Russell introduces three key strategic enhancements to the Australian Bond Fund

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The Russell Australian Bond Fund ('The Fund') employs multiple strategies and sources of active return to provide investors with core exposure to the Australian fixed income markets. The Fund is also included in many of Russell's multi-asset funds and Pooled Superannuation Trusts (PSTs) for Australian investors. In this Q&A, Senior Portfolio Manager Clive Smith discusses three key strategic enhancements approved this October, including the termination of Pacific Investment Management Company (PIMCo).

Questions and answers

Can you summarise the three key strategic enhancements being made to the Russell Australian Bond Fund?

The three key changes are designed to provide Fund investors with a total return (before costs and tax) higher than the benchmark over the long term. Through these changes, Russell is:

1. **Increasing our ability to proactively manage key exposures**. To achieve this goal, we are increasing the Fund's allocations to exchange-traded funds (ETFs) by just over 7% and also making a minor increase to Asian credit.

2. **Providing further return diversification** through the addition of a more efficient means of accessing currency strategies via the Russell Conscious Currency Index, and

3. **Managing the Fund's overall risks for investors** through the termination of PIMCo (see more detail below) and reallocation of assets to WAMCo, UBS, ETFs, Asian credit and currency strategies.

Why did Russell terminate PIMCo?

Our manager research team believes the nature of Bill Gross's departure on 26 September has led to increased risk in the stability of excess returns and that, combined with several other factors—such as potential outflow and retention of key personnel at PIMCo—drove our decision to terminate PIMCo's assignment. This decision also aligns with the broader restructure of the Russell Australian Bond Fund (outlined in this Q&A).

What is the Fund's new structure?

At this time, we are reallocating assets to the Fund's other managers and strategies, namely WAMCo, UBS and Russell ETFs. We are also introducing a new approach to managing currency strategies. (The table below outlines the Fund's new structure.)

RUSSELL AUSTRALIAN BOND FUND

Managers and strategies	Old target weight	New target weight	Style
Pacific Investment Management Company (PIMCo)	18.2%	0%	Core plus
Aberdeen Asset Management	29.2%	20.5%	Core
Western Asset Management Company (WAMCo)	18.2%	28.0%	Core plus
UBS Global Asset Management (Australia)	29.2%	36.0%	Core
Western Asset Management Company (WAMCo)	2.1%	2.5%	Asian Credit
Russell Investments			
Russell ETFs	3.1%	10.5%	Positioning strategies
Russell Conscious Currency Index	0%	2.5%	Positioning strategies

Source: Russell Investments as at 17/10/2014

Why is Russell including currency exposures in an Australian fixed income fund?

Russell's investment team is introducing a more efficient and systematic means of accessing currency exposures in the Russell Australian Bond Fund through an allocation to a mandate managed against the Russell Conscious Currency Index.

All investors, whether they realise it or not, are exposed to currency—either directly or indirectly. For example, most investors don't realise that around 20% of the Australian bond market[1] is comprised of foreign-domiciled issuers. The associated currency exposures, though indirect, can ultimately impact an investor's returns. Accordingly, there are material opportunity costs as a result of ignoring currency impacts on investment performance. Russell believes such exposures, even if indirect, should be proactively managed.

Additional reasons for including currency strategies within an Australian fixed income fund are:

1. The factors which drive returns in currency markets are very similar to those which drive relative returns within fixed income markets, such as differences in inflation expectations, central bank monetary policies, capital flows, etc.

2. Finally, Russell research[2] highlights that introducing currency exposure into a fixed income portfolio provides a new return source which has historically exhibited a lower correlation to many traditional types of fixed income investments. These diversification benefits may be particularly useful for investors in more concentrated fixed income

[1] As measured by the Bloomberg Composite Index.

[2] Smith, Clive. "Can including currency strategies improve the outcome for an Australian fixed income investor?" Russell Research. 26 September 2014.

markets, especially given the current low levels of both interest rates and credit spreads.

Are active currency strategies a new addition to the Russell Australian Bond Fund?

No. The Fund has historically allowed active currency exposures to be utilised by the Core plus managers, particularly PIMCo, as part of their suite of value-adding strategies. At the Fund level, such exposures have been modest and comprised no more than around 2%-3% of the Fund's exposures. The utilisation of the Russell Conscious Currency Index (RCCI) strategy provides a more efficient means of accessing the diversification benefits available from currency exposures in a more systematic manner.

Importantly, the Fund's overall strategic exposure to currency strategies is not expected to increase materially following the (a) introduction of RCCI and (b) termination of PIMCo.

Why are the Fund's allocations to ETFs increasing?

To give greater flexibility for the management of portfolio exposures, which is particularly important in volatile markets. ETFs diversify the Fund's return sources and allow for greater risk management.

How do these changes align with prior changes to the Russell Australian Bond Fund in the last year?

Russell originally added allocations to ETFs and Asian credit to the Australian Bond Fund in September 2013. These strategies were added to enhance the portfolio management tools and Russell's ability to dynamically adjust Fund exposures based on market conditions.

Are additional Fund enhancements planned?

The Russell Australian Bond Fund will continue to evolve as our research progresses. Currently, we are actively reviewing the Fund's construction for potential enhancements to align with its objectives.