Affirmative Investment Management

Affirmative Global Bond Fund

Monthly report 28 February 2019

Key facts

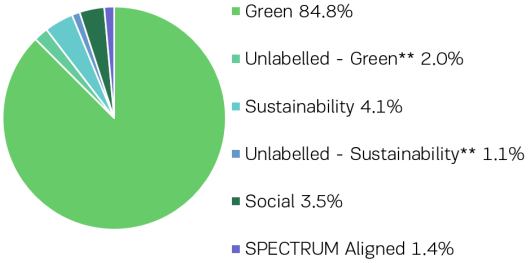
Fund inception date	6 April 2018
Liquidity	Daily
FUM	AUD 25.6m
Benchmark	Bloomberg Barclays Global Aggregate (hedged to AUD)

Characteristics

	Portfolio	Benchmark
Modified duration (years)*	5.08	6.99
Average maturity (years)	5.97	8.83
Yield to maturity (unhedged) (%)**	2.46	1.96
Yield to maturity (hedged) (%)†	2.89	2.53
Average coupon (%)	2.24	2.68
Average rating	AA-	AA-
Number of bonds	60	NA
Annualised tracking error (%)††	-	NA

* Modified duration is the weighted average duration of the portfolio, taking into account potential future interest rate changes.
**Yield to maturity is the estimated annual rate of return that would be received if the Fund's current securities were all held to their maturity and all coupons and principal were made as contracted. Excludes cash and FX.
†Hedged yield is an estimate calculated using: normal yield (bond market weightings x yield in each bond market) + hedged yield (interpolated yield of the forwards as of the hedged date x weight of currency hedged).
††Tracking error is ex-post and will not be populated until a year has passed since inception of the fund.

Impact bond allocation



*When held SPECTRUM Aligned bonds relate to issuers that deliver products or services in a range of sectors, where at least 50% of revenues are generated from sectors aligned with eligible sectors (green, social, and sustainable) and there is a clear commitment in the issuers' strategy or mission to achieving UN SDGs. All other bonds are in our core SPECTRUM universe, where SPECTRUM is a label for our proprietary in-house analysis which we use to verify impact bonds.
**These are bonds that we have independently verified as having a positive environmental or social impact, despite not being self-labelled as a green/social/sustainable bond by the issuer.

Top 5 issuers

Fund	Weight (%)
Kommunalbanken AS	8.78
European Investment Bank (EIB)	8.26
Nederlandse Waterschapsbank N.V.	7.54
Ontario, Government of	4.40
Westpac Banking Corporation	4.01

Investment objective

The Affirmative Global Bond Fund seeks to simultaneously create a positive and verifiable environmental and social impact, whilst targeting a total return in excess of the benchmark after fees over rolling three year periods, in support of the UN Sustainable Development Goals and the global COP 21 Climate Change Accord.

Performance

	1mth	3mth	6mth	1yr	2yrs	3yrs	5yrs	ITD
Fund (gross) (%)	0.40	2.65	2.65	-	-	-	-	2.87
Fund (net of fees) (%)	0.35	2.51	2.37	-	-	-	-	2.36
Benchmark (%)	0.07	2.48	2.32	-	-	-	-	2.85
Excess return* (%)	0.29	0.03	0.06	-	-	-	-	(0.48)

Past performance is not a reliable indicator of future results.
*Calculated using the net of fees return.

Performance comment

During the month the portfolio rose 0.35% versus a benchmark return of 0.07%. The main driver of return in February was security selection with currency positions and bond market weightings having only very small contributions. The portfolio benefited from a lower average credit rating than the benchmark in euro denominated bonds and strong performance of non-government bonds. The underweight position in the Yen proved positive but this was balanced by poor returns from the Australian dollar. Utility bonds notably performed well, particularly those of Spanish and Italian domiciled issuers. Since inception the portfolio has risen 2.36% (net) with the benchmark returning 2.85% with risk aversion in May and August and December's credit market volatility impacting.

Contributors

- Security selection in euro denominated bonds
- Underweight position in Japanese yen
- US yield curve positioning

Detractors

- Underweight position in Japanese bonds
- Poor performance of UK currency
- Overweight position in Australian dollar

Signatory of: PRI Principles for Responsible Investment

Certified Responsible Investment — Certified by RIAA

Environmental Finance Green Bond Awards 2018 Winner — Green bond fund of the year managed by AIM Affirmative Investment Management

US SIF Member 2018

Carbon Yield

cfi.co 2016 Best Green Bond Team Winner UK

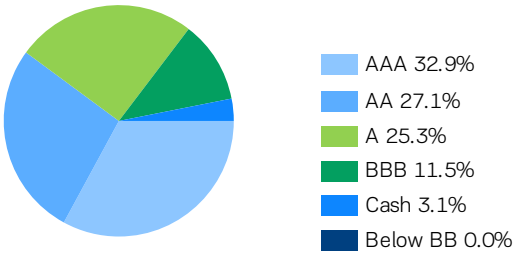
Market update

Government bond yields generally rose a little over the month. In contrast, yields of credit product fared better as improved sentiment led yield differentials to continue to narrow after January's strong performance. Credit spreads have now reversed the sharp sell-off experienced in the 4th Quarter of 2018. The theme of lower risk aversion both supported equity markets and credit spreads. Emerging market bond performance in local currency was driven more by individual country issues rather than macro trends. In terms of returns in local currency, emerging markets and high yield posted the best returns. In government markets, Japanese bonds posted the best local currency returns although the Yen fell 2.3% against the US$. Sterling was stronger and the A$ fell versus the US$.

The USA posted a Q4 GDP of 2.6% representing a slowdown from Q3, partly driven by weaker sentiment associated with President Trump's government shutdown. This still represents above trend growth. Europe and UK were weaker with the ECB President noting that risks had shifted to the downside. In the UK, sentiment is still suffering from Brexit concerns leading to weaker PMI's. Japanese growth rebounded from a very weak Q3 posting a Q4 GDP print of +1.9%.

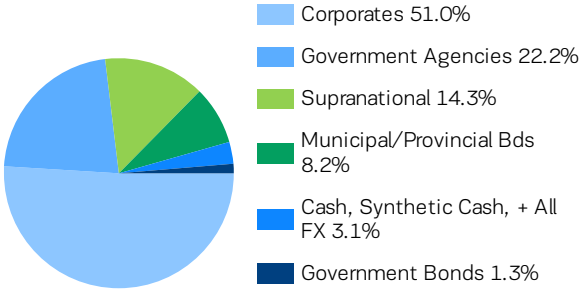
Robust green and social issuance volumes have continued, bolstered by a tap of the French government bond - the largest single green bond now over €16.5bn. Euro denominated issuance continues to be firm. Poland and Madrid returned to the market with sizeable issues and Digital Realty tapped its January debut euro issue. New issuers OP Corporate Bank of Finland and leasing and fleet management company, LeasePlan, also launched euro bonds. Bonds from the second telecom sector issuer Verizon, pulp and paper manufacturer Stora Enso and long dated US utility issuance indicate how the market continues to broaden and mature.

Credit rating allocation



Weights are absolute
Values may not sum exactly to 100% due to rounding

Sector allocation



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Values may not sum exactly to 100% due to rounding

Portfolio positioning

Overall the portfolio is underweight weighted duration relative to the benchmark by 1.91 years, predominantly due to the portfolios underweight position in Yen bonds (1.6 years).

In bond market terms, we are underweight US$ bonds by 0.4 years and overweight the Euro bloc by 0.3 years.

With regards to currency, we have an underweight in US$ of 7%, but this is paired with a range of overweight exposures to currencies which we would expect to do well in a period of recovering US and global growth, including Canada, Australia, Mexico, Malaysia and South Africa. In Asia, we are underweight Yen by 6%, reflecting weak nominal growth and unattractive yields. In Europe, we are overweight the Europe bloc by 5% mostly reflected in overweights in Norway and Sweden.

In terms of specific issuer positioning, the Community of Madrid again issued as it steadily expands its yield curve of impact bonds. With the maturity one year longer than its February 2018 issue, it allowed us to switch longer and increase yield at attractive terms - more than implied by the yield curve alone. Finnish OP Corporate Bank offered good value when it issued its debut euro denominated green bond with an ambitious framework, allowing us to switch from the similarly rated National Australia Bank at a flat yield, when European issues normally trade tighter. The new issue from MORHomes is helping meet investor demand for long maturity securities.

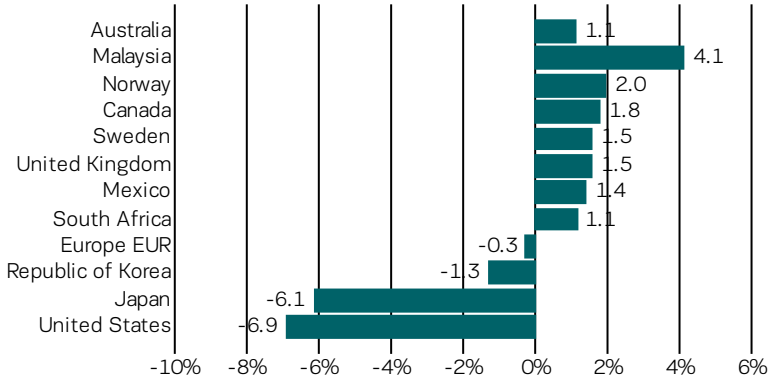
Outlook and strategy

Despite some improvements, global business surveys remain disappointing with more marked weakness in Europe. China's activity is also slowing, and the debt burden remains a concern for global markets. Global trade tensions continue to linger. Investors remain mindful the withdrawal of policies designed to boost asset prices and support economies after the 2008 crisis could be a painful process. The US central bank is trying to strike a balance between global headwinds and better domestic momentum. Its meeting minutes reflected a softer tone, with many committee members "not yet clear" on the path of monetary policy this year as inflation rates were not judged strong enough to justify higher rates. Other central banks remain trapped in a difficult position. They are anxious to normalise policy to provide scope to ease if conditions worsen but struggle to move away from emergency settings. With real yields still low, global expansion - however slow - implies risk to higher yields from current levels. Yield increases could be slow and uneven as central banks tighten then pause as investor confidence weakens at each attempt. The increase of European corporate bond yield spreads versus government rates in the last quarter of 2018 has now been largely reversed with spreads back to approximately where they were in October. They are likely to revert to the earlier pattern of slow widening, which should allow the positive carry of corporates to make headway again.

The outlook for impact bond issuance remains positive, with total issuance expected to be in the $200bn region again during 2019. We continue to expect more diversity of issuer by type and across rating categories.

Currency allocation

Active FX Exposure (MV%)



The benchmark is 100% hedged to AUD

Affirmative Global Bond Fund

Quarterly portfolio impact update Q4 2018

AIM Affirmative Investment Management

Impact reporting

At AIM, in accordance with issuers annual reporting cycles, we produce a comprehensive annual impact report detailing the environmental and social impacts of our portfolios based on data collected throughout the year via engagement with issuers. The following quarterly update is a forward-looking snapshot showing expected impacts of the portfolio.

Engagement

Over the fourth quarter, we had 30 engagements with issuers, ranging from roadshow meetings to individual information requests prompted by AIM.

An example of our engagement resulting in issuer improvement includes the SMFG green bond. Previously we had advised that SMFG could improve their green bond impact reporting by disclosing proceeds allocation by geography across technologies (e.g. a breakdown of wind investments geographically) and green bond investment adjusted impact key performance indicators (KPI), such as pro-rated CO_2e emissions avoided based on SMFG lending share.

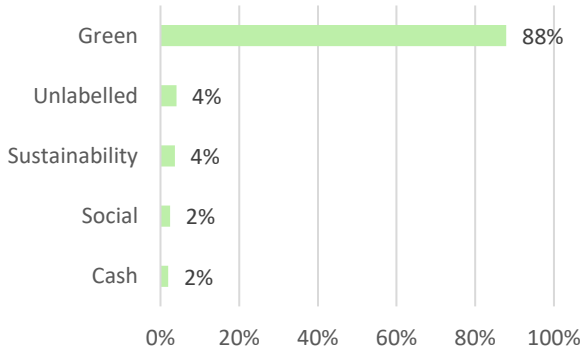
We strongly seek to limit impact double counting, including presenting pro-rated KPIs where possible. This is not currently a norm in the market however we continue to advocate.

Portfolio information
Top 5 impact bond frameworks

Name	Average weight since inception %
Kommunalbanken AS Green Bond	6.7
Nederlanse Waterschapsbank N.V. Green Bond	6.1
Ontario Province Green Bond	4.3
Transport for London Green Bond	4.0
Westpac Banking Corporation Green Bond	3.5

Distribution by bond type

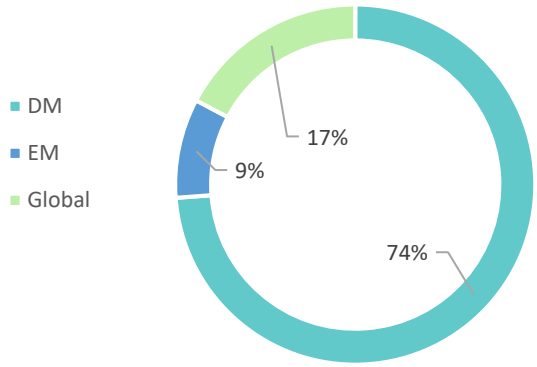
(% of portfolio holdings since inception to 4Q18)



Unlabelled bonds are those that are not labelled as green, social, or sustainable by Bloomberg, but have been determined to have a sufficient positive environmental or social impact using our proprietary in-house analysis.

Expected projects
Geographic distribution

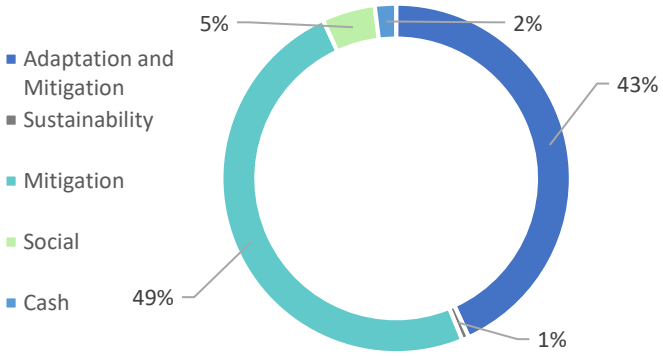
(% of portfolio holdings since inception to 4Q18)



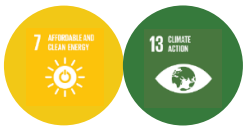
Since inception, the portfolio has been invested in impact bonds with a developed market focus, such as Kommunalbanken (KBN) Green Bond, a Norwegian local authority funding body supporting Norway's transition to a climate-resilient, low-carbon society. Ontario Province and Transport for London green bond frameworks both fund infrastructure projects, in Canada and the UK, respectively. Low-carbon transportation contributes to a healthier environment by improving air quality, as well as reducing GHG emissions. A major holding is also NWB, which will be discussed at length on the next page.

Expected projects
Impact goal distribution

(% of portfolio holdings since inception to 4Q18)



Reflecting the heavy concentration of the portfolio in green bonds, the majority of the portfolio supports climate change mitigation and adaptation (92%), most closely related to SDG 7 - affordable and clean energy, and SDG 13 - climate action. The portfolio primarily supports climate mitigation focussed activities, those that help reduce greenhouse gas emissions (for example, renewable energy generation and energy efficiency improvements in buildings).



Impact bond highlight
NWB Green Bond

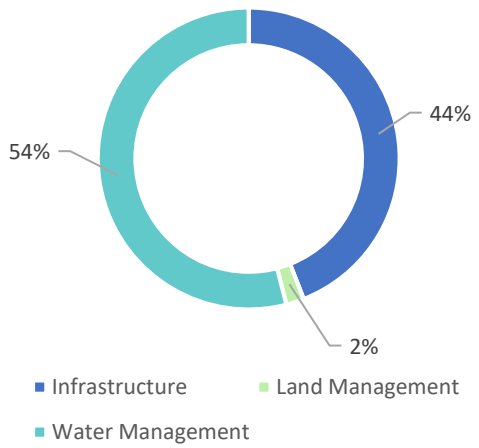
As with all impact bonds included in our investment universe, NWB (Nederlandse Waterschapsbank) was internally verified and met our in-house proprietary SPECTRUM criteria, covering expected positive social and/or environmental impacts, sufficient transparency and reporting and issuer responsibility, amongst other factors. NWB issued its first green bond in 2014 and is one of the leading issuers of water-focussed green bonds, promoting climate resilience in a climate-vulnerable country such as the Netherlands which has two thirds of its surface area vulnerable to flooding and 26% below sea-level.

NWB green bond proceeds are earmarked for on lending to Dutch Water Authorities – responsible for flood protection, water management and water quality in the Netherlands. Dutch Water Authority investments are largely under the the government's "Delta Plan" which aims to increase the water management resilience against expected climate change in the coming decennia – such as heavier rainfall patterns as well as longer periods of drought.

Flood prevention (classified as infrastructure in the AIM sector taxonomy) remains the highest investment area for water authorities (average 28% from 2015-17), closely followed by water system management and cleaning and transport of wastewater.

NWB Green Bond
Sector distribution

(2017 Impact Report, categorised by AIM)



NWB holdings

Issue date	Size	Maturity date	ISIN
March 2016	US$1250m	March 2026	US63983TBB08 / XS1386139841
Nov. 2017	US$500	Nov. 2021	XS1716989287 / US63983TBK07

Example Project
Dike reinforcement using soil mix

Dutch Water Authorities are responsible for managing and maintaining 97% of the country's flood defences estimated at 3,600km in length, primarily against flooding from the sea and major rivers and lakes.

New statutory requirements were introduced in 2017 to reduce likelihood of drowning due to flooding to 1 in 100,000 per annum. With the introduction of these new standards the Water Authorities are expected to undertake substantial dike reinforcement operations – it is estimated that over 1,100 km of defences and 256 lock and pumping stations require improvement. All flood defences must meet the new safety standards by 2050. In 2009 only 57% of primary flood defences comply with the new safety standards, reaching 73% in 2015. Results from the 2017 changes are yet to be disclosed.

An example of the types of projects and challenges that the Dutch Water Authorities face: the reinforcement of the Ijssel dike which protects against flooding of the river Holland Ijssel in the Province of South Holland between Rotterdam and Gouda.

River Ijssel near Doesburg
Source: Michielverbeek - Own work, CC BY-SA 4.0

The dike was insufficiently high at parts which resulted in a shifting of the dike, making it unstable and allowing water from the river to flow into the hinterland. Traditional methods of reinforcement were unavailable due to the region's weak soil. Similarly, there was insufficient space in inner city Gouda to strengthen the dike.

Instead an alternative method, the Cutter Soil Mixing Method, of injecting the dike with cement from the inside in a soil treatment process was approved – permitting the weak soil to take on the properties of concrete. Reinforcement works were underway throughout 2017.

92% of the portfolio supports climate change mitigation and adaptation

Further Information

To find out more about this Fund, please contact your local Business Development Manager, Adviser Services on 13 18 36 (8am to 7pm Sydney time) or visit colonialfirststate.com.au/investments

AIM is a strategic Alliance Partner of Colonial First State (CFS)

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