DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

31 March 2022

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/performance

Investment Option Overview

Investment Category	Australian Shares
Suggested Investment timeframe	5 years
Relative risk rating	7 / Very High
Investment style	Specialist - Quality
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	100%	96.77%
Cash	0%	3.23%

Sector Allocation	%
Communication Services	8.91%
Consumer Discretionary	11.12%
Consumer Staples	2.36%
Energy	5.12%
Financials	23.03%
Health Care	8.36%
Industrials	5.84%
Information Technology	5.78%
Materials	18.66%
Real Estate	7.59%
Utilities	0.00%
Cash	3.23%

Top Holdings	%
BHP Group Ltd	13.3%
National Australia Bank Limited	9.4%
CSL Limited	8.4%
Macquarie Group Limited	6.6%
Woodside Petroleum Ltd	5.1%
Tabcorp Holdings Limited	4.7%
Telstra Corporation Limited	4.4%
Aristocrat Leisure Limited	4.1%
Lendlease Group	4.1%
QBE Insurance Group Limited	3.8%

Portfolio Summary

Over the past quarter, there were a number of changes to the Portfolio and the current positioning is as follows:

- Positive on diversified quality mining companies generating strong cash flows.
- Positive on high quality industry leaders with strong pricing power to offset inflation.
- Adding to domestic defensive exposures given relative outlook for domestic economy.
- Overweight financials with leverage to higher rates but underweight banks (given they have recession risk).
- Disciplined on valuations, especially longer duration stocks where valuations are highly sensitive to interest rates changes.
- Cautious on low quality/negative cash flow companies where higher interest rates will expose excessive risk taking.
- Cautious on companies that have experienced significant over consumption during COVID-19.
- Positive on companies that have been under-earning due to COVID-19 restrictions.

Investment Option Commentary

Over the past quarter the fund manager has undertaken a range of moves aimed at building further portfolio resilience. The fund has increased the quality of the portfolio, adding to areas of the market generating strong returns with improving industry structures. During the quarter the fund manager exited their positions in Coles Group Limited (COL), James Hardie Industries (JHX), Virgin Money UK (VUK) and Xero Limited (XRO).

Market Commentary

The market moved higher in the March quarter, with the S&P/ASX 200 Accumulation Index returning 2.24% during the period. The bifurcation of sector performance was extreme, with commodity and energy exposures significantly outperforming.

Energy (+25.1%) was the best performing sector during the period. Energy prices reached extreme levels as an already tight market was faced with the prospect of Russian sanctions. Russia is a significant global supplier of coal, oil and natural gas and its quasi-removal from markets has caused severe shortages in seaborne energy and a threat to European gas supply.

Utilities (+12.7%) also outperformed, correlating with energy prices. Energy wholesalers AGL (AGL +25.7%) and Origin (ORG +18.9%) were the best performers, with Origin benefitting from its gas exposure and AGL the subject of a speculative takeover bid from private equity.

Information Technology (-14.0%) was the worst performing sector during the period. Bonds sold off heavily during the period, pushing bond yields to pre-pandemic levels. Consisting of largely longer-duration companies, the sector bore the brunt of the rate impact, with key companies Xero (XRO -27.3%) and Wisetech (WTC -12.8%) the largest contributors.

Healthcare (-10.7%) also underperformed, similarly impacted by macro factors. The Healthcare sector carries higher valuations courtesy of its growth profile and defensive nature, and was therefore sold off during the value rotation that accompanied the bond rout. Sonic Healthcare (SHL -23.9%) and Fisher and Paykel Healthcare (FPH -26.5%) were key contributors.

Outlook

Parallels with the 1970’s

It is hard not see the parallels with the 1970’s. In that decade oil price shocks were caused by Middle Eastern countries embargoing oil exports to the West as punishment for supporting Israel in Yom Kippur war. Energy prices fed into consumer prices, higher wage demands and spiralling inflation. There is much less reliance on oil now, but greater reliance on natural gas. There is less unionised labour, a greater ability to leverage technology and higher consumer debt so there is a reluctant to assume the decade plays out precisely as the 1970’s did but nonetheless it is instructive. Sector performance in the 1970’s was led, not surprisingly, by energy and materials with the consumer being squeezed out as a greater proportion of money was spent on necessary items such as oil and utilities.

Australia is the lucky country

Australia is well positioned relative to other developed world economies given that the demand for resources benefits Australia through the Terms of Trade (TOT). Rising TOT enable Australia to purchase more imports for a given quantity of exports, thereby increasing domestic real income. This supports employment, government revenues and increased shareholder profits.

The outlook for equities is more challenging than it has been for some time. The end of quantitative easing, higher interest rates and rising inflation increases the risks for investors. Australia, however, looks relatively well placed given its ability to supply commodities from a politically secure environment.

Availability

Product name	APIR
SignatureSuper*	AMP1213AU
SignatureSuper Allocated Pension*	AMP1222AU
SignatureSuper Term Pension*	AMP1222AU
Flexible Lifetime Investment**	AMP1207AU
Flexible Lifetime Investment (Series 2)**	AMP1441AU

*Closed to new investors.
**Closed to new and existing investors

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