# (AMP) Balanced Index

Quarterly Investment Option Update

30 June 2018

## Aim and Strategy

To provide moderate to higher returns primarily from capital growth with some income over the long term by investing across the main asset classes, with higher 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 time frame.

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

## Availability

| Product name | APIR |
|---|---|
| AMP Flexible Lifetime Super | AMP1027AU |
| CUSTOM SUPER | AMP1027AU |
| Flexible Lifetime - Allocated Pension | AMP1016AU |
| Flexible Lifetime - Term Pension | AMP1037AU |
| Flexible Lifetime Investment | AMP1050AU |
| Flexible Lifetime Investment (Series 2) | AMP1390AU |
| METCASH SUPERANNUATION PLAN | AMP1027AU |
| Signature Super | AMP0784AU |
| Signature Super Allocated Pension | AMP1137AU |

| Top Ten Australian Shares Exposure | % |
|---|---|
| COMMONWEALTH BANK AUST | 7.63 |
| BHP Billiton Ltd | 6.55 |
| Westpac Banking Corp | 6.01 |
| CSL Ltd | 5.27 |
| Australia & New Zealand Banking Group Ltd | 4.82 |
| National Australia Bank Ltd | 4.42 |
| WESFARMERS LTD | 3.34 |
| Macquarie Group Ltd | 2.41 |
| WOOLWORTHS GROUP LTD | 2.38 |
| Rio Tinto Ltd | 2.09 |

## Investment Option Overview

| | |
|---|---|
| **Investment category** | Diversified - Balanced |
| **Suggested investment timeframe** | 5 to 7 years |
| **Relative risk rating** | Medium |
| **Investment style** | Index Focussed |

| Top Ten International Shares Exposure | % |
|---|---|
| APPLE INC | 2.25 |
| Microsoft Corp | 1.73 |
| HENDERSON GLOBAL EQUITY MULTI STRATEGY FUND | 1.65 |
| Amazon.com Inc | 1.63 |
| Alphabet Inc | 1.59 |
| Facebook Inc | 1.18 |
| JPMORGAN CHASE & CO | 0.89 |
| Royal Dutch Shell PLC | 0.75 |
| EXXON MOBIL CORPORATION | 0.74 |
| UnitedHealth Group Inc | 0.73 |

| Actual Allocation | % |
|---|---|
| International Shares | 27.65 |
| Australian Equities | 26.53 |
| Cash | 9.67 |
| Australian Fixed Interest | 9.02 |
| Listed Property | 8.17 |
| International Fixed Interest | 7.98 |
| Alternative Assets | 7.95 |
| Others | 3.05 |

## Investment Option Commentary

### Global

The second quarter of 2018 saw a significant rise in geopolitical tensions. From a military standpoint the US, Britain and France launched airstrikes against Syria in the wake of the country's use of chemical weapons. The risks of a full-blown trade war also increased during the quarter, with both the US and China threatening a cycle of counter-retaliatory measures; increasing the risk of an escalating tariff spiral. The US also increased its negative rhetoric with Europe, threatening to impose tariffs on European automotive imports. European stability has been rocked by protracted elections processes, changes of power bases and internal tensions within the union. On the more positive side, the conclusion of the US-North Korean summit was seen as a tentative move in the right direction, although much remains to be formally agreed.

In the US, the US Federal Reserve raised interest rates again to a 1.75%-2.00% range, remaining on its planned trajectory despite the uncertainty caused by the current antagonistic global trade environment. The US ten-year bond yield broke the psychologically important 3% level for a period before pulling back. Inflation is edging towards the 2% target rate. US economic data remains overall positive, with very low unemployment figures and supportive personal spending growth, improving business conditions, and high consumer confidence. The US dollar also remains strong. However, a report by the International Monetary Fund (IMF) said that the US's burgeoning budget deficit could provide a fillip to inflationary and interest rates pressures, with the potential to significantly impact financial markets.

In Asia, Japanese data was mixed, with household expenditure and production weaker than hoped for but labour market data remaining robust, aligning with a commensurate rise in consumer confidence. The Bank of Japan kept monetary policy static and has continued to manage future expectations. Core inflation remains below target, meaning easy monetary conditions are likely to remain in place for the foreseeable future. In China, economic data has generally weakened, suggesting a slowdown in growth may be starting; with industrial production, retail sales, investment and credit growth all pulling back. Recent business conditions purchasing managers' indices have also been mixed; often rising for the official surveys but falling according to the Caixin surveys. In an attempt to mitigate the downside, the Chinese administration is reducing taxes to give a boost to consumption and the State Council has telegraphed cuts to required bank reserve ratios to improve lending to small businesses.

In Europe, geopolitical uncertainty continued. French President, Emmanuel Macron, has said Europe now faces a 'moment of truth'. In Italy, the Five Star Movement and Lega finally formed a government, averting the immediate risk of a constitutional crisis but once more raising the question of Eurozone stability. However, Italy's new government is now an uneasy blend of technocrats and politicians, often with opposing views. Spain also came under some pressure, as Spanish Prime Minister Mariano Rajoy was ousted in a no confidence vote, following corruption scandals in his party. Pedro Sanchez will now leads Spain. French President Emmanuel Macron is seeking bedrock support from German Chancellor Angela Merkel on European stability measures, as signs of dissention at the periphery increase. However, Merkel's position of strength has been eroded to an extent by friction with her Interior Minister who is more sympathetic to Italy's stance.

On the economic front, the Eurozone's composite business conditions purchasing managers index rose in June, following four months of falls; however industrial production has reduced, imparting mixed signals. The latest Centre for European Economic Research Financial Market Survey showed a reduction in German investor confidence, with expectations for growth slowing. Core inflation remains stubbornly around the 1% level on a year-on-year basis; thus the European Central Bank is likely to be slow in exiting ultra-easy monetary policy.

Emerging markets have come under pressure, with both equities and currencies impacted. Concerns that a strong US dollar will put pressure on emerging market funding requirements also came to the fore and emerging market bonds have seen some significant outflows. If the US dollar remains strong, this could cause some additional stress for energy-dependent emerging markets which will have to contest with both a higher dollar and a higher oil price. Emerging market currency stress saw particularly significant depreciation in the Turkish lira and Argentinian peso; with the Argentinian Government attempting to defend the peso by raising interest rates to 40%, prior to receiving a loan from the IMF. The deal has initiated national protests as many Argentinians blame the protracted austerity following the country's 2001-02 economic crisis on IMF interventionist measures.

Commodity prices have exhibited some general support, indicating the global market has a bias towards growth expectations, although escalating trade-war risks have the potential to change the outlook. Oil is likely to be supported while geopolitical tensions remain. The US withdrawal from the Iranian nuclear deal framework will also likely constrain supply dynamics.

### Australia

The most recent data from the Australian Bureau of Statistics has confirmed a weaker domestic housing environment with elevated valuations, high personal debt levels, and tightening lending standards. In the broader economy, skilled vacancies continue to fall, indicating softening growth. Against a mixed economic backdrop and falling business confidence, the Reserve Bank of Australia is likely to be remain accommodative for the foreseeable future, unless external economic events force its hand.

The Reserve Bank of Australia's Financial Stability Review continued to highlight risks for Australian and global asset prices as interest rates rise in the longer term, and domestically while household debt remains at elevated levels. However, it sees housing-related risks diminishing as macro-prudential measures take effect. More broadly, it sees the resilience of Australian banks improving and is not too concerned by the rise in short-term funding costs.

On the positive side, while net exports remain robust, gross domestic product should be supported and infrastructure expenditure should inject some additional demand into the economy. Although the most recent National Australia Bank business survey showed business conditions and confidence slipping, this was from a very high base and overall they remain solid.

The last budget before the next general election provided few surprises, with some marginal tax cuts in the short term but more significant changes being phased in from 2022, but constrained by high national debt levels. The government has stated its intention to return the economy to surplus; however its long-term projections appear optimistic and subject to many variables outside the government's control. The intention is to cut the corporate tax rate to 25% for large companies by 2026-27. Overall, the budget had a very much forward-looking pre-election perspective with the likelihood of future change or adaption.

The Royal Commission into the banking, superannuation and financial services industry is continuing, with an interim report due no later than 30 September 2018 and the final report to be delivered by 1 February 2019.

Improved visibility and stability on economic data would be welcome and would provide a more solid platform for Australian business planning and investment.

## Australian dollar

After falling in April, rising strongly in May, then pulling back again in June, the Australian dollar (AUD) closed the quarter with little change in value against most major currencies. In recent months, Australia has been seen as somewhat of a safe-haven amid ongoing external geopolitical concerns, such as trade tensions between China and the US or European stability, however, rising overseas interest rates, such as those in the US, has helped keep a lid on any significant gains for the AUD. This was despite rising resource prices, which tends to support a higher AUD. Against the US dollar, the AUD closed at approximately 0.74 (down from 0.77), against the euro it finished at 0.63 (up from 0.63), while against the UK pound it closed at 0.56 (up from 0.55).

## International shares

Despite a number of global concerns for investors throughout the June quarter, most markets climbed the 'wall of worries' to rise strongly. The MSCI World ex Australia Net Index finished the period higher by 3.4% in local currency terms. Concerns included negative US rhetoric towards Europe with the threat of tariffs on automotive imports, ongoing US/China counter-retaliatory tariff threats, early inflationary concerns in the US, currency concerns in emerging markets (EM) as the US dollar rose and subsequent concerns around the increasing real debt levels of many EM companies which hold their debt in US dollars. The MSCI Emerging Markets total return index was consequently down by 3.5%. China's market particularly suffered amid the US trade skirmishes, ending the period down by 10.6%. Meanwhile, the US S&P 500 total return index ended the period up 3.4%, as companies continue to grow their earnings and economic growth remains strong. The UK's FTSE 100 total return index was extremely strong and reached record-highs in the June quarter, up 9.6% as the Sterling fell (leading to a significant increase in earnings for many UK-based international businesses), commodity prices rose and the Bank of England remained a little less hawkish than expected. (All figures quoted in local currency terms.)

## Australian shares

Australian shares were up very strongly in the June quarter, the S&P/ASX200 Accumulation Index soaring 8.5% during the period. Energy and healthcare were the standout sectors for the quarter, rising 19.7% and 16.5% respectively, largely driven by rising resource prices and the rising US dollar; which is heavily tied to the earnings expectations for many Australian businesses, notably (and respectively) BHP and CSL, who were the market's top contributors for the quarter. Telecommunications was the only negative performing sector, down 13.7% for the period, as Telstra fell further on continued shorter-term concerns of reducing profits and dividends, despite the business announcing cost-cutting to be on track and further detailing their new strategy to gain market share. Meanwhile, one of the top performing stocks was poker machine manufacturer Aristocrat Leisure, which rose by 29% over the June quarter as the company announced soaring revenue amid strong growth in its digital gaming division.

## International bonds

Global government bonds yields moved higher in April, as markets regained their appetite for risk amid further evidence of strengthening economic conditions. In May, fears of a populist anti-European government coming to power in Italy prompted a sell-off in the debt of peripheral European nations and a flight to the quality of higher rated issuers. The US was one of the recipients of the shift in investment flows. After trending upwards early in June, amid an easing of political uncertainty in Italy and optimistic economic commentary from central bankers in Europe and the US, yields subsequently reversed this momentum to fall amid escalating trade tensions. The US 10-year bond yield ended the quarter at 2.86%, while the German 10-year bond yield and the Japanese 10-year bond yield ended at 0.30% and 0.04% respectively.

## Australian bonds

Driven largely by actions in the global bond markets, government bond yields in Australia trended higher in April, with the greatest moves occurring within long-dated maturities. Similarly mirroring overseas trends, domestic yields fell during May, as government bonds benefited from the flight to quality, with long-dated maturities again experiencing the greatest moves. During June, yields followed a similar path to their overseas counterparts, with their initial upward momentum spurred on by a favourable quarterly gross domestic product result. A subsequent trend reversal saw the Commonwealth Government 2-year bond yield end the quarter at 1.98%, while the Commonwealth Government 10-year bond yield ended at 2.63%. In addition to the lead provided by global trade concerns, local bonds were also influenced by the latest Australian labour force data.

## Cash

Australian interest rates remain on hold at 1.5%, where they have now been sitting at for 23 months, with little to no recent sign of any change of tack from the Reserve Bank (RBA). Three and six-month Australian bank bill rates closed at 2.10% and 2.22% respectively and the spread between their US counterparts continues to narrow. While a brightening outlook for mining investment, strengthening non-mining investment, booming infrastructure spending and strong growth in export volumes argue against a rate cut, topping-out dwelling investment, uncertainty around the consumer, continuing weak wages growth and inflation, falling home prices in Sydney and Melbourne, tightening bank lending standards and the threat to global growth from a US driven trade war all argue against a hike.

### Australian listed property securities

Australian listed real estate was very strong during the period, with the S&P/ASX 200 A-REIT Accumulation Index finishing up by around 10%. The market was boosted when Scentre Group released its first quarter earnings update, which rose by 1.1% in the first quarter, driven by the major retailers. Earlier in the period it also surprised the market by announcing an on-market share buy-back of up to approximately A$700 million. However, the challenge facing retail was illustrated by Vicinity Centres' announcement that it plans to sell up to A$1 billion of sub-regional and neighbourhood shopping centres and news that the Australian business of Toys 'R' Us entered voluntary administration. In other retail news, shareholders approved the takeover of Westfield Corp by Unibail-Rodamco.

The e-commerce challenge facing Australian retailers increased during the month when Amazon launched its Prime service. It will offer free two-business day delivery on eligible products and access to videos, e-books and gaming for A$6.99 a month.

The residential market continues to soften, especially in Sydney and Melbourne where prices have reached historic highs, as banks tighten lending criteria and mortgage rates show signs of moving upwards. Weekend auction clearance rates in both cities fell below 60% in late June.

### Australian Direct Property

The quarter saw an improvement in leasing activity across the property sectors. Interest rates remain at historical lows, and commercial real estate transaction values were higher than last quarter, with evidence of higher prices being paid particularly in the larger markets of Sydney and Melbourne.

The office sector showed an improvement in vacancy rates across the all the major capital city markets. Sydney finished at 4.5% and Melbourne at 4.6%, after a strong quarter of above-trend net absorption. Incentives remain stable and all CBD markets are seeing stable or growing effective rents. In terms of the other CBD markets, Brisbane and Perth fundamentals are slowly improving. Perth remains the most challenging, however, the prime end of the market is benefiting from the tenant "flight to quality". There was also a notable rise in sale transactions this quarter, supporting another 12.5bps in yield compression for Sydney and Melbourne prime assets. Yields in other CBD markets were generally stable through the quarter.

In retail, the consumer remains cautious despite a small rise in confidence in June, as household debt remains elevated and low wages growth persists. Australian retail sales growth was tracking at around 2.6% pa in May. Retailers continue to roll out their online platforms; with Amazon launching 'Amazon Prime' in June, and to grow their market share of e-commerce in Australia. JLL Research are reporting an average 0.8% increase in vacancy rates across all the retail formats from last year and there is great divergence in performance between locations and quality. Sydney and Melbourne remain the only markets seeing rental growth, with malls in areas of strong population growth likely to outperform a generally flatter overall environment.

In industrial, there was a general increase in leasing activity primarily in existing assets. Melbourne has seen strengthened demand, particularly from the e-commerce and transport & logistics sectors and limited vacancy additions in the prime assets. JLL Research reported improvements in conditions in both Brisbane and Perth, as vacant space trends down. Vacancies in most of the markets that are feeling the winds of residential encroachment are falling to very low levels. These conditions are being reflected in rising rents, land values, and asset prices. Rental growth has been constrained to the inner pockets of Sydney and Melbourne industrial areas, while the southern Brisbane precinct is now experiencing some reasonable rental growth.

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