Macquarie Income Opportunities

Quarterly Investment Option Update

31 March 2021

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
Global High Yield	0-15	3
Emerging Market Debt	0-15	5

Sector Allocation	%
Banking	20.8
Treasuries	11.7
Residential Mortgage	9.3
Electric	4.0
Transportation	3.8

Regional Allocation	%
Australia	45.8
United States	19.6
UK	2.7
Europe Ex UK	9.6
Other	10.4
Cash	11.9

Top Holdings	%
Australian Government	6.1
Australian Government	2.4
Rabobank	2.2
Province of Ontario	1.6
National Australia Bank	1.5
Morgan Stanley	1.2
Australian Government	1.2
Australian Government	1.2
Westpac Banking Corporation	1.0
Bank of America	0.9

Investment Option Commentary

The Fund underperformed the benchmark in the first quarter (before fees). While the Fund's credit positioning positively contributed to performance, this was offset by the Fund's duration positions as government bond markets suffered their worst start to a year in decades. The main detractor of duration performance was the exposure to AUD rates, with local curves steepening sharply and pricing in much more aggressive moves than we think is realistic from the Reserve Bank of Australia (RBA) in coming years. Amongst positive contributors, investment grade (IG), emerging markets (EM) debt and high yield (HY) credit all added to performance, reflecting the Fund's 'barbell' position in higher-beta sectors and recovery trades, which performed relatively well despite setbacks on the vaccination progress in some parts of the world. The overall credit market performance was characterised by significant spread compression, with BBB outperforming A-rated corporates and HY outperforming IG.

The Fund's credit sector exposures were reduced slightly during the quarter, with reductions focused on areas with little upside. These were a combination of longer-dated IG that were at tight spreads, were vulnerable to a rate rise and offered little upside even in the most positive risk scenario, and a small number of recovery trades that had performed strongly and offered little further spread compression. Holdings of Southwest Airlines and Sydney Airport, for example, were sold early in the quarter after trading back at or tighter than their pre-pandemic spread levels. The Fund's positioning has remained heavily focused on the barbell of higher-beta sector exposures and BBB-rated IG, while generally decreasing long-dated, lower-beta IG and instead preferring short-dated bonds with some spread as a place to maintain liquidity. The EM debt exposure was sensibly increased somewhat during the quarter, as this space offers some relative spread pick-up and capital upside versus most other parts of the market, and offers places to opportunistically accumulate some credit exposure. The Fund added modestly to its duration positioning during the quarter, viewing the gradual move higher in rates as offering entry levels to rebuild a position – after the interest rate duration in the Fund had been materially cut back in late 2020.

Market Commentary

The first quarter of 2021 was dominated by two evolving themes: the rollout of vaccinations and the delivery of further US fiscal stimulus. The two themes combined to provoke an upward revision to global growth expectations for 2021, even though the details reveal a very divergent path to recovery across regions and sectors. Asset markets embraced these themes, with equities pushing to new highs while credit spreads tightened. Bond yields surged higher, led by the US and Australia but with some marked divergence where the macro news was less positive, such as Europe, which had a more muted rise in yields through the quarter.

The rollout of vaccinations is highly dependent on supply. The UK and the US have led the way amongst developed countries, whereas supply problems have significantly hindered the rollout across Europe and, across emerging countries, the picture is even more divergent.

For the US, early in the quarter the Democratic party secured both the Georgia Senate seats and this gave them control of Congress, albeit on the slenderest of margins in the Senate – relying on the casting vote of the Vice President. However, this was enough for the Democrats to successfully pass another large fiscal stimulus package in March, including a substantial cash payment to qualifying households. With vaccination progress enabling a gradual re-opening and fiscal stimulus taking place, financial markets quickly embraced this positive news even though the economic fundamentals only began to improve through March.

Central banks have maintained a cautious stance despite the emergence of positive news on vaccines and fiscal stimulus, with the US Federal Reserve stating that that the activity gap created by the pandemic is large and will take some time to close when many of the inflationary pressures are most likely temporary. This consistent theme around developed countries has caused yield curves to steepen, as short-end rates remain strongly supported by the prospect of steady policy for some time to come.

Outlook

In the coming quarter, the recovery outlook for the US is poised to lead the way, while Europe is expected to continue struggling. The US will benefit from the upcoming substantial fiscal package, which includes large direct stimulus payments. As the services sector gradually re-open, the benefit should manifest in both spending and employment. These all point to a likely robust rebound in growth in the coming quarter, which will be accompanied by the surge in oil prices and base effects to push headline inflation rates higher. Interestingly though, central banks have been consistently citing the transitory nature of these inflation factors, expecting the large structural dampeners on inflation to contain the longer-term risks. Thus, a gap has opened between the markets' outlook for inflation and that of central banks. This suggests that bond market volatility is likely to persist until one side shifts their view.

Certainly, the rise in US rates has been larger and quicker than we had expected, but elsewhere the move in rates has been more gradual. Thus, the scene is set for a lot of noise in fixed income markets, where managing duration risk is in focus. We are also alert to any shift by policy makers. We expect central banks to maintain their easy policy stance, which leaves fiscal as the likely factor for surprise. On one hand, as economies re-open the huge fiscal support measures are expected to roll off. The risk here is that there is an 'activity gap' particularly in terms of employment. On the other hand, there is scope for fiscal policy to shift from 'support' to 'direct' stimulus. The US is again leading the way, with President Biden outlining an ambitious infrastructure package. This could help lift the current low level of productivity, as it tilts policy toward investment into the supply side of the economy. While there is still a long way to go for the passing of the package, theoretically the US fiscal policy is supportive of growth going forward. But as it is supply-driven, the inflation risk should be contained. A side effect to consider is that this fiscal initiative could widen the gap of growth further between the US and regions such as Europe.

Macquarie therefore expect a challenging investment climate to persist, where Macquarie's intention is to maintain discipline and recognise that opportunities will present themselves.

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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