

# UBS Income Solution Fund

August 2022

## Fund description

The Fund is an actively managed, diversified portfolio of corporate credit, asset backed and other fixed income securities, cash equivalents and cash. The Fund may hold up to 25% in high yield securities (which may include unrated securities).

## 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.

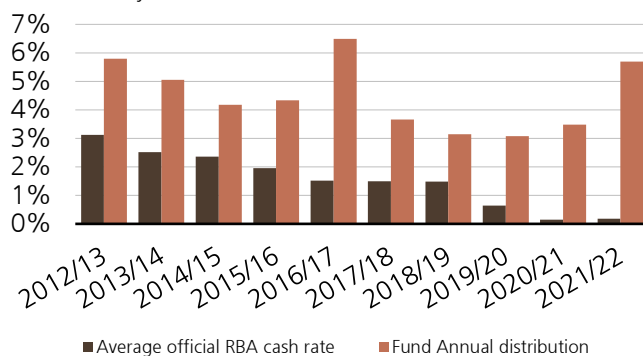
The Fund's investment strategy is to invest in a portfolio of Australian and global corporate credit, asset backed, and other fixed income securities, cash equivalents and cash.

## Investment return objective

The Fund aims to outperform (after management costs) the Reserve Bank of Australia Official Cash Rate over rolling three year periods.

## Income History

As at financial year 30 June 2022



## Fund information

Inception date	17 April 2002
Fund size	\$ 330.8 m
Management fee	0.60% pa
Minimum initial investment	\$50,000
Distributions	Monthly
Monthly distribution estimate cents per unit (CPU)	0.15
Buy/sell spread	+ 0.10% / - 0.20%
Currency management	Hedged to AUD
APIR code	UBS0003AU

## Portfolio statistics

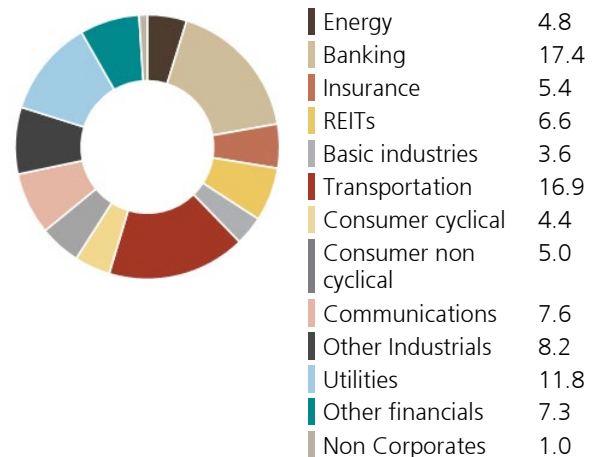
Modified Duration (yrs)	1.23
Spread Duration (yrs)	3.80
Yield to Maturity <sup>1</sup> (%)	5.05
Official cash rate (%)	1.85
Average Credit Rating	BBB

<sup>1</sup> 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.

## Credit quality (%)

Investment Grade	76.59
High Yield	18.77
Cash and other	4.65

## Industry allocation (ex cash) (%)



## Investment performance

Fund	1 month %	3 months %	1 year % pa	3 year % pa	5 years % pa	Since inception* % pa
Total return	(0.02)	(0.25)	(3.87)	(0.05)	1.42	4.35
Benchmark**	0.16	0.32	0.42	0.36	0.79	3.52
<b>Added Value</b>	<b>(0.18)</b>	<b>(0.57)</b>	<b>(4.29)</b>	<b>(0.41)</b>	<b>0.63</b>	<b>0.83</b>

\*Inception date: 17 April 2002. \*\* RBA Official Cash Rate, Prior to 1 February 2017 benchmark was Bloomberg AusBond Bank Bill Index.

Performance figures are net of ongoing fees and expenses. The performance figures quoted are historical, calculated using end of month 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. Growth returns are the returns due to change in initial capital value. Distribution returns are the returns due to the distributions paid. <sup>1</sup>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. <sup>2</sup> Source: RBA, 2019

## Market highlights

- Australian Government bond yields rose across the term structure.
- Australian credit spreads tightened over August.
- The RBA raised the cash rate target by 50bps in August and 50bps in September.

## Global Market review

The rally in fixed income from July went into reverse in August. After returning 1.6% in July, US Treasuries lost 2.5% in August, for a year-to-date negative return of 10%. The pan-European Aggregate lost 5.7%, the worst month on record, following a gain of 3.6% in July. US high yield, which added 6% in July, lost 2.4% in August while Euro high yield, which gained 5.1% in July, returned a negative 1.2%, for a loss year-to-date of 11.9%. US senior loans had a negative return of 1% in August, while Asian high yield lost over 18%. The yield on 10-year US Treasuries rose from 2.65% to 3.19%.

In the US, headline consumer prices were flat month-over-month in July, compared with consensus forecasts for a 0.2% increase after a 1.3% rise in June. Year-over-year, headline CPI rose by 8.5%, which was lower than consensus estimates of 8.7% and down from 9.1% in June. Fed officials continued to stress that "While the lower inflation readings for July are welcome, a single month's improvement falls far short of what the Committee will need to see before we are confident that inflation is moving down." Turning to activity, the ISM Manufacturing PMI edged down to 52.8 from 53 in June, while the Services PMI rebounded to 56.7, up from 55.3. Nonfarm payrolls increased by 528,000, and the unemployment rate fell to 3.5%, matching the pre-pandemic level, which is a 50-year low. Industrial production rebounded 0.7% month-over-month, hitting a record high. The yield curve inverted, with 2-year Treasury yields around 35 basis points higher than 10-years. On the political front, Democrats passed the Inflation Reduction Act through reconciliation, and the Chips and Science Act was also enacted on a bipartisan basis. President Biden issued an executive order providing student debt relief although this faces potential legal challenges.

In the Eurozone, inflation hit a new record high for August of 9.1%, based on flash figures. This was the ninth consecutive record for consumer price rises in the region, with the climb starting back in November 2021. Dutch central bank Chief Klaas Knot and Estonia's Madis Müller both argued that 75 basis points should be discussed.

Meanwhile, Bundesbank President Joachim Nagel argued that the ECB must "react decisively" and made the case for front-loading rate moves. Natural gas prices were volatile amid energy supply concerns, with the Dutch TTF benchmark rising as much as 56% during the month, hitting a peak on 25 of August, before falling on reports that the European Commission is seeking new ways to address energy costs. The composite purchasing managers' index reading came in below 50 for the second consecutive month in August. In the UK, inflation pushed into double digits for July, for a year-on-year reading of 10.1%. Core inflation, which excludes energy, food, alcohol, and tobacco, came in at 6.2% in the year to July 2022, rising from 5.8% in June and ahead of expectations for 5.9%. The Bank of England raised rates for the sixth meeting in a row in August, with a 50-basis point increase, the largest single increase since 1995.

In China, July activity data, with a few exceptions, slowed from June readings. Outside the auto sector (boosted by subsidies and tax cuts), restaurant services (enjoying pent-up demand), and electricity production (helped by high summer temperatures), indicators for all sectors slowed sequentially.

In Japan, data showed second quarter GDP growing 2.2% quarter on quarter, up from 0.1% growth in the first three months of the year. The yen came under further pressure against the US dollar in August—from JPY 131.6 at the start of the month to JPY138.6 at the end.

Broad commodities (UBS CMCI Total Return Index) ended August nearly unchanged versus July. This was primarily driven by the agriculture sector rising by more than 3% as result of weather-related crop downgrades in the US, Western Europe, South America, and China. All other sectors delivered a negative performance, with precious metals down the most.

## Australia Market Review

The Australian sovereign yield curve sold-off over August in line with moves in offshore bond markets as global investors remained concerned about the inflation outlook and pace of central bank hikes. Australian 3-year Government bond yields rose 55bps, ending the month at 3.21% while the 10-year Government bond yield increased similarly by 54bps, to end the month at 3.60%. The spread of Australian 10-year Government Bond yields against US 10-year Government bond yields was unchanged from the prior month at 41bps. The Bloomberg AusBond Composite 0+ year index returned -2.54% in August, driven primarily by duration. Credit spreads were marginally tighter over the month (Bloomberg AusBond Credit 0+ year index tightened from 139bps to 137bps).

In early August, the RBA raised the official cash rate target by 50bps to reach 1.85%, a move that was widely anticipated by market participants. The RBA Board Minutes from the August meeting provided some additional insights into the Board's intentions, "The Board expects to take further steps in the process of normalizing monetary conditions over the months ahead, but it is not on a pre-set path. It is seeking to do this in a way that keeps the economy on an even keel. The path to achieve this balance is a narrow one and subject to considerable uncertainty."

On the data front, July's unemployment print of 3.4%, a near 50-year low, together with a participation rate print of 66.4% continues to suggest tight labour market conditions. Meanwhile, retail sales printed at a healthy 1.3% in the month of July, signalling that the consumer is so far proving resilient in the face of higher interest rates. Given still strong activity data and RBA narrative – it seems the upcoming Q3 CPI print in October will be a key data release that domestic investors are focused on to gain more insights on the path for central bank policy.

### **Australia ESG insights**

As a large institutional fixed income investor in CBA globally, we had a chance to discuss their recently published first climate report. Earlier this year CBA joined the UN-convened Net-Zero Banking Alliance, which compels CBA to set and commit to emissions reduction glidepaths in its highest emitting sectors in order to achieve net zero financed emissions by 2050. For example, whilst thermal coal mining represents less than 0.1% of CBA lending exposure, it represents 4% of CBA's total financed emissions. CBA targets a full exit from thermal coal by 2030 and is on track. In addition, upstream gas extraction represents just 0.4% of lending exposure but 19.8% of total financed emissions – here CBA has set an interim reduction target of 17% by 2030 and is on track. Whilst there has been good progress so far, CBA will face a number of challenges in the years ahead such as the reliability of emissions data (CBA is working with the CSIRO to address some of these issues) and the fact that CBA is yet to provide reductions targets for other high-emitting sectors like coal-fired power and agriculture. These are not issues unique to CBA, but to Australian banks in general, and global investors will increasingly be comparing them to other jurisdictions such as Europe, who are far more advanced in dealing with some of these issues.

### **Portfolio**

The portfolio produced positive absolute return but underperformed the benchmark over August. Australian Government bonds sold-off at the front end of the curve, thus causing a detraction to the fund's performance against the lower duration bank bill index. Within credit management, Australian corporate credit spreads tightened over the month which contributed to the portfolio's relative performance while widening credit spreads in US high yield market was a small detractor.

### **Outlook**

A focus on hawkish central banks and the subsequent rise in government bond yields in August has improved the entry point for duration. The US has been at the forefront of the inflation cycle and it may still be too early to call a peak despite early signs that energy, food and durable goods inflation is rolling over. Yet importantly, over time, we expect the market to gain more confidence on central banks resolve and ability to tame inflation and focus instead on the deterioration in global growth as financial conditions tighten, European energy crunch concerns build and the US consumer falters.

Australia is experiencing the same themes but with a lag of one or two quarters thanks to the later re-opening of the economy and the slower response from the RBA. Headline CPI inflation is currently running at 6.1% y/y and there is sufficient momentum and breadth in prices to expect the annual rate to accelerate further into year-end with most forecasters seeing a peak close to 8%. At the same time, accumulated household savings, robust retail sales data and a near 50-year low on the unemployment rate provides some comfort about the near-term outlook for economic activity. However, more forward-looking indicators such as consumer confidence surveys and house prices, which are deflating, are consistent with growth slowing well below its potential rate into next year.

The RBA has followed in the footsteps of global central banks, delivering a rapid 225bps of rate hikes since May in an effort to restore credibility in the fight against inflation. We expect the RBA to step down to smaller 25bp increments in Q4 as the tightening starts to bite, with the cash rate ending the year at around 2.75-3%. By comparison, the August sell-off has seen the market re-price a cash rate peak near 4%, with rates expected to stay near that level for years to come. Such a path is unlikely to be realised given the significant adverse impact it would have on household's debt servicing costs and with 10-year yields above 3.5%, a level we have previously flagged as offering value, as a result we have begun to scale into a long duration position.

We still hold the view that investment grade credit spreads globally will move wider into year-end driven by tighter financial conditions, increased new issuance and increasing risks of recession. Also, we expect firms to have less flexibility to pass higher input costs through to consumers leading to a deterioration in corporate fundamentals. Australia credit should however offer relative value in this environment as spreads have moved wider point for point with the US, whereas in the past the local market had traded with a beta of 0.30 to 0.60. In fact, aggregate OAS levels are now the same as the US for a shorter duration and better-quality market.

## Client Services

Telephone: (03) 9046 4041 Freecall: 1800 572 018 Email: [ubs@unitregistry.com.au](mailto:ubs@unitregistry.com.au) [www.ubs.com/am-australia](http://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 License 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.

