

UBS Australian Bond Fund

May 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 ¹
Modified duration (yrs)	5.13	5.33
Spread duration ² (yrs)	3.23	2.03
Weighted avg maturity (yrs)	6.05	6.13
Average credit quality	AA	AA+
Yield to maturity (%)	3.63	3.17

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

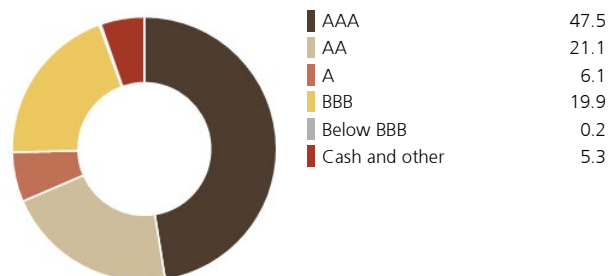
² Option adjusted spread duration ex Treasury.

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	30 November 1989
Fund size	\$ 848.9 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 ⁴	1.86	3.30
Government inflation-linked	0.00	0.00
Semi-government	1.59	1.44
Government related	0.63	0.34
Corporates	0.98	0.23
Financials	0.45	0.10
Industrial	0.37	0.10
Utility	0.16	0.03
Credit hedge ⁵	-0.19	0.00
Securitised	0.07	0.01
Cash and cash equivalents	0.00	0.00

By Tenor	Fund	Benchmark
0–3 year	0.28	0.43
3–5 year	0.94	0.73
5–7 year	0.92	0.93
7–10 year	1.03	1.71
10+ years	1.95	1.53

⁴ Includes derivatives. ⁵ Spread duration contribution.

Investment performance

Fund	1 month %	3 months %	1 year % pa	3 year % pa	5 years % pa	Since inception* % pa
Total return	(1.10)	(6.39)	(9.09)	(2.08)	0.75	7.04
Benchmark**	(0.89)	(6.02)	(8.54)	(1.76)	0.99	7.04
Added Value	(0.21)	(0.37)	(0.55)	(0.32)	(0.24)	0.00

*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 May.
- The RBA raised both the cash rate target and interest rate on Exchange Settlement balances by 25bps in May.

Performance review

Fixed income sectors generated mixed performance in May with US bond markets generally outperforming their European counterparts. US corporate bonds were amongst the strongest performers, buoyed by falling US Treasury yields and narrowing credit spreads. On the other hand, European investment grade and high yield bonds both generated negative returns (in USD terms) driven primarily by widening spreads. Elsewhere, locally denominated Emerging Market bonds posted solid positive returns with gains in both local rates and EMFX. The yield on 10-year Treasuries fell from 2.93% to 2.84% and the 2-year equivalent declined from 2.71% to 2.56%.

The Australian bond market underperformed their global counterparts as Australian government bond yields took another leg up in May. The Australian 10-year bond yields rose 22bps to finish the month at 3.35%, with the spread against US 10-year bond yields widening to 50bps (from +19bps at the end of the prior month). The Bloomberg AusBond Composite 0+ year index returned -0.89% in May driven by both rise in bond yields and credit spreads widening (Bloomberg AusBond Credit 0+ year index widened from 117bps to 126bps).

Following strong inflation data prints for the month of April which reached the RBA's target range, the RBA announced a cash rate target and interest rate on Exchange Settlement balances increases by 25bps on 3rd May. Surprising the market expectation of a 15bps hike, Australian 10-year government bond yields spiked to a high of 3.57% and traded in a wide range over the month. Other notable data released in May includes the retail sales figures which printed at 1.6% (MoM), outperforming market consensus of 0.6% suggesting a recovery in consumption. In the board minutes post the RBA's meeting, the RBA cited strong labour market conditions with progress towards full employment, and evidence of price and wages growth allowing the bank to move towards normalisation of interest rate policy. The Board also added that it will not roll over maturing government bonds and similar with global central banks, intends to shrink balance sheets in next couple of years, while maintaining a cautious approach by not spooking the market with intention to immediately dispose bonds purchased during the pandemic.

Our Australian duration positioning was largely neutral over the month and thus, the portfolio's relative performance was flat despite the rise in domestic government bond yields.

On global rates exposures, our existing spread tightener positions - short US duration against Australia duration; short US duration against New Zealand interest rate swaps - both contributed negatively to relative performance as US 10-year bond yields fell while Australian government bond yield rose, and New Zealand yields were stable over the month. During the month, we also added to our short Japan duration position with the view that there might be a 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. During the month, we bought some protection on credit through the Markit iTraxx Australia CDS index which suffered a small negative to relative performance as the index rallied late in the month following positive news of easing China's lockdowns resulting in improved global risk-on sentiment.

Australia ESG insights

Vicinity Centres, Australia's largest shopping centre REIT, issued its inaugural green bond in May (\$300m for 6 years, 4.927% coupon). With the use of proceeds, Vicinity aims to improve energy efficiency of its portfolio of shopping centres. Specifically, it is targeting 85% of existing assets to achieve a 5 star NABERS energy rating or above by 2030, to enable it to achieve a 5.5 NABERS energy Portfolio Rating (NABERS is an energy rating system which assesses assets on a scale of 0 to 6 stars, 6 being the most energy efficient). At a coupon of almost 5%, we don't believe the bond was issued with a 'greenium' (spread discount due to its green nature). We think the volume and pricing of the deal reflected the market's defensiveness amidst the current market conditions rather than Vicinity Centres' solid portfolio of shopping centres, the buoyant retail environment and the fact that Vicinity is a leader in sustainability within the shopping centre REITs space.

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. For 2022 calendar year to date we have seen some of the largest losses on major bond indices on record, including -8.10% for the AusBond Composite to the end of May. While the negative momentum has continued in May, 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, high employment levels and a high savings rate are all 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 continue to place upward pressure on inflation with the RBA's preferred trimmed mean measure now at 3.7%, comfortably breaching the upside of the RBA's 2-3% target band and likely to go higher over coming quarters. All told though, we see the unemployment rate fall further through 4% - the level thought to represent full employment - underlying inflation will rise further above 4% and wages will also show stronger upside momentum.

As a result, the RBA is following 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 towards 3.50%. 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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