

Ironbark Karara Australian Share

Quarterly Investment Option Update

30 June 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
Manager Style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	100%	97.21%
Cash	0%	2.79%

Sector Allocation

Energy	10.04%
Consumer Discretionary	11.11%
Industrials	11.68%
Utilities	3.79%
Materials	20.57%
Consumer Staples	3.13%
Information Technology	1.81%
Financial ex Property Trusts	29.04%
Communication Services	1.27%
Health Care	4.62%
Property Trusts	0.15%

Top Holdings

BHP Group	7.99%
Westpac Banking Corporation	5.45%
Commonwealth Bank of Australia	5.28%
Australia and New Zealand Banking Group	5.04%
Brambles	4.71%
Rio Tinto	4.60%
National Australia Bank	3.83%
Oil Search	3.62%
Origin Energy	3.58%
QBE Insurance Group	3.54%

Portfolio Summary

The oil price weighed on the Fund with all energy holdings underperforming, however, it was the political turmoil and ultimate change to the Prime Minister in Papua New Guinea that resulted in Oil Search (down 10%) to be the biggest underperformer during the quarter. The Fund added to the Oil Search position following the resolution of the orderly leadership spill. Although the investment manager expects some minor delays in the timeline, the project remains compelling and the government needs the investment and associated economic benefits that will flow from the project to stimulate broader economic growth.

Heavy flooding in the mid-west US delayed planting, impairing QBE's crop underwriting earnings for this crop cycle. The fall in interest rates also contributed to the stock falling by 4%. QBE's exposure to rates is now much lower than it has historically been and the investment manager doesn't view losses resulting from a 1-in-100-year event as material to valuation.

Downer (down 10%) suffered collateral damage from the insolvency of its large German partner on a Victorian wind farm project. Downer has all but completed its portion of the job (on time and budget), however it might be liable for its partner's losses on the project. The relatively small size and advanced status of the project suggest that these would not be material to the company, however could break its record of six years of delivering on their earnings guidance.

Resources were mixed with Newcrest (up 25%) benefiting from the higher gold price. The higher iron ore price lifted the not-held Fortescue (up 36%) with the impact of this offset by an underweight to South32 (down 15%).

The ongoing focus of the market on a small cohort of defensive growth companies was reinforced by the decline in global bond yields and continued to detract from the strategy. Key detractors in this group were CSL (up 10%), Cochlear (up 19%) and Xero (up 23%). Collectively, health care and technology companies detracted in excess of 0.40% from the Fund's performance.

The underweight to traditional bond proxies was relatively neutral for the Fund with REIT's underperforming the market despite some significant dispersion within the sector with Scentre (down 7%) and Goodman Group (up 14%).

Market Commentary

The surprise federal election result propelled the Australian market higher as the risk of a further weakening in the domestic property market receded enabling the S&P/ASX 300 Accumulation Index to deliver a total return of 8.05%, materially outperforming global equity markets with the MSCI World Index delivering a total return of 3.4% during the quarter.

The key driver of the outperformance was the banking sector with financials ex property delivering an 11% return as the tail risk from the property market weakness reduced considerably. The median return of S&P/ASX 300 companies was much lower at only 3.9% during the quarter.

The Reserve Bank of Australia followed the global dovish tilt and cut interest rates by 0.25% in June and followed with an additional 0.25% at the start of July citing the ability for unemployment to fall further without stoking inflation. The combination of the Reserve Bank of Australia cuts and the election result have had a positive impact on business and consumer confidence. Importantly, nascent evidence is emerging that property prices have stopped falling and buyers are returning. Overall, the combination of supportive monetary and fiscal policies should provide a tailwind to the domestic economy over the coming 12-18 months.

Outlook

In a backdrop of uncertainty around an ageing cycle, trade and geopolitical tensions, investors have aggressively chased growth, certainty, and yield. This has created valuation gaps between high and low PE stocks and high and low volatility stocks which have extended close to record levels.

Hard economic data has weakened indicating that growth in key economies is softening again after last year's sharp slowdown. The investment manager believes this is the direct result of the shock to global trade and business confidence from renewed US tariffs and technology bans.

The divergence between housing related sectors and the rest of the domestic economy has further to run. Pending income tax cuts, infrastructure spending and easy monetary policy should support private consumption and push savers into riskier assets as the return to cash collapses, potentially over-inflating asset prices. While low or negative return on cash and bonds, macro uncertainty and risk aversion continue to orientate investors towards 'safe' proxies, the investment manager believe the nominal economic backdrop is one that can still support reasonable earnings growth at close to long-term trend levels.

Market valuations have deteriorated this year, yet still appear historically reasonable in many sectors. Yields on traditional defensives are close to all-time lows, and although spreads to bonds are high, international experience points to limited scope for further yield compression. Meanwhile, a narrow group of growth stocks has driven valuation dispersion to a lead that has historically proved to be unsustainable. A shortage of genuine growth stocks and a narrow benchmark has meant these champions are more expensive in Australia than any other market. Renewed loosening of global liquidity increases the risk that these valuation differentials continue to widen, but individual earnings delivery is critical given high growth and margin expectations.

Overall, the Fund remains positioned for a somewhat more constructive economic 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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