Ironbark Karara Australian Share

Quarterly Investment Option Update

30 September 2018

Aim and Strategy

To outperform the S&P/ASX 300 Accumulation Index over rolling four-year periods. 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 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	7 years
Relative risk rating	6 / High
Investment style	Core

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	100%	98.67%
Cash	0%	1.33%

Sector Allocation	
Energy	10.47%
Consumer Discretionary	6.93%
Industrials	9.99%
Utilities	4.11%
Materials	19.83%
Consumer Staples	7.36%
Information Technology	1.85%
Financial ex Property Trusts	31.18%
Communication Services	1.41%
Health Care	5.39%
Property Trusts	0.14%

Top Holdings	
BHP Billiton	7.80%
Australia and New Zealand Banking Group	6.05%
Westpac Banking Corporation	5.82%
Commonwealth Bank of Australia	4.99%
Wesfarmers	4.71%
National Australia Bank	4.51%
Rio Tinto	4.39%
Brambles	3.98%
AGL Energy	3.75%
Origin Energy	3.38%

Portfolio Summary

- The September quarter saw a significant rotation away from emerging markets and towards the US with the US equity market being the pillar of strength (S&P 500 up 7.2%).
- The global growth outlook remains strong after the modest slowdown in the first quarter. The investment manager believes this economic cycle has some room to run and is more likely to end from rising inflation in response to tight labour and commodity markets than from 'old age'.

Market Commentary

The September quarter saw a significant rotation away from emerging markets and towards the US with the US equity market being the pillar of strength (S&P 500 up 7.2%). The S&P/ASX 300 Accumulation Index delivered a 1.5% total return, which was broadly in line with the MSCI All Country World Index excluding the US.

Concerns escalated around the unintended consequences arising from Hayne's Royal Commission. The bearish narrative focuses on further tightening of system wide credit availability on the back of heightened verification activity of household expenses. Commentary from policy makers demonstrate full awareness of the issues with repeated reassurances of no desire to tighten credit availability further. To date, house lending activity in 2018 is exceeding expectations held at the start of the year with owner occupiers more than offsetting the retreat of the investor. However, the major banks continue to lose share to non-bank lenders presumably due to more restrictive underwriting standards.

Domestic employment conditions remain strong with trend employment growth running at 2.5% year-on-year. The growth in employment has reduced the unemployment rate to 5.3% as of August. Whilst wages are showing minimal pressure currently, wage pressure is building with many lead indicators suggesting wage inflation pick up to occur over the next 12-18 months.

Contrary to many concerns around the domestic consumer over the last several months, the strength in the employment market is outweighing the impact of the modest decline in house prices with wealth still appreciably higher on a multi-year view. Consumer confidence took a hit following the leadership turmoil in Canberra in August but largely recovered in September. To date, neither aggregate data nor company feedback is yet to suggest any weakening in consumer spending.

Reporting season sparked historically high volatility and dispersion in sector returns. Results themselves were generally more muted with profit surprises, particularly positive ones, low in number and magnitude while forward earnings growth was trimmed by less than 1%, to around 5%. Cost pressures being faced consistent with higher commodity prices and a tightening labour market are placing mild pressure on margins.

Outlook

The outlook for equities appears reasonable with earnings growth at long-term trend levels across a broad range of sectors. Earnings are being capitalised at rates which, in aggregate, are marginally above long term averages. While this does not shout great value, fixed income and other asset classes seem relatively less attractive given they are more reliant on subdued inflation, very low real interest rates and low credit spreads.

Equity markets have been driven by a narrow cohort of stocks resulting in significant valuation dispersion near historic extremes. Reporting season saw a number of 'market darlings' failing to deliver to the often-lofty earnings growth expectations with costs to deliver high revenue growth being frequently underappreciated. In many cases, share prices were surprisingly insensitive to this disappointment. The investment manager believes that more variability in relative prices and ultimately a higher cost of money will eventually correct this. Even if this doesn't eventuate, these stocks are seen as exposed to falling investor confidence of any form. The Fund remains materially underweight to this area.

With evidence of ongoing house price declines, investors' concerns around the Australian economy is cautious. The investment manager believes that the modest falls in house prices currently being observed is likely to modestly curtail housing investment but is unlikely to have significant flow-on effects to the broader economy. However, they do note that the current situation does increase the susceptibility to an external macro shock during this adjustment period.

Overall, the Fund is positioned for a more reflationary environment than what is currently priced by the market and the investment manager believes that 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.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP0056AU
AMP Flexible Super - Retirement account	AMP1343AU
AMP Flexible Super - Super account	AMP1472AU
CustomSuper	AMP0056AU
Flexible Lifetime - Allocated Pension	AMP0588AU
Flexible Lifetime - Term Pension	AMP0887AU
Flexible Lifetime Investment	AMP0832AU
Flexible Lifetime Investment (Series 2)	AMP1407AU
SignatureSuper	AMP0736AU
SignatureSuper Allocated Pension	AMP1125AU

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