Macquarie Income Opportunities

Quarterly Investment Option Update

30 September 2018

Aim and Strategy

Aims to outperform the Bloomberg AusBond Bank Bill Index over the medium term (before fees). It aims to provide higher income returns than traditional cash investments at all stages of interest rate and economic cycles. This strategy provides exposure to a wide range of Australian credit-based securities (predominantly floating and fixed rate corporate bonds, and asset-backed securities) and cash. It may also provide exposure to global investment grade credit securities, global high yield credit securities, emerging market debt, hybrid securities and a range of other credit opportunities when they are expected to outperform and reduce exposure to these sectors when they are expected to underperform. This strategy can hold securities either directly or indirectly through investments managed by a member of the Macquarie Group and external managers. This strategy may also be exposed to derivatives to implement its investment strategy or to hedge risk. This strategy is generally hedged to Australian dollars.

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au

Investment Option Overview

Investment category	Aust. Fixed Interest
Suggested investment timeframe	3 years
Relative risk rating	5 / Medium to High
Investment style	Income

Asset Allocation	Benchmark (%)	Actual (%)
Investment Grade	20-100	95.0
Hybrids	0-10	0.1
Global High Yield	0-15	0.0
Emerging Market Debt	0-15	0.0
Credit Opportunities	0-20	4.9

Sector Allocation	%
Banks	26.1
Residential mortgage	10.5
REITs	6.1
Non-agency CMBS	4.6
Transportation	4.3

Top Holdings	%
Westpac	1.8
NAB	0.8
Bank of America Corporation	0.7
Sun Group Finance	0.6
Westpac	0.6
Medallion	0.6
AGL	0.6
CBA	0.6
Westpac	0.6
AMP	0.6

Regional Allocation	%
Australia	55.6
United States	22.8
UK	3.1
Europe Ex UK	7.5
Other	11.0

Investment Option Commentary

The Fund outperformed the benchmark over the quarter. Investment grade credit sector allocations were the most significant drivers of the result, with security selection also adding value. Holdings of Australian major bank subordinated debt (which has been very well supported despite the weak equity market performance of the banks) was a large positive contributor, as were holdings of longer dated (>10yr to maturity) offshore corporate and financial issuers, as credit curves flattened. Duration positioning detracted slightly, with a negative from the overweight to duration somewhat offset by positive regional selection, minimising the overall drawdown.

Market commentary

The September quarter continued the general themes of this year so far: volatility and divergence between the US and the rest of the world. US data remained robust, trade negotiations moved forward in some cases (but notably not between China and the US), and emerging markets in particular continued to be volatile and weak. The end of the quarter brought more supportive sentiment, with rebounds in equities and several emerging markets, though the underlying drivers of tighter USD liquidity and growth questions remain an issue.

Economic data continues to be strong in the US, shaking off expectations that the country would converge toward a global economy that is showing signs of decelerating. In contrast, economic data from other regions generally showed a deceleration: Chinese retail sales, for example, continued the path lower set so far this year, and European PMI data remained well below late 2017 highs.

Trade policy remained a key concern. The US announced an initial 10% tariff on a further $US200bn of Chinese goods, and China in turn announced tariffs on a further $US60bn of imports. There appears little actual progress in trade negotiations between the countries, suggesting that the current impasse may mark the beginning of a much more long-term period of tension between the two powers. The US did sign an updated USMCA agreement with Canada and Mexico and indicated progress on tariffs and trade with the EU, another key ally that it had singled out on trade. The progress with allies likely frees up the US to be more belligerent in the trade stand-off with China.

China continued to gradually ease monetary and fiscal policy through the quarter, in response to stress signals in the economy as equity markets and the currency fell. The country had been driving a long-term deleveraging path after years of rapid debt growth, but tight financial conditions have been impacting growth indicators and increasing the number of corporate defaults in the local bond market. The People's Bank of China cut the bank reserve requirement ratio again early in July and injected a record amount of liquidity via its medium-term lending facility (MLF), particularly targeted at smaller / lower quality borrowers. The moves signal an ongoing willingness of the Chinese leadership to support the domestic economy but set against clear signs of an overall slowdown.

Emerging markets renewed weakness mid-quarter, as concerns centred around Turkey drove a degree of contagion in the space. Turkey's issues centred around access to USD liquidity, US sanctions, and an unwillingness to hike rates significantly. And while the US sanctions were reasonably unique to the country, other factors (particularly tighter USD financial conditions) are becoming increasingly common themes in market sell-offs this year. Into the end of the quarter rate hikes from Turkey and IMF engagement from Argentina helped to calm the worst portions of the EM market, thought the underlying fault lines still remain.

Outlook

Recent months have brought negative market movements, though mostly these have remained isolated to specific markets. Strong underlying growth in the US is providing a fundamental backstop to equity and credit market pricing, and while there remain significant risks (trade policy, political tensions), it does not appear there is a significant 'real economy' catalyst to undo the current uptick in US growth. However, our concerns remain centred around financial factors, with interest rates rising and higher USD likely to continue to cause abrasion in selected markets. The backdrop of withdrawing central bank liquidity and support is a key common factor and will be an underlying influence for the foreseeable future.

Macquarie continue to believe there are opportunities to continue to participate in market performance (though somewhat reduced, given valuations on offer), with an eye to gradually managing risk levels downward as spreads tighten further. For now, solid growth momentum and corporate earnings provide a robust basis for participating in credit market performance.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1525AU
AMP Flexible Super - Retirement account	AMP1585AU
AMP Flexible Super - Super account	AMP1573AU
CustomSuper	AMP1525AU
Flexible Lifetime - Allocated Pension	AMP1537AU
Flexible Lifetime - Term Pension	AMP2018AU
Flexible Lifetime Investment (Series 2)	AMP2038AU
SignatureSuper	AMP1549AU
SignatureSuper Allocated Pension	AMP1561AU

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