Schroder Fixed Income

Quarterly Investment Option Update

31 March 2019

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	100.00%	85.18%
Cash & Equivalents	0%	10.15%
Global Investment Grade	0%	4.48%
Australian High Yield	0%	5.17%
Global High Yield	0%	-4.99%

Sector Allocation	%
Cash & Equivalents	12.78%
Government	25.70%
Semi-Government	18.02%
Supranational/Sovereigns	19.05%
Corporates	17.14%
Subordinated	2.35%
Collateralised	4.96%

Top Holdings	%
TREASURY (CPI) NOTE 0.25 15-JAN-2025	4.178%
AUSTRALIA (COMMONWEALTH OF) 5.5 21-APR-2023 Reg-S	3.714%
AUSTRALIA (COMMONWEALTH OF) 2.75 21-APR-2024 Reg-S	3.287%
QUEENSLAND TREASURY CORPORATION GOVTGUAR 3.25 21-JUL-2026	2.769%
AUSTRALIA (COMMONWEALTH OF) 4.25 21-APR-2026 Reg-S	2.569%
INTERNATIONAL BANK FOR RECONSTRUCT 2.8 13-JAN-2021 (SENIOR)	2.259%
AUSTRALIA (COMMONWEALTH OF) 3.75 21-APR-2037 Reg-S	1.903%
AUSTRALIA (COMMONWEALTH OF) 3.25 21-APR-2025 Reg-S	1.794%
NEW SOUTH WALES TREASURY CORP NONDMUNI 2.75 20-NOV-2025	1.755%
AUSTRALIA (COMMONWEALTH OF) 4.75 21-APR-2027 Reg-S	1.737%

Quality Allocation	%
AAA	52.27
AA	19.01
A	6.11
BBB	16.61
Below BBB	-4.61
Cash & Equivalents	10.60
Not Rated	0.01

Portfolio Summary

The Schroder Fixed Income Fund Professional Class returned 3.47% (before fees) over the March quarter, slightly above the benchmark return.

Over the quarter, their credit exposures contributed positively to both spread and carry as credit assets rallied, following a more "patient" stance by the Fed, and as their long credit exposure provided a little extra income vs the benchmark. The Fund's duration positioning also contributed positively, however their long inflation position, particularly in Australia, underperformed. The Fund Manager were modestly constructive on duration through most of the quarter, building a long position in Australia given the downside cyclical risks, flatteners in Europe where policy options are limited, and neutral exposure to the US, waiting for softer data to play out. They additionally shifted their US yield curve exposure from flatteners to steepeners, and also moved back shorter duration by the quarter end. They also marginally added to their high versus low quality theme in credit, by buying a little more Australian investment grade versus selling US high yield.

Market commentary

Equity markets continued to rise in March, with many indices posting their strongest quarterly return since 2009. In the US, the yield curve between 3-month T-bills and 10-year Treasuries inverted for the first time since 2007, a potential flag for recession – although it should be noted that the lead time from curve inversion to recession has varied significantly over different cycles, ranging from less than 12 months to over three years. Nevertheless, the Fed stated that it is no longer expecting any further rate hikes in 2019, while money markets are pricing in almost two rates cuts over the next year. Money markets in Australia are pricing a similar degree of easing in light of weak growth figures and the property market continuing to decline, particularly in Sydney and Melbourne. Meanwhile, the ECB also announced its expectation that rates in Europe will remain on hold through 2019, along with a further round of TLTRO loans aimed at providing cheap financing for European banks. In the UK, Brexit voting continued to dominate headlines with Theresa May's Brexit proposal defeated for a third time in Parliament, despite May offering up her resignation to lend support to the deal. A number of other Brexit proposals were also voted down.

Global equities returned 1.6% in local currency, while the Australian market posted a more modest rise of 0.7% over the month. China A shares continued to be the global standout, with the market rallying 5.5% in March and almost 30% over the first quarter. Within Australia, yield sensitive sectors like REITs were the standout performers, while Banks and Energy stocks lagged the broader market. Global government bonds also rallied, with 10-year yields in the US falling by 0.31% to end March at 2.41%. In Australia, 10-year yields followed a similar pattern, dropping by 0.33% to end the month at 1.78%. 10-year yields also contracted in other markets, falling by 0.25% in Germany and 0.06% in Japan. There was little movement in credit spreads, with investment grade moving slightly tighter over the month, while high yield spreads widened by about 10 bps.

Outlook

The Fund Manager's analysis continues to suggest the US is in the late stage of the economic cycle, when both slowing growth and lifting inflation are problematic. However, their models are also still saying recession is more than 12 months away – and perhaps the Fed pause can allow the US cycle to extend, although it's unlikely to reaccelerate meaningfully. Alongside this, corporate fundamentals are weakening, but not yet especially problematic.

Extension of the cycle may be a palatable outcome for the time being but the real worry is the next downturn, especially for economies that never managed to 'normalise'. Many central banks have not yet tightened policy in this cycle and now, with growth downgraded and inflation still MIA, they are being forced to consider further easing. This is not how it is meant to work! No wonder central banks are rethinking their approach — there's currently underway a big Fed review of its policy framework – or, in the case of the RBA which has been exploring how it might run a QE program, at least contingency planning.

Meanwhile, credit asset valuations are now back in expensive territory, to some degree supported by the more dovish central bank environment – in which the pace of stimulus withdrawal slows, policy certainty increases, and market volatility falls. Schroder's assessment of the time to US recession and underlying credit fundamentals means they are happy to hold higher quality credit for carry but are cautious in building a significant exposure to credit at this point in the cycle. At some point, risky assets will face the headwind of either much weaker growth or rising rates/liquidity withdrawal. Hence, to manage this trade-off between earning income for the portfolio and managing the risk of valuation adjustment, they're positioned long Australian investment grade credit – the best return-for-risk asset in the fixed income universe at present – but short in US high yield.

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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