

Schroder Fixed Income

Quarterly Investment Option Update

30 September 2019

Aim and Strategy

To obtain exposure to a range of domestic and international fixed income assets with the objective of outperforming the Bloomberg AusBond Composite 0+Yr Index, whilst delivering stable absolute returns over time. The option adopts a Core-Plus investment approach whereby a core portfolio comprising of Australian investment grade bonds (including government, semi-government, supranational and corporate bonds) is complemented by investments in a diverse range of global and domestic fixed income securities. The targeted result is a defensive strategy which is broadly diversified with low correlation to equity markets.

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au

Investment Option Overview

Investment Category	Fixed Interest
Suggested Investment timeframe	3 to 5 years
Relative risk rating	Low to medium
Investment style	Core
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Aust. Investment Grade	99.99%	81.05%
Cash & Equivalents	0%	10.46%
Global Investment Grade	0%	4.27%
Australian High Yield	0.01%	8.03%
Global High Yield	0%	-3.80%

Sector Allocation	%
Cash & Equivalents	10.9
Government	10.6
Semi-Government	20.9
Supranational/Sovereigns	22.1
Corporates	25.2
Subordinated	3.4
Collateralised	6.7

Quality Allocation	%
AAA	47.9
AA	16.3
A	7.0
BBB	20.6
Below BBB	-2.6
Cash & Equivalents	10.7
Not Rated	0.0

Top Holdings	%
QUEENSLAND TREASURY CORPORATION GOVTGUAR 3.25 21-JUL-2026	3.21
INTERNATIONAL BANK FOR RECONSTRUCT 2.8 13-JAN-2021 (SENIOR)	2.13
AUSTRALIA (COMMONWEALTH OF) 4.5 21-APR-2033 Reg-S	1.84
AUSTRALIA (COMMONWEALTH OF) 4.75 21-APR-2027 Reg-S	1.77
AUSTRALIA (COMMONWEALTH OF) 3.75 21-APR-2037 Reg-S	1.75
NEW SOUTH WALES TREASURY CORP NONDMUNI 2.75 20-NOV-2025	1.74
TREASURY CORPORATION OF VICTORIA GOVTGUAR 3.0 20-OCT-2028 Reg-S	1.68
AUSTRALIA (COMMONWEALTH OF) 3.0 21-MAR-2047 Reg-S	1.48
WESTERN AUSTRALIAN TREASURY CORPOR NONDMUNI 3.0 21-OCT-2026	1.39
WESTERN AUSTRALIAN TREASURY CORPOR NONDMUNI 6.0 16-OCT-2023	1.36

Investment Option Commentary

To the end of September, the Schroder Fixed Income Fund returned -0.61% (before fees) over the month, 2.25% (before fees) over the quarter and 11.47% (before fees) over the year. While a little below the benchmark in the month, over the quarter and year Schroder have delivered returns significantly ahead of the benchmark.

Having been longer than benchmark duration by close to 1 year in August, Schroder took some profit at the end of that month and the start of September. However, following the sharp move higher in yields in early September Schroder bought back again to end the month at 0.75 years long. Changes to their credit allocations were small, but one item worthy of note was their initiation of a position in US mortgages. Schroder are anticipating further economic weakness to drive both more central bank easing and higher risky asset volatility.

Market Commentary

Equity markets rebounded in September, with value stocks significantly outperforming growth and momentum stocks over the month. This also resulted in more value orientated sectors like financials, and regions such as Europe being strong relative performers. Oil prices surged mid-month following a drone attack on a Saudi processing plant, but a quick resolution to the supply disruption meant that prices retraced their move quite quickly. Central banks continued to ease monetary policy, with the Fed cutting interest rates by 25 bps to target a 1.75% to 2% range, whereas the ECB announced a 10 bp reduction in deposit rates to 0.5%, while also bringing back QE and introducing deposit tiering to provide some support to the European banking sector. Locally, the prospect of additional policy easing and potential QE, have helped to support a rebound in the Australian housing market, most notably in Sydney and Melbourne.

Global equities returned 2.3% in local currency terms, while the Australian market was slightly weaker posting a return of 1.8% over the month. Global government bond yields moved higher over the month, with US 10-year yields rising by 0.17% to end September at 1.66%. In Australia, 10-year yields lifted from their all-time lows, moving higher by 0.13% to end the month at 1.02%. 10 year yields also increased by 0.13% in Germany and by 0.06% in Japan. Despite the monthly increase, global yields are still lower over the quarter, with Australia and the US seeing the strongest compression in yields. Credit spreads tightened modestly over the month across both investment grade and high yield, as well as in Emerging Market debt.

Outlook

Schroder continue to expect downside economic risks will dominate markets for some time, even as central banks are easing policy and there are signs US-China trade tension may be thawing. Unfortunately, much of the damage of tight US policy, at least relative to the rest of the world, and tariffs is already in the pipeline, which means that policy shifts need to be more proactive to counter the fallout. While the fallout to date has mainly been in global manufacturing and trade, the clear risk is that it spreads to services, where the developed economy jobs largely reside.

Schroder would be more optimistic if policy stimulus were delivered more comprehensively. While the ECB and the RBA have eased considerably, their cry for more help from fiscal policy has to date been unanswered. The PBoC are easing but seem determined to avoid a significant reflating of the Chinese property sector, while the Fed have been hesitant in committing to anything beyond 'insurance' cuts. Recent turbulence in the US repo market is most likely a sign that US policy is too tight, with liquidity unable to move quickly to where it needs to be. Whether there is anything more sinister under the surface remains to be seen. Schroder have been closely watching US recession indicators to gauge the magnitude of the economic slowdown, and consequently how concerned they should be for riskier assets. Schroder still think recession is some time off, but with activity expected to slow further in the near term this assessment could be pulled forward. Valuations remain reasonably full on most riskier assets, perhaps supported by too optimistic earnings expectations, which given the backdrop suggests caution is warranted.

The investment option is positioned overweight in high quality Australian credit which remains a relatively favourable return-to-risk proposition, but short in US high yield which is vulnerable to softer growth and rising earnings and default risk. This leaves us earning a small amount of extra carry versus the benchmark, but able to capture some of the likely widening in credit spreads as market volatility increases.

It will be a challenge to maintain yield, diversify exposures and efficiently manage risk in a low yield world, however the portfolio is well positioned for the environment we envisage.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1288AU
AMP Flexible Super - Retirement account	AMP1376AU
AMP Flexible Super - Super account	AMP1505AU
CustomSuper	AMP1288AU
Flexible Lifetime - Allocated Pension	AMP1295AU
Flexible Lifetime Investment (Series 2)	AMP2040AU
SignatureSuper	AMP1302AU
SignatureSuper Allocated Pension	AMP1309AU

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