

MAR 2022 | Commentary

WESTERN ASSET CONSERVATIVE INCOME FUND

Investment objective

The Fund aims to achieve a before-fee-and-tax return in excess of the Bloomberg Ausbond Bank Bill Index over rolling one year periods.

Performance (%)	1 mth	3 mths	1 yr	3 yrs pa	5 yrs pa
Fund (net)	-0.30	-0.29	-0.32	0.75	1.30
Benchmark	0.00	0.01	0.04	0.46	1.02

Calendar year performance (%)	2021	2020	2019	2018	2017
Fund (net)	0.20	0.94	2.03	1.95	2.43
Benchmark	0.03	0.37	1.50	1.92	1.75

Fund details	
Inception date	June 2001
Benchmark	Bloomberg AusBond Bank Bill Index
ISIN	AU60SSB01312
APIR	SSB0131AU

Monthly review

What happened in the market?

In early March the bond market appeared to be of two minds; on the one hand the risk and uncertainty posed by events in Ukraine was pulling yields lower and on the other hand the spectre of central bank action around the world to combat rising inflation was pushing yields higher. It soon became apparent that the Federal Reserve's (Fed) first rise in the fed funds rate for this cycle was projected by the Federal Open Market Committee (FOMC) to be the first of many over the remainder of this year and through the next. The Fed's stance shifted significantly more hawkish, even for members who had been noted doves over recent months. Together the acknowledgement that inflation had been far less transient and become much more broad-based as well as an observation of tightness in the jobs market were enough to tip the balance towards a likely accelerated normalisation of policy rates.

Australian sector spreads lagged global counterparts; they have been slower to wind out over the past couple of months but did not retrace in the latter half of March when global credit spreads tightened. Corporate and covered bond spreads ended the month between 19 and 23 bps wider on average, while supranational, sovereign and agency (SSA) bonds came under pressure caused by currency-related selling from the Japanese investor base and widened around 15 bps. Asset-backed security spreads repriced wider as more than A\$6.5 million of deals priced in the primary market from nine issuers and moved out by around 16 bps. However, semi-government spreads actually narrowed in March and outperformed all other sectors. Bendigo, Suncorp and Westpac were among the domestic banks to issue bonds in March while Monash University issued its first bond into the Australian market and AusNet issued its first bond since Brookfield took ownership of the utility.

The Australian Dollar Trade-Weighted Index appreciated strongly in March on the back of higher commodity prices and expectations of rate rises being brought forward, gaining more than 9% on the weaker Japanese yen, 4.5% versus the euro and 3% versus the US dollar.

What happened in the Fund?

The Western Asset Conservative Income Fund was down 0.30% (net of fees) during March, compared to the Bloomberg AusBond Bank Bill Index which was flat for the month. The negative absolute return was largely attributable to interest rate positioning, where a small long duration position underperformed as yields rose during the month. The Fund's corporate and asset backed allocations also underperformed as spreads widened during the period.

What is the outlook?

As the Australian economy continues to recover, supply-chain disruptions are likely to persist in the short term and to contribute to inflationary pressures, which have been compounded by commodity price reactions related to Russian hostilities in Ukraine. The significant removal of pandemic constraints and restrictions in order to minimise supply-chain disruption has been beneficial from an economic perspective. As central banks embark on policy normalisation, the more hawkish tilt from some, including the Fed, has seen momentum in the selloff carry yields above where we think central bank policy rates are likely to end up in the time frames expected—this also includes the RBA's policy trajectory. Central banks will still have a keen eye on achievement of policy objectives and would be wary of overburdening consumers and businesses from rising rates as they progress through the cycle. We added to our duration position later in the month via the 10-year key rate as it approached 3% for the first time in nearly five years. If short-end expectations continue to move higher we may seek to add duration at the back end as markets would eventually be expected to price in policy error, leading to a fatter yield curve. As always, we will keep our interest-rate positioning nimble and seek to take advantage of volatility and yield-curve shape.

Given our perspective on the rates trajectory, we expect non-sovereign bond sectors to be less impacted than feared in recent market pricing. Semi-government bonds spreads have held in well relative to other domestic spread sectors with recent new deals targeted as demand for HQLA remains strong. SSA bonds by contrast have widened further and continue to appear attractive on a relative basis. We continue to seek value in the corporate and asset-backed sectors, which have cheapened recently, and will selectively add exposure to credit to take advantage of steeper credit curves. This remains judicious, with the majority of the overweight still focussed on shorter maturities to manage spread risk.

The Australian dollar gained further ground versus the major currencies in March as strong economic data fed expectations for near-term rate rises and as commodity prices continued to rise, particularly with hostilities continuing in Ukraine. As long as commodity prices remain elevated and the economy continues to hum along, the currency should remain around the mid US\$0.70 range or higher.

Past performance is not a reliable indicator of future performance.

Highlights

- Invests in a portfolio of Australian short duration credit, cash and cash-like securities
- Seeks to protect capital and deliver returns in excess of the cash rate
- Designed to capture relative value opportunities in duration management as well to identify securities with attractive yield characteristics

About us

Franklin Templeton

Franklin Resources, Inc., is a global investment management organisation, operating as Franklin Templeton, which is headquartered in California. Franklin Resources, Inc., provides, through its subsidiaries, deep investment expertise across all asset classes - including equity, fixed income, and multi-asset solutions. Franklin Resources, Inc. is listed on the New York Stock Exchange and has employees in over 34 countries.

Western Asset

Western Asset Management is one of the world's leading fixed-income managers. With a focus on long-term fundamental value investing that employs a top-down and bottom-up approach, the firm has nine offices around the globe and deep experience across the range of fixed-income sectors. Founded in 1971, Western Asset has been recognized for an approach emphasizing team management and intensive proprietary research, supported by robust risk management.



Ratings

Quantitative



The Western Asset Conservative Income Fund received an overall rating of 3 stars out of 39 Australian Short Term Fixed Interest funds as of 30 September 2021.

Qualitative



For enquiries, please contact Investor Services Team on 1800 673 776, email auclientadmin@franklintempleton.com or visit franklintempleton.com.au.

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