

DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

30 June 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	97.02
Cash	0	2.98

Sector Allocation	%
Communication Services	9.41
Consumer Discretionary	11.75
Consumer Staples	2.07
Energy	9.50
Financials	20.21
Health Care	9.83
Industrials	4.49
Information Technology	5.94
Materials	16.99
Real Estate	6.83
Utilities	0.00
Cash	2.98

Top Holdings	%
BHP Group	12.09
CSL	9.83
National Australia Bank	8.04
Woodside Energy Group	7.42
Macquarie Group	5.02
Telstra Corporation	4.87
Aristocrat Leisure	4.30
The Lottery Corporation	4.14
QBE Insurance Group	3.96
Computershare	3.92

Portfolio Summary

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

- Reduced position in diversified quality mining companies but favour those exposed to a recovering China.
- Positive on high quality industry leaders with strong pricing power to offset inflation. Ausbil has been adding to quality names which have de-rated.
- Focusing on ensuring the resilience of the earnings of the portfolio in light of slowing economy.
- Overweight financials with leverage to higher rates but underweight banks (given they have recession risk).
- 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 initiated a position in Worley (WOR), and increased their holdings in Domino's Pizza Enterprises (DMP) and BHP Group (BHP). The managers exited their position in SKYCITY Entertainment Group (SKC) and reduced their holdings in Qube Holdings (QUB) and Macquarie Group (MQG).

Market Commentary

The market finished lower in the June quarter, with the S&P/ASX 200 Accumulation Index returning -11.90% during the period.

Energy (+1.5%) was the best performing sector during the period. Energy prices remained high in the quarter, with Brent holding above USD 100 per barrel, peaking above USD 120 per barrel in May. The ongoing Russian sanctions continue to stress an already undersupplied market, with northern hemisphere nations attempting to stockpile ahead of their winter season.

Utilities (+0.6%) also outperformed, largely in sympathy with higher energy prices. The gentailers were mixed, with Origin Energy (ORG -8.0%) struggling with higher coal prices, leading to plant outages, while AGL Energy (AGL +6.9%) was largely immune due to its coal supply chain integration. The outages and high electricity prices have drawn the ire of regulators and politicians, causing direct market intervention on the east coast.

Information Technology (-27.2%) was the worst performing sector during the period. A continued bond selloff during the period heaped pressure on long-duration growth stocks. Implications of a potential recession also weighed, with the more cyclical names hit harder. Key constituents Xero (XRO -25.1%), WiseTech Global (WTC -25.9%) and Block Inc (SQ2 -51.2%) were again the largest contributors.

AREITs (-17.7%) also underperformed, similarly impacted by macro factors. The REITs are strong bond proxies, with their property valuations heavily influenced by the long-term interest rates. The quick move up in key rates has caused property valuations to appear stretched, with fund manager-style operators Goodman (GMG -22.1%) and Charter Hall (CHC -34.4%) the most exposed.

Outlook

Outlook for Interest Rates

The outlook for interest continues to evolve as rate markets balance generationally high inflation with rising recession risks. Historically a reliable predictor of negative economic recessions, the US treasury yield curve has now inverted and markets have begun pricing lower terminal rates. Expectations for demand destruction from rising interest rates, energy prices and living costs have begun to anchor rates but an economy grappling with labour shortages and impacted supply chains continue to drive prices up. With the Federal Reserve reiterating its commitment to rein in inflation, slowing economic activity would be welcomed. Failure to achieve more sustainable economic activity risks the need for significantly higher interest rates, driving the global economy into recession. Globally, DNR expects rates to continue grinding higher in the absence of moderating inflation. Despite some dovish calls for a subsequent easing cycle to address recession risk, DNR views the chances of rates returning to emergency settings seen during CY20/21 as unlikely.

Outlook for Inflation

DNR observes several pressures impacting inflation around the world. Short to medium term factors including supply chain imbalances, Ukrainian war impacts and frictional labour shortages from lower worker mobility are likely to fade. However, several trends may place longer term upward pressure on prices. DNR believes a partial de-globalisation of supply chains and higher inventory on hand requirements will yield higher costs, to be borne by customers. Importantly, a decade of underinvestment in fossil fuel projects, combined with the structural challenges of the energy transition, will have longer term impacts on energy prices. Central Banks around the world are mostly committed to bringing inflation back to tolerable ranges, and whilst current levels are not sustainable, DNR believes that a return to the ultra-low inflation environment of the past decade is unlikely, without addressing supply side issues in key commodities markets.

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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