DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

30 September 2018

Aim and Strategy

To invest in a high conviction portfolio of Australian shares that aims to outperform the S&P/ASX 200 Accumulation Index benchmark by 4% p.a. (before fees) over a rolling three-year period. DNR Capital seeks to identify good quality businesses that are mispriced by overlaying DNR Capital's quality filter with a strong valuation discipline.

DNR Capital's security selection process has a strong bottom up discipline and focuses on buying quality businesses at reasonable prices. The portfolio construction process is influenced by a top-down economic appraisal and also considers the risk characteristics of the portfolio such as security and sector correlations. The investment strategy results in a high conviction portfolio of 15 to 30 securities that is invested for the medium term.

Investment Option Performance

To view the latest investment performances for each product please visit amp.com.au

Investment Option Overview

Investment category	Australian Shares
Suggested investment timeframe	5 years
Relative risk rating	6 / High
Investment style	Specialist - Quality

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	95-100%	96.82%
Cash	0-5%	3.18%

Sector Allocation	%
Communication Services	1.82
Consumer Discretionary	5.88
Consumer Staples	8.39
Energy	5.82
Financials	27.18
Health Care	3.27
Industrials	14.57
Information Technology	7.77
Materials	16.43
Real Estate	5.70
Utilities	0.00
Cash	3.18

Top Holdings	%
BHP Billiton	8.37
National Australia Bank Limited	8.31
Lendlease	5.70
Macquarie Group	5.61
Woolworths Group	5.28
Tabcorp Holdings	4.85
Commonwealth Bank of Australia	4.81
Brambles	4.71
James Hardie Industries	4.50
Link Administration Holdings	3.82

Portfolio Summary

- With technology driving disruption, opportunities exist to invest in growth businesses that are developing global, scalable business models. On the contrary, the ability to find value at the other end of the market should increase as the market overlooks more traditional, quality businesses.
- Macroeconomic themes are driving markets. US-China relations are tempering growth in the global markets just as bond yields increase – leading to dangerous conditions for emerging markets. Domestically, property is coming under pressure as the Royal Commission forces tighter credit controls and future policy threatens demand.
- The focus remains on quality and valuation discipline as DNR navigate a market that is polarising by nature. Market darlings are enjoying higher multiples which are prone to rising bond yields while out-of-favour businesses are sitting at attractive multiples but face structural headwinds.

Investment Option Commentary

The success story over the past few years has been those companies exposed to technology. DNR have seen an acceleration in the pace of disruption around the globe as corporates digitise and take advantage of data and new technology. This is driving productivity and the development of new business models. The excitement of these business models is that if you develop a leading platform, then there is the opportunity to take the platform global.

The question is what price to pay for these types of opportunities. The gap between market-loved stocks and unloved stocks is high by historical standards, but then DNR would also argue the gap in the opportunity between a stock with a global growth opportunity and a stock facing disruption from, say an Amazon entering the market, has never been greater.

Market Commentary

The market is being influenced by a number of strong macroeconomic themes. The rise of populism and the fragmentation of political parties is causing polarisation in global politics, evidenced by the increasing confrontations between the US and China. The push by the US to become more insular is stimulatory from a fiscal policy standpoint, but the ramp up in tariffs (primarily targeted at China) is proving inflationary and negative for global growth.

Bond yields and interest rates are also on the rise as the US economy prices in fuller employment, wage pressures and impending inflation – raising the cost of capital globally and pushing the USD higher. Emerging markets are the most at-risk from these increases, as the debt is substantial and majority USD-denominated. Previously, stimulatory policy from China has helped to support the economies of the EM's but Beijing's directive to reduce debt has reduced the likelihood of this outcome.

Domestically, the markets are also digesting the weak outlook for residential property, which is casting shadows on financials, consumer goods and industrials exposed to the cycle. The Royal Commission has forced the banks in to stricter lending standards. This has the effect of restricting demand for properties, particularly in the higher price brackets. This, coupled with the potential for the removal of negative gearing, decreases in CGT tax breaks, a rollover of loans from interest-only to principle-and-interest, a build-up of supply and the aforementioned increase in cost of capital globally, paints a bearish picture for the sector.

Outlook

DNR believe it is time for some caution. Market optimism means many businesses have been re-rated higher and some of these will not deserve the market darling status that they currently enjoy. Further, higher bond yields can place pressure on these extended valuations, given a significant level of value is in the terminal year. In some cases, the opportunities are difficult to ignore and a business that creates a large global presence will be interesting regardless of where bond yields land. DNR are a little more bullish in this regard following reporting season, which highlighted the level of earnings growth and long-term potential in many businesses. DNR remain invested in a range of quality businesses, with large opportunities and conservative debt levels, but continue to remain vigilant on valuations. This means DNR have a basket of growth companies but are managing the risk based on the size of the active positions and overall allocation to these types of opportunities.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1199AU
AMP Flexible Super - Retirement account	AMP1386AU
AMP Flexible Super - Super account	AMP1515AU
CustomSuper	AMP1199AU
Flexible Lifetime - Allocated Pension	AMP1203AU
Flexible Lifetime - Term Pension	AMP1235AU
Flexible Lifetime Investment	AMP1207AU
Flexible Lifetime Investment (Series 2)	AMP1441AU
SignatureSuper	AMP1213AU
SignatureSuper Allocated Pension	AMP1222AU

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