

# Aberdeen Cash Enhanced Fund



## Investment objective

To provide exposure to relatively low risk, high credit quality and highly liquid cash in addition to Australian and international fixed income securities, to generate income. The Fund aims to outperform the benchmark UBSA Bank Bill Index over the suggested investment time frame.

## Investment strategy

To focus on maintaining high credit quality and liquidity, and to aim to actively add value through interest rate, credit and relative value strategies. The strategies involve both fundamental and model driven analysis and seek to exploit as many return generating opportunities as possible (including limited access to international markets) and are therefore well risk diversified.

## Performance summary

	1 Month %	3 Months %	1 Year %	3 Years %pa	5 Years %pa	Since Inception <sup>^</sup> %pa
Cash Enhanced Fund Net returns*	0.47	1.36	8.60	6.37	6.14	6.01
Cash Enhanced Fund Gross returns**	0.50	1.46	9.01	6.75	6.48	6.32
UBS Australian Bank Bill Index returns	0.42	1.20	4.05	5.52	5.76	5.69
Net returns* vs Index	0.05	0.16	4.55	0.85	0.38	0.32
Gross returns** vs Index	0.08	0.26	4.96	1.23	0.72	0.63

\* 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. Retail investors should refer to net returns.

<sup>^</sup>This figure represents the annualised performance of the Fund from the first full month of operation in August 2003.

Please note: Prior to 1 May 2009 the Fund was known as the Credit Suisse Cash Enhanced Fund.

Past performance is not a reliable indicator of future results.

## Performance review

The portfolio returned 0.50% in July compared to the UBS Bank Bill Index return of 0.42% (both before fees).

The defensive credit positioning of the portfolio during the month of July detracted slightly from performance. This was offset by the attractive running yield in the portfolio, and the solid performance in the financial and Australian AAA mortgage-backed sectors.

We were surprised by the strong recovery in risk sentiment following the European bank stress tests. As a result, the underweight positions to the Australian Itraxx credit index and European supranational issuers detracted from performance, as these sectors recovered from the weakness seen in May and June.

During the month, our rates positioning reflected a view that bond markets had become overvalued. This short duration position added value in the earlier part of the month. We trimmed the size of the position mid-month, which assisted in limiting downside in the second half, as bonds performed quite strongly following the benign inflation data. Our positioning for a flattening of the yield curve (longer maturity bonds outperformed shorter maturities during the month), had little impact on performance in July.

## Market review

The RBA left the cash rate unchanged at its July meeting. Bank bill yields closed lower at month end, despite a brief move higher in the middle of the month. June employment data showed a strong 45,900 rise in employment, which saw market expectations rising to a 20% chance of a rate hike at the August meeting. Slower global growth, namely weaker US data and a lower-than-expected Australian Q2 CPI of 0.6%, saw the market remove rate hike expectations. We closed the month with the market pricing in a relatively flat cash rate outlook for the remainder of this year.

The BBSW/OIS spread reached a 2010 high of 45 basis points in late June, as the financial year end approached, and continued to narrow throughout the month of July as concerns over global financial conditions eased. Bank bill yields closed as follows: 1-month fell 7 basis points to 4.68%, 3-month fell 14 basis points to 4.78% and 6-month were also down 6 basis points to 4.94%.

## Sector holdings

	Fund %	B/mark %
Cash & Cash Equivalents	35.46	100.00
Government	0.00	0.00
Semi Government	0.00	0.00
Corporate	64.54	0.00
Supra/Sovereign	0.00	0.00
Financials	21.83	0.00
Non-Financials	10.74	0.00
Asset-Backed	31.97	0.00

## Sector holdings: credit duration (yrs)\*

	Fund	B/mark
Cash & Cash Equivalents	0.00	0.00
Government	0.00	0.00
Semi Government	0.00	0.00
Corporate	1.59	0.00
Supra/Sovereign	0.00	0.00
Financials	0.40	0.00
Non-Financials	0.62	0.00
Asset-Backed	0.58	0.00

\* Credit duration measures exposure to changes in credit spreads. It is a more realistic measure of credit positioning than % holding.

## Security type

	Fund %	B/mark %
Fixed	6.08	-
Floating	52.95	-
Inflation-Linked	5.43	-
Hybrid	0.00	-
Cash & Cash Equivalents	35.55	100

## Portfolio analytics

	Fund	B/mark
Modified Duration (years)	-0.08	0.13
Yield to Maturity (% p.a.)	6.65	4.69

The Fund is positioned:

- short duration for a rise in overall yields
- long slope for a flattening yield curve.

## Further information

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## Aberdeen Cash Enhanced Fund

After the challenges for credit markets in May and June, July was a strong month. Credit outperformed both Commonwealth and semi-government bonds by around 60 basis points, as spreads tightened. Sovereign/supranational bonds also outperformed Commonwealth and semi-government bonds, though not to the extent of the financial and corporate sectors. The Itraxx Australia index of CDS spreads tightened by 23 basis points, mirroring the strong performance of the US and European markets, while the UBS Credit index spread tightened by 3 basis points to 133 basis points.

Although economic data releases were soft during the month, especially in the US, several developments helped credit market sentiment. Bond auctions from Spain, Greece and Portugal were viewed positively, despite relatively narrow placement, and the release of the European stress tests for the banking system proved to be a catalyst for all risk assets to rally. Although questions remain over the rigour of the tests, the lack of major surprises helped financial spreads in particular to contract from the wide levels reached at the end of June. A further positive driver for financials was the softening of Basel III reform language and extension of implementation timeframes. Quarterly earnings from the US were mixed, with major US financials reporting softer revenue from investment banking but also sharp reductions in credit costs. Management outlook statements expressed caution about the extent of the earnings impact from recent regulatory changes and this will remain a drag on equity performance. For non-financial corporates, balance sheets are healthy and should withstand the likely weakening in the US recovery, while outright funding costs are very low. Certainly, economic data released during the month confirmed the prevailing view of the Federal Reserve, that growth would remain subdued and therefore there was no reason to remove monetary stimulus.

After limited new issuance in May and June due to the volatility in spreads, July saw a reasonable amount of supply both locally and globally. The US market has now seen over \$500 billion of new investment grade issuance year-to-date. In terms of local issuance, new deals in July have come from the sovereign/supra sector (KFW, EIB, EDC, IFC), financials (ANZ, Westpac) and corporates (SPI Australia, APT, Sydney Airport) to bring total monthly new issuance to \$5.6 billion. The domestic banks have largely completed their funding task for the current year, but given the size of funding required for the next two to three years, it is likely any spread stability will be met with proactive new issuance.

### Outlook

As we noted last month, rates markets have shifted lower in yield in recent months, initially in a somewhat disorderly response to the bad European news of May and more recently, in an orderly manner on expectations of a more stable but lower growth environment. The tone of European and British fiscal austerity is likely to be replicated elsewhere, suggesting cash rates will stay low for longer as the naturally dampening effect of fiscal tightening diminishes the need for monetary tightening. In future, lower public debt should also compress government-cash spreads (or similarly, reduce sovereign CDS spreads) although, given the obstacles to lower and sustainable debt levels, such compression will likely be volatile and lengthy. Cyclical normalisation and convergence opportunities will be delayed or reduced in magnitude due to the substitution of fiscal-for-monetary tightening. However, an increasingly compelling diversification argument and the strong fiscal story suggest Australian bonds should be reasonably well supported, in spite of likely cyclical outperformance of the domestic economy for some time.

While credit performed well during July we retain our cautious stance in the medium term, believing there is scope for modest spread contraction in the longer term. Moreover, as credit spreads are relatively wide in an historical context, the high running yield is a significant driver of the overall returns expected from the allocation to credit.

Our caution stems more from macro-economic influences than the outlook for credit quality at the individual corporate level. The events of May were a clear signal to European governments of the need for increased fiscal austerity and budgetary repair. As a consequence, the greater focus on delevering will result in higher taxes, lower public spending and slower growth than was forecast earlier in 2010. This has knock-on effects for the banking system, which is already experiencing high levels of loan losses. A low growth environment, with the risks of another bank or even sovereign default scare, is not a strong environment for risk assets. Furthermore, the US seems to be continuing down the path of profligacy as growth slows, the housing market weakens and unemployment remains high. This could result in pressures on US credit worthiness in the years to

### Credit rating profile

	Fund %	B/mark %
AAA	30.73	0.00
AA	11.89	0.00
A	12.87	0.00
BBB	11.49	0.00
A-1+	22.18	0.00
Cash	10.83	0.00

## Aberdeen Cash Enhanced Fund

come, although this has not eventuated to date. It is also worth mentioning that some strategists believe China is a bubble economy, especially the housing market. This is weighing on some investors' minds, although we do not subscribe to the bubble view.

In contrast to the gloomy macro picture, at the individual corporate level the environment is quite robust. In general, corporates have strong balance sheets with ample cash, strong margins and limited refinance pressure. Top-line sales have been slightly weak but credit quality is high. Default rates in non-investment grade markets have been falling sharply. This gives us confidence that credit fundamentals have support in the medium term. The key local influence for credit spreads is the banking sector, specifically funding issues and eventual regulatory reform. The four "majors" have significant amounts of wholesale funding to complete in coming years and as a result of proposals regarding banking liquidity regulations, they will no longer be able to help each other by investing in bank bonds as "liquid assets". The threat of sizable new issuance will keep a floor under local senior bank spreads and, by implication, the wider Australian credit market, given the relative lack of non-bank credit.

Our strategy in recent months has been to reduce our credit exposure to a smaller overweight, mostly through hedging with Itraxx CDS contracts and the swap market, but also by selling the cash credit which we viewed as overpriced. It is likely we will retain this cautious stance with current fund positioning providing a relatively small exposure to credit risk and giving us the flexibility to change fund positioning when the market outlook becomes clearer.

### Key information

APIR Code	CSA0029AU
Benchmark	UBSA Bank Bill Index
Date of Launch	August 2003
Income Payable	Monthly
MER	0.35% pa
Buy/Sell Spread	+0.05%/-0.10%
Fund Size	A\$426.428m
Redemption Unit Price	\$1.1083

### Important information

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

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