DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

31 March 2019

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%	95.2%
Cash	0-5%	4.03%

Sector Allocation	%
Communication Services	3.00
Consumer Discretionary	7.97
Consumer Staples	8.66
Energy	6.31
Financials	23.48
Health Care	1.44
Industrials	14.91
Information Technology	7.33
Materials	17.68
Real Estate	5.20
Utilities	0.00
Cash	4.03

Top Holdings	%
National Australia Bank	8.52
BHP Group	7.90
Macquarie Group	5.72
James Hardie Industries	5.26
Lendlease Group	5.20
Brambles Limited	4.95
Link Administrative Holdings	4.95
Tabcorp Holdings	4.80
Seek Limited	4.77
Treasury Wine Estates Limited	4.49

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 and defensives are enjoying higher multiples which are prone to rising bond yields while out-of-favour businesses are sitting at attractive multiples but can face structural headwinds.

Investment Option Commentary

The inversion of the yield curve has caused some concern for the market. While this has been a strong signal for recession in the past and clearly needs due consideration, many aspects of the current cycle are unusual and therefore DNR Capital believes need to be interpreted with some caution.

Market Commentary

The US Federal Reserve has signalled a slower return to rate normalisation, pausing any imminent increases to the fed funds rate which now sits at 2.25%. The US rates act as a barometer for the rest of the world and as such, global markets have recovered on the news, expecting lower rates for longer.

The Chinese economy is experiencing a slow down as the nation transitions from production to consumption. Traditionally, the Chinese central government has intervened in these situations, to prop up its production, however with increased emphasis on debt reduction and uncertainty around US trade relations, China has produced a more measured stimulus response which is starting to show signs of bearing fruit.

Australian Equities have rallied since the beginning of the year as global thematics wash over our market. The decision from the Federal reserve regarding interest rates has stimulated markets, as debt remains cheaper for longer. Despite the bullish sentiment, the market is fractured in its convictions. The state of the local economy has defensive companies carrying premium valuations, while there is weakness in companies that have exposure to the consumer and domestic housing cycle, as property prices continue to fall and expectations around demand deteriorate.

Outlook

Indicators remain mixed—an inverted bond yield signals a possible recession in 18 months' time while better Chinese data and the US stimulating suggests an improving economic backdrop. With defensives already pricing in a slowdown, DNR Capital are generally finding better bottom-up opportunities elsewhere. As a consequence, rather than adding to expensive defensives, DNR Capital have increased cash (allowing dividends to build), sold a riskier stock with less valuation support ALS (ALQ) and added a new position (based on bottom-up research) in Aristocrat Leisure (ALL).

Beneficiaries from lower-for-longer bond yields should be companies with duration growth characteristics and those that benefit from stimulated activity.

Key companies that will benefit from lower-for-longer bond yields include:

- Defensives with valuation support—Tabcorp Holdings (TAH), Aurizon Holdings (AZJ), Brambles (BXB)
- Quality growth—SEEK (SEK), REA Group (REA), Treasury Wine Estates (TWE), Aristocrat Leisure (ALL)
- Lower bond stimulating activity—Macquarie Group (MQG), Lendlease (LLC), James Hardie Industries (JHX)

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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