K2 Australian Absolute Return

Quarterly Investment Option Update

31-December-2017

Availability

Product name	APIR
AMP Flexible Super – Choice (Retirement)	AMP1622AU
AMP Flexible Super – Choice (Super)	AMP1613AU
CustomSuper	AMP1598AU
Flexible Lifetime – Allocated Pension	AMP1634AU
Flexible Lifetime – Super	AMP1598AU
Signature Super	AMP1604AU
Signature Super – Allocated Pension	AMP1628AU

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 preserve capital and aim to generate a 10+% p.a. return, after fees, over the long term. This may be suitable for those seeking diversification within traditional asset class exposure, and those with a high risk tolerance. The portfolio generally invests in listed equities in Australia and New Zealand (across sectors that the investment manager believes will add greatest value) although it may also invest in other investments as permitted by its constitution. Typically the portfolio will hold between 50 and 70 listed equities. If deemed appropriate, the portfolio may be 100% invested in cash. While implementing the long /short strategy the gross invested position of the portfolio will not exceed the net asset value.

Investment category: Specialist equities

Suggested Investment Timeframe: 5 to 7 years

Relative Risk Rating: High

Investment Style: Opportunistic

Asset Allocation	Benchmark (%)	Actual (%)
Cash and deposits		11.66
Mortgages		
Australian fixed interest		
Global fixed interest		
Australian property		
Global property		
Australian equities		85.80
International equities		2.54
Alternatives		
Other		

Holdings

Industry Exposure	%
Basic Materials	19.91
Communications	2.54
Consumer Cyclical	6.97
Consumer, Non Cyc	10.32
Diversified	1.46
Energy	7.20
Financial	30.89
Industrials	7.49
Technology	0.61
Utilities	0.97
Cash	11.66

Regional Exposure	%
Australia	85.80
New Zealand	2.54
Cash	11.66

Top Ten Securities	%
MACQUARIE GROUP LTD	6.095%
BHP BILLITON LIMITED	6.032%
SUNCORP GROUP LTD	4.896%
MEDICAL DEVELOPMENTS INTERNA	4.800%
ALUMINA LTD	4.269%
BORAL LTD	3.670%
RIO TINTO LTD	3.645%
WOODSIDE PETROLEUM LTD	3.476%
FORTESCUE METALS GROUP LTD	3.439%
PACT GROUP HOLDINGS LTD	3.350%

Market Commentary

Australian equities closed out 2017 on a positive note as commodities rallied and offshore suitors circled domestic companies like seagulls to a chip. Frank Lowy recommended Westfield investors accept a bid from Europe's Unibail-Rodamco, while the heavily shorted Aconex delivered a bitter Christmas present to the bears as Oracle bid a ~50% premium. The 19th National Congress in China delivered no surprises, while cyclicals outperformed as Chinese growth expectations continued to hold firm. Australian politics suffered a turbulent quarter as dual citizenship cases went to the High Court and the banking sector became a political football as PM Turnbull announced a Royal Commission in late November. With loan growth muted, national house prices -0.3% QoQ, a struggling consumer and the overhang of a Royal Commission, it is understandable investors remain guarded on the big 4 banks into 2018. The RBA left rates on hold at 1.5% while the AUD fell -0.3% to USD0.781.

Energy (+17.9%) and materials (+12.9%) were strong quarterly performers as commodity prices remained firm, while technology

(+15.6%) stocks pushed higher globally. Financials (+2.0%) were a key underperformer given the headwinds discussed above.

Investment Option Commentary

The Fund averaged 82.8% net exposure for the quarter; long and short exposure were 85.1% and 2.3% respectively. At a sector level for the quarter Financials net exposure averaged 30.8% and Materials averaged 25.2%. At a stock level the best contributors for the quarter were Medical Developments International, BHP Billiton and Macquarie Group. Cash was the largest detractor of relative performance.

Outlook

FY2018 has so far been a constructive period for equity investors. For the financial year to date the K2 Australian Fund has delivered a return of 10.0% after fees. K2's Australian team identified a number of investment opportunities during the first quarter and net equity exposure gradually rose to over 80% by late October. As investor confidence resurfaced the Fund subsequently enjoyed strong returns throughout the second quarter.

The Australian equity market continues to look relatively appealing on global valuation metrics. The median PE of Australia's largest 20 companies is 11% lower and the dividend yield is 160 basis points higher than leading developed market peers. Bureaucratic dilution has played an important role in this valuation disparity; Australia's banks have been forced to raise $100 billion of additional capital only to be recently subjected to a tax on selective liabilities. More capital and less profits does not typically attract global investors. The fund manager believe that this banking ROE dilution will be partly offset by an improved performance from the resource sector. Historically the ROE of the resource sector has moved in-line with the CRB Price Index in Australian dollars. Over the past 6 months this price index has risen by 12% yet the ROE projections for the resource sector has averaged just 10%. Between 2009 and 2014 the resource sector consistently delivered ROE's of at least 15%. Given that global economic conditions have dramatically improved, the fund manager believe there is meaningful upside in the return profile for Australia's largest resource companies. As a result the fund manager feels that Australia's ROE will rise over the coming 12 months and the PE discount to global peers will subsequently contract.

Discount rates will be another important valuation consideration over the coming 12 months. It is common knowledge that over the years ahead central banks will increasingly become net sellers of government bonds. At some point speculators will look to "front run" this structural trend. It is likely that long bond yields will exhibit more volatility and this should lead to higher valuation discount rates. Equity markets can still perform well under these conditions but earnings growth must offset higher discount rates.

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