Schroder Australian Equities

Quarterly Investment Option Update

31 March 2019

Aim and Strategy

To outperform the S&P/ASX 200 Accumulation Index after fees over the medium to long term by investing in a broad range of companies from Australia and New Zealand. With an established pedigree of investing in Australian equities for over 50 years, the Schroder Australian Equity option is an actively managed core Australian equity portfolio with a focus on investing in quality stocks predominantly in Australia characterised by strong returns on capital with a sustainable competitive advantage. The option draws on Schroders' deep research capabilities, with a long term focus on investing, it is suitable as a core portfolio holding over the medium term to long term.

Sector Allocation	%
Energy	4.5%
Materials	26.0%
Industrials	8.4%
Consumer Discretionary	6.0%
Consumer Staples	6.3%
Health Care	1.5%
Information Technology	0.5%
Communication Services	5.8%
Utilities	2.9%
REITs	2.6%
Financial (ex Property Trusts)	33.0%
CASH	2.4%

Top Holdings	%
Commonwealth Bank	6.9%
BHP Group Ltd	5.9%
Rio Tinto Limited	5.5%
ANZ Banking Group Ltd.	4.9%
Westpac Banking Corporation	4.4%
Woolworths Group Ltd	4.1%
National Australia Bank Limited	3.6%
Telstra Corporation Limited	3.2%
Brambles Limited	2.7%
ASX Limited	2.4%

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	3 - 5 years
Relative risk rating	6 / High
Investment style	Core

Asset Allocation	Benchmark (%)	Actual (%)
Equities	95%-100%	97.6%
Cash	0%-5%	2.4%

Portfolio Summary

On a sector basis, the underweight positions to the Financials (ex-REITs) & Health Care contributed to relative performance. Conversely, the overweight to Consumer Staples and an underweight to Information Technology were the main detractors from relative performance.

At a stock level, positive contributors to performance included the overweight positions in Rio Tinto, Santos, Cleanaway Waste Management and Iluka Resources. An underweight to CSL has also contributed to return. Detracting from performance were nil holdings in Fortescue Metals and Goodman Group alongside the overweight positions in Crown Resorts, Nufarm and Bingo Industries.

Acrow Formwork and Construction Services Limited (o/w, -31.4%) Acrow has strong exposure to the non-residential construction markets in NSW and Victoria, and continues to show strong revenue growth, however reinvestment in capacity continues to consume most of the operating cashflow generated by the business. The major competitor's offshore owner has just filed bankruptcy, which may help industry structure and in any event should help pricing in the Australian market given ongoing buoyant demand levels.

Market Commentary

Mintech is the word. Mining and Technology were the twin pillars of strength in the Australian equity market through the first quarter, as unlikely as that may seem. The old world and the new; the nearest dated cashflow returns in the market on the one hand, and the longest dated on the other.

As bonds in Australia move from 2.8% a little less than 6 months ago through 1.8% at the end of the last quarter, following the global path, the equity market has followed suit. This global move followed the Book of (President) Trump.

The best performing sector in the first quarter, in Australia and globally, was IT. Whilst the sector performance in the quarter was a similar experience, there are two big differences in looking at IT globally as opposed to locally. One difference is that in 2018, IT globally was a market performer, whereas in Australia it had a strong year. Secondly, free cashflow generation globally for IT companies is in the main very strong, and M&A levels relatively small; whereas in Australia it is the reverse, with goodwill a high percentage of total assets and free cashflows minimal. It is true that lower discount rates increase the relative value of longer dated cashflows, and hence longer dated growth may in turn attract a higher valuation as rates decline. The trickier issue is the more practical one of what will those cashflows actually be, and will the large amount of growth that is already priced in eventuate. As Schroder have highlighted previously, given the paucity of current cashflows for many companies in this sector, in their view, the best way to align their current market pricing against global comparables is by reference to price to sales multiples, and on that basis the Australian stocks could easily halve from current levels, in which case they revert to something approaching where they were, in many cases, a little more than a year ago. Cumulatively, the market cap attaching to these companies is akin to that of Woolworths; a doubling or halving is a large impact upon relative market performance, as can be seen in the performance of many active managers (including us) against index through last year and the first quarter.

Outlook

Risks can come from different sources. The most obvious to equity investors is operating leverage – earnings downgrades are normally met with a greater fall in the equity price than the fall in earnings growth expectations (just as, in the longer run, upgrades typically are accompanied by a re-rating). Financial leverage hurt equity owners far more than operating leverage through the GFC years, but ever since easy monetary and credit conditions have rendered financial leverage impotent as a risk to equity holders. Predictably, the equity in more leveraged entities, both publicly and privately owned, have done better in such an environment. The January resumption of the monetary policy put – through the word "Patient" - will likely see this endure, rather than be challenged, and has significant consequences for portfolio structure in an interest rate sensitive market such as Australia. Schroder in turn have reduced their long run Bond rate assumption, can only look to be as vigilant as they can in assessing financial and operating leverage, whilst not blinding themselves to the inevitable episodic opportunities that present themselves.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP0465AU
AMP Flexible Super - Retirement account	AMP1375AU
AMP Flexible Super - Super account	AMP1504AU
CustomSuper	AMP0465AU
Flexible Lifetime - Allocated Pension	AMP0636AU
Flexible Lifetime - Term Pension	AMP0944AU
Flexible Lifetime Investment	AMP0995AU
Flexible Lifetime Investment (Series 2)	AMP1438AU
SignatureSuper	AMP0813AU
SignatureSuper Allocated Pension	AMP1177AU
SignatureSuper Select	AMP0813AU

Contact Details

Web: www.amp.com.au
Email: askamp@amp.com.au
Phone: 131 267 (Mon. to Fri. 8:30am to 7:00pm AEST)