Multi-asset real return strategy

Investment update to 30 September 2019

The multi-asset real return (MARR) strategy is invested across a range of assets in a manner which seeks returns while managing the risk of negative returns. It doesn't have common restrictions such as asset class limits; instead the manager is unconstrained in their ability to combine individual assets to extract return potential while controlling risk. This can provide a more reliable path of returns and better preserve investors' capital in difficult markets.

Investing in the MARR strategy, rather than just share markets, is expected to help protect our portfolios in challenging economic scenarios (eg in an environment of rising inflation).

The MARR strategy in MLC's Inflation Plus portfolios is managed by Ruffer LLP (Ruffer). MLC Inflation Plus portfolios' allocations to MARR are shown in Table 1. MLC Horizon portfolios have an indirect allocation through their investment in the MLC Inflation Plus strategies.

Table 1: MLC Inflation Plus portfolios' target allocation to MARR as at 30 September 2019

MLC MasterKey Super & Pension Fundamentals	MARR %	MLC Wholesale	MARR %
MLC Inflation Plus Assertive Portfolio	13.0	MLC Wholesale Inflation Plus Assertive Portfolio	15.0
MLC Inflation Plus Moderate Portfolio	10.0	MLC Wholesale Inflation Plus Moderate Portfolio	12.5
MLC Inflation Plus Conservative Portfolio	6.0	MLC Wholesale Inflation Plus Conservative Portfolio	7.0

Source: MLC Asset Management Services Limited. Based on the portfolios' target allocations.

An explanation of how fees are deducted from returns is in Appendix 1.

Investment objective

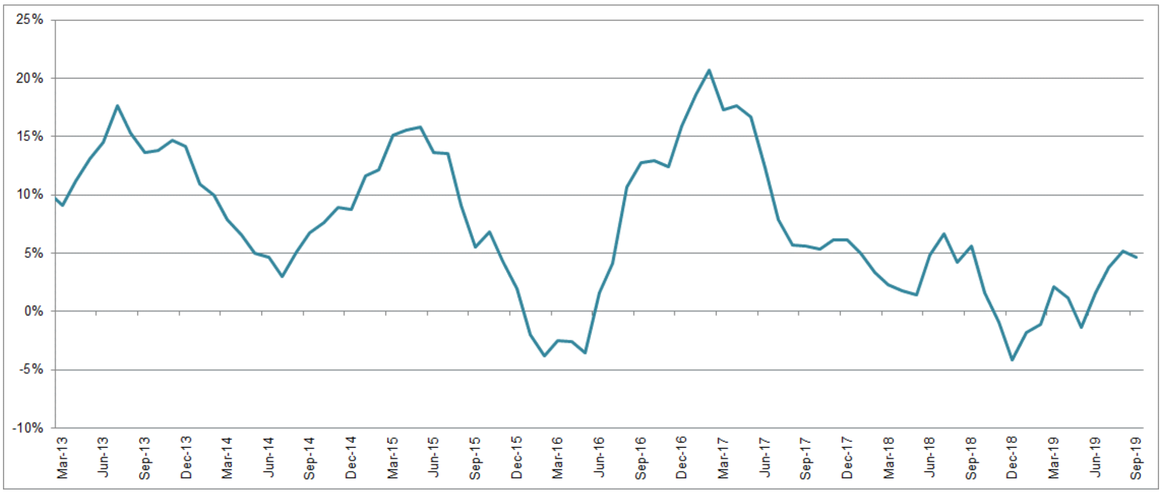
The strategy aims to limit the risk of negative nominal returns in any 12 month period.

About the manager

London based Ruffer was established in 1994. It has managed the MARR strategy for MLC since 2009.

Performance

Chart 1: Performance of MARR (rolling 1 year returns) to 30 September 2019 (before fees and tax)



Source: MLC Asset Management Services Limited. Returns are calculated before deducting fees and tax. Past performance is not a reliable indicator of future performance.

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The MARR strategy has worked well for the MLC portfolios as shown in Chart 1 and Table 2. It has made an important contribution to returns in our portfolios and helped to moderate risk.

Table 2: Returns to 30 September 2019 (before fees and tax)

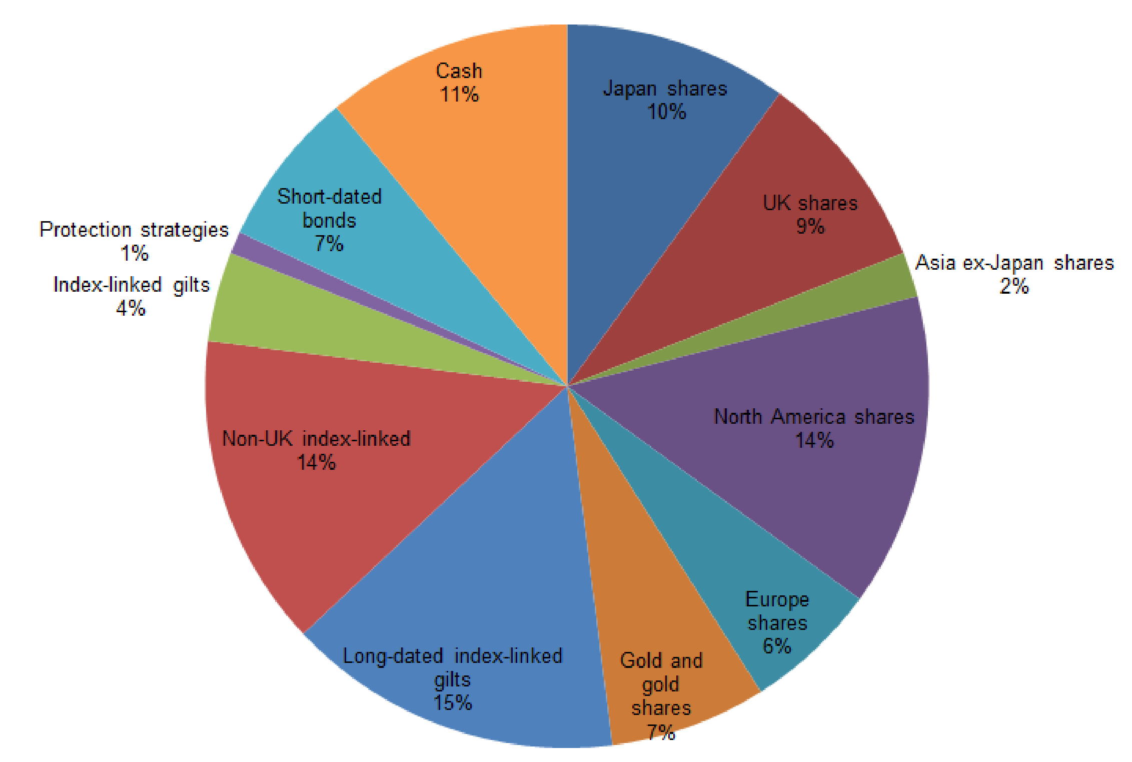
	3 mths %	1 year %	2 years % pa	3 years % pa	5 years % pa	7 years % pa
MARR strategy	4.0	4.7	5.2	5.3	6.8	7.7

Source: MLC Asset Management Services Limited. Returns are calculated before deducting fees and tax. Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market. Figures are rounded to one decimal place.

Notes: From 1 September 2015 the strategy was fully managed by Ruffer. Prior to this, the strategy was managed by Ruffer and Pyrford International Ltd.

Asset allocation

Chart 2: Asset allocation at 30 September 2019



Source: Ruffer.

Current portfolio commentary and positioning

Returns are before fees and tax

Ruffer notes the September 2019 quarter saw the strategy make further progress, with strong returns from the inflation-linked bonds, gold and Japanese shares more than offsetting falls elsewhere. Since the second quarter the central dynamic has been sharply falling global bonds yields as markets reflected a slowdown in the global economy and fears over trade wars, Brexit, and the situation in Hong Kong. Signs of weakening economic activity, especially in the world's industrial sectors, saw recession fears rise.

As investors drove bond yields to ever-lower levels the strategy's long-duration bonds and gold-related investments provided a positive tailwind. With the German economy flirting with a technical recession, the European Central Bank provided yet more monetary easing in September. The result was the stock of negative yielding debt – that is debt on which a loss is guaranteed – which has doubled this year to $17 trillion or 30% of the index.

Ruffer believes the strategy's positive performance in August was evidence of the better balance of protective assets they have put in place since the December quarter; as global share markets fell the strategy was comfortably in positive territory.

Factors that helped performance:

- **Japanese shares**. Strong stock selection meant that the strategy's holdings in Japan returned 10% on average, with most names contributing positively, notably Bandai Namco (+29%) and Fujitsu (+16%).
- **UK index-linked bonds.** The collapse in government bond yields meant that UK index-linked bond prices rose sharply, with the longer maturities registering double-digit gains.
- **Gold mining shares**. With gold's zero yield, nothing looks more attractive relative to negative interest rates and so the strategy benefitted as the gold price rose by nearly 7%.

Factors that hurt performance:

- **Option protection.** Shares protection helped the strategy during August's share market declines but were a cost as a whole. The strategy had minimal interest rate protection so benefitted fully from the fall in bond yields.

Table 3: Summary performance attribution for the quarter

Five largest positive contributions	%	Five largest negative contributions	%
UK index-linked bonds	+1.7	Option protection	-0.4
Gold and gold shares	+1.1	ArcelorMittal	-0.2
Bandai Namco	+0.3	Cleveland Cliffs	-0.2
Celgene	+0.2	Valaris	-0.2
Fujitsu	+0.1	Centene	-0.2

Source: Ruffer.

Appendix 1: Understanding fees that are deducted from returns in this investment update

As MLC Horizon and Inflation Plus portfolios invest in the MARR strategy and a range of other asset classes and strategies, only some of the fees disclosed in the Product Disclosure Statements (PDSs) relate directly to the management of the MARR strategy. Therefore, the MARR strategy's performance is reported before deducting most of the fees and taxes disclosed in the PDSs.