

Schroder Fixed Income

Quarterly Investment Option Update

31 December 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	83.10
Cash & Equivalents	0	12.77
Global Investment Grade	0	4.19
Australian High Yield	0.01	3.21
Global High Yield	0	-3.27

Sector Allocation	%
Cash & Equivalents	12.77
Government	25.69
Semi-Government	18.01
Supranational/Sovereigns	19.03
Corporates	16.54
Subordinated	2.99
Collateralised	4.96

Top Holdings	%
US TREASURY INFL (TII) 0.2500 15/01/2025	4.176
AUSTRALIA GOVERNMENT BOND 5.5000 21/04/2023 SERIES 133	3.713
AUSTRALIAN GOVERNMENT 2.7500 21/04/2024 SERIES 137	3.286
QUEENSLAND TREASURY CORPORATION 3.2500 21/07/2026 SERIES REGS	2.768
AUSTRALIAN GOVERNMENT 4.2500 21/04/2026 SERIES 142	2.568
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT 2.8000	2.258
AUSTRALIAN GOVERNMENT 3.7500 21/04/2037 SERIES REGS	1.902
AUSTRALIAN GOVERNMENT 3.2500 21/04/2025 SERIES 139	1.793
NEW SOUTH WALES TREASURY CORPORATION INDEX LINK 2.7500 20/11/2025 SERIES CIB1	1.755
AUSTRALIA (GOVERNMENT OF) 4.7500 21/04/2027 SERIES 136	1.737

Quality Allocation	%
AAA	53.62
AA	18.92
A	5.12
BBB	12.19
Below BBB	-2.49
Cash & Equivalents	12.66
Not Rated	0.01

Investment Option Commentary

Having started the quarter with duration about 1 year shorter than benchmark, the Manager added back considerably to be only 0.1 years shorter at year end. The buying was in both Australia and particularly the US, mostly over the month of November. This buying coincided with US yields in the upper part of their range (ie decent if not outstanding value), the downgrade in their cycle view, and some strong sentiment and momentum indicators. This leaves them a little overweight Australian interest rate risk, neutral in the US and short in Europe, where value remains poorest. Although they hold a much-reduced aggregate duration position versus the benchmark now, in addition to the country positions, they have largely kept in place both yield curve flatteners and inflation-linked exposures and look for moderate repricing in each. They still expect to be adding considerably more duration to the portfolio on opportunity through 2019, as the US economic cycle ages further.

Market commentary

Global equity markets fell sharply in December as concerns over the global growth outlook and the Federal Reserve continuing to raise short term rates both weighed on market confidence. The Fed's decision to increase short term rates by 0.25% in December, drew the ire of president Trump who discussed the possibility of firing the Fed Chair Powell. Globally, oil prices continued their decline in December, with WTI oil falling by an additional 11% in the month, thereby further dampening the shorter term outlook for inflation. The Trade War between the US and China resulted in weaker Chinese manufacturing activity and also weaker US factory activity. In the UK, Brexit continues to loom as an issue as Theresa May pushed back a vote on a Brexit deal within the UK parliament, while May also survived a vote of no confidence on her own leadership. Domestically, the Q3 GDP was relatively weak, growing by only 0.3% over the quarter, while property prices continued their downward trend, being led by weakness in the Sydney and Melbourne markets.

Global equities fell by approximately 8% in December and 13.3% over the quarter in local currency terms, with the US and Japan experiencing the sharpest declines over both the month and the quarter. The Australian market which underperformed in November, fared better through December and was only down by -0.1%, however over the quarter it still dropped 8%. Government bond yields also fell globally amidst the volatility, with US 2 and 10 year yields both moving lower during the month by 0.30%, to end it at 2.49% and 2.68% respectively. Australian 10 year yields moved 0.27% lower to end the month at 2.32%, while German and Japanese yields also fell by 0.07% and 0.09% respectively. Global Bond Yields were also lower through the quarter across all major markets, with the largest fall coming through in US 2 year yields. Credit markets continued to weaken as spreads widened across the board, with weakest sector being High Yield where spreads widened by roughly 100bps during the month and 200 bps over the quarter.

Outlook

Having been startled by the Fed's apparent hawkishness in early October, markets now assign a small chance of the Fed easing in 2019. This abrupt turnaround in expectations has been driven by concern about the pace and magnitude of US growth deceleration, given unresolved trade tension between the US and China and the rapid tightening in financial conditions courtesy of market gyrations. Helped by a falling oil price, markets have quickly shifted from worrying about upside inflation to worrying about downside growth.

Beyond the US, the global economy has broadly been weakening for some time. However, the Manager does not think the economic cycle is over yet. Their recession indicators still put the most likely timing for the start of a possible US recession 12-18 months away, though this has become more probable. They believe they have clearly seen the US growth peak, and they are in the volatile late stage of the cycle.

The Manager's view has evolved over several months. They have downshifted their view on the US economy because of the impact of trade wars and feedback from tighter financial conditions, impacting manufacturing and housing in particular. Yet despite the deceleration, the US economy remains robust and still likely to generate above potential growth over the course of 2019. They have similarly downshifted their inflation view, though still expect core inflation to pick back up above 2% driven by a tight labour market. The Fed is likely to pause tightening to review the unfolding data, but could well deliver further modest tightening.

The near-term set up for markets looks somewhat positive after the recent washout. It's unlikely to get a strong growth reacceleration, but more attractive risky asset valuations and a possible dovish shift by central banks should provide support. Whereas previously the Manager was looking for higher bond yields alongside tighter policy to unhinge risky assets, now the opportunity looks to be in selectively adding to assets that have underperformed.

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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