Multi-asset real return strategy

Investment update to 31 December 2018

The multi-asset real return (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 31 December 2018

MLC MasterKey Super & Pension Fundamentals	MARR %	MLC Wholesale	MARR %
MLC Inflation Plus Assertive Portfolio	14.0	MLC Wholesale Inflation Plus Assertive Portfolio	16.0
MLC Inflation Plus Moderate Portfolio	11.0	MLC Wholesale Inflation Plus Moderate Portfolio	13.5
MLC Inflation Plus Conservative Portfolio	7.0	MLC Wholesale Inflation Plus Conservative Portfolio	8.0

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

The 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).

Investment objective

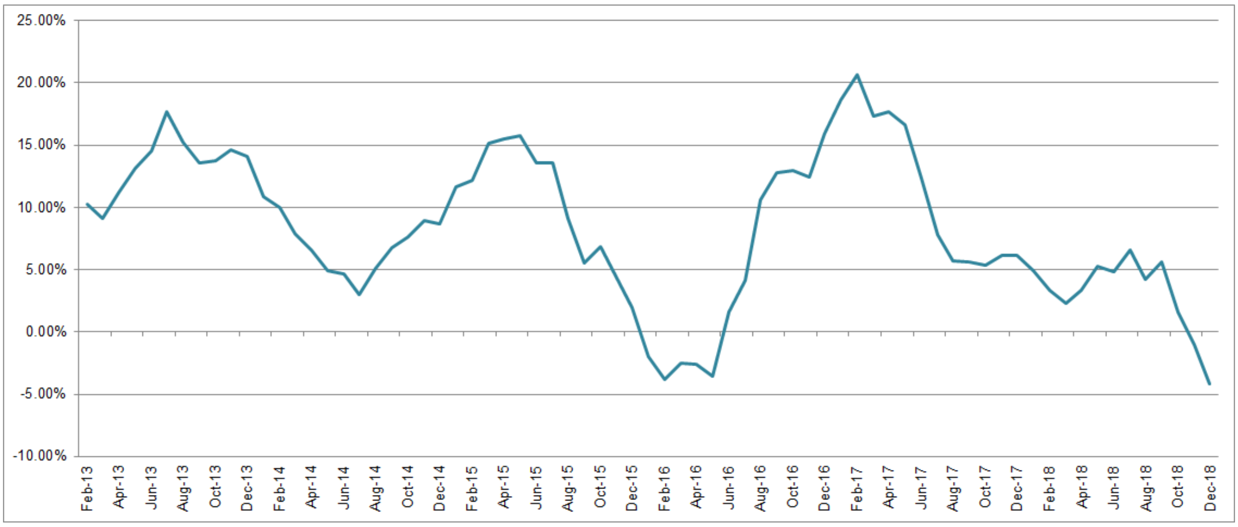
The strategy aims to limit the risk of negative nominal returns in any 12 month period.

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 31 December 2018 (before fees and tax)



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

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 31 December 2018 (before fees and tax)

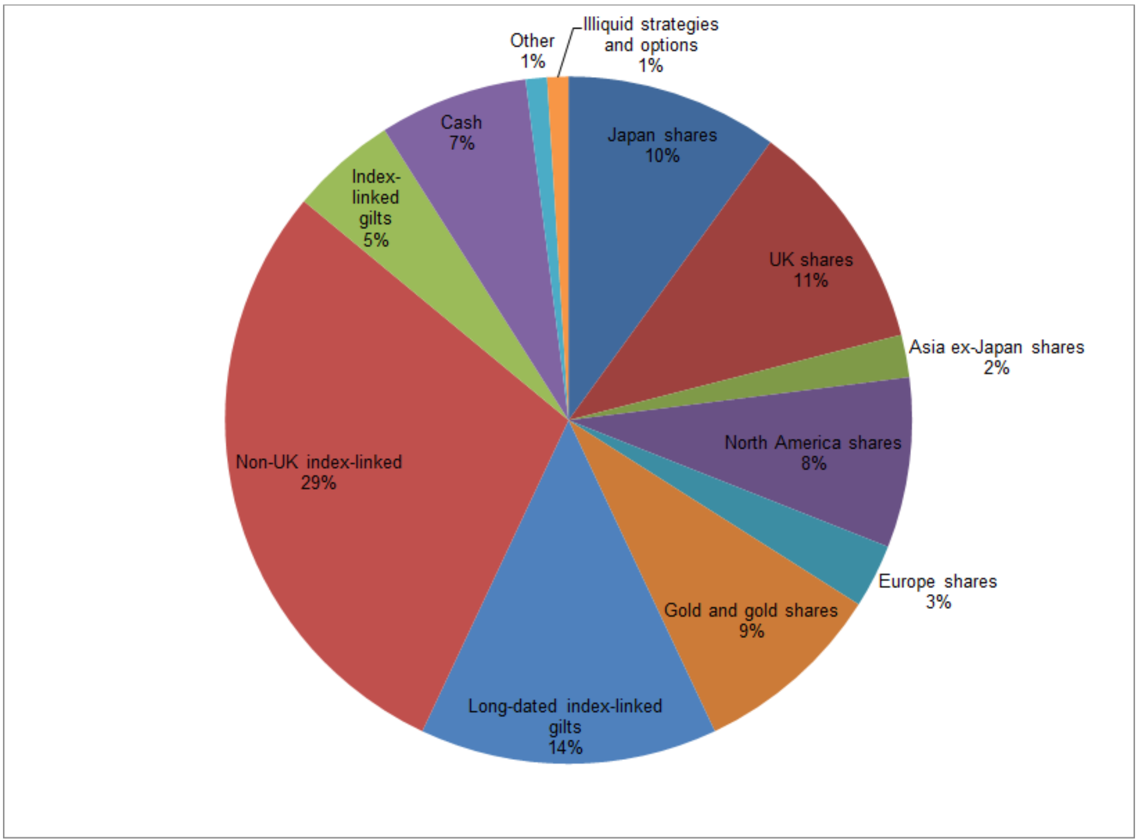
	3 mths %	1 year %	2 years % pa	3 years % pa	5 years % pa
MARR strategy	-5.4	-4.2	0.9	5.6	5.5

Source: NAB 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 31 December 2018



Source: Ruffer.

Current portfolio commentary and positioning

Returns are before fees and tax

Ruffer notes the final quarter of 2018 saw global share markets succumb to some of the many problems that Ruffer feared lay in their path – principally the impossibility of reconciling high valuations with rising interest rates, inflation pressures and political uncertainties. For the strategy this brought a little satisfaction, but mainly frustration and disappointment. Frustration in that while the protection assets in the strategy started to deliver, especially in December as the market falls worsened, overall the strategy still declined in value, falling about 5% in the quarter as global markets fell between 10-17%. Disappointment, as this resulted in the strategy recording a calendar loss for only the second time since we've been managing the strategy for MLC.

Why did this happen? Ruffer notes the strategy's share exposure, although cautious in magnitude, was focused on cyclical and financial stocks and these fell as much, if not more, than broader indices. Index-linked bonds failed to provide much of an offset as investors continued to battle with the future path of interest rates. Meanwhile markets fell enough to hurt the strategy's shares, but not enough for the strategy's option protection to kick in meaningfully. Had markets fallen further these would have provided a substantial contribution. Ruffer believes these will be vital offsets in 2019, with the potential to deliver strong positive returns if markets continue to struggle.

Factors that helped performance:

- **Gold**. As share markets fell, gold played its traditional role as a safe haven. Gold mining stocks such as Barrick and Kinross gained more than 20%, rewarding Ruffer's decision to increase exposure to 8% in September.

Factors that hurt performance:

- **Global shares.** Despite cutting shares back to just 35% of the portfolio ahead of the steepest market falls, Ruffer's focus on value stocks provided no protection. Financials, oil, cyclicals and Japanese shares were hit especially hard in the general market sell-off.

Table 3: Summary performance attribution for the quarter

Five largest positive contributions	%	Five largest negative contributions	%
LF Ruffer Gold Fund	+0.4	Mitsubishi UFJ	-0.5
Japanese yen	+0.4	National Oilwell Varco	-0.5
US dollar	+0.4	Tesco	-0.5
Barrick Gold/Randgold Resources	+0.3	T&D	-0.5
US index-linked bonds	+0.1	Sumitomo Mitsui Financial Group	-0.4

Source: Ruffer.

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