Ironbark Karara Australian Share

Quarterly Investment Option Update

31 March 2019

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%	97.58%
Cash	0%	2.42%

Sector Allocation	(%)
Energy	10.04
Consumer Discretionary	10.05
Utilities	5.08
Industrials	10.85
Materials ex Metals & Mining	5.26
Information Technology	2.16
Metals & Mining	15.04
Financial ex Property Trusts	30.07
Consumer Staples	3.43
Communication Services	1.25
Real Estate	0.15
Health Care	4.20
Property Trusts	0.00

Top Holdings	(%)
BHP Group Ltd	7.93
Westpac Banking Corporation	5.73
Australia and New Zealand Banking Group	5.46
Commonwealth Bank of Australia	4.99
Rio Tinto Limited	4.88
Brambles Limited	4.47
AGL Energy Limited	4.37
National Australia Bank Limited	3.84
Origin Energy Limited	3.68
QBE Insurance Group Limited	3.67

Portfolio Summary

The portfolio underperformed against the S&P/ASX 300 Accumulation Index for the March quarter.

Holdings in Rio Tinto (up 33%) and BHP (up 20%) benefited from the supply disruptions in iron ore, however approximately half of their outperformance was offset by Fortescue (up 78%) that benefited even further given its higher operating leverage and the larger rise in the price for its low-grade ore. The combination of lower supply and an improved demand outlook in China suggests some upside to consensus iron ore expectations over the next 12-24 months, however, the investment manager sees the long-term outlook as largely unchanged and haven't materially changed their long-term price assumptions.

The Fund was not exposed to several popular stocks whose results came up short including Cochlear (up 1%), CSL (up 6%), Resmed (down 9%) and Woolworths (up 5%). Although their relative underperformance made decent contributions, each bounced strongly off their post results lows. Seemingly, investors remain un-phased on the strength of medium-term growth, or more likely, are in no mood, due to the lack of defensive growth substitutes to disagree. This remains a continuing point of difference for the strategy as the premium being ascribed to these 'quality' businesses remains near historical peaks despite earnings momentum only marginally better than the overall market.

Small cap holdings were mixed with Altium (up 50%) benefiting from a solid result that demonstrated strong sales momentum and strengthening of its PCB market positioning. Costa Group (down 30%) provided a disappointing trading update in January with the downgrade attributed to several factors including subdued consumer demand, disappointing citrus volumes and higher water costs due to the drought.

Other activity included an overall net increase in the position to Ansell (up 17%) as they demonstrated their ability to navigate the significant slowdown in global industrial production, which had been a concern.

Market Commentary

In the quarter, there was progress on the trade wars and a dovish shift by the Federal Reserve. The deep pessimism surrounding the economic outlook receded, enabling equity markets to rebound strongly with the MSCI World Index up 12.3% despite negative earnings revisions of approximately 4%. Australian equity markets slightly underperformed, yet still delivered their best quarterly return for nearly a decade, with the ASX 300 delivering a total return of 10.9%. Credit spreads also contracted back sharply from the highs made in the previous quarter and now sit back below historical average levels.

Domestic economic conditions deteriorated during the quarter and house price declines accelerated during the summer period. The sharp slowdown in the consumer that many expected and feared at the end of last year failed to materialise, albeit there has been a modest slowing in consumer spending and a recent minor deterioration in confidence. Business confidence has reduced, however conditions remain above average, and importantly, the employment market remains strong with ongoing employment growth and the job vacancy rate still high.

This reporting season was one of the weakest seasons over recent years with earnings momentum low and earnings revision trends the most negative since 2009 with industrial earnings per share growth cut by 3.4%. Every sector except the resources sector had negative earnings revisions with margin pressure from rising cost pressures seemingly a bigger drag than weak revenues. However, relief rallies in domestic exposed businesses were common as the pessimism that had been priced, failed to be realised.

Outlook

In Australia, the investment manager expects continuing divergence between housing-linked and other sectors of the economy in 2019. They don't see the significant excess stock of housing, further tightening in credit or the decline in employment 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. This looks less likely after recent developments.

The Reserve Bank of Australia is likely to be quick to act at any sign that the labour market is deteriorating and whilst the cash rate is low by historical targets, further rate cuts will still provide some assistance to indebted households. And whoever forms the next Government, it is likely to provide significant fiscal support if conditions do deteriorate.

Within equity markets there remains a group of stocks that have driven valuation dispersion to historic extremes. Given a shortage of genuine growth stocks and a narrow benchmark, Australia has more than its fair share of these stocks. Some renewed loosening of global liquidity increases the risk that these valuation differentials continue to widen, but the recent reporting season confirmed it is hard for these 'highly rated' companies to deliver to both high growth and margin expectations.

Overall, the Fund remains positioned for a somewhat more constructive environment than is currently envisaged by the market. The Investment Manager still see 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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