

# (AMP) Conservative Index

Quarterly Investment Option Update

31 December 2017

## Aim and Strategy

Aim and strategy: To provide returns primarily from income as well as some capital growth over the short to medium term, by investing mainly in defensive assets with some exposure to growth assets. Exposure to individual asset classes will be attained through the use of index focussed investment managers.

This investment option seeks to provide an index focussed solution to diversified investing. Through a process of diversified market analysis combined with selection of the most appropriate investment managers for each underlying asset class, this investment is designed to provide market tracking returns over the suggested investment timeframe.

Global shares may be partially or fully hedged back to Australian dollars.

## Investment Option Performance

To view the latest investment performances please visit [www.amp.com.au](http://www.amp.com.au)

## Availability

Product name	APIR
<a href="#">AMP Flexible Lifetime Super</a>	AMP1028AU
<a href="#">CUSTOM SUPER</a>	AMP1028AU
<a href="#">Flexible Lifetime - Allocated Pension</a>	AMP1017AU
<a href="#">Flexible Lifetime - Term Pension</a>	AMP1038AU
<a href="#">Flexible Lifetime Investment</a>	AMP1051AU
<a href="#">Flexible Lifetime Investment (Series 2)</a>	AMP1393AU
<a href="#">METCASH SUPERANNUATION PLAN</a>	AMP1028AU
<a href="#">Signature Super</a>	AMP0793AU
<a href="#">Signature Super Allocated Pension</a>	AMP1146AU

Asset Allocation	Benchmark	Range (%)
Australian Shares	N/A	5 -25
Global Shares	N/A	0-20
Growth Alternatives	N/A	0-15
Australian Property	N/A	0-10
Australian Bonds	N/A	15-35
Global Bonds	N/A	10-30
Cash	N/A	15-35

## Investment Option Overview

<b>Investment category</b>	Diversified - Conservative
<b>Suggested investment timeframe</b>	3+ years
<b>Relative risk rating</b>	Low
<b>Investment style</b>	Index Focussed

Top Ten Australian Shares Exposure	%
COMMONWEALTH BANK AUST	8.61
Westpac Banking Corp	6.46
BHP Billiton Ltd	5.90
Australia & New Zealand Banking Group Ltd	5.10
National Australia Bank Ltd	4.87
CSL Ltd	4.02
Wesfarmers Ltd	3.18
Telstra Corp Ltd	2.57
Woolworths Group Ltd	2.23
Macquarie Group Ltd	2.03

Top Ten International Shares Exposure	%	Actual Allocation	%
APPLE INC	2.08	Cash	27.64
HENDERSON GLOBAL EQUITY MULTI STRATEGY FUND	1.53	International Fixed Interest	20.09
Alphabet Inc	1.50	Australian Fixed Interest	20.08
Microsoft Corp	1.46	International Shares	10.93
Amazon.com Inc	1.08	Australian Equities	10.18
Facebook Inc	1.02	Alternative Assets	6.00
JPMorgan Chase & Co	0.88	Listed Property	5.09
EXXON MOBIL CORPORATION	0.72		
Johnson & Johnson	0.69		
Berkshire Hathaway Inc	0.67		

## Investment Option Commentary

### Global

Global shares continued to be buoyed by generally positive data and sentiment, with the International Monetary Fund revising up its global forecasts.

At the end of the quarter, and as widely telegraphed to the market, the US Federal Reserve raised interest rates again by 0.25% to a 1.25-1.50% range. However, as wages growth and inflation remain under target, future hikes are likely to remain gradual. President Trump nominated Jerome Powell to succeed Janet Yellen as Chair of the US Federal Reserve, a move considered a vote for the status quo in terms of policy. The House of Representatives and Senate passed the administration's tax reform programme during December; both are now finessing and reconciling the final bill.

The US reported strong business conditions purchasing managers' indices, a rebound in new home sales, solid gains in durable goods orders and historically low jobless claims, indicating overall robust business investment conditions. However, despite relatively high US asset valuations, current low volatility suggests there may be an element of market complacency, which increases the risk of a correction.

In Asia, Japan's Shinzo Abe's Liberal Democratic Party led coalition was returned with a large victory, retaining a two-thirds parliamentary majority and somewhat assisted by an uncoordinated opposition campaign. Core inflation remains significantly below the Bank of Japan's 2% target, ensuring its accommodative monetary and fiscal policy and 0% 10-year bond-yield target will remain in place for the time being. However, overall Japanese economic data remains strong; with further gains in the Tankan business conditions indices, strong machine orders and positive economic sentiment. In China, foreign exchange reserves continue to rise with capital outflows remaining under control. Chinese equities saw some volatility during the quarter, following fresh government imposed liquidity restrictions and additional measures introduced to reduce the risk for loans linked to the shadow banking sector. The Chinese Communist Party Congress saw President Xi Jinping entrench his power base further with a seven-member leadership team. Key outtakes from the congress include a focus on sustainable growth, supply-side economic reforms, rebalancing towards more consumption-based growth and policies to manage financial risks, pollution and inequality. Chinese export and import growth has been stronger than expected, indicating continuing solid growth. Infrastructure and property investment has also increased.

In Europe, the European Central Bank announced a further extension of its quantitative easing programme, albeit at a reduced rate of €30 billion a month from January 2018 for nine months, with an intention to then taper down. The German political environment remained in a state of flux as initial coalition talks to form a new government collapsed. However, this uncertainty is seen by most market participants as a short-term risk that is unlikely to have any significant long-term impacts on European stability. Despite political uncertainty, overall Eurozone business conditions purchasing managers indices remain strong, with the German Ifo Institute for Economic Research's Business Climate Index approaching its highest level since 1969, and European economic sentiment at its highest levels since 2001. In a sign of regulatory tightening, some of the world's largest banks are to discuss financial settlements with the European Commission, in an attempt to finalise a probe into allegations they organised a cartel to influence the US\$5.3 trillion global foreign exchange market. The UK and European Union agreed initial terms of reference for the UK to split from the union, which will allow trade negotiations to proceed, although there remains a significant way to go.

Elsewhere, crude prices have exhibited some recent support, despite some pull-backs and volatility, due to increasing demand and restricted supply, including ongoing supply restrictions from the Organization of the Petroleum Exporting Countries.

### Australia

As expected, the Reserve Bank of Australia (RBA) kept interest rates on hold during the quarter, retaining a neutral short-term bias on future movements. Forces moving against an interest rate cut include improving global growth, strong business confidence, jobs growth, and high levels of household debt. However, record low wages growth, low underlying inflation, housing affordability and the relatively strong Australian dollar are providing countering forces. The next move in interest rates is still likely to be up, however, with the conflicting pressures, this is unlikely to occur until late into 2018 or into 2019. With economic growth taking a while to gather momentum it will likely be a while until this feeds through to wages growth and higher underlying inflation.

The RBA's Financial Stability Review reported Australia's financial system as being robust, however the primary risks remain centred around household debt and the housing market. It also announced it will be conducting bank stress tests, which have the potential to justify a further tightening of macro-prudential standards if weaknesses are found.

Evidence continues to mount that the property price boom in Sydney is over, with latest CoreLogic data showing a further decline in prices and with auction clearance rates falling. However the Australian-wide market exhibits a more mixed picture, with Perth showing signs of bottoming, Melbourne cooling and Adelaide, Brisbane and Canberra seeing moderate growth. APRA has also indicated it will look into how banks assess living expenses and the total debt of borrowers. This is likely to result in a tightening of lending standards and add to downward dwelling price pressure.

The Australian investment cycle is showing some positive signs as it makes the final transition away from a mining-dominated economy. Non-mining investment plans should lead to a boost in growth and somewhat offset the weaker housing market and more subdued consumer spending. Weak wages growth and uncertainty on energy prices, set against a background of high household debt, are likely to constrain consumer spending for a while yet. On the positive side, an increase in liquefied natural gas exports and robust population growth should help stabilise economic growth.

### Australian dollar

After falling slightly against many currencies earlier in the quarter, the Australian dollar strengthened a little towards the end of 2017, supported by good employment figures and commodity prices. The Reserve Bank of Australia remains neutral in regard to its stance on interest rates, which have been on hold at 1.5% for 17 months in a row. Against the US dollar, the Australian dollar ended the quarter barely changed, at US\$0.7822. It closed slightly lower against the euro (at €0.6514), as well as against the British Pound (at £0.5782), Japanese yen (at ¥88.1092) and slightly higher against the Swiss Franc (at CHF0.7622).

### International shares

International equity markets saw yet another very strong quarter and were again accompanied by very low levels of volatility. Globally, conditions remain in somewhat of a sweet-spot, with strong economic growth and supportive financial conditions, even as the US (and others) raised interest rates. Global shares ended the period up around 5.3%, as measured by the MSCI World ex Australia Net Index in local currency terms. (The return was slightly stronger in Australian dollar terms due to currency movements.) The US S&P 500 Total Return Index continued to climb through record-highs and closed the quarter up 6.6% (in US\$ terms) as corporate earnings remained strong and President Trump's proposed tax cuts continued to drive optimism. Most other major markets were also very strong, with Japan's TOPIX 100 Net Total Return Index up 8.7%, UK's FTSE 100 Accumulation Index returning 5.0% and the Chinese S&P/CITIC300 Total Return Index returning 6.0%. Continental European shares however ended the quarter close to flat. Emerging markets too did well, the MSCI Emerging Markets Accumulation Index closing up another 5.7% as they continued to benefit from the global pickup in trade and generally strong resource prices (All figures in local currency terms).

### Australian shares

Australian shares were up very strongly in the December quarter, the S&P/ASX 200 Total Return Index finishing the period 8.2% higher. Energy, information technology and materials were the best performing sectors; while utilities, financials and industrials were relatively poor performers (despite still doing well in absolute terms). The quarter saw investors become less optimistic on Australian banks, on the news of an upcoming Royal Commission into alleged misconduct in the financial services industry. Australia's financial companies are already under a significant degree of scrutiny by regulators, and markets are concerned about what the upcoming investigations may unearth, particularly in regard to lending practices. A standout positive performer for the quarter was gas/oil explorer and producer, Origin Energy, as investors continued to gain optimism from rising consumer energy prices, as well as managements' debt-reduction strategy. Looking at the market as a whole, some analysts have continued to question whether Australian corporate earnings multiples are too optimistic, given some of the challenging economic conditions in Australia such as low growth, high debt levels, weak consumer spending, lack of wages growth and rising living costs. Population growth and a pickup in LNG exports however are likely to provide some positive support.

### International bonds

Global government bond yields were mostly mixed over the first two months of the December quarter. The US 10-year bond yield moved higher amid continued signs of strength in the US economy and generally favourable corporate profit results. In contrast, yields in Japan edged lower, while those in Germany remained relatively stable. The mixed pattern of yield movements continued into December, amid the legislative passage of US tax reforms and a commitment by the European Central Bank to continue with monetary stimulus. The US 10-year Treasury bond yields ended the quarter at 2.41%, with comparable maturities in Germany and Japan ending at 0.43%, and 0.048% respectively.

### Australian bonds

Australian government bond yields moved lower over the course of the first two months of the quarter, weighed down by anaemic wages growth and a deceleration in retail sales. Moreover, a lower than expected third quarter inflation result reinforced a consensus view that monetary policy will remain unchanged for an extended period. Domestic yields moved higher during December as the overall tone in data releases improved during the month, which included continued strengthening in the labour market. In addition, sentiment was buoyed by mid-year updates from federal and state governments showing broad improvements in projected fiscal positions. The Australian Commonwealth 10-year bond yield ended the quarter at 2.63%, while its 2-year counterpart ended at 1.97%.

### Cash

The Reserve Bank of Australia (RBA) maintained its neutral stance on interest rates, which have remained on hold at 1.5% for an extended period. Still-low levels of underlying inflation combined with extremely expensive (though apparently deflating) east coast property markets, low wages growth and weakness in the consumer sector all remain key concerns for the RBA. Three and six-month Australian bank bill rates were both up by 9 bps, finishing the quarter at 1.80% and 2.00% respectively.

### Australian listed property securities

Australian listed real estate strengthened during the period with the surprise announcement by Unibail-Rodamco that it had agreed the acquisition of Westfield Corp, owner of 35 Westfield-branded malls in the US and UK, in a A\$33 billion deal. This represents a purchase price at a 17.8% premium to the previous close. The e-commerce growth trend continues to drive interest in Australian industrial and logistics properties, as shown by The Blackstone Group acquiring a third portfolio of such assets. The purchase from Goodman Group for approximately A\$400 million will lift its Australian property portfolio to around A\$3 billion. However retail remains under pressure as shopping habits move online, with the apparel retailer Specialty Fashion Group

announcing that it would close around 300 of its 1,019 stores in Australia. Those in better locations are likely to be quickly re-let but this will further pressurise some of the more marginal shopping developments. Stockland and Vicinity Centres recorded moving annual turnover growth, or total consumer spending in its retail centres, of just 0.3% and 0.2% respectively in the September quarter. The pessimistic retail environment reflects the ongoing difficulties faced by retail from the long-term growth of e-commerce. Dexus announced an increase in its office occupancy by income rate, details of four lettings in the recently acquired MLC Centre in Sydney and a decrease in financial year 2018 office lease expires. This reflects the ongoing strength of the Sydney office market.

### Australian Direct Property

Benign economic conditions continued in the fourth quarter, with no change in official interest rates, and GDP growth steady at 3% yoy. The low cost of capital environment is anticipated to continue into 2018, however pricing for assets remains sharp, with yields for prime assets in Sydney, Melbourne and to a lesser extent Brisbane seeing an average yield compression of 40 basis points during calendar year 2017. Retail consumption conditions remain the one weak economic spot in an otherwise comparatively rosy outlook for Australian markets. Consumer confidence continues to weaken, as wage growth stalls. However business confidence conditions, backed by record levels of business investment has seen confidence rise to its highest levels since 2007. Globally, the world economy is moving into a period of strategic adjustment as technological change and adaptation drive structural economic changes. Australia is not immune to these changes, with Amazon launching operations in December, creating a significant boost to online sales growth in the short to medium term. Investors are paying keener attention to fundamentals in assets, and pricing them appropriately.

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