Responsible Investment Leaders Balanced

Quarterly Investment Option Update

30/06/2018

Aim and Strategy

To provide a total return (income and capital growth) after costs and before tax, above the return from the relevant benchmarks of the underlying investments on a rolling 5 year basis. The portfolio invests in all asset classes, but with an emphasis on growth assets (shares and property).

With the exception of cash and listed property, the portfolio is managed using a Responsible Investment approach – an approach that focuses on investing in companies that contribute to a socially and environmentally sustainable world (see page for more information).

(Responsible investing/multi-manager investment approach)

Investment Option Performance

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

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1033AU
AMP Flexible Super - Retirement account	AMP1371AU
AMP Flexible Super - Super account	AMP1500AU
CUSTOM SUPER	AMP1033AU
Flexible Lifetime - Allocated Pension	AMP1022AU
Flexible Lifetime - Term Pension	AMP1043AU
Flexible Lifetime Investment	AMP1056AU
Flexible Lifetime Investment (Series 2)	AMP1434AU
METCASH SUPERANNUATION PLAN	AMP1033AU
Signature Super	AMP0977AU
Signature Super Allocated Pension	AMP1173AU

Investment Option Overview

Investment category	Diversified - Balanced
Suggested investment timeframe	5 years
Relative risk rating	Medium
Investment style	Responsible investing / Multi-manager

Asset Allocation	Benchmark	Range (%)
Australian Shares	30	20-40
Global Shares	27	15-53
Growth Alternatives	4	0-13
Australian Property	5	0-20
Global Property	4	
Property & Infrastructure - Australian Infrastructure	0	0
Global Infrastructure	0	0
Australian Bonds	13	0-20
Global Bonds	12	0-25
Cash	5	0-15

Top Ten Australian Securities	%
BHP Billiton Ltd	7.61
Westpac Banking Corp	6.37
National Australia Bank Ltd	6.33
COMMONWEALTH BANK AUST	5.71
CSL Ltd	4.93
Macquarie Group Ltd	4.42
Rio Tinto Ltd	3.22
Australia & New Zealand Banking Group Ltd	2.98
Woodside Petroleum Ltd	2.44
LendLease Group	2.12

Top Ten International Shares Exposure	%
APPLE INC	1.74
Microsoft Corp	1.74
TOTAL SA	1.71
PepsiCo Inc	1.57
Equinor ASA	1.46
Estee Lauder Cos Inc/The	1.39
Alphabet Inc	1.37
Unilever PLC	1.27
Mastercard Inc	1.18
Cigna Corp	1.16

Actual Allocation	%
International Equities-(UH)	32.52
Australian Equities	25.33
Fixed Interest	20.86
Cash	6.36
Direct Property	5.32
International Listed Property	3.58
Infrastructure	2.64
Emerging Markets	1.95
Alternative Assets Growth	1.44

Portfolio Summary

- The Fund produced a strong absolute return in the June quarter.
- Australian and international equites contributed to the absolute return, driven by strong performance in the Australian resources sector and earnings results in the US, respectively.
- We continue to prefer international equities to Australian equities and remain underweight fixed income.

Investment Option Commentary

The RIL Balanced Fund produced a positive absolute return in what was a mixed period for global equity markets. The Fund's performance in the June quarter was predominately driven by Bennelong's growth-oriented strategy, which benefited from strong outperformance from CSL, Reliance Worldwide Corporation and IDP Education following positive earnings announcements and positive sentiment from a falling Australian dollar. DNR also added value over the quarter thanks to a strong takeover bid for BWX. An overweight to Macquarie also added value, as it reported strong results with positive forward guidance. The Ausbil ESG Focus Fund underperformed over the quarter mainly due to their holing in Link Administration Holdings, which downgraded earnings after the Federal Budget made changes to how inactive superannuation member balances are dealt with. The AMPC ESG Index strategy detracted modestly.

The RIL International Share Fund underperformed the benchmark by 27 bps in Q2 2018, although it has still had a strong year to 30 June, now above its benchmark by 92bps. Over the quarter, the Fund's slight overweight to emerging markets detracted, along with the overweight to financials with-in emerging markets, largely due to the rising US dollar and concerns about a US/China trade war. Significant detractors included Singaporean bank DBS and pan-Asian insurer AIA.

Within the emerging markets allocation, Stewart Investors performed strongly as their quality growth approach provided positive absolute returns in a negative market. Overweights in Tata Consultancy Services and Vitasoy International Holdings were the main contributors to performance on the back of upgraded earnings. Stewart has had a strong year, earning back its underperformance experienced in 2017, when value significantly underperformed growth.

The Diversified Fixed Income portfolio performed roughly in line with its benchmark over the quarter. The outperformance of Australian government bond manager AMP Capital and Australian inflation-linked bonds manager Ardea was partially offset by a slight underperformance from RIL's international credit manager, AB.

RIL's global REIT exposure performed in line with its benchmark over the quarter. Real estate fundamentals remain relatively sound. Industrials are benefiting from positive sentiment thanks to e-commerce, while retail landlords are experiencing negative sentiment for the same reason. The direct property sector continued to perform well in Australia. Cap rates in office, retail and industrial continued to firm, driving valuations and capital returns. Office fundamentals remain strong in Sydney and Melbourne, with RIL's underlying investments, Investa Commercial Property Fund and the GPT Wholesale Office fund both experiencing strong returns over the quarter and the year. The Australian retail property sector remains challenged by weak sales growth, moderate rent reversion and increasing incentives to attract tenants.

Market commentary

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 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.

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.

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.

Outlook and positioning

Whilst trading conditions are likely to continue to exhibit volatility, we continue to believe that the outlook for equity markets remains positive, supported by healthy global growth and accommodative monetary policy. As such, we remain overweight to international equities, primarily through European holdings. European equity markets continue to be relatively good value compared with other developed markets and we believe they are positioned favourably for upside in the year ahead.

While global economic conditions appear favourable, we are seven years into a bull run, so seek protection where appropriate. We have maintained some options protection over US equities in case of market weakness.

The outlook for Australian equities is less optimistic on a relative basis. Soft consumer spending and a slowing housing cycle will likely keep growth below Reserve Bank of Australia (RBA) and Federal Government forecasts. Nevertheless, declining drag from lower mining investment, strong public infrastructure spending and improving conditions for trade should all help keep Australia out of recession for the time being.

For some time, our view has been that bond yields are not sustainable at current low levels. Domestically, record low wages growth, low underlying inflation, the impending slowdown in housing construction, risks around the consumer and the rise in the Australian dollar limit the risk of a rate hike in the near future. We believe the best estimate of future returns are current yields and with Australian and US 10-year bond yields at around 2.8% and 3.0% respectively, this does not offer appealing value. We remain underweight to the asset class, with a higher than normal cash weighting.

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What you need to know