

UBS Diversified Fixed Income Fund

September 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.

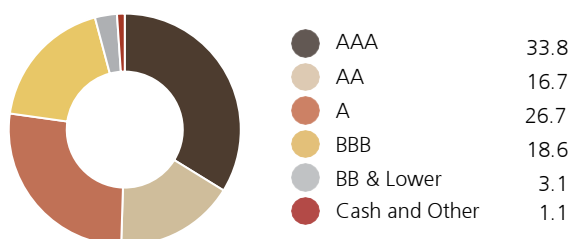
Key statistics	Fund	Benchmark ¹
Modified duration (yrs)	6.52	6.70
Spread duration ² (yrs)	4.44	3.25
Weighted avg maturity (yrs)	7.52	7.64
Average credit quality	A1	Aa2
Yield to maturity ³ (%)	1.41	1.06

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	\$ 884.0 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	2.95	4.12
Government inflation-linked	0.23	0.00
Semi-government	0.86	0.93
Government related	0.86	0.52
Corporates	1.32	0.81
Financials	0.42	0.25
Industrial	0.72	0.47
Utility	0.18	0.09
Securitised	0.30	0.33

By Country

Australia	3.39	3.02
USA	0.67	1.41
Japan	0.51	0.63
Canada	-0.01	0.11
Euro area	0.85	0.88
UK	0.01	0.27
New Zealand	0.27	0.00
China	0.79	0.21
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	(1.09)	0.15	(1.31)	3.35	2.67	5.77
Benchmark**	(1.24)	0.18	(1.16)	4.11	2.89	6.20
Added value	0.15	(0.03)	(0.15)	(0.76)	(0.22)	(0.43)

*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 bond yields rose across the term structure.
- Australian credit spreads widened marginally over the month of September.
- The RBA maintained the cash rate at 0.10%.

Performance review

Developed market high-beta segments outperformed their lower beta counterparts during the month of September. However, total returns were negative given headwinds from the move higher in rates in both the US and Europe. The only credit segments showing a positive return were US and European senior loans, which are insulated from higher rates. EM Sovereign bonds in USD dollar fell during the month, reflecting their longer duration as well as developments in China's property sector and one of its most indebted companies, Evergrande.

US rates sold off during the month, with the 10-year yield up 18 bps to 1.48% driven by a more hawkish than expected tone from the FOMC meeting on September 21-22. The Fed indicated that it was on track to start tapering its quantitative easing asset purchases, currently running at USD 120bn a month, soon. In his post-meeting press conference, Chair Powell confirmed that the tapering announcement could be made as soon as the next meeting. Treasury Secretary Janet Yellen said that the debt ceiling must be raised by 18 October for the government to continue paying its bills. The House voted to suspend the ceiling, but Republicans in the Senate used the filibuster to prevent a vote, insisting that Democrats add a debt ceiling increase to their budget reconciliation bill. Job growth exceeded 1 million in July but slowed sharply in August to just 235,000. At the same time, job openings soared to record highs as businesses struggled to find workers.

The Australian bond market delivered negative return in September largely due to rising Australian Government Bond yields. The Australian 3-year government bond yields rose 7bps to 0.31% while 10-year bonds yields rose 33bps to 1.49% over the month. The spread between Australian and US10 year government bond yields narrowed its difference to end the month at the same level (from -15bps at the end of the prior month). Credit spreads widened marginally over the month. Semi-government bonds performed well in September on the back of the announcement from RBA that the Common Liquidity Facility (CLF) will be slowly phased out over 2022. The Bloomberg AusBond Composite 0+Yr Index returned -1.51% in September.

Our overall short duration positioning contributed positively to relative performance as global developed markets yields rose during September. Within duration management, our underweight duration in the UK, Canada and the US contributed positively to relative performance, as yields rose sharply. Overweight positions in Australia and New Zealand detracted a little from performance, while the long China duration allocation was broadly neutral. Elsewhere, our overweight position in investment grade credit contributed positively to relative performance, largely via carry, as spreads remained stable over the month.

Outlook

We continue to expect the global economic expansion to proceed, albeit unevenly as the spread of COVID-19 impacts economies differently and as policy support diminishes in some jurisdictions. Vaccine coverage has been a key consideration in our thinking on the durability of the recovery. On this front, the rapid vaccine rollout in Australia since July has increased our optimism that growth in the coming months will look markedly better than the third quarter. Accordingly, there are signs that the sensitivity of Australian government bonds to global equivalents has picked up again, which should result in modest upward cyclical pressure on yields into year-end. We are however conscious that longer-dated forward rates have not got far to travel before they start to look high in the context of an overleveraged global economy.

Another feature of the global recovery that we are tracking closely is the high incidence of supply bottlenecks and the impact on inflation. These disruptions have emerged in sectors such as lumber, shipping and now the energy sector. So far, Australia has avoided the worst of the inflationary pressures experienced by the likes of the UK and US but there is uncertainty as to whether this will remain the case as the larger states of New South Wales and Victoria re-emerge from lockdown. We are keeping a watchful eye out for signs that this could feed through to higher headline CPI inflation here. While likely to be temporary, this could present investment opportunities with inflation breakeven rates trading considerably lower than peers.

One aspect that remains consistent is that the RBA has pre-committed to maintaining its current pace of QE until February and is insistent that it is unlikely to consider raising the cash rate until 2024. This contrasts with the

Reserve Bank of New Zealand, which recently raised its cash rate, as well as the Bank of England and US Federal Reserve, where some committee members are entertaining possible rate rises next year. We continue to find the RBA's more dovish stance credible. Even though headline inflation may surprise to the upside, the bank's favoured underlying measures as well as wages growth are set to remain pinned down.

Meanwhile, credit has continued to perform well, despite some weakness in equities. 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. The accumulated and still growing stock of bonds on global central banks' balance sheets will also underpin demand for high quality credit and is likely to help keep a ceiling on any spread widening episodes. Based on this backdrop, we expect the Australian corporate

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