Fixed Interest Sector Wrap
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Morningstar Manager Research
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Executive Summary

Our Fixed Interest Sector Wrap starts by examining how well unconstrained bond funds handled the steep rise in sovereign bond yields in late 2016. Many investors have favoured these strategies for precisely this scenario, so it was encouraging too that most could do so effectively, at least compared with more traditional index-relative offerings. That said, the positive relationship that many of these funds have with credit should be kept in mind. While drawing conclusions from such a short timespan requires circumspection, this initial evidence suggests that unconstrained bond strategies can play a role in a diversified portfolio, though understanding each vehicle's own quirks is essential given the wide assortment of options that are available.

This topic naturally extends into a discussion on the ongoing merits of more traditional bond funds. We revisit our longstanding view these strategies remain among the most effective portfolio insurance policies. While acknowledging the limitations of past references, high-grade bonds with duration have continued to diversify risky assets effectively and for sound fundamental reasons. It's undoubtedly true that low bond yields globally makes this insurance particularly expensive compared to history, but the value of portfolio diversity in attempting to meet long-term investment goals should never be forgotten, and the usefulness of traditional bond strategies is entwined within this portfolio context.

After this, we look at some of the notable trends in fund flows across this asset class. The continued popularity of unconstrained fixed interest funds suggests that investors remain fixated on how to position their bond allocation to handle a rising interest rate environment.

We finish with an outline of changes to Morningstar Analyst Ratings™, as well as detailing new coverage and funds that we've dropped, and explaining why each change has occurred.

Unconstrained Bonds – Did They Survive Their First Test?

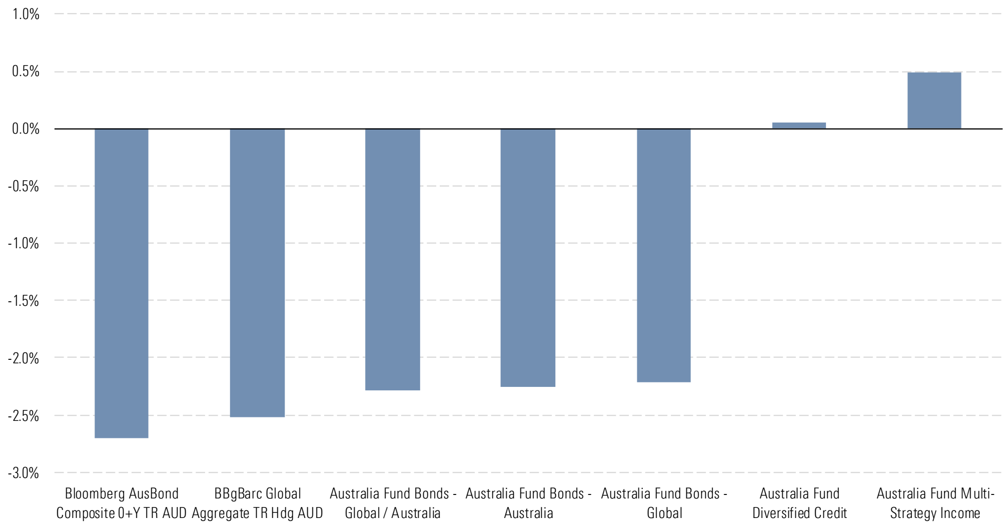
2016 was a year characterised by global financial markets' vulnerability to shock geopolitical events and central banks' actions. This was particularly observable in fixed income markets in the final months of the calendar year. October and November were especially difficult for bond investors to navigate, primarily due to rises in United States and Australian 10-year bond yields, and of course, Donald Trump's unexpected presidential election win. Most traditional fixed income funds took a beating, yet there were some notable outperformers from managers of nontraditional or unconstrained fixed income funds. In their first serious test in a rising rate environment, these funds delivered for investors—a repeat of what happened during the taper-induced jitters of 2013—and highlighted the diversity among an asset class of seemingly analogous players.

Here's a quick refresh of what happened. Government bond yields in the U.S. and abroad (notably the United Kingdom) started to rise in July 2016 amid data that suggested the economic picture was not as weak as the market was pricing. It was the perfect storm for a rate increase in late 2016, with the presidential election on Nov. 8, Donald Trump's triumph and the resulting tax reform and fiscal stimulus optimism saw stock markets quickly rally. Meanwhile, the Bank of Japan also expressed a desire to steepen its yield curve while the European Central Bank indicated that it would consider tapering its bond purchase program. From hovering around 1.56% at the end of September, U.S. Treasury yields rose to 2.37% by November end; a spike that caused noteworthy capital losses, with global bonds posting a loss of 2.52% over the period October and November 2016.

Australian bond investors suffered a similar fate. The 10-year Australian Government Bond yield continued to track its U.S. counterpart and shot up to 2.7% by the end of November, increasing by around 70 basis points from the end of September. As a result, Australian bonds suffered a 2.7% decline in October and November 2016.

Exhibit 1 shows Morningstar's five fixed income category average returns plus indices for the same period.

Exhibit 1 Returns for Fixed Income Indices and Category Averages in October-November 2016



Source: Morningstar Direct

The three Australian and Global bond fund categories evidently suffered the most pain. However, investors can take some comfort in that the average fund outperformed the Bloomberg AusBond Composite Index. Furthermore, the trailing returns of these categories continued to fare relatively well. During 2016, the average Australian bond fund returned 2.41% while the average Global bond fund returned 4.89%, while the corresponding figures over an annualised three-year basis were 4.13% and 5.29%.

Diversified Credit and Multistrategy Income Funds Shine

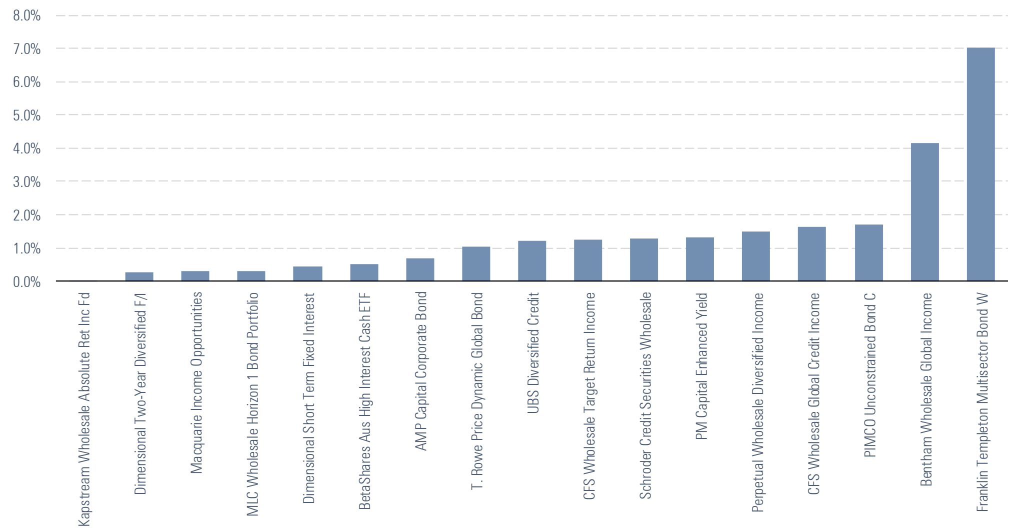
What is probably most apparent in Exhibit 1 is that the nontraditional or unconstrained bond categories (diversified credit and multistrategy income) were the stellar performers on a relative basis. Of course, this only covers a short span of time, but it was a similar story on the previous occasion that markets became particularly nervous about rising bond yields—the mid-2013 taper tantrum. These fund types are viable options for investors looking to allocate to the defensive and income generating portion of their portfolios outside of traditional fixed income vehicles. Pleasingly, these funds appear to have delivered on their promise to protect capital in a rising rate environment.

Diversified Credit funds invest in Australian and/or global credit securities. They typically focus on active credit selection to deliver higher returns than government bonds and can invest in sub-investment-grade and unrated issues. Their overall credit quality is typically "BBB" or above.

Multistrategy income funds were the best performers on average, just shading Diversified Credit. As the name suggests, these funds focus on income generation and are generally exposed to a combination of different security types to provide an enhanced yield. They can include investments in Australian and Global bonds, corporate debt, private debt, hybrid securities, emerging markets, and asset-backed securities.

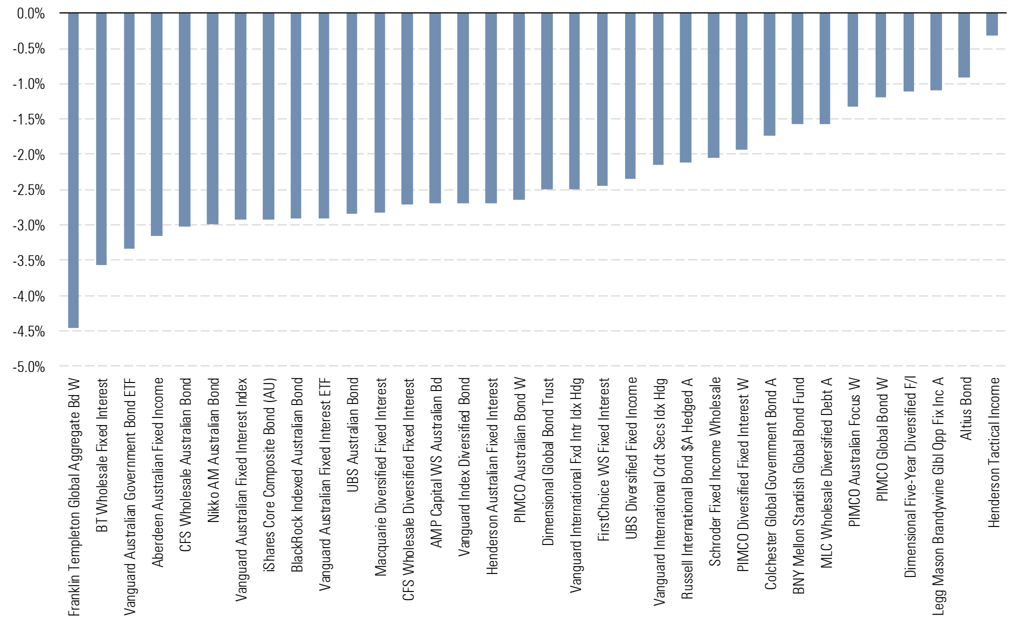
So, how did the managers that we cover perform? Exhibits 2 and 3 highlight all the fixed income funds within Morningstar's coverage across the five fixed income categories, broken down by positive (Exhibit 2) and negative (Exhibit 3) fund returns between 1 October and 31 December 2016.

Exhibit 2 Morningstar Fund Coverage Returns, 3 Months to 31 December 2016



Source: Morningstar Direct, Morningstar Calculations

Exhibit 3 Morningstar Fund Coverage Returns, 3 Months to 31 December 2016



Source: Morningstar Direct, Morningstar Calculations

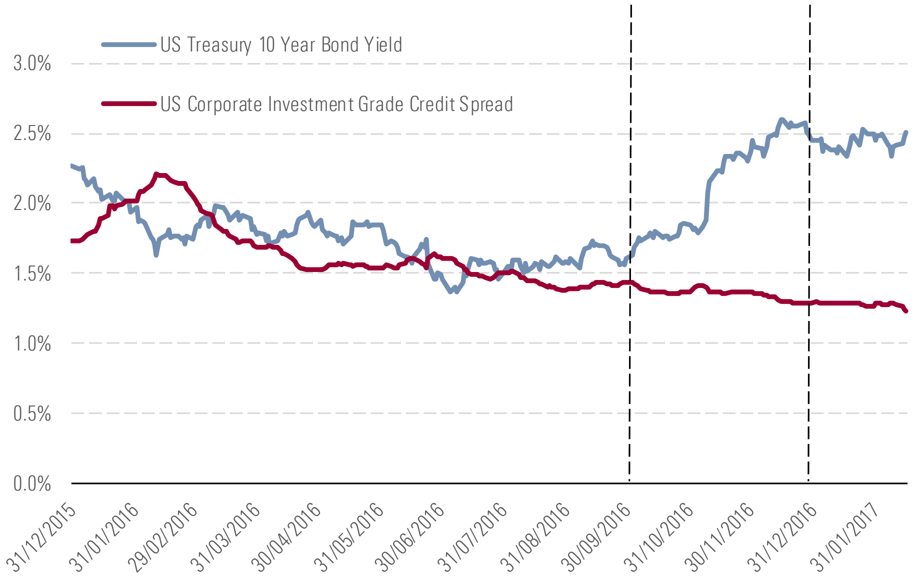
The funds that posted the highest returns were **Franklin Templeton Multisector Bond 17390** and **Bentham Wholesale Global Income 10751** (both multistrategy income offerings). Negative duration positioning contributed to outperformance for both funds, where interest rate strategies were used to take advantage of rising U.S. rates.

As for the laggards, **Franklin Templeton Global Aggregate Bond 19700** (Global bonds) suffered due to the portfolio's duration and yield-curve positioning as well as currency exposure to a weaker Mexican peso. One of the main detractors to performance for the **BT Wholesale Fixed Interest 2950** (Australian bonds) was the adverse impact of rising yields on Australian government bond positions.

Digging Deeper

Should we be surprised by these results? Well, many nontraditional bond funds have exchanged interest-rate risk for some other risk, such as high-yield, emerging-markets debt, or other "spread" or "risk" sectors. Risk free rates and credit spreads can move for very different, and sometimes opposing, reasons. Sovereign bond yields are a function of a country's expected real economic growth and expectations of inflation. Credit spreads reflect how the market prices a corporate issuer's risk of default, tending to be stable or falling when there is optimism about an economy and corporate sector's health, while increasing amid fear and uncertainty. In the fourth quarter of 2016, it was sovereign bond yields that jumped sharply as concerns rose over potentially inflationary U.S. fiscal policy, while credit spreads remained relatively benign. Shorter interest rate duration allowed many nontraditional bond funds to avoid the worst of the sharp rise in yields. The relative outperformance of nontraditional bond funds in late 2016 consequently shouldn't come as a major surprise. For some added context, it is worth noting that it was only a year earlier in 2015 that more traditional bond funds generally outperformed their flexible counterparts as credit broadly struggled. Exhibit 4 separates the US 10-year Treasury bond yield (blue) and investment grade credit spreads (maroon), with the fourth quarter of 2016 the period between the two vertical dotted lines.

Exhibit 4 US 10-Year Treasury Bond Yield and Investment-Grade Corporate Bond Option Adjusted Spreads, 12 months to February 2017



Source: Federal Reserve Bank of St Louis, Morningstar Calculations

A Place for Nontraditional Fixed Income in your Portfolio—With a Caveat

It is important for those considering an investment in a nontraditional bond fund to understand and be comfortable with each fund's investment style, given the sheer variety of risk profiles. Most use an absolute return benchmark keyed to short-term rates such as three-month bank bill swap or cash rates. Those benchmarks provide no guide to the underlying securities and therefore no template or parameters for risk control. It means that there's no way to judge whether, based on sector or security selection, a fund has earned better (or worse) returns simply because it invested in riskier securities outside of an index otherwise representing its peer group's investable universe. So, it's difficult to make meaningful apples-to-apples risk/reward comparisons among funds.

That said, the final months of 2016 show the difficulty of navigating investment markets during uncertain times—even for the uber-informed and most active market participants. It is important investors are aware of the different options available to best diversify a portfolio. Traditional fixed income funds were hit hard over this period, and while they continue to have a role to play in portfolios, there are alternatives to consider where capital preservation and income are the primary objectives in the face of rising interest rates. While we're mindful of the dangers in drawing broad conclusions from a limited time span, in this testing backdrop of swift market movements the nontraditional fixed income vehicles have proved they have their place in a portfolio.

Is the Role of Traditional Bond Funds Treading on Thin Ice?

The natural counterpoint to flexible bond strategies is where that leaves traditional, index-relative capabilities. We've written extensively about this topic in previous sector wraps, such as our June 2016 article "RIP for Bonds. Rest in Peace or Role in Portfolio?" and "Why Invest in Fixed Interest?" in our March 2012 report. These articles have ultimately settled on a simple conclusion: high quality fixed interest funds carrying interest rate duration remain the best way of diversifying a broader portfolio of risky assets. In effect, they are a form of insurance if equity markets head south.

However, the era of low yields makes this insurance expensive, at least compared with history. The prospect of a skinny yield when sovereign bond yields barely exceed typical inflation rates have spurred many to favour nonduration risks from their fixed interest portfolio. Credit has been especially popular. Stagnant flows into the majority of traditional fixed interest funds contrasts the interest in more credit-oriented and flexible bond strategies, a topic we explore in greater detail later in "Investors Show High Rates of Interest in Unconstrained Strategies". Meanwhile, the Australian listed hybrid market has been particularly strong since the start of 2016, with many significant new issues such as CBA PERLS VIII and NAB Capital Notes 2 heavily oversubscribed. Healthy trading on the secondary market during 2016 also reinforces the market appetite for these instruments.

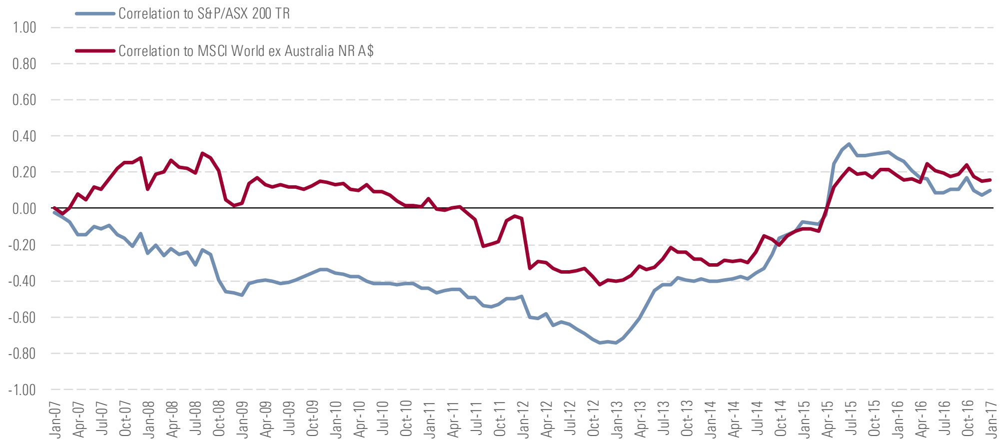
Others may also question the value of bond portfolios when interest rates on cash and term deposits appear competitive with sovereign bond yields globally. Why pay a fee for an externally-managed portfolio and take capital risk to boot? Such sentiments aren't surprising given repeated warnings about artificially and unsustainably low interest rates, and the pain that higher yields could inflict on duration-laced investments.

Does a traditional index-relative high-grade bond portfolio still make investment sense?

The Stats Say Yes

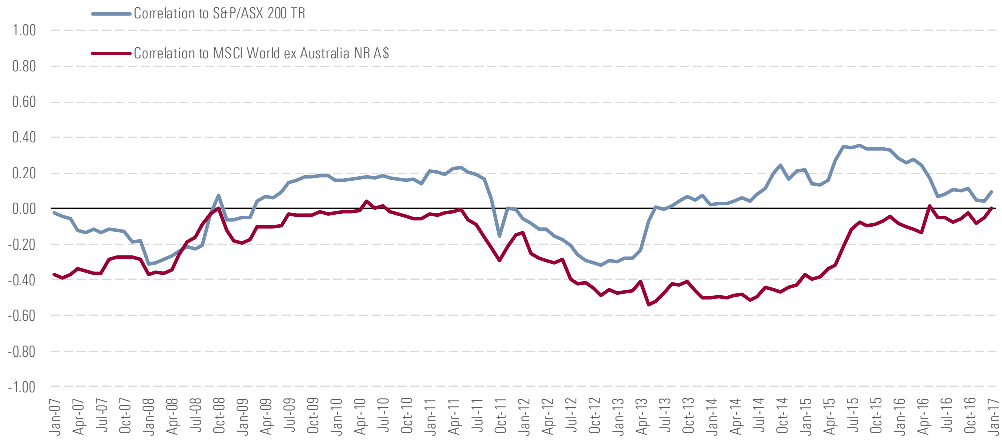
Let's re-examine our comments about the diversifying qualities of high-grade bonds. The simplest way is to look at historical correlations of standard market indices. The rolling three-year correlations between the indices representing Australian and international equities and fixed interest between January 2007 to January 2017 are shown in the following exhibits.

Exhibit 5 Rolling 3-Year Correlation Between the Bloomberg AusBond Composite 0+ Index and Indices Representing Australian and International Equities from January 2007-January 2017



Source: Morningstar Direct, Morningstar Calculations

Exhibit 6 Rolling 3-Year Correlation Between the Bloomberg Barclays Global Aggregate Index Hedged AUD and Indices Representing Australian and International Equities from January 2007-January 2017



Source: Morningstar Direct, Morningstar Calculations

Exhibits 5 and 6 show that correlations have rarely been greatly positive—the highest mark was a shade under 0.4. There is some variability over time, but no obvious data to dispute the notion that bonds have diversified equities effectively.

There Are Fundamental Reasons Too

Traditional index-relative and passive fixed interest funds have benefited from the broad-based decline in sovereign bond yields. Meanwhile, equities have fluctuated significantly, so low correlations between these indices are understandable. Still, it makes sense for returns from equities and fixed interest to differ greatly, particularly during periods of stress. In such times, investors lower their return and growth expectations and value stability of income and capital, and liquidity more highly. These traits are present in bonds. This exerts downward pressure on interest rates, allowing bonds to generate capital gains that can coincide with weakness in equities.

We've seen this play out multiple times. High-grade, duration-sensitive bonds fared particularly well during equity market jitters in 2010 (unexpectedly subdued U.S. growth), 2011 (European sovereign debt market woes), and of course 2008. Furthermore, these funds generally did a better job than more flexible bond strategies on these occasions, demonstrating the defensive qualities of high credit quality interest rate duration. Notably, the average returns of funds in the Morningstar categories of Australian and Global Bonds mostly exceeded those in the diversified credit and multistrategy income camps. Exhibit 7 illustrates this point.

Exhibit 7 Morningstar Category Average Returns of Australian Bonds, Global Bonds, Diversified Credit and Multi-Strategy Income Funds in 2008, 2010 and 2011

Name	2008	2010	2011
Australia Fund Bonds - Australia	11.22	6.40	10.05
Australia Fund Bonds - Global	3.62	9.57	7.94
Australia Fund Diversified Credit	-14.17	9.09	3.28
Australia Fund Multi-Strategy Income	-12.20	8.06	4.24

Source: Morningstar Direct, Morningstar Calculations

Limited to History

The limitation of this analysis is that it's based purely on history. Meanwhile, the starting point of 2017 is far different to 2007. Prolonged economic stagnation would likely be needed to deliver the same total returns that bonds attained in the preceding ten years. This scenario shouldn't be dismissed—global growth in developed markets since the 2008 financial crisis has been well below historical norms despite enormous monetary stimulus, and negative yields in parts of continental Europe and Japan have redefined what's possible. That said, in September 2016 the Bank of Japan strove to lift its long-term bond yields back to zero given the pressures borne on its financial system, while the prospect of the Fed continuing to lift interest rates remains the elephant in the room, particularly while the memory of the 2013 taper tantrum still lingers. Investors should be judicious when attempting to extrapolate past relationships into the future given these circumstances.

Portfolio Context

Given where sovereign bond yields are sitting, it makes sense to moderate return expectations from fixed interest. Repeating historical returns from this asset class likely requires taking additional risk—whether it be duration, credit and/or liquidity.

But this doesn't make the sector irrelevant. If diversity remains a pillar of portfolio construction—and in our view, it is essential—high-grade duration-sensitive bonds remain one of the few investments that can be expected to perform meaningfully differently to risky assets. The need for portfolio diversity also stems from the difficulty in predicting financial markets and cycles. Indeed, interest rates have defied expectations by continuing to fall since 2010, confounding most active managers.

Meanwhile, favouring credit is an understandable move. Investors should nonetheless be clear in their expectations for what each is designed to achieve. Why did hybrids fare so well in 2016? Falling credit spreads, as concerns about sluggish growth and disinflation dwindled following the recovery in commodity prices. The reverse was true only a few months earlier, however. Surprise, surprise, this alternating risk-on/off period matched the experience of Australian equities. It's not a 1:1 relationship, but credit is positively correlated to equities, especially as you go deeper down the issuer quality spectrum and capital structure. Additionally, many credit funds and individual hybrids possess little duration, and so are almost wholly beholden to moves in credit spreads.

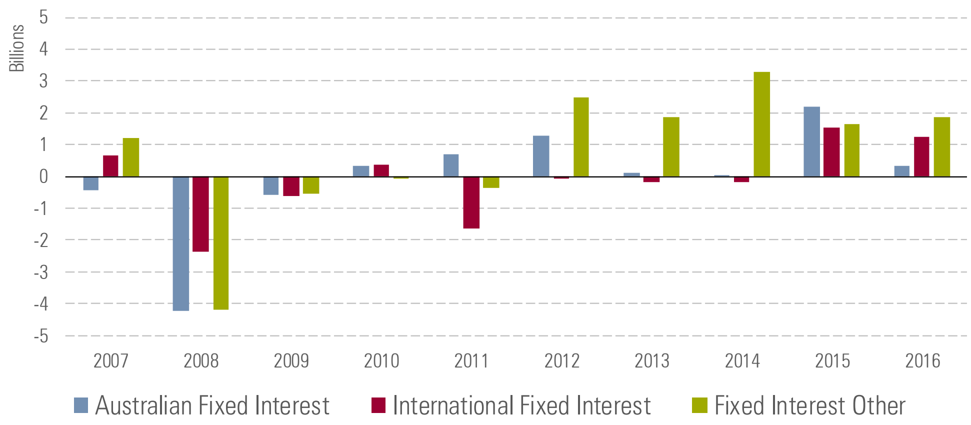
What about cash over bonds as a portfolio anchor? Cash obviously offers unsurpassed capital stability, but on the flipside, this doesn't help a portfolio as much when risk aversion hits. Lower yields can quickly reduce the reinvestment returns too.

All of this is not to diminish the usefulness or merit of credit, hybrids or cash. Instead, it's a reminder to consider the total portfolio viewpoint when thinking about an investment allocation. A period of rising interest rates won't be pleasant for bondholders, but that's not the only possible outcome and many managers have been careful about taking duration risk anyway. Building a portfolio that can handle both the good times and the tough spells is the most sensible way of trying to meet investors' goals. There are clearly risks to bear in mind, but no one ever regrets having insurance when it's needed. Bond funds remain an important part of the equation, in our opinion.

Investors Show High Rates of Interest in Unconstrained Strategies

The spate of unexpected events in 2016 will live long in the memory, but for asset flows in Australia normal service was resumed. Since 2012, the growth of "fixed interest other", a group containing funds in the Morningstar categories of diversified credit, multistrategy income, and high yield, which collectively include many nontraditional bond funds such as **Kapstream Wholesale Absolute Return Income Fund 17256, Bentham Wholesale Global Income 10751 and Franklin Templeton Multisector Bond 17390**, has dwarfed "Australian fixed interest" and "international fixed interest" funds. (To be fair, this "Other" category also includes funds in the bonds - global/Australia category, such as **PIMCO Diversified Fixed Interest 10882**.) This wasn't true in 2015, perhaps as investors started to become more accepting of the prospect of a sustained period of low interest rates and the value that a traditional index-aware bond fund has in these circumstances. Nonetheless, the longer-term trend continued in 2016, as Exhibit 8 demonstrates.

Exhibit 8 Estimated Annual Net Flow into Fixed Interest Funds



Source: Morningstar Direct, Morningstar Calculations

These unconstrained strategies promise more levers to pull to navigate through a low yield environment. By untethering interest rate positioning from a typical benchmark, portfolio managers are better equipped to protect a portfolio's absolute returns against rising bond yields than a more traditional index-relative offering—if they're good enough.

Notable Winners

A look at the biggest winners in net flows in 2016 is revealing. Several are from the nontraditional camp. A broad range of strategies have garnered flows including: **Kapstream Wholesale Absolute Return Income Fund 17256**, **Bentham Wholesale Syndicated Loan 11771**, and **Loomis Sayles Senior Floating Rate Loan Fund 40522**. However, **T. Rowe Price Dynamic Global Bond Fund 40282** topped the list. While it falls into the bonds – global category given its investment universe, it adopts a flexible approach, with a focus on government bonds. Its assets have increased rapidly due to a large inflow in the last quarter of 2016. Indeed, another major recipient of inflows **Henderson Tactical Income 17406** is another strategy that resides in a more traditional fixed income category (bonds - Australia), but has a relatively wide remit for setting interest rate duration and extra emphasis on capital stability courtesy of its split Bloomberg AusBond Composite/Bank Bills Index. As an aside, client reaction to the Kapstream and Henderson strategies will be worth looking out for given plans for their respective parents to merge (Janus Capital and Henderson Global Investors), and broad commonality in portfolio positioning (favouring Australian credit and taking less interest rate risk).

Elsewhere, PIMCO remained among the main recipients of inflows. Its popularity shouldn't come as a surprise, given the shop's strong short- and long-term performance across a wide range of strategies.

Much has been made of the demand for low-cost options, so what about passive strategies? BlackRock saw inflows into its domestic and global bond unlisted strategies. Outflows from Vanguard's pooled trusts is misleading—some large clients moved out of its unit trusts into separate accounts, and these are not accounted for in the data. Asset flows into exchange-traded funds, or ETFs, was muted, but it's worth remembering that many of these products are still relatively new. Sixteen were launched during 2015, suggesting investor demand for low-cost fixed interest exposure is not abating. That said, Russell's semi-government and government ETFs experienced outflows.

In summary, renewed popularity in nontraditional bond strategies suggests that investors remain wary of taking interest rate risk and concerned by the prospect of higher sovereign bond yields. It's now up to the portfolio managers to prove their worth in what could be a very different market environment.

Changes to Morningstar Analyst Ratings

We take a medium- to long-term outlook when determining qualitative recommendations. Our views about the merits of investment strategies move over time based on manager-specific factors such as investment team composition, changes to investment process, and our degree of relative conviction.

In this review, we upgraded our Morningstar Analyst Ratings™ for three strategies, placed two strategies Under Review, we ceased covering three strategies, and initiated coverage of another seven strategies.

Exhibit 9 Changes to Morningstar Analyst Ratings

Strategy	Ticker	Old Rating	New Rating
Upgrades			
BNY Mellon Standish Global Bond Fund	40606	Neutral	Bronze
Colchester Global Government Bond AUD H	40930	Bronze	Silver
Vanguard Australian Government Bond ETF	VGB	Neutral	Bronze
Other			
Advance International Fixed Interest Multi-Blend W	11173	Bronze	Under Review
Nikko AM Australian Bond	10858	Bronze	Under Review
Ceased Coverage			
Goldman Sachs Global Strategic Bond	40086	Under Review	-
PIMCO Unconstrained Bond W	40299	Neutral	-
Russell Australian Select Corporate Bond ETF	RCB	Negative	-
New Coverage			
PIMCO Global Credit Fund	11067	-	Silver
PIMCO Income Wholesale	41334	-	Silver
Payden Global Income Opportunities	19589	-	Neutral
Vanguard Australian Corporate Fixed Interest ETF	VACF	-	Neutral
Vanguard International Credit Securities Index (Hdg) ETF	VCF	-	Neutral
Vanguard International Fixed Interest Index (Hdg) ETF	VIF	-	Bronze
iShares Government Inflation	ILB	-	Neutral

Source: Morningstar Direct

Upgrades

BNY Mellon Standish Global Bond Fund

We upgraded BNY Mellon Standish Global Bond from Neutral to Bronze. We believe portfolio managers Raman Srivastava and Brendan Murphy are developing into a strong duo. They can look to a sprawling team for insights, including highly-regarded CIO David Leduc. The final decisions, however, are left to the portfolio managers, which helps them keep a close eye on the absolute risk of positions and correlations between trades. This considered approach has enabled them to make some shrewd sector and currency decisions to protect the portfolio.

Colchester Global Government Bond AUD H

We upgraded Colchester Global Government Bond from Bronze to Silver, after initiating coverage of this strategy the previous year. While this is a relatively new vehicle for retail investors in Australia, Colchester has successfully managed similar institutional strategies in the U.K. for well over a decade. They've used the same process the whole time, and the firm's founding investors are all still involved. This stability sets them up well for the future and deserves recognition via an upgrade to the rating on this strategy.

Vanguard Australian Government Bond ETF

We upgraded Vanguard Australian Government Bond from Neutral to Bronze. Our growing conviction in VGB is due to its increased size, which has lowered the associated transactions costs. Trading volumes have picked up and bid-ask spreads have fallen significantly to levels consistent with the high liquidity of the Australian government bond sector. Hence, our prior concerns regarding the ETF’s lack of scale have lessened.

Downgrades and Other Changes

Nikko AM Australian Bond

We downgraded Nikko AM Australian Bond from Bronze to Neutral in February 2017, then in April 2017, we placed the fund's rating Under Review. Nikko has progressively parted ways with numerous senior staff, largely due to a major client loss which saw funds under management decline sharply. The latest changes announced in March 2017 will see head of Australian Fixed Income, James Alexander, relocate to Singapore to join the firm’s Global Multi-Asset team, while John Sorrell and Leo Leslie will join the global credit division of the Global Fixed Income team. The restructure will also see two analysts and one portfolio manager leave the local unit. These departures are further compounded by the loss of Roger Bridges, its global rates and currency strategist, in February 2017, and three departures in April 2016, including former portfolio manager Anita Daum. For this reason, we have placed this strategy Under Review and will seek to gain more information about its prospects in the coming period.

Advance International Fixed Interest Multi-Blend

We placed Advance International Fixed Interest Multi-Blend Under Review. This is after the appointment of Martyn Wild as CIO in July 2016 and the significant changes he has been implementing. Among much turnover across the group, Ron Mehmet has left the business, but Daniel Park remains as portfolio manager. Wild is introducing a new investment process, which we will be seeking to get a better understanding of in the near term. The significant changes to personnel and process give us reason to be watchful

New Coverage

PIMCO Global Credit Fund

We initiated coverage of PIMCO Global Credit at Silver. This well-tested strategy is led by highly-astute and long-tenured managers in Robert Mead and Mark Kiesel. The pair capitalise on PIMCO's deep team of credit analysts and its rigorous industry and company research. This strategy doesn't shy away from risk, visible in exposure to emerging markets, high yield and contingent convertible bonds, and it is much more sensitive to broad moves in risk free interest rates than most peers given its longer duration. But ultimately, we are confident PIMCO can diligently construct the portfolio and manage these risks appropriately.

PIMCO Income Wholesale

We initiated coverage of PIMCO Income Wholesale at Silver. This vehicle only began in Australia in late 2015, but has been around since 2007 in the U.S. Over that span, Dan Ivascyn and comanager Alfred Murata have set a high bar for performance and in meeting the goal of steady income without incurring excessive volatility. Exposure to higher yielding nonagency mortgage backed securities has been a big reason for its success. While PIMCO needs to manage the flood of assets this strategy has attracted even as the nonagency mortgage sector shrinks, it can handle this development courtesy of its flexible mandate to invest in areas such as high yield bonds and emerging markets. The portfolio's high sensitivity to credit should be borne in mind, but we expect its expert leaders to attain strong risk-adjusted returns.

Payden Global Income Opportunities

We initiated coverage of Payden Global Income Opportunities at Neutral. Team stability is among Payden & Rygel's main selling points. A highly-seasoned leadership group includes this strategy's key decision-makers Brian Matthews, Scott Weiner and Brad Boyd, each of whom are veterans at the firm. Sector teams are also helmed by longtime colleagues, fostering consistency in the investment strategy. This is a high-octane portfolio, evident in its allocation to sub investment grade securities regularly approaching the 50% cap. It's proven rewarding without being unduly volatile, though we remain conscious of the difficulty in swinging around sector exposures markedly such as what occurred in 2008-09. Income distributions have also been inconsistent, despite the fund's "income" moniker." While these are factors to consider, there's promise in this unconstrained approach.

Vanguard International Fixed Interest Index (Hdg) ETF

We initiated Vanguard International Fixed Interest Index at Bronze. The strategy tracks the Barclays Global Treasury Index, offering access to a portfolio of global investment-grade government bonds for a low management fee. Vanguard's strong execution capabilities add value. This fund ably provides a simple, cheap, and effective global sovereign exposure.

Vanguard Australian Corporate Fixed Interest ETF

We initiated Vanguard Australian Corporate Fixed Interest at Neutral. Launched in May 2016, VACF tracks the Bloomberg AusBond Credit 0+Yr Index, which is dominated by highly rated corporate bonds. The strategy sticks to relatively high-quality credit, and is diversified across several issues. VACF is buoyed by a very competitive fee.

Vanguard International Credit Securities Index (Hdg) ETF

We initiated Vanguard International Credit Securities Index at Neutral. VCF aims to emulate the Barclays Global Aggregate Government-related and Corporate Index (AUD Hedged). Vanguard's global operations provides economies of scale, including a very low fee. However, the ETF was only incepted in December 2015 and remains small.

iShares Government Inflation ETF

We initiated iShares Government Inflation ETF at Neutral. The ETF tracks the Bloomberg AusBond Inflation Government Index for a low 0.26% fee. iShares has extensive experience in passive investing, and the ASX listing makes an easy way to access inflation-linked bonds. But with less than AUD 100 million in assets, ILB would be more appealing once it grows.

Dropped Coverage

Goldman Sachs Global Strategic Bond

PIMCO Unconstrained Bond W

Russell Australian Select Corporate Bond ETF

We ceased coverage of Goldman Sachs Global Strategic Bond, PIMCO Unconstrained Bond W and Russell Australian Select Corporate Bond ETF as these vehicles failed to meet our criteria for ongoing research.

Morningstar Medallists

Investment strategies with Morningstar Analyst Ratings™ of Gold, Silver, or Bronze carry the tag Morningstar Medallists. These are the strategies that in our opinion truly stand out, and share common traits including a capable and stable team, robust processes, and an ability to deliver in a variety of market conditions.

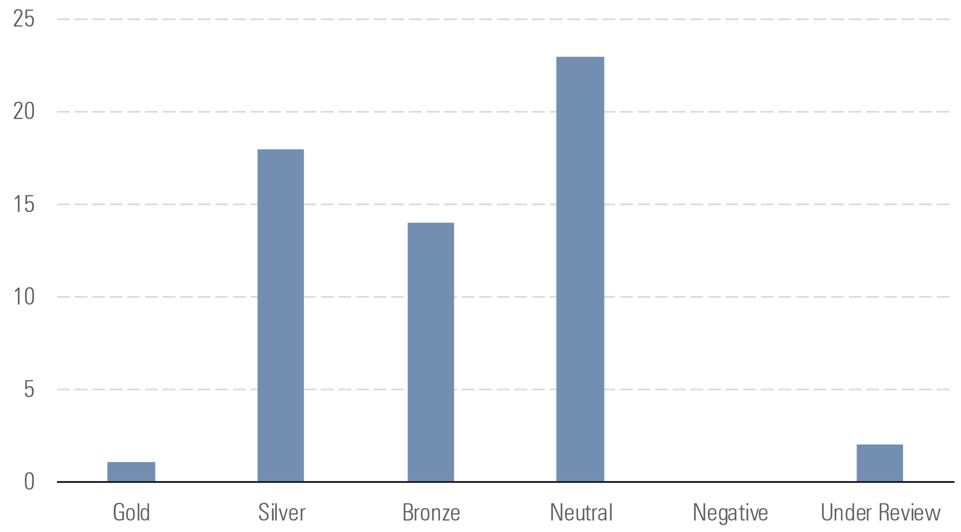
Exhibit 10 Morningstar Medallists

Ticker	Name	Morningstar Analyst Rating
10881	PIMCO Australian Bond W	Gold
10751	Bentham Wholesale Global Income	Silver
9093	BlackRock Indexed Australian Bond	Silver
40930	Colchester Global Government Bond AUD H	Silver
17390	Franklin Templeton Multisector Bond W	Silver
5666	Henderson Australian Fixed Interest	Silver
17406	Henderson Tactical Income	Silver
IAF	iShares Core Composite Bond (AU)	Silver
16192	Legg Mason Brandywine Glbl Opp Fix Inc A	Silver
10715	Macquarie Income Opportunities	Silver
17158	PIMCO Australian Focus W	Silver
10882	PIMCO Diversified Fixed Interest W	Silver
10883	PIMCO Global Bond W	Silver
11067	PIMCO Global Credit Fund	Silver
41334	PIMCO Income Wholesale	Silver
10862	Schroder Fixed Income Wholesale	Silver
VAF	Vanguard Australian Fixed Interest ETF	Silver
4487	Vanguard Australian Fixed Interest Index	Silver
19090	Vanguard Diversified Bond Index	Silver
16869	AMP Capital WS Australian Bd	Bronze
40606	BNY Mellon Standish Global Bond Fund	Bronze
2950	BT Fixed Interest WS	Bronze
8406	Dimensional Five-Year Diversified F/I	Bronze
19700	Franklin Templeton Global Aggregate Bd W	Bronze
17256	Kapstream Wholesale Absolute Ret Inc Fd	Bronze
13443	Perpetual Wholesale Diversified Income	Bronze
8049	PM Capital Enhanced Yield	Bronze
8922	Schroder Credit Securities Wholesale	Bronze
2579	UBS Australian Bond	Bronze
4866	UBS Diversified Fixed Income	Bronze
VGB	Vanguard Australian Government Bond ETF	Bronze
6428	Vanguard International Fxd Intr Idx Hdg	Bronze
VIF	Vanguard Intl Fxd Intr Idx (Hdg) ETF	Bronze

Source: Morningstar Direct

We designated 33 of the 58 fixed interest strategies we assessed as Morningstar Medallists. One achieved the highest possible Analyst Rating of Gold. 18 strategies attained Silver, and we designated a further 14 as Bronze.

Exhibit 11 Distribution of Morningstar Analyst Ratings for Fixed Interest Funds at April 2017



Source: Morningstar Direct

Appendix

Name	Ticker	Morningstar Analyst Rating	Global Fund Report Analysis Date	Indirect Cost Ratio (ICR)
Aberdeen Australian Fixed Income	3219	Neutral	16/01/2017	0.51
Advance Int Fix Intr Multi-Blend W	11173	Under Review	21/11/2016	0.65
Altius Bond	19311	Neutral	6/04/2017	0.55
AMP Capital Corporate Bond	5335	Neutral	12/03/2017	0.36
AMP Capital WS Australian Bd	16869	Bronze	12/03/2017	0.36
Bentham Wholesale Global Income	10751	Silver	15/01/2017	0.77
BetaShares Aus High Interest Cash ETF	AAA	Neutral	15/02/2017	0.18
BlackRock Indexed Australian Bond	9093	Silver	6/02/2017	0.20
BNY Mellon Standish Global Bond Fund	40606	Bronze	9/02/2017	0.50
BT Wholesale Fixed Interest	2950	Bronze	5/04/2017	0.50
CFS Wholesale Australian Bond	4122	Neutral	28/02/2017	0.46
CFS Wholesale Diversified Fixed Interest	4712	Neutral	28/02/2017	0.58
CFS Wholesale Global Credit Income	10872	Neutral	28/02/2017	0.62
CFS Wholesale Target Return Income	12410	Neutral	6/03/2017	0.52
Colchester Global Government Bond A	40930	Silver	30/03/2017	0.60
Dimensional Five-Year Diversified F/I	8406	Bronze	28/02/2017	0.28
Dimensional Global Bond Trust	19212	Neutral	28/02/2017	0.35
Dimensional Short Term Fixed Interest	5839	Neutral	28/02/2017	0.19
Dimensional Two-Year Diversified F/I	13305	Neutral	28/02/2017	0.25
FirstChoice WS Fixed Interest	11292	Neutral	27/10/2016	0.77
Franklin Templeton Global Aggregate Bd W	19700	Bronze	12/01/2017	0.59
Franklin Templeton Multisector Bond W	17390	Silver	19/01/2017	0.93
Henderson Australian Fixed Interest	5666	Silver	15/12/2016	0.47
Henderson Tactical Income	17406	Silver	15/12/2016	0.45
iShares Core Composite Bond (AU)	IAF	Silver	28/12/2016	0.20
Kapstream Wholesale Absolute Ret Inc Fd	17256	Bronze	13/11/2016	0.70
Legg Mason Brandywine Glbl Opp Fix Inc A	16192	Silver	26/01/2017	0.71
Macquarie Diversified Fixed Interest	9839	Neutral	12/03/2017	0.62
Macquarie Income Opportunities	10715	Silver	12/03/2017	0.50
MLC Wholesale Diversified Debt A	16244	Neutral	5/03/2017	0.50
MLC Wholesale Horizon 1 Bond Portfolio	13402	Neutral	5/03/2017	0.52
Nikko AM Australian Bond	10858	Under Review	3/04/2017	0.45
Perpetual Wholesale Diversified Income	13443	Bronze	8/12/2016	0.70
PIMCO Australian Bond W	10881	Gold	24/01/2017	0.50
PIMCO Australian Focus W	17158	Silver	25/01/2017	0.50
PIMCO Diversified Fixed Interest W	10882	Silver	25/01/2017	0.50
PIMCO Global Bond W	10883	Silver	25/01/2017	0.49
PM Capital Enhanced Yield	8049	Bronze	6/01/2017	0.57
Russell International Bond $A Hedged A	15190	Neutral	12/02/2017	0.01
Schroder Credit Securities Wholesale	8922	Bronze	31/10/2016	0.75
Schroder Fixed Income Wholesale	10862	Silver	31/10/2016	0.50
T. Rowe Price Dynamic Global Bond	40282	Neutral	19/01/2017	0.40

Name	Ticker	Morningstar Analyst Rating	Global Fund Report Analysis Date	Indirect Cost Ratio (ICR)
UBS Australian Bond Fund	2579	Bronze	29/01/2017	0.45
UBS Income Solution Fund	8855	Neutral	15/02/2017	0.60
UBS Diversified Fixed Income Fund	4866	Bronze	29/01/2017	0.55
Vanguard Australian Fixed Interest ETF	VAF	Silver	22/01/2017	0.20
Vanguard Australian Fixed Interest Index	4487	Silver	16/12/2016	0.24
Vanguard Australian Government Bond ETF	VGB	Bronze	16/12/2016	0.20
Vanguard Index Diversified Bond	6432	Silver	16/12/2016	0.75
Vanguard International Crdt Secs Idx Hdg	9152	Neutral	16/12/2016	0.34
Vanguard International Fxd Intr Idx Hdg	6428	Bronze	16/12/2016	0.26
PIMCO Global Credit Fund	11067	Silver	24/01/2017	0.56
Payden Global Income Opportunities	19589	Neutral	22/12/2016	0.74
PIMCO Income Wholesale	41334	Silver	24/01/2017	0.78
Vanguard Australian Corp Fxd Intr ETF	VACF	Neutral	19/12/2016	0.26
Vanguard Intl Credit Secs Idx (Hdg) ETF	VCF	Neutral	19/12/2016	0.30
Vanguard Intl Fxd Intr Idx (Hdg) ETF	VIF	Bronze	19/12/2016	0.20
iShares Government Inflation (AU)	ILB	Neutral	6/02/2017	0.26

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