

Ironbark Karara Australian Share

Quarterly Investment Option Update

31 December 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	97.17
Cash	0	2.83

Sector Allocation	(%)
Energy	9.25
Consumer Discretionary	10.05
Utilities	5.37
Industrials	10.59
Materials ex Metals & Mining	5.04
Metals & Mining	15.04
Information Technology	1.69
Consumer Staples	4.19
Financial ex Property Trusts	30.30
Communication Services	1.23
Real Estate	0.16
Health Care	4.26
Property Trusts	0.00

Top Holdings	(%)
BHP Group Ltd	8.20
Westpac Banking Corporation	6.00
Australia and New Zealand Banking Group	5.55
Commonwealth Bank of Australia	5.53
AGL Energy Limited	4.68
Rio Tinto Limited	4.45
Brambles Limited	4.29
National Australia Bank Limited	3.96
Origin Energy Limited	3.41
Wesfarmers Limited	3.39

Portfolio Summary

The sharp increase in risk aversion and appetite for defensive stocks was a headwind for the portfolio given the portfolio has been positioned for a constructive economic environment. The lack of exposure to real estate trusts, infrastructure and defensive growth dragged on relative performance during the quarter.

The oil price fall along with a strong aversion to growth exposed areas of the market hit energy stocks hard. Energy holdings Origin (down 22%), Santos (down 25%) and Oil Search (down 21%) all had a significant negative impact on the strategy. Marginally offsetting this was Qantas (down 2%) as analysts start to upgrade earnings as the benefits of lower fuel prices flow through. Within the sector, the fund manager continued to reduce Santos in favor of Oil Search and Origin during the quarter.

After decent recent performance QBE was marked down 9% after updating the market that the lower cost of their reinsurance arrangements would be offset by a greater loss allowance. Overall this was broadly in line with the fund manager's expectations. Price weakness was attributed to downgrades due to the up-front restructuring costs and the fall in bond rates. The investment manager was pleased with the update and thinks that QBE is progressing with conservative assumptions along a trajectory of improving margins. The position was increased.

The overweight to the major miners was a positive with both BHP (down 1%) and Rio Tinto (flat) being rewarded for converting higher commodity prices into higher margins, divesting smaller assets, paying down debt and promptly returning the excess capital. Anticipation that Chinese policymakers will revert to traditional fiscal stimulus is adding to the perception of defensive. Both positions were trimmed following strong relative performance.

A series of disappointments by non-portfolio holdings Lendlease (down 41%), Bluescope (down 35%) and WorleyParsons (down 41%) made a positive material contribution.

Market Commentary

The relatively subdued volatility in financial markets over the past two years ended abruptly during the quarter with the US experiencing its worst December performance since 1931. The S&P 500 unwound year to date gains, falling 14% over the quarter, resulting in a 4.4% fall over the course of 2018. Global equity markets fell by a similar amount with the MSCI World Index producing a negative total return of 13.4%. Australian equity markets losses were marginally better but still recorded a negative total return of 8.4% for the S&P/ASX 300 Accumulation Index.

The quarter begun with a sharp move lower, as high tech and growth companies were hit by a wall of selling. This coincided with higher bond yields and rising expectations of central bank liquidity withdrawal. Tightening financial conditions quickly assumed a self-reinforcing nature and by year-end, markets had concluded a significant further slowdown was inevitable with participant commentary focused on the potential of a recession.

Despite the sharp market moves, economic data indicated growth remained above trend. However, weakness in the manufacturing sector and soft external demand emerged across most economies with trade tensions a driver. Trade talks between US President Trump and Chinese President Xi at the start of December made in-principle progress. The growing real economic impact and market volatility have added pressure for both sides to reach a resolution yet consensus starts 2019 expecting little.

Outlook

Recent indicators suggest that global growth remains above trend, however, that momentum slipped further in the December quarter. Contrary to the investment manager's expectations, the uncertainty and second order impacts around Trump's trade war have damaged corporate confidence and investment. Markets are now pricing deep concerns that the impacts of further tariffs, and the tightening of financial conditions that have flowed from these, will push economies and earnings into recession in 2019. The investment manager believes this to be unlikely. US economic data suggests growth remains comfortably above 2%. Income growth remains strong, household and corporate balance sheets are in decent shape and this cycle has not created the significant private sector excesses seen before previous hard landings.

In Australia, the investment manager expects some divergence between housing-linked and other sectors of the economy in 2019. The investment manager doesn't see the significant excess stock of housing, or expect a further tightening in credit or the decline in employment that will be needed to accelerate house price declines and trigger significant flow-on effects to the broader economy. However, the current situation raises the vulnerability to an external macro shock during this adjustment period.

The likelihood of fiscal easing into the election is supported by the strong budget position. Tax cuts or higher spending would reverse the negative drag seen over the last couple of years where deficit reduction has been prioritised. The significant spending by state governments in infrastructure continues unabated.

Market declines in 2018 have pushed the market multiple back to 14 times, below long run averages. The Fund multiple is comfortably below this. With local long bond yields of 2.3%, the implied equity risk premium has continued to rise. Unless widespread downgrades emerge, this should ultimately be supportive for returns.

Overall, the Fund remains underweight to interest rate sensitive sectors and is positioned for a more constructive environment than is currently envisaged by the market. The investment manager still sees 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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