# Schroder Fixed Income

Quarterly Investment Option Update

30 September 2018

## Aim and Strategy

To obtain exposure to a range of domestic and international fixed income assets with the objective of outperforming the Bloomberg AusBond Composite 0+Yr Index, whilst delivering stable absolute returns over time. The option adopts a Core-Plus investment approach whereby a core portfolio comprising of Australian investment grade bonds (including government, semi-government, supranational and corporate bonds) is complemented by investments in a diverse range of global and domestic fixed income securities. The targeted result is a defensive strategy which is broadly diversified with low correlation to equity markets.

## Investment Option Performance

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

## Investment Option Overview

| | |
|---|---|
| **Investment category** | Fixed Interest |
| **Suggested investment timeframe** | 3 to 5 years |
| **Relative risk rating** | Low to medium |
| **Investment style** | Core |

| Asset Allocation | Benchmark (%) | Actual (%) |
|---|---|---|
| Aust. Investment Grade | 99.99% | 80.31% |
| Cash & Equivalents | 0% | 16.68% |
| Global Investment Grade | 0% | 4.03% |
| Australian High Yield | 0.01% | 3.36% |
| Global High Yield | 0% | -4.38% |

| Sector Allocation | % |
|---|---|
| Cash & Equivalents | 16.68% |
| Government | 26.33% |
| Semi-Government | 17.36% |
| Supranational/Sovereigns | 18.64% |
| Corporates | 12.51% |
| Subordinated | 3.14% |
| Collateralised | 5.35% |

| Top Holdings | % |
|---|---|
| Us treasury infl (tii) .25% 15 jan 2025 | 4.051% |
| Australian government sr 133 5.5% 21 apr 2023 | 3.732% |
| Australian government sr 137 2.75% 21 apr 2024 | 3.497% |
| Queensland treasury corp sr regs 3.25% 21 jul 2026 | 2.690% |
| Australian government sr regs 3.75% 21 apr 2037 | 2.441% |
| Intl bk recon & develop sr mtn 2.8% 13 jan 2021 | 2.238% |
| Australian govt sr 140 4.5% 21 apr 2033 | 2.053% |
| Australian government sr 142 4.25% 21 apr 2026 | 1.950% |
| Australian government sr 139 3.25% 21 apr 2025 | 1.773% |
| Queensland treasury corp sr regs 3.25% 21 jul 2026 | 1.746% |

| Quality Allocation | % |
|---|---|
| AAA | 53.65 |
| AA | 18.86 |
| A | 3.19 |
| BBB | 11.23 |
| Below BBB | -3.56 |
| Cash & Equivalents | 16.61 |
| Not Rated | 0.01 |

## Portfolio Summary

- Trade tensions and stronger US fundamentals were the main issues impacting financial markets in the month of September, and the quarter as a whole
- Altogether the Fund Manager's cautious positioning leaves us defensively placed, appropriate against a backdrop of rising rates, higher inflation, and growth risk beyond. Such positioning also allows the flexibility to respond to opportunities as they arise, and monitoring developments closely with a view to setting up the portfolios more constructively for future returns.

## Market commentary

Trade tensions and stronger US fundamentals were the main issues impacting financial markets in the month of September, and the quarter as a whole. Relations between the US and China continued to be contentious with the US implementing a 10% tariff on USD200bn of Chinese goods, which is also slated to rise to 25% in the start of the new year. China responded by implementing its own tariffs, covering $60bn of US imports with tariffs ranging from 5% to 10%, and threatening to increase them further if the US follows through with its increase in January. A strong US economy and signs that wages growth is beginning to rise, saw markets that have been skeptical of the US Federal Reserve's ability to continue to raise cash rates, move to price in cash rates continuing to rise in the near future.

Government bond yields in major markets were higher over both the month and the quarter, most noticeably in the US, where 10-year yields increased by 0.20% in September to end the month at 3.06%. Australian bonds followed the global trend ending the month 0.15% higher at 2.67%. Credit spreads, particularly in high yield and emerging markets, tightened over the month.

## Outlook

Ongoing robust economic activity in the US – in absolute terms, and relative to other countries – continues to define the market environment in 2018. It's driving US rates and the USD higher, and outperformance of US equities and credit over non-US peers.

On the one hand the Fund Manager's expectations have been playing out nicely – strong US growth is forcing the Fed, worried that inflation is already at target and the economy is turbo-charged with tax cuts, to tighten by more than markets have expected. On the other, it is also expected concerns around both higher rates/inflation and trade war escalation would unhinge risky US assets, which has not occurred, yet.

Most likely, investors have responded more to the current growth story than to looming inflation risk and slowing growth ahead – making US equities and credit even more vulnerable to extended valuations when these issues do become front-of-mind. To date, the rise in US inflation has only been gradual, and not strong enough to push the Fed to accelerate from its gradual tightening path. Rate rises have not yet been hurting US companies, flushed with strong operating profitability and repatriation windfalls, and have mostly been creating trouble abroad, with USD funding drying up for vulnerable borrowers. Similarly, markets seemingly believe Trump's 'win' narrative on trade wars – against the evidence that protectionism is bad for all – ignoring the impacts on the US but punishing other countries. Goldilocks apparently lives on in the US.

Across the portfolios, the Fund Manager has been running cautious positioning for some time now, involving shorter duration than the benchmark (currently about 0.8 years shorter), exposure to inflation linked bonds, and limited credit risk. Despite persistent underperformance, and hence improved relative valuation, the US Treasury market remains the preferred underweight given the upside cyclical outlook for higher interest rates. In Australia and Europe (especially), bonds are more expensive, but the cyclical pressure is weaker, hence the Fund Manager are also short but by a lesser amount. In each case the portfolio is running small yield curve flattening positions to capture eventual policy tightening cycles. The portfolio also has in place explicit inflation protection in both the US and Australia via inflation-linked bonds.

## Availability

| Product name | APIR |
|---|---|
| AMP Flexible Lifetime Super | AMP1288AU |
| AMP Flexible Super - Retirement account | AMP1376AU |
| AMP Flexible Super - Super account | AMP1505AU |
| CustomSuper | AMP1288AU |
| Flexible Lifetime - Allocated Pension | AMP1295AU |
| Flexible Lifetime Investment (Series 2) | AMP2040AU |
| SignatureSuper | AMP1302AU |
| SignatureSuper Allocated Pension | AMP1309AU |

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