Macquarie Income Opportunities

Quarterly Investment Option Update

30 June 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	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	91
Global High Yield	0-20	4
Emerging Market Debt	0-15	5

Sector Allocation	%
Banking	27.7
Residential Mortgage	10.1
Transportation	4.0
Non-Agency CMBS	3.5
Treasuries	3.5

Regional Allocation	%
Australia	35.7
United States	22.3
UK	6.7
Europe Ex UK	10.7
Other	10.1
Cash	14.5

Top Holdings	%
Royal Bank of Scotland	2.7
Australian Government	2.1
Province of Ontario	1.5
National Australia Bank	1.3
Groupe BPCE	1.1
Morgan Stanley	1.0
Barclays	1.0
ABN AMRO Bank	0.9
Volkswagen Leasing GmbH	0.8
Bank of America	0.8

Investment Option Commentary

The Fund outperformed the benchmark over the second quarter, with interest rate duration and credit positioning both contributing. Government bond yields staged a notable recovery after a very weak start to the year in Q1, with 10 year US Treasuries (the key global benchmark) falling from a peak yield of 1.77% on 30 March, to finish June at 1.47%. Lowered expectations for fiscal policy spending, some concern around new virus variants, and a retreat of the reflation narrative were all cited as contributing to the sharp change in tone. In contrast, the themes in credit markets this quarter remained entirely consistent with the last several quarters: ongoing performance (thought at a slower pace), spread compression and higher beta/lower quality outperforming, all continued.

Amongst credit sectors, investment grade credit was the largest contributor, reflecting the continued strong performance of BBB credit (where the majority of exposures are held), and the significant allocation to this asset class. Amongst single names, travel exposures such as those to Qantas and Rome Airport were amongst the largest positive contributors, as well as holdings of corporate hybrids. Australian mortgage-backed securities were also a key contributor, with strong housing fundamentals and very strong demand for the asset class re-pricing the entire sector tighter – particularly in the lower tranches where the portfolio sources most of its exposure.

The Fund reduced some global investment grade exposures over the quarter, reflecting overall tight spreads and limited upside in many credit markets and little upside in much of this asset class, with excess cash re-invested in short-dated credit (with an average maturity below 2 years) – this part of the market offers some yield with minimal price volatility. Overall, the Fund maintains a preference for higher beta credit (including high yield, emerging markets debt and BBB-rated IG credit), balanced with higher liquidity, with materially reduced exposure to higher quality investment grade credit.

Market Commentary

The second quarter was primarily dominated by the interacting themes of vaccination rollout and the gradual re-opening of economies. However, in June, the decision of the US Federal Reserve (Fed) became the focal point, as markets were surprised by the shift in tone and forecasts for the outlook of rate hikes. Despite the Fed continuing to emphasise that the recent rise of inflation is transitory, markets viewed the upward shift in rate expectations as validation of their speculation. This caused shorter-term yields to push higher. Longer-dated bond yields went the other way, with the already flattening yield curve moving flatter. The debate amongst market participants was not only interpreting the Fed's signal, but also why the bond market rallied. There is merit in the view that earlier-than-expected Fed tightening could put a lid on the recovery and hence cap inflation, but there were also more subtle technical forces at play, which combined to squeeze many 'short' positions that further fuelled the rally in Treasury yields.

While these events were unique to the US, the impact rippled across countries, and curve flattening was a common theme and magnified in Australia and New Zealand, where recovery has already returned to pre-pandemic levels. Risk markets proved resilient, with credit spreads grinding tighter and high yield bonds outperforming. Emerging markets spreads ended the quarter tighter, though gave back some gains after the Fed's shift in tone, as the weaker dollar trend reversed.

Outlook

The pandemic continues to exert an influence on the shape of recovery as countries are at different stages, while new variants remind that vaccination may quell the hospitalisation risk but the virus will likely be with us for some time to come. There are still many unanswered questions on the future, such as: when will normal activity resume; when will international travel resume; what will the post-virus workplace look like?

As we move into the second half of 2021, attention is on the shape of recovery as economies re-open and whether the current inflation pulse will prove transitory as expected by policy makers or persistent. A key feature of the pandemic was massive government support to workers and businesses, but this is nearing its end, with many states in the US deciding to withdraw the Federal support early in the hope that this encourages people back to work. How quickly these furloughed/unemployed workers return will be key in determining the shape of the recovery. Businesses trying to re-open have reported difficulty in hiring and many have offered financial incentives, including higher wages, which has fuelled concerns that inflation will become persistent. Yet the data has shown that the majority of government transfer support to these workers during the pandemic was saved, suggesting that persistent uncertainty will hold back consumption. While supply disruption is likely to continue to pressure

inflation, in our opinion, the evolution of consumer income and demand will prove the decisive determinant of inflation longer term.

These vital but unanswered questions, combined with low bond yields and tight valuations, guide to a cautious approach to investment. However, Macquarie also recognise the ferocious insatiable need for yield. The manager balance these forces by maintaining discipline and 'doing the work' to determine the best risk-adjusted positioning for portfolios.

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

**Closed to new and existing investors

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