UBS Income Solution Fund

July 2020

Fund description
The Fund is an actively managed, diversified portfolio of corporate credit assets with exposure to Australian and global markets, designed to provide an income yield to investors. The majority of the Fund will be invested in investment grade securities with some exposure to non-investment grade securities.

Investment strategy
We seek to build the optimal portfolio exhibiting attractive income and risk characteristics and we undertake this by employing both top-down research and bottom-up security specific analysis. The Fund will be managed with the intention of maximising total return (income plus growth). We aim to hedge foreign currency exposures to the Australian dollar.

Investment return objective
The Fund aims to outperform (after management costs) the Reserve Bank of Australia Official Cash Rate over rolling three year periods.

Income history
As at financial year 30 June 2020

![Income history chart]

Credit quality (%)
- Investment Grade: 73.8%
- High Yield: 15.7%
- Cash and other: 10.5%

Investment performance

<table>
<thead>
<tr>
<th>Fund</th>
<th>1 month</th>
<th>3 months</th>
<th>1 year</th>
<th>3 years</th>
<th>5 years</th>
<th>Since inception*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total return</td>
<td>1.08</td>
<td>3.46</td>
<td>0.29</td>
<td>2.52</td>
<td>3.21</td>
<td>4.86</td>
</tr>
<tr>
<td>Benchmark**</td>
<td>0.02</td>
<td>0.06</td>
<td>0.60</td>
<td>1.18</td>
<td>1.48</td>
<td>3.89</td>
</tr>
<tr>
<td>Added Value</td>
<td>1.06</td>
<td>3.40</td>
<td>(0.31)</td>
<td>1.34</td>
<td>1.73</td>
<td>0.97</td>
</tr>
</tbody>
</table>

*Inception date: 17 April 2002. ** RBA Official Cash Rate, Prior to 1 February 2017 benchmark was Bloomberg AusBond Bank Bill Index.

Performance figures are net of ongoing fees and expenses. The performance figures quoted are historical, calculated using end of month prices, and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. Performance can be volatile and future returns can vary from past returns. Growth returns are the returns due to change in initial capital value. Distribution returns are the returns due to the distributions paid. 1Yield to Maturity (YTM) is the estimated annualised rate of return that would be received if the Fund’s current securities were all held to maturity. Note that YTM does not account for fees or taxes. YTM is not a forecast, and is not a guarantee of the future return of the Fund. 2 Source: RBA, 2019.

Fund information

<table>
<thead>
<tr>
<th>Inception date</th>
<th>17 April 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund size</td>
<td>$270.4 m</td>
</tr>
<tr>
<td>Management fee</td>
<td>0.60% pa</td>
</tr>
<tr>
<td>Minimum initial investment</td>
<td>$10,000 (via mFund and online application $5,000)</td>
</tr>
<tr>
<td>Distributions</td>
<td>Monthly</td>
</tr>
<tr>
<td>Monthly distribution estimate CPU</td>
<td>0.195</td>
</tr>
<tr>
<td>Buysell spread1 effective 29/06/20</td>
<td>+ 0.075% / - 0.35%</td>
</tr>
<tr>
<td>Currency management</td>
<td>Hedged to AUD</td>
</tr>
<tr>
<td>APIR code</td>
<td>UBS0003AU</td>
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<tr>
<td>mFund code</td>
<td>UAM05</td>
</tr>
</tbody>
</table>

1Due to increased volatility in the markets resulting from COVID-19, the buy/sell spreads for certain funds may have varied. For more information, please download our latest Buy/sell spreads from our website.

Portfolio statistics

- Modified Duration (yrs): 1.99
- Spread Duration (yrs): 3.19
- Yield to Maturity1 (%): 2.17
- Official cash rate (%): 0.25
- Average Credit Rating: BBB+

Industry allocation (ex cash) (%)
- Banking: 27.8%
- Insurance: 6.7%
- REITs: 2.8%
- Other financials: 2.4%
- Basic industries: 2.9%
- Transportation: 12.7%
- Consumer cyclical: 6.2%
- Consumer non-cyclical: 7.5%
- Communications: 9.7%
- Other industrials: 8.4%
- Energy: 0.9%
- Utilities: 8.2%
- Non-corporates/other: 3.9%

Inception: 17 April 2002

UBS Asset Management
All data as at 31 July 2020

UBS Asset Management
All data as at 31 July 2020

UBS Asset Management
All data as at 31 July 2020
Market highlights

- Australian and global bond markets return positive performance over July
- Risk asset gain over the month, credit spreads tighten along with market optimism
- Fed extends emergency lending programs, EU agrees terms of the recovery fund
- RBA prepared to scale-up bond purchases and ‘will do whatever is necessary’ to keep bond markets functional

Performance review

After fees and expenses, the portfolio increased by 1.08% over the month, outperforming its benchmark by 106bps. Risk assets marched higher in July buoyed by a combination of factors including continued fiscal and monetary easing by policy makers and optimism that a vaccine for COVID-19 could be made commercially available by year-end. In bond markets, both spread sensitive and rate sensitive assets performed well as most longer-dated government bond yields moved lower and credit spreads tightened. The Australian bond market returned positive performance with credit the main driver of total returns. Offshore, European bonds outperformed their US and emerging market counterparts while by asset class high yield outperformed investment grade. Primary issuance in the Australian credit market remained active with new bonds issued by both offshore and local corporates over the month. The new issuance was met with healthy participation as investors continue to search for yield in the current market environment.

The fund delivered positive performance with Australian and global grade credit spreads continuing to contract over July. Positioning within Australian financials, industrials and utilities all contributed to returns over the month. The fund’s small strategic allocation to US short-duration high yield securities also added to returns as high yield markets outperformed investment grade credit over July.

Outlook

Concerns around a ‘second wave’ of infections have emerged just as the rate of COVID-19 mortality and infection rates appeared to have flattened in many regions globally. In response, authorities are winding back some of the relaxation in social distancing measures which may curb developing optimism around a faster-than-expected economic recovery. Aggressive easing in monetary and fiscal policy continues to provide essential near-term support for economic activity and has underpinned a strong recovery in risk assets. Bond yields remain anchored at low levels reflecting near zero or negative policy rates, asset purchase programs and liquidity provisions. The key uncertainty continues to be the sustainability of a recovery in consumption and evolution of the unemployment rate where job losses have been severe. Geopolitics adds to the uncertain outlook with a potential re-escalation in US-China trade tensions and as the US Presidential race draws near.

In Australia, policy settings are at the effective lower bound. The RBA has reiterated its commitment to ensuring the normal functioning of bond markets through bond purchases and its yield target for 3 year government bonds at 0.25%. Front-end yields remain anchored while longer-dated bond yields trade alongside both fundamental and technical factors. Demand for the recent issuance of ultra-long dated Australian government bonds highlights investor appetite for yield in the current market environment. Recent data points are showing the extent of the pandemic impact, with GDP growth registering a negative print of -0.3% over Q1 and expectations of a deeper contraction for the second quarter. Unemployment has risen to 7.4% with part-time roles replacing full-time positions. Headline inflation has moved to its lowest level since 1931, albeit driven by transitory factors. The ‘second wave’ of infections in Victoria and the reissue of lockdown measures in parts of the state, along with early signs of spread into states such as New South Wales and Queensland, is a set-back for early optimism around the recovery in the Australian economy and underscores the heightened uncertainty surrounding the medium-term outlook.

The US Fed has employed its full range of policy tools, with cash rates at the zero bound and a wide range of quantitative easing measures implemented. The latest GDP print is representative of the scale of the economic impact in the US, with growth shrinking 9.5% over Q2 – the steepest decline in quarterly records history dating back to 1947. In contrast, jobs growth has continued to surpass expectations. There is still significant uncertainty about the pace of the US economic recovery, particularly in light of increased infections and renewed lockdowns in some states. Fiscal policy is providing strong support to households and businesses, and a new stimulus package is likely to pass Congress in the coming month. Investor focus is expected to shift towards November’s elections in the months to come. A resurfacing of US-China trade tensions adds to geopolitical risks.

Europe is on the path to normalization as COVID-19 restrictions are being eased. Fiscal support has been plentiful thus far, and an EU recovery fund of EUR 750 billion is being finalised. The ECB has increased its bond-purchase program, enabling it to continue buying bonds into the middle of 2021. At EUR 1.35 trillion, this should be large enough to absorb the surge in bond issuance that will accompany national fiscal plans. These measures should facilitate the recovery in the second half of 2020, even if the recovery is likely to take time as households and firms adapt to the post-COVID-19 world.

Economic activity in China has recovered from the trough in the first quarter of the year. The GDP print of 3.2% for Q2 is further evidence of the turnaround in conditions, accompanied by improving PMI indicators and industrial production data. Conditions are being support by a multi-faceted policy approach: announced fiscal stimulus package is now up to 7–8% of GDP; and the PBOC has cut the reserve requirement ratio (RRR) by 150–200bps year-to-date, with another 100–300bps of cuts expected by year-end.

Investment grade and high yield credit markets have rebounded strongly from the sharp volatility in late Q1. US and European markets have led much of the retracement given the sizeable intervention in corporate bond markets by the Fed and ECB. The Australian credit market has managed to follow suit despite the absence of RBA support, with domestic credit spreads tightening over the last few months. Primary issuance activity has helped lift overall sentiment and confidence. Corporate solvency issues emerge at a time where leverage is elevated, particularly in...
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