AMP International Share Enhanced Index

Quarterly Investment Option Update

30 June 2018

Aim and Strategy

To provide a total return (income and capital growth) after costs and before tax, higher than the return from the benchmark on a rolling 12 month basis. The portfolio invests in international shares and partially replicates the MSCI World Accumulation (ex-Australia) Index. Some of the portfolio's underlying managers may use short selling with the aim of implementing the investment objectives. The portfolio may be geared, but in normal circumstances, the portfolio will be no more than 100% exposed to international share market movements, after taking into account derivative positions. In normal circumstances, the portfolio is unhedged to Australian dollars.

Investment Option Performance

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

Availability

Product name	APIR
Flexible Lifetime Investment	AMP0994AU
Flexible Lifetime Investment (Series 2)	AMP1396AU

Investment Option Overview

Investment category	Diversified
Suggested investment timeframe	5-7 years
Relative risk rating	High
Investment style	Index Focussed

Top Ten Securities 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

Asset Allocation	Benchmark	Range (%)
International shares	100	95-100
Cash	0	0-5

Regional Exposure	%
North America	64.05
Europe ex UK	17.60
Japan	8.60
United Kingdom	5.86
Cash	2.10
Asia ex Japan	1.72
Australasia	0.06
Others	0.01

Industry Exposure	%
Information Technology	18.90
Financials	15.84
Consumer Discretionary	13.40
Industrials	12.10
Health Care	10.94
Consumer Staples	6.45
Energy	6.29
Materials	5.07
Utilities	2.91
Real Estate	2.72
Telecommunication Services	1.66
Unclassified	1.65
Cash	1.25
Other	0.82

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.)