

# Perennial Value Income Wealth Defender

Quarterly Investment Option Update

30-June-2016



## Availability

Product name	APIR
Flexible Super – Choice (Retirement)	AMP1589AU
Flexible Super – Choice (Super)	AMP1577AU
CustomSuper	AMP1529AU
Flexible Lifetime – Allocated Pension	AMP1541AU
Flexible Lifetime – Super	AMP1529AU
Signature Super	AMP1553AU
Signature Super – Allocated Pension	AMP1565AU

## Investment Option Performance

Investment performances are subject to product fees and where relevant tax as outlined in the product PDS. Therefore investment performance may differ between products. In addition, activity on your account such as contributions and deductions will also impact the investment performance specific to you. To view the latest investment performances for each product, please visit [www.amp.com.au](http://www.amp.com.au). You can also view the last investment performance specific to you by visiting your My Portfolio account.

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## Overview

**Aim & Strategy:** To generate an attractive level of tax-effective income by investing in a diversified portfolio of higher yielding Australian shares while using protection strategies to dynamically protect the portfolio through market cycles, thereby reducing the magnitude of significant negative returns in falling equity markets. The Fund will typically hold approximately 30 stocks, with a minimum holding of 20 and maximum of 70. Stocks will have a minimum market capitalisation of AUD\$1bn at the time of initial acquisition. The strategy actively manages allocations between equities, derivative protection and cash throughout the market cycle with the aim of enhancing long

term performance by maximising returns when markets rally and minimising the magnitude of losses when markets fall. The protection strategies, including equity and index derivatives, are used to cushion the impact of losses when equity markets fall in a cost effective manner. The types of derivatives used include index futures and options on share and volatility indices, as well as options on single stocks. In periods where Perennial Value believes that there is higher than normal market risk, the amount of derivative protection in the portfolio may increase. Conversely, when the market view is more positive, the amount spent on portfolio protection may be lower.

**Investment category:** Australian equities

**Suggested Investment Timeframe:** 5+ years

**Relative Risk Rating:** High

**Investment Style:** Value

Asset Allocation	Benchmark (%)	Range (%)
Australian Shares	100	50 - 100
Cash/Other	0	0 - 50

## Holdings

Industry Exposure	%
Energy	4.3
Materials	11.2
Industrials	0.8
Consumer Discretionary	6.7
Consumer Staples	5.7
Health Care	0.0
Financials-x-Real Estate	41.9
Real Estate	6.6
Information Technology	0.0
Telecommunication Services	8.8
Utilities	2.2
Other	11.8

Regional Exposure	%
Australia	100

Top Ten Securities	%
Westpac Banking Corp	9.0
Telstra Corporation.	8.8
ANZ Banking Group Limited	6.9
Commonwealth Bank.	6.8
National Australia. Bank	6.5
Wesfarmers Limited	5.7
BHP Billiton Limited	4.8
Event Hospitality	4.3
Woodside Petroleum	4.3
Stockland	3.3

## Market Commentary

Whilst the market ended strongly for the quarter, there was significant volatility throughout. This was characterised by very strong months in April and May followed by the volatility in June, with the market not pricing in the events in the UK. On the day of the Brexit result, the protection portfolio performed well, highlighting the benefits of having a permanent overlay in place to cushion the effects of unexpected events. As such, we believe this is a safer way of protecting the downside in the long run, rather than trying to time markets or predict decisions like Brexit. For the month, after a strong bounce post the Brexit outcome, the protection portfolio delivered a positive return of 60bps.

Notwithstanding the good outcome in June, the overlay was a significant detractor for the quarter. This was essentially due to the very strong months of April and May. We continue to focus on the long term cost of protection given from month to month it can be quite volatile. Since inception of the overlay, the portfolio has carried protection at all times, and to date has cost 3.1% on an annualised basis. This is higher than our target in a market characterised by relatively high levels of volatility. Over time, we would expect the cost of the protection portfolio to be lower than this with material payoffs in the event of significant market falls.

## Investment Option Commentary

The 2016 financial year has been very difficult for true-to-label value investors such as Perennial Value, as investors have flocked to stocks with perceived earnings certainty such as infrastructure REITs and healthcare. This has pushed their valuations to very high levels and their dividend yields to very low levels. For example, CSL and Transurban – two stocks which we do not hold on valuation grounds – are currently trading on FY17 P/E ratios of 24.3 times and 25.4times and offering FY17 gross dividend yields of only 2.1% and 4.5% respectively. Not holding these and other similarly expensive stocks has impacted our performance over the past 12 months.

What is clear to us however, is that value as a strategy is a proven performer over the long term, as is our investment process. This is reflected in the performance of the Perennial Value Shares for Income Portfolio, which substantially forms the basis of the stock portfolio of the Perennial Value Income Wealth Defender portfolio. In addition to delivering a 7.7% p.a. pre-tax distribution yield, the Trust has also outperformed the benchmark by 1.1% p.a. in total return terms over its 10 year track record. There have been periods where we have seen value perform poorly in the past, however, on each occasion, we have remained disciplined, stayed true to our process and have been rewarded by subsequent strong outperformance. We have no reason to believe that this will not be the case going forward as relative market valuations inevitably normalise.

During the quarter we reduced our position in BHP, which had rallied some 47% from its lows in January. We also significantly reduced our holding in Flight Centre at an average price of \$36.11, ahead of the profit downgrade which saw the stock finish the quarter at \$31.58. While this stock has been a strong contributor to the portfolio over the past 12 months, we were concerned about the impact of slowing outbound travel, particularly given the potential consumer sentiment issues as a result of the upcoming election. Proceeds were used to establish a position in Bank of Queensland. The banks offers a relatively straight forward exposure to the Queensland economy, with the state accounting for around half of its loan book. We believe that this region will benefit from the pick-up we are currently seeing in domestic tourism and which we expect to continue into the future. The stock is trading on an attractive valuation, with an FY17 gross yield of 10.5%.

Perennial Value remains alert and active in ESG issues. Earlier in the year, we wrote to the Board of Ansell regarding their executive remuneration policy. Our strong preference was to adopt an approach which combined hurdles tailored to company and sector specific financial metrics, earnings per share targets, and return on capital targets, and to exclude the commonly adopted total shareholder return (TSR) metric. The key reason for this is that share prices may not reflect the underlying performance of the business in the short to medium term. Pleasingly, during the quarter, Ansell advised changes to its executive remuneration framework and adopted all of our recommended changes.

## Outlook

The portfolio remains exposed to the theme of ongoing transition to the east coast economy through overweight positions in consumer discretionary, building and construction-related stocks. The portfolio remains overweight in the large-cap, low-cost, financially-sound resources companies. We remain underweight the “expensive defensive” sectors of the market such as Healthcare, Infrastructure and REITs. These sectors have become a crowded trade and valuations remain stretched as a result of historically low interest rates. The portfolio continues to exhibit Perennial Value’s true to label value characteristics, offering better value than the overall market on each of our four valuation characteristics; price to earnings, price to free cash flow, gross dividend yield and price to net tangible assets.

**As always, our focus will continue to be on investing in quality companies which are offering attractive valuations and have the ability to deliver high levels of franked dividend income to investors, while carrying a level of protection sufficient to reduce the magnitude of significant negative returns during sharp equity markets falls. Further, we believe the current very low interest rates highlight the relative attractiveness of financially-sound, high dividend yielding equities.**

#### **What you need to know**

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