Responsible Investment Leaders Balanced

Quarterly Investment Option Update

31 December 2017

Aim and Strategy

To provide a total return (income and capital growth) after costs and before tax, above the return from the relevant benchmarks of the underlying investments on a rolling 5 year basis. The portfolio invests in all asset classes, but with an emphasis on growth assets (shares and property).

With the exception of cash and listed property, the portfolio is managed using a Responsible Investment approach – an approach that focuses on investing in companies that contribute to a socially and environmentally sustainable.

(Responsible investing/multi-manager investment approach)

Investment Option Performance

To view the latest investment performances please visit www.amp.com.au

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1033AU
AMP Flexible Super - Retirement account	AMP1371AU
AMP Flexible Super - Super account	AMP1500AU
CUSTOM SUPER	AMP1033AU
Flexible Lifetime - Allocated Pension	AMP1022AU
Flexible Lifetime - Term Pension	AMP1043AU
Flexible Lifetime Investment	AMP1056AU
Flexible Lifetime Investment (Series 2)	AMP1434AU
METCASH SUPERANNUATION PLAN	AMP1033AU
Signature Super	AMP0977AU
Signature Super Allocated Pension	AMP1173AU

Investment Option Overview

Investment category	Diversified - Balanced
Suggested investment timeframe	5 years
Relative risk rating	Medium
Investment style	Responsible investing / Multi-manager

Asset Allocation	Benchmark	Range (%)
Australian Shares	30	20-40
Global Shares	27	15-53
Growth Alternatives	4	0-13
Australian Property	5	0-20
Global Property	4	
Property & Infrastructure - Australian Infrastructure	0	0
Global Infrastructure	0	0
Australian Bonds	13	0-20
Global Bonds	12	0-25
Cash	5	0-15

Top Ten Australian Securities	%
Westpac Banking Corp	7.59
COMMONWEALTH BANK AUST	7.31
BHP Billiton Ltd	6.74
National Australia Bank Ltd	6.43
CSL Ltd	5.66
MACQUARIE GROUP LTD	4.60
Australia & New Zealand Banking Group Ltd	4.15
Rio Tinto Ltd	2.72
Janus Henderson Group PLC	2.66
Transurban Group	2.49

Top Ten International Shares Exposure	%
Johnson & Johnson	2.02
Alphabet Inc	1.76
3M Co	1.75
PepsiCo Inc	1.71
APPLE INC	1.48
Samsung Electronics Co Ltd	1.35
Cigna Corp	1.32
Cummins Inc	1.25
Statoil ASA	1.23
Accenture PLC	1.12

Actual Allocation	%
International Equities-(UH)	31.79
Australian Equities	27.70
Fixed Interest	15.62
Cash	14.07
Direct Property	5.24
International Listed Property	3.43
Infrastructure	2.70
Emerging Markets	1.98
Alternative Assets Growth	1.42
Australian Fixed Interest	0.00
Australian Listed Property	0.00
Intl Fixed Interest - Credit	0.00
Intl Fixed Interest - Govt	0.00
Other	-3.94

Portfolio Summary

> The RIL Balanced Fund reported a positive absolute and relative return for the quarter, with most asset classes outperforming their benchmarks.

> International and emerging-market equities were significant contributors to performance, with markets rising in response to an improving global growth outlook.

> We continue to prefer international equities to Australian equities and remain underweight fixed income.

Investment Option Commentary

The RIL Balanced fund had a strong end to 2017, with the Fund seeing a positive absolute return and strong relative performance versus benchmark in the December quarter.

The Fund's international equities allocation, RIL International Shares Fund, was the quarter's standout performer. International equities outperformed the benchmark by over 75bps for the quarter. Stock selection in developed markets such as US, Japan and Spain was the key positive contributor. In US, an underweight to General Electric Company (GE) added the most value. Shares in GE slumped as it revealed its turnaround plan in November 2017. Furthermore, the Fund's overweight to emerging markets added to the relative performance, as emerging markets outperformed developed markets in the quarter, despite one of the fund's two managers underperforming due to its value style.

The Australian equities allocation also had a strong period. The RIL Australian Share Fund outperformed by 85bps in Q4 and for the financial year to date, outperformed its benchmark by 55bps. DNR was the standout manager, delivering extremely strong outperformance (409bps) most notably through holdings in NetWealth, an investment platform which has rallied since its IPO in November and Aconex which jumped ~45% on the back of a takeover bid. RIL's other managers Bennelong, AMPCI and Ausbil were more challenged, as excluded gaming and resources stocks rallied throughout December.

The performance of the Diversified Fixed Income portfolio was marginally below benchmark for the quarter, entirely due to the performance of Australian government bonds, while the listed property portfolio generated strong outperformance owing to stock selection in the specialist property sector.

Market commentary

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 did well; the MSCI Emerging Markets Accumulation Index closed 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 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.

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 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%.

Outlook and positioning

We remain relatively comfortable in maintaining a bias towards international equities through Europe. European equity markets continue to be relatively good value when compared with other developed markets. Europe is positioned much more favourably for any upside for the year ahead. With a maturing business cycle in the US, increasing global equity valuations and gradual tightening of global monetary policy, markets could see some volatility through 2018, but with the inflation outlook continuing to be positive, we remain cautiously optimistic. In emerging markets, earnings growth should benefit from increased trade and low valuations, however any potential rises in the US dollar could stifle returns somewhat.

While global economic conditions appear favourable, we are seven years into a bull run and markets collectively are no longer cheap. In this context, we have maintained some options protection over US equities in case of any market weakness.

The outlook for Australian equities is less optimistic on a relative basis. Soft consumer spending and a slowing housing cycle will likely keep growth below Reserve Bank of Australia (RBA) and Federal Government forecasts. Nevertheless, declining drag from lower mining investment, strong public infrastructure spending and improving conditions for trade should all help keep Australia out of recession.

For some time, our view has been that bond yields are not sustainable at current low levels. Domestically, record low wages growth, low underlying inflation, the impending slowdown in housing construction, risks around the consumer and the rise in the A$ limit the risk of a rate hike until sometime in 2018. The best estimate of future returns are current yields and with Australian and US 10-year bond yields at 2.8% and 2.4% respectively, this does not offer appealing value. We remain underweight to the asset class, with a higher than normal cash weighting.

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