Macquarie Wholesale Australian Fixed Interest

Quarterly Investment Option Update

30 September 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	4 / Medium
Investment style	Active
Manager style	Single Manager

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

Sector Allocation	%
Investment grade credit	54.1
High yield credit	6.3
Emerging markets debt	5.8
Cash	33.8

Quality Allocation	%
AAA	11.5
AA	8.4
A	5.1
BBB	31.5
BB and below	9.4
Unrated	0.3
Cash	33.8

Top Holdings	%
US Government	2.7
US Government	2.5
Groupe BPCE	1.9
Westpac Banking Corporation	1.9
Royal Bank of Scotland	1.8
Commonwealth Bank of Australia	1.5
ABN AMRO Bank	1.3
Pacific National	1.1
Province of Ontario	1.1
Ampol Ltd	1.0

Investment Option Commentary

The fund outperformed the benchmark over the third quarter, with currency and credit positioning key contributors. Credit traded in a tight range for the quarter, with the 81-91bps range on US investment grade index equal to the smallest total move in the post-financial crisis era. Bond yields were more volatile and generally finished the quarter higher (bond prices lower), with continued concern on inflation fears, and some bringing forward of central bank tightening expectations after Fed statements indicated a tapering of bond purchases was imminent, and the median FOMC's 'dot plots' moved the first hike into late 2022. Currency markets were likewise more volatile, with USD strength evident particularly against currencies such as AUD and emerging markets. The only notable underperformer in credit markets were Chinese property companies, which on widened sharply on concerns over the debt sustainability and size of the overall sector, which spilled over slightly into broader Asian credit.

The fund has been positioned with a 'barbell' of higher liquidity, a higher allocation to high yield, emerging markets and higher beta investment grade, and a somewhat reduced allocation to higher quality investment grade credit, which is generally fully valued. 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. The higher beta investment grade and high yield corporate credit allocations were the key drivers of credit performance in the quarter, with contributors from northern hemisphere airlines (such as Delta and Air Canada), which benefited from plans to further open air travel amongst notable single names.

With a focus on capital preservation and managing the downside, the fund was positioned through the quarter with lower than historical interest rate duration (of under 1.5 years), 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
SignatureSuper	AMP0964AU #

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