

DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

30 September 2019

Aim and Strategy

To invest in a high conviction portfolio of Australian shares that aims to outperform the S&P/ASX 200 Accumulation Index benchmark by 4% p.a. (before fees) over a rolling three-year period. DNR Capital seeks to identify good quality businesses that are mispriced by overlaying DNR Capital's quality filter with a strong valuation discipline.

DNR Capital's security selection process has a strong bottom up discipline and focuses on buying quality businesses at reasonable prices. The portfolio construction process is influenced by a top-down economic appraisal and also considers the risk characteristics of the portfolio such as security and sector correlations. The investment strategy results in a high conviction portfolio of 15 to 30 securities that is invested for the medium term.

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au

Investment Option Overview

Investment Category	Australian Shares
Suggested Investment timeframe	5 years
Relative risk rating	6 / High
Investment style	Specialist - Quality
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	95-100%	95.24%
Cash	0-5%	4.76%

Sector Allocation	%
Communication Services	3.27
Consumer Discretionary	13.76
Consumer Staples	6.08
Energy	4.35
Financials	22.62
Health Care	0.00
Industrials	14.73
Information Technology	6.46
Materials	17.55
Real Estate	6.41
Utilities	0.00
Cash	4.76

Top Holdings	%
BHP Billiton	8.37
National Australia Bank Limited	8.31
Lendlease	5.70
Macquarie Group	5.61
Woolworths Group	5.28
Tabcorp Holdings	4.85
Commonwealth Bank of Australia	4.81
Brambles	4.71
James Hardie Industries	4.50
Link Administration Holdings	3.82

Portfolio Summary

The Portfolio is positioned as follows:

- Underweight banks given structural headwinds and low interest rates.
- Underweight bond proxies given lack of valuation support.
- Overweight a basket of names with sustainable growth.
- Overweight a basket of names with defensive characteristics.
- Overweight de-rated quality stocks where we believe the market has overcooked concerns.
- Overweight companies with improving quality characteristics.

Investment Option Commentary

A key factor driving momentum stocks has been the outlook for the economy and interest rates. The difference between the current market and the market prior to the GFC is that the high valuations ahead of the GFC were in cyclical stocks. A high degree of optimism meant the market was paying too much for diversified financials and resource-related stocks. Profit margins were very high in these sectors, yet defensive names offered relative protection. The past decade has been an odd bull market. Driven by quantitative easing and low interest rates, nervous investors have gravitated to defensive and growth companies in an uncertain world.

Stocks with perceived risks or cyclical exposure are trading cheaply. A rotation to these stocks would likely accelerate if the market becomes convinced that the recent economic softness is turning. We have seen stimulus in the form of lower interest rates across the globe and some modest fiscal stimulus in some markets. We would not be surprised to see these efforts accelerate if the current economic climate remains subdued, albeit the political climate is making decisive action difficult. Furthermore, uncertainty regarding Brexit and trade wars has had a negative impact on business confidence. At the beginning of the year the market was complacent regarding the trade war risks, but now there is little expectation of a resolution, the balance of risk is weighted to the upside in the event that there is a resolution.

Market Commentary

Australian equities have continued their rise from the beginning of the year due to a number of macro factors. The US Federal Reserve has paused its rate-hiking due to stalling economic data and begun cutting rates, prompting markets to consider lower rates for longer.

Domestically, a weak economy has resulted in an easing stance from the RBA, which, coupled with a re-election of the Coalition Government, has provided confidence in the markets. Concerns still remain around housing despite some positivity post-election, though the most prominent threat to markets is the ongoing trade dispute between the US and China, which has reached new levels of pessimism.

Office fundamentals in Sydney and Melbourne remain strong. The two main reasons for the low vacancy in Sydney are the conversion of office buildings into residential units and Sydney's new light rail. This has taken out supply and has led to higher rents. The Brisbane and Perth office market is slowly improving post the end of the resource boom.

Residential markets appear to be stabilising, with Sydney and Melbourne recovering some of their previous declines. Post the surprise Federal election result, auction clearance rates have improved and the looser RBA rate policy has added momentum to the residential market.

Outlook

Economic data remains mixed. We are seeing some positive lead indicators emerge but manufacturing remains soft. Consequently, maintaining some balance across the portfolios continues to make sense. At present we are performing better as the market rewards value. We have reduced the banks' position, which balances out our underweight to bond proxies. The outlook for bank earnings in a low interest rate environment is poor. In addition, other business lines like forex, credit cards and payments face pressure. Banks have bounced since the election as the fear of a deterioration in housing eased. Valuations do not appear particularly attractive although the dividend yield will retain attraction for some investors. We see earnings declining over the next three years and this might place downward pressure on dividends. We have also added to our resource position given recent underperformance has improved relative attractiveness

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1199AU
AMP Flexible Super - Retirement account	AMP1386AU
AMP Flexible Super - Super account	AMP1515AU
CustomSuper	AMP1199AU
Flexible Lifetime - Allocated Pension	AMP1203AU
Flexible Lifetime - Term Pension	AMP1235AU
Flexible Lifetime Investment	AMP1207AU
Flexible Lifetime Investment (Series 2)	AMP1441AU
SignatureSuper	AMP1213AU
SignatureSuper Allocated Pension	AMP1222AU

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