DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

31 December 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.

Sector Allocation	%
Communication Services	2.75
Consumer Discretionary	6.95
Consumer Staples	10.19
Energy	6.34
Financials	24.51
Health Care	2.44
Industrials	15.59
Information Technology	7.10
Materials	17.10
Real Estate	5.40
Utilities	0.00
Cash	1.64

Top Holdings	%
National Australia Bank	8.45
BHP Group	8.28
Commonwealth Bank of Australia	6.11
Macquarie Group	6.00
Lendlease	5.40
Woolworths Group	5.27
James Hardie Industries	5.08
Tabcorp Holdings	4.93
Treasury Wine Estates	4.92
Link Administration Holdings	4.86

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%	98.36%
Cash	0-5%	1.64%

Investment Option Commentary

Despite being well positioned for the risk of increasing bond rates, which shocked markets in the quarter, a number of individual stocks were detrimental to performance. Lendlease had issues with its engineering business which led to substantial write-offs, while Clydesdale was targeted due to its exposure to a potential Brexit and WorleyParsons suffered from an ill-timed acquisition and a falling oil price.

DNR Capital expects ongoing volatility, but are finding good bottom-up opportunities. Some of their strongest periods of outperformance have emerged from downturns as they use the volatility to add to positions held in quality businesses at attractive valuations. DNR Capital have identified a number of high conviction ideas with significant excess returns on offer and have accumulated substantial active positions in these companies.

Market Commentary

Trade tensions between the US and China is the largest source of uncertainty for financial markets. Financial markets enjoyed a brief relief following the G20 summit, with President Trump agreeing to postpone raising tariffs on Chinese imports by two months to 1 March 2019, and President Xi Jinping pledging to engage in substantive talks to open up the Chinese economy to US imports and addressing US concerns about forced technology transfers and IP theft. While both sides have much to lose from an extended conflict, major hurdles remain for a trade deal that is palatable for both sides.

The broader macroeconomic and geopolitical landscape is equally as tumultuous, with Chinese growth, US recessionary risk, Brexit scenarios and Australian housing all impacting markets. The global economy has slowed in the face of these factors over the past six months, leading to the potential inversion of the yield curve. A negative yield curve means bond investors are expecting a slowing economy, and historically it has often, but not always, been a leading indicator of recession. Markets appear to be focusing on all the negatives and quickly joining the dots.

Outlook

DNR Capital remains constructive on the outlook. The US consumer fundamentals are healthy, and US lead indicators and manufacturing data are also positive. the US economy is on track to deliver its fastest pace of growth since 2004 (+3.3% GDP growth in 2018). 2019 is expected to slow to +2.3% (consensus) as fading stimulus, tighter financial conditions and slowing global growth act as headwinds. Nonetheless, ongoing fiscal stimulus, decent credit growth, rising wages and a decline in the savings rate should continue to support the economy. In the fund manager's view, fears of an impending recession are overblown. Furthermore, banks are well capitalised and the consumer in the US has less gearing.

The Chinese economy is currently enduring a slowdown, but to put this in perspective Chinese GDP growth is expected to slow from +6.9% in 2017, to +6.6% in 2018 to +6.2% in 2019. While there is potential for headwinds from US trade barriers (exports to the US currently account for 4% of China's GDP), Chinese policymakers appear willing to provide stimulus to soften the fall. If Chinese growth is to rebound, domestic demand will need to reaccelerate. There appears to be scope for broad-based easing to stimulate growth and liquidity conditions (including further monetary easing).

While earnings growth expectations in Australia appear modest, there is some small downside risk. With housing sentiment low and household deleveraging likely, the risk is that there is a broader economic impact resulting from the correction. The wealth effect has already been seen on high-value items (e.g. car sales are down 15% year-on-year).

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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