

UBS Diversified Fixed Income Fund

May 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)	6.02	6.20
Spread duration ² (yrs)	3.57	3.09
Weighted avg maturity (yrs)	7.34	7.41
Average credit quality	Aa3	Aa2
Yield to maturity ³ (%)	3.60	2.88

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

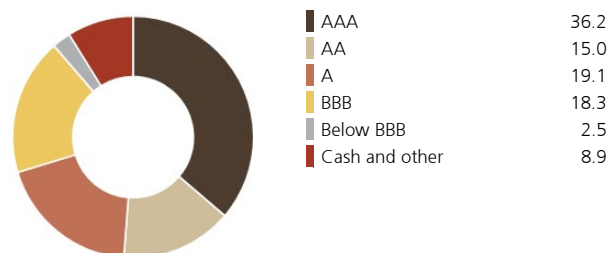
² Option adjusted spread duration ex Treasury.

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	\$ 683.2 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 ⁴	2.97	3.79
Government inflation-linked	0.12	0.00
Semi-government	0.77	0.86
Government related	0.71	0.44
Corporates	1.18	0.72
Financials	0.43	0.23
Industrial	0.60	0.41
Utility	0.16	0.08
Securitised	0.27	0.40

By Country	Fund	Benchmark
Australia	3.12	2.73
USA	0.96	1.42
Japan	0.11	0.59
Canada	0.10	0.10
Euro area	0.80	0.75
UK	0.15	0.22
New Zealand	0.48	0.00
China	0.27	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	(0.91)	(6.02)	(8.48)	(1.79)	0.66	5.22
Benchmark**	(0.54)	(5.57)	(7.93)	(1.19)	1.04	5.66
Added Value	(0.37)	(0.45)	(0.55)	(0.60)	(0.38)	(0.44)

*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 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%.

In the US, recession fears dominated much of the month. Retail sales and housing activity showed signs of cooling. But the month ended on a positive note. Data pointed to a 0.9% rise in consumer spending for April, versus forecasts for 0.7%, while figures for March were also revised higher. News on inflation was also encouraging, with the Federal Reserve's favourite gauge - the personal consumption expenditures (PCE) index rising just 0.2% month-on-month in April. The release of the minutes of the Fed's last meeting contained hints that policymakers may be willing to slow or pause rate hikes later in the year. The minutes showed that "many participants" judged that front-loading rate hikes "would leave the committee well positioned later this year to assess the effects of policy firming."

Domestic 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).

Our duration positioning delivered mixed performance contribution over May as government bond yields traded in a volatile fashion over the month across the different markets. Within duration management, our underweight duration in US detracted from relative performance as US 10-year government bond yields fell by 9bps. A small underweight in UK duration was positive to relative performance as gilts rose strongly. Overweight duration positioning in Australia and New Zealand was a detractor as yields inched higher during the month. We also increased our short position in US and Japan in May and added long duration positions in Germany. On credit, our underweight US corporates and overweight Australian corporates was a detractor as spreads moved to our disadvantage.

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.

We think monetary policy in the US, UK and Canada will have to tighten given strong domestic demand, high inflation and very low unemployment. The Eurozone will also need to confront its inflation problem shortly, while it may take somewhat longer in Japan.

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.

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

Telephone: (03) 9046 4041 **Freecall:** 1800 572 018 **Email:** ubs@unitregistry.com.au 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.

