December 2018

Monthly Commentary

Aberdeen Global - Australian Dollar Income Bond Fund

Performance Summary % (in denominated currency)

A MIncA AUD	1M	3M	6M	YTD	1Y[A]	3Y[A]	5Y[A]	10Y[A]	Launch[AB]
NAV to NAV	-0.10	0.00	1.33	1.94	2.15	N/A	N/A	N/A	3.31
Charges Applied[C]	-5.10	-5.00	-3.74	-3.16	-2.95	N/A	N/A	N/A	-0.17
Benchmark[D]	0.15	0.48	0.99	1.77	1.91	N/A	N/A	N/A	1.85

Source: Lipper, total return basis, NAV to NAV, gross income reinvested, 30 November 2018

All return data includes investment management fees, performance fees, and operational charges and expenses, and assumes the reinvestment of all distributions. **Past performance is not a guide to future results**

[A] Annualised; [B] Inception date: 01/06/2017; [C] Includes the effect of initial sales charge and/ or capacity management charge i.e. an assumed 5% of the Gross Investment Amount. NAV to NAV figures are a better reflection of underlying investment performance; [D] Bloomberg AusBond Bank Bill

Performance Commentary

In a tough month for both equities and credit, the fund delivered a modest negative return and was down slightly against cash. Australian corporate bond spreads widened, but the main weakness was from offshore investment grade and high yield, which underperformed on credit-spread widening. Duration added significantly to performance, as Australian and the US government yields fell. Despite increased volatility, the fund continued to perform well relative to its competitive opportunity set and is expected to meet its distribution targets.

Fund Activity

The fund invested in Anheuser-Busch Inbev (ABI), one of the largest manufacturers and distributors of alcoholic beverages, globally. ABI has a solid 'BBB' rating and is expected to receive an upgrade to an 'A' over the next few years. The AUD 2024's bonds valuation remains attractive, relative to the AUD cyclical consumer sector.

Global Bond Market Review

The Australian economy is expected to emerge unscathed from the various self-inflicted problems, across housing and lending and politics. Wealth effects are always discussed in Australia because of the importance of the housing cycle historically, but our analysis over the years has highlighted important changes in the transmission channels. In any case, wealth effects have had a chequered history in the literature and are not just based on the notion that households spend more because rising prices make them feel better. Net household wealth held up, as unemployment rate reduced. This should bode well with the Reserve Bank of Australia (RBA). A shift in rhetoric should come in the first half, to prepare markets for an increase in the cash rate in the second half.

The US is in a state of flux: growth, seen so far as the result of tax cuts, could slow down, as trade tensions lead to higher costs and supply-side price increases. Meanwhile, wage growth could lead to higher inflation and may breach the Federal Reserve's target. The Fed will, nevertheless, need to continue withdrawing stimulus and maintain an anodyne tone to appease risk assets. Conversely, China is in the midst of activating stimulus through infrastructure investment, although it has not been sufficient to offset the slowdown in other sectors, such as property. The Eurozone awaits a rebound amid ECB's targeted longer-term refinancing operations (TLTRO) due next year.

There are competing drivers for credit markets at present. US growth, low interest-rates and buoyant corporate earnings supported the market with solid credit returns at the beginning of the year. However, in the medium term, we expect a challenging environment; downside risks to growth remain as key developed economies, such as the US, enter the later stages of the cycle. In addition, the recent Italian deficit concerns were amplified by the imminent winding back of ECB largesse. Moreover, local-currency emerging-market debt markets' risk premia moved significantly relative to the developed markets. Inflows into fixed-rate credit reduced, in favour of the low-duration loan funds. New issue supply for loans market experienced greater demand than the fixed-rate-high-yield market, due to the increased uncertainty about tenor risk in credit, rather than defaults. This is likely to continue. Markets also took into consideration the geopolitical risks, including trade tensions, and the turn in the policy cycle after central banks reduced their levels of accommodation.

Under these circumstances, we expect default rates to stay low. Hence, we maintain an overweight to credit, but at a reduced scale, with a preference to sell at attractive valuations rather than add to our exposure on market corrections. For these reasons, we have further reduced our credit allocation in favour of derivatives and more liquid and higher-rated instruments, where we see better opportunities.

Australian Fixed Income Team
Aberdeen Standard Investments

For more information

Client Services Team
Tel: +65 6395 2701
Fax: +65 6632 2993

Aberdeen Standard Investments (Asia) Limited
21 Church Street
#01-01 Capital Square Two
Singapore 049480
Tel: +65 6395 2700
Fax: +65 6632 2998

aberdeenstandard.com.sg

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