

Macquarie Balanced Growth

Quarterly Investment Option Update

31 March 2022

Aim and Strategy

The portfolio aims to provide medium to long-term capital growth, together with some income, by investing in a balanced level of growth and income. The option provides exposure to a diversified portfolio of growth assets, including equities and alternative assets, with some exposure to cash and fixed interest. The option employs an active investment approach that identifies and pursues investment opportunities within set limits through a combination of active management within each asset class and tactical asset allocation across asset classes to meet the objectives of the portfolio. A varying portion of the foreign currency exposure is hedged through currency hedging solutions, whether passive or active.

Asset Allocation	Benchmark (%)	Actual (%)
Cash	1.5	9.9
Strategic Income*	9.0	10.2
Australian Fixed Interest	17.5	7.8
Global Fixed Interest	7.5	7.7
Inflation Linked Bonds	5.0	3.3
Australian Equities	26.0	32.9
Global Developed Markets	13.5	15.3
Global Emerging Markets Equities	12.0	3.7
Alternative Assets**	8.0	9.3

* Invests predominantly in high quality Australian and global credit securities

** may include investments in such asset classes as private equity, infrastructure or hedge funds

Investment Option Performance

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

Investment Option Overview

Investment Category	Multi Sector (Balanced)
Suggested investment timeframe	5 years
Relative risk rating	6/ High
Investment style	Active
Manager style	Single Manager

Investment Option Commentary

The Fund delivered a negative return over the quarter and underperformed the strategic benchmark, which was primarily driven by the Fund's overweight bias to defensive assets. The Fund shifted its asset allocation from a moderate overweight bias in growth assets to neutral throughout the quarter.

In the March quarter, international and Australian equities delivered mixed performance with heightened volatility, detracting -5.1% and contributing +2.1%, respectively. With regard to fixed interest, the sector delivered a significant negative result, returning -3.7% domestically and -2.2% offshore. International infrastructure and property exposures returned a mixed result as well, contributing +3.6% and detracting -3.5% respectively. During the quarter, market participants continued to digest the economic impact from the Russia-Ukraine conflict, renewed public health measures in China and accelerating monetary policy trajectories of central banks. Significant volatility is observed across asset markets, with wide trading ranges for most.

During the quarter, the fund tactically managed the Fund's overall growth exposure. Early in the quarter, growth asset exposure was reduced, shifting the Fund to a 'neutral' stance in anticipation of heightened volatility, as global central banks were expected to increase the risk-free rate. As stock markets experienced significant turbulence in late February, exposure to growth assets was increased, following an improved valuation matrix, and then reduced growth asset exposure again at the end of March, with valuations becoming less attractive. Whilst the Fund made gains from its asset allocation changes during the quarter, performance was offset by weakness in defensive asset markets. The Fund's long-held bias to Australian equities and infrastructure assets also aided in minimising the impact.

Market Commentary

Fixed income market performance in March was primarily driven by the significant upward move in bond yields, as central banks signalled a more aggressive response to the rising trend of inflation. The Ukraine-Russia conflict has ignited another supply shock to the global economy. Both hard and soft commodity prices increased sharply in response. This shock hit just as expectations and early evidence were suggesting that the impact from the pandemic supply shock were beginning to dissipate. Expectations had been that inflation would begin to fall during coming months and quarters. Instead, inflation has risen and there is uncertainty as to how its path will evolve. Central banks, aware of the medium term risks to growth but cognisant of the current economy resilience, have been pushed into a more aggressive stance on monetary policy.

Shorter-term bond yields have risen more than longer-dated bond yields. This price action has reflected the expectation of more aggressive central bank actions but at the same time reflects a market belief that the impact on economic growth will be significant. The US yield curve is close to inverting (that is, a negative spread between short and longer dated bond yields) and such a move, if sustained, has historically been a reliable long-term indicator of recession. Indeed, risk markets did sell off but, either encouraged by underlying corporate fundamentals; recent economic data; or the hope for a near term end to the war, risk markets have rallied – with equities finishing the month higher and credit spreads sharply tighter.

Outlook

With the first quarter of 2022 at an end, we have witnessed another black swan event – the escalating tension between Russia and Ukraine. The impact of this geopolitical tension is likely to influence financial markets twofold. Firstly, via the uncertainty of further escalation and the corresponding global political dynamic and secondly via the impact of financial and political sanctions against Russia on the global economy. The increased geopolitical tension has created greater market tail-risk. However, the manager views further significant escalation as unlikely, and have positioned the Fund accordingly. Importantly, there have been significant price movements in commodities, rates as well as currency markets. There are complex reasons behind these price movement such as demand/supply imbalances, inflation expectations and inventory management. Nevertheless, these significant price movements indicate that tail risks are rising in the global economy and asset markets.

The manager expects the severe financial and political international sanctions against Russia will likely persist regardless of the severity or duration of the conflict. We expect these sanctions will impair the Russian economy, interrupt global supply chains and lead to higher commodity prices. In turn, this may lead to weaker global growth and persistently higher global inflation via further interruptions to the global supply chain. Furthermore, COVID-19 continues to trigger significant public health measures in China. Public health measures (such as lockdowns) tend to weaken economic activities in the short term, generate supply crunches and subsequently inflationary pressures. The geopolitical conflict, coupled with the COVID-19 pandemic may create higher and more persistent inflation than originally anticipated.

In terms of the removal of accommodative central bank policies, there may be dual impacts. Firstly, in a financial system with a significant level of debt and moderating fundamentals, a rise in interest rates can lead to a few

probable outcomes – namely, increased credit risks, as refinancing risks rise, and downward pressure on earnings, which may weaken economic growth as well as the labour market. These possible outcomes, coupled with abnormally high asset valuations, could result in an eventual ‘bubble burst’.

Ultimately, the manager expects the outlook for returns in both growth and defensive assets will be challenged in 2022. The manager sees an increasing possibility of a significant risk-aversion event. However, given the current low levels of risk-free rates as well as the strong corporate earnings and economic fundamentals, it is expected that growth assets will continue to deliver positive returns in near term, albeit with higher volatility. As a result, the fund is now positioned with a ‘neutral’ growth/defensive asset allocation which will likely be maintained over the next few months.

Availability

Product name	APIR
SignatureSuper*	AMP0958AU

*Closed to new investors

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