Macquarie Income Opportunities

Quarterly Investment Option Update

31 December 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/performance

Investment Option Overview

Investment Category	Australian 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	92
Hybrids	0-10	0
Global High Yield	0-15	3
Emerging Market Debt	0-15	5

Sector Allocation	%
Banking	19.7
Treasuries	13.7
Residential mortgage	9.3
Electric	4.3
Transportation	4.0

Regional Allocation	%
Australia	47.4
United States	19.9
UK	2.6
Europe Ex UK	8.8
Other	10.1
Cash	11.2

Top Holdings	%
Australian Government	1.8
Australian Government	1.3
Province of Ontario	1.1
National Australia Bank	1.1
Australian Government	1.1
Australian Government	1.0
Morgan Stanley	0.8
ING Bank	0.8
Bank of America	0.7
Rabobank	0.7

Investment Option Commentary

The Fund outperformed the benchmark through the final quarter of the year, with financial markets continuing to recover (and surpass, in many areas) levels from the beginning of 2020. Performance for the quarter was driven by credit allocations, with corporate sectors (investment grade and high yield) and emerging markets all being strong contributors. The quarter was characterised by a strong chase for yield amongst investors, with a theme of spread compression very notable, particularly post the vaccine news in November. High yield credit outperformed investment grade credit, BBB credit outperformed single-A credit, and the 'COVID impacted' sectors outperformed the non-COVID impacted. Amongst individual issuers, selected holdings in travel and other affected sectors were generally the top performers, including Australian airports, airline lessors and selected airlines.

The Fund trimmed its allocation to global investment grade credit modestly through the quarter, with much less spread tightening potential going forward from 'generic' investment grade (that is, not heavily virus impacted) meaning that there are better risk-adjusted opportunities elsewhere. Overall, the Fund maintained its barbell approach of having strong liquidity while holding allocations to higher beta sectors and selected 'recovery' trades, which Macquarie believe is appropriate given the backdrop of modest overall spreads, low yields, and the potential for volatility in the short- to medium-term outlook.

Market Commentary

The fourth quarter of 2020 in financial markets can be summed up as a triumph for hope over reality. Starting with the strong rebound in growth in Q3, expectations firmed on the path to recovery from the woes of the pandemic. News toward the end of the quarter that science was able to concoct multiple viable vaccines fuelled expectations that a full recovery will be in place during 2021. Though the reality was more sombre. With schools and colleges returning after the northern summer break, virus cases began to rise. At the same time, most countries had eased restrictions, hoping the falling cases in the summer meant that the worst was behind. However, the pandemic surged into a large second wave during the quarter, which again pressured hospitals and forced governments to re-tighten restrictions. Thus, the recovery began to falter during November and December, and in some parts of Europe and the UK the risk of a double-dip recession is real. Asset markets shrugged off the current problems, choosing to focus on the prospects for better times in 2021, taking significant comfort in the strong commitment of support coming from global central banks and the efforts of governments to provide fiscal support to those most impacted by the pandemic.

Interestingly, the turmoil of the US election did not derail the buoyant mood by asset markets. In fact, the prospect of a Democratic President simply added fuel to the belief that even more fiscal support will be delivered in the new year. Equities, led by tech, surged to new highs, while credit spreads tightened. Bond yields began to edge off their historic lows and inflation expectation soared, despite the actual data confirming a significant deflation shock in 2020.

Outlook

What are the themes that will shape 2021? First, the virus is still very much with us and likely to extend through the first quarter and probably longer. The global vaccination process has begun but the pace is expected to vary across geography, particularly depending on supplies and the particular choice of vaccine being used. While the manufacturing sector has continued to recover, the service sector in much of the northern hemisphere has been devastated. The overhang of unemployment and destruction to many small businesses will likely take a number of years to get back to where things were in January 2020. Central bankers have extended their already massive level of support to unbelievable levels, with a commitment to do even more if necessary. Left wing politicians have been arguing for years for an expansive fiscal policy, and in 2020 budget deficits and debt soared globally. However, they would argue that the expansion of fiscal policy was largely due to the delivery of necessary 'support' to those most severely impacted by the pandemic, rather than 'stimulus'. This will be a challenge of 2021, that is, whether governments can shift their support to growth-generating stimulus.

What about valuations? Risk assets have ended the year at levels that seemingly ignored the fundamental shock to the economy. The solving ingredient is the overwhelming policy support. Central bankers have acted, since the financial crisis of 2008, to contain each crisis with increasing levels of stimulus. In addition, lessons have been learned from actions to reverse, for example, the taper tantrum (2013) and the Fed tightening through 2017-18, such that markets are assuming that the bar for policy reversal will be much higher in the future. Turning to fiscal policy, where politics has often been seen to get in the way of common sense, it is far less certain how the path will look in 2021. So their expectation is that the decisions made on fiscal policy could be an important driver on how asset markets re-assess their outlook through the coming year.

To date, Macquarie have acted to participate in the risk asset rally, leveraging sector rotation, assessment of credit quality, curve and name selection to generate performance. Duration holdings have been near historically low levels and they expect it to gradually accumulate if yields push higher.

Availability

Product Name	APIR Code
AMP Flexible Super - Super	AMP1573AU
AMP Flexible Super - Retirement	AMP1585AU
CustomSuper	AMP1525AU
Flexible Lifetime - Super	AMP1525AU
Flexible Lifetime - Allocated Pension	AMP1537AU
Flexible Lifetime - Term Pension	AMP2018AU
Flexible Lifetime - Investments (Series 2)	AMP2038AU**
SignatureSuper	AMP1549AU
SignatureSuper - Allocated Pension	AMP1561AU

**Closed to new and existing investors

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