Invesco Global Targeted Returns

Quarterly Investment Option Update

30-June-2018

Availability

Product name	APIR
Flexible Lifetime – Allocated Pension	AMP2050AU
Flexible Lifetime – Super	AMP2049AU
Flexible Super – Retirement	AMP2051AU
Flexible Super – Super	AMP2052AU

Investment Option Performance

Investment performances are subject to product fees and where relevant tax as outlined in the product PDS. Therefore investment performance may differ between products. In addition, activity on your account such as contributions and deductions will also impact the investment performance specific to you. To view the latest investment performances for each product, please visit **www.amp.com.au**. You can also view the last investment performance specific to you by visiting your My Portfolio account.

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Overview

Aim & Strategy:

The Fund is an 'all weather' solution that can help meet investors' needs in terms of: capital growth; capital stability; complementary investments; value for money; access to money; transparency, and management by a trusted investment manager in Invesco.

The Fund aims to achieve a positive total return in all market conditions, targeting a gross return of cash + 5% p.a. with less than half the volatility of global equities over rolling three-year periods.

The Fund typically comprises 20-30 investment ideas including both relative value and directional trades across a wide range of assets, broadly categorised as equities, rates, currencies, credit and volatility. This includes investing in warrants, collective investment schemes, commodities and derivatives across established, developing or emerging markets. Every single idea has to work alongside its fellow ideas and have the potential to offer a positive return in Invesco Perpetual's Asset team's underlying core economic thesis, which sets out a broad macro backdrop for their investment ideas.

Risk is measured both on an individual idea level and on a group level: across the ideas, asset type, geographical regions, and market factor (risk on/risk off). By measuring the contribution or marginal risk of each idea, the diversification benefits of combining the ideas are enough to reduce the risk of the portfolio to less than half that of global equities.

Investment category: Alternatives

Suggested Investment Timeframe: 3-5 years

Relative Risk Rating: Medium

Investment Style: A fundamental, unconstrained, high conviction approach focused on leveraging a diversified, value-adding set of investment ideas into a single risk-managed portfolio.

Portfolio statistics

Risk by Strategy	%
Equity	28.28%
Interest Rates	16.08%
Credit	4.94%
Currency	33.33%
Commodity	6.21%
Volatility	3.82%
Inflation	7.34%

Regional Exposure	%
Asia	3.08%
Australia	4.21%
Canada	2.17%
Cayman Islands	2.21%
Chile	2.06%
China	0.52%

Europe	7.87%
France	2.70%
Germany	1.61%
Hong Kong	4.53%
India	5.55%
Ireland	0.29%
Japan	6.62%
Norway	0.87%
Russia	0.14%
Singapore	0.16%
Sweden	3.47%
Switzerland	4.23%
United Kingdom	7.77%
United States	8.24%
Other	31.71%

Market Commentary

Most equity markets made progress over the quarter. News flow was dominated by the possibility of a trade war. Despite hopes that this was all posturing, the escalating rhetoric between the US and China led to tariffs on $50bn of goods, which has been followed by President Trump's threat of a further US$200 billion in sanctions. This negatively impacted Asian equity markets and other trade sensitive countries.

Asian currencies also tumbled, which led to speculation that China was allowing its currency to devalue as a warning to the US. On the other side of this equation was the strong US dollar, which was another dominant feature of the quarter as robust economic data coming out of the US allowed the US Federal Reserve (Fed) to raise rates in June. The move was well telegraphed and the Fed found sufficient reason to nudge up its economic forecasts and signal two further rate hikes before the end of the year.

This was in stark contrast to Europe where, at the same time, the European Central Bank (ECB) was significantly more cautious as disappointing data and, specifically, low inflation numbers enforced its commitment to the bond-buying programme. The ECB made it clear that it expected rates to remain at lows until mid- 2019. Political risk in Europe was another big issue as markets expressed concern about a Eurosceptic coalition government in Italy. The coalition's declaration that it was prepared to go on a 'spending spree' in an attempt to re-invigorate the Italian economy also did not help. Although contagion was broadly contained this time around, yields spiked on Italian government bonds (BTP). The 2-year BTP swung from negative yields to almost 3% before returning towards 1% at quarter end. This volatility saw something of a flight to perceived 'safety' with core government bonds rallying.

In the UK, lacklustre domestic growth data meant doubts began circulating around a previously 'certain' May interest rate hike. In something of a déjà vu for the Bank of England (BoE), it had to row back on what appeared to be firm guidance that rates would rise. However, 'soggy' inflation and continued uncertainty around Brexit saw egg on the face of market traders when May and June passed with no action taken by the BoE. The pound hit its highest level against the dollar since the Brexit referendum in April, but slumped quickly down to 2017 levels before the end of the quarter. This helped the UK equity markets to a strong showing over the period.

Oil prices also helped boost UK equity markets and the energy sector in general as they got back to levels only previously seen in 2014, boosted by a perceived tightness in US supplies and uncertainty over Iran's future role in the international community.

Elsewhere, the on/off meeting between the two Korean presidents ignited hope for a more peaceful future on the Korean peninsula. More broadly, trade-related issues in Asia and US-dollar related currency woes prompting interest rate hikes in Turkey, Argentina, Indonesia and the Philippines made a tough quarter for emerging markets. Latin America was particularly hard hit with issues from a truckers' strike in Brazil to a strong showing from a left-wing presidential candidate in Mexico roiling local markets.

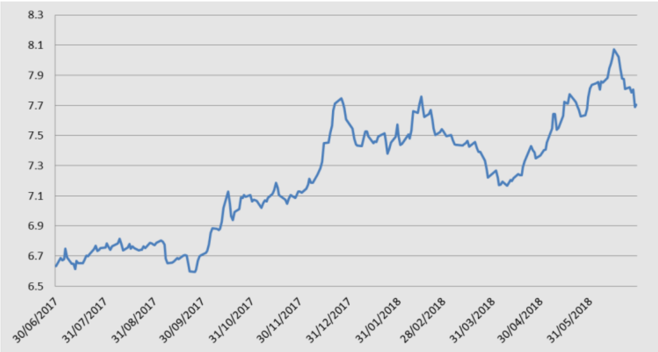
Treasury yields ended marginally higher as the market absorbed the Fed's revised forecasts, however, yields remained somewhat supressed as trade war fears sustained a flight to safety. Domestic political problems in Germany coupled with the general uncertainty around trade saw bond yields there end the quarter near five-month lows.

Performance commentary

Performance was marginally negative during the quarter. Both positive and negative contributions were spread across a wide range of ideas, with no particular theme or asset type dominating.

The Mexican exposure in an emerging market debt idea proved detrimental as markets reacted badly to the strong showing of the leftist candidate ahead of the presidential elections. Yields on five-year Mexican government debt moved higher during April, May and June before staging something of a recovery towards quarter end.

Figure 1. Yields on Mexican 5-year debt rose during Q2



Source: Bloomberg as at 30th June 2018

Exposure to Asian equities was one of the biggest detractors as the region fell victim to the escalation in global trade disputes. Equity markets were trading around nine-month lows towards the end of the quarter. However, losses for the Asian equity idea were at least partially mitigated by the fund's hedging strategy.

The impact of US sanctions against a number of Russian companies weighed on our 'Currency – Russian Ruble vs US Dollar' idea as the ruble lost around 10% of its value against the dollar. The idea had performed well for the fund since inclusion but the fundamental investment case for the ruble proved secondary to the political risk now posed by sanctions and, as a result, the idea was removed.

Despite global equities inching forward over the quarter the fund's global equities idea was held back as the element of the idea included to protect against sharp market falls, the volatility of the Swiss equity market, lost money over the period.

While the team sold out of their Italian debt position ahead of the major market sell-off, they were still exposed as it became clear that the political situation was not going to be easily resolved, meaning the idea made a small loss over the quarter.

Other ideas to make noteworthy losses included a preference for the Swedish krona over the euro. The krona continued to hit new lows as the Riksbank extended a period of extremely low interest rates in the hope of stimulating inflation. Despite a brief recovery during May, the idea went backwards again in June as Sweden is expected to fare badly in the event of any trade war escalation.

On the upside, the team's 'Interest Rates – Yield Compression' idea was one of the biggest winners with difference in yields between long-term debt in the Eurozone and the UK narrowing over the period.

A number of currency ideas were also prominent among the positive contributors. For example, the recently added US dollar vs Taiwanese dollar idea performed well as trade concerns made the Asian region in general a laggard. In addition, a strong showing in US data and a relatively hawkish US Federal Reserve boosted the dollar.

This also carried through to the US dollar vs euro idea, which was among the top performers, with the US appearing to move forward while the European Central Bank was significantly more cautious following disappointing data. The Italian imbroglio also left its mark on the euro.

Among the equity ideas, Japanese, European and UK ideas performed well. The UK idea benefited from the advance in the local markets fuelled at least partially by sterling weakness but also by their heavy weighting in the oil and gas sector, which was boosted by rising oil prices. The nuanced beta exposure boosted the idea's returns.

Similarly, in Japan, despite a more muted advance in the markets, the structure of the idea meant the fund made steadily positive gains throughout the reporting period.

European idea made progress as related markets rose over the quarter and was helped by the performance of the relative value trade preferring French to German equities before removing this element from the idea.

Other noteworthy ideas to add to performance over the quarter were the short commodity idea, and the Australian interest rates idea. While Australia suffered in the backdraft of the trade tensions, yields there fell and the fund's short commodity idea was boosted by the strong showing of energy stocks during the quarter.

Fund Strategy

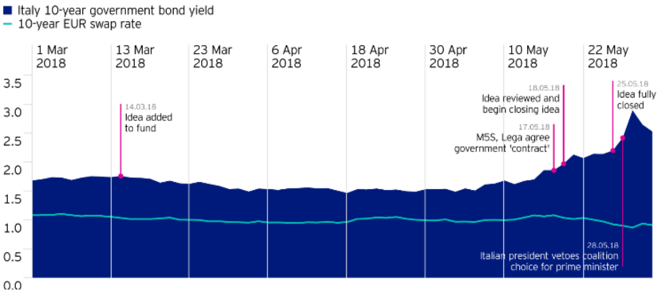
The team looks to review the portfolio in its entirety over a single quarter, testing each idea against its original premise and reacting to any sudden changes in the rationale behind an idea.

While there were no new ideas added to the fund during the quarter, there were two good examples of how the team remains flexible enough to react quickly to geopolitical events when necessary. This saw the removal of two ideas from the portfolio.

The first was our 'Currency – Russian Ruble vs US Dollar' idea, removed during April. This came following the enhanced sanctions announced against a number of Russian companies with links to the Russian president. The team believed the fundamentals underlying the Russian economy are some of the best in emerging markets, the carry in nominal and real terms is high and valuations are not necessarily a concern (especially after the recent falls). However, they deemed the uncertainties and political risks too high to continue to hold the idea.

The second was the removal of an 'Interest Rates – Italy vs Europe' idea. The original thesis of this idea was, in part, predicated on the expectation of further upgrades for Italy's government debt from the major ratings agencies. However, it became apparent that this would be highly unlikely given the outlook of a combined 5 Star and Lega coalition, which led to close the idea. The fund was able to exit before the biggest part of the sell-off in Italian assets towards the end of the month.

Figure 2. Yields on Italian government debt spiked



Source: Bloomberg as at 31 May 2018

There were a number of other changes to implementation of existing ideas. Some of the more significant ones included the removal of our preference for French equities vs German equities in an 'Equity – European Divergence' idea. This has performed reasonably well for the fund, but the team were unsure of the potential for greater returns going forward.

Invesco also added an options structure to an 'Equity – Selective Asia' idea. Here, they sold out-of-the-money options on the Hang Seng Chinese Enterprise index to partially fund our exposure. The team did this to achieve conditional beta exposure in lieu of more directional market beta.

Another change in the interest rates space saw the close out the Europe vs UK leg of an 'Interest Rates – Yield Compression' idea. This part of the idea had performed well for the fund as the difference in yields between the two long-dated interest rate swaps had narrowed.

Other adjustments included increasing the size of a number of currency ideas, such as 'Currency – US Dollar vs Taiwanese Dollar' and 'Currency – Chilean and Mexico vs Australia and New Zealand'.

Invesco also added some duration (interest rate sensitivity) to the US leg of our 'Interest Rates - Yield Compression' idea. Here, they believe the difference between US and UK long-term interest rates will narrow.

Outlook

Over the next two-to-three years, Invesco believe the global economy is going to experience oscillation between positive cyclical and negative structural drivers.

Growth should remain positive but momentum appears to be slowing as policy responses diverge. The manager is wary that a stronger US dollar and the possibility of trade disruption could reveal weaknesses in some emerging market economies. Additionally, the team struggle to see how real rates could move meaningfully higher without sustainable investment.

Invesco believe inflation is likely to remain contained by a lack of pricing power and the ongoing debt overhang. However, we could see glimpses of positive real wage growth but overall the global price of labour should remain low. It also appears that core bond yields are ultimately capped by structurally lower nominal economic growth.

Central banks appear to be in a phase of 'price discovery', which the team sees as only providing support for a gradual change in policy as structural influences continue to anchor interest rate expectations. They believe that as global liquidity grinds lower, this could cap the upside for credit growth and that, without a self-sustaining recovery and policy changes, political populism will remain prevalent.

Risk assets appear to us to require an increasingly selective and nuanced approach, particularly in emerging markets (EM). Regional drivers, such as the euro, US capital expenditure and EM local debt, have become more important. In this environment, credit markets look vulnerable and equity returns continue to be determined by earnings growth and income. For this reason, access to diversified alpha through our colleagues' equity and credit strategies is a useful source of potential additional value.

Finally, Invesco believe higher levels of volatility are here to stay and bouts of volatility are likely to be triggered by a broad range of sources. Fixed income and currency volatility remain sensitive to central bank action and investor behaviour (such as the search for yield) also has an influence.