Macquarie Wholesale Australian Fixed Interest

Quarterly Investment Option Update

30 June 2021

Aim and Strategy

To outperform the Bloomberg AusBond Composite Index over the medium term (before fees) by using an active investment strategy.

Investment Option Performance

To view the latest investment performances for each product please visit 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	Active
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian and global fixed income	100%	100%

Sector Allocation	%
Investment grade credit	41.7
High yield credit	5.9
Emerging markets debt	5.1
Cash	47.3

Quality Allocation	%
AAA	8.7
AA	7.6
A	5.1
BBB	22.7
BB and below	8.7
Unrated	0.0
Cash	47.3

Top Holdings	%
Australian Government	2.3
Royal Bank of Scotland	1.2
Pacific National	1.0
Province of Ontario	1.0
Ampol	1.0
AMP Life	1.0
AusNet Services	1.0
KINGF 2019-1 C	1.0
QBE Insurance	1.0
LAUCC 2017-2 B	0.9

Investment Option Commentary

The Fund outperformed the benchmark over the second quarter, with interest rate duration and credit positioning both contributing. Government bond yields staged a notable recovery after a very weak start to the year in Q1, with 10 year US Treasuries (the key global benchmark) falling from a peak yield of 1.77% on 30th March, to finish June at 1.47%. Lowered expectations for fiscal policy spending, some concern around new virus variants, and a retreat of the reflation narrative were all cited as contributing to the sharp change in tone. In contrast, the themes in credit markets this quarter remained entirely consistent with the last several quarters: ongoing performance (thought at a slower pace), spread compression and higher beta/lower quality outperforming, all continued.

The Fund reduced some higher beta exposures (low investment grade and higher quality high yield) over the quarter, reflecting overall tight spreads and limited upside in many credit markets. This included some corporate hybrids (generally rated BBB or BB), US HY exposures, and bank loans – for example, a hybrid issued by BP that was added in September last year. 'Generic' investment grade – high quality, longer duration credit with little carry or spread tightening potential – was further reduced during the month, with almost all of this sector having been trimmed over the past several months. Excess cash continues to be re-invested in short-dated credit (with an average maturity below 2 years) after recent relative underperformance – this part of the market offers some spread with minimal price volatility. Overall, the Fund maintains a clear preference for higher beta credit (including high yield, emerging markets debt and BBB-rated IG credit), balanced with higher liquidity, with materially reduced exposure to higher quality investment grade credit.

Market Commentary

The second quarter was primarily dominated by the interacting themes of vaccination rollout and the gradual re-opening of economies. However, in June, the decision of the US Federal Reserve (Fed) became the focal point, as markets were surprised by the shift in tone and forecasts for the outlook of rate hikes. Despite the Fed continuing to emphasise that the recent rise of inflation is transitory, markets viewed the upward shift in rate expectations as validation of their speculation. This caused shorter-term yields to push higher. Longer-dated bond yields went the other way, with the already flattening yield curve moving flatter. The debate amongst market participants was not only interpreting the Fed's signal, but also why the bond market rallied. There is merit in the view that earlier-than-expected Fed tightening could put a lid on the recovery and hence cap inflation, but there were also more subtle technical forces at play, which combined to squeeze many 'short' positions that further fuelled the rally in Treasury yields.

While these events were unique to the US, the impact rippled across countries, and curve flattening was a common theme and magnified in Australia and New Zealand, where recovery has already returned to pre-pandemic levels. Risk markets proved resilient, with credit spreads grinding tighter and high yield bonds outperforming. Emerging markets spreads ended the quarter tighter, though gave back some gains after the Fed's shift in tone, as the weaker dollar trend reversed.

Outlook

The pandemic continues to exert an influence on the shape of recovery as countries are at different stages, while new variants remind that vaccination may quell the hospitalisation risk but the virus will likely be with us for some time to come. There are still many unanswered questions on the future, such as: when will normal activity resume; when will international travel resume; what will the post-virus workplace look like?

As we move into the second half of 2021, attention is on the shape of recovery as economies re-open and whether the current inflation pulse will prove transitory as expected by policy makers or persistent. A key feature of the pandemic was massive government support to workers and businesses, but this is nearing its end, with many states in the US deciding to withdraw the Federal support early in the hope that this encourages people back to work. How quickly these furloughed/unemployed workers return will be key in determining the shape of the recovery. Businesses trying to re-open have reported difficulty in hiring and many have offered financial incentives, including higher wages, which has fuelled concerns that inflation will become persistent. Yet the data has shown that the majority of government transfer support to these workers during the pandemic was saved, suggesting that persistent uncertainty will hold back consumption. While supply disruption is likely to continue to pressure inflation, in our opinion, the evolution of consumer income and demand will prove the decisive determinant of inflation longer term.

These vital but unanswered questions, combined with low bond yields and tight valuations, guide to a cautious approach to investment. However, Macquarie also recognise the ferocious insatiable need for yield. The manager

balances these forces by maintaining discipline and ‘doing the work’ to determine the best risk-adjusted positioning for portfolios.

Availability

Product name	APIR
SignatureSuper	AMP0964AU #

Closed to new members

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