

UBS Australian Bond Fund

September 2021

Fund description

The Fund is an actively managed, diversified portfolio of largely investment grade fixed income securities, cash equivalents and cash.

Investment strategy

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.

The Fund’s investment strategy is to invest in a portfolio of largely investment grade fixed income securities, cash equivalents and cash.

Investment return objective

The Fund aims to outperform (after management costs) the Bloomberg AusBond Composite 0+Yr Index over rolling three year periods.

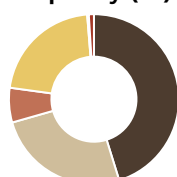
Key statistics	Fund	Benchmark ¹
Modified duration (yrs)	5.76	5.85
Spread duration ² (yrs)	3.99	2.16
Weighted avg maturity (yrs)	6.64	6.64
Average credit quality	AA	AA+
Yield to maturity ³ (%)	1.38	0.01

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 (%)



AAA	45.2
AA	25.4
A	6.6
BBB	21.6
Below BBB	0.3
Cash and other	1.0

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

Fund information

Inception date	30 November 1989
Fund size	\$ 1,119.2 m
Management fee	0.45% pa
Minimum initial investment	\$50,000
Distribution frequency	Quarterly
Buy/sell spread	+ 0.025% / – 0.08%
APIR code	SBC0813AU

Fund positioning – modified duration contribution (yrs)

By sector	Fund	Benchmark
Government nominal ⁴	2.05	3.68
Government inflation-linked	0.00	0.00
Semi-government	1.85	1.52
Government related	0.65	0.39
Corporates	1.12	0.25
<i>Financials</i>	0.43	0.10
<i>Industrial</i>	0.51	0.11
<i>Utility</i>	0.18	0.03
Credit hedge ⁵	0.00	0.00
Securitized	0.10	0.01
Cash and cash equivalents	0.00	0.00
By Tenor		
0–3 year	0.35	0.37
3–5 year	0.73	0.77
5–7 year	1.02	0.86
7–10 year	1.45	1.84
10+ years	2.22	2.01

⁴ Includes derivatives.

⁵ Spread duration contribution.

Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	(1.49)	0.25	(1.56)	3.87	2.98	7.54
Benchmark**	(1.51)	0.31	(1.54)	4.13	3.06	7.53
Added Value	0.02	(0.06)	(0.02)	(0.26)	(0.08)	0.01

*Inception date: 30 November 1989. **Bloomberg AusBond Composite 0+ Yr Index.

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.

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.

In September, Australian Government bond yields rose across the term structure. Our overall Australian duration relative to benchmark was flat throughout the month, and thus there was no contribution to index-relative performance from domestic rates positioning. On yield curve positioning, our slight overweight on belly (5-7 years) and underweight on slightly longer-end of the curve (7-10 years) contributed a slight negative to relative performance as rates rose more on the longer-end. Late in the month, we executed a switch out to the long end of the curve, from 9-years to 20-year Australian government bonds.

The overall portfolio's global rates positioning contributed positively to returns over the month. The short US Treasuries and 10-year Gilts positions contributed positively to relative performance as developed market government bond yields rose over the month. We took profit on the 10-year Gilts position as it reached our target yield.

We also added a long position in New Zealand's 10-year interest rate swap in early September which contributed a slight negative to relative performance as the NZ government bond yields rose.

Australian semi-government bond spreads tightened marginally over the month. We added beta in the semi-government sector through purchasing longer-dated Victoria State government (TCV) bond. As spreads tightened, the overweight in semi-government contributed a slight positive to relative performance. Supranational bond spreads traded in a tight range in September. Our overweight supranational position had no impact on relative performance as yields ("carry") compensated for a small spread widening. We remain overweight corporate credit and added modestly to that position during the month through buying bonds in the utilities and airlines sector. The portfolio overweight exposure to corporates benefited marginally from the yields ("carry"), contributing a slight positive to relative performance.

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 credit market will continue to perform reasonably well.

Client Services

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