Macquarie Income Opportunities

Quarterly Investment Option Update

30 September 2021

Aim and Strategy

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

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. The strategy predominantly provides exposure to a wide range of domestic and global investment grade floating and fixed rate instruments, asset-backed securities, and cash. The strategy may also have opportunistic exposure to other fixed income sectors and instruments such as, high yield and emerging markets debt as well as other fixed income instruments. Interest rate risk will generally be hedged through the use of derivatives such as swaps and futures. The investment process aims to reduce the risk of the portfolio being adversely affected by unexpected events or downgrades in the credit rating of the portfolio's investments. A disciplined framework is used to analyse each sector and proposed investment to assess its risk. The strategy may be exposed to derivatives to implement its investment strategy. For example, protection may be purchased on issuers that are believed to be over-valued or at risk of downgrade. These positions increase in value when the underlying instrument falls in value and decrease in value when the underlying instruments rises in value. The portfolio is generally hedged to Australia dollars. However, any exposure to emerging markets debt issued in the local currency of the debt will generally be unhedged. Small active currency positions may also be taken when the investment manager believes that there are opportunities to add value or hedge risks in the portfolio.

Investment Option Performance

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

Investment Option Overview

Asset Allocation	Benchmark (%)	Actual (%)
Investment Grade Credit	n/a	89
Global High Yield	n/a	3
Emerging Market Debt	n/a	8
Cash	n/a	0

Sector Allocation	%
Banking	24.8
Residential Mortgage	10.2
Transportation	5.2
Non-Agency CMBS	3.3
Consumer Cyclical	2.9

Regional Allocation	%
Australia	34.6
United States	20.1
UK	7.0
Europe Ex UK	9.5
Other	10.1
Cash	18.7

Top Holdings	%
Royal Bank of Scotland	2.6
Province of Ontario	1.4
Barclays	1.0
ABN AMRO Bank	0.9
Commonwealth Bank of Australia	0.9
ING Group	0.8
PUMA Series 2021-2	0.8

Investment Option Commentary

The fund performed in line with its longer-term target, against a backdrop of very limited fixed income market moves.

In terms of credit positioning, the fund has been positioned with a ‘barbell’ of higher liquidity, a higher allocation to high yield and emerging markets, and a somewhat reduced allocation to fully valued investment grade credit. This gives the fund the opportunity to maintain some carry in an otherwise low-yield environment but also to be nimble in taking opportunities as they present, in line with the fund’s flexible approach.

With a focus on capital preservation and managing the downside, the fund was positioned through the quarter with very low interest rate duration, given the backdrop of low yields and some continued concerns around inflation and central banks’ responses. Given the uncertain outlook for duration returns, the fund engaged in currency option-based portfolio hedges, buying put options in AUD vs. USD to protect the fund in a ‘risk off event’. This positioning added meaningfully to returns, as the AUD significantly underperformed and the position was actively managed to lock in some gains

Market Commentary

With vaccination rates pushing higher and recovery (albeit stuttering) underway, it is not a surprise to hear from policy makers that they are considering withdrawing the huge stimulus support injected into the economy. Worker assistance schemes in many countries have either ended or been nearing an end, so fiscal support is already turning into fiscal drag. During the third quarter of 2021 the narrative from central banks began to evolve. Rate hikes have been delivered in some emerging market countries, while the US Federal Reserve (Fed) and the Bank of England sent signals that they are readying to taper their quantitative support. With rising asset prices the clear winner of global policy maker efforts, the prospect of this being reduced is causing some concern. On top of this, commodity prices (oil and natural gas prices in particular) are launching higher. This is fuelling inflation fears but also talks about stagflation.

Bond yields have begun to trek higher, with the more hawkish-than-expected Fed meeting in September igniting an acceleration. Yield curves are steepening, with short rates protected by the prospect of target rates remaining on hold while longer rates embracing increased concerns that inflation will run ‘hotter’ for longer.

Risk markets have baulked but this came off tight levels. Investment grade spreads are little changed over the quarter while high yield spreads have widened, albeit modestly. Emerging markets spreads have widened, with a stronger dollar and negative headlines coming from China the key drivers.

Outlook

Financial markets have entered the fourth quarter with a plethora of uncertainties, yet risk assets remain near historically tight valuations. Though bond yields are edging upwards and the highs posted earlier in the year are not far away. From a macro perspective, the outlook remains uncertain largely because the pandemic continues, albeit differently in respective countries. The pandemic continues to exert its significant economic influence around the globe via compromised supply chains. These supply chain problems can only be fixed once the pandemic has passed. The impact of the supply chain problems with inflation rates elevated and shortages of many goods is being felt across all consumers and businesses. There are fierce debates about whether financial markets should believe that these problems are transitory or more persistent, characterised by higher inflation.

The manager’s inflation scorecards are signalling that the current inflation pulse is indeed being driven by cyclical factors while structural drivers remain benign. In the past, research shows that persistent inflation is driven by demand, while the current inflation is largely driven by supply factors. Looking back to the 1970s (a common reference for supply-driven inflation), the problem with oil supply was a deliberate and persistent act of restraint by OPEC, but in contrast the current problem is a result of the pandemic and there is a global will to fix the problem. Another important contrast with the 1970s is that wages rose persistently due to high unionisation, which is quite different to today, with wage rises being delivered to targeted areas of labour shortages. However, stagflation was a big problem in the 1970s and there are worrying signs that this environment is emerging today, where rising inflation dampens growth. This is a challenging time for central banks and investors as risks for a misstep are high.

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

**Closed to new and existing investors

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