- BGC to conduct additional educational support at both the individual member level and or local meeting group level
- AIA members will also receive free membership to our weekly fixed income newsletter

CONTACT DETAILS



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