



IMAP Independent Thought Podcast

Episode 38: The IMAP Australia's Best - Managed Account Award Winner Series: "Navigating Australian Fixed Income: Hybrids, Credits and Bonds"

Join our host Emily Barlow (Perpetual Private) and Charlie Callan (BondAdviser) our Fixed Interest Category Winner at the IMAP Managed Account Awards 2025.

They discuss.

- The key changes they are seeing in the Australian fixed interest market right now
- AT1 hybrids are trading at post-GFC tight, with Big Four margins around +185bps. What's driving this demand-supply imbalance?
- How investors think about liquidity and volatility risk
- Tier 2 spreads have compressed too far, partly due to ETFs making up about 8% of the universe. What's your advice on positioning in this context?
- BondAdviser have noted wave of issuance recently; is this just post-reporting season activity, or a sign of deeper appetite for A\$ credit?
- Will international names continue dominating issuance
- Lonsec recently downgraded Metrics' flagship fund. Should investors read this as a broader signal for the private credit space?
- Private Credit as an asset class and the way investors should assess risk in this part of the market

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Emily Barlow – Perpetual Private

Hello and welcome back to the IMAP Independent Thought Series podcast.

My name is Emily Barlow, an investment director at Perpetual, and I am your podcast host.

Today we're diving into the Australian fixed income markets, which has seen some real shifts over the past year, from tightening hybrid spreads, bond yields at decade highs, and private credit downgrades.

To help us make sense of it all, I'm joined by Charlie Callan, Director and Portfolio Manager at Bond Adviser.

BondAdviser combines independent research, proprietary data, and portfolio solutions to make fixed income more transparent and investable.

They were also recently awarded the IMAP Fixed Income Award 2025 for the second year running.

Welcome to the podcast, Charlie.

Charlie Callan - Bond Adviser

Thanks, Emily. Good to be here.

Emily Barlow – Perpetual Private So let's get started with the macro environment. How would you characterize the key changes you're seeing in the Australian fixed income market right now?

Charlie Callan - Bond Adviser

So there's two main changes for us. One is on the investment side and one's on the what we like to call the plumbing side.

On the investment side, we've got a market right now that is ripe for issuance. Meaning there are new bonds coming into the market.

Credit spreads are very low, which is what issuers love, and yields are relatively high, which is what investors love. So the market is really firing on all cylinders, which is great.

Now, on the plumbing side, which is about connecting the pipes to allow investors into this market, there has been a very big shift in private client demand for direct bond ownership.

Now, most may not realise it, but it's actually quite difficult to buy a bond. It isn't just like opening a Comsec account, for instance, like you do with shares.

And because of this private client demand, we've seen some really clever plumbing to enable wholesale private clients to access this market directly.

That's one of the big changes that we've seen.

Emily Barlow – Perpetual Private

And do you see these shifts as structural or more cyclical in nature?

Charlie Callan - Bond Adviser

On the plumbing side, there is no doubt it is structural. So, the technology and the adoption is here to stay.

Our understanding is the investors love being able to access these bonds directly. And the reason why is because it's cheap. It's very forecastable in terms of future cash flows. So, it really suits those in retirement or needing to know their streams of incomes. And the returns are being found to be really attractive, especially relative to term deposits, you know, which Australian investors know and love so well.

Bonds are a little bit foreign to them, but those that are getting involved are really enjoying it. Now, on the investing side, it is definitely cyclical, right?

Spreads widen and tighten as the macro cycle changes, and to cast your mind back to 2020, 2021 era where we had ultra-low rates, there was an absolute void of demand for bonds, because the yields were so low.

And it's no surprise that when yields are higher now, investors are trying to lock in those long-term fixed-rate coupons as the RBA is now starting to cut rates.

Emily Barlow – Perpetual Private

So if we move this discussion onto hybrids, and bond advisors have flagged that 81 hybrids are trading at post-GFC tightness with big fall margins at around 185 basis points. What's driving this demand-supply imbalance?

Charlie Callan - Bond Adviser

Yes, great question, and it's a pretty simple equation.

APRA's banned Australian banks from issuing hybrids, so no more are being issued.

And as existing investors are getting paid their coupon and their principal back through time, there's a lot of rolling demand for that asset class, which has been around for 25 years, maybe 20 of that in a more developed sense. There's plenty of people that still own these hybrids that are very happy holders.

So you have less primary and secondary supply and now primary is new bonds, secondary is selling it into the market, and that's leading to a rise in price, but also a fall in liquidity.

We've seen average weekly volumes in hybrids be 10% lower to what they've been over the course of the prior 2 years, and we expect that to fall through time.

Actually, really topical this morning, literally not even 5 minutes ago, UBS came out to the market saying that they're going to issue an AT1 hybrid in Aussie dollar form into the wholesale market here. So it won't be listed on the exchange. But one of the things that we had hoped that we'd see is some of the bigger international banks come into our domestic market.

Now, there's some nuances as to why that's not attractive to them with respect to franking credits and the like, but cross-currency hedging, etc, and so that's a really interesting development this morning to see them (UBS) come into the market.

Emily Barlow – Perpetual Private

You do mention that not as many international banks are coming in as expected, which suggests that there aren't going to be as many hybrids as there were before. Do you have a view of where investors might turn as an alternative for hybrid?

Charlie Callan - Bond Adviser

There's no one good answer for this in truth. In our view, the replacement has to be a bit of a blend. So it can't just be tier two debt, for instance, and it can't just be private credit.

It has to be a little bit of a few different products to give you a kind of comparable risk return profile. And the way that we have thought about this is you can take about a third of bank senior debt, a third of tier two, and then a third of maybe bank equity, or maybe something like offshore AT1 exposure, or maybe private credit, something that's you know, a riskier product that pays more income, that has more volatility and it's capital returns.

When you blend the three of those together, just roughly a 1/3, 1/3, 1/3, you get to a kind of relatively comparable risk return profile over the longer term that hybrids illustratively displayed.

Emily Barlow – Perpetual Private

You mentioned tier two securities, which are those bonds that rank below senior bonds but above equity and hybrids.

And I know that bond advisers in the market have argued that spreads on these bonds have been compressed too far, and partly due to ETF demand, which now makes up about 8% of the universe.

With this over- compression, what is your advice on positioning for investor portfolios?

Charlie Callan - Bond Adviser

Another really important and topical question. Fixed income ETFs have been a fantastic addition to the toolkit for investors.

It has unlocked a convenient and low-cost method of access into this market. But what we've seen, particularly in the past year or so, has been a rapid inflow into some of these things like subordinated tier two debt, and that has certainly been one of the biggest beneficiaries of this hybrid market ceasing to exist as it previously has.

The benefit, however, is now starting to create some risks that need to be better understood by investors.

We've seen some ETFs now own very large positions in singular bonds. For instance, an ETF owning more than 10% of a single bond line. That might seem like a small number, but the truth is that everyone on the street knows that they hold that, and they know exactly how much they hold of it. And so it does create a few risks in the event of a market sell-off.

If you were to have big outflows to some of these ETFs, it makes it a bit of a force seller in that asset class. And like I said, everybody on the street knows that, and that's always a recipe for a bad price.

Even though you know tier two ETFs might be passive products, you as an investor still need to be very active and alert to the risks that are present within the product itself.

Now, we think there's two broad solutions to that. Number 1 is better diversification, right? So picking products that own lots of different bonds, or you can (if you're really sophisticated), go out and access this market directly.

You are not having that kind of commingled risk as well. So yes, they've certainly compressed too far in our opinion, but that doesn't matter whether it's an ETF or if you're holding it directly, we think that it's an asset class that people need to be involved in, but we're certainly trimming our exposure at the moment.

Emily Barlow – Perpetual Private

You mentioned a couple of times investing directly. So just a quick question on that. How much money do you need to be investing in this space to be able to create a diversified portfolio?

Charlie Callan - Bond Adviser

Good question. So previously, if you would have asked me this question, I reckon 5 years ago, I probably would have said 10 million dollars. It's changed a lot now. It's probably if you're doing it with the right counterparties, you can probably get away with about 20 bonds for a million dollars.

What's happened previously in the bond market is that minimum parcel sizes were normally about half a million dollars. So to get 20 bonds into a portfolio, or ideally 30, then you're talking about quite a large number.

Now, what's happened is that there's been new kind of technologies and mechanisms to provide access down to lower minimum parcels.

Now some of these minimum parcels are down to \$50,000, \$10,000, even \$5,000, and that's making it a lot easier to build a diversified portfolio of direct bonds.

The number is a lot lower now. It's anywhere from 1 to 2 million I would say.

Emily Barlow – Perpetual Private

Thanks, changing tack a little bit, but going back to issuance. Bond advisers have noted a wave of issuance recently. and just a question on whether or not this is connected at all to post-reporting season activity or a sign of deeper appetite for Aussie dollar credit?

Charlie Callan - Bond Adviser

Post-corporate reporting is always "supply season" for new bonds. So it's always busy at this sort of time of year, and it's always busy in March as well. But I think that the first part of that question is really asking, is there a deeper appetite for a dollar credit? And the answer to that is 100% correct.

Deutsche Bank put out some research recently saying that the Australian bond market is now the world's third largest from a credit perspective. Our market has recently benefited from a massive amount of offshore issuance. So foreign companies issuing bonds in A-dollar form. And the reasons as to why this has occurred is twofold, or threefold actually.

The first is that the costs of A-dollar hedging have cheapened. So from a currency, cross-currency perspective it's relatively cheap.

Number two is that our spreads have compressed a long way on a relative basis as well. So the credit costs for them is lower, and

Then the third, which is an interesting structural shift, is that Australia's credit market has been added to some of the big bond indices out of Asia.

And so that's seen a lot more primary and secondary activity in our market, and that is also conducive to larger and stronger amounts of future issuance.

What issuers don't like is investing a bond that then never trades. If our bond market is more liquid and there's more active participants in it, they have a better understanding of what their secondary price is, which helps in turn enable them to price new bonds at an efficient price.

Emily Barlow – Perpetual Private

Okay, great and moving on to the last topic for the podcast, which is private credit. And let's start off by addressing recent news around Lonsdale's recent downgrade of the Metrics flagship fund.

Should investors be reading this as a broad signal for the private credit space, or is this something more specific?

Charlie Callan - Bond Adviser

This is topical, ASIC this morning published their report into the private credit sector as well. So, there's plenty of discussion around this space.

We are not hiding the fact that we've been a little bit concerned about some parts of private credit for some time, but we've never been concerned about Metrics.

We have been investing in private credit now for nearly a decade, and across this period of time, we must have done hundreds of meetings with different managers across Australia, the US, Europe, and across Asia. And we think we have a pretty good understanding of the difference between what the good, the bad, and the ugly looks like.

Generally speaking, we see Metrics as a first-class manager, certainly in the top tier of domestic managers without question. And I think that the ASIC scrutiny into this asset class will only widen the gap between the "haves" and the "have nots" within private credit. And with scale, it enables you to provide additional forms of transparency, external valuations, things that make the product more transparent, and present.

What we're really concerned about is on the other side, which is the "garage band" private credit funds that have recently emerged. Say two origination bankers in a Bloomberg is not an appropriate, nor a tested way of managing fixed interest capital.

Emily Barlow – Perpetual Private

So for those looking at private credit managers more broadly, what would you suggest they keep an eye out for?

Charlie Callan - Bond Adviser

I think so. There's lots of different things, right? I'll talk about things like external valuations, external trustees, and responsible entities, big institutional mandates as well, is a really important one.

Big institutions do a lot of very granular due diligence, and they understand the space really well. So, if you take a really cynical view, which is, oh, you know, the valuation firms get paid to write a good report and the trustees do the same and whatnot because they're all being paid by the manager.

If you want to take that stance, that's fine. But it's really hard to argue with the fact that there's big institutional mandates that that it's a subscale or sub-tier shop, because big institutional mandates are very, very picky with what they need and want.

And if they don't get it, they just leave. They walk with their feet, right? There's no need for them to stick around.

So, if you're investing in managers that don't have any institutional support, you've really got to ask yourself why.

And I'll give you two really big, kind of important things to think about with product credit.

The first is does every new dollar of capital into this market diminish the attractiveness of the asset class?

That sounds like a like a big and complicated question, and it's one that I've been wrestling with for a while. And the conclusion that I'm coming to is that private credit is unique with respect to other asset classes because when more capital comes into the asset class, it actually makes future returns riskier.

If you think about equities or if you think about public credit, for every new dollar of investor capital that comes in, it pushes the price of the existing securities up because you've got to go in and buy the security, right? So that means existing investors in the asset class are better off.

In private credit, I don't think this occurs because when a new dollar of capital comes into the market, the lender has to go and write a new loan to deploy that capital. They can't just go buy it.

So, if it's a new loan that's been written and if it's riskier or if it returns less, then it dilutes the quality of returns for existing investors, but also new investors. And I think the real question is at what point does the marginal quality of this lending fall to the point that the risk and return doesn't stack up anymore relative to other parts of fixed income and credit?

And ultimately that is when we're going to step out of the asset class to enable a cycle of renewal for the kind of bad to get washed away.

I think there's another point, just to kind of labour the point here, because it's really important this asset class. It's in relation to illiquidity.

I think fixed income is not well understood by most investors. And I think private credit is even less understood. So private credit is not inherently dangerous, right? Lending has been around for a very long time. The risk is the execution and quality of your counterparties.

And as so always happens in financial markets, it's actually the bad that bring the good down with them.

So, if you have everyone running for the door at the same time, everyone trying to pull their money out of private credit at the same time, that's when bad things happen.

And I don't think there's a lot of managers that are thinking carefully enough about the asset and liability risk from the investor perspective.

Then again, another really important point here for people to understand the difference between the small and the big in private credit is that the difference in return between the biggest and best in the market and the newest and riskiest in the market is not very large, right?

So, it's not like something like hedge funds or private equity, where if you go find a new rising star, you might get massive returns off the back of this because someone's a genius. The trick's in the name for fixed income, right? It is fixed income.

You don't have massive upside return in this asset class. So, you take on huge operational and key person risk in these new managers, but you don't get any benefit in return relative to the bigger part of the market. Normally you actually take on a worse fee, and you take on larger portfolio asset concentration risk.

So, if you ever hear someone talking to you about private equity-styled private credit investing, you should absolutely run the other way because they have no idea what they're talking about in terms of the fundamental risks of this asset class.

Emily Barlow – Perpetual Private

Thanks, Charlie. That's really interesting. And just turning it back to investors, do you think that should impact the way that they think about risk and portfolio construction for this part of the market?

Charlie Callan - Bond Adviser

Yeah, definitely. For us, we've come from the public credit side of the fence, and we take a real granular view into credit risk and concentration risk and liquidity. And I think to some extent that's been a little bit forgotten by some investors who are just going out and chasing a headline number, which it does look attractive on a private credit basis.

But it's not an all-in-one replacement for your defensive part of your portfolio.

For us, it's a bucket that is generally flexed from circa 10 to 30 percent of portfolios, depending on the type of risk that we're seeking in portfolios, and where we think the attractiveness of private credit is relative to the cycle. It's not something that you can hold the entirety of your fixed income exposure to. You have to think about diversification.

People talk about diversification being a free lunch. On your defensive side of your portfolios, I can't emphasise how important that is, because coming back to that point of downside versus upside risk, in fixed income, you have limited upside. You're only going to earn a fixed return, right?

But your downside to that is so much larger than your potential upside. So, you have that is when diversification is so critical and important. And that is what investors need to be really, really alert and heightened to.

It's not appropriate to have 2 investments, 1 in private credit and 1 in some big bond fund, and call that your defensive portfolio. It has to be more diversified than that.

I like to call fixed income a broad church. There is such a huge amount of different exposures that you can get and different ways to take risk. And when you blend that together really well, you get really attractive portfolio outcomes.

Emily Barlow – Perpetual Private

Charlie, thank you. This has been a really fascinating conversation from hybrids and tier two spreads to risks in the private credit space.

Thank you so much for joining us.

Charlie Callan - Bond Adviser

Thanks, Emily. Great to chat.

Emily Barlow – Perpetual Private

And to our listeners, thanks for joining us. If you enjoyed this discussion, please subscribe and share it with your network.

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