# Macquarie Income Opportunities

Quarterly Investment Option Update

31 December 2018

## Aim and Strategy

To provide higher income returns than traditional cash investments (with some volatility over short time periods) by investing in a diversified portfolio of both domestic and global credit based securities. The benchmark used is the Bloomberg AusBond Bank Bill Index. The portfolio invests predominantly in floating rate notes, Residential Mortgage Backed Securities (RMBS) and Commercial Mortgage Backed Securities (CMBS), which make up the core portfolio. The investment manager also takes an opportunistic approach to investing in hybrids, global investment grade debt securities, global high yield securities, emerging market debt securities and credit opportunities (such as Australian RMBS, offshore asset backed securities, bank loans and other credit opportunities) which aim to take advantage of dislocated market conditions. International investments are generally hedged to the Australian dollar.

## Investment Option Performance

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

## Investment Option Overview

| | |
|---|---|
| **Investment category** | Aust. Fixed Interest |
| **Suggested investment timeframe** | 3 years |
| **Relative risk rating** | Medium |
| **Investment style** | Active |

| Sector Allocation | % |
|---|---|
| Investment grade corporate | 64.2 |
| Investment grade government* | 9.6 |
| Asset-backed securities | 16.2 |
| High yield corporates | 0.0 |
| Emerging markets corporate | 0.0 |
| Emerging markets government | 0.0 |
| Cash | 10.0 |

* Government exposure is utilised to manage interest rate duration

| Top Holdings | % |
|---|---|
| Westpac | 1.8 |
| NAB | 1.4 |
| Bank of America Corporation | 0.8 |
| Westpac | 0.7 |
| Sun Group Finance | 0.7 |
| CBA | 0.6 |
| CBA | 0.6 |
| Medallion | 0.6 |
| AGL | 0.6 |
| AMP | 0.6 |

| Quality Allocation | % |
|---|---|
| AAA | 11.40 |
| AA | 9.90 |
| A | 33.80 |
| BBB | 32.40 |
| BB and below | 1.0 |
| Unrated | 1.4 |
| Cash | 10.5 |

## Investment Option Commentary

The Fund underperformed the benchmark over the quarter. Global credit and broader risk markets were more volatile during the December quarter, as concerns over reduced central bank support, the US government shut down, falling oil prices and Brexit headlines caused an increase in volatility. The Fund's credit positioning has been concentrated to investment grade names, avoiding exposure to the more volatile high yield and emerging market sectors through 2018. This benefited performance, as spreads for the US high yield sector widened significantly, with the decline in oil prices adding to the negative sentiment. By comparison US investment grade credit weathered the volatility better, with record low issuance levels providing some technical support for the sector, although there was still some spread widening for the sector which detracted from Fund performance. The Fund's overweight duration position positively contributed to performance during the quarter, providing a hedge against the increase in market volatility and partially offset some of the detraction from the Fund's credit exposure.

## Market commentary

The recent volatility in markets persisted through December quarter, as market sentiment was impacted by events including the US Federal Reserve (Fed) rate hike, the partial US government shutdown, an earnings season that provided weaker guidance, Brexit concerns and weakness in the oil market. Some reprieve did come towards the year end, due to large pension fund purchases of equities as part of their quarter-end rebalancing which helped to stabilise markets. China-US trade negotiations also appeared to be progressing, with China proposing significant tariff cuts.

The intentions of the Fed remained a market focus during the December quarter, as there were concerns that there was a predetermined path for rate rises and with limited consideration for developments in financial markets. The Fed hiked the target range for the federal funds rate to 2.25% to 2.50% in December, resisting pressure from President Trump to leave interest rates unchanged. The Fed did lower its projection for 2019 gross domestic product (GDP) growth to 2.3% from 2.5% and revised their forecast to 2 rate hikes in 2019 compared to 3 rate hikes previously, but it signalled "gradual" rate increases are still in the cards. Fed Chair Jerome Powell continued to assert Fed interest rate decisions are independent of political consideration, as President Trump has consistently blamed the Fed for the recent decline in the US equity market.

European credit spreads widened in December quarter as Brexit concerns, reduced European Central Bank (ECB) stimulus and political tensions all weighed on markets. The ECB meeting in December did not change the tone materially for risk markets and the central bank decided to end net QE purchases at year end as expected. Redemptions will continue to be re-invested. In the UK, Prime Minister Theresa May survived the Conservative Party confidence vote by a margin of 200 to 117. However, the ultimate endgame for Brexit is likely to continue to the March deadline or beyond. The Prime Minister failed to secure parliamentary support for the deal she has negotiated with the EU hence the vote has been postponed until mid-January. The UK had hoped to seek some concessions from the EU at a summit in Brussels however, no material changes were agreed to and the rescheduled vote is likely to face strong opposition.

On a more positive tone, trade negotiations between the US and China have been progressing somewhat as China proposed to cut tariffs on US vehicle imports from 40% to 15%. The Chinese government has also drafted new legislation with proposed greater intellectual property protection for overseas firms operating in China and to refrain from interfering in the operation of foreign businesses.

## Outlook

The reduction in the support provided by central banks, particularly in the US, has increased volatility throughout 2018 and caused a number of 'cracks' to appear, most recently in the developed world's equity markets. Strong underlying growth in the US is providing a fundamental backstop, and while there remain significant risks (including trade policy and political tensions), it does not appear there is a significant 'real economy' catalyst to undo the current uptick in US growth. Although weaker earnings guidance and some weaker macroeconomic data coming through will require continued monitoring.

Macquarie continue to believe there are opportunities to participate in credit markets with a strong risk management focus, while noting that recent volatility is bringing more attractive valuations back into certain corners of the market. For now, solid growth momentum and corporate earnings provide a robust basis for participating in credit markets.

## 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 |

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