

UBS Cash Fund

August 2022

Fund description

The Fund is an actively managed portfolio predominantly comprising Australian cash and cash equivalent investments. The Fund may also invest in investment grade corporate bonds and asset backed securities, and longer term Australian Federal and State government bonds.

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 predominantly comprising Australian cash and cash equivalent investments.

Investment objective

This Fund aims to provide investors with a total return (before management costs) equivalent to the Bloomberg AusBond Bank Bill Index over rolling 12 month periods.

Portfolio Statistics

	Fund	Benchmark
Modified Duration (yrs)	0.22	0.13
Yield to maturity ¹ (%)	2.42	2.17
Average rating	AA-	

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.

Fund information

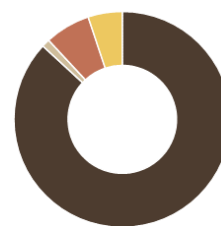
Inception date	11 May 1989
Fund size	\$ 842.8 m
Management fee	0.10% pa
Minimum initial investment	\$50,000
Distribution frequency	Monthly
Buy/sell spread	+/- 0.00%
APIR code	SBC0811AU

Credit Quality (%)

Long term	Fund
AA	3.2
A	3.3
BBB+	0.2

Short term	Fund
Treasury Securities	0.0
A1+	35.8
A1	52.1
A2	5.3

Fund positioning (%)



Certificates of Deposit	86.9
Commercial Paper	1.2
Floating Rate Notes	6.8
Cash	5.1

Investment performance

Fund	1 month %	3 months %	1 year % pa	3 year % pa	5 years % pa	Since inception* % pa
Total return	0.16	0.35	0.36	0.33	0.90	5.00
Benchmark**	0.15	0.33	0.37	0.36	0.95	5.18
Added Value	0.01	0.02	(0.01)	(0.03)	(0.05)	(0.18)

*Inception date: 30 November 1989. **Bloomberg AusBond Composite 0+ Yr Index.

Performance figures are net of ongoing fees and expenses. The performance figures quoted are historical, calculated using end of month redemption 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.

Global Market review

The rally in fixed income from July went into reverse in August. After returning 1.6% in July, US Treasuries lost 2.5% in August, for a year-to-date negative return of 10%. The pan-European Aggregate lost 5.7%, the worst month on record, following a gain of 3.6% in July. US high yield, which added 6% in July, lost 2.4% in August while Euro high yield, which gained 5.1% in July, returned a negative 1.2%, for a loss year-to-date of 11.9%. US senior loans had a negative return of 1% in August, while Asian high yield lost over 18%. The yield on 10-year US Treasuries rose from 2.65% to 3.19%.

In the US, headline consumer prices were flat month-over-month in July, compared with consensus forecasts for a 0.2% increase after a 1.3% rise in June. Year-over-year, headline CPI rose by 8.5%, which was lower than consensus estimates of 8.7% and down from 9.1% in June. Fed officials continued to stress that "While the lower inflation readings for July are welcome, a single month's improvement falls far short of what the Committee will need to see before we are confident that inflation is moving down." Turning to activity, the ISM Manufacturing PMI edged down to 52.8 from 53 in June, while the Services PMI rebounded to 56.7, up from 55.3. Nonfarm payrolls increased by 528,000, and the unemployment rate fell to 3.5%, matching the pre-pandemic level, which is a 50-year low. Industrial production rebounded 0.7% month-over-month, hitting a record high. The yield curve inverted, with 2-year Treasury yields around 35 basis points higher than 10-years. On the political front, Democrats passed the Inflation Reduction Act through reconciliation, and the Chips and Science Act was also enacted on a bipartisan basis. President Biden issued an executive order providing student debt relief although this faces potential legal challenges.

In the Eurozone, inflation hit a new record high for August of 9.1%, based on flash figures. This was the ninth consecutive record for consumer price rises in the region, with the climb starting back in November 2021. Dutch central bank Chief Klaas Knot and Estonia's Madis Müller both argued that 75 basis points should be discussed. Meanwhile, Bundesbank President Joachim Nagel argued that the ECB must "react decisively" and made the case for front-loading rate moves. Natural gas prices were volatile amid energy supply concerns, with the Dutch TTF benchmark rising as much as 56% during the month, hitting a peak on 25 of August, before falling on reports that the European Commission is seeking new ways to address energy costs. The composite purchasing managers' index reading came in below 50 for the second consecutive month in August. In the UK, inflation pushed into double digits for July, for a year-on-year reading of 10.1%. Core inflation, which excludes energy, food, alcohol, and tobacco, came in at 6.2% in the year to July 2022, rising from 5.8% in June and ahead of expectations for 5.9%.

The Bank of England raised rates for the sixth meeting in a row in August, with a 50-basis point increase, the largest single increase since 1995.

In China, July activity data, with a few exceptions, slowed from June readings. Outside the auto sector (boosted by subsidies and tax cuts), restaurant services (enjoying pent-up demand), and electricity production (helped by high summer temperatures), indicators for all sectors slowed sequentially.

In Japan, data showed second quarter GDP growing 2.2% quarter on quarter, up from 0.1% growth in the first three months of the year. The yen came under further pressure against the US dollar in August—from JPY 131.6 at the start of the month to JPY138.6 at the end.

Broad commodities (UBS CMCI Total Return Index) ended August nearly unchanged versus July. This was primarily driven by the agriculture sector rising by more than 3% as result of weather-related crop downgrades in the US, Western Europe, South America, and China. All other sectors delivered a negative performance, with precious metals down the most.

Australia Market Review

The Australian sovereign yield curve sold-off over August in line with moves in offshore bond markets as global investors remained concerned about the inflation outlook and pace of central bank hikes. Australian 3-year Government bond yields rose 55bps, ending the month at 3.21% while the 10-year Government bond yield increased similarly by 54bps, to end the month at 3.60%. The spread of Australian 10-year Government Bond yields against US 10-year Government bond yields was unchanged from the prior month at 41bps. The Bloomberg AusBond Composite 0+ year index returned -2.54% in August, driven primarily by duration. Credit spreads were marginally tighter over the month (Bloomberg AusBond Credit 0+ year index tightened from 139bps to 137bps).

In early August, the RBA raised the official cash rate target by 50bps to reach 1.85%, a move that was widely anticipated by market participants. The RBA Board Minutes from the August meeting provided some additional insights into the Board's intentions, "The Board expects to take further steps in the process of normalizing monetary conditions over the months ahead, but it is not on a pre-set path. It is seeking to do this in a way that keeps the economy on an even keel. The path to achieve this balance is a narrow one and subject to considerable uncertainty."

On the data front, July's unemployment print of 3.4%, a near 50-year low, together with a participation rate print of 66.4% continues to suggest tight labour market conditions. Meanwhile, retail sales printed at a healthy 1.3% in the month of July, signalling that the consumer is so far proving resilient in the face of higher interest rates.

Given still strong activity data and RBA narrative – it seems the upcoming Q3 CPI print in October will be a key data release that domestic investors are focused on to gain more insights on the path for central bank policy.

Australia ESG insights

As a large institutional fixed income investor in CBA globally, we had a chance to discuss their recently published first climate report. Earlier this year CBA joined the UN-convened Net-Zero Banking Alliance, which compels CBA to set and commit to emissions reduction glidepaths in its highest emitting sectors in order to achieve net zero financed emissions by 2050. For example, whilst thermal coal mining represents less than 0.1% of CBA lending exposure, it represents 4% of CBA's total financed emissions. CBA targets a full exit from thermal coal by 2030 and is on track. In addition, upstream gas extraction represents just 0.4% of lending exposure but 19.8% of total financed emissions – here CBA has set an interim reduction target of 17% by 2030 and is on track. Whilst there has been good progress so far, CBA will face a number of challenges in the years ahead such as the reliability of emissions data (CBA is working with the CSIRO to address some of these issues) and the fact that CBA is yet to provide reductions targets for other high-emitting sectors like coal-fired power and agriculture. These are not issues unique to CBA, but to Australian banks in general, and global investors will increasingly be comparing them to other jurisdictions such as Europe, who are far more advanced in dealing with some of these issues.

Positioning and Attribution

Duration, yield curve and inflation-linked strategies

Australian Government bonds sold-off across the term structure in August. The portfolio's slight long duration position over the month contributed a small negative to relative performance. During the month, we repositioned some of our duration from the 10-year tenor into 20-year tenor. Our overall global rates exposures contributed a strong positive to relative performance, primarily driven by our outright short Japan 10-year and short German 2-year Schatz positions, and our cross trade between German 2-year Schatz (short) against New Zealand 2-year interest rate swaps (long). Meanwhile, the other existing spread tightener trade - long New Zealand 10-year interest rate swaps against short US 10-year duration – detracted slightly. A small outright long New Zealand duration position was also a slight detractor to relative performance.

Sector/security

As Australian credit spreads tightened over the month, the portfolio's overweight positions across corporates, contributed positively to relative performance. Our positioning within the semi-government and supranational sectors were flat to relative performance. We closed the Markit iTraxx Australia CDS position which contributed a small loss in August. During the month, we added risk across semi-government (11-year TCV – Treasury Corp of Victoria), corporate (diversified sectors and tenor) and supranational sectors (5-year Canada Pension Plan Investment Board).

Outlook

A focus on hawkish central banks and the subsequent rise in government bond yields in August has improved the entry point for duration. The US has been at the forefront of the inflation cycle and it may still be too early to call a peak despite early signs that energy, food and durable goods inflation is rolling over. Yet importantly, over time, we expect the market to gain more confidence on central banks resolve and ability to tame inflation and focus instead on the deterioration in global growth as financial conditions tighten, European energy crunch concerns build and the US consumer falters.

Australia is experiencing the same themes but with a lag of one or two quarters thanks to the later re-opening of the economy and the slower response from the RBA. Headline CPI inflation is currently running at 6.1% y/y and there is sufficient momentum and breadth in prices to expect the annual rate to accelerate further into year-end with most forecasters seeing a peak close to 8%. At the same time, accumulated household savings, robust retail sales data and a near 50-year low on the unemployment rate provides some comfort about the near-term outlook for economic activity. However, more forward-looking indicators such as consumer confidence surveys and house prices, which are deflating, are consistent with growth slowing well below its potential rate into next year.

The RBA has followed in the footsteps of global central banks, delivering a rapid 225bps of rate hikes since May in an effort to restore credibility in the fight against inflation. We expect the RBA to step down to smaller 25bp increments in Q4 as the tightening starts to bite, with the cash rate ending the year at around 2.75-3%. By comparison, the August sell-off has seen the market re-price a cash rate peak near 4%, with rates expected to stay near that level for years to come. Such a path is unlikely to be realised given the significant adverse impact it would have on household's debt servicing costs and with 10-year yields above 3.5%, a level we have previously flagged as offering value, as a result we have begun to scale into a long duration position.

We still hold the view that investment grade credit spreads globally will move wider into year-end driven by tighter financial conditions, increased new issuance and increasing risks of recession. Also, we expect firms to have less flexibility to pass higher input costs through to consumers leading to a deterioration in corporate fundamentals. Australia credit should however offer relative value in this environment as spreads have moved wider point for point with the US, whereas in the past the local market had traded with a beta of 0.30 to 0.60. In fact, aggregate OAS levels are now the same as the US for a shorter duration and better-quality market.

Client Services

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