

Ironbark Karara Australian Share

Quarterly Investment Option Update

30 September 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%	96.50%
Cash	0%	3.50%

Sector Allocation	%
Communication Services	1.34%
Consumer Discretionary	11.18%
Consumer Staples	2.98%
Energy	10.51%
Financial Ex Property Trusts	28.33%
Health Care	6.19%
Industrials	11.93%
Information Technology	1.38%
Materials Ex Metals & Mining	18.84%
Real Estate	0.18%
Utilities	3.65%

Top Holdings	%
BHP Group	6.88%
National Australia Bank	5.24%
Commonwealth Bank of Australia	4.97%
Westpac Banking Corporation	4.56%
Australia and New Zealand Banking Group	4.46%
Origin Energy	4.03%
Qantas Airways	3.86%
Rio Tinto	3.71%
Brambles	3.70%
QBE Insurance Group	3.67%

Investment Option Commentary

The Ironbark Karara Australian Share Fund returned 3.48% (net) for the quarter, an outperformance of 0.93% when compared with the S&P/ASX 300 Accumulation Index return of 2.55% for the quarter.

The improvement in the outlook of the consumer sectors was a key positive contributor for the quarter, with principal beneficiaries being Qantas (up 19%), JB Hi-Fi (up 34%), Coles (up 18%) and Star Entertainment (up 9%). Offsetting these returns was the underweight position to Woolworths (up 14%).

JB Hi-Fi continues to capture market share from other retailers demonstrating the best-in-class retailing skills of its management team. The stock has now reached levels that the investment manager believes reflects the underlying quality of the franchise with the position being trimmed during the quarter.

Qantas initially lagged the rally of other companies exposed to the domestic consumer. The result firmly demonstrated that matching capacity to demand underpins the earnings outlook of the business. Incoming Virgin management signaled the urgent need to improve cash flow generation via more aggressive rationalisation of capacity and their network. This underpins the outlook for increasing returns in Qantas's domestic business. Despite the price recovery, the investment manager continues to see significant value in Qantas.

James Hardie (up 33%) rebounded strongly as the new management team has been able to engineer a quick recovery in their US fibre cement business. Positive feedback from the site visit through its US and European operations added to the market's confidence of their ability to continue to gain market share. This represents a turnaround from the last couple of years of weak penetration growth that led investors to question the strength of their US fibre cement franchise. The improving US housing market has been an additional tailwind.

In addition to the overhang from Brexit, CYBG (down 39%) suffered from two key developments during the quarter. The first was that the result showed weakness in lending book margins below prior expectations. The second was the deadline for payment protection insurance claims delivered an unexpected surge in the lodgment of claims across the industry resulting in further provisions being required. This moves their capital position from comfortable to tight that will likely necessitate a dividend cut this year. The company is now trading on less than half its tangible assets, which the investment manager believes is well below what is justified by the operational outlook despite the apparent headwinds.

Resources were a small drag on the Fund with BHP Group (down 8%) and Rio Tinto (down 8%) being somewhat offset by no holding in South32 (down 16%) and other junior miners.

Market Commentary

The Australian reporting season was generally disappointing with negative earnings revisions to more than half of the companies in the S&P/ASX 100, as guidance statements disappointed, however this was partly driven by the introduction of the new lease accounting standard. However, the typical stock bounced as the results were no worse than feared, and companies exceeded expectations on dividends and free cash flow. Management teams are responding to the subdued revenue with a range of companies initiating cost-cutting programs.

The fall in bond yields and rising investor risk aversion continued to support the ongoing strength in the narrow cohort of stocks with defensive growth characteristics. As a result, price-earnings ('PE') dispersion increased sharply with the top quintile of industrial companies in the S&P/ASX 200 observing an expansion of their PE from 35.3 to 39.4 times, which now exceeds the highs reached prior to the GFC and tech boom.

Outlook

Looking forward, the investment manager believes what they are experiencing is most likely to prove to be a mid-cycle slowdown. Many labour and commodity markets remain tight. The political calculus of fiscal policy has shifted in many countries, and spending stimulus is likely to be added on top of ultra-easy monetary policy if the slowdown extends. Somewhat higher inflation still seems the most likely work out of this economic cycle. This will prove very challenging to elevated valuations in many asset classes and sectors.

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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