

# Aberdeen Standard Australian Fixed Income Fund

Monthly factsheet - performance data and analytics to 31 August 2019



## Investment objective

To provide exposure to primarily Australian fixed income securities, to generate income with some capital growth potential over the medium to long term. The Fund aims to outperform the Bloomberg AusBond Composite Bond Index over the suggested investment time frame (3 years plus).

## Investment strategy

To aim to actively add value through interest rate, credit and relative value strategies. The strategies involve both fundamental and model driven analysis that seeks to exploit as many return generating opportunities as possible, and are therefore well risk diversified.

The Fund may have a limited exposure to international fixed income securities.

## Performance (%)

	1 Month	3 Months	1 Year	Per annum		
				3 Years	5 Years	Since Inception <sup>1</sup>
Aberdeen Standard Australian Fixed Income Fund net returns <sup>2</sup>	1.42	3.39	10.05	4.29	5.03	6.82
Aberdeen Standard Australian Fixed Income Fund gross returns <sup>3</sup>	1.46	3.53	10.61	4.82	5.56	7.24
Bloomberg AusBond Composite Bond Index	1.51	3.54	11.20	4.68	5.30	6.89
Net returns <sup>2</sup> vs index	-0.09	-0.15	-1.15	-0.39	-0.27	-0.07
Gross returns <sup>3</sup> vs index	-0.05	-0.01	-0.59	0.14	0.26	0.35

1. This figure represents the annualised performance of the Fund from the first full month of operation.

2. Net performance figures are calculated using end-of-month exit prices, post standard fees, reflect the annual reinvestment of distributions and make no allowance for tax. If investing through an IDPS Provider, the total after fees performance returns of your investment in the Fund may be different from the information we publish due to cash flows specific to your portfolio and any fees charged by the IDPS Provider.

3. Gross performance figures are calculated using end-of-month exit prices, pre-fees, reflect the annual reinvestment of distributions and make no allowance for tax. These returns are provided for the purpose of wholesale investors only. Retail investors should refer to net returns.

Please note: Prior to 1 May 2009 the Fund was known as the Credit Suisse Australian Fixed Interest Fund. On 29 September 2014 the benchmark was renamed due to the acquisition of UBS Australia bond indexes by Bloomberg Indexes.

Past performance is not a reliable indicator of future results.

## Performance review

The Fund returned 1.46% in August (before fees), underperforming the benchmark by 0.05%.

Positive contributions:

- Overweight US duration
- US Treasury / German Bunds convergence trade
- Excess carry from credit

Negative contributions:

- Inflation strategies
- US curve steepener
- Underweight AU duration
- Liquid financial bonds

## Sector holdings (%)

	Fund	Index
Cash & Cash Equivalents	3.52	0.00
Government	19.28	52.36
Semi Government	17.64	23.89
Corporate	59.95	23.74
Supra/Sovereign	28.39	14.16
Financials	11.57	3.53
Non-Financials	10.51	5.51
Asset-Backed	9.48	0.54
CDS	0.00	0.00
Swaps	-0.39	0.00

Figures may not always sum to 100 due to rounding.

## Sector holdings: credit duration (yrs)<sup>4</sup>

	Fund	Index
Cash & Cash Equivalents	0.03	0.00
Government	0.00	0.00
Semi Government	1.30	1.21
Corporate	1.92	0.87
Supra/Sovereign	0.85	0.55
Financials	0.43	0.11
Non-Financials	0.38	0.19
Asset-Backed	0.26	0.02
CDS	0.00	0.00
Swaps	-0.26	0.00

4. Credit duration measures exposure to changes in credit spreads. It is a more realistic measure of credit positioning than % holding.

## Portfolio structure (%)

	Fund	Index
Fixed Rate Bonds	76.12	100.00
Floating Rate Notes	15.07	0.00
Inflation-Linked Bonds	6.32	0.00
Swaps & CDS	-0.39	0.00
Loans	0.00	0.00
Cash & Cash Equivalents	2.87	0.00

Figures may not always sum to 100 due to rounding.

## Credit rating profile (%)

	Fund	Index
AAA	68.87	74.73
AA	10.67	18.25
A	10.86	4.22
BBB	6.80	2.80
<BBB	0.00	0.00
A-1+	1.70	0.00
Cash	1.11	0.00

Figures may not always sum to 100 due to rounding.

## Portfolio analytics

	Fund	Index
Modified Duration (years)	6.28	5.55
Yield to Maturity (%)	1.67	1.06

The Fund is positioned:

- long duration for a fall in overall yields
- long slope for a flattening yield curve

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### Performance Commentary:

Credit strategies marginally underperformed the benchmark. This was principally due to the fund's holdings in liquid financial bonds, which reversed recent trend of spread tightening. Outside of this, it was fairly quiet with stable spreads in non-financials. Certain supranational, sovereign and agency (SSA) bonds with 2025 maturity were pressured as Japanese life-insurance companies liquidated lines. The impact on the fund was negligible as it holds shorter-dated bonds. The fund sold some of its higher-beta bonds in late July early August and is running a more defensive credit position compared with early 2019.

Interest rate strategies delivered positive returns, while inflation positions detracted from performance. Our preference for longer-dated US Treasuries added value, while underweights to Australian duration hurt performance. The sharp surge in risk aversion on the back of increased trade tensions resulted in relatively high-yielding US Treasuries outperforming developed-market peers, such as Australian and German bonds. The portfolio increased its defensive positioning during the month by increasing duration and introducing a US Treasury / German Bund spread narrower. These two positions benefited from the risk-off move. However, the US curve steepener underperformed and was subsequently closed.

### Strategy changes – Interest Rates:

- Increased duration exposure
- Introduced US Treasury / German Bund spread narrower
- Closed US curve steepener

Fed chief Jerome Powell's characterisation of the recent rate cut as a "mid-cycle adjustment" meant that the US curve steepener was no longer considered defensive. As a result, the fund replaced this position with a US Treasury / German Bund spread narrower, which should perform under heightened market volatility.

(Note – Flattener: preference for longer dated assets over shorter tenor bonds; Steepener: preference for shorter dated assets over longer tenor bonds. E.g. A 2s 10s curve steepener expresses a preference for 2 year over 10 year bonds)

### Market review

"Buy bonds, wear diamonds" is a quip that has been doing the rounds on social media over the last few months. Not quite institutional-level investment advice, but very effective if you had followed it in August. Bonds had a solid month, with regime-breaking falls in yields delivering stellar returns to investors positioned on the safe side. Naturally, Donald Trump played a starring role as his volte-face on Chinese trade negotiations caught markets offside. With economic data prints confirming that global corporates are turning off the spending taps during this period of heightened uncertainty, the prolonged effects of the trade war are starting to be priced into markets.

It was notable that during the month, Trump had initially looked to gift US consumers an early Christmas present in the form of deferred tariff implementation, which the market viewed as a major concession. Trump also met with multiple industry leaders to discuss the impact of tariffs, including Tim Cook of Apple (not "Tim Apple", as Trump referred to him during the press conference). The good vibes were put to bed with news of new Chinese tariffs, a devaluation of the Chinese yuan and a flurry of retaliatory tweets.

US 10-year Treasury yields fell from 2.0% to 1.5% over the course of August. Shorter bonds rallied to a lesser degree, leading to a flattening of the yield curve. Australian 10-year government bonds slid by 0.3% to yield 0.9% at month-end after having outperformed in prior months. Gold had another solid session, advancing 8% to the highest level in six years, while copper, a decent proxy for global industrial production, fell 5%. Emerging market currencies fell around 4% after the yuan devaluation, with the Australian dollar falling just 2%.

Despite the strong safe haven bid, risk assets stayed relatively solid. After trading in a saw tooth pattern, the S&P 500 fell just 2% and US investment-grade credit spreads widened by just 0.12% during August. Australian credit spreads were flat, delivering small but positive excess returns versus government bonds. Australian swap spreads tightened, which is typically a 'risk-on' kind of price action, while the index credit-default swap contract widened by only 0.04%. This was a very resilient performance considering iron-ore prices fell from USD120/t to around USD90/t. Investors focused on the improvement in domestic property dynamics, where auction clearance rates increased significantly as East Coast house prices rose once again.

### Key information

ASX mFund Code	AFZ21
APIR Code	CRS0004AU
Benchmark	Bloomberg AusBond Composite Bond Index
Date of launch	February 1993
Income payable	31 March, 30 June, 30 September and 31 December
Management costs	0.54% pa of the net asset value of the Fund comprising: Management Fee 0.51% pa Indirect costs 0.03% pa
Buy/Sell spread	+0.05%/-0.15%
Fund size	A\$296.88m
Redemption unit price	\$1.2178

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## Outlook

Our macro outlook is dominated by two factors –the uncertainty emanating from the US-China trade relationship and easier global financial conditions.

The recent G20 Summit concluded with an uneasy truce but details, as is often the case with Donald Trump, remain scarce. A trade resolution between the US and China remains an upside scenario, resulting in a positive skew to our yield forecasts. In the base case, however, we don't expect any swift resolution of global trade tensions. This will continue to weigh on global economic activity and delay the recovery that we expected earlier in 2019. These dynamics have led central banks to proactively intervene to ease financial conditions, shielding their respective economies from shocks to confidence and investment. We expect the Fed to deliver rate cuts in 2019, and the ECB will remain on hold for the foreseeable future.

In Australia, policy is easing on multiple fronts: monetary, fiscal and macro-prudential. The RBA cut the cash rate in June and we expect another cut in 2019. Further tax cuts are expected to be passed in July, supporting household disposable income. Australian Prudential Regulation Authority has also proposed to lower the debt serviceability test for mortgage holders, offsetting the reduced borrowing capacity of households following closer scrutiny of expenses and harsher enforcement of debt-to-income limits in 2018. Collectively, these policies represent a notable easing of policy to support Australian households; lowering the interest rate burden, releasing disposable income and stabilising house prices. Since the re-election of the coalition government, auction clearance rates have recovered and house prices have stabilised. In the absence of a sharp rise in the unemployment rate, household consumption should gradually recover. Elsewhere, the mining sector is doing well and supporting gross domestic income. With increasing likelihood of infrastructure investment in China (supporting the domestic economy while the trade war remains in place), the growth in national income is sustainable and will be a tailwind. Overall, these policies are reflationary, pinning down real yields at the front end, while supporting longer-term inflation expectations.

The dovish tilt of global central banks underpins the desire for excess spread and reinforces a carry/roll focus for global investors. Given where government bond yields are, credit spreads are an increasingly meaningful contributor to the overall yield on a corporate bond. Global default rates remain very low while revenue/earnings growth is positive, albeit at a much lower level than 2017/18. Given Trump's repeated references to the S&P 500 as being some kind of proof of his presidential prowess, we think that it is unlikely that the current trade spats deteriorate into an all-out war that hurts equities, particularly in the lead-up to the 2020 US election. However, we do acknowledge that we are late-cycle and do not want to be overextending into relatively illiquid parts of the credit spectrum at this juncture.

We continue to dynamically dial up/down our active credit position with liquid instruments, while maintaining a greater proportion of higher-quality credit in funds (we have increased our allocations to AAA-rated state government and supranational bonds).

## Important information

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