

# UBS Diversified Fixed Income Fund

February 2022

## Fund description

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

## Target market

The Target Market Determination (TMD) for the Fund sets out the class of consumers for whom the product, including its key attributes, would likely be consistent with their likely objectives, financial situation and needs. To access to the TMD and other Fund documentation visit our [website](#).

## 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.

## Investment return objective

The Fund aims to outperform (after management costs) the Benchmark over rolling three year periods.

## Key statistics

	Fund	Benchmark <sup>1</sup>
Modified duration (yrs)	6.55	6.49
Spread duration <sup>2</sup> (yrs)	4.04	3.18
Weighted avg maturity (yrs)	7.40	7.64
Average credit quality	A1	Aa2
Yield to maturity <sup>3</sup> (%)	2.16	1.82%

<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.

## Fund information

Inception date	31 January 1997
Fund size	\$ 766.2 m
Management fee	0.55% pa
Minimum initial investment	\$50,000
Distribution frequency	Quarterly
Buy/sell spread	+ 0.05% / - 0.15%
APIR code	SBC0007AU

## Credit quality (%)



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

## Fund positioning – modified duration contribution (yrs)

By Sector	Fund	Benchmark
Government nominal <sup>4</sup>	3.33	4.04
Government inflation-linked	0.21	0.00
Semi-government	0.86	0.91
Government related	0.72	0.45
Corporates	1.18	0.76
Financials	0.42	0.24
Industrial	0.59	0.44
Utility	0.16	0.08
Securitised	0.25	0.34

By Tenor	Fund	Benchmark
Australia	2.81	2.89
USA	1.24	1.41
Japan	0.65	0.62
Canada	-0.07	0.11
Euro area	0.76	0.83
UK	0.16	0.26
New Zealand	0.42	0.00
China	0.53	0.23
Other	0.03	0.16

<sup>4</sup>Includes derivatives.

## Investment performance

Fund	1 month %	3 months %	1 year % pa	3 year % pa	5 years % pa	Since inception* % pa
Total return	(1.32)	(2.30)	(1.64)	1.33	2.32	5.53
Benchmark**	(1.25)	(2.74)	(1.69)	1.87	2.59	5.96
<b>Added Value</b>	<b>(0.07)</b>	<b>0.44</b>	<b>0.05</b>	<b>(0.54)</b>	<b>(0.27)</b>	<b>(0.43)</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 rose across the term structure.
- Australian credit spreads widened over February.
- The RBA ended the bond purchasing program and announced that the Board would make a decision about bond maturity reinvestment in May.

## Performance review

Global equities and fixed income markets fell for a second straight month in February, as the outset of war between the Russia and Ukraine added to worries about the outlook for growth, inflation, and central bank policy. Markets experienced heightened volatility, especially toward the end of the month as investors weighed the impact of Russia's invasion of Ukraine, potential disruptions to the flow of commodities, and the ramping up of global sanctions on Russia. The conflict has escalated rapidly. Stricter sanctions have been announced by many countries, including measures to cut off select Russian financial institutions from the SWIFT global payments system. Sanctions and punitive measures so far have allowed, generally, for a continued flow of commodities from Russia to global markets, though the conflict has affected some oil pipelines and supplies of wheat.

Uncertainty about the flow of commodities comes at a time when global consumers are already facing inflation at multi-decade highs, and signs that price pressures are broadening. US CPI hit 7.5% year-over-year in January, a 40-year high; Eurozone consumer prices rose by a record 5.1%; and UK CPI was 5.5%, a three-decade high. With inflation still elevated, central banks have continued to signal a shift toward tighter policy. Public comments from FOMC members continue to suggest that the US Federal Reserve will start raising rates at their next meeting on March 16th, with balance sheet reduction likely to begin a bit later in the year. The Bank of England raised interest rates again in February, to 0.5%, while the European Central Bank kept rates on hold but said inflation risks were tilted to the upside.

The Australian bond market delivered negative return in February as domestic government yields rose across the term structure and credit spreads widened. The Australian 3-year Government bond yields rose 23bps to 1.54% while 10-year bonds yields rose 24bps to 2.14% over the month. The spread between Australian 10-year and US 10-year Government bond yields widened, ending the month at +31bps (from +12bps at the end of the prior month). Domestic credit spreads referenced by the Bloomberg Ausbond Credit 0+Yr Index, widened 7bps from 83 to 90bps.

Our defensive duration positioning delivered a positive performance contribution over February, as bond yields rose across the developed markets, particularly in the US and the UK. We took profits on our underweight duration positions in the US and UK during the early part of the month and began to lighten the overweight allocation to Chinese sovereign bonds as well. Offsetting this, our overweight position in investment grade credit detracted, as global credit spreads widened, although the Australian market performed better than its counterparts in the US and Europe.

## Outlook

2022 is shaping up to be a volatile year for financial markets with the outlook depending on how far financial conditions can tighten without jeopardising the recovery. Recently, Russia invaded their neighbouring country Ukraine amid an escalation in tensions. This has also led to safe-haven flows into fixed income and increased volatility. Yet ultimately we do not see these events derailing the trend towards monetary policy tightening in most geographies, especially when taking into account renewed upside risks to inflation from even higher commodity prices. Consequently, we continue to think that government bond yields are more likely to be biased higher in the near-term.

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. At the same time, we are observing an acceleration and broadening out of inflation. As Australia transitions to "living with the virus", we are conscious of the inflationary experience of other western economies where disruptions to labour and goods supply have been at least as significant and often longer lasting than the negative impact to demand. Higher energy and food prices should also contribute to another strong inflation release in Q1 after a bumper 1.0% q/q increase in the RBA's preferred trimmed mean measure in Q4. All told, 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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