United Income Focus Trust (UIFT)

UIFT:
Where to from here?

March 2022

UOB Asset Management

The following paper "UIFT: Where to from here? – March 2022" is contributed by Wellington Management, the sub-manager of the United Income Focus Trust. All views expressed are based on available information as of the date of publication.

Amidst this challenging and uncertain market environment, we believe that UIFT can offer investors:

1. Genuine diversification across a range of asset classes
2. Dynamic asset allocation and risk mitigation controls
3. Focus on quality and liquidity with less sub-investment grade credit
4. The potential to confidently re-risk after a downturn and select attractive investment opportunities

Market complications piled up during the start the year, weighing on equity and bond returns. It all began with higher-than-expected inflation (US CPI hit 7.5% in January) and the Fed's firm response (signalling a first interest rate hike in March). Then it took another turn with Russia's invasion of Ukraine — creating a massive and distressing humanitarian crisis, while adding another layer of market complexity given Russia's role as a global supplier of commodities. More recently, Wellington saw concerns over the Chinese economy/COVID-zero policy/dual listing policies, which further weighed on risk sentiment.

So where to from here? Wellington's current base view is that we should expect a protracted conflict with little clarity on the "winner", but with diminishing impacts on risk sentiment. Wellington thinks markets will continue to grapple with the trade-offs between inflation and growth and the central bank's response. They remain convinced that inflation will be higher and stickier than expected. The war in Ukraine and sanctions on Russia only bolster this view, given the likelihood of additional supply-chain disruptions and shortages in agricultural, metal, and energy commodities. Higher energy prices could also weigh on growth.

In this challenging and uncertain market environment, we believe that UIFT can offer investors:

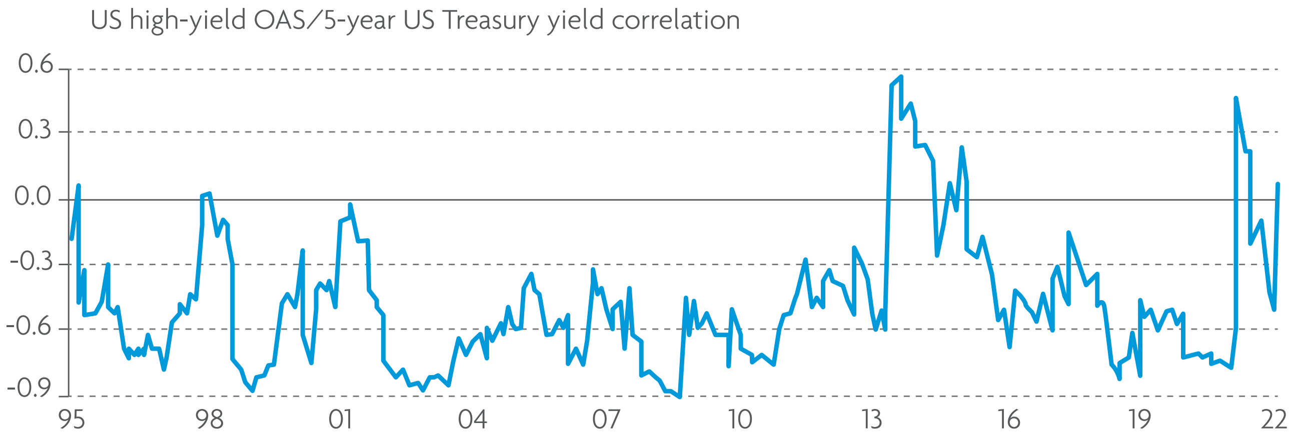
Genuine diversification across a range of asset classes: potentially providing resilience in volatile markets

- The core equity exposure to high dividend yielding equities should continue to do well as economies reopen and Wellington sees momentum continue behind traditional "value" sectors. Over the past year, the high dividend-yielding equities in the portfolio have outperformed high yield fixed income (which peers have a higher allocation to).
- While UIFT has a strategic tilt towards dividend-yielding equities, Wellington has sought to better balance the factor footprint of the portfolio with an allocation to growth equities. This has provided diversification benefits and allowed the portfolio to source total return opportunities from a greater opportunity set. In the past few months, growth companies have underperformed higher dividend/value peers, however, the contraction in these names has provided a great opportunity to invest in high quality companies that Wellington believes are secular winners at much more reasonable valuations.

Dynamic asset allocation and risk mitigation controls: Wellington's active asset allocation process allows the portfolio to efficiently lean into the most attractive segments, while their robust risk management process helps protect the portfolio.

- During the initial phases of the Russian invasion of Ukraine, Wellington sought to cushion the weakness in equity markets by allocating to equity risk mitigation hedges to help protect against further drawdown.
- Wellington has also been dynamic in their active asset allocation, shifting from neutral to an underweight to European equities as risks grew in the east and European inflation moved higher. At the same time, Wellington further lowered their exposure to growth fixed income as they continue to believe spreads, which have been at exceptionally tight levels, will be challenged. The figure below shows that the correlation of US Treasury yields and high-yield spreads has turned positive recently; an atypical relationship that augurs poorly for spreads should rates rise.

Breaking the pattern
Correlations between spreads and yields turn positive



Source: Bloomberg | Chart data: January 1995 - February 2022

Focus on quality and liquidity with less sub-investment grade: As uncertainty persists, Wellington believes their focus on high quality and liquid instruments positions them well to navigate market volatility and capitalise on potential attractive opportunities to re-risk.

- Competitors continue to have a strong reliance on lower quality credit (typically two times more exposure than UIFT), even though the asset class is expensive relative to its longer-term history with potentially less attractive future return expectations. This exposure also leaves them more exposed to credit and liquidity risk (especially if central bank support is questioned). Even within Wellington's high yield allocation, there is a strong focus on quality as they seek to avoid names with high default/solvency risks, and instead favour issuers who can generate high free-cash-flow relative to debt. Wellington believes that providing higher income while taking a high-quality posture and avoiding issuers with elevated default risk is compelling.

The potential to confidently re-risk after a downturn and select attractive investment opportunities

- Given the repricing that Wellington has already seen, Wellington continues to favour a moderate overweight to global equities over the next 6-12 months and will take advantage of opportunities to re-risk at more attractive valuation levels.

  Why? Wellington believes that consumer spending should remain resilient given the accumulation of savings and higher nominal wages, and companies should continue to benefit from relatively strong growth. In addition, COVID restrictions continue to lift and bearish risk sentiment is at an extreme. Finally, with geopolitical risk running high, central banks are likely to be cautious in removing liquidity while Wellington has seen signs that fiscal spending may increase, which would benefit risk assets.

Below is a summary of Wellington's latest multi-asset views over the next 6-12 months horizon:

Wellington's multi-assets views

Asset Class	View	Change
Global Equities	**Moderately OW**	–
US	Moderately OW	↑
Europe	Moderately UW	↓
Japan	Moderately OW	–
Emerging markets	Moderately UW	–
Defensive Fixed Income	**Moderately UW**	↑
US Govt	Moderately UW	↓
European Govt	Neutral	↑
Japanese Govt	Moderately OW	–
Global IG Credit	Moderately OW	↑
Growth Fixed Income	**Moderately UW**	↓
High Yield	Neutral	↑
Emerging Market Debt	Neutral	↓

OW = overweight. UW = underweight

Source: Wellington Management. Views have a 6 – 12 month horizon and are those of the authors and Wellington's Investment Strategy Team. Views are as of 24 March 2022, are based on available information, and are subject to change without notice. Individual portfolio management teams may hold different views and may make different investment decisions for different clients. This material is not intended to constitute investment advice or an offer to sell, or the solicitation of an offer to purchase shares or other securities,

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