

DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

31 March 2020

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%	98.77%
Cash	0-5%	1.23%

Sector Allocation	%
Communication Services	4.15
Consumer Discretionary	18.02
Consumer Staples	5.32
Energy	4.65
Financials	17.30
Health Care	4.00
Industrials	16.47
Information Technology	3.78
Materials	20.37
Real Estate	4.71
Utilities	0.00
Cash	1.23

Top Holdings	%
BHP Group	7.66
National Australia Bank	7.16
Rio Tinto	5.99
Treasury Wine Estates	5.32
James Hardie Industries	5.29
SEEK	5.21
Macquarie Group	5.02
Wesfarmers	5.00
Lendlease	4.71

Portfolio Summary

The Portfolio is positioned as follows:

- Overweight market leaders.
- Overweight resources that can benefit from stimulus and continue to operate and earn revenue.
- Increased to a basket of mid-cap companies with strong market positions.
- Underweight banks given they are highly leveraged to the economy and medium-term profits are impacted by lower interest rates and higher bad debts.
- Underweight defensives which have benefitted in the short term from resilient earnings but do not offer the upside that other areas of the market provide.

Investment Option Commentary

Over the past month the investment manager have focused on reviewing the investment cases for all their holdings. This includes revisiting valuation models and detailed stress-testing of all assumptions. They have also been speaking directly with the management of companies to understand how they are dealing with the current crisis, reviewing balance sheets, and the likely impact of the situation on long-term cash flows. While management and the market can attempt to estimate the short-term impact of the COVID-19 disruption, DNR Capital believe there is more value in understanding the potential longer-term impact.

The following summarises major recent moves:

- They added to existing quality names oversold—Wesfarmers (WES), Rio Tinto (RIO), National Australia Bank (NAB).
- They built new positions in quality names sold off—Ramsay Health Care (RHC), Cochlear (COH) and Sydney Airport Holdings (SYD).

They have funded the above from a combination of cash and stock exits including:

- Link Administration Holdings (LNK)—Exited remaining balance on quality concerns.

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 decided to keep rates at their low levels due to stalling economic data.

Domestically, a weak economy has resulted in continued easing from the RBA, with talks of preparedness to continue to cut rates and the possibility of initiating quantitative easing if rate cuts continue to have minimal economic effects. Housing continues to recover from its mid-year lows, though the most prominent threat to markets remains to be the ongoing trade dispute between the US and China.

International markets have been tumultuous over the period as investors weigh up the increasing possibility of easier monetary policy against the unforgiving geopolitical landscape.

The end of the period saw global bonds have their largest increase in recent months following the agreement between the US and China on moving to a 'phase one' trade deal which spurred a sell-off in treasuries. However, as inflation in the US remained subdued over majority of the period the Fed were prompted to keep rates lower. The RBA have trodden a similar path, with further cuts and the beginning of the quantitative easing discussion. Australian bond yields remain well below US yields.

Outlook

Lower interest rates support equity valuations and historically the market PE has broadly tracked movements in the official cash rate. Currently, the 12-month forward PE for the Australian market is ~17.4x, its highest level since the start of 2001, while earnings growth expectations for 2020 are just +5%. The ASX 200 Industrials ex-Financials finished the year at 24.3x, close to three standard deviations above its long-term average.

The divergence between high PE sectors and low PE sectors remains at record highs (~22x). Areas that are generally associated with earnings certainty and higher growth, like healthcare and technology, continue to be valued at increasingly higher premiums to the rest of the market. Recently, more cyclical parts of the market have participated in the market rally; including retailing, media and the diversified financials. However, valuations for resources, banks and insurance continue to remain towards the lower end of sector multiples. Looking forward, two key questions remain. Whether low interest rates can continue to support high valuations, and whether the divergence in valuations across sectors will revert.

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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