Macquarie Income Opportunities

Quarterly Investment Option Update

31 December 2019

Aim and Strategy

Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles. This strategy provides exposure to a wide range of Australian credit-based securities (predominantly floating and fixed rate corporate bonds, and asset-backed securities) and cash. It may also provide exposure to global investment grade credit securities, global high yield credit securities, emerging market debt, hybrid securities and a range of other credit opportunities when they are expected to outperform and reduce exposure to these sectors when they are expected to underperform. This strategy can hold securities either directly or indirectly through investments managed by a member of the Macquarie Group and external managers. This strategy may also be exposed to derivatives to implement its investment strategy or to hedge risk. This strategy is generally hedged to Australian dollars.

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au

Investment Option Overview

Investment Category	Aust. Fixed Interest
Suggested Investment timeframe	3 years
Relative risk rating	5 / Medium to High
Investment style	Income
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Investment Grade	20-100	100.0
Hybrids	0-10	0.0
Global High Yield	0-15	7.1
Emerging Market Debt	0-15	100.0

Sector Allocation	%
Banks	25.8
Residential mortgage	10.4
Non-agency CMBS	5.9
Electric	5.4
REITs	5.3

Regional Allocation	%
Australia	70.3
United States	9.0
UK	2.4
Europe Ex UK	7.1
Other	11.2

Top Holdings	%
CBA	1.5
NAB	1.4
Suncorp	1.0
CBA	0.9
ANZ	0.9
Bank of America	0.9
Transurban	0.8
NAB	0.8
Westpac	0.7
AGL	0.6

Investment Option Commentary

The Fund outperformed the benchmark in the final quarter of 2019 (gross of fees), as most risk markets rallied. Holdings of global investment grade (IG) credit were the key driver of the returns, with spreads on US corporate credit around 20bps tighter to finish the year at the tightest level since early 2018. Government bond yields were modestly higher over the quarter, which detracted sightly from the Fund's returns – Macquarie used higher yields to begin rebuilding their duration position, which they had trimmed meaningfully as global yields fell sharply. Tentative agreement on a Phase 1 trade agreement, which at the least avoided a meaningful increase in tariffs scheduled for December, and policy stimulus were the biggest influence on the market – with the US Federal Reserve (Fed) in particular ramping up its balance sheet into year end to avoid any potential liquidity stresses.

Macquarie made some modest changes to the Fund over the quarter but maintained their broad position in global IG credit, offset somewhat with a modest interest rate duration position. Key changes over the quarter were adding further to their structured securities holdings. This was mostly in US Agency mortgage-backed securities, as this portion of the market lagged corporate credit for most of 2019 and they viewed it as an attractive, higher quality place to allocate. Structured additions also included Australian RMBS, which offer value and will be fundamentally supported by local house price gains. In turn, the total corporate credit exposure was trimmed, on lower valuations – though it remains their largest position overall.

Within corporate credit, Macquarie added aircraft leasing companies which still offered attractive value, despite a strong rally so far in 2019, and new issuance from pharmaceutical company AbbVie and medical conglomerate Danaher, amongst others. The AbbVie and Danaher deals were both to fund M&A purchases, continuing their strategy from the last several years of participating in new deals post-M&A that offer a credible business and deleveraging plan.

Within interest rate duration, they added modestly to their position in US interest rate duration as Treasury bond yields rose through 1.80%. While government bond yields are likely to remain volatile, continuing to add to duration at higher yield levels makes sense given low inflation, supportive central banks, and economic uncertainty.

Market Commentary

The Phase 1 trade deal between the US and China led risk assets to close the quarter at or near record highs, with US investment grade (IG) spreads closing the year at 93bps, the tightest level since February 2018 when the market was positive about the impact of US President Trump's corporate tax cuts. In summarising US earnings season, industrial demand ex aerospace and defense was weak as a result of trade and global growth, the transportation sector and commodity chemicals were notably continuing their recent weakness, the US consumer remains strong, and some very poor results were being given a 'pass' by the market, for example Caterpillar missed expectations and cut guidance, but shares were up almost 10% over the month. Focusing on financials, bank performance continues to beat expectations, despite fears about lower net interest margins as rates have fallen, while capital markets, loan growth, and asset quality is very strong. The YoY earnings decline was around 2.2% with mixed outlooks, as many companies guided to the lower end of previous ranges.

The US Federal Reserve (Fed) expanded its balance sheet by $US112bn over the month, capping off an increase of over $US400bn since they began buying Treasury bills in September. This change in Fed direction has reversed more than half of the total balance sheet reduction that occurred through 2018 and the first half of 2019, though the new purchases are of a lower duration. The balance sheet expansion was initially targeted at avoiding a year end liquidity squeeze in funding markets, after the September quarter end revealed market liquidity was thin.

European credit also performed well with corporate spreads rallying to 93bps, closing at the tightest level of the year. UK credit outperformed core peers as Boris Johnson's Conservative party secured a strong majority in the December general election. Supply totaled €631bn in 2019 which is a €143bn YoY increase, with gross non-financial supply the largest on record at €345bn as the resurgence of reverse Yankee issues coming to Europe boosted overall numbers.

Outlook

Asset markets across the board delivered investors positive returns for 2019. That said, the seeds for such performance were in part a response to the weakness through 2018. As Macquarie look to 2020 and prepare for their Strategic Forum in January, the key question asked is what can investors expect from the year ahead?

Macquarie's strategy since their September Strategic Forum has been to cautiously participate in risk markets but remain mindful that duration has, and can continue, to provide an important balance within a fixed income investment strategy. they reduced their overweight duration positions significantly into the rallying bond market environment of past quarters and this has provided the opportunity to gradually add back as bond yields rise. In this context they remain mindful that the coming year is likely to prove more difficult and therefore their debate of the investment themes in January will be critical to any reassessment of their current positioning.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1525AU
AMP Flexible Super - Retirement account	AMP1585AU
AMP Flexible Super - Super account	AMP1573AU
CustomSuper	AMP1525AU
Flexible Lifetime - Allocated Pension	AMP1537AU
Flexible Lifetime - Term Pension	AMP2018AU
Flexible Lifetime Investment (Series 2)	AMP2038AU
SignatureSuper	AMP1549AU
SignatureSuper Allocated Pension	AMP1561AU

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