Schroder Fixed Income

Quarterly Investment Option Update

30 June 2023

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/performance

Investment Option Overview

Investment Category	Fixed Interest
Suggested Investment timeframe	3 years
Relative risk rating	3/ Low to Medium
Investment style	Core
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Aust. Investment Grade	100%	91.0%
Cash & Equivalents	0%	11.9%
Global Investment Grade	0%	-4.2%
Australian High Yield	0%	2.3%
Global High Yield	0%	-1.0%

Sector Allocation	%
Government	16.0%
Semi-Government	24.7%
Supranational/Sovereigns	14.7%
Corporates	27.0%
Subordinated	6.5%
Collateralised	3.0%

Quality Allocation	%
AAA	34.3%
AA	28.9%
A	10.5%
BBB	20.4%
Below BBB	1.5%
Not Rated	1.9%

Top Holdings	%
AUSTRALIA (COMMONWEALTH OF) 2.75 21-NOV-2029 Reg-S	3.6%
NEW SOUTH WALES TREASURY CORPORATI GOVTGUAR 3.0 20-MAR-2028 Reg-S	2.8%
QUEENSLAND TREASURY CORPORATION NONDMUNI 1.75 21-AUG-2031 Dual 144a|Reg-S	2.5%
AUSTRALIA (COMMONWEALTH OF) 2.25 21-MAY-2028 Reg-S	2.3%
WESTERN AUSTRALIAN TREASURY CORP 1.75 22-OCT-2031	2.3%
AUSTRALIA (COMMONWEALTH OF) 3.0 20-SEP-2025 Reg-S	1.8%
AUSTRALIA (COMMONWEALTH OF) 3.25 21-JUN-2039 Reg-S	1.8%
TREASURY CORPORATION OF VICTORIA 1.5 10-SEP-2031	1.8%
QUEENSLAND TREASURY CORPORATION NONDMUNI 1.75 20-JUL-2034 Dual 144a|Reg-S	1.7%
KFW GOVTGUAR 3.2 11-SEP-2026 (SENIOR)	1.7%

Investment Option Commentary

Over the June quarter the portfolio returned -3.08% (before fees), underperforming the benchmark by 0.13%. The portfolio's longer duration than the benchmark was the key detractor, with yields rising as concerns over the US regional banking crisis eased and growth in many countries held up better than expected. After the large selloff in fixed income last year, over the calendar year to date the portfolio's returns have stabilized at higher yields levels than anticipated, and are moderately ahead of benchmark.

Schroder made several changes to positioning during the quarter – predominantly modestly increasing duration as yields rose, and increasing exposure to higher yielding credit to capture higher income opportunities. The manager also bought some inflation protection in the US and shifted yield curve exposures flatter.

The Schroder Fixed Income Fund aims to deliver low-risk income and diversification by accessing the opportunities and managing the risks, across the spectrum of fixed income opportunities. The current environment is both offering attractive yields over medium-term investment horizons and good diversifying potential as the cycle turns, while volatility is creating opportunities for active managers. Schroder are positioned with an up-in-quality stance, favouring investment grade credit to help generate income, and with overweight interest rate exposure to help provide diversification.

Outlook

2023 has thus far been a choppy year for bonds. The year started with yields at attractive levels, and largely bonds have earned their income as prices have gyrated, leaving yields now at about the same level as they started. Inflation remains uncomfortably high, which has seen developed economy central banks continue to tighten, pushing yield curves materially flatter as longer term yields have remained largely anchored. Meanwhile, better than expected growth data has seen credit spreads narrow (and other risky assets rally) in spite of tighter policy.

Coming into this year Schroder firmly believed high-quality fixed income offered attractive relative and absolute value. Schroder also expected the economic cycle to turn in favour of bonds - as headline inflation softens with supply chains normalising, as growth weakens with rate hikes and cost pressures biting, and as central banks complete their aggressive tightening.

Waiting for the bite

The predicted turn in the cycle is clearly taking longer to materialise than anticipated. In part, this is simply because it takes time for policy tightening to bite. Common estimates are that rate hikes don't fully impact for 12-18months – suggesting they won't truly be felt until later this year. Schroder also expect central banks still have a bit more work to do - in Australia and anticipate the RBA will need to hike a further two times.

In spite of higher interest and general living costs, consumers have remained surprisingly resilient. Buffers built up during Covid have proved effective (to date) in offsetting some of the ongoing real income squeeze, and some relief for wage earners is now in sight with wage rises on the horizon in Australia, amid an ongoing tight labour market. Housing markets have also stabilised earlier than expected, in Australia partly driven by a firm rebound in migration. Strong competition may actually see a relaxation of home lending conditions in Australia, in contrast to the ongoing tightening of credit supply expected in the US and Europe.

Profitability & growth holding up

Meanwhile, in spite of higher input costs and reduced sales volumes, corporate profitability (in aggregate) is also holding up better than expected, in turn supporting labour markets. In general, corporates have been able to pass higher costs through, albeit that there are specific sectoral winners (eg utilities) and losers (eg discretionary retailers).

Growth holding up, in spite of inflation, has also proved greatly beneficial for asset allocators, as this has supported returns in riskier assets, sending bond-equity correlations back to negative this year. This supports the idea in fixed income portfolios to again pair duration exposure with income generating assets.

Albeit that the consumer and business spending slowdown is taking longer to materialise than predicted, the balance of risks continues to move towards slowing growth and moderating inflation. High quality fixed income is poised to do well relative to other assets, particularly should downside risks gather speed. Higher than comfortable core inflation likely increases downside growth risk as central banks maintain their focus on fighting inflation, meaning rate cuts are unlikely this year and leaving riskier assets vulnerable. Bonds should again fulfil their role as cyclical diversifiers.

Positioning

Drawing together Schroder's key research inputs, their key views remain little changed. Now is the time to consider:

- **Owning interest rate risk** in the countries where central banks have tightened most aggressively / where inflation is showing best evidence of softening (e.g. the US) and in markets which have greater sensitivity to interest rates (e.g. Australia). Within these markets, short dated bonds should do relatively better than longer dated, once rates peak.
- **Holding up-in-quality allocations.** 67% of the portfolio is allocated to issuers rated AA and better, mostly via their government, semi-government and supranational allocations. Within credit allocations, Schroder prefer investment grade. The high quality of Australia's investment grade credit market, its short tenor, and relatively wide spread make it particularly appealing to us versus other corporate bond markets. The manager has been able to access good yield in this way, while minimising their exposure to riskier credit.
- **Rotating issuers to improve overall credit quality;** within their Australian credit allocations the manager has been buying banks from an underweight position, and de-risking by reducing lower rated corporate issuers. Schroder believe that Australian banks are well positioned, with simpler business models than global peers, high liquidity and robust capital levels.
- **Staying liquid,** providing greater flexibility to position actively. Schroder expect market volatility to remain high as we come to the forecast turn in the cycle. The manager expects to use this volatility to continue to accumulate interest rate duration and spread assets at attractive levels.

High-quality fixed income can offer attractive income levels and improved diversification benefits as the cycle turns. Schroder believe asset allocators should consider a rebalance back in favour of fixed income.

Availability

Product name	APIR
Flexible Lifetime Investment (Series 2)**	AMP2040AU
SignatureSuper*	AMP1302AU
SignatureSuper Allocated Pension*	AMP1309AU

*Closed to new investors
**Closed to new and existing investors

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