Macquarie Wholesale Australian Fixed Interest

Quarterly Investment Option Update

31 December 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	63.1
High yield credit	7.8
Emerging markets debt	7.0
Cash	22.1

Quality Allocation	%
AAA	13.5
AA	8.4
A	6.6
BBB	37.6
BB and below	11.5
Unrated	0.3
Cash	22.1

Top Holdings	%
US Government	3.2
US Government	3.0
Westpac Banking Corporation	2.2
Groupe BPCE	2.1
Royal Bank of Scotland	2.1
Commonwealth Bank of Australia	1.8
ING Group	1.5
ABN AMRO Bank	1.5
Province of Ontario	1.3
Pacific National	1.2

Investment Option Commentary

The Fund underperformed the benchmark over the quarter, partly contributed by the significant sell-off in rates markets early in the quarter. The Fund's positioning in credit markets added to performance, driven by running yield in higher beta credit assets.

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 and emerging markets 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 and auto parts manufacturers, reflecting the overall strength in the continuing cyclical recovery.

The Fund maintained its reduced investment grade credit exposure over the quarter, reflecting 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, Macquarie 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 the investment manager 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?

Macquarie 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, Macquarie 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. Macquarie remain invested but with balance, with the intention of using periodic volatility to selectively participate in opportunities.

Availability

Product name	APIR
SignatureSuper*	AMP0964AU

*Closed to new investors

Contact Details
Web: www.amp.com.au
Email: askamp@amp.com.au
Phone: 131 267

INSIGHTS
IDEAS
RESULTS