

Aberdeen Australian Fixed Income Fund



Investment objective

To provide exposure to primarily Australian fixed income securities, to generate income with some growth potential over the medium to long term. The Fund aims to outperform the UBSA Composite Bond Index over the suggested investment time frame.

Investment strategy

The investment strategy of the Fund is 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 summary

	1 Month %	3 Months %	1 Year %	3 Years %pa	5 Years %pa	Since Inception [^] %pa
Australian Fixed Income Fund Net returns*	1.79	3.10	6.87	6.98	6.16	7.32
Australian Fixed Income Fund Gross returns**	1.83	3.23	7.41	7.48	6.57	7.67
UBSA Composite Bond Index returns	1.35	2.47	1.67	6.86	5.98	7.36
Net returns* vs Index	0.44	0.63	5.20	0.12	0.18	-0.04
Gross returns** vs Index	0.48	0.76	5.74	0.62	0.59	0.31

* 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.

** 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.

[^]This figure represents the annualised performance of the Fund from the first full month of operation in June 1993.

Please note: Prior to 1 May 2009 the Fund was known as the Credit Suisse Australian Fixed Interest Fund

Past performance is not a reliable indicator of future results.

Performance review

The portfolio outperformed the index in January. Our overweight position to credit was the major contributor to performance during the month. The credit index (adjusted for duration) outperformed the government index by 0.5%, led by a further narrowing in spreads in financials, and subordinated debt in particular. We have retained our overweight in the portfolio, but are reducing gradually. We retain our overweight to mortgage backed securities, where we see most value on a risk/return basis.

In terms of interest rate strategies, our curve flattening position added value as longer dated bonds outperformed. Our duration positioning over the month had little impact on performance. Market-neutral relative value strategies also had limited impact on performance during the month.

Market review

The Australian bond market delivered a 1.35% return in January as yields fell from their relatively high levels at the end of December. Three-year yields fell by 15 basis points to 4.51%, while 10-year yields fell by 26 basis points to 5.38%. These moves were driven largely by increasing risk aversion globally. Examples of this risk aversion included the reluctance of certain countries to bailout Greece's precarious fiscal position; Chinese authorities looking to restrain bank lending via direct controls; and Barrack Obama's poorly received proposed bank insolvency levy. However, Australia's strong set of economic data was in contrast to the increased nervousness offshore. The Australian unemployment rate fell to 5.5% in December, November retail sales rose 1.4% month

Portfolio analytics

	Fund	B/mark
Modified Duration (years)	3.23	3.40
Yield to Maturity (% pa)	6.48	5.43

Sector holdings

	Fund %	B/mark %
Government	-	26.81
Semi Government	18.03	32.45
Corporate	63.46	40.74
Supra/Sovereign	2.99	21.96
Financials	36.01	15.41
Non-Financials	10.53	3.31
Asset-Backed	13.93	0.06
Cash, short term, derivatives	18.51	-

Security type

	Fund %	B/mark %
Fixed	37.92	100.00
Floating	43.53	-
Inflation-Linked	0.04	-
Hybrid	-	-
Cash, short term, derivatives	18.51	-

Credit rating profile

	Fund %	B/mark %
AAA	43.47	80.09
AA	19.71	13.03
A	17.31	5.17
BBB	8.81	1.71
<BBB	0.00	-
A-1+	10.70	-
A-1	-	-
A-2	-	-
A-3	-	-

Further information

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on month, building approvals rose, and the CPI came in ahead of expectations at 0.5% quarter on quarter and 2.1% year on year. This strong domestic data helped to flatten the yield curve (where longer dated bond yields fell by more than shorter dated) although in aggregate, Australian yield moves kept pace with those offshore.

Credit markets began January positively, with spreads tightening. Local and offshore new issuance volumes were robust, though local supply has been mainly in the Supranationals. Markets turned more negative later in the month, with the start of the US earnings season, which kicked off with JP Morgan on 15th January. In the last two weeks of the month, spreads widened by 20 basis points on the local ITRAXX CDS index, demonstrating a high correlation with weaker equity markets. The ASX 200 fell 6% in January and the S&P 500 was down 3.7%. However, overall spreads tightened modestly by 3 basis points on the UBS Credit Index, as investors continued to prefer cash bond assets.

Asset quality at all the major US banks continues to deteriorate, and management comments were decidedly cautious about the strength of the US recovery and future asset quality. For Q4, Citigroup and Bank of America made losses, Morgan Stanley posted earnings a long way below estimates, but strong profits were recorded at Wells Fargo and Goldman Sachs. All of this news was overshadowed by rising sovereign credit risk, poor new issue performance and rising political and regulatory uncertainty, led by President Obama's initiatives in particular. In addition, the tightening of monetary policy in China dampened risk appetite.

Sovereign risk was a focus again, as Greece performed poorly. In the US, President Obama announced plans to introduce major changes to the banking sector in the form of taxes on liabilities to recoup lost TARP funds, reduced proprietary trading and controls over the funding of hedge funds. While not necessarily credit negative, the resulting uncertainty warranted a higher risk premium for the sector. CDS spreads on the large US banks widened 40 basis points to 50 basis points on the month.

Local new issue supply was \$12.6 billion in January (excluding Commonwealth Government Bonds), mostly comprised of increases to existing issues or new issues from the Supra sector. However, the Queensland State Government issued \$4 billion of 2014 debt without a Commonwealth guarantee, which was a big positive for the semi-government bond market, given the strong demand. In addition, AMP Bank issued \$1 billion of Residential Mortgage Backed Securities in the Progress 2009-1 trust, which was an upsized deal that priced at 130 basis points over bank bills. Encouragingly, the securitised funding channels are open again for the likes of Bank of Queensland and Suncorp, which should reduce the need to issue senior unsecured bonds and will greatly assist the non-bank lenders.

Outlook

Our broad views on rates and credit remain unchanged, notwithstanding some change in market sentiment over the last month. In particular, the market reacted to a reduction in risk appetite acknowledging that the path to the 'new normal' interest rate setting will be bumpy. Key themes associated with slower growth include macro management measures in China to restrict bank lending, fears of further fiscal tightening given instability in Europe, and political pressures in the U.S surrounding regulation. We retain our long term view that 'normalisation' will eventually be global and involve policy removal, higher yields and flatter curves. However, opposing forces in the shorter term include the attraction of holding bonds for carry (given liquidity, steep curves), recurrence of risk aversion, and speculation on longer term regulatory reform impacts.

Both credit and equity markets appeared to reach an inflection point in mid-January, as the Q4 results season commenced. Having moved from an environment where most "risk on" trades performed well, markets have taken a decidedly cautious tone, with equities falling, spreads widening and growth currencies weakening. The three main negatives that could generate further weakness for risk assets are the policy tightening and growth/inflation outlook for China; uncertainty around the Obama administration's proposed bank controls and the growing concern around sovereign risk.

Maturity profile

	Fund %	B/mark %
0-1yrs	27.20	12.87
1-3yrs	31.28	29.12
3-5yrs	12.94	26.26
5-7yrs	6.28	11.08
7-10yrs	13.51	13.97
10+yrs	8.79	6.70

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However, for corporate credit markets, these are not necessarily negative developments. The Obama proposals could in fact make bank debt less risky by reducing leverage. Sovereign risk stems from budget deficits and weak growth, in contrast to strong balance sheets and margins for most corporates. Finally, the tightening of policy in China is prudent for the medium term and growth will remain relatively robust. However, it is likely that in the short term, markets will question the notion of a smooth recovery and focus more on the macro risks. In this environment, credit will not deliver the outstanding returns seen in 2009. While we feel credit still presents reasonable value on a longer-term historical basis, we will continue to selectively reduce risk.

Key information

APIR Code	CRS0004AU
Benchmark	UBSA Composite Bond Index
Date of Launch	June 1993
Income Payable	31 March, 30 June, 30 September and 31 December
MER	0.51% pa
Buy/Sell spread	0.30%/0.30%
Fund Size	A\$421.20m
Redemption Unit Price	\$1.1372

Important information

This document has been prepared by Aberdeen Asset Management Limited ABN 59 002 123 364 AFSL No. 240263.

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