

UBS Diversified Fixed Income Fund

August 2021

Fund description

The Fund is an actively managed, diversified portfolio of Australian and global fixed income assets.

Investment strategy

The strategy is managed employing both top-down macroeconomic research and bottom-up security specific analysis to build a portfolio with the core defensive characteristics of the fixed interest asset class. Whilst the Fund seeks to be fully hedged to Australian dollars, we may invest in strategic foreign currency exposures that will not exceed 10% of the total portfolio.

Investment return objective

The Fund is actively managed, based on fundamental research that draws upon the investment insights of our fixed income teams. The approach employs both "top-down" research, including analysis of economic factors, market data and macro credit themes and "bottom-up" research in respect of particular securities including analysis of earnings and cash flow stability, balance sheet strength, industry and valuation.

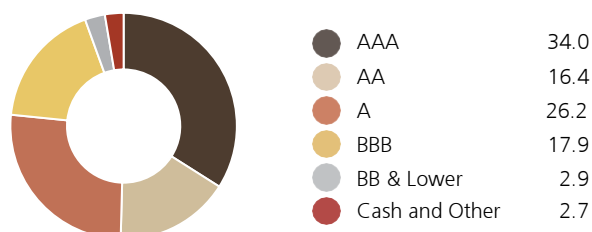
Key statistics	Fund	Benchmark ¹
Modified duration (yrs)	5.88	6.80
Spread duration ² (yrs)	4.35	3.28
Weighted avg maturity (yrs)	6.96	7.77
Average credit quality	A1	Aa2
Yield to maturity ³ (%)	1.25	0.9

¹ Benchmark statistics do not reflect month end rebalancing for new issues and reinvestment of coupons.

² Option adjusted spread duration ex Treasury.

³ Yield to Maturity (YTM) is the estimated annualised rate of return that would be received if the Fund's current securities were all held to maturity. Note that YTM does not account for fees or taxes. YTM is not a forecast, and is not a guarantee of the future return of the Fund.

Credit quality (%)



Note: Credit ratings for physical holdings only, 'cash and other' includes the effect of derivatives.

Fund information

Inception date	31 January 1997
Fund size	\$ 906.0 m
Management fee	0.55% pa
Minimum initial investment	\$50,000
Distribution frequency	Quarterly
Buy/sell spread	+ 0.05% / - 0.15%
APIR code	SBC0007AU

Fund positioning – modified duration contribution (yrs)

By sector	Fund	Benchmark
Government nominal ⁴	2.42	4.21
Government inflation-linked	0.23	0.00
Semi-government	0.83	0.93
Government related	0.86	0.53
Corporates	1.26	0.81
Financials	0.40	0.25
Industrial	0.68	0.48
Utility	0.18	0.09
Securitised	0.28	0.30

By Country

Australia	3.35	3.09
USA	0.41	1.39
Japan	0.50	0.63
Canada	-0.01	0.11
Euro area	0.83	0.91
UK	-0.13	0.29
New Zealand	0.13	0.00
China	0.76	0.20
Other	0.04	0.16

⁴Includes derivatives.

Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	(0.05)	1.87	0.43	3.64	2.87	5.84
Benchmark**	(0.06)	2.04	0.81	4.40	3.13	6.28
Added value	0.01	(0.17)	(0.38)	(0.76)	(0.26)	(0.44)

*Inception date: 31 January 1997. **50% Bloomberg AusBond Composite 0+ Yr Index / 50% Bloomberg Global Aggregate (hedged to \$A). Performance figures are net of ongoing fees and expenses. The performance figures quoted are historical, calculated using end of month redemption prices, and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. Performance can be volatile and future returns can vary from past returns.

Market highlights

- Australian government yields fell early in the month before recovering to close the month flat.
- Australian credit spreads were broadly stable, trading in a tight range.
- The RBA maintained the cash rate at 0.10%.

Performance review

Developed market government bond yields rose during the month of August. The 10-year US Treasury ended the month close to 1.3%, up modestly from around 1.22% at the start of the month. The yield on 10-year German Bunds ended the month at -40bps. Consequently, duration-sensitive sectors such as US and European IG generated negative returns. Spreads tightened in higher beta sectors such as US and European HY leading to positive total returns for the month. EMD hard currency bonds posted a positive monthly return driven by spread tightening despite rising US Treasury yields.

US economic data released in August indicated robust growth and continued inflationary pressure as the supply side struggled to keep up with demand. Nonfarm payrolls increased by 943,000 in July, the most since August 2020. The ISM Services Index hit a record high as consumers shifted their spending toward services. Core CPI rose by 0.3% month-on-month, the smallest increase since February. However, the spread of the delta variant caused new COVID-19 cases to rise in August, with record high infections and hospitalizations in some areas. In his speech at the Jackson Hole symposium, Fed Chair Powell said that he expects the Fed to begin tapering its USD 120bn per month asset purchases by the end of the year, though he emphasized that tapering and rate hikes are two separate decisions.

The Australian bond market delivered a slight positive return in August. Credit spreads were broadly stable, trading in a tight range over the month. Semi-government bonds' spreads widened by 4bps on the back of high issuance during the month. The Bloomberg AusBond Composite 0+Yr Index returned 0.09% in August. The Australian 3 year government bond yields remained flat at 0.24% while 10 year bonds were 2bps lower in yield, to 1.16%. The spread between Australian and US 10 year government bond yields extended its difference to end the month at a spread of -15bps (from -4bps at the end of the prior month).

Our overall short duration positioning contributed positively to relative performance as global developed markets yields rose during August. Within duration management our overweight duration in Australia, New Zealand and China detracted slightly as yields rose on the month while our underweight duration in the UK and US contributed positively to relative performance.

Our overweight position in corporate credit contributed positively to relative performance as spreads tightened on the month together with the extra yield ("carry") generated.

Outlook

While we remain broadly optimistic on the outlook for global growth given easy fiscal and monetary policy settings, the economic risks resulting from outbreaks of the more contagious delta strain of COVID-19 suggests recovery will continue to be uneven across both global economies. In this regards the varied pace of rollout of COVID-19 vaccines across countries, and the impacts emanating from any further genetic mutations, will continue to be a headwind to more robust growth and inflationary pulses.

Although we expect inflation to move higher on stronger growth and ongoing supply bottlenecks, it is not expected to be sufficiently strong to warrant most central banks changing course in the near-term. Monetary policy settings globally remain highly accommodative, and central banks will retain these settings for some time in order to support their economies. However, we expect to see some central banks – with the US Federal Reserve in particular – discussing on a more consistent basis about when they will taper and ultimately begin to raise rates. While removing excess stimulus is still some way off for other central banks, markets may become skittish if they try to get too far ahead of the expectations they have fed to markets over the past year.

In contrast to changes in messaging from the US Fed, the RBA continues to be quite resolute in signalling that it will continue to pursue a accommodative monetary stance for some time. The excess liquidity that is being generated should continue to support the local bond market and act as a counterbalance to currency strength.

Risk assets across-the-board continue to perform well. Within credit, we expect investor demand to remain strong in an environment where official cash rates are at or close to zero and investors globally continue their reach for yield. Explicit support for high quality credit from central banks in the US and Europe will also underpin demand and is likely to help keep a ceiling on any spread widening episodes. Based on this backdrop, we expect the Australian corporate credit market will continue to perform reasonably well.

Client Services

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