

# UBS Diversified Fixed Income Fund

November 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.

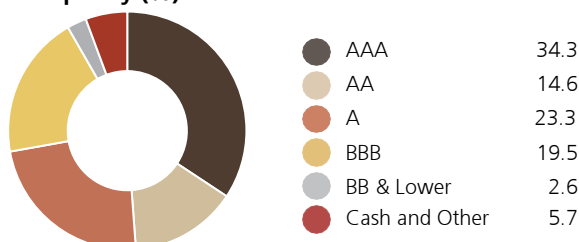
Key statistics	Fund	Benchmark <sup>1</sup>
Modified duration (yrs)	6.62	6.70
Spread duration <sup>2</sup> (yrs)	4.34	3.27
Weighted avg maturity (yrs)	7.65	7.68
Average credit quality	A1	Aa2
Yield to maturity <sup>3</sup> (%)	1.96	1.29%

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

<sup>2</sup> Option adjusted spread duration ex Treasury.

<sup>3</sup> 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	\$ 844.7 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 <sup>4</sup>	3.07	4.24
Government inflation-linked	0.23	0.00
Semi-government	0.89	0.93
Government related	0.82	0.52
Corporates	1.36	0.81
<i>Financials</i>	0.43	0.25
<i>Industrial</i>	0.74	0.47
<i>Utility</i>	0.18	0.09
Securitised	0.26	0.21
By Country	Fund	Benchmark
Australia	3.70	2.97
USA	0.53	1.45
Japan	0.50	0.62
Canada	-0.02	0.11
Euro area	0.83	0.88
UK	0.05	0.29
New Zealand	0.40	0.00
China	0.59	0.21
Other	0.03	0.16

<sup>4</sup>Includes derivatives.

## Investment performance

Fund	1 month %	3 months %	1 year %	3 years % pa	5 years % pa	Since inception* % pa
Total return	1.35	(2.16)	(2.61)	2.90	2.93	5.69
Benchmark**	1.41	(1.76)	(2.02)	3.76	3.33	6.14
<b>Added value</b>	<b>(0.06)</b>	<b>(0.40)</b>	<b>(0.59)</b>	<b>(0.86)</b>	<b>(0.40)</b>	<b>(0.45)</b>

\*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 fell across the term structure.
- Australian credit spreads widened over the month of November largely due to concerns of omicron variant.
- The RBA began normalising monetary policy with cessation of YCC operations and tapering of QE.

## Performance review

Credit spreads widened during the month of November, with high-beta segments most affected by worries over rising inflation and later the impact of the omicron variant. It was a month of two parts for longer-term US government bond yields. For much of the month, yields trended higher amid concern over the potential for swifter policy tightening from the Federal Reserve. This contributed to a rise in 10-year Treasury yields from 1.56% at the start of November to around 1.68% by 24th November. But the mood shifted abruptly with growing concern over the omicron variant, sending the 10-year yield down to 1.46% by the end of the month.

In the US, COVID-19 case counts trended higher in November, although conditions vary across the country. Despite this, there was some improvement in mobility indicators. Economic data for October was generally strong, with nonfarm payrolls rising by a better-than-expected 531,000, coupled with upward revisions to previous months' data. The unemployment rate fell to a post-pandemic low of 4.6%. The 6.2% inflation rate in October was the highest since a brief period in 1990, and excluding this period, inflation has not been this high since 1982. The Fed begun tapering its QE asset purchases under a plan that would end the program by mid-2022.

The Australian bond market delivered positive return in November largely due to falling domestic government bond yields. The Australian 3-year Government bond yields fell 35bps to 0.87% while 10-year bonds yields fell 40bps to 1.69% over the month. The spread between Australian 10-year and US 10-year Government bond yields narrowed, ending the month at +25bps (from +54bps at the end of the prior month). Both credit and semi-government bond spreads widened over the month. The Bloomberg AusBond Composite 0+Yr Index returned 2.08% in November.

Our duration positioning delivered mixed performance over November as global bond markets rallied over concerns of new variant omicron. Our overweight duration positions in Australia, New Zealand and China contributed positively to relative performance while underweight positions in the UK, Canada and the US contributed negatively to relative performance. Overall duration position contributed a slight positive to relative performance largely driven by the duration position in Australia which the 10-year bonds yields fell 40bps to 1.69% over the month. Elsewhere, our overweight position in investment grade credit contributed a slight negative to relative performance as yields ("carry") were not sufficient to negate effect of the spreads widening.

## Outlook

We continue to expect the global economic expansion to proceed, albeit unevenly as the spread of COVID-19 (including new variants) impacts economies unequally and as policy support diminishes at different speeds. We remain confident that the Australian economy will rebound strongly from the third quarter contraction amid high vaccine coverage, stronger political will to avoid future lockdowns and a high household savings rate. Improving expectations for domestic growth has seen an increased sensitivity of Australian government bonds to global equivalents resulting in some cyclical upward pressure on yields. We are however conscious that there are limits to how far long-dated bond yields can get dragged higher, especially given 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, US and even the Eurozone but there is uncertainty as to whether this will remain the case as the larger states of New South Wales and Victoria re-open. We note that the Q3 inflation release surprised to the upside with the trimmed mean measure running at 2.1%. While this is still well below peers, underlying inflation is now within the RBA's 2-3% target band for the first time in six years and it is plausible that it could hit the mid-point sometime next year.

Higher domestic inflation as well as a global shift in a hawkish direction from central banks such as the Bank of England, Reserve Bank of New Zealand and Bank of Canada has caused a sharp jump in short-dated yields culminating in the RBA's Yield Curve Control formally being renounced on 2 November. Some more volatility is expected as QE is also being wound down and bonds try and find a more market-determined level. However, at the time of writing, it appears that any future RBA tightening looks well-priced with 90bps of implied hikes factored in for 2022 and an implied terminal cash rate close to 2% in five-years' time. The latter is above our central estimate of c.1.5%.

Meanwhile, credit spreads have been relatively resilient, despite some weakness in global equities. We expect investor demand to remain strong so long as 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.

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