Legg Mason Australian Real Income

Quarterly Investment Option Update

31-December-2017

Availability

Product name	APIR
AMP Flexible Super – Choice (Retirement)	AMP1789AU
AMP Flexible Super – Choice (Super)	AMP1795AU
CustomSuper	AMP1819AU
Flexible Lifetime – Allocated Pension	AMP1813AU
Flexible Lifetime – Super	AMP1819AU
Signature Super	AMP1807AU
Signature Super – Allocated Pension	AMP1801AU

Investment Option Performance

Investment performances are subject to product fees and where relevant tax as outlined in the product PDS. Therefore investment performance may differ between products. In addition, activity on your account such as contributions and deductions will also impact the investment performance specific to you. To view the latest investment performances for each product, please visit **www.amp.com.au**. You can also view the last investment performance specific to you by visiting your My Portfolio account.

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Overview

Aim & Strategy: To provide a total return from a portfolio invested in Australian real estate investment trusts, utility, infrastructure and similar securities that are listed on the Australian Securities Exchange (ASX). For example, securities may be from companies that hold physical assets such as A-REITs, toll roads, ports, airports, electricity and gas grids. The portfolio expects to hold about 20 to 25 securities. At the time of purchasing securities, the portfolio aims to limit exposure to individual securities to 9% of the portfolio and hold cash and cash equivalents of no more than 10% of the portfolio.

Investment category: Property

Suggested Investment Timeframe: 3 to 5 years

Relative Risk Rating: Medium to High

Investment Style: Active

Asset Allocation	Actual (%)	Range (%)
Australian Equities	98.09	90-100
Cash	1.91	0-10

Holdings

Industry Exposure	%
Diversified REIT	22.5
Retail REIT	28.0
Office REIT	3.9
Industrial REIT	3.3
Gas & electricity grids	11.1
Multi utilities	20.0
Airports, ports & rail	5.1
Toll Roads	6.1

Regional Exposure	%
Australia	100
Japan	0.0
North America	0.0
UK	0.0
Europe (ex UK)	0.0
Emerging Markets	0.0
Cash	0.0

Top Ten Securities	%
Vicinity Centres	7.0
Scentre Group	6.3
Stockland Corporation	6.1
Transurban	5.9
AGL Energy	5.6
Ausnet Services	5.5
Westfield Corporation	4.5
Mirvac Group	4.1
Contact Energy	3.9
APA Group	3.9

Market Commentary

The December quarter saw positive returns across the Australian real asset universe. The real estate sector outperformed as the S&P/ASX 300 A-REIT Accumulation Index rose 7.8%, compared with the broader Australian equity market which was up 7.6% (as measured by the S&P/ASX 200 Accumulation Index). The infrastructure and utilities sectors were weaker, the ASX Infrastructure Accumulation Index and ASX 300 Utilities Accumulation Index rising 5.0% and 3.3% respectively. Real assets performed strongly over the 2017 calendar year, particularly infrastructure and utilities, which were up 12.5% and 9.1% respectively, while Australian real estate investment trusts (A-REITs) rose 6.4%.

The retail sector had been under pressure in the final quarter of 2017, with the anticipation of Amazon launching in Australia. However, the launch was underwhelming when it finally occurred in December and missed Black Friday and the early part of the Christmas shopping season.

In Australian economic news, 61,600 jobs were added in November, including 41,900 full time, as per Australian Bureau of Statistics (ABS) seasonally adjusted Labour Force data. This was well ahead of expectations and the biggest monthly increase in over two years. In the Federal Government's Mid-Year Economic and Fiscal Outlook, the expected underlying cash deficit has improved by $5.8 billion, compared with May's federal budget estimate. The budget remains on track to return to surplus in 2020–21. The domestic economy continues to be supported by a low level of interest rates as the Reserve Bank of Australia (RBA) made no change to the official cash rate, which has remained at 1.5% since August 2016.

Investment Option Commentary

At the sector level, real estate was the main positive contributor.

At the stock level, Westfield Corporation, AusNet Services and Stockland Corporation were the largest positive contributors to the portfolio's performance. The bottom contributors were, Spark Infrastructure, Arena REIT and Mercury NZ.

Westfield (the shopping mall operator) outperformed, reflecting the proposed cash and scrip takeover from Unibail-Rodamco for the company. The combined entity will have a platform of 104 assets, attracting 1.2 billion visitors annually, with 84% of the assets being flagship shopping malls. The existing malls in Europe will also be rebranded Westfield. The deal is not due to close until June 2018.

AusNet Services announced solid first-half results for the 2018 financial year, leading to upgrades with the result 10% ahead of consensus. AusNet received the Australian Energy Regulator (AER) final return decision on its regulated gas assets. With no change to the draft decision, this provided certainty on the regulated return for the next five years.

Stockland Corporation fared well with a positive quarterly update which reflected the ongoing strength in housing prices and demand on the east coast of Australia; the company's distribution outlook was also reconfirmed and this was another positive for the share price.

Spark Infrastructure detracted, largely reflecting weaker sector share price performance for owners of utility networks, a rise in Australian bond yields over the month and a growing expectation that there will be higher 10-year bond rates in 2018. Rising bond yields results in higher debt costs, however, this can be mitigated with hedging.

Arena REIT was weak despite an expected net revaluation uplift of $22 million.

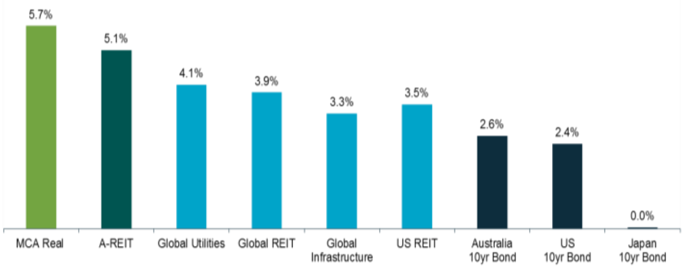
New Zealand electric utility Mercury NZ was relatively softer, with some weakness in both the domestic equity market and the New Zealand dollar continuing from the outcome of the country's election.

Outlook

It is worth highlighting that Australian economic fundamentals remain solid and the Fund sees a robust outlook for the real asset sector. The fund manager believes the cash rate and bond rates are currently too low (relative to the Fund's expected Australian GDP nominalgrowth rate), and the potential for bond yields to rise (either perceived or actual) remains a headwind.

However, in relation to real assets, the hedging of debt costs will mitigate cash-flow impacts and current yields have already priced in much higher bond yields. This is evidenced by the wide spread of the attractive real asset earnings and dividend yields over relatively low cash rates and long bond yields. High relative yields mean Australian real assets are also attractive compared with other global real asset options, and the sector also offers an attractive investment opportunity for offshore investors.

Comparison of Dividend Yields*:



Past performance is not a guide to future returns.
Source: Martin Currie Australia, FactSet; as at 31 December 2017. Data calculated for the representative Martin Currie Australia Real Income. This strategy is not constrained by a benchmark.
A-REIT: S&P/ASX A-REIT Index, Global REIT: MSCI Global REIT Index, Global Utilities: MSCI Global Utilities Sector Index, Global Infrastructure: MSCI World Core Infrastructure Index, US REIT: S&P US REIT Index
*Next 12 Months (NTM) Income yield is calculated using the weighted average of broker consensus forecasts of each portfolio holding – because of this, the returns quoted are estimated figures and are therefore not guaranteed. Assumes zero percent tax rate and full franking benefits realised in tax return for MCA Real Income.

Overall, the Fund thinks the recent real asset market volatility is providing tactical opportunities to invest in an attractive asset class, with solid fundamental growth support leveraged to Australia's world-leading population growth. While the macro environment and uncertainty over long bond yields is making for a volatile market, the Fund remains positive on the prospects for high-quality real assets, with conservative balance sheets, sustainable cash flows and distributions.