

# UBS Australian Bond Fund

April 2022

## Fund description

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

## 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.

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

## Investment 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 <sup>1</sup>
Modified duration (yrs)	5.40	5.38
Spread duration <sup>2</sup> (yrs)	3.64	2.07
Weighted avg maturity (yrs)	6.36	6.19
Average credit quality	AA	AA+
Yield to maturity (%)	4.43	2.97

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

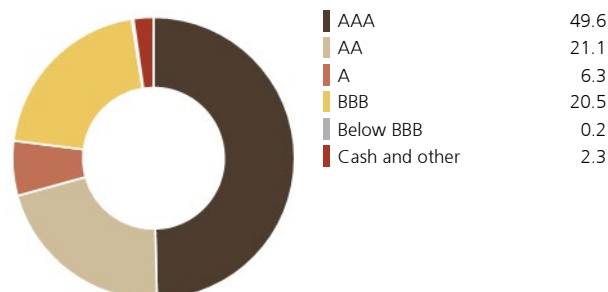
<sup>2</sup> Option adjusted spread duration ex Treasury.

<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	30 November 1989
Fund size	\$ 832.7 m
Management fee	0.45% pa
Minimum initial investment	\$50,000
Distribution frequency	Quarterly
Buy/sell spread	+ 0.025% / – 0.08%
APIR code	SBC0813AU

## 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>	1.92	3.31
Government inflation-linked	0.00	0.00
Semi-government	1.66	1.47
Government related	0.69	0.35
Corporates	1.04	0.24
Financials	0.48	0.10
Industrial	0.39	0.11
Utility	0.17	0.03
Credit hedge <sup>5</sup>	0.00	0.00
Securitised	0.08	0.01
Cash and cash equivalents	0.00	0.00

By Tenor	Fund	Benchmark
0–3 year	0.35	0.45
3–5 year	0.84	0.71
5–7 year	1.07	0.97
7–10 year	1.10	1.57
10+ years	2.04	1.68

<sup>4</sup> Includes derivatives. <sup>5</sup> Spread duration contribution.

## Investment performance

Fund	1 month %	3 months %	1 year % pa	3 year % pa	5 years % pa	Since inception* % pa
Total return	(1.52)	(6.57)	(7.87)	(1.15)	1.21	7.09
Benchmark**	(1.49)	(6.33)	(7.47)	(0.91)	1.40	7.09
<b>Added Value</b>	<b>(0.03)</b>	<b>(0.24)</b>	<b>(0.40)</b>	<b>(0.24)</b>	<b>(0.19)</b>	<b>0.00</b>

\*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 over April.
- The RBA kept cash rate target at 0.10% in April but raised the cash rate target by 25bps on 3rd May as inflation data printed strongly in late April.

### Performance review

Credit sectors took another leg down in April with US high grade and EM hard currency sovereign bonds amongst the worst performers as yields moved higher and credit spreads widened. 10-year US Treasury yields climbed 59bps to 2.93% in April, having reached an intra-month high of 2.98%. The US dollar outperformed all other G10 currencies driven by market expectations of faster and further rate hikes by the US Fed relative to other developed countries.

The downtrend for the Australia bond market continued with another month of negative performance in April. The Bloomberg AusBond Composite 0+ year index returned -1.49% for April, and -9.32% YTD – a result of 4 months of consecutive negative returns. This was driven primarily by the sell-off in Australian government bonds where 10-year yields rose 146bps YTD. The Australian 3-year Government bond yields increased 37bps to 2.71% while 10-year bonds yields rose 29bps to 3.13% over the month. The spread between Australian 10-year and US 10-year Government bond yields narrowed, ending the month at +20bps (from +50bps at the end of the prior month). Domestic credit spreads referenced by the Bloomberg AusBond Credit 0+Yr Index, widened 9bps from 108 to 117bps.

Early in April, the RBA kept the cash rate target at 10 basis points, highlighted the rebound and recovery in the Australian economy while maintaining the rhetoric that inflation remained lower than in many other countries and will be manageable. They would re-assess the situation with the upcoming data. Later on in the month, Q1 CPI printed strongly with the RBA's preferred trimmed mean measure (YoY) now at 3.7%, comfortably breaching the upside of the RBA's 2-3% target band. As a result, the RBA raised cash rate target by 25bps on 3rd May, surprising the market expectation of a 15bps increase.

### Australia ESG insights

Investors will likely be aware of the ever growing sustainable bond space, incorporating green, social and sustainability (GSS) bonds. UBS-AM has been an active buyer in this space, however, it's important to understand that not all sustainable bonds are equal. We have developed our own approach to determine whether GSS bonds are suitable for investment. Our credit analyst team consider a multitude of factors with the starting point being the green, social or sustainability framework that sets out the issuer's targets and objectives. Analysts review these frameworks to assess: 1) The credibility of Use of Proceeds of eligible projects; 2) Clarity and degree of ambition around targets; 3) Reporting transparency; and 4) Alignment with ICMA Standards. Attention is also given to alignment with UNSDG's, the Climate Bond Initiative and (where relevant) the EU Taxonomy. Ultimately, a conclusion can then be drawn as to whether a greenium (spread discount) is justified for a particular GSS bond.

Our overall slight long Australian position contributed a small negative relative performance as rates rose across the curve in April. In early April, following the surge in government bond yields on the front-end of the curve, we initiated a calendar spread trade on the Australian 90-day bank bill futures with long Dec 2022 contract against short Jun 2022 contract with the view that market is pricing in elevated yield expectation and that the 3-month BBSW rate should normalize in the upcoming months.

On global rates exposures, our existing spread tightener position - short US duration against New Zealand interest rate swaps - contributed a slight positive to relative performance as this spread tightened slightly over the month. We also took partial profit on our other spread tightener position, short US duration against long Australian duration in April as the spread between Australian 10-year and US 10-year Government bond yields narrowed, ending the month at +20bps (from +50bps at the end of the prior month). During the month, we also initiated a short Japan duration position with the view that there might be a slight chance the government fails to defend the yield target while downside risk was limited.

Australian credit spreads across all sectors widened over the month with the corporate sector being impacted the most. The portfolio's overweight positions across Australian semi-government, supranational and corporates contributed negatively as spreads widened.

## Outlook

We wrote at the start of the year that bond yields were more likely to be biased higher in the months ahead particularly at the front-end of government yield curves as central bank tightening gathers pace. This turned out to be an understatement as continued upside surprises in inflation has seen an aggressive re-pricing of rate hike expectations across the globe. Q1 saw some of the largest quarterly losses on major bond indices on record, including -5.88% for the AusBond Composite. While the negative momentum has run into the second quarter, we assess the outlook as more balanced from here.

To be sure, the near-term outlook for the Australian economy remains strong with most COVID restriction gone while pre-election fiscal handouts and a high savings rate are supporting nominal household spending. However global growth is showing signs of rolling over while domestic inflation has strong momentum and breadth. Higher fuel, housing and food prices contributed to another strong CPI release in Q1 with the RBA's preferred trimmed mean measure now at 3.7%, comfortably breaching the upside of the RBA's 2-3% target band. All told, we expect the coming months to see the unemployment rate fall through 4% - the level thought to represent full employment - underlying inflation rise further above 4% and wages to also show stronger upside momentum.

As a result, the RBA has finally followed in the footsteps of other Anglo-Saxon central banks, hiking the cash rate by 25bps in May and making wholesale upward revisions to its inflation forecasts. A tightening cycle beckons. Yet slightly counter-intuitively, we think that a central bank that is now alert to the inflation risk leans supportive for duration, especially with 10-year yields now well above 3%. Yet, with rate volatility likely to persist in the short-term, we continue to prefer to express this on a cross-market basis for now. The peak in RBA cash rate is currently priced at 3.5% in twelve to 18 months' time. Whereas this level might be appropriate for the US economy, it looks too high for Australia given the more heavily levered and cash rate sensitive household.

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, as well as conflict in Ukraine provides a more challenging outlook for corporate credit than 2021. The recent moves wider in spreads beyond the 2018/19 wides restores some risk premium and puts spreads back closer to what we'd categorise as fair value. We continue to think the relatively low duration and high quality of Australian credit fare better than other markets such as the US.

## Client Services

Telephone: (03) 9046 4041 Freecall: 1800 572 018 Email: [ubs@unitregistry.com.au](mailto:ubs@unitregistry.com.au) [www.ubs.com/am-australia](http://www.ubs.com/am-australia)

Investors should consider the PDS and seek professional financial and taxation advice before deciding whether the product is appropriate for them and whether to acquire, or to continue to hold the investment. Your investment in the Fund does not represent deposits or other liabilities of UBS or any member company of the UBS Group including UBS Asset Management (Australia) Ltd (ABN 31 003 146 290) (AFS Licence No. 222605), the issuer of the Fund. Your investment is subject to investment risk, including possible delays in repayment and loss of income and capital invested. The repayment of capital or income is not guaranteed by any company in the UBS Group. Offers of interests in the Fund are contained in the Product Disclosure Statement dated 29 September 2021. Any potential investor should consider the relevant product disclosure statement (PDS) in deciding whether to acquire, or continue to hold, units in a fund. UBS has also issued a target market determination (TMD) that describes the class of consumers that comprises the target market for each UBS fund and matters relevant to their distribution and review. A copy of the PDS, PDS addition information and TMD is available from UBS Asset Management (Australia) Ltd, the issuer of the UBS Funds, on our website <https://www.ubs.com/au/en/asset-management.html> or by calling (03) 9046 4041 or 1800 572 018.

The PDS for this fund is only available to persons receiving the PDS (electronically or otherwise) while physically in Australia, unless expressly authorised by us in writing. The offer does not constitute an offer or invitation in any place in which, or to any person to whom, it would be unlawful to make such an offer or invitation. This Fund (or the PDS) has not been registered under the laws of any jurisdiction outside Australia. The Fund may not be offered or sold in the United States of America or to 'U.S. Persons' (as defined in 'Regulation S' of the Securities Act of 1933, as amended).

This document may not be reproduced or copies circulated without prior authority from UBS Asset Management (Australia) Ltd.

© UBS Group AG 2022. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.

