Blackrock Scientific Hedged International Alpha Tilts

Quarterly Investment Option Update

31 December 2018

Aim and Strategy

To provide returns before fees that exceed the MSCI World ex-Australia Net TR Index (hedged in AUD) by 2.5% to 3.0% pa over rolling three-year periods, while maintaining a similar level of investment risk to the index. The strategy utilises a combination of active stock selection strategies across international developed stock markets that aim for the best trade-off between returns, risk and costs.

Investment risk is managed by diversifying across many regions and countries and by holding the shares of a large number of companies within each industry. A passive currency hedge is used to convert the currency exposure of the Index back to Australian dollars. This type of hedging strategy involves the forward sale of a set of currencies in amounts that correspond to the beginning of period value of the international assets in the portfolio. The hedge is then reset periodically or as required, to account for any changes in the value of the international assets in the portfolio. When derivative positions are established, they will always be backed by cash holdings and/or underlying assets. Derivative securities will not be used to leverage exposures.

Investment Option Performance

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

Investment Option Overview

Investment category	Global Shares
Suggested investment timeframe	5 years
Relative risk rating	6 / High
Investment style	Core (Hedged)

Asset Allocation	Benchmark (%)	Actual (%)
Global Shares	99-100	99.3
Cash	0-1	0.7

Regional Allocation	%
United States	61.16
Japan	9.19
United Kingdom	4.68
Germany	4.04
Canada	3.82
Switzerland	3.22
France	3.02
Netherlands	2.54
Italy	1.53
Ireland	1.45
Norway	0.87
Spain	0.80
Cash	0.72
Denmark	0.64
Hong Kong	0.54
Belgium	0.42
Singapore	0.39

Sector Allocation	%
Communication Services	7.28
Consumer Discretionary	9.84
Consumer Staples	9.73
Energy	5.50
Financials	16.28
Health Care	13.65
Industrials	12.36
Information Technology	16.09
Materials	2.71
Real Estate	2.96
Utilities	2.88
None	0.72

Top Holdings	%
APPLE INC	2.07
MICROSOFT CORP	2.02
AMAZON COM INC	1.47
JOHNSON & JOHNSON	1.13
ROCHE HOLDING PAR AG	1.05
UNITEDHEALTH GROUP INC	1.04
FACEBOOK CLASS A INC	0.98
ORACLE CORP	0.95
TORONTO DOMINION	0.95
CITIGROUP INC	0.93
APPLE INC	2.07
MICROSOFT CORP	2.02

Portfolio Summary

The international stock selection strategy finished the quarter lower as nearly all insight groups detracted, the exception being a very small gain from Valuation insights. Cross Border Thematics, and the trending insights (Momentum and Sentiment) fared worse.

Investment Option Commentary

The majority of underperformance was observed in North America (poor Cross Border Thematics and Sentiment), and Europe (Quality), whilst the Asian regions provided small outperformance (Japanese Sentiment notably positive). Sectors that detracted included North American Financials, especially through overweight in banks, and overweight retailers in Consumer Discretionary and underweights in Consumer Staples, whilst favourable positioning in Information Technology contributed. Overweight in European autos led to the Consumer Discretionary sector detracting, though German and Nordic telecoms helped the Communications sector add. Overall the best performing sectors were Communications and Information Technology, with Consumer Discretionary and Financials the worst.

Positive contributors to performance included an underweight position in Nvidia and an overweight position in Koninklijke KPN. Nvidia – The US chipmaker was hit by the cryptocurrency mining bust which led to excess inventories and weaker pricing, as well as performance issues on its latest product whilst its major competitor continues to win market share. The underweight position was driven by the majority of insights being negative, especially Cross-Border Thematics.

Market Commentary

The MSCI World Ex Australia Index declined 11.10% in unhedged AUD terms and 13.60% in fully hedged to AUD terms over the fourth quarter of 2018. The last three months of the year proved to be a challenging period for financial markets which showed a sea of red across most international share markets. Signs of tightening financial conditions, ongoing global trade tensions and weaker Chinese economic activity data raised concerns regarding the outlook for global growth. The sell-off in equities was widespread and pushed the annual return for most share markets around the world well into negative territory, making 2018 the worst year for global equities since 2008. Equity volatility measures such as the VIX increased significantly over the quarter and investor sentiment plummeted. The general risk-off tone led to a rotation into more defensive sectors and fixed income assets outperforming equities.

In the US, the S&P 500 index fell 14% in the fourth quarter of 2018 leading to a negative annual return of 6.5%. Corporate earnings releases over the quarter were neither outstanding nor terribly bad, but investors focused on some US technology giants which reported lower-than-expected earnings. Equity indices in other countries also delivered significant negative returns over the quarter. Part of the widespread sell-off was due to jitters about an intensification of the US-China trade conflict. Many investors believe that trade protectionism is likely to have knock-on effects on broader trade dynamics outside of the US and China, as it feeds through the highly globally integrated corporate value chains. In addition, economic data coming out of the Eurozone painted a negative picture on the European economy.

Emerging markets followed a similar trajectory to their developed market counterparts, with the MSCI Emerging Markets Index declining approximately 9% in the last quarter of 2018. China's Shanghai Composite Index fell over 11% which makes it one of the world's worst performing equity benchmarks this year (down over 25%). Japanese stocks were caught in the global market rout, with the Nikkei falling 16.8% over the quarter. The Nikkei dropped below 20,000 in December (for the first time since September 2017) which marked a 21% decline since its high in early October – pushing the index into what is technically known a bear market.

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
Flexible Lifetime Investment	AMP0839AU
Flexible Lifetime Investment (Series 2)	AMP1400AU
AMP Flexible Lifetime Super	AMP0663AU
AMP Flexible Super - Retirement account	AMP1335AU
AMP Flexible Super - Super account	AMP1464AU
CustomSuper	AMP0663AU
Flexible Lifetime - Allocated Pension	AMP0621AU
Flexible Lifetime - Term Pension	AMP0910AU
SignatureSuper	AMP0787AU
SignatureSuper Allocated Pension	AMP1139AU

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