

# Western Asset Conservative Income Fund

SEP 2022 | Commentary

## 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)	0.05	0.47	-0.27	0.45	1.10
Benchmark	0.15	0.42	0.52	0.38	0.95

## 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?

The Bloomberg Ausbond Composite Index contracted in September, as it has done for eight of the nine months so far this calendar year. The 1.36% fall in September, brings the year-to-date fall to an unprecedented 10.05%. During September central banks of Australia, Canada, the eurozone, Norway, Sweden, Switzerland, the UK and the US all raised policy rates by 50-100 basis points (bps), supporting the rhetoric of a firm commitment from each of them to bring inflation under control. Domestically, the Reserve Bank of Australia (RBA) Governor's comments around the likely need to slow the pace of future rate rises as the absolute level of rates rose was taken as guidance that the central bank was keen to scale back the policy aggression, particularly when the minutes of the September meeting showed an active discussion around raising by 25 or 50 bps. This was in contrast to most other central banks that had ratcheted up hawkish sentiment. The newly selected UK Prime Minister Liz Truss kicked off her new job with a fiscal stimulus package that seemed at odds with the central bank's objective of controlling inflation. The UK financial market reacted aggressively resulting in sharp volatility that saw much of the yield curve trade in a 160-170 bps range on the day and prompted the Bank of England to step in to calm the market. There was some spill over of the volatility into international bond markets. Australia's was 35 bps higher around the 2-year point, 29 bps higher for the 10-year and 26 bps higher on the 30-year, resulting in some further flattening of the curve at the long end.

The Australian Dollar Trade-Weighted Index depreciated 2.8% in September, led by a 6.5% decline versus the US dollar, 4% versus the pound sterling and 2.5% versus the euro and yen. The underperformance came as the RBA's rate trajectory appeared likely to diverge from many central banks in the coming months and as commodity prices softened.

### What happened in the Fund?

The Fund was up 0.05% (net of fees) during September, in comparison the benchmark as measured by the Bloomberg AusBond Bank Bill Index was up 0.15% in September. Underperformance was largely attributable to the Fund small long duration position which detracted as yields rose during the period. The Funds spread sector allocation also detracted at the margin as spreads widened.

From a positioning standpoint, we tactically adjusted our duration overweight to capture ranges, ending the month where it started. We continue to believe that the increasingly aggressive monetary policy track being priced in for the major central banks creates a greater likelihood of either an economic downturn or a moderation in policy setting projections. In either scenario, market yields would likely move lower again. As always, we will keep our interest-rate positioning nimble and seek to take advantage of volatility and yield-curve shape. We are mindful of the potential impact of monetary policy on non-sovereign sectors. While we continue to seek value in the corporate and SSA sectors, which have cheapened further, we are cautious in adding to our overweight credit position and maintain a focus on shorter maturities to manage spread risk.

### What is the outlook?

The RBA provided further clues on a possible scale back of rate rises when speaking publicly. The RBA acknowledged that the rate rises to date had yet to fully make their way through to the consumer due to lags in the transmission mechanism while retaining the belief that Australian households had built sufficient financial buffers to withstand the likely rate rises still to come. At the end of September, pricing for the end-of-year cash rate had eased to 3.1% with debate over when the deceleration would occur although many economists still expected the RBA to raise the cash rate another 50 bps in October. We think that it is likely to end the year around the 3.00% mark. The pace of rate rises will likely add pressure on consumers with consumer sentiment likely to slide. The construction industry continues to face challenges with cost overruns due to supply chain delays and a significant rise in the cost of material inputs as well as skilled labour that has put a substantial squeeze on the profitability and solvency of those firms.

Geopolitical issues also continue to hamper normalisation of global economic activity and drive inflation with the ongoing Russian hostilities in Ukraine precipitating the conundrum of strong European sanctions on Russia while remaining heavily reliant on Russia for gas, which in turn has put the squeeze on supply to Europe. Tensions between the US and China over Taiwan carry the risk of compounding the effect on inflation and trade disruption. Prices for energy commodities in general remained elevated with the inflation in energy markets looking unlikely to reverse for some time. With the southern winter in rear view, domestic Covid cases have dwindled along with hospitalisations and this hopefully portends a diminishing impact from the pandemic over the months ahead and beyond. However, making substantial gains on skilled immigration remains a challenge for the government in order to alleviate some labour capacity constraints.

The Australian dollar dipped in September as commodity prices softened but remained elevated. The RBA's policy trajectory looks set to diverge from that of other central banks and seems unlikely to make ground relative to the fed funds rate. As a result, the Australian dollar is likely to rely on relative economic gains and commodity prices to stabilise at high levels in order to support the currency and lift it back towards the US\$0.70 mark in coming months.

[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 as at 30 September 2022.

#### Qualitative



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