Aberdeen Standard Australian Fixed Income Fund

Monthly factsheet - performance data and analytics to 31 March 2019

AberdeenStandard Investments

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[1]
Aberdeen Standard Australian Fixed Income Fund net returns[2]	1.57	3.08	5.96	3.88	4.78	6.72
Aberdeen Standard Australian Fixed Income Fund gross returns[3]	1.62	3.21	6.50	4.41	5.31	7.14
Bloomberg AusBond Composite Bond Index	1.82	3.43	7.20	4.17	5.07	6.78
Net returns[2] vs index	-0.25	-0.35	-1.24	-0.29	-0.29	-0.06
Gross returns[3] vs index	-0.20	-0.22	-0.70	0.24	0.24	0.36

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 1.62% in March (before fees), underperforming the benchmark by 0.20%.

Another month of strong absolute performance, but in relative terms the Fund fell behind the benchmark. The preference for inflation-linked securities against nominal bonds detracted from performance, as did positioning for higher yields. Over the month, both global yields and Australian implied inflation expectations fell as a pessimistic scenario was priced in. This is in stark contrast to equity markets and risk assets in general, which have retraced almost all the underperformance experienced over the fourth quarter of 2018. We see lower probability of a global recession and local disinflationary risk, and as such see value in holding inflation protection. We also used lower yields as an opportunity to reduce interest rate sensitivity in the portfolio.

Credit strategies were flat on the month. The underweight to domestic major banks was a cost as their credit spreads rallied harder than offshore financials. Similarly, the overweight to semi-government bonds was a small cost as spreads widened. These factors were offset by supranational lines that rallied as offshore central banks sought additional carry in Australian bonds. Excess carry compared with the benchmark was a further positive factor.

Sector holdings (%)

	Fund	Index
Cash & Cash Equivalents	3.03	0.00
Government	18.10	51.38
Semi Government	23.08	24.09
Corporate	56.20	24.53
Supra/Sovereign	27.32	14.48
Financials	7.81	3.89
Non-Financials	11.57	5.60
Asset-Backed	9.50	0.56
CDS	0.00	0.00
Swaps	-0.40	0.00

Figures may not always sum to 100 due to rounding.

Sector holdings: credit duration (yrs)[4]

	Fund	Index
Cash & Cash Equivalents	0.00	0.00
Government	0.00	0.00
Semi Government	1.72	1.14
Corporate	1.88	0.88
Supra/Sovereign	0.91	0.55
Financials	0.24	0.11
Non-Financials	0.49	0.20
Asset-Backed	0.24	0.02
CDS	0.00	0.00
Swaps	-0.36	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	75.83	100.00
Floating Rate Notes	12.79	0.00
Inflation-Linked Bonds	8.75	0.00
Swaps & CDS	-0.40	0.00
Loans	0.00	0.00
Cash & Cash Equivalents	3.03	0.00

Figures may not always sum to 100 due to rounding.

Credit rating profile (%)

	Fund	Index
AAA	68.51	73.56
AA	8.16	19.30
A	11.21	4.38
BBB	9.12	2.75
<BBB	0.00	0.00
A-1+	1.70	0.00
Cash	1.30	0.00

Figures may not always sum to 100 due to rounding.

Portfolio analytics

	Fund	Index
Modified Duration (years)	5.24	5.35
Yield to Maturity (%)	2.23	1.88

The Fund is positioned:
- short duration for a rise in overall yields
- short slope for a steepening yield curve

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Market review

The recent dovish turn of global central banks resulted in some peculiar movements in asset prices during March; while bond markets focused their energy on the downside economic developments, risk assets reverted to the quantitative easing (QE)-era playbook of 'climbing the wall of worry'. The S&P 500 stock index increased by 2% while Chinese A shares jumped more than 4%. At the same time, interest rate volatility spiked as 10-year US and German bond yields fell by 0.31% and 0.25% respectively, delivering handsome returns to bondholders. This is what it sounds like when doves cry.

Yield curves flattened as Chinese PMIs (Purchasing Managers' Indices) remained sub-50, with the official manufacturing PMI coming in at 49.2 while the US manufacturing PMI fell from 54.9 in February to 53.0 in March – the lowest level since June 2017. Closer to home, Australian business confidence took a dive to -0.4 in March after a decent run of good vibes. 3-year Australian government bonds, which had been trading north of 2% as recently as December 2018, plummeted from 1.63% to 1.39% during the month as an increasing number of economists called for multiple interest rate cuts from the Reserve Bank of Australia (RBA).

Despite the stark fall in yields, credit spreads were very well behaved. US and Australian investment grade corporate credit returned around 0.3% over government bonds, so total returns were very strong at 2.5% and 1.5% respectively (the difference in total returns is principally due to the longer duration of the US investment grade corporate bond index). US high yield credit underperformed government bonds by 0.25% as spreads widened by around 0.13% – an interesting observation given the general risk-on tone. While it is obvious that the high yield universe is more acutely exposed to a slowdown in economic growth, it isn't very often that equities and high yield diverge to this degree.

The fall in all-in yields saw many global corporates rush back to the new issue market in the US, Europe and across Asia, but things remained a little quieter in Australia. Local issuance was dominated by state government and supranational entities, while a handful of corporates got involved. Chemicals-and-explosives player Incitec Pivot issued A$450m of 7-year bonds with a coupon of 4.3%, while Stockland and Dexus defied the negative news about the local property market to issue bonds at respectable credit spreads. In the unrated space, Peet Ltd issued A$75m of 5-year bonds at a coupon of 6.75%.

Outlook

We retain high conviction that the Australian economy will emerge unscathed from the various self-inflicted problems it has been navigating across housing, lending, and politics. However, the extended slowing in household income will weigh on activity in the near future and likely delay the timing of monetary tightening indefinitely. Furthermore, the risk that the RBA may have to cut rates has increased and depends on the trajectory of the global economy more so than the wealth effect from housing. Our outlook for employment is sufficiently positive to keep the unemployment rate steady, and with the labour market sitting at full capacity and wage growth slowly trending higher the RBA is likely to remain comfortably on hold with a neutral stance.

The US is in a state of flux, caught between a slowdown in activity from lofty levels and the risk of accelerating wage growth. A previous government shutdown, an unconvincing suspension in the trade war with China and generally stratospheric levels of policy uncertainty are also beginning to be felt in the survey data. Adding to that, our adjusted Phillips curve foreshadows a build-up in inflationary pressures in the months ahead. However, the risk is that deteriorating business sentiment will constrain investment and jobs growth sooner than wage pressures can build. We forecast a limited slowdown in our central case and see a recovery in the offing, as households and corporate USA have resilient balance sheets with which to navigate the current soft patch. In contrast to market expectations we forecast scope for an additional increase in the Fed funds rate later this year and in the meantime a highly data-dependent Fed China on the other hand is in the midst of activating stimulus–largely through infrastructure investment–that has not been sufficient to offset slowing in the manufacturing sector. The Eurozone awaits a rebound after various temporary factors clouded the signal-to-noise ratio in the economic data. The ECB is in the process of revising its outlook to upgrade the downside risks and in our assessment will also re-ignite targeted longer-term refinancing operations (TLTRO).

Credit endured an exceedingly tough 2018 and started 2019 at attractive valuation levels relative to the last few years. However, we do not believe that 'the last few years' is the optimal yardstick for assessing relative valuation in 2019 as these years encompassed globally-coordinated quantitative easing from major central banks and record low yield and credit spread levels, and as a result artificially suppressed default rates. We now have a Fed funds rate in the mid-2s that not only impacts core global yield levels (and in turn refinancing rates for corporates) but also the hedging costs for the large overseas buyers of US investment-grade credit that drove 2017s issuance boom. Global

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$293.88m**
Redemption unit price	**$1.1942**

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economic growth has slowed and our expectation is that US corporate earnings will continue to meaningfully decelerate in 2019. Taking these factors into account, valuations could best be described as fair, but the recent rally in spreads is starting to make this harder to justify. We continue to believe that approaching credit from a 'sell the rally' angle makes more sense than the 'buy the dip' mantra that was so powerful in 2016 and 2017. For these reasons, we will 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). Ultimately, given we expect default rates to stay low, a degree of credit overweight is warranted but at reduced scale.

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