Macquarie Income Opportunities

Quarterly Investment Option Update

31 December 2017

Availability

Product name	APIR
AMP Flexible Super – Choice (Retirement)	AMP1585AU
AMP Flexible Super – Choice (Super)	AMP1573AU
CustomSuper	AMP1525AU
Flexible Lifetime – Allocated Pension	AMP1537AU
Flexible Lifetime – Super	AMP1525AU
Signature Super	AMP1549AU
Signature Super – Allocated Pension	AMP1561AU

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 higher income returns than traditional cash investments (with some volatility over short time periods) by investing in a diversified portfolio of both domestic and global credit based securities. The benchmark used is the Bloomberg AusBond Bank Bill Index. The portfolio invests predominantly in floating rate notes, Residential Mortgage Backed Securities (RMBS) and Commercial Mortgage Backed Securities (CMBS), which make up the core portfolio. The investment manager also takes an opportunistic approach to investing in hybrids, global investment grade debt securities, global high yield securities, emerging market debt securities and credit opportunities (such as Australian RMBS, offshore asset backed securities, bank loans and other credit opportunities) which aim to take advantage of dislocated market conditions. International investments are generally hedged to the Australian dollar.

Investment category: Credit and Fixed Interest trading strategies

Suggested Investment Timeframe: 3 years

Relative Risk Rating: Medium

Investment Style: Active

Asset Allocation	Range (%)	Actual (%)
Investment Grade	20-100	94.9
Hybrids	0-10	0.2
Global High Yield	0-15	0.0
Emerging Market Debt	0-15	0.0
Credit Opportunities	0-20	4.9

Holdings

Industry Exposure – Top 5	%
Banks	23.1
Residential mortgage	13.3
REITs	5.8
Transportation	4.7
Electric	4.5

Regional Exposure	%
Australia	53.8
United States	22.3
UK	4.7
Europe Ex UK	8.9
Other	10.3

Top Ten Securities	%
NAB	1.2
Bank of America Corporation	0.8
Lloyds Banking Group	0.7
AGL	0.6
AMP	0.6
Westpac	0.6
Federation Centres Ltd	0.6
Connecteast Finance Pty Ltd	0.5
CBA	0.5
Macquarie Group Ltd	0.5

Market Commentary

The final quarter of 2017 featured a short period of credit market weakness, but the most part continued the low volatility, low inflation chase for yield that had been evident for much of the year. Continued solid economic growth, improving corporate fundamentals evident in earnings and positivity around US tax reform all provided a backdrop for most risk markets to continue to perform.

US earnings early in the quarter were positive, with approximately two-thirds of companies beating sales expectations and almost 80% beating earnings estimates. A number of key industrial names had surprisingly good results, and overall the leverage (a key metric for credit investors) continues to moderate as earnings grow faster than debt levels.

Global economic data continued at a strong pace through the quarter, with momentum from earlier central bank stimulus and a pickup in confidence. Key surveys of manufacturing data in both the US and Europe signalled continued strong expansion, and Chinese data also indicated better than expected credit growth and trade data. Inflation and wages data continue to be very subdued, which remains supportive for asset markets but less so for workers. The inflation 'riddle' is heavily driven by ongoing labour market slack, the impact of demographics and globalisation, and the amount of debt in the world – all likely to be structural factors.

Amongst central banks, the US Federal Reserve (Fed) hiked short term rates again during December, and the European Central Bank (ECB) announced a tapering of their asset purchase program. The Fed's move was widely expected but the three hikes this year marks a clear acceleration in the pace of rate hikes, despite inflation pressure remaining subdued. The ECB's taper is also significant, but its immediate impact on credit markets is likely to be modest as markets expect credit purchases to be tapered by a smaller amount. The overall message from the ECB was quite dovish, with hikes pushed further into the future and 2019 at the earliest.

Credit markets broadly performed well in the fourth quarter, though there was a notable dip mid-November, most clearly in the high yield market. The weakness was initially caused by single name issues (the breakdown of US high yield issuers Sprint and T-mobile's merger talks, which weighed on the Telco sector). But the key was that these moves were compounded by investors wary about credit valuations. The move was short-lived: better valuations and strong fundamentals quickly bought buyers back into the market.

Investment Option Commentary

The Fund outperformed the benchmark over the quarter. Performance was driven by a combination of asset allocation and security selection within global investment grade credit. Positioning in global interest rate duration also contributed, as a long position in AUD duration performed before being shifted into the US long end, where we saw significant interest rate curve flattening. Amongst credit security selection, metals and mining and energy credits performed strongly, given the general strength in commodities, and telco issuers were also overall strong contributors. This more than offset some weakness from the technology sector most notably with Broadcom announcing a takeover of fellow chipmaker Qualcomm, causing spreads on both issuers to widen.

Issuance continued at a strong pace in global credit, with the US market hosting over $US250bn of new issuance. Australian issuance volumes were also strong, with 5 year deals from NAB and Westpac, as well as 7 year issuance from infrastructure names including Ausgrid. Vodafone also returned to the market with 5 and 10 year bonds. The Fund participated mostly in secondary purchases, with the primary market for the most part trading too tight for its liking.

Outlook

Growth and optimism for continued momentum in the global economy have buoyed most asset markets worldwide over recent months. The presence of central bank liquidity which reached a peak in 2017 has added to this impact: depressing volatility and driving a desire for yield from investors. Many markets, including global equity and credit markets, are near or at their historic highs, implying much of the optimism is already factored into current pricing. And while Macquarie believe the broad backdrop is likely to remain benign in the short to medium term there is clearly less room for error in case of a slowdown or policy misstep. The amount of liquidity support in the world is widely expected to sharply decrease in 2018, though markets so far remain calm. As a result Macquarie see opportunities to continue to participate in market performance but with an eye to any budding imbalances in credit markets. For now, solid growth momentum and corporate earnings provide a robust basis for continued credit market performance.

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