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July 2010

Future Directions Australian Bond Fund - Wholesale

Investment objective

To provide a total return, after costs and before tax, higher than the return from the Fund's performance benchmark on a rolling 3 year basis.

Minimum suggested time frame

2 to 3 years

Type of fund

The Fund invests primarily in short and long term fixed interest securities, including government, bank, corporate and asset backed securities, derivatives and currency.

Performance benchmark

The average weighted return of the market indices used to measure the performance of the asset classes in which the fund invests.

Inception date

06 Nov 2002

Fund size

$1,131.74 million

Management costs

0.5%

Distribution frequency

Quarterly

Buy/sell spread

+0.00/-0.06

Investment approach

The Fund is managed using a multi-manager style with passive re-weighting to the benchmark asset mix (ie no active or significant positions away from the benchmark).

Target asset allocation

Manager	Allocation
AMP Capital Investors	72.0%
Vianova Asset Management	10.0%
AMP Capital Core Plus Strategies Fund	18.0%

Performance – periods to 31 July 2010

%	1 mth	3 mth	1 yr	3 yr	5 yr	incept
Before tax and after fees	0.35	2.87	9.09	7.24	5.73	5.81
Before tax and fees	0.39	3.00	9.63	7.77	6.25	6.33
Benchmark	0.27	3.31	7.81	7.52	6.02	6.01
Growth	0.35	0.48	2.24	0.07	-0.70	-0.22
Income	-0.00	2.39	6.85	7.16	6.43	6.03

*Performance more than 1 year is annualised

Returns are calculated using the unit price which uses the net asset values for the relevant month end. This price may differ from the actual unit price for an investor applying for or redeeming an investment. Actual unit prices will be confirmed following any transaction by an investor. Returns quoted are before tax, after Class 'O' fees and costs, assume all distributions are reinvested and are annualised for periods greater than one year.

Performance and Activity

The Future Directions Australian Bond Fund - Wholesale (the Fund) returned 0.35% (Before tax and after fees) in the month of Jul, compared to the benchmark return of 0.27%

The Fund once again benefited from its overweight position to investment grade credit, as spreads ground tighter and excess yield over benchmark continued to accrue. Other contributors to performance were broad-based as most sectors performed well, which was in keeping with the positive tone of asset markets over the month. Amongst the better performers were exposures to offshore credit denominated in euros and US dollars, particularly through recent purchases of US financial senior-ranked bonds. The Fund also benefited from the tactical use of derivative strategies, which allowed it to better manage its overall beta to the market during recent volatility.

July saw a net increase in the Fund's exposures to the government and semi-government sectors over the month. These were funded primarily by reducing AMP Capital's exposure to a number of European supra-national issuers. The Fund remains overweight investment grade credit. The main industry overweights include Financials, Industrials, Utilities and Securitised. There are no material industry underweights. These positions are largely funded from the government, semi-government and supra-national and sovereign guaranteed buckets.

Given the expectations for both global and domestic growth, the Fund is positioned to be short global yields in New Zealand, Canada and the US, and for flattening yield curves in Australia and Europe. In terms of currencies, the Fund maintains a preference to be long European and Asian currencies and short commodity-related currencies. Over the course of July, global bonds weakened with the rally in risk assets, which saw the Australian yield curve flatten. This led to a positive contribution from the Fund's interest rate positioning while currency positions resulted in a modest negative contribution.

Market commentary

A moderation in both global and domestic economic data saw the market price in an extended period of stable monetary policy by the Reserve Bank of Australia (RBA), particularly after a softer than expected inflation result. Australian bond yields initially sold off in July after stronger employment data prompted the market to price in a greater chance of future RBA tightening. However, the modest June quarter inflation data reversed this trend and resulted in a rally into month end. Three-year Australian government bonds opened the month at a yield of 4.39% and closed 0.17% higher at 4.56%. Ten-year bonds traded similarly and the yield closed the month 0.14% higher at 5.20%.

In the Australian credit market, spreads tightened sharply over the month, with lower-rated investment grade credit outperforming higher grade credit, particularly within the non-financial sectors. In credit derivative markets, the iTraxx Australia tightened 19 bps to 116 bps, the iTraxx Europe tightened 25 bps to 105 bps and the North American CDX IG index tightened 19 bps to 104 bps. The most significant transaction in July was a ten-year bond in A$300 million from BBB-rated APA Group at 240 bps over swaps. This was the first transaction for a mid BBB-rated entity in the local market, and was met with solid investor demand. In addition, there were numerous supra-national and high grade financials issued over the month, as well as a A$1.25 billion ANZ three-year bond issue. Global investment grade issuance continues to be well supported by investors against a backdrop of very strong technicals and company fundamentals.

Outlook

Concerns over the global recovery have seen good returns from Australian bonds over the past month. However, low yields suggest that Australian bonds are going to see poor returns over the medium term.

As credit spreads return to the more 'normal' levels typically seen through economic downturns, we expect investors to revert to a more stock-specific focus. We are still faced with a yield dilemma in many developed countries i.e. the yield on credit is starting to look less compelling due to base government bond yields, while longer-term spreads are still wide compared to previous cycles. Lower-quality issuers, particularly those in cyclical industries that are traditionally more exposed to periods of economic contraction, will likely be impacted the hardest by what is happening in the global economy. However, many strong companies have been caught up in market repricing as well, with spreads widening in many cases beyond levels that are appropriate from a fundamental viewpoint. From a risk-adjusted return perspective, the prospects for these investments over the medium term look to be attractively priced and we will focus on these issuers accordingly.

Manager focus

Vianova Asset Management (absolute return strategies)

The Vianova Asset Management portfolio narrowly outperformed its benchmark in July.

In absolute terms, the portfolio performed well over the month. On a relative basis, the duration strategy contributed strongly to overall performance while the portfolio's yield curve strategy was also positive after the yield curve steepened, especially at the short end. Against this, the portfolio's sector strategy generated a relatively weak result for the month.

In terms of transaction activity, the portfolio bought government June 2011 bonds, three-year September futures and Westpac negotiable certificates of deposit for June 2011. In addition, the portfolio sold government May 2013 bonds and government June 2011 bonds.

The portfolio's sector weightings as at 31 July 2010 were as follows: government bonds (43%), corporate bonds (22%), semi-government bonds (19%), discount securities (13%), government-guaranteed bonds (2%) and cash (1%). The portfolio's current credit weightings are: AAA (79%), AA+ (3%), AA (15%), A (2%) and BBB+ (1%).