Schroders Australian Equities

Quarterly Investment Option Update

30-June-2018

Availability

Product name	APIR
Flexible Super – Choice (Retirement)	AMP1375AU
Flexible Super – Choice (Super)	AMP1504AU
CustomSuper	AMP0564AU
Flexible Lifetime – Allocated Pension	AMP0636AU
Flexible Lifetime – Investments (Series 1)	AMP0995AU
Flexible Lifetime – Investments (Series 2)	AMP1438AU
Flexible Lifetime – Super	AMP0465AU
Flexible Lifetime – Term Pension	AMP0944AU
MultiFund Flexible Income Plan	AMP0990AU
Signature Super	AMP0813AU
Signature Super – Allocated Pension	AMP1177AU

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 outperform the S&P/ASX 200 Accumulation Index over the medium to longer term. The core of the investment manager's investment philosophy is that corporate value creation, or the ability to generate returns on capital higher than the cost of capital, leads to sustainable share price outperformance in the long term. The investment process is a combination of qualitative industry and company competitive position analysis and quantitative financial forecasts and valuations.

Investment category: Australian equities

Suggested Investment Timeframe: 3 to 5 years

Relative Risk Rating: High

Investment Style: Growth / Quality

Asset Allocation	Actual (%)	Range (%)
Equities	97.1%	95%-100%
Cash	2.9%	0%-5%

Holdings

Industry Exposure	%
Energy	4.68%
Materials	26.13%
Industrials	7.87%
Consumer Discretionary	6.03%
Consumer Staples	7.82%
Health Care	1.53%
Information Technology	34.63%
Telecommunication Services	0.78%
Utilities	3.35%
Financial-X-Property Trusts	2.18%
Property Trusts	2.11%
Cash	2.90%

Top Ten Securities	%
BHP Billiton Limited	7.40%
Commonwealth Bank of Australia	7.20%
ANZ Banking Group Ltd.	5.40%
Westpac Banking Corporation	5.10%
Rio Tinto Limited	4.50%
Woolworths Group Ltd	4.40%
National Australia Bank Limited	4.00%
Telstra Corporation Limited	3.10%
Lendlease Group	2.90%
CYBG	2.70%

Market Commentary

Almost all sectors sit at historic extremes in terms of price earnings ratios versus history. If historic relationships hold true, there will be strong returns to be made as things normalise. Globally, investors with strong valuation disciplines have been challenged for some years and are roundly the class dunces at present. The facts, therefore, seem to point strongly towards positioning for a reversion in these extremes. For the most part, the fund manager concludes these extremes will be transitory. Profit and cash flow fundamentals will always rule in the end and the pushing of valuations to ludicrous extremes has happened many times before. Eventually, if real cash profits (not the accounting fictions which are currently popular) do not follow valuations, gravity will unwind the artificial market value creation.

Taking healthcare as an example, Fisher and Paykel Healthcare (+11.8%), CSL (+23.9%), Cochlear (+10.2%) and Resmed (+14.5%) all report margins and returns on capital stratospherically higher than the broader market. None sell their products into free markets. Customers generally don't pay the bill, taxpayers or insurers do. The fund continues to expect that governments will seek to reduce the excessive prices charged by these companies in an effort to deliver better value for the taxpayer. The only losers, when governments fail to keep the prices in check are taxpayers, as the residual disposable income available to purchase goods and services reduces accordingly. In general, the companies are happy (they earn egregious profits), the patients are happy (they receive excellent but exceptionally expensive products and perceive them as nearly free), and intermediaries such as health insurers or governments are generally able to pass on the costs to the general public as higher premiums or taxes. The unintended side effect is the progressive squeezing which this places on free market businesses trying to sell goods and services to consumers who are progressively relieved of more of their disposable income. Each of the businesses above trades at multiples far above the market average. Given this multiple is effectively the discounting of expected future profits, investors are expecting these egregious profits will grow far more quickly than the broader market, necessarily taking them to ever more excessive levels.

Investment Option Commentary

Contributors

Santos (o/w, +23.7%) the fund manager is always sceptical in instances where companies repel takeover bids, as the equation which sees the vast majority of acquirers destroy value must inherently work in reverse. After assessing and rejecting a bid from Harbour Energy at around $7, the company has turned the blowtorch on itself. Delivering longer term cash flows from the asset base to vindicate this stance will be difficult, albeit the exogenous factor (oil prices) which dominates this equation for most oil and gas companies is also the major driver for Santos. The fund manager continues to believe Santos represents better value than the majority of peers in the sector, but acknowledge that share prices now reflect a significantly more optimistic long-term oil price scenario than was the case 12 months ago.

Alumina (o/w, +18.6%) Whilst the commodity prices now reflected in the valuation of the company's portfolio of low-cost, quality assets is now significantly higher than was the case when excessive Chinese capacity had depressed prices for many years, the fund believes the current valuation reflects reasonable but far from excessive prices in the longer term. As with many resource businesses, low levels of debt is perplexing as to why many investors still see them as riskier investments than highly geared businesses with less volatility in underlying operations. Must be something to do with resource companies having to live with free market pricing!

Seven West Media Limited (o/w, +55.6%) To borrow from Mark Twain again, "reports of my death have been greatly exaggerated". Free to air television has been consigned to the scrap heap for some time given an expectation that much of this revenue would eventually be ceded to other forms of media. Whilst the environment will undoubtedly remain challenging as both the quantum of available viewing content and its cost continue to escalate, moves to bring cost more in line with sustainable revenues are positive. Given the exceptionally low multiples accorded to the business given earnings pressures over recent years, the fund still believes valuation is more than reasonable.

Detractors

CSL (u/w, +23.9%) The narrative which identifies CSL as both an efficient and highly innovative developer and manufacturer of plasma derived products is both powerful and accurate. It does not justify paying a ridiculous price for the business. The industry is relatively small (by global pharmaceutical standards), concentrated and currently enjoying exceptionally high prices for its products, particularly in the US. Valuations are extrapolating and vastly increasing these already high profits on the expectation that competing therapies in the longer term can be ignored and government buyers will remain happy to be fleeced. The fund does not feel these extrapolations are warranted.

Brambles (o/w, -11.0%) Escalating fuel and transport cost pressures, particularly in key markets such as the US, continue to raise question marks on the ability of the company to sustain and grow profits from what the fund believes remains a strong and market leading pallet pooling business. Scepticism around the appetite of new management to improve business efficiency and extract pricing which fairly reflects the value proposition to the customer is probably well-founded, as the longer term history remains littered more with excuses than successes.

Outlook

The lure of the fast buck remains as powerful as ever. As the fund has raised many times, the overly financialised world has elevated asset price speculation far above the tedium of saving wage and salary income, one of the side effects of manipulating interest rates and driving wealth inequality. It is perhaps unsurprising that the equity market echoes these 'Louis Vuitton' characteristics, where the glittering and glamorous command prices far in excess of the bland and mainstream. Expectations that these conditions will prevail into the distant future may be possible, however, the fund manager's analysis of the facts and history suggest it is improbable. Sometimes the things you know for sure just ain't so.