

UBS Income Solution Fund

March 2024

Fund description

The Fund is an actively managed, diversified portfolio of corporate credit, asset backed and other fixed income securities, cash equivalents and cash. The Fund may hold up to 25% in high yield securities (which may include unrated securities).

Target market

The Target Market Determination (TMD) for the Fund sets out the class of consumers for whom the product, including its key attributes, would likely be consistent with their likely objectives, financial situation and needs. To access to the TMD and other Fund documentation visit our website.

Investment strategy

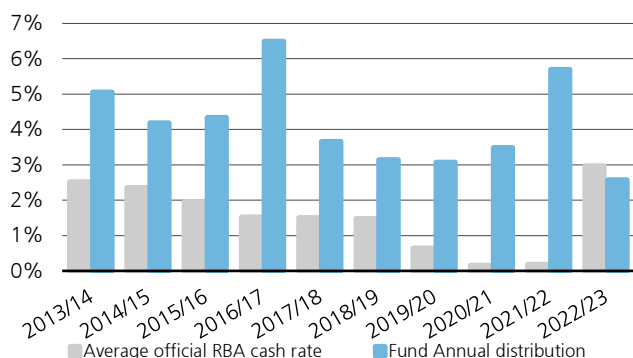
The Fund is actively managed, based on fundamental research that draws upon the investment insights of our fixed income teams. The approach employs both “top-down” research, including analysis of economic factors, market data and macro credit themes, and “bottom-up” research in respect of particular securities, including analysis of earnings and cash flow stability, balance sheet strength, industry and valuation. The Fund’s investment strategy is to invest in a portfolio of Australian and global corporate credit, asset backed, and other fixed income securities, cash equivalents and cash.

Investment objective

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

Investment objective

As at financial year 30 June 2023



Fund information

Inception date	17 April 2002
Fund size	\$ 319.0m
Management fee	0.60% pa
Minimum initial investment	\$ 50,000
Distributions	Monthly
Monthly distribution estimate cents per unit (CPU)	0.15
Buy/sell spread	+ 0.10% / - 0.20%
Currency management	Hedged to AUD
APIR code	UBS0003AU

Key statistics

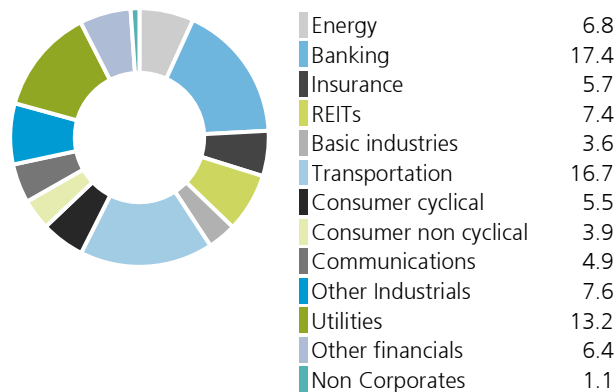
Modified Duration (yrs)	2.39
Spread Duration (yrs)	3.17
Yield to Maturity ¹ (%)	5.52
Official cash rate (%)	4.35
Average Credit Rating	BBB

¹ Yield to maturity (YTM) is not a distributed yield nor reflects anticipated income to be earned by the fund. It may include the effect of some derivatives, including swaps and FX forwards, which can form a significant part of the investment strategy but do not pay a regular income. It is in the base currency of the master fund and not specific to a share class.

Credit quality (%)

Investment Grade	80.22
High Yield	18.45
Cash and other	1.33

Industry allocation (ex cash) (%)



Investment performance

Fund	1 month %	3 months %	1 year %	2 years % pa	3 years % pa	5 years % pa	Since inception* % pa
Total return	0.79	1.67	6.93	4.70	2.51	2.51	4.52
Benchmark**	0.34	1.07	4.12	3.09	2.08	1.48	3.53
Added Value	0.45	0.60	2.81	1.61	0.43	1.03	0.99

* 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. 1 Yield 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.

Market review

- Australian sovereign bond yields fell modestly across the term structure with a flattening bias.
- Australian credit spreads tightened slightly over March.
- The RBA maintained the cash rate target at 435bps.

Global market review

In March, global Fixed Income markets saw their first positive monthly return in 2024 as major central banks are now pivoting toward rate cuts while still examining the right timing as the Fed, ECB and BoE all kept rates unchanged over the month. In the US, investors gained more confidence that the US policy rate has passed its peak and rate cuts could be seen this year. Yet, markets also continued to slightly trim back the excessive expectation on the timing and scale of rate cuts over the month. US government bond markets were tighter as the 5-year and the 10-year yield declined 3bps and 5bps respectively over the month. Rates markets in Europe also followed a similar pattern with the German Bund 10-year and UK Gilts 10-year yields falling 11bps and 19bps respectively. On the credit side, investment grade credits in the US and Europe outperformed their high yield counterparts. While spreads in the US high yield space tightened and delivered positive total return, spreads in the European high yield bond market widened and resulted in lower positive total return over the month.

In the US, activity data rebounded after some weather-induced weakness to start the year. Car sales reversed nearly all of their January decline, bouncing back to 15.8 million units on an annualized basis. Housing starts also surged to above 1.5 million, well above the consensus estimate. Stronger-than-expected data was broadly shared throughout real estate, as building permits and existing home sales also beat estimates. Retail sales were one exception, as the control group was flat on the month, bucking expectations for a 0.4 percent advance. Job growth surprised to the upside in February, with payrolls up 275,000 versus 229,000 expected. However, January's robust increase of 353,000 was revised downwards to show a more moderate gain of 229,000. The unemployment rate unexpectedly rose to 3.9 percent. The JOLTS report suggested further cooling in the job market, with openings falling and the private sector quit rate

below 2.4 percent, well under what it averaged in 2018 and 2019. Initial jobless claims continue to signal that there is little outright weakness in the labour market, ending the month at 210,000. Inflation data once again surprised to the upside in February, with the core CPI rising 0.4 percent month-on-month, a tick hotter than anticipated, as did core producer prices with a 0.3 percent increase. Core PCE inflation was in line with expectations, up 2.8 percent year-on-year. The preliminary reading of the composite S&P Global US purchasing managers index moderated to 52.2 from 52.5, as anticipated, with a pickup in momentum in the manufacturing sector offset by a deceleration in services. The Federal Reserve kept interest rates unchanged at a range of 5.25 to 5.5 percent at its March meeting and kept the statement nearly identical to January's. The Summary of Economic Projections revealed a pro-growth bias. Monetary policymakers (on net) moved their forecasts for growth and core inflation this year higher, and the unemployment rate a tick lower. At the same time, the median official sees 75 basis points as most appropriate for 2024 given these economic conditions. During the press conference, Fed Chair Jerome Powell suggested that the recent pickup in price pressures was a bump in the road amid an otherwise disinflationary trend, and that strong hiring would not be in itself a reason to hold off on rate cuts. Powell also added that the Federal Reserve is likely to announce plans to slow the pace of its balance sheet reduction in the near future.

In Europe, confidence data continued to improve over the course of the month. The European Commission's gauge of consumer confidence inched higher to -14.9 in March from -15.5, while the Sentix gauge of investor confidence advanced to -10.5 from -12.9. Both readings were ahead of the consensus forecast. Germany's IFO business climate index also rose to 87.8 in March, better than the expected 86 and above February's upwardly revised 85.7.

Conditions in the manufacturing sector continue to deteriorate, bucking the global trend. The flash reading of the HCOB Manufacturing PMI fell to 45.7, countering expectations for a modest improvement. However, this is being offset by more strength in services, where the flash PMI rose to 51.1 and drove an improvement in the composite PMI to 49.9 from 49.2. The European Central Bank kept rates unchanged and stressed data dependency in determining the path forward for rates. During the press conference, President Christine Lagarde said the central bank would "know a lot more in June," somewhat

tipping her hand as to the expected start date for easing. Unlike the Fed, the ECB revised both its growth and inflation forecasts lower in their March projections. Compensation per employee, a key component for the inflation outlook, slowed to 4.6 percent year-on-year in Q4, down from the 5.1% pace in Q3. Labor market data in the UK softened somewhat, with the unemployment rate edging up to 3.9 percent in January and employment change unexpectedly declining by 21,000 for the three months ending January, whilst expectation was for a small increase. However, pay growth remains robust, with average weekly earnings excluding bonuses edging lower to growth of 6.1 percent year-on-year for the three months ending January. Inflation data was mixed, as core CPI ran at an annual rate of 4.5 percent in February, a tick lower than expected, while service sector inflation ran a tick hotter than expected at 6.1 percent. The Bank of England kept rates unchanged at its March meeting, but the two officials who had been dissenting and favoured more hikes joined the majority decision, with the central bank broadly sending the signal that rate cuts will come before long. In his budget speech, Chancellor Jeremy Hunt made some changes to tax policy which will contribute to 265 billion pounds of debt issuance in this fiscal year. Home prices rose, with the Rightmove index up 0.8 percent year-on-year and the monthly increase accelerating to 1.5 percent from 0.9 percent.

In Japan, wage pressure is building. The annual Shunto wage negotiations showed a pick-up in pay, with Japan's largest labour union federation securing a total pay increase of 5.3 percent compared to last year, the largest pay increase in more than 30 years. Real cash earnings ran well above estimates with a decline of just 0.6 year-on-year in January, better than estimates for a 1.5 percent drop. Retail sales jumped in February, up 1.5 percent month-on-month, though the prior reading of 0.8 percent growth was revised lower to an increase of just 0.2 percent. Tokyo Core CPI moderated in line with expectations, with price pressures up 2.4 percent year-on-year in March. The Bank of Japan tiptoed away from its accommodative policy, becoming the last central bank in the world to move its policy rate out of negative territory with a hike to a range of 0 to 0.1%, its first policy rate increase in 17 years. The central bank also ended the yield curve control and ETF purchasing policies, while indicating it would still buy longer-term government bonds as needed. Governor Kazuo Ueda stressed the "importance of maintaining an accommodate environment" to achieve sustainable 2 percent inflation. The quarterly Tankan survey showed an improvement in conditions for large non-manufacturing firms as well as a better outlook. Manufacturing firms had a slightly lower assessment of current conditions but an improvement in the outlook.

In China, economic data pointed to a solid showing for the first two months of the year, albeit with a continued drag from the property sector. Fixed asset investment, industrial production and exports all ran well above expectations for January and February on a cumulative basis relative to the same period in 2023. Retail sales were a tick below expectations at an annual growth of 5.5 percent. Property sales, however, contracted by nearly 33 percent year-on-year, while investment was down 9 percent. New and used home prices also contracted on a monthly basis for February. Broad surveys of the economy

improved by more than expected in March, with the National Bureau of Statistics' non-manufacturing PMI up to 53 versus a consensus estimate of 51.5. The corresponding manufacturing PMI came in at 50.8 (50.1 expected) and the Caixin manufacturing PMI was a touch above estimates at 51.1.

Commodities showed some strong performance in March, with the UBS CMCI Total Return Index up by 4.36 percent, bringing the YTD return to a level of 5.18 percent. Oil futures rose 4.6 percent as physical markets continued to tighten in the US, Ukrainian strikes knocked out Russian refinery capacity and speculative buying continued to pick up steam. Gold futures surged to all-time highs on heightened geopolitical risks. Industrial metals posted modest gains on the month.

Australia Market Review

Australian sovereign bond yields fell modestly across the yield curve over March with a flattening bias, in line with global trends albeit outperforming US Treasuries. Resilience in the US economy continues to be underscored by a stronger-than-expected increase in non-farm payrolls, while core PCE came in within market expectations. Markets have continued to scale back expectations of FOMC rate cuts, now with three cuts priced for the year with June the deemed the most likely start date. The Australian 3-year Government bond yield fell slightly at -8bps, ending the month at 3.62% while the 10-year Government bond yield dropped -18bps to end the month at 3.96%. Credit spreads tightened slightly (Bloomberg AusBond Credit 0+ index tightened from 111bps to 110bps). The Bloomberg AusBond Composite 0+ year Index returned 1.12%.

In March, the RBA kept the official cash rate target unchanged at 4.35%. Minutes from the March meeting saw the Board acknowledging that economic data over preceding weeks had been in line with their expectations, and that it will continue to monitor developments in the economic situation. Domestic inflation continues to moderate, driven by softer goods inflation while services price inflation remains elevated. In terms of the labour market, while conditions remained tight, there had been some easing in recent months in line with softer economic growth. Going forward, the Board will continue to focus on balancing the objectives of controlling inflation and bringing the labour market to full employment.

On the domestic economic data front, Australia's headline CPI for February came in weaker-than-expected (3.4% YoY vs. C 3.5%), a step in the right direction for the RBA while retail sales over the month was reported in line with market expectations. Elsewhere, the labour market data remains volatile with a much stronger-than-expected change in employment for February (116.5k vs. C 39.7k), while the unemployment rate dropped to 3.7% from 4.1% the previous month.

Portfolio

The portfolio outperformed the benchmark over March.

Australian sovereign bond yields fell across the yield curve over March, broadly in line with trends in global bond markets. This resulted in positive relative performance from the portfolio's duration positioning around the short end of the curve. In addition, the positive relative performance was further supported by our positioning within Credit Management, where the portfolio's overweight position in Australian and US high yield corporates benefited from the extra yields ("carry") and a modest tightening in credit spreads.

Outlook

We favour long duration strategies on the basis that the global rate cycle has turned. The resurgence of a "higher for longer" narrative runs counter to our expectations that most major central banks (ex. Bank of Japan) will start to unwind restrictive policy from mid-2024 amid continued disinflation and soft growth.

This disinflationary trend has become increasingly evident in Australia with the recent CPI data generally surprising most forecasters, including the RBA, to the downside. The current inflation trend appears to be running at around

3.5%, a sharp deceleration from the 5%-plus annual growth rates recorded in Q3 last year. Progress may slow from here, yet we consider the RBA's 2-3% inflation target to be well within reach in the second half of this year. Meanwhile, we continue to see evidence that the labour market is gradually loosening while growth is set to stay below potential for the foreseeable future led by the consumer as the squeeze in real disposable income continues to work its way through the economy.

The RBA's cash rate is likely at its peak based on our reading of the inflation trend and already restrictive nature of current policy settings. In fact, the market has started to anticipate a pivot to an easing cycle later in the year albeit one that is considerably shallower than peers such as the Eurozone, US, UK, New Zealand and Canada where cutting cycles of 150-200bps are priced in. Given this, current Australian bond yields look attractive, and we think 3-year bond yields can trend down to at least 3% this year.

Usually, credit spreads would move wider in the latter stages of the economic and rates cycle and as recession risks linger. However, high all-in yields continue to provide strong support to the Australian and global credit markets. Market technicals have also been positive for AUD credit as cash is being deployed amid relatively low issuance.

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