Schroder Australian Equities

Quarterly Investment Option Update

31 December 2021

Aim and Strategy

To outperform the S&P/ASX 200 Accumulation Index after fees over the medium to long term by investing in a broad range of companies from Australia and New Zealand. With an established pedigree of investing in Australian equities for over 50 years, the Schroder Australian Equity option is an actively managed core Australian equity portfolio with a focus on investing in quality stocks predominantly in Australia characterised by strong returns on capital with a sustainable competitive advantage. The option draws on Schroders' deep research capabilities, with a long-term focus on investing, it is suitable as a core portfolio holding over the medium term to long 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	Core
Manager style	Single Manager

Asset Allocation	Benchmark (%)	Actual (%)
Equities	90%-100%	98.58
Cash	0%-10%	1.42

Sector Allocation	%
Energy	3.39
Materials	25.72
Industrials	11.45
Consumer Discretionary	2.61
Consumer Staples	7.30
Health Care	7.19
Information Technology	1.85
Communication Services	9.35
Utilities	1.65
REITs	3.94
Financial-X-Property Trusts	24.13
Cash	1.42

Top Holdings	%
BHP Group Ltd	5.3%
Telstra Corporation Limited	5.1%
Commonwealth Bank of Australia	4.8%
Rio Tinto Limited	4.0%
Brambles Limited	3.7%
South32 Ltd.	3.6%
Alumina Limited	3.6%
National Australia Bank Limited	3.4%
Incitec Pivot Limited	3.1%
Westpac Banking Corporation	3.1%

Portfolio Summary

The S&P / ASX 200 Accumulation Index rose by 2.1%, while the Schroder Australian Equity Fund rose by 2.3% (post-fee), outperforming by 0.2% (post-fee) during the quarter.

During the period, the Fund added value primarily through sector allocation. The underweight exposure to the Information Technology and Health Care sectors contributed to the overall Fund performance. Detracting from performance included the underweight allocation to the Real Estate sector and an overweight allocation to the Materials sector.

At a stock level, contributors included the underweight position in Afterpay and overweight allocation to South32, Incitec Pivot and Metcash. Conversely, detractors from performance included the overweight position in Alumina and underweight positions in the Fortescue Metals and Macquarie Group

Investment Option Commentary

Visiting the operations centre of a sports bookmaking operation for the first time (many years ago), some of my misconceptions were shattered. I'd expected the process of setting odds to be incredibly sophisticated. It wasn't. While reams of historic data provided a rough basis for assessing odds, spreads were left incredibly wide waiting for the wagers of educated punters to assess mispricing and provide better information. Educated punters provided operators with useful information in setting odds, but not much profit. The punter at the pub after a few schooners provided plenty of profit and not much useful pricing information. Long shots still won and funded plenty of celebratory rounds but, over time, those more adept at assessing the odds and exploiting loopholes took money from the others. Equity investing is remarkably similar. Schroder see their role as making an educated and ongoing assessment of the odds (the likelihood a business is worth more or less than the prevailing market value). University lecturers and economists might believe investment is about precise discount rates, cashflow forecasts and risk premia; real life suggests it's more about rough estimates and adapting to new information together with very healthy doses of pure emotion.

We leave 2021 behind as another year of strong returns as zero interest rates continue to punish the risk averse and transfer their wealth to those with greater risk appetite and generally greater wealth. Though we might debate the true rate of inflation and the extent to which we should incorporate runaway house prices as a cost of living, prices are rising. This means that real interest rates are negative; probably substantially so. While any simplistic assessment of the odds would overwhelmingly favour higher interest rates, the vast artificial wealth created in the past decade and the perverted state in which it has left the financial system do not work in favour of those expecting fairness to be restored for the risk averse investors funding the lifestyles of the more fearless and fortunate. Schroder believe the odds of either declining government intervention or any significant winding back of central bank intervention are low. Watching manic merger and acquisition activity facilitate declining competition and job losses whilst company management simultaneously call for population growth to suppress wage inflation and sell a lot more shares than they buy might incite anger over the path to the current situation and its demonstrable unfairness, but it won't change history or the beliefs of those engineering the environment. While equities offer better inflation protection prospects than bonds and cash, there are plenty of arguments supporting reasonably priced companies, as investment will always be about relative choices.

December saw CSL undertake one of the largest domestic capital raisings ever (≈A$7bn) to partially fund the A$17.2bn purchase of Vifor Pharma. Paying 6 times sales for a large Swiss listed company in tangentially relevant products and sectors in a time of full valuations seems a far cry from the 2003 Aventis Behring metrics, which underpinned much of the company's exceptional long-term performance. It also highlights the subtle pressures impacting companies which become emotional favourites of investors. Exceptional success and execution invariably create demanding growth expectations on an increasingly large revenue and earnings base. Given the earnings multiple accorded to CSL has rarely been higher (>40 times), it is fair to say investors have not tempered their longer-term growth expectations. Expected percentage growth rates are retained, required dollar profit growth rises markedly. CSL's high multiple and low debt costs rather than a low acquisition multiple explain the claimed double-digit earnings accretion. In assessing the odds of CSL as an investment, Schroder do not expect Vifor Pharma to be a major swing factor. 20% – 30% value increments or decrements on a $17bn acquisition just don't move the dial hugely for a $140bn company. Whether the prospects of the existing business justify the lofty multiple will dominate the payoff for investors and remain the source of Schroder's cautious stance.

Investors in the healthcare sector are accustomed to significant revenue growth, high margins and high returns on capital. Their bet, in paying very high multiples for these high margins and returns, requires this situation to remain durable indefinitely. Paying 40+ times earnings and 8 times the net asset value of the merged business (all intangible) turns high returns for the company into low returns for an investor. Emotive language around delivering greater benefit to patients and the need to be rewarded for the significant risks taken through long patent periods and high prices perhaps disguise the reality that much of the sector is pursuing exactly the same goals as most other companies and achieving them very successfully.

Profitability would suggest governments haven't done a great job getting a reasonable deal for the taxpayer, particularly in the US. Those of you who've read Patrick Keefe's 'Empire of Pain' chronicling the history of the Sackler family, the vast wealth created through opioids and the role and methods of marketing to doctors in stimulating demand may have some pause in questioning whether a broadening lens around sustainability and business practices might perhaps include elements of the healthcare sector. While the ethics of CSL are in no way questionable, multiples are firmly attached to expectations of growth, a term which remains intoxicating for politicians, economists and company management yet incredibly poorly understood. Whilst anchored in energy, physics and productivity, the insistence on translating and miscommunicating it in financial terms is highly damaging.

One area in which Schroder have altered their view on the odds in recent months is gold exposure. Gold, like cryptocurrencies, has never been a comfortable territory for rationalists. It is a case study on the myriad of behavioural factors which determine why investors believe something constitutes an 'asset', and how its value is determined. Little value in use and enough above ground stock to keep people in jewellery for a while create an uncomfortable circular. It is a store of value and a protection against the debauchment of the value of fiat currency (a very real and increasing risk) only while others believe it, and the price reflects the extent to which a buyer is prepared to exchange cash for it in preference to other goods or assets. In an environment in which concern over inflation protection has been high, price performance has been far from exciting. Crypto enthusiasts have been far more successful in enticing new investors into their Ponzi schemes than gold bugs. The financial performance of most gold miners has been similarly unexciting. Producing more gold and growing reserve ounces invariably takes precedence over making more cash. While Schroder have historically held a small percentage of the portfolio in gold stocks as an insurance policy; the chance that sharp shocks see a significant amount of cash shift from real estate, equities and towards gold, pushing the price of gold and gold equities markedly higher, we've concluded other commodity businesses should achieve this outcome far more effectively, albeit not necessarily over a short-term time frame. In assessing (perhaps guessing) the future path for gold prices, one factor which weighs heavily in an environment of necessary commitment to addressing climate change, is the lack of necessity. Gold mining exists and emits carbon to increase the above ground stock of a largely unnecessary commodity and should arguably be close to the top of the list for elimination for ESG focused investment. This is not the case for most other commodities as there is a very real cost in starving investment to highly necessary areas.

Availability

Product name	APIR
SignatureSuper*	AMP0813AU
SignatureSuper Allocated Pension*	AMP1177AU
SignatureSuper Term Pension*	AMP1177AU
Flexible Lifetime Investment (Series 1)**	AMP0995AU
Flexible Lifetime Investment (Series 2)**	AMP1438AU

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

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