Macquarie Income Opportunities

Quarterly Investment Option Update

30 September 2020

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:
www.amp.com.au/performance

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	95
Hybrids	0-10	0.0
Global High Yield	0-15	0
Emerging Market Debt	0-15	5

Sector Allocation	%
Banking	20.9
Residential mortgage	10.4
Electric	4.2
Non-agency CMBS	3.8
Owned No Guarantee	3.8

Regional Allocation	%
Australia	38.5
United States	18.6
UK	3.0
Europe Ex UK	7.6
Other	9.8

Top Holdings	%
NAB	1.8
Suncorp	1.3
CBA	1.1
Bank of America	1.1
WST_20-1	1.1
Suncorp	1.0
Transurban	0.8
METR_19-1	0.8
Downer Group	0.7
AMP Capital	0.7

Investment Option Commentary

The strategy outperformed the benchmark over the quarter, with performance driven by credit positioning. The largest contributors included global IG holdings, reflecting the size of these positions in the Fund, some overall spread tightening, and our positioning overweight in BBB-rated credit which significantly outperformed the broader IG market. Multiple other sectors also contributed to returns, notably the emerging markets debt and structured security sectors. The Fund's duration positioning contributed positively to performance, though the impact was more modest. Positions in AUD interest rate duration were a key positive driver in September and helped offset the impact of credit market volatility late in the month.

The strategy continued to refine its positioning over the quarter. Given the strong rebound in credit markets since the March lows, some trimming in higher quality IG positions was carried out mid-quarter, focusing mostly on sectors that had performed strongly and had limited upside likely remaining. On the other hand, the strategy has added positions in developed market high yield credit concentrated in BB exposures. This sector has performed materially worse than IG through some weakness in July and offered an attractive pick-up versus IG. In addition, the credit exposures within each sector have continued to move towards single name exposures that have value on offer, with some corporate hybrids and aviation exposures added during the quarter.

Duration positioning within the strategy remained largely stable during the quarter, though positions were tilted toward Australia given the expectations for continued central bank support, and outperformance of the US market leading up this quarter. The strategy trimmed its overall duration late in the quarter as the US election neared. The risk-reward of holding USD duration was reduced as the US election approaches, given that any clear election outcome is likely to lead to significantly more fiscal stimulus, and FX positions and credit hedges are more likely to be effective hedges in the case of a contested or very close outcome.

Market Commentary

In the US investment grade (IG) market, spreads closed 14bps tighter at 136bps, while high yield (HY) tightened 109bps to finish the quarter at 517bps. The rally in credit spreads was very much broad based to begin the quarter driven by a combination of factors, including a better-than-expected start to the earnings season and historically attractive spread levels. European IG credit was the outperformer for the quarter, compressing 30bps to 119bps.

Australian credit performed broadly in line with global credit in Q3, tightening by 24bps. Sector performances were mixed, with the repo-eligible financials trade reaching its peaks in July before the chase for yield led to industrial bonds closing the gap in August.

Outlook

Summarising the economic outlook, the investment manager observed that there is a noticeable bounce in economic activity, however it is uneven across countries and sectors. The depth of decline in growth was severe and it will take multiple quarters (if not more) to get back to where the investment manager were in January, due in part to the persistence of the virus and the need for social distancing, before the virus impacted the economy and they recognise that this starting point was one where the pace of economic growth was already lacklustre.

They also considered the outlook for inflation given the incredible policy action delivered. They noted that the structural factors that have worked to depress inflation for the past decade(s) are still present and if anything worse and are now coupled with a significant output gap. Also, simply doing more monetary easing is unlikely to improve its lack of effectiveness. Thus, low inflation is likely to persist, but the investment manager recognise that if fiscal support turns into sustained and substantive stimulus this could change the current environment.

With the 'lower for longer' environment likely to continue the absence of yield theme is expected to characterise fixed income investment for a considerable period. This is expected to strongly influence credit and emerging markets, though the investment manager believes that the uncertainty surrounding the US election is likely to encourage caution in the short term. On duration we are tactical during this period, adding if yields back up on the promise of more stimulus.

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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