Blackrock Global Bond

Quarterly Investment Option Update

31 December 2018

Aim and Strategy

To generate capital and income return for investors seeking exposure to international fixed income markets, including Australia. The option aims to outperform the Bloomberg Barclays Global Aggregate Index (Australian dollar hedged) over rolling three-year periods. The option invests predominantly in international debt securities and foreign currency exposures. These include a broad universe of investment instruments, including fixed interest securities, mortgage securities, asset-backed securities, derivatives, repurchase agreements, stock lending and units in pooled investment funds.

Investment Option Performance

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

Investment Option Overview

Investment category	Global Fixed Interest
Suggested investment timeframe	2 years
Relative risk rating	4 / Medium
Investment style	Core

Asset Allocation	Benchmark (%)	Actual (%)
Australian/ International Fixed Interest and Cash	0-100	100

Regional Allocation	%
United States	34.7%
Japan	16.3%
United Kingdom	9.6%
Germany	6.8%
France	5.8%
Australia	3.2%
Other	23.6%

Sector Allocation	%
Treasuries	50.2%
Government Related	12.3%
Corporates	17.6%
Securitized	20.5%
FX	-4.2%
Cash Securities	3.6%

Investment Option Commentary

The fund’s overweight to short-maturity treasuries was the main detractor as short-term US rates continued to move up during the month. BlackRock still have conviction in this position. BlackRock believes the likelihood of the Fed being more hawkish than what the market is currently expecting is low. As a result, BlackRock favour short-dated treasuries for its attractive carry and the relatively limited downside risk.

In the eurozone, the fund’s overweight to Italy detracted from performance, offsetting the positive returns from the underweight to Germany bunds. To BlackRock’s surprise, the Italian government set its budget deficit targets over the next few years to be higher than required by the European Commission, which drove a sell-off in late September. BlackRock have been trimming its positions since the news to reassess the investment thesis.

Market commentary

The yield curve flattened over the quarter, with the spread between 2-year and 10-year bonds narrowing by 4bps. The Fed’s fourth rate hike in the year came in December against the unusual backdrop of the S&P 500 having dropped nearly 10% since the previous meeting in early November, and US equities heading towards their worst annual performance since the financial crisis. The median of the Fed’s “dot plot” also showed policymakers had lowered their expectations of the number of rate moves in 2019 from three to two. However, the overall message was not as dovish as investors had hoped and equity markets tumbled further.

The yields on 10-year government bonds fell broadly across the eurozone in the fourth quarter in response to signs that growth was slowing across the region and globally, and as comments from the US Federal Reserve became more dovish. The yield on the benchmark 10- year German bund fell 23 bps to 0.24%. Germany remains a key concern, with activity falling sharply in the region’s largest economy, and near-stagnation in manufacturing output.

Japanese government bonds rallied over the quarter, led by long-dated bonds, as softer earnings, escalating trade tensions, political uncertainties and signs of weakening global growth drove demand for safe-haven assets. The benchmark 10-year yield briefly turned negative in late December – for the first time since September 2017 – before closing just in positive territory, a fall over the quarter of 13 bps.

Gilt yields rallied lower over the quarter, led by bonds with maturities of six to 10 years, as escalating trade tensions, political uncertainties and signs of weakening growth turned a sell-off at the start of the quarter into a strong rally to the end of the year. This saw the 5-year yield fall 27 basis points (bps) to 0.90%, the 10-year yield fall 29 bps to 1.28% and the 30-year yield fall 10 bps to 1.82%. A collapse in oil prices over the quarter pared market expectations of longer-term inflation, and the 30-year breakeven rate fell 7 bps to 3.34%.

Outlook

BlackRock expect global growth to slow next year and see U.S. growth stabilizing at a much higher level than other regions, even as the effects of 2018’s fiscal stimulus fade. Markets are vulnerable to fears that a downturn is near, even as BlackRock sees the actual risk of a U.S. recession as low in 2019. Global earnings growth is also set to moderate in 2019, tracking the more subdued growth outlook.

The fund manager sees the process of tighter financial conditions pushing yields up (and valuations down) set to ease in 2019. Why? U.S. rates are en route to neutral — the level at which monetary policy neither stimulates nor restricts growth. BlackRock estimate the current neutral rate at around 3.5%, right in the middle of the 2.5%-to-3.5% long-term range identified by the Fed and they expect the Fed to pause its quarterly pace of hikes amid slowing growth and inflation in 2019.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1102AU
AMP Flexible Super - Retirement account	AMP1338AU
AMP Flexible Super - Super account	AMP1467AU
CustomSuper	AMP1102AU
Flexible Lifetime - Allocated Pension	AMP1107AU
Flexible Lifetime - Term Pension	AMP1111AU
Flexible Lifetime Investment	AMP1116AU
Flexible Lifetime Investment (Series 2)	AMP1403AU
SignatureSuper	AMP1113AU
SignatureSuper Allocated Pension	AMP1142AU

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