Macquarie Core Plus Australian Fixed Interest

Quarterly Investment Option Update

31 March 2022

Aim and Strategy

To outperform the Bloomberg AusBond Composite Index over the medium term (before fees) by using an active investment strategy.

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	Active
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian and global fixed income	100%	100%

Sector Allocation	%
Investment grade credit	64.1
High yield credit	7.6
Emerging markets debt	7.2
Cash	21.1

Quality Allocation	%
AAA	13.4
AA	8.6
A	7.8
BBB	37.3
BB and below	11.6
Unrated	0.2
Cash	22.1

Top Holdings	%
US Government	3.4
US Government	2.9
Westpac Banking Corporation	2.4
Groupe BPCE	2.2
Commonwealth Bank of Australia	1.8
ING Group	1.5
ABN AMRO Bank	1.5
Province of Ontario	1.3
Pacific National	1.3
AMP Life	1.2

Investment Option Commentary

The Fund underperformed the benchmark for the first quarter, with a consistent sell-off in government bonds and volatile (and ultimately weaker) credit markets the key drivers. Fixed income markets have had a historically weak start to 2022 with the worst first-quarter total returns in US investment grade (IG) credit since 1980 – reflecting prolonged inflation concerns, sharply more aggressive central bank hiking expectations, and credit market volatility around the Russia-Ukraine conflict. The Fund's underperformance was principally driven by duration positioning, with holdings of AUD duration the most significant mover – though Macquarie continue to view moves in this region as pricing too aggressively and offering attractive value. Amongst credit sectors, IG and emerging markets (EM) credit were the larger detractors, reflecting the larger allocation overall to IG credit and EM's linkage into Russia/Ukraine, leading to some underperformance of that sector.

The Fund maintained its strategic 'barbell' positioning, with a high liquidity balance (approximately 40% cash and short-dated IG credit), generally modest duration levels, and sourcing yield through higher-beta sectors such as high yield (HY) and EM. The Fund took advantage of significant spread widening at point in the quarter, particularly in March, to add to IG and HY issuers and tactically trade in HY credit. Specifically, the Fund added US issuers such as Bank of America (in Europe, after a significant repricing), US media company Discovery (after bonds fell by 15+ pts), and added an Euro X-Over tactical trade (the European HY credit default swap index), which was removed after significant spread tightening.

The outlook for the remainder of 2022 looks to be volatile, with multiple challenges for markets and policymakers to face. The key underlying variable is inflation, which unless tackled, does tie the hands of policymakers. Macquarie believe a nimble approach is the most appropriate stance for the foreseeable future – owning significant liquidity, adding credit exposures on weakness, and managing total risk in market rallies. The Fund is well set up for this going forward, with significant room to add to both risk assets and duration positioning as opportunities continue to present themselves.

Market Commentary

Fixed income market performance in March was primary 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 in coming months and quarters. Central banks, aware of the medium terms 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 from their inter-month wides.

Outlook

Macquarie had already modified their outlook for 2022 to reflect the impact from the war in Ukraine, to one where short-term inflation would remain more elevated than Macquarie previously expected, and at the same time they assessed that the medium term risks to growth have increased. That said, the aggressive signalling from the US Federal Reserve (Fed) was a surprise but not in the context of increased pressures on inflation in recent weeks. The challenge now is for the Fed to drive inflation back towards target without inflicting too much damage on growth. From their perspective, tighter monetary policy will, in time slow aggregate demand. Current high inflation, however, is largely being driven by supply problems. This is a classic tool and target mismatch, which implies that the task in front of the Fed is difficult and, for markets, suggests that further volatility should be expected as the Fed navigates this path.

Rate markets globally have re-priced sharply. The overhang of negative yields is quickly evaporating, evidenced by 2-year German yields moving into positive territory for the first time since 2014. None of this makes bonds an obvious buy, particularly as the Fed and other central banks are in aggressive hiking mode, but for investors, yields are indeed starting to look attractive outright and as a hedge against risk assets.

While inflation is now a problem, for risk assets the path of growth through 2022 should prove critical. This second supply shock has increased the risk of recession in the 12-18 months ahead. How central banks navigate the delivery of tighter monetary policy likely holds the key to whether recession becomes a reality, or we experience a ‘soft landing’ for the economy. Macquarie’s investment approach has been cautious, and their outlook implies that fixed income markets will experience further volatility in the months ahead but one where value is beginning to re-emerge.

Availability

Product name	APIR
SignatureSuper*	AMP0964AU

*Restricted. Please see your Product Disclosure Statement

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