

UBS Diversified Fixed Income Fund

April 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 ¹
Modified duration (yrs)	6.38	6.25
Spread duration ² (yrs)	3.78	3.12
Weighted avg maturity (yrs)	7.68	7.44
Average credit quality	Aa3	Aa2
Yield to maturity ³ (%)	6.13	2.75

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

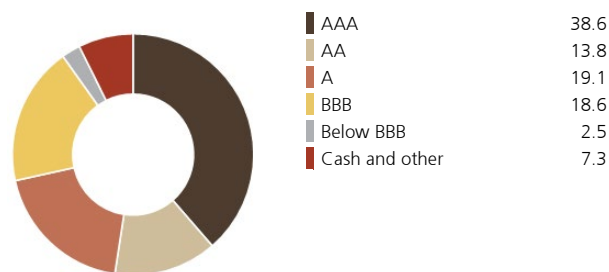
² Option adjusted spread duration ex Treasury.

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.

Fund information

Inception date	31 January 1997
Fund size	\$ 706.8 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 ⁴	3.22	3.85
Government inflation-linked	0.12	0.00
Semi-government	0.81	0.88
Government related	0.75	0.44
Corporates	1.21	0.72
Financials	0.45	0.23
Industrial	0.60	0.41
Utility	0.16	0.08
Securitised	0.28	0.37

By Country	Fund	Benchmark
Australia	3.15	2.75
USA	1.12	1.42
Japan	0.31	0.59
Canada	0.10	0.10
Euro area	0.77	0.76
UK	0.16	0.23
New Zealand	0.49	0.00
China	0.26	0.24
Other	0.03	0.15

⁴Includes derivatives.

Investment performance

Fund	1 month %	3 months %	1 year % pa	3 year % pa	5 years % pa	Since inception* % pa
Total return	(2.26)	(6.41)	(7.41)	(1.00)	1.03	5.27
Benchmark**	(2.19)	(6.25)	(7.21)	(0.51)	1.33	5.70
Added Value	(0.07)	(0.16)	(0.20)	(0.49)	(0.30)	(0.43)

*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 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.

In the US, consumer price inflation reached a 40-year high of 8.5% in March, with signs of price pressures broadening. Fed Chair Jerome Powell described the US jobs markets as "unsustainably hot" and said "there's something in the idea of front-loading" rate hikes. Nonfarm payrolls grew by 431,000 in March, and the unemployment rate fell to a near 50-year low of 3.6%. The US economy contracted at a 1.4% annualized pace in 1Q22, far below consensus estimates of +1.0%. The decline was driven mainly by net exports, which subtracted 3.2 percentage points from GDP growth. Consumption and business investment, the main drivers of the economic cycle, both showed solid gains.

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.

Our defensive duration positioning delivered a mixed performance contribution over April, as bond yields continued to climb across the developed markets. Within duration management our underweight duration positioning in the US, Canada, UK was a contributor to benchmark relative returns while our overweight duration positioning in New Zealand and Australia was a detractor.

During the month, we increased our short position in semi-core European markets against Germany and also added to our 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. On an excess return basis, our overweight positioning to European corporates, specifically financials and industrials, and Australian corporates detracted from benchmark relative returns while our underweight USD corporates was a contributor 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 and some of the largest quarterly losses on major bond indices on record, including the Ausbond Composite (-5.88%). We think monetary policy in the US, UK and Canada will have to tighten given strong domestic demand, high inflation and very low unemployment. For Eurozone and Japan it will likely remain supportive due to growth remaining well below the pre-pandemic trend and no evidence of higher wage growth. For example, the Fed QE purchases made its balance sheet much larger than the peak following the 2008 financial crisis. The European Central Bank (ECB) also announced a major stimulus package in the form of "Pandemic Emergency Purchase Programme" (PEPP) which ended on March 31st, 2022. Additionally, many other countries have also introduced similar large scale monetary and fiscal support packages.

Economic fundamentals still remain supportive for investment grade bonds but monetary tightening and less liquidity support should lead to moderately wider credit spreads over the course of the year. We therefore see opportunities to add allocation to corporate and SSA sectors later in the year at more attractive valuations though this is unlikely to add significant excess return in 2022. In addition to holdings in agencies, supranationals and investment grade corporates, we see selective opportunities in highly rated emerging market sovereign and corporate bonds.

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

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