Schroder Real Return

Quarterly Investment Option Update

30 September 2019

Aim and Strategy

To deliver an investment return of 5% pa before fees above Australian inflation over rolling three-year periods. Inflation is defined as the RBA's Trimmed Mean, as published by the Australian Bureau of Statistics. The portfolio invests across a broad array of asset classes including equity, alternatives and debt to ensure the portfolio is truly diversified in both an economic and asset class sense. The portfolio employs an objective-based asset allocation framework in which both asset market risk premia and, consequently, the asset allocations of the portfolio are constantly reviewed. As risk premia (and thereby expected returns) change, so too will the asset allocation of the portfolio (and sometimes significantly). The portfolio will reflect those assets that in combination are most closely aligned with the delivery of the objective. The investment manager believes that in effect it's not the asset classes that are important but the likely characteristics of the return. The approach utilises a combination of Schroder's longer-term return estimates together with their shorter-term value, cycle and liquidity framework

Investment Option Performance

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

Investment Option Overview

Investment Category	Multi Sector (Specialist)
Suggested Investment timeframe	5 years
Relative risk rating	4 / Medium
Investment style	Active
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian Fixed Interest	N/A	16.8
Global Fixed Interest	N/A	7.5
Australian Shares	N/A	10.3
Global Shares	N/A	12.8
Growth Alternatives	N/A	0
Defensive Alternatives	N/A	22.31
Listed Property & Infrastructure	N/A	0
Unlisted Property & Infrastructure	N/A	0
Cash	N/A	30.4

Sector Allocation	%
Australian Equities	10.3%
Global Equities	12.8%
Property	0.0%
Higher Yielding Credit	10.1%
Emerging Market Debt	5.0%
Absolute Return Strategies	-0.5%
Australian Fixed Income	16.8%
Global Fixed Income	7.5%
Inflation Linked Bonds	3.7%
Mortgages & Floating Rate Credit	4.0%
Cash	30.4%

Portfolio Summary

The US Economy continued to improve over the quarter, with strong jobs and wages growth, together with very optimistic survey results from both consumers and small businesses. The Federal Reserve hiked the Fed Funds rate by 0.25% in September, with the market pricing in roughly three additional rate hikes over the next twelve months. On the back of this, the US equity market was the standout performer rallying by almost 8% during the quarter, with the S&P 500 continuing to make new all-time highs. Amongst other developed markets, Japanese Equities also performed strongly as a result of improved corporate earnings and a weaker Yen. The Australian Equity market returned -1.3% over the month, being weighed down by concerns in the healthcare sector, but remained up by 1.5% over the quarter. Stock selection within the core active Australian equity portfolio added value over the quarter.

Investment Option Commentary

On many occasions the Fund Manager has commented on how markets look stretched, based on valuations, pointing to a low return outlook over the next 3 years. The other side of this coin is that markets are also more vulnerable to shocks, the more stretched valuations are the greater the likely downside shift if markets are confronted with negative news. It is therefore prudent to scan the horizon for likely shocks that may destabilise markets. The most damaging of shocks is a US recession. A typical shock will see greed turn to fear and often leads to a 20% plus fall in equity markets, like the European shock in 2011. However, while terrible at the time, markets generally recover in a year or so. However, a recession while seeing a move from greed to fear, also sees a sharp deterioration in corporate fundamentals, often leading to a 50% fall and the recovery can take 5, 6 or 7 years.

Market Commentary

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Outlook

More near-term risks are ones the Fund Manager has been discussing for a while now: rising US inflation and President Trump’s tariff war with China. The Fund Manager first commented on the risk of rising inflation in the US late last year. The analysis was based on the non-linear relationship between the unemployment rate and inflation i.e. the unemployment rate has little impact on inflation until it falls below a tipping point. The prime example of this phenomenon was the 1960s where the falling of the unemployment rate from 7% to 4% had little effect on inflation, but once it fell below 4%, inflation began to rise sharply. Once again, the unemployment rate is below 4% and inflation has begun to rise. As a further rise in inflation is not expected by markets, a continuation of rising inflation would be a significant shock and would lead to a sharp rise in volatility.

The Fund Manager has argued that the path of least resistance is for a continued escalation in the US’s trade war with China. Mid-term elections are won by the party that can energise their base (voting is non-compulsory) and President Trump is using the trade dispute with China to rally his supporters. So far markets have not reacted much to the trade dispute, either assuming it will be resolved soon or will have only a minor impact on the strong US economy. While most analysis points to a modest impact from rising tariffs, it generally assumes it will be spread out. However, the Fund Manager thinks it will be concentrated in a short period of time, as supply lines get disrupted, and this will have a negative impact on business confidence. Also, with the political momentum for further escalation, it might take a reaction from markets to short circuit this. However, with significant tariffs only just been implemented, the Fund Manager thinks the impact is still to be realised.

Diversified portfolios are most vulnerable in the lead in to recession, which our indicators suggest is unlikely in the near future. However, valuations are stretched, suggesting markets are primed for a very positive environment, and that the margin for safety is low. The Fund Manager sees a couple of near-term potential shocks, and therefore believe its defensiveness will pay off and opportunities will present themselves – and as the Fund Manager has shown in the past the portfolio will be quick to avail itself of them when they do.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1850AU
AMP Flexible Super - Retirement account	AMP1870AU
AMP Flexible Super - Super account	AMP1866AU
CustomSuper	AMP1850AU
Flexible Lifetime - Allocated Pension	AMP1854AU
SignatureSuper	AMP1858AU
SignatureSuper Allocated Pension	AMP1862AU
SignatureSuper Select	AMP1858AU

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