AIM AND STRATEGY
To provide a total return, after costs and before tax, higher than the return from the Barclays Capital Global Aggregate Index (hedged back to Australian dollars) on a rolling 3 year basis through investing in fixed or floating interest rate securities in countries around the globe. These securities may include government securities, government related securities, corporate securities, asset backed securities and hybrid securities (such as convertible notes) in both developed and emerging markets.

INVESTMENT OPTION PERFORMANCE*
To view the latest investment performances please visit www.amp.com.au

INVESTMENT OPTION OVERVIEW
Investment category  Fixed Interest - Enhanced Fixed Interest

Suggested investment timeframe  2-3 years

Relative risk rating  Low - Medium

Investment style  Multi-Manager

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<tr>
<th>Asset Allocation</th>
<th>Benchmark (%)</th>
<th>Range (%)</th>
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<tbody>
<tr>
<td>International fixed interest and cash</td>
<td>100</td>
<td>0-100</td>
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PORTFOLIO SUMMARY

> Most major global government bond yields fell during the quarter, mainly due to factors such as softer European and Asian economic data and a continuation of the fall in the oil price.

> All four segments posted strong returns, however the total fund underperformed its benchmark this quarter.

> Bond yields are not expected to move greatly over the short term.

INVESTMENT OPTION COMMENTARY

As part of our ongoing portfolio review process, we made some changes to the Future Directions International Bond Fund. These changes resulted in replacing global bond fund manager Aviva Investors with AMP Capital. Please refer to our letter dated 1 July 2014 or our Client Services Team for further details. The commentary provided below relates to the Fund’s new structure.

All four segments posted solid positive returns and were either in line with their index or outperformed. The Fund as a whole also posted a decent positive return, but was short of meeting its benchmark. The global government bond allocation – the relatively best performing sector this quarter – posted strong returns and comfortably outperformed the benchmark during the quarter. Kapstream comfortably outperformed its benchmark, which was mostly due to the weakened Australian dollar and the Russian ruble. Other contributors were the overweight positions to Italy and Spain. Detractors for the quarter were the overweight positions in US treasuries and Australian sovereigns, the overweight position to Germany and underweight position to Japan.

AMP Capital’s outperformance was largely due to a short position in the Russian ruble. Detractors from returns were the short duration position in an environment of falling yields, and the curve steepening position. Colchester marginally underperformed its benchmark. This was mainly due to the short positions in the Russian ruble and the New Zealand dollar, as well as the long position in the Japanese yen. This was partially offset by the overweight positions in Norway and Mexico and the underweight position in Russia. In global credit, both Morgan Stanley and BlackRock outperformed the benchmark. October’s performance for Morgan Stanley was supported by a positive impact from its credit positions in investment grade bonds, while the exposure to high yield securities detracted slightly.

In November the driver for the underperformance was the overall credit positions in investment grade and high yield. In December the credit positions in investment grade bonds had a positive impact on the relative performance, mainly driven by security selection and selective sector underweights (mainly energy). Blackrock’s outperformance came mainly from interest rate positioning, while also benefitting from the underweight allocation to the energy sector and short positions in big European supermarkets with names such as Tesco and Metro AG. Putnam marginally underperformed its benchmark for the quarter, but contributed positively to the Funds’ total return.

In October and November the overall term structure strategies were the main detractor, which were partially offset by gains from being long peripheral Europe versus short Germany in November. In December the overall term structure strategies were the largest contributors, while these were partially offset by the negative impact of a short position in Japanese government bonds. The global securities component managed by Wellington also performed in line with its benchmark.

Over the course of the quarter, the underperformance in October was mainly due to the tactical duration and yield curve positions. The underweight position to 30 Year Ginnie Mae’s, as well as security selection within asset backed securities were the main contributors to the marginal outperformance for November. December’s outperformance came from the portfolio’s slight bias toward a flatter yield curve, exposure to non-agency residential mortgage back securities and underweight to collateralised mortgage back securities.

MARKET COMMENTARY

Most major global government bond yields fell during the quarter, mainly due to factors such as softer European and Asian economic data and a continuation of the fall in the oil price. US 10-year government bond yields ended the quarter 32 basis points lower at 2.17%. In Europe, the UK’s 10-year government bond yields fell 67 basis points to 1.76% and German 10-year government bond yields fell 41 basis points to 0.54%. Japan’s 10-year government bond yield fell 20 basis points to 0.33%. Corporate bonds, as measured by the Barclays Global Aggregate Credit (Hedged) in Australian dollars, rose by 2.43%.

OUTLOOK

Low bond yields will likely mean soft medium-term returns from government bonds. Bond yields are not expected to move greatly over the short term given the weak commodity prices, subdued wage pressures and...
significant spare capacity in the global economy. An interest rate hike from the US Federal Reserve is unlikely until around the middle of next year. With the somewhat decreasing yet ever-present threat of geopolitical events, bonds may still prove valuable to investors during any lift in volatility that may likely be experienced over the short to medium term. Further out we expect bond yields to rise.

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