Schroder Fixed Income

Quarterly Investment Option Update

31 December 2021

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/performance

Investment Option Overview

Investment Category	Fixed Interest
Suggested Investment timeframe	3 years
Relative risk rating	4/ Medium
Investment style	Core
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Aust. Investment Grade	100%	72.9%
Cash & Equivalents	0%	10.5%
Global Investment Grade	0%	3.0%
Australian High Yield	0%	8.4%
Global High Yield	0%	5.2%

Sector Allocation	%
Government	26.1
Semi-Government	21.4
Supranational/Sovereigns	4.5
Corporates	31.8
Subordinated	4.0
Collateralised	6.4

Quality Allocation	%
AAA	31.8
AA	22.4
A	9.0
BBB	25.0
Below BBB	3.8
Not Rated	1.8

Top Holdings	%
NEW SOUTH WALES TREASURY CORPORATI GOVTGUAR 3.0 20-MAR-2028 Reg-S	4.2
AUSTRALIA (COMMONWEALTH OF) 0.25 21-NOV-2024 Reg-S	3.4
AUSTRALIA (COMMONWEALTH OF) 2.75 21-MAY-2041 Reg-S	2.7
AUSTRALIA (COMMONWEALTH OF) 2.25 21-MAY-2028 Reg-S	2.5
NEW SOUTH WALES TREASURY CORPORATI 2.0 08-MAR-2033	2.0
AUSTRALIA (COMMONWEALTH OF) 4.75 21-APR-2027 Reg-S	1.6
AUSTRALIA (COMMONWEALTH OF) 2.75 21-NOV-2029 Reg-S	1.6
AUSTRALIA (COMMONWEALTH OF) 3.0 21-MAR-2047 Reg-S	1.6
TREASURY CORPORATION OF VICTORIA 1.5 10-SEP-2031	1.5
QUEENSLAND TREASURY CORPORATION NONDMUNI 1.75 20-JUL-2034 Dual 144a|Reg-S	1.4

Investment Option Commentary

The Schroder Fixed Income Fund delivered a negative return over the quarter, however 2021 was another good year with the fund outperforming the benchmark over the last 12 months.

Despite firming global inflation, bond prices recovered some of October's weakness in November and December. Bond yields moved lower, aided by the uncertainty surrounding the new Omicron COVID variant. The portfolio's underperformance was concentrated in the month of October where, although the Manager was short duration versus benchmark, they were positioned for Australian bonds to outperform global markets, and for longer-term, rather than shorter-term, inflation expectations to move higher.

Market Commentary

Equity markets moved sideways on uncertainty around the Omicron variant and a more hawkish shift from the US Federal Reserve (Fed), before rallying in the latter stages of the month as markets began to look through the shorter-term risks and focus on expected growth over the coming year, which at this stage is still expected to be quite healthy. Developed market central banks shifted towards a more hawkish outlook, with the Fed signaling a faster pace of tapering. This could see tapering end in March, rather than June, and as a result markets priced in a potential for an official rate increase earlier than it had previously anticipated. Meanwhile the Bank of England lifted its policy rate to 0.25%, owing to inflationary pressures. Ultimately, the monetary policy decisions going forward will be heavily dependent on the inflation data, which could ease to some extent if the current supply bottlenecks become more manageable. In China, it's a different story, as the People's Bank of China has been easing monetary policy through a 0.5% cut to the reserve requirement ratio. This easing bias could continue in to 2022.

Developed market equities rallied by 4.0% in December, while the Australian market underperformed, but still delivered a return of 2.7% for the month. This was also the case over the fourth quarter, where developed market equities rose by 8.3% in local currency terms, while the Australian marked only rose by 2.1%. Emerging markets fell by -1.3% over the quarter in US dollar terms. Australian 10 year yields were broadly flat, ending the month at 1.67%, while US 10 year yields moved up by 0.07% to close at 1.51%. 10 year government bond yields were also generally unchanged in Japan, but moved higher by 0.17% in Germany. Over the quarter, the biggest moves were in short dated maturities in Australia and the US, where Australian 3 year yields jumped by 0.60%, while in the US 2 year yields increased by 0.45% as both markets began to price in more official rate increases.. In credit, global spreads moved tighter over month, however in Australia they remained flat. While over the quarter, credit spreads were generally moderately wider, with the exception of US high yield which saw a small degree of tightening.

Outlook

As we close out 2021, COVID continues to be top of mind for the second year running with Omicron cases rising significantly. Omicron as a milder variant is a compelling narrative that has helped to stabilise markets into year end. It is hard to separate Omicron's virulence vs other variants given the widespread levels of vaccine and better treatments. Nevertheless, the latest wave is resulting in less hospitalisations relative to previous waves and Schroder see this as one of the key metrics of measuring lockdown risk, suggesting that the global economic recovery is unlikely to be derailed. If there is one thing that we have learned this year, it is that the global economy has proven to be resilient in the face of pandemic-related challenges.

The past year has offered a break from "the new normal" features of the US economy that dominated the previous decade, as unprecedented policy stimulus coupled with severe disruptions to supply chains and labour supply triggered an inflation spike. How inflation, the labour market, and monetary policy evolve in 2022 will determine whether we return to "the new normal" or pivot towards higher inflation and interest rates.

Looking forward, the key risks to markets continue to be around inflation and growth. Growth appears to have peaked from elevated levels and whilst slowing, stills appears to be above trend. Inflation is expected to peak in the first half of 2022. Against this backdrop there is also concern that the fiscal pulse will be weaker going forward and that monetary policy settings remain extremely accommodative and will need to be adjusted. Markets are pricing in official rate increases, hence the recent volatility in sovereign bond yields, however the transition to more appropriate monetary policy setting has only just begun. The reaction function for the central banks around the actual timing and pace of the adjustment remains tied to the data which as we know can surprise and lead to spikes in volatility.

In Australia, Schroder believe the yield curve looks unusual compared to elsewhere, with more official interest rate increases but lower inflation factored into current yields. The RBA is adamant that it won't be lifting official rates until core inflation, driven by stronger wages growth, picks up. Schroder think it will and the RBA will be forced into action earlier than it expects, but still slower than the US Fed and other developed markets. The manager's preference in Australia has been to own inflation-linked bonds, be positioned for a pull-forward of rate increase expectations and preferring longer-dated government and semi-government bonds that offer value. Schroder have recently moderated this view by trimming some inflation linked exposure as they look to position for a move higher in real yields as rate hike expectations now look fully priced in Australia.

With faster policy tightening a key risk for 2022 alongside the withdrawal of liquidity by central banks, credit remains vulnerable to further weakness. Reduction of central bank balance sheets has now started and historically, credit spreads start to widen 6-12 months from when tapering begins, with spreads peaking at 11-16 months. The extent of credit widening will depend on whether we pivot towards higher inflation and interest rates or we return to the 'new normal'. Overall, Schroder remain constructively positioned across our credit exposure, particularly in Australia where the market is shorter in duration and higher credit quality than global credit markets. However, Schroder have reduced their position by adding some hedges in Australian credit via derivatives and maintain hedges in US high yield, leaning against stretched valuations and further weakness as we move through this mid-cycle slowdown.

As we embark on 2022, the outlook for bond markets remains challenged given the uncertainty over the persistence of inflation, the impact on growth and the central bank response. Schroder is expecting more volatility in rates markets where extreme moves do create opportunity. As we work through this next phase of expansion, the interaction between interest rates and riskier assets needs to be monitored carefully. Schroder is more cautious on risky assets given the upcoming stimulus withdrawal.

Availability

Product name	APIR
Flexible Lifetime Investment (Series 2)**	AMP2040AU
SignatureSuper*	AMP1302AU
SignatureSuper Allocated Pension*	AMP1309AU

*Closed to new investors
**Closed to new and existing investors

Contact Details
Web: www.amp.com.au
Email: askamp@amp.com.au
Phone: 131 267