AMP Capital Corporate Bond Fund

Quarterly Investment Option Update

30 June 2018

Aim and Strategy

To provide a total return (capital growth and income) after costs and before tax, above the UBS Credit Index 0+, on a rolling 3 year basis. he portfolio aims to provide investors with regular monthly distributions through investment in an actively managed portfolio of credit securities such as corporate bonds. The portfolio focuses on investment grade rated corporate bonds in the Australian market, and also has exposure to global bond markets. Exposure to global credit securities will principally be hedged back to Australian dollars. Investments may also include:

• Asset backed securities and derivatives, preference shares, convertible bonds, hybrid securities and loans in the Australian market.

• Global credit securities and derivatives in global credit markets, which may also include a small exposure to emerging markets.

• Non-investment grade rated securities up to a maximum of 10% of the portfolio's investments.

• Cash and cash-like securities such as bank bills.

• Government, semi-government, government guaranteed or similar securities.

• Other financial products, such as securities and managed strategys offered by AMP Capital or their associates.

Investment Option Performance

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

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1289AU
AMP Flexible Super - Retirement account	AMP1322AU
AMP Flexible Super - Super account	AMP1452AU
CUSTOM SUPER	AMP1289AU
Flexible Lifetime - Allocated Pension	AMP1296AU
Flexible Lifetime Investment (Series 2)	AMP2037AU
METCASH SUPERANNUATION PLAN	AMP1289AU
Signature Super	AMP1303AU
Signature Super Allocated Pension	AMP1310AU

Investment Option Overview

Investment category	Fixed Interest - Credit and Fixed Interest Trading Strategies
Suggested investment timeframe	3+ years
Relative risk rating	Medium
Investment style	Active

Asset Allocation	Benchmark	Range (%)
Australian Bonds	100	90-100
Cash	0	0-10

Top Ten Securities Exposure	%
Westpac Banking Corp	3.14
National Australia Bank Ltd	2.91
CREDIT SUISSE (SYDNEY BRANCH) AG	2.61
Australia & New Zealand Banking Group Ltd	2.61
UBS AG AUSTRALIA	2.31
BRISBANE AIRPORT CORP LT	2.17
DOWNER GROUP FINANCE PTY	1.93
Telstra Corp Ltd	1.75
FORD MOTOR CREDIT CO LLC	1.58
BANK OF AMERICA CORP	1.55

Credit Ratings Exposure	%
A	36.92
BBB	36.00
AA	13.50
AAA	7.88
BB	3.28
Cash	1.57
CCC	0.58
Agency/Government	0.27
Not Rated	0.01

Portfolio Summary

- The Corporate Bond Fund delivered a total return of 0.51% (after fees) in the June quarter, outperforming the benchmark by 2 basis points.
- Credit excess returns were neutral over the quarter, with positive contributions from interest rate factors.
- The Fund has been gradually rotating its physical credit exposures into more defensive names, whilst maintaining a relatively low sensitivity to interest rate moves.

Investment Option Commentary

The Corporate Bond Fund delivered a total return of 0.51% (after fees) in the June quarter, outperforming the benchmark by 2 basis points.

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. 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.

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.

Credit excess returns over the quarter were essentially neutral, as the income generated by the Fund’s underlying securities was offset by the impact of wider credit spreads. Interest rate management enhanced returns, primarily reflecting the positive impact from duration in a falling yield environment.

At the sector level, the allocation to industrials, utilities and senior-ranked banks were the main contributors to credit-related performance. Subordinated banks, diversified financials and communications were the main detractors at the sector level.

At the security level, Downer, Brisbane Airport and Deutsche Bahn were the main contributors to performance. Subordinated exposures to Credit Suisse Group, Westpac and ABN AMRO Bank were the main detractors.

The Fund’s duration exposure is primarily in the front end of the Australian curve, where we see better valuations, while maintaining a strategic bias for the Australian yield curve to steepen. This duration exposure has been beneficial of late given the weaker market backdrop, though we are approaching valuations where we would anticipate tactically reducing this exposure somewhat in the near-term.

The Fund’s credit exposures are positioned primarily in shorter-dated, higher-grade exposures to reduce sensitivity to credit spreads, with recent activity through selective participation in primary markets and reductions of more cyclical exposures. This defensive positioning has worked well through the recent widening in credit spreads and has neutralised the negative performance impacts from this wider spread environment. We remain on watch for opportunities to selectively add exposure where we feel valuations provide better compensation for risk.

The Fund rotated its major bank exposure over the quarter through a combination of primary and secondary market activity, with risk additions to ANZ and Westpac, and reductions of National Australia Bank and Commonwealth Bank of Australia. Other notable Fund additions through primary issuance included bonds from Groupe BPCE and Barclays; subordinated bonds from Bank of Queensland, and corporate bonds from Brisbane Airport and DBNGP Finance. The Fund also added exposure to Banco Santander, UBS, and Volkswagen in secondary markets. Other reductions of note included exposures to Morgan Stanley, Stockland, Vodafone, Intel, Apple, Ausgrid Finance, and Investa Office Fund.

The Fund remains well-diversified across sectors. Key exposures within Financials are to senior-ranked bonds, with larger weights to Westpac and National Australia Bank domestically, and to Credit Suisse and UBS amongst the foreign banks. Across Corporates, the key sector exposures are to Utilities (with the larger exposures being Ausnet Services and United Energy Distribution), Real Estate (Stockland, Scentre Group (Westfield)) and Industrials (Brisbane Airport, Downer).

Market commentary

In contrast to their overseas counterparts, domestic credit spreads were less volatile during April. Spreads nevertheless ended the monthly slightly wider, driven primarily by financials. During May, domestic credit spreads continued to widen, largely in line with global credit markets which were impacted by the political uncertainty in Italy, with financials continuing their underperformance. During June, domestic credit spreads widened only slightly relative to their global counterparts, with the divergence in magnitude of spread movements being primarily driven by the low level of domestic primary issuance compared to substantial issuance seen in the US and Europe. Spread widening was generally uniform across domestic financials and corporate issuers.

We remain cautious on adding risk, given tighter valuations and the strong likelihood that we are transitioning out of the persistent low-volatility environment we have seen for much of the past two years. Solid macroeconomic data and corporate balance sheets more generally provide support within this environment for an overweight credit exposure, but with increasing focus on shorter tenors and lower aggregate credit beta.

Credit spreads globally are at the tighter end of recent post-Global Financial Crisis experience, and especially so once accounting for the increase in the average tenor of securities over the past few years. We are not concerned at this stage that markets are mispricing default or rating transition premia, but see some potential for pockets of the market to reprice risk premia pertaining to volatility and or liquidity. Indeed, we continue to see evidence of this in market behaviour this year, with credit spreads offshore having largely retraced their 2017 tightening since the turn of the year.

Global central bank policy in the US and Europe has begun to show increasing hawkishness. Investor caution has increased in cash credit markets, which were previously typified as low volatility trading environments, and we have seen some signs that investors are adjusting their positioning in higher-beta segments of the credit market. There is also an important acknowledgement of liquidity and underlying positioning that may impact market pricing as we move into a more transitionary phase for global central banks. The potential for correlations to behave somewhat differently as markets adjust to higher interest rates is also a factor we are watching closely. Geopolitical risks are likely to remain a point of caution for investors. More recently, risk assets have shown a degree of weakness, with increasing trade tensions between the US and China, a pick-up in Chinese corporate defaults, and the potential re-focus on European sovereign risk through recent Italian news among the areas of concern.

Outlook

We remain cautious on adding risk, given higher valuations. However, we note continuing underlying policy support and other broadly strengthening macroeconomic data trends counterbalance this somewhat. We have been moving the Fund more defensively positioned within its credit allocation over recent months as a result of this. Ultimately we feel any such periods of volatility may prove to be opportunities to add risk given the broader backdrop, and will be carefully balancing our signals from our investment process on fundamentals, sentiment and valuations as we move through these environments.

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