Schroder Real Return

Quarterly Investment Option Update

31 March 2021

Aim and Strategy

To deliver an investment return of 4-5% 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.

Sector Allocation	%
Australian Equity	15.56%
Global Equity	10.77%
Absolute Return	-0.06%
High Yielding Credit	13.47%
Insurance Linked Securities	3.60%
Asian Credit	4.98%
Emerging Market Bond	4.97%
Commodities	0.98%
Australian Fixed Income	16.39%
Australian Inflation Linked	3.03%
Global Fixed Income	8.94%
Cash & Cash Equivalents	17.38%

Investment Option Performance

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

Investment Option Overview

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

Investment Option Commentary

The Schroder Real Return Fund ("Fund)" returned 0.75% (pre-fees) for the month of March.

Equities were the largest positive contributor in March, adding 0.7% to overall portfolio returns, with 0.4% coming from Australian equities and 0.3% from global equities. Australian fixed income and equity option positions were marginal positive contributors. Over the quarter, the equity allocation was the largest positive contributor, with Australian equities adding 0.8%, global equities adding 0.8%, and option positions adding 0.2%. Our high yield credit and Australian hybrids exposure was another positive contributor over the quarter.

Though were no major detractors in March, though our emerging market debt, commodities and global corporates positioning all detracted at the margin. Over the quarter, duration was the largest detractor, having a -0.4% impact on returns, followed by foreign exchange which detracted by -0.2%.

Market Commentary

March 2021 marked one year since the market turmoil induced by the global COVID-19 economic shutdowns and accompanying uncertainty of the pandemic. While from an economic and social perspective it's been a difficult and uncertain path to recovery, from an investment perspective it's been a much more positive story. Financial assets (particularly equities and credit), commodities and Australian residential property have performed much better than most would have predicted a year ago. To put this into context, US equities (i.e. the S&P 500) ended March 2021 78% higher than the low point in March 2020.

However, the real market story of the past 12 months has been about stimulus and liquidity. Not only has this helped facilitate the economic recovery, it has propelled asset prices significantly higher. While the liquidity taps seem unlikely to be turned off anytime soon, it seems unlikely that markets will repeat their remarkable Lazarus-like performance of the past year – despite a much more positive economic prognosis.

There are several reasons for this.

First, in the case of credit, spreads are already significantly compressed and the risk of higher interest rates is rising. In other words, not much more can be squeezed out of credit. A good outcome is relatively stable and moderate returns (i.e. 'carry').

Second, while equities still offer upside potential, the strong run in most markets has left them relatively fully valued – even allowing for a relatively constructive earnings outlook. Furthermore, the more bullish arguments for equities that had been based around the large gap between earnings yields and bond yields has also weakened, as mid- to long-dated bond yields have risen.

Finally, while central banks (including the RBA) remain firmly committed to low policy rates and ongoing aggressive support, markets will firmly test their resolve if economic data continues to be strong and concern about inflation builds. Any material upside surprise to upcoming inflation numbers could provide some real headwinds.

None of this is to say that markets are about to turn ugly. Rather, it is to recognise that returns from here on will likely be tougher to come by, particularly with interest rates as low as they are. The positive is that economic recovery is still unfolding well, and policy settings are likely to continue to underpin growth with most policy makers reluctant to put the brakes on too early (China being the exception, given they have started to limit credit growth). However, we also need to recognise that economies and markets are not the same thing. Markets have already moved to price in a significant economic recovery and it will take ongoing growth without persistent inflation to propel equity markets materially higher.

Outlook

Equities

Equity markets overcame initial concerns around higher bond yields and rallied through March, being supported by a strong outlook for corporate earnings and the US congress giving final approval to Biden's $1.9 trillion fiscal support package. Global equities returned 4.2% in local currency terms, while the Australian market underperformed with a return of 2.4%. The style rotation towards value continued, with value equities outperforming growth equities by about 5% in the month, though growth has still outperformed over a one-year timeframe. Emerging markets lagged, with a return of -1.5% in USD terms mostly due to a retracement in China, as a stronger US dollar, and a slower than expected vaccine rollout weighed on sentiment.

With the moderate pullback in equity markets in late February and early March, we took the opportunity to add 2% to our equity allocation, taking the overall equity weight to 26%. This was implemented through a blend of Australian and global equities. Additionally, with the significant amount of fiscal stimulus in the US expected to support economic and earnings growth, we rotated our positioning towards the US market, from emerging market equities. The underlying style tilt of the portfolio is remains towards value, and performance is benefiting from stock selection alpha in our global and Australian equity strategies as value equities recover some of the underperformance from 2020.

Fixed income

US bond yields continued to rise through March driven by the prospect of higher inflation, while yields in other markets fell through the month. US 10-year treasury yields increased by 0.34% to end the month at 1.74%, while Australian 10-year treasury yields moved in the opposite direction, falling by 0.13% to end the month at 1.79%. Similarly, longer end bond yields also fell in Germany and Japan by 0.03% and 0.06% respectively over the month. Credit spreads also diverged during March, with high yield spreads continuing to compress, global investment grade relatively flat, and Australian investment grade moderately wider.

Through March, we increased portfolio duration by 0.25yrs to target 1.0yr in aggregate. With the increase in longer end US yields, some value is starting to re-emerge in bond markets. While yields could rise further if the expected pick-up in inflation is more structural rather than transitory, duration is now offering some carry over the cash rate and can offer the portfolio some additional protection if growth and inflation are lower than expected.

Availability

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

Contact Details

Web: www.amp.com.au
Email: askamp@amp.com.au
Phone: 131 267

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