Macquarie Income Opportunities

Quarterly Investment Option Update

30 September 2019

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

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	
Hybrids	0-10	
Global High Yield	0-15	
Emerging Market Debt	0-15	

Sector Allocation	%
Banks	25.8
Residential mortgage	10.4
Non-agency CMBS	5.9
Electric	5.4
REITs	5.3

Regional Allocation	%
Australia	70.3
United States	9.0
UK	2.4
Europe Ex UK	7.1
Other	11.2

Top Holdings	%
CBA	1.5
NAB	1.4
Suncorp	1.0
CBA	0.9
ANZ	0.9
Bank of America	0.9
Transurban	0.8
NAB	0.8
Westpac	0.7
AGL	0.6

Investment Option Commentary

Despite uncertainties around Brexit and the trade war between China and the US, the Fund outperformed this quarter. The dovish tilt from central banks around the world, better than expected US corporate earnings results as well as the Fund's allocation to the emerging markets sector in September helped drive outperformance. The long duration position provided an effective hedge against the detraction from the overweight credit exposure in August when credit spreads widened.

It was a strong quarter of issuance with the US IG market seeing a record amount of primary issuance in September. These new issues were taken down well. In Australia, issuance in the credit market was dominated by the financials along with several ABS/RMBS and corporate deals. The Fund selectively participated in new issues which included buying Apple and Disney in the primary market along with a modest allocation to high quality emerging markets names in USD.

Market Commentary

After spreads hit their tightest levels since October 2018, credit markets were flat to weaker in the September quarter as the broader macro themes continued to drive performance.

US Federal Reserve (Fed) expectations in July drove US investment grade (IG) spreads to tighten to 108bps, though this reversed in August as trade concerns pushed spreads back out to as wide as 124bps, demonstrating that while the 'chase for yield' is real, shocks to the real economy can still rattle credit markets. September was more positive with spreads tightening 5bps to 115bps despite $US165bn in issuance, however, year to date issuance remains down modestly on last year at -4% YoY. High yield (HY) finished the quarter 31bps wider at 463bps, demonstrating that the market has become more discerning despite central banks returning to provide support, which was especially the case with CCCs. Overall earnings have been mildly positive, in line with previous years with 75% of corporates beating earnings and 50% beating sales, though guidance has been mixed. Earnings misses have generally been punished, particularly in HY where there is no tolerance for weak numbers. On a positive note the consumer appears to be in good shape with key retailers such as Target and Lowes performing well, though department stores continue to be weak. This was balanced by weaker industrials, for example John Deere which cut guidance yet again.

Europe started the quarter well on the back of expectations that an announcement of more stimulus from the European Central Bank (ECB) would be coming. European IG rallied 13bps to close at an option adjusted spread of 99bps, close to cycle tights of 73bps reached in February 2018. This moderated in August as trade concerns came to the fore and it also looked like the relentless rally in sovereign spreads was setting a limit for how low credit yields can go, which saw spreads widen to 109bps. In September, European IG closed the month 2bps wider at an option adjusted spread of 111bps. Non-financial gross issuance of €52bn set an all-time record, and understandably this sector underperformed on the month as the trend of US issuers taking advantage of low European rates continued. A no-deal Brexit scenario remains a key risk for European credit and there has been minimal progress on this front.
In September the ECB announced a package of measures to stimulate the economy including an open-ended asset purchase programme of €20bn per month, improved targeted longer-term refinancing operation terms, deposit rate tiering and a 10bps rate cut. The open-ended nature of the stimulus has been taken positively by risk assets, and there is an expectation that credit purchases could make up a greater proportion of the new programme.

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Outlook

The yield curve inverting is a reliable warning of rising recession risk, and history shows that the timing on average from inversion to recession is 11-15 months. That said, many voices are calling that 'this time is different'. The team have come to the conclusion that while risks for a US recession had certainly risen through 2019 to-date, there is an absence of corroborating factors to convince that a recession 12 months ahead is a high conviction call. Importantly, our research suggests that if the US did enter recession in 2020, it is most likely to be short and shallow. Further, if Macquarie apply their process to the rest of the world, they find that the risk for recession is higher in some countries, particularly those exposed to global trade.

For rates markets the conclusion, again, is to not fear duration as global bond yields are set to remain 'lower for longer'. While duration positioning was steadily reduced as bond yields plunged in recent months, their rates team's guidance is to gradually accumulate into any back up in yields in coming months.

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

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