Ironbark Karara Australian Share

Quarterly Investment Option Update

30-June-2018

Availability

Product name	APIR
AMP Flexible Super – Choice (Retirement)	AMP1343AU
AMP Flexible Super – Choice (Super)	AMP1472AU
CustomSuper	AMP0056AU
Flexible Lifetime – Allocated Pension	AMP0588AU
Flexible Lifetime – Super	AMP0056AU
Flexible Lifetime – Term Pension	AMP0887AU
MultiFund Flexible Income Plan	AMP0983AU
SignatureSuper	AMP0736AU
SignatureSuper Allocated Pension	AMP1125AU
Flexible Lifetime Investment	AMP0832AU
Flexible Lifetime Investment (Series 2)	AMP1407AU

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: The Karara Capital is an active investment manager whose approach to Australian equities is built on the belief that original, forward-looking research can identify underappreciated companies. Karara Capital's approach emphasises the development of insights into a company's longer-term prospects. They look to consider all factors that they believe are relevant and carefully assess whether this view is reflected in the market place. Portfolios are built from a diverse range of insights and close attention is paid to understanding the interplay between the holdings. The strategy will primarily invest in 25-35 companies included in the S&P/ASX 100 Index plus an allocation to smaller companies. The allocation to smaller companies is generally between 0-20% of the portfolio, however this can vary over time. Investments of the strategy may also include derivatives such as index futures, which would be used for risk management purposes or as substitutes for physical securities.

Investment category: Australian shares – core

Suggested Investment Timeframe: 5+ years

Standard Risk Measure: 6/ High

Asset Allocation	Actual (%)	Range (%)
Australian Shares	98.25%	90%-100%
Cash	1.75%	0-10%

Holdings

Industry Exposure	%
Consumer Discretionary	6.41
Consumer Staples	7.59
Energy	10.53
Financial ex Property Trusts	31.10
Health Care	6.39
Industrials	8.53
Information Technology	1.95
Materials ex Metals & Mining	5.68
Metals & Mining	14.74
Property Trusts	0.26
Telecommunications Services	0.08
Utilities	4.99
Cash	1.75

Regional Exposure	%
Australia	100

Top Ten Securities	%
BHP Billiton Limited	7.59
Westpac Banking Corporation	6.21
ANZ Banking Group Limited	6.16
Commonwealth Bank of Australia	5.14
Wesfarmers Limited	4.72
National Australia Bank Limited	4.52
Rio Tinto Limited	4.34
AGL Energy Limited	4.29
Origin Energy Limited	3.86
Brambles Limited	3.20

Market Commentary

June was characterised by continued heightened investor risk aversion. The Australian equity market was supported by ongoing strength in commodity markets and a rotation out of emerging market equities with the S&P/ASX 300 delivering a total return of 3.2%, which was a material outperformance versus the MSCI World Index, which only delivered a total return of 0.3%.

Global economic data indicated global growth somewhat rebounded from the dip that occurred between January and April. Whilst the specific drivers of Europe's weakness in the first-half are unclear, it appears the result of a confluence of factors that are likely to be transient. The European Central Bank announced the cessation of its Quantitative Easing program by the end of the year leaving the Bank of Japan as the final major central bank with an ongoing bond-buying program. The US Federal Reserve continued to tighten with a further 0.25% interest rate rise with expectations of a further 0.25-0.50% of tightening over the balance of the year. The US 10-year government bond yield increased modestly to 2.85% from 2.74%.

Domestic activity indicators have remained healthy with employment up 2.5% year-on-year and the unemployment rate falling to 5.4%. Job vacancies have surged with some evidence of wage pressures emerging. Despite current activity indicators in Australia suggesting ongoing solid growth, investors are fearful about the impact of the modest softening in the housing market that is underway.

Investment Option Commentary

The Fund underperformed the S&P/ASX 300 Accumulation Index during the June quarter.

Telstra (down 6%) finally rebased their earnings to reflect the heightened competition dynamics prevailing in the telecommunications sector. They have effectively signalled an all-out battle for market share with both price reductions and significant investment in the rollout of the 5G mobile network. While cost reduction activities should buffer some of the earnings impact, the key success factor of this strategy will be the lack of prospective returns for their competitors from the upcoming rollout of 5G forces consolidation, with a tie-up between Vodafone and TPG seen as the most logical outcome. Telstra is not held by the Fund.

Ramsay Healthcare (down 12%) announced a modest earnings downgrade but pointed to challenges in its business for the year ahead. A key challenge for the private health sector remains the declining private health insurance participation rate, which is at the margin redirecting patients back into the public system and potentially creating short term over capacity in the private hospital industry. Ramsay is not held by the Fund.

Brambles (down 2%) continued its underperformance as investors continued to be concerned over input cost inflation in its US pallet operations. The size of its recent underperformance seems materially outsized versus the risk with the investment manager's expectation remaining that cost recovery will occur, however it will take time. The escalation in its input costs is not unique to Brambles and will further entrench the pallet pooling model, of which CHEP is the dominant player.

APA group (up 16%, however not held in the Fund) received a takeover offer from CKI at $11 per share. The offer is compelling for the company, however whilst significant regulatory hurdles exist, they are not insurmountable.

Qantas (down 3%) was sold down as some queried their ability to recover higher fuel bills. The investment manager's view remains that the domestic industry structure will enable full recovery in the domestic market, however their international operations may be impacted.

CYBG Group (up 10%) and Virgin Money agreed the final terms of their merger. There is strong industrial logic for the tie-up with it providing significant synergies, funding advantages, scale and market position benefits. The position in CYBG Group was increased during the month funded by a reduction in Macquarie Group (up 8%).

The position in Navitas (up 1%) was exited. The strong demand to study in Australia is skewing towards higher value post-graduate degrees which Navitas does not have any exposure to. Furthermore, the potential for immigration levels and heightened population growth to become a flashpoint during the upcoming election cycle is seen as an unappreciated risk.

The position in Crown was exited and partly funded an increase in the position in Star Entertainment. Other Fund activity included position increases in Aristocrat and Boral.

Outlook

Global growth is expected to continue to recover in the second half of the year. Slack in developed countries is reducing steadily and with above-trend growth expected to continue for some time, the investment manager expects inflation pressures to continue to build. Complacency around longer term inflation risks remains quite high with many expecting any upturn in inflation will be modest despite more evidence of an acceleration of wages in the US and elsewhere. This view, combined with significant investor concerns around the robustness of growth, continues to support large pools of global capital defensively positioned in assets with low or negative real yields and a preference for long-term defensive growth stocks despite valuations that are extremely high versus history.

This positioning has been encouraged by easy financial conditions but which are now either tightening modestly (US) or close to it (EU). Risks are rising that the market is underestimating the extent of tightening that may ultimately be required. However in the near-term, the investment manager anticipates that the key central banks response remains modest as they will welcome inflation that modestly exceeds their targets and as it takes pressure off indebted countries and households.

Whilst the global growth improvement is relatively synchronised, Australia is lagging. The pickup in domestic economic data over the last year has been encouraging, particularly employment growth, which now appears to be driving a reasonable growth in household income. Going forward, the investment manager expects aggregate consumer spending to be broadly in line with nominal household income growth (approximately 4%) and Australian gross domestic product growth to be slightly above trend at approximately 3%. Strong population growth is assisting headline growth numbers with per-capita growth quite low in a historical context. To this end, the debate on immigration needs close monitoring through the coming election, however at this stage the investment manager expects reductions, and should they occur, to be small.

House prices are moderating with small real price declines occurring due to the tightening in investor credit over the last 12 months. Reasonable owner occupier demand and good employment conditions are expected to prevent a significant correction. From a high starting point, an orderly adjustment within the context of a broader economy that is performing well is a best case outcome, even if takes several years. Whilst there is risk, the investment manager does not anticipate a material spill over from the housing market into household consumption while employment conditions remain solid. As a small open economy, the key risk to house prices remains to be external macro shocks which have, if anything, diminished of late.

Moderate global growth and recovery of pricing power in some sectors suggest a reasonable environment for many stocks. However, after the expansion in valuations in recent years, sustained gains will require continuing profit delivery.

Overall market valuation metrics appear quite reasonable in a historical context, however high valuation dispersion exists with a cohort of stocks with defensive growth characteristics extreme by historical standards. This starting point, along with the prospect of higher real bond yields and broadening growth, is increasing the opportunity cost of holding these stocks. Failure by any of these companies to meet or exceed expectations, which is quite common and possibly likely to become more so in an environment of tighter input markets, can be expected to have larger consequences than what has been the case over the past couple of years. The Fund remains materially underweight to this area.

The Fund remains positioned for a more reflationary environment than what is currently priced by the market. The investment manager believes there are good risk-adjusted returns available in many sectors. Within this, the emphasis is on quality companies whose prospects are unappreciated by the market.

and charges and their employees and directors receive salaries, bonuses and other benefits.

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