BT Australian Share

Quarterly Investment Option Update

31-December-2017

Availability

Product name	APIR
AMP Flexible Super – Choice (Retirement)	AMP1340AU
AMP Flexible Super – Choice (Super)	AMP1469AU
CustomSuper	AMP0860AU
Flexible Lifetime – Allocated Pension	AMP0875AU
Flexible Lifetime – Investments (Series 1)	AMP0835AU
Flexible Lifetime – Investments (Series 2)	AMP1405AU
Flexible Lifetime – Super	AMP0860AU
Flexible Lifetime – Term Pension	AMP0916AU

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**. 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 provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 300 Accumulation Index over the medium to long term. It is an actively managed portfolio of Australian shares which has the potential for long term capital growth and tax effective income, and offers diversification across a broad range of Australian companies and industries. The portfolio may also hold cash and may use derivatives for managing market exposure. The investment manager's process for Australian shares is based on a core investment style and aims to add value through active stock selection and fundamental company research which focuses on four key factors: valuation, financial risk, franchise and management quality.

Investment category: Australian equities

Suggested Investment Timeframe: 7+ years

Relative Risk Rating: High

Investment Style: Core

Asset Allocation	Benchmark (%)	Range (%)
Australian Shares	100	80-100
Cash	0	0-20

Holdings

Industry Exposure	%
Cash and Short Term	3.02
Consumer Discretionary	6.20
Consumer Staple	4.24
Energy	6.55
Financials x Prop Trusts	32.28
Health Care	7.42
Industrials	7.22
Information Technology	1.05
Materials	22.08
Real Estate Investment Trusts	3.26
Telecommunication Services	3.71
Utilities	0.00
Derivatives	2.99

Top Ten Securities	%
BHP Billiton Limited	9.53
Commonwealth Bank of Australia Limited	9.13
ANZ Banking Group Limited	7.13
Westpac Banking Corporation	5.98
CSL Limited	4.35

Qantas Airways Limited	4.22
Telstra Corporation Limited	3.71
Rio Tinto Limited	2.58
Caltex Australia Limited	2.52
Metcash Trading Limited	2.51

Market Commentary

Performance for the domestic equity market was strong over the final quarter of calendar year 2017. The S&P/ASX 300 Accumulation Index advanced by 7.7% over the quarter, where most of the hard lifting was done by Resources (+15.6%), as commodity prices continue to rise, supporting the miners and the oil players. Industrials (+6.1%) on the other hand jumped less high.

In terms of sector performance, all the 11 GICS sectors finished the quarter in the black, with Materials (+13.0%) heading up the rank. With the help of a rising iron ore price and copper price, on the back of the continuous production curb imposed by China, the diversified miner duo BHP Billiton (BHP, +14.7%) and Rio Tinto (RIO, +13.9%) both finished the quarter meaningfully higher. Also helping on sector performance was steel manufacturer, Bluescope (BSL) which added a hefty 40.1% over the quarter. BSL sold off in August when management reported underwhelming FY17 results, alongside a weak guidance for 1HFY18. The guidance was upgraded in December, as a result of higher steel prices and domestic volumes. The company will also benefit from the latest US tax reform as a partial US dollar earner. On the other hand, noticeable detractors within Materials over the quarter included lower-grade iron ore producer, Fortescue (FMG, -5.1%) and explosives manufacturer Orica (ORI, -7.0%). As the discount between high-grade and low-grade iron ore continued to widen due to increased demand for quality ores from Chinese buyers, the share price of FMG reacted negatively. For Orica, the disappointing FY17 results released in November saw the stock retreat over the period. It recouped some of the losses in the December trading. Outside Materials, performance from Energy (+18.3%) was also strong over the quarter. The oil price rose, and touched a two-year high during December, as strong global demand as well as production disruptions in Libya and the North Sea both supported the commodity price. As such, major oil companies, including Origin Energy (ORG, +25.9%), Woodside Petroleum (WPL, +13.7%) and Santos (STO, +35.6%) all recorded meaningful gains. For STO, the revelation of Harbour Energy's then offer to acquire the company back in August also lifted investor sentiment. Other sectors that posted a double-digit gain over the quarter include Consumer Staples (+10.6%), Consumer Discretionary (+10.3%) as well as Information Technology (+16.7%).

On the other side of the spectrum, performance from index heavyweight Financials (+3.7%) was less impressive. The confirmation of a Royal Commission into the banks weighed on the "Big Four", which saw two of them finish the quarter in the red (ANZ, -0.3%; NAB, -3.1%); whilst gains from the other two were also somewhat limited (WBC, +1.1%; CBA, +6.8%). NAB in particular incurred some selling after unveiling in November the additional spending of $1.5 billion for a restructure plan over the next three years. Also finishing below the index's return was Real Estate (+6.5%): the outperformance of Westfield (WFD, +21%), which received a cash and scrip acquisition offer from European commercial property giant Unibail-Rodamco, was somewhat offset by the 8.8% loss from Lendlease (LLC). Management downgraded the outlook of its Australian construction business for FY18 due to some engineering projects, which weighed on LLC's share price.

Finally on macro developments, the US Federal Reserve finished its December hike, which had been well-broadcast leading up to the meeting. Investor sentiment more broadly was supported by the passing of the much-anticipated US tax reform. Strong US data like ISM manufacturing, retail sales and Gross Domestic Product (GDP) growth also helped support risk appetite. Economic releases were also solid in Europe and dovish messaging from the European Central Bank was perceived positively. Meanwhile, in Asia Xi Jinping consolidated his power at the 19th Communist party assembly and emphasised quality over quantity for future growth. Data released during the period revealed the Asian giant grew at a healthy 6.8% over the year. Reasonable leading indicators and import figures were also encouraging. Elsewhere, pockets of geopolitical risks like Catalonia's push for independence, Merkel's coalition losing its majority and North Korean missile tests had little impact on markets.

Investment Option Commentary

The portfolio outperformed the index for the quarter, capping a strong 2017 in terms of both absolute and relative performance.

Several of the more non-consensus positions such as Metcash and Santos made positive contributions to relative performance. Qantas – one of the largest positions in the portfolio – detracted in Q4 as the market expressed concerns over an increasing oil price. At this point BT believe that these concerns are overdone, as the airline's hedging programme provides a measure of immunity to short-term movements, although remaining mindful that further, sustained oil price increases could present a risk in 2019. Nevertheless, Qantas remains a key driver of the portfolio's outperformance over the year.

Contributors

Metcash (overweight, +24.2%) - Reported its 1H18 results early in December, which saw EPS over the period increase by 14.8% compared to 1H17, as the benefits of the latest hardware HTH acquisition started to flow in. The Food & Grocery business also performed better than expected on the back of continuous cost-out from the Working Smarter program, in spite of the negative ex-tobacco sales growth over 1H17. Metcash (MTS) remains one of our highest conviction stocks: from its half-yearly results, cash flow was evidently strong, whilst the release of inventory from the hardware acquisition demonstrates improved business efficiency. Debts were also brought down meaningfully, reflecting a business with much lower risks when compared to just a few years ago. The fact that the stock is still trading at 13-14x means that the market is yet to fully appreciate the quality of MTS. With Aldi now approaching the end of its rollout in WA and SA, and the weak WA economy stabilising, MTS's negative ex-tobacco sales growth is expected to improve from here. That said, BT are cognisant that the supermarket industry remains highly competitive.

Santos (overweight, +35.6%) - Oil and gas company, Santos (STO) held its strategy day in November to update guidance for FY17 and FY18. Their forecast free cash flow breakeven price now sits at US$32/bbl, with an ongoing target of $US 35-40/bbl. BT believe the company has done well in cost-out on the East coast, and management is also seeing STO becoming an onshore provider with structurally lower costs in comparison to peers. BT also think the company's FY18 guidance is somewhat conservative, with good projects like the PNG LNG and the Darwin LNG backfill on hand. While the stock has run hard recently on the back of a rising global oil price, the investment manager still believe there is large enough upside potential from STO for us to uphold our conviction, given the quality of its assets portfolio. The recent talk of a potential takeover by Harbour Energy – even if it does not eventuate – is a good reminder of the intrinsic value of those assets.

NAB (underweight, -3.1%) - Held its 2H trading update over the month, which saw FY17 cash earnings come in a touch below consensus, while the 2H17 dividend was kept flat at 99 cents (a 79% payout ratio). Overshadowing the results was the unveiling of $1.5 billion in new spending on a restructure plan over the next three years. This will translate into a large restructuring provision for FY18, and will see the payout ratio increase towards 90% alongside the guided flat dividend. As such, investors sold off the stock following the trading update. The confirmation of a Royal Commission into the banking sector also kept a lid on the performance of the sector. NAB is the largest underweight amongst the 'Big Four' in our portfolio, while ANZ remains our preferred exposure.

Detractors

Qantas (overweight, -13.6%) - National airliner Qantas (QAN) started the quarter strongly in October, however gave back all the gains later in the quarter and finished the period 13.6% lower. Whilst there was nothing new surfacing in regard to QAN's business, the rising oil price over the December quarter clearly weighed on investor sentiment. In addition, the removal of QAN from the MSCI Australia Index (as it nears its 49% limit of foreign ownership), as well as the end of the company's share buy-back also put some pressures on its share price. That said, it remains one of BT's highest conviction positions due to its strong business fundamentals and the appealing stock valuation. BT remain mindful that if oil prices remain elevated for a sustained period, it can begin to feed through into increased costs and remove some of the expected upside from here. However, BT are not currently at that point and QAN's hedging immunises it against a significant surge in fuel costs in the near term.

ANZ (overweight, -0.3%) - Banks in general retreated in November: the strengthening expectation that the Federal government would be forced to capitulate to pressure for a Royal Commission into financial services was officially sealed by the announcement made by the Turnbull government. Many people are seeing this as the "least-worst" outcome for the banks given that a Commission defined by the Coalition is likely to be more benign than one drawn up by the Labor government and that it should be manageable as a result. This does seem a reasonable view at this point, however BT is mindful that the last Royal Commission into the sector – to investigate the collapse of HIH insurance – also began with a relatively tight mandate which later broadened and ultimately published recommendations for the banks. It will be important to keep track of the Commission's direction in case it does begin to delve into some unexpected areas. BT is neutral on the "Big Four" in aggregate, with ANZ remaining the most preferred exposure and NAB the least.

Amcor (overweight, +1.4%) - Performance of packaging company, Amcor (AMC) was somewhat anaemic over the December quarter. Rumours from the previous quarter around Amcor's potential takeover of its global peer, Bemis failed to spark any further media coverage after management responded vaguely without much clarity that Amcor regularly assesses a range of strategic options. As previously communicated, AMC remains a key position of the portfolio, while the investment team watch closely on any further development on the M&A front.