

# Future Directions Australian Bond

Quarterly Investment Option Update

31 March 2019

## Aim and Strategy

To provide a total return (income and capital growth) after costs and before tax, above the return from the benchmark over a rolling three-year basis. The portfolio invests in short and long-term fixed interest securities including inflation linked bonds, government, semi-government, bank, corporate and asset-backed securities, derivatives and currency. The portfolio may also have exposure to international securities in both developed and emerging markets. In normal circumstances the portfolio's international investments are fully hedged back to Australian dollars. The benchmark is a combination of 85% Bloomberg AusBond Government 0+ Year Index and 15% Bloomberg AusBond Inflation Government 0+ Year Index.

## Investment Option Performance

To view the latest investment performances please visit [www.amp.com.au](http://www.amp.com.au)

## Investment Option Overview

|                                       |                           |
|---------------------------------------|---------------------------|
| <b>Investment category</b>            | Australian Fixed Interest |
| <b>Suggested investment timeframe</b> | 2 years                   |
| <b>Relative risk rating</b>           | Low to Medium             |
| <b>Investment style</b>               | Multi-Manager             |

| Asset Allocation          | Benchmark (%) |
|---------------------------|---------------|
| Australian fixed interest | 100           |
| Cash                      | 0             |

| Actual Allocation            | %     |
|------------------------------|-------|
| Australian fixed interest    | 85.59 |
| International fixed interest | 3.97  |
| Cash                         | 10.44 |

## Portfolio Summary

- The Fund produced a strong return over the March quarter and outperformed its benchmark.
- All asset classes delivered positive returns as markets rallied.
- Underlying manager engagement included: talking to Australian companies as they work through the implications of the Modern Slavery Act on their businesses; working with Australian financial institutions dealing with the aftermath of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry; continuing to address climate change and plastic pollution, including investing in the first 'green bond' issuance in the telecommunications sector, which will finance projects devoted to energy efficiency; and focusing on the misuse of antibiotics and the rise of treatment-resistant bacterial and fungal diseases posing a direct threat to human health.

## Fund Performance

The Fund posted a positive return (before fees) in the March quarter and outperformed the benchmark. The largest component of the portfolio, held in conventional government bonds and managed by **AMP Capital**, outperformed its benchmark, with the smaller inflation-linked component, managed by **Ardea**, also outperforming its respective benchmark during the period. Each underlying manager generated positive absolute performance. **AMP Capital's** interest rate strategies were the main driver of performance during the period, aided by carry, whilst currency strategies were neutral overall. The portfolio's paid US inflation swap positions added value overall, particularly during January and February. However, the UK positions and short euro durations positions were mixed as Brexit concerns flared, whilst the global bond rally impacted on some Asian steepening positions such as Korea in the latter half of the quarter, with some positions being trimmed during the month of March. Inflation-linked bond fund manager **Ardea's** relative performance benefited from an overweight to volatility strategies in Australia during the period. Additional outperformance was achieved by the portfolio's overweight to physical bonds, which was hedged with an offsetting position in government bond futures to neutralise the increase in duration that would otherwise result from an overweight to physical bonds. A curve flattening position of overweight to 10-year interest rate swaps against an underweight to 3-year interest rate swaps also contributed to returns. Conversely the portfolio's positioning in breakeven inflation rates detracted from performance.

Ardea oversees an Australian inflation-linked bond portfolio. The exposure to inflation-linked fixed income provides very defensive characteristics and includes an important hedge against inflation. The Ardea strategy invests mainly in inflation linked bonds, but can also invest in nominal government and semi-government bonds, inflation derivatives, interest rate derivatives, and bank bills. Ardea is a longer term, fundamentally driven, value investor with a focused approach across three main strategies – inflation, interest rates and arbitrage. The highly experienced team has worked together for a number of years, previously at Credit Suisse Asset Management before forming Ardea in 2008. Ardea is majority owned by its investment team.

## Market Review

Early in the March quarter, Australian government bonds largely mirrored their overseas counterparts as risk assets rebounded, with the domestic rally also reflecting growing concerns around house prices and ongoing mixed economic data releases including weak December quarter inflation. Diverging from offshore moves, domestic bond yields continued to fall in February, as markets reacted to the RBA changing its cash rate guidance to a neutral stance lowering its economic growth and inflation forecasts. Bond yields continued to fall in March on the back of fears of slowing global economic growth and dovish central banks. Furthermore, local bonds rallied amid the release of largely soft domestic economic data, including a disappointing December quarter GDP reading. Similar to their US peers, Australian bonds saw an inversion of the 3-month to 10-year yield curve late in the period. The Commonwealth Government 2-year bond yield ended the quarter at 1.46%, while the 10-year bond yield ended at 1.78%.

## Outlook

Australian yields continue to trade at a premium to those available in Japan and Europe, making Australian sovereign fixed income and corporate credit relatively attractive from an international and yield perspective in the shorter to medium term. The Reserve Bank of Australia continues to exhibit an accommodative bias in its communications, and a weak economic backdrop is increasing the probability of a rate decrease in the short term. A weak housing market and high household debt levels continue to be an area for concern, although currently there is little evidence of significant non-performing loans.

## Availability

| Product name                               | APIR       |
|--|------------|
| AMP Flexible Lifetime Super                | AMP0066AU* |
| AMP Flexible Super - Retirement account    | AMP1345AU* |
| AMP Flexible Super - Super account         | AMP1474AU* |
| CustomSuper                                | AMP0066AU* |
| Flexible Lifetime - Allocated Pension      | AMP0599AU* |
| Flexible Lifetime - Term Pension           | AMP0920AU* |
| Flexible Lifetime - Investments (Series 1) | AMP0693AU* |
| Flexible Lifetime - Investments (Series 2) | AMP1409AU* |
| SignatureSuper                             | AMP0796AU* |
| SignatureSuper - Allocated Pension         | AMP1149AU* |
| SignatureSuper Select                      | AMP0796AU* |

\*Closed to new investors

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