Specialist Diversified Fixed Income

Quarterly Investment Option Update

30 June 2018

Aim and Strategy

To provide a total return (income and capital growth) after costs and before taxes, above the performance of 60% of the Bloomberg AusBond Composite Bond All Maturities Index and 40% of the Barclays Global Aggregate Bond Index (Hedged to AUD) benchmarks, on a rolling 3 year basis.

The strategy provides exposure to a diversified portfolio of Australian and international fixed income securities including government securities, government-related securities, corporate securities, asset-backed securities, cash, derivatives and foreign currency. The strategy will gain fixed income exposure by primarily investing in a range of actively managed strategys which are managed by AMP Capital. These underlying strategys managed by AMP Capital will diversify manager risk across a range of investment managers by using a multi-manager approach. Exposures are to managers who demonstrate competitive advantages, within the various investment styles that are used when investing in the Australian and international fixed income markets.

Investment Option Performance

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

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1959AU
AMP Flexible Super - Retirement account	AMP1966AU
AMP Flexible Super - Super account	AMP1973AU
CUSTOM SUPER	AMP1959AU
Flexible Lifetime - Allocated Pension	AMP1952AU
Flexible Lifetime Investment (Series 2)	AMP1991AU
Signature Super	AMP1975AU
Signature Super Allocated Pension	AMP1977AU

Asset Allocation	Benchmark	Range (%)
Australian Bonds	60	40-80
Global Bonds	40	20-60
Cash	0	0-10

Actual Allocation	%
International Fixed Interest	63.03
Australian Fixed Interest	36.06
Cash	0.91

Investment Option Overview

Investment category	Fixed Interest
Suggested investment timeframe	2 -3 years
Relative risk rating	Medium
Investment style	Multi - Manager

Portfolio Summary

> Global government bond yields were somewhat mixed in the June quarter
> The Fund posted a positive return for the quarter but lagged its benchmark. Two of the four underlying managers exceeded their benchmarks
> Very low, though rising sovereign bond yields continue to point to low medium-term returns.

Investment Option Commentary

The Fund posted a positive return for the June quarter but lagged its benchmark. Three of the four underlying managers delivered positive absolute outcomes, with AMP Capital and Schroders also outperforming their respective benchmarks.

Within the Australian bonds sector, AMP Capital produced a positive return and outperformed its benchmark. Performance benefited from interest rate management, reflecting the contributions from duration management and yield curve positioning. Credit positioning detracted, as rising credit spreads more than offset the positive impact of the excess carry earned on credit securities held. At the sector level, exposures to semi-governments, utilities and securitised product were the main contributors to performance. Exposures to banks – subordinate, diversified financials and an underweight to supra-nationals were the main detractors.

AB delivered a negative absolute return and lagged its cash benchmark over the quarter. Sector selection was the primary driver of negative performance, with exposures to investment-grade and high-yield corporates in the eurozone, investment-grade corporates and sovereign bonds within emerging-markets (EM), and corporate bonds in the US the main detractors. Currency decisions also detracted. Exposure to commercial mortgage-backed securities in the US added value. Losses from overweights to the Argentine peso and the Brazilian real outweighed gains from an underweight to the Taiwan dollar.

Schroders posted a positive return for the quarter and outperformed its benchmark. The manager is still positioned with a lower exposure to interest rates relative to the benchmark. This position, along with inflation protection, were the main drivers of performance, while credit positions slightly detracted from overall performance.

PIMCO produced a positive return but lagged its benchmark over the quarter. Long exposure to the Argentine peso relative to the US dollar detracted as the former depreciated on the back of worsening inflation dynamics. Long positioning in the Turkish lira also detracted due to concerns regarding central bank independence. The overweight to 10 year US duration contributed as rates rallied amid political turmoil in Italy. An underweight duration position in Italy also contributed as yields rose sharply, whereas an underweight duration position in the UK modestly detracted as yields declined due to soft economic data and the central bank's decision to leave rates unchanged.

Market commentary

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

Very low, though rising, sovereign bond yields point to low to medium-term returns. The abatement of deflationary pressures, as commodity prices trend up, the gradual reduction in spare capacity and a shift in policy focus from monetary to fiscal stimulus indicate yields are likely to steadily trend higher. Emerging market economies have seen some outflows.

Australian yields continue to trade at a premium to those available in Japan and Europe, making Australian sovereign fixed income and corporate credit relatively attractive from an international and yield perspective. The Reserve Bank of Australia has a short-term neutral policy in regards to the timing and direction of interest rate changes. However, conflicting economic pressures and a low inflationary environment mean it is too early to be considering interest rate hikes. Housing market and household debt levels continue to be an area for concern.

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