Macquarie Income Opportunities

Quarterly Investment Option Update

31 December 2021

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/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	0-100	89
Global High Yield	0-25	4
Emerging Market Debt	0-25	7
Cash	0-100	0

Top Sector Allocation	%
Banking	26.3
Residential Mortgage	10.1
Transportation	5.0
Consumer Cyclical	3.4
Non-Agency CMBS	3.1

Regional Allocation	%
Australia	32.8
United States	17.4
UK	6.5
Europe Ex UK	12.2
Other	9.3
Cash	21.8

Top Holdings	%
Royal Bank of Scotland	2.3
ING Group	2.1
BNP Paribas	1.7
Province of Ontario	1.3
Groupe BPCE	1.3
Barclays	1.0
ABN AMRO Bank	1.0
Commonwealth Bank of Australia	0.9
Volkswagen Leasing GmbH	0.8
PUMA Series 2021-2	0.7

Investment Option Commentary

The Fund underperformed the benchmark for the final quarter of 2021, with duration positions the key detractor in October as short end yields repriced significantly higher. Credit markets were slightly weaker, given the increase in overall market volatility, and the Fund's positioning in credit markets added to performance, driven by running yield in higher beta credit assets. Currency positioning also added value: the Fund held defensive positions via options in short AUD and other currencies, that performed well amidst the overall weaker market environment.

Government bond markets were the key movers during the quarter, with inflation running high (particularly in the US). Markets began to question central banks' stated commitment to low rates, and several ended up changing their policy stance over the quarter, including meaningful policy moves from the RBA and Bank of England, and a change in rhetoric from the US Federal Reserve, amongst others. That left bond market yield curves flatter over the quarter. The Fund held a lower duration position than in previous years, however, a significant portion of the duration position was held in Australia, which was amongst the most heavily affected. The Fund opportunistically added duration in late October amidst the peak of the market disorder, and improvements in bond markets meant duration positioning added value in both November and December. Overall, the Fund's duration position remains below its long term neutral level, and we continue to seek opportunities to increase this as appropriate.

Credit markets were generally well behaved, though overall spreads widened over the quarter. The spread widening was mostly a reaction to bond market volatility and changes in central bank rhetoric, as credit investors questioned the impact that lower monetary support would have for markets. The Fund's positioning in credit added value, most significantly from higher beta asset classes (high yield credit): high yield performance tends to be tied more strongly to the economy, which remains in good shape, rather than volatility in the bond market, which generally impacts investment grade spreads. Amongst top performers were selected travel names (such as Air Canada, reflecting the resilience in overall travel demand despite new variants) and some auto parts manufacturers, reflecting the overall strength in the continuing cyclical recovery.

The Fund reduced its holdings of investment grade credit over the quarter, further reflecting the tight spreads in investment grade credit, and our strategy of maintaining a 'barbell' approach in credit allocations: reduced investment grade credit (particularly the higher quality, fully valued sectors), and higher emerging markets and high yield, and higher liquidity. This approach maintains some yield in an environment where yield is hard to come by, but also keeps liquidity available in case of market volatility. To replace the investment grade sales, we continue to favour shorter dated subordinated debt, which offers attractive spreads with very limited sensitivity to interest rate or broad credit market volatility.

Market Commentary

Asset markets entered the final quarter of the year hopeful that the latest virus concern (Delta variant) had passed and the prospect was for stronger growth and return to more normal-like times. Alas, the emergence of the Omicron variant put paid to this hope and, while this creates another layer of uncertainty looking ahead, asset market pricing implies that the worst is now behind.

During Q4, asset markets were buffeted by the prospect that the path of global monetary policy tightening was spreading from emerging market to developed market central banks. There were three key central bank meetings in December: the US Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE). In summary, the guidance was more hawkish than markets expected, which was a bias for tighter monetary policy going forward. In fact, the BoE delivered a 0.25% hike in its base rate, while the Fed guided its intention to hike rates earlier (in 2022) and more quickly. Even the perma-dovish ECB was leaning more hawkish. The driving factor behind their messaging was "higher and persistently higher-than-expected inflation".

With central banks moving to remove the pandemic stimulus, at the same time Omicron has created uncertainty on the economic outlook. Despite this uncertainty, asset markets ended the year with an aura of calm. Bond yields were broadly contained within ranges and yield curves were relatively flat given the elevated fears on inflation. Credit spreads, while off their lows, ended the year at the tighter end of valuations. Only emerging market spreads are cheaper, albeit modestly, and not a surprise given the stronger bias of the dollar of late.

Outlook

The pandemic has defined the past two years' investment climate. While the signs are positive that the world is reaching a turning point in 2022, the legacy of the pandemic will linger for some time. As we consider the outlook for 2022, two questions come to the forefront: as fiscal stimulus wanes and central banks begin to withdraw support, where will the trend of economic growth settle; and how persistent is the inflation impulse?

We previously identified that the future trend of monetary policy was shifting from easing to tightening. The fiscal shift is less clear and even less understood. Asset markets embraced the global fiscal stimulus through 2020-2021. However, with the US seemingly unable to get the promised new fiscal stimulus through Congress it is a timely reminder that government spending is in fact decelerating from the initial surge, which will act as a drag on growth during 2022. And it should not be lost that many governments have an intent to begin the process of clawing back the explosion of government deficits. How these play out in 2022 will have important implications for growth, where our bias is that with the gyrations the trend will likely settle on the pre-pandemic trend.

The inflation outlook is complicated by the global disruption to supply. If this disruption persists, then even the uninspiring pre-pandemic growth trend would likely be enough to keep inflation elevated relative to pre-pandemic averages. Yet, forward looking asset markets could foresee a scenario where policy tapering begins to slow demand at the same time the supply chain begins to normalise, which could deliver a disinflation impulse.

Thus, we confront the outlook having to balance investors' need for yield against tight valuations and a high level of uncertainty and multiple possible scenarios for 2022. We remain invested but with balance, with the intention of using periodic volatility to selectively participate in opportunities.

Availability

Product name	APIR
Flexible Lifetime Investment (Series 2)	AMP2038AU**
SignatureSuper	AMP1549AU*
SignatureSuper Allocated Pension	AMP1561AU*
SignatureSuper Term Pension	AMP1561AU*

**Closed to new and existing investors

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