ANZ Australian Fixed Income Portfolio

Investment strategy and approach

The ANZ Australian Fixed Income Portfolio ('the Portfolio') is a portfolio that focuses on constructing a diversified portfolio using major Australian fixed income sectors. Value is added through duration management, yield curve positioning, sector rotation and issue selection. Market risk is controlled by constraining duration exposure as well as a focus on diversification.

The medium-term investment objective of the Portfolio is to outperform the Bloomberg AusBond Composite 0+ Year Index. The suggested investment time frame is three to five years.

Portfolio performance (before fees and taxes)

	1mth	3 mths	1yr	3yr	5 yrs (p.a.)	Since inception (p.a.)[2]
Portfolio total return	-1.53%	-1.16%	7.66%	5.33%	4.29%	5.56%
Bloomberg AusBond Composite 0+Yr Index	-1.64%	-1.32%	7.26%	5.14%	4.18%	5.52%
Total return relative to benchmark[1]	0.11%	0.15%	0.39%	0.19%	0.12%	0.04%

1. The benchmark is the Bloomberg AusBond Composite 0+ Year Index
2. Inception date is 1 July 2010

Figures may not add up due to rounding.

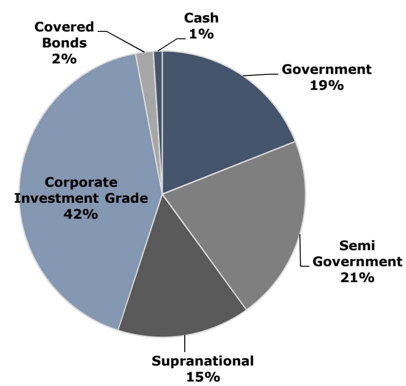
Running Yield 3.14%

Duration: 5.55

Issuer exposure

Government of Australia	19.9%
Queensland Treasury Corp.	7.6%
New South Wales Treasury Corp.	4.7%
Government of Germany	3.4%
State of Western Australia	3.1%
State of Victoria	3.0%
National Australia Bank Limited	2.0%
Government of the Netherlands	1.7%
Westpac Banking Corporation	1.6%
South Australian Government Financing Authority	1.6%
Other	51.5%
Total	**100.0%**

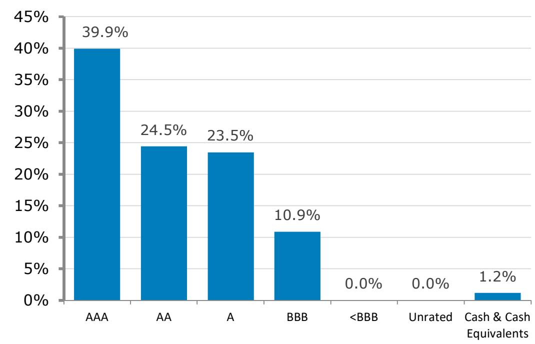
Sector exposure



Top 10 Holdings

10Y Australia T-Bond (SFE) Dec 19	6.0%
Government Of Australia 2.25% 21-may-2028	2.5%
Government Of Australia 2.75% 21-jun-2035	1.8%
Government Of Australia 2.75% 21-may-2041	1.6%
Government Of Australia 2.75% 21-nov-2027	2.4%
Government Of Australia 3.0% 21-mar-2047	2.1%
Government Of Australia 3.25% 21-apr-2029	2.5%
Government Of Australia 4.5% 21-apr-2033	1.9%
Queensland Treasury Corp. 4.25% 21-jul-2023	2.1%
Treasury Corporation Of Victoria 3.0% 20-oct-2028	1.5%
Other	75.5%
Total	**100.0%**

Credit rating exposure



The above performance is based upon the Model Portfolio. Individual Portfolios may differ from this due to factors that include timing of implementation, cash flows and corporate actions.

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Market and Portfolio Commentary

The Bloomberg Ausbond Composite Index returned -1.64% in December. This was its worst monthly return since September 1994 when yields were influenced higher by the Federal Reserve which was in the middle of a tightening cycle and had already hiked the fed funds rate by 1.75% over a six-month period. Despite three of the final four months of 2019 having negative returns, the Australian bond market had its best annual performance in five years due to a sharp decrease in yields through the first eight months of the year. The Australian Fixed Income Portfolio outperformed its benchmark by 0.11% in December due to a combination of carry and spread compression on corporate sector bonds. Security selection detracted slightly.

Interest rate strategies were neutral for relative performance as a slight underweight duration position was offset by a yield curve-flattening position at the long end as the curve steepened.

The tit-for-tat trade dispute between the US and China received a reprieve with the announcement they had reached a "phase one" trade deal in which the US will scale back tariffs on Chinese goods in exchange for a Chinese commitment to minimum purchases of US goods and intellectual property protections. Although not yet ratified, this removed some uncertainty for the market, as did the landslide victory for Boris Johnson in the UK parliamentary election, and drove global and domestic yields higher in December. The 1-year Australian government bond yield was 23 bps higher and the yield curve steepened from there with the 10-year 34 bps higher and the 30-year yield up 37 bps.

Domestic data released leading into year-end remained mixed and included the 3Q19 GDP which disappointed slightly at 0.4% quarter-over-quarter versus 0.5% expected. GDP for the year ended September 2019 was slightly higher at 1.7%. House prices continued to trend higher off two-year lows reached in the middle of the year and private sector credit picked up. There was a large increase in jobs following a poor report the month prior; however, the large majority of the pickup was in part-time positions. Skilled vacancies continued to drop as they did every month in 2019 while job advertisements also declined having been weak throughout the year as well.

Credit issuance rounded out the year on a low-key note as expected with A$325million issued in the non-bank corporate space which included an unrated deal from Seek while NAB and ANZ took the opportunity to issue subordinated debt. The lack of issuance created a technical bid for spread sectors in the secondary market as investors sought to reinvest coupons and maturities. Corporate sector spreads compressed around 4 bps while supranational, sovereign and agency (SSA) issues tightened around 3 bps; however, semi-government spreads widened marginally.

The Australian dollar gained more than 3% versus the US dollar and Japanese yen; it gained 2% versus the euro and more than 1% on the pound Sterling given a broad risk-on sentiment. A small rise in commodities and more patience suggested by the RBA on monetary policy also contributed.

Outlook and Strategy

The RBA has tempered market expectations a little when referring to the "long and variable lags" of monetary policy in presenting the case for patience in determining the need for further adjustments to policy. However, many pundits are still convinced a lack of improvement in the data will force the bank's hand and as such expect a cut in 1Q20 while also adding another cut midway through the year with QE to follow. The bushfires around the country caused significant disruption, primarily to agriculture and tourism, but also to other productive resources that were diverted to the cause such as labour foregone as volunteer firefighters were called to action. Assistance announced from state and federal governments, along with rebuilding efforts, is likely to provide some compensatory stimulus to the economy. One question is whether the RBA has a propensity to look through data pertaining to the bushfire period and perhaps wait a little longer before making a decision to cut. External portfolio manager Western Asset Management (WAMCO) do not consider two cuts in 2020 to be a foregone conclusion albeit that the weight of risks still remain to the downside in terms of disruption to global growth from trade and geopolitical disputes. Then there is still the issue of whether banks would be prepared to pass through any further cuts at these extremely low levels which would render the cuts largely ineffective from a consumer perspective. As the dominant contributor to domestic GDP, the consumer has in recent quarters been softening despite the solid labour market.

A recovery in the housing market appears well underway as the rise in house prices in each of the past six months, particularly in the major centres of Sydney and Melbourne, has recouped about two-thirds of the value lost over the prior two years. This upswing is yet to show through in the hitherto lacklustre consumer and business sentiment.

WAMCO take a tactical approach to interest rate strategies and neutralised their small duration underweight mid-month after yields moved higher. They also reduced their 3s/20s curve-flattening position. They retain a flattening position in the 30-year versus the 10-year tenor as a ballast to an overweight credit position. They also continue to take note of relative value among sectors and added some spread duration to semi-government bonds as relative value indicators favoured that sector, particularly in the longer tenors.

WAMCO believes monetary conditions globally remain extraordinarily accommodative. They believe such conditions will continue to favour spread sectors and in their opinion, these sectors should continue to be the best-performing fixed-income assets and remain their major theme. WAMCO maintain an overweight to corporate bonds with a concentration in large financials, property trusts and utilities, focussed at shorter maturities to manage spread risk. They will continue to add selectively where market volatility has forced spreads wider than credit fundamentals would justify or as new opportunities present.

The Australian dollar gained some ground in December to finish 2019 around half a percent lower than where it began on both its trade-weighted index and versus the US dollar, which WAMCO believe is a little surprising given the RBA cut three times during the year but the Fed did the same in the US which diminished the impact to the Australian dollar. With a dovish RBA, WAMCO expect the Australian dollar to slide a little lower but remain in the mid-to-high US$0.60 range.

Launch date

01 July 2010

Fees

Please refer to the relevant PDS and the Investment Menu/Managed Account Profile for more information.

Fund currency

Australian dollar

Distributions

The Fund generally distributes on a quarterly basis. The amount (if any) distributed to each unitholder will be based on the number of units held and the distribution per unit at the end of each distribution period.