Macquarie Income Opportunities

Quarterly Investment Option Update

31 March 2019

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	5 / Medium to High
Investment style	Income

Sector Allocation	%
Banks	28.6
Residential mortgage	10.8
REITs	5.5
Non-agency CMBS	5.2
Electric	4.3

Top Holdings	%
NAB	1.4
CBA	1.4
NAB	0.9
Bank of America Corporation	0.9
ANZ	0.8
NAB	0.8
ING Bank	0.8
Sun Group Finance	0.7
NAB	0.7
Westpac	0.7

Regional Allocation	%
Australia	64.0
United States	17.9
UK	3.1
Europe Ex UK	7.4
Other	7.6

Quality Allocation	%
AAA	11.5
AA	13.0
A	22.9
BBB	29.4
BB and below	0.6
Unrated	1.5
Cash	21.1

Investment Option Commentary

The Fund outperformed over the quarter, with overweight exposure to investment grade (IG) credit significantly contributing to performance as US IG spreads rallied nearly 40bps from the wides at the start of the year. The Fund's long duration position also contributed to the excess returns, as global bond yields rallied sharply into quarter-end. The March quarter was very positive for risk assets as they hit 6-month highs, while bond yields dropped to their lowest levels since December 2017. These market moves were brought on by: positive central bank rhetoric that was followed by action with the US Federal Reserve (Fed) pausing any further tightening; the European Central Bank offering additional support via the new series of Targeted Longer-Term Refinancing Operations; and China undertaking fiscal stimulus. This collective shift in central bank policy led risk assets to rally while longer-dated bond yields fell.

Market commentary

The March quarter was a very positive quarter for risk assets as they hit 6-month highs, at the same time bond yields dropped to their lowest levels since December 2017. These market moves were brought on by positive central bank rhetoric that was followed by action with the US Federal Reserve (Fed) pausing any further tightening, the European Central Bank (ECB) offering additional support via the new series of Targeted Longer-Term Refinancing Operations (TLTRO) and China undertaking fiscal stimulus. This collective shift in central bank policy, from a tightening bias to be more dovish, led risk assets to rally while longer dated bond yields fell. As a result yield curves flattened, as investors digested what this means against a slowing global economic backdrop.

The Fed softened its stance throughout the quarter starting with a January speech by Fed Chair Powell where he indicated that they would take a "patient" approach to tightening and "wouldn't hesitate" to change balance sheet policy if needed. The quarter finished with the March Federal Open Market Committee (FOMC) meeting where the FOMC removed two rate hikes projected for 2019 and stated that they will reduce balance sheet unwinds by $US15bn in May and stop the unwind in October.

The quarter commenced with concerns over Chinese growth as gross domestic product (GDP) printed at 6.6% for Q4 2018, the slowest rate of growth since 1990. This resulted in several actions which included the People's Bank of China reducing the reserve requirement ratio to free up $US116bn for new lending, plans to set up a central bank bills swap system, an increase in total social financing, and tax cuts amounting to $US298bn were announced. The last measure was implemented after GDP forecasts were revised down from 6.5% to 6.0%.

European data was poor over the quarter finishing with both German and French Purchasing Managers' Index (PMI) data printing below 50 in March. This weaker data led to more supportive action from the ECB which included introducing another round of the TLTRO program to allow cheap collateralised financing to financial institutions along with affirming that they remain on hold. Brexit negotiations also cast a shadow over sentiment with little sign of progress as the deadline has been extended initially to 12 April and an Emergency EU summit is scheduled for 10 April. Theresa May's Withdrawal Agreement has now been rejected three times and Parliament have failed to agree on a viable alternative. However, despite the negative sentiment specific to the European macro environment, European credit performed well, buoyed by broader global risk markets.

Rates markets rallied over the quarter as central banks globally shifted to a more dovish policy outlook. The spread between US 3-month and 10-year Treasury yields inverted for the first time since 2007, which had markets concerned about global growth and US 10-year Treasury bond yields reached 2.36%, their lowest level since December 2017. In Europe, Bund yields traded as low as -0.8%, the lowest level since 2016. In the US there was a strong risk appetite over the quarter with the S&P 500 index hitting 6-month highs led by tech stocks, though financials suffered on lower yields (flatter curves) and growing expectations of long rate pauses or even rate cuts. Credit performed well with US investment grade credit rallying nearly 40bps from its wides at the start of the year and high yield credit also rallied over 100bps. This rally led BBB names like General Electric and AB Inbev to retrace from their wides.

Outlook

The more dovish stance continuing from the Fed, and other central banks, has been encouraging given the recent slowdown in global economic indicators. Whilst there are encouraging signals from central banks pausing and delaying the reduction of support, Macquarie believe the hurdle for additional support is still high and markets may need to be weaker prior to eventuating. Given where risk assets are priced, especially the higher beta sectors, there is less urgency to add risk against this backdrop. They continue to believe there are opportunities to participate in credit markets with a strong risk management approach and a focus on avoiding names that may suffer from idiosyncratic risks.

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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