

UBS Australian Bond Fund

January 2022

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.

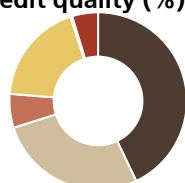
Key statistics	Fund	Benchmark ¹
Modified duration (yrs)	5.73	5.70
Spread duration ² (yrs)	3.69	2.14
Weighted avg maturity (yrs)	6.48	6.49
Average credit quality	AA	AA+
Yield to maturity ³ (%)	2.08	1.75

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	42.9
● AA	27.2
● A	6.2
● BBB	18.6
● Below BBB	0.3
● Cash and other	4.7

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

Fund information

Inception date	30 November 1989
Fund size	\$ 968.4 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	2.16	3.57
Government inflation-linked	0.00	0.00
Semi-government	1.80	1.52
Government related	0.62	0.36
Corporates	1.07	0.25
<i>Financials</i>	0.51	0.10
<i>Industrial</i>	0.39	0.12
<i>Utility</i>	0.17	0.03
Credit hedge ⁵	0.00	0.00
Securitized	0.08	0.01
Cash and cash equivalents	0.00	0.00
By Tenor		
0–3 year	0.31	0.40
3–5 year	0.87	0.68
5–7 year	1.10	0.95
7–10 year	1.29	1.83
10+ years	2.16	1.84

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	(1.09)	1.18	(3.86)	2.09	2.91	7.37
Benchmark**	(1.02)	1.13	(3.46)	2.29	3.02	7.36
Added Value	(0.07)	0.05	(0.40)	(0.20)	(0.11)	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 yield curve flattened with the front-end rising higher than the long-end.
- Australian credit spreads widened over January.
- The RBA maintained the cash rate target at 10 basis points and ceased further purchases under the bond purchase program.

Performance review

Virtually all major fixed income sectors generated negative returns in January. Developed market bonds in Europe and the US suffered from rising yields but generally outperformed corporate bonds and other spread sectors that were impacted by a combination of rising yields and widening spreads. EM local currency bonds were one of the best performing asset classes buoyed by gains in EM FX that largely offset losses in local rates. China Fixed Income posted a solid gain for the month as rates rallied and the currency held its own against the dollar. The US 10-year yield moved up around 27 basis points to 1.78% at the end of the month while the 2-year yield, which is more sensitive to Fed policy expectations, rose even more, up around 45 basis points to end the month at 1.18%.

The Australian bond market delivered negative return in January as global and domestic government bond sold off. The Australian 3-year Government bond yields rose 40bps to 1.31% while 10-year bonds yields rose 23bps to 1.90% over the month. The spread between Australian 10-year and US 10-year Government bond yields narrowed, ending the month at +12bps (from +16bps at the end of the prior month). Similar to global bond markets, domestic credit spreads mostly widened. The semi-government sector referenced by the Bloomberg Ausbond Semi-government 0+Yr Index, widened 3bps from 26 to 29bps.

Australian Government bond yields rose over the month with most of the price action taking place in the earlier half of the month. Following this sharp move higher in yields, we took profit on the overall short duration positions and neutralised our duration to end the month.

On our global rates trades, we took profit on our short UK gilts and US positions following the sell-off in bond markets early in the month. We continue to run a spread tightener position with short US duration against New Zealand interest rate swaps which had little impact on relative performance as this spread remained stable over the month.

Australian corporate credit and semi-government bond spreads widened over the month. The portfolio's overweight positions across Australian semi-government bonds, supranational and corporates contributed negatively - however the higher portfolio yield ("carry") negated some of the loss from spread widening. During the month, we slightly trimmed our overweight position in corporates by selling bonds in the BBB rating bucket.

Outlook

2022 is shaping up to be a volatile year for financial markets. Last year's negative returns on benchmark bond indices such as the AusBond Composite were a result of a slow and steady realisation that higher-than-expected inflation will require higher interest rates. This year represents the next phase, with the outlook depending on how far financial conditions can tighten without jeopardizing the recovery. Initially we think government bond yields will continue to be biased higher, led by the front-end. Yet there comes a point where tighter conditions will collide with overleveraged economies. These episodes are often associated with large drawdowns in risky asset prices, leaving bonds to once again provide the ballast in investors' portfolios.

We remain confident that the Australian economy will continue to rebound strongly amid high vaccine coverage, stronger political will to avoid future lockdowns and a high household savings rate. We do however expect Omicron to at least temporarily jolt the low inflation consensus, which is already showing signs of cracking after a bumper Q4 inflation release (i.e. trimmed mean CPI at 1.0% q/q). The lesson from western countries that have been "living with the virus" for some time has been that disruptions to labour and goods supply have been at least as significant and often longer lasting than the negative impact to demand. As a result, we expect the coming months to see the unemployment rate fall below 4% - the level thought to represent full employment - underlying inflation breach the upside of the RBA's 2-3% target band and wages to also show stronger upside momentum.

The RBA has already wound down Yield Curve Control and QE since October 2021 but has so far communicated that it is willing to take a patient approach to raising the cash rate. Yet the incoming data will test this resolve and we expect the bank to follow in the footsteps of other Anglo-Saxon central banks in hiking rates, potentially as early as mid-year. Tactically we favour positioning short duration in the front-end of the yield curve as hikes come into view. Long-dated bond yields can remain comparatively stable, and our expectation is that 10-year ACGBs find support with yields in a 2-2.5% range.

It is our view that this tightening of monetary conditions, including a drying up of the flow of central bank QE and higher real yields, provides a more challenging outlook for corporate credit than 2021. Spreads are more likely to drift wider as markets demand some return of risk premium that had been compressed in the QE era, even if the relatively low duration and high quality of Australian credit should see it outperform other markets such as the US.

Client Services

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