

Macquarie Income Opportunities

Quarterly Investment Option Update

30 June 2020

Aim and Strategy

Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles. This strategy provides exposure to a wide range of Australian credit-based securities (predominantly floating and fixed rate corporate bonds, and asset-backed securities) and cash. It may also provide exposure to global investment grade credit securities, global high yield credit securities, emerging market debt, hybrid securities and a range of other credit opportunities when they are expected to outperform and reduce exposure to these sectors when they are expected to underperform. This strategy can hold securities either directly or indirectly through investments managed by a member of the Macquarie Group and external managers. This strategy may also be exposed to derivatives to implement its investment strategy or to hedge risk. This strategy is generally hedged to Australian dollars.

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au

Investment Option Overview

Investment Category	Aust. Fixed Interest
Suggested Investment timeframe	3 years
Relative risk rating	5 / Medium to High
Investment style	Income
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Investment Grade	20-100	95
Hybrids	0-10	0.0
Global High Yield	0-15	0
Emerging Market Debt	0-15	5

Sector Allocation	%
Banking	20.9
Residential mortgage	10.4
Electric	4.2
Non-agency CMBS	3.8
Owned No Guarantee	3.8

Regional Allocation	%
Australia	38.5
United States	18.6
UK	3.0
Europe Ex UK	7.6
Other	9.8

Top Holdings	%
NAB	1.8
Suncorp	1.3
CBA	1.1
Bank of America	1.1
WST_20-1	1.1
Suncorp	1.0
Transurban	0.8
METR_19-1	0.8
Downer Group	0.7
AMP Capital	0.7

Investment Option Commentary

The Investment Option outperformed the benchmark in the second quarter of 2020, as markets rebounded from a very weak start to the year. While a modest improvement in economics was evident by the end of the quarter, the support from governments and central banks was the key reason that markets (and particularly credit markets) rebounded strongly. This was evidenced by the mix of performance: sectors that have the most direct central bank support, such as investment grade (IG) credit (particularly shorter maturities), have retraced Q1's weakness the most, in some cases back to their pre COVID-19 levels.

The Investment Option's holdings of global IG securities were the largest single contributor to returns, reflecting the rebound in that market and the portfolio's position size in this sector. In particular, BBB credit in USD was a significant contributor, with existing positions and new issuance added in this ratings category. Amongst issuers and industry sectors, the Investment Option favoured adding positions in sectors where performance is expected regardless of the path of the virus: such as telecommunications, utilities, and financials. Holdings in these industries were amongst the largest contributors to the quarter's returns, as investors took comfort in the relatively stable nature of their businesses (and the capital cushions in place in the case of the financial sector). Energy credit also significantly contributed to performance and we slightly trimmed positions in this sector given the strong rally.

Other risk sectors also contributed, though the impacts were more varied in size. Emerging markets (EM) credit was a strong contributor, with the increase in EM exposures at the end of Q1 and into April also adding to returns. Duration positioning was a small positive, after contributing very strongly in 2019 and 1Q20, reflecting much lower volatility in government bond yields as central banks have been heavily influencing these markets.

Overall, credit spreads still remained wide versus historical averages, but tight for any comparable period in history during a significant recession. Hence, the outlook is mixed and market performance is likely to be volatile. Pricing in markets remained relatively bifurcated, with short dated and high quality credit more or less back to pre-crisis levels while more stressed sectors still remained relatively wide.

Market Commentary

In the US IG market, spreads closed 122bps tighter at 150bps while HY tightened 254bps to finish the quarter at 626bps. The US Federal Reserve buying began in May, starting with the exchange traded fund (ETF) portion of the secondary market corporate credit facility. The purchases were small in the context of the broader market but were consistent in size (approximately \$US300m per day) and encompassed both IG and HY market ETFs.

Australian credit underperformed global credit in Q2, tightening 41bps compared to US and European IG, which compressed 122bps and 90bps respectively. Australian spreads lagged offshore credit markets and continued to widen through till the middle of April, with corporate credit spreads lagging even further, posting its widest in early May. As a result, financial bonds outperformed corporates, largely driven by better liquidity with corporates relatively closing the gap towards the end of the quarter.

Outlook

Follow the money or focus on the fundamentals? This is and will be an ongoing debate for portfolio managers. Credit spreads have contracted sharply and investors have followed the money. The deflationary shock from lockdowns, along with central banks' commitment to keeping rates low for an extended period and discussions about engaging in yield curve control, are combining to keep bond yields low despite the euphoria in risk assets.

As we enter the second half of 2020, we consider the likely environment, barring the emergence of a vaccine. We assume that the hurdle for countries to re-impose lockdowns is expected to be high, but it seems likely that the new social distancing environment will persist. This environment will pose ongoing challenges for certain sectors and companies, particularly in services, where survival is not a certainty. Here, both the top down analysis and the bottom up sector and company analysis will play important roles in the security selection process.

For the broader economy, we monitor the mobility data but pay more attention to actual spending data as this provides real information on demand. High frequency data is showing that demand has bounced since countries re-opened, but that spending has concentrated on food while non-food purchases remain weak. In addition, government support to furloughed and unemployed workers is masking the risk to income and many of these temporary support measures are due to roll off or being reviewed in the coming months. We are also monitoring supply chains, which have been severely disrupted by the pandemic, evidenced by the plunge in global trade.

Geopolitical risks have escalated and the US presidential election now looms on the horizon. Elsewhere, we also monitor the approach to fiscal policy where moves to shun the return of austerity (as the UK government did) and turn support into stimulus would have important implications for the shape of recovery that will ultimately unfold.

This uncertain outlook has encouraged us to resist the psychological pressure from following the recent rally and maintain a cautious path, where additions to credit exposure reflect a bias for quality. We believe there will be ample time to participate in opportunities and will remain prudent and patient as the situation continues to evolve.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1525AU
AMP Flexible Super - Retirement account	AMP1585AU
AMP Flexible Super - Super account	AMP1573AU
CustomSuper	AMP1525AU
Flexible Lifetime - Allocated Pension	AMP1537AU
Flexible Lifetime - Term Pension	AMP2018AU
Flexible Lifetime Investment (Series 2)	AMP2038AU
SignatureSuper	AMP1549AU
SignatureSuper Allocated Pension	AMP1561AU

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