# Pendal Australian Equity

Quarterly Investment Option Update

30-June-2018

## 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 | Actual (%) | Range (%) |
|---|---|---|
| Australian Shares | 100 | 80-100 |
| Cash | 0 | 0-20 |

## Holdings

| Industry Exposure | % |
|---|---|
| Cash and Short Term | 1.26 |
| Consumer Discretionary | 5.35 |
| Consumer Staple | 4.44 |
| Energy | 9.78 |
| Financials x Prop Trusts | 28.49 |
| Health Care | 9.10 |
| Industrials | 8.87 |
| Information Technology | 2.16 |
| Materials | 23.92 |
| Real Estate Investment Trusts | 2.18 |
| Telecommunication Services | 2.76 |
| Utilities | 0.00 |
| Derivatives | 1.68 |

| Top Ten Securities | % |
|---|---|
| BHP Billiton Limited | 10.32 |
| ANZ Banking Group Limited | 7.20 |
| Commonwealth Bank of Australia | 7.15 |
| CSL Limited | 6.22 |
| Westpac Banking Corporation | 4.58 |
| Qantas Airways Limited | 4.30 |
| Amcor Limited | 3.16 |
| Telstra Corporation Limited | 2.76 |
| Santos Limited | 2.65 |
| Origin Energy Limited | 2.56 |

## Market Commentary

The S&P/ASX 300 Accumulation Index finished the June quarter with a gain of 8.4%, making the Financial Year 2018's return a +13.2%. Earnings growth has powered these gains, as the Royal Commission and a challenging environment has seen the banks de-rate, keeping the market's aggregate valuation rating steady. This is important, as ultimately the Fund Manager sees earnings-driven market growth as more sustainable than valuation-driven returns. The market's return was broadly in-line with the +8.8% 12-month gain from the MSCI World (Local Currency). In the US, the S&P 500 gained +12.2% and the NASDAQ +22.3%, while Japan's Nikkei was up +11.3%. European returns were muted, with the UK's FTSE 100 up +4.4% over 12 months, and Germany's DAX down -0.2%.

## Investment Option Commentary

While resources outperformed (S&P/ASX 300 Resources +16.0%), Industrials and A-REITs also posted solid gains. The portfolio made absolute gains, helped by strong performance from CSL and Santos. However the overweights in Metcash and JB Hi-Fi saw the portfolio finish behind the index for the quarter.

## Outlook

The Index returned 13.2% for the financial year, including dividends. At just under 16x, the next-twelve-month price/earnings for the S&P/ASX 300 remains above its long term average, however not egregiously so given the low target interest rate of the RBA. While rates remain low the Fund Manager believes that the market can maintain its current valuation – and does not expect imminent rate rises given the lack of inflation in the economy. This leaves earnings to drive stock markets. The Fund thinks that there is enough juice in the economy to support mid-single digit earnings growth, helped by the pipeline of infrastructure spending and a pick-up in capex in corporate Australia. As a result the Fund Manager continues to expect Australian equities to return somewhere near high single-digit returns for the next year, once dividends are factored in.

The market's key feature remains the increase in stock dispersion in recent times. This is driven partly by the decline in previous thematic drivers – but the scale of disruptive challenges facing a large swathe of corporate Australia is paramount. This provides a fertile ground for active managers to add value.

Our key positions at the moment include BHP Billiton in resources. Chinese supply-side policy settings continue to support commodity prices and earnings growth, while the company's strategy of divesting its poorly-performing assets should lead to improved capital allocation and return on equity. The Fund also maintains conviction in Metcash. The Fund Manager believes the market's reaction to the loss of the Drake contract in South Australia has been disproportionate, while it also believes the improving trends in supermarket sales are underestimated. At this point, the implied valuation for the IGA business is little more than two times EBITDA, which the Fund Manager believes is far too low given the programmes in place to drive revenue growth.

Qantas dragged slightly over the quarter, however it also remains among the highest conviction positions. Disciplined pricing and capacity in the domestic market underpin continued earnings and cash flow. A pick up in corporate capex – not least by the West Australian miners – is helping domestic demand growth while trends in its international market have also turned positive for the first time in a while. At 9.9x next-12-month price/earnings, the Fund Manager thinks that Qantas continues to offer a compelling opportunity despite its strong gains over the last five years.

## What you need to know

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