DNR Capital Australian Equities High Conviction

Quarterly Investment Option Update

30 June 2021

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	6 / High
Investment style	Specialist - Quality
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Australian Shares	95-100%	96.78%
Cash	0-5%	3.22%

Sector Allocation	%
Communication Services	10.54%
Consumer Discretionary	14.56%
Consumer Staples	2.91%
Energy	3.82%
Financials	24.75%
Health Care	1.63%
Industrials	7.95%
Information Technology	6.04%
Materials	17.87%
Real Estate	6.92%
Utilities	0.00%
Cash	3.01%

Top Holdings	%
BHP Group Ltd	10.06%
National Australia Bank Limited	7.85%
Macquarie Group Limited	6.34%
Tabcorp Holdings Limited	5.26%
Telstra Corporation Limited	5.20%
Aristocrat Leisure Limited	4.93%
Lendlease Group	4.05%
Computershare Limited	3.95%
Woodside Petroleum Limited	3.88%
Seek Limited	3.62%

Portfolio Summary

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

- Reopening beneficiaries: SKYCITY Entertainment Group (SKC).
- Beneficiaries of infrastructure/green new-deal spending: ALS (ALQ), QUBE Holdings (QUB).
- Improving quality: Computershare (CPU).
- Strong franchise companies: James Hardie Industries (JHX), SEEK (SEK), Aristocrat Leisure (ALL).
- Resilient/defensive companies: Tabcorp Holdings (TAH).

Investment Option Commentary

Over the past quarter the team have undertaken a range of moves aimed at building further portfolio resilience. The fund has cut a number of more volatile names and increased the quality of the portfolio, adding to areas of the market generating strong returns with improving industry structures.

Positions initiated over the quarter:

- **CSL Limited (CSL):** CSL offers defensive earning's growth and the recent underperformance, driven by concerns over near-term collection volumes, provides an opportunity to start building a position. CSL is currently trading on a multiple of 33x FY23, which is reasonable given the medium-term outlook for double-digit earnings growth and the defensive nature of earnings.

- **Commonwealth Bank of Australia (CBA):** CBA offers modest but robust earnings growth and a sound dividend yield. The fund sees the position as more defensive relative to ANZ, which tends to have more volatile earnings.

Market Commentary

The market continued to rally in the June quarter, with the S&P/ASX 200 Accumulation Index returning 8.29% during the period. The vaccination drive continues across Europe and North America, where economies and borders are reopening. The progress in Asia, South America and the Pacific has been much slower, with vaccine hesitancy and lack of supply causing delayed reopenings and scattered lockdowns. The rotation to value and cyclical stocks was halted and reversed during the period, with the markets unconvinced by the longer-term outlook for economic growth and inflation, causing bond rates to fall.

Information Technology (+12.1%) was the top performer during the period. The reversal of bond rates favoured growth stocks, with the sector recovering strongly from the value rotation late in 2020. Afterpay (APT +16.4%) was the top contributor to performance, followed by Xero (XRO +8.3%) and Computershare (CPU +12.4%).

Consumer Discretionary (+11.1%) also outperformed, as a number of higher-growth retailers rallied. Wesfarmers (WES +12.2%) was the key contributor, while Aristocrat (ALL +25.4%) and Dominos (DMP +25.2%) directly benefitted from the strong reopening and consumer spending seen across Europe and the Americas.

Utilities (-5.8%) were the worst performing sector, despite falling bond rates, as a number of stock-specific issues caused the sector to fall. Both AGL (AGL -15.0%) and APA Group (APA -11.2%) have been suffering from increased scrutiny on their exposure to fossil fuels and the global move towards renewables. The shift in energy sources is seen as a risk to the terminal values of the assets, resulting in deep discounts.

Similarly, Energy (-2.9%) also underperformed, despite an increasing oil price. Environmental compliance concerns and stranded asset risks continue to weigh on the sector, with structural challenges proving difficult to value. Key contributors to the underperformance were Woodside (WPL -7.5%) and Oil Search (OSH -7.1%).

Outlook

Outlook for interest rates

Significant attention has been placed on June's Federal Open Market Committee (FOMC) commentary. Chairman Jerome Powell acknowledged that the committee had begun "talking about talking about" raising interest rates, contrasting last June's insistence that they were not even "thinking about thinking about" raising rates. Notably, the median expectation for rates to increase moved forward from 2024 to 2023. The market's response saw a sharp rise in the US dollar and a general flattening of the yield curve. The implied level of future inflation, which had been steadily rising since the beginning of the year, also declined.

The reaction surprised many investors, given the implied negative impact on equity valuations from rising interest rates. Support among investors for the Federal Reserve's transitory inflation view has grown however, and the pull forward of rate hikes suggests a willingness to contain any breakout. Subsequent economic data has further galvanised the case for a not too hot nor too cold 'Goldilocks' economic recovery. While still broadly debated, questions around pace of growth and permanence of inflation will begin to be answered.

Outlook for inflation

With the economic data pointing to synchronised global GDP growth, the recovery has exceeded the expectations of economists and the International Monetary Fund (IMF), leading many to question whether the global economy is running too hot. As such, the key debate in financial markets is firmly around inflation. While there is general agreement that prices will rise in the near term, many central banks view it as transitory and are pushing back strongly on the idea that interest rates need to rise to contain excess pricing pressures.

The fund's favoured barometer of consumer price expectations is breakeven inflation, which measures the difference between inflation-linked, and non-inflation-linked, government bonds. This indicator is at near decade highs, although for now well within ranges tolerable to central banks.

This dynamic is creating a range of opportunities. Since positive news of vaccine efficacy late in 2020, the sharp rise in bond yields has seen some sustained derating of higher growth and longer duration stocks. This remains volatile, however, and subject to unpredictable macroeconomic factors.

Availability

Product name	APIR
AMP Flexible Lifetime Super	AMP1199AU
AMP Flexible Super - Retirement account	AMP1386AU
AMP Flexible Super - Super account	AMP1515AU
CustomSuper	AMP1199AU
Flexible Lifetime - Allocated Pension	AMP1203AU
Flexible Lifetime - Term Pension	AMP1235AU
Flexible Lifetime Investment**	AMP1207AU
Flexible Lifetime Investment (Series 2)**	AMP1441AU
SignatureSuper	AMP1213AU
SignatureSuper Allocated Pension	AMP1222AU

**Closed to new and existing investors

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What you need to know