Specialist Diversified Fixed Income

Quarterly Investment Option Update

31 December 2017

Aim and Strategy

To provide a total return (income and capital growth) after costs and before taxes, above the performance of 60% of the Bloomberg AusBond Composite Bond All Maturities Index and 40% of the Barclays Global Aggregate Bond Index (Hedged to AUD) benchmarks, on a rolling 3 year basis.

The strategy provides exposure to a diversified portfolio of Australian and international fixed income securities including government securities, government-related securities, corporate securities, asset-backed securities, cash, derivatives and foreign currency. The strategy will gain fixed income exposure by primarily investing in a range of actively managed strategies which are managed by AMP Capital. These underlying strategies managed by AMP Capital will diversify manager risk across a range of investment managers by using a multi-manager approach. Exposures are to managers who demonstrate competitive advantages, within the various investment styles that are used when investing in the Australian and international fixed income markets.

Investment Option Performance

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

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1959AU
AMP Flexible Super - Retirement account	AMP1966AU
AMP Flexible Super - Super account	AMP1973AU
CUSTOM SUPER	AMP1959AU
Flexible Lifetime - Allocated Pension	AMP1952AU
Flexible Lifetime Investment (Series 2)	AMP1991AU
Signature Super	AMP1975AU
Signature Super Allocated Pension	AMP1977AU

Asset Allocation	Benchmark	Range (%)
Australian Bonds	60	40-80
Global Bonds	40	20-60
Cash	0	0-10

Actual Allocation	%
International Fixed Interest	62.48
Australian Fixed Interest	36.38
Cash	1.14

Investment Option Overview

Investment category	Fixed Interest
Suggested investment timeframe	2 -3 years
Relative risk rating	Medium
Investment style	Multi - Manager

Portfolio Summary

- Global government bond yields were somewhat mixed in the December quarter, while credit spreads were generally narrower.
- The Fund posted a positive return for the quarter and outperformed its benchmark. Three of the Fund's four underlying managers outperformed their respective benchmarks.
- Very low, though rising sovereign bond yields continue to point to low medium-term returns.

Investment Option Commentary

The Fund posted a positive return for the December quarter and outperformed its benchmark. All underlying managers delivered positive outcomes, with three of the four managers outperforming their respective benchmarks.

Within the Australian bonds sector, **AMP Capital** produced a positive return and outperformed its benchmark. Credit positioning was the major driver of performance, reflecting the contribution of the excess carry earned on credit securities held. Interest rate management had a minimal impact on active returns, with yield curve positioning detracting slightly as the curve flattened. The portfolio began the quarter with a small short duration position, which was maintained during October. In November AMP Capital switched to a modest long duration position which was kept to the end of the quarter and was focused in the short end of the yield curve. The Fund did, however take profit in the middle of the quarter on some of the long duration positions in the short end of the curve in Australia.

AB delivered a positive absolute return and significantly outperformed its cash benchmark over the quarter. Sector and security selection was the main driver of performance, primarily the exposure to investment-grade and high-yield corporates in the eurozone. Positions in US investment-grade corporates and Japanese inflation-linked securities also added value. Conversely, country and yield curve positioning detracted overall, with losses from positioning in Mexico and the US outweighing gains from Australia. Currency decisions also had a negative impact on returns, with an underweight in South Korean won detracting, whilst an overweight in the Polish zloty contributed.

Schroders posted a positive return for the quarter, and marginally outperformed its benchmark. The portfolio maintains its cautiously positioning against a backdrop of low bond yields and narrow credit spreads, with a short overall duration position and a modest allocation to high quality credit.

PIMCO produced a positive return and underperformed its benchmark over the quarter. The primary detractor to relative performance came from interest rate management, with both duration and yield curve positioning detracting. Currency decisions overall also marginally crimped returns. Sector selection was the main contributor during the period, with an overweight to inflation-linked bonds and securitised assets, including agency and non-agency mortgage backed securities adding value. The portfolio also benefitted from the performance of select holdings of US non-agency mortgage backed securities.

Market commentary

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. Credit spreads, in both investment grade and high yield, were generally narrower seeing corporate bonds outperform government 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%.

Outlook

Very low, though rising, sovereign bond yields point to low medium-term returns. The abatement of deflationary pressures, as commodity prices trend up, the gradual reduction in spare capacity and a shift in policy focus from monetary to fiscal stimulus indicate that yields are likely to steadily trend higher.

Australian yields continue to trade at a premium to those available in Japan and Europe, making Australian sovereign fixed income and corporate credit relatively attractive from an international and yield perspective. The Reserve Bank of Australia currently has a short-term neutral policy in regards to the timing and direction of interest rate changes and conflicting economic pressures mean it is too early to be talking about interest rate hikes. Housing market and household debt levels continue to be an area for concern.

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What you need to know