ATI·AM
Above The Index Asset Management Pty Ltd

# Fact Sheet

# ATI Australian Equity Portfolio

## Information as at 30 June 2015

### Portfolio Objective

The ATI Australian Equity Portfolio seeks to achieve total returns (includes income and capital appreciation, before the deduction of fees and taxes) that exceed those on the S&P/ASX300 Accumulation Index by 3% p.a. over rolling five-year periods.

### Performance Update

| (*Returns to 30 June 2015) | 1 Month (%) | 3 Months (%) | 1 Year (%) | 3 Years (% p.a.) | 5 Years (% p.a.) | Inception (% p.a.) |
|---|---|---|---|---|---|---|
| ATI Equity Portfolio (gross) | (4.5) | (7.2) | 4.6 | 14.8 | 8.9 | 7.3 |
| Benchmark Index | (5.3) | (6.5) | 5.6 | 14.7 | 9.5 | 5.9 |
| Relative Outperformance | 0.8 | (0.7) | (1.0) | 0.1 | (0.6) | 1.4 |

*Past performance is not a guarantee of future results and may not be indicative of them. The gross returns are calculated using the Portfolio's net asset value of a model mandate within the OneVue SMA product. Performance assumes reinvestment of all income. Inception date is 23 December 2005.

### Portfolio Details as at 30 June 2015

| Largest Holdings | Portfolio Weight (%) | Benchmark Weight (%) |
|---|---|---|
| Commonwealth Bank | 8.3 | 9.2 |
| ANZ Bank | 8.1 | 6.1 |
| Westpac Bank | 7.6 | 7.0 |
| Telstra | 7.2 | 5.1 |
| National Australia Bank | 7.1 | 6.0 |
| BHP Billiton | 5.3 | 6.3 |
| Wesfarmers | 3.8 | 3.3 |
| CSL | 3.8 | 3.0 |
| AMP | 3.1 | 1.3 |
| AGL Energy | 2.7 | 0.7 |

| Sector Allocation | Portfolio Weight (%) | Benchmark Weight (%) |
|---|---|---|
| Financials | 48.0 | 47.0 |
| Materials | 11.5 | 14.8 |
| Telecommunications | 9.4 | 5.9 |
| Healthcare | 8.3 | 6.1 |
| Consumer Staples | 5.7 | 6.5 |
| Consumer Discretionary | 2.8 | 4.3 |
| Energy | 2.7 | 5.1 |
| Utilities | 2.5 | 2.1 |
| Industrials | 1.6 | 7.2 |
| Information Technology | 2.5 | 0.9 |

### Selected Portfolio Statistics as at 30 June 2015

| | |
|---|---|
| Inception Date | 23-Dec-05 |
| Number of Stocks | 38 |
| ATI Funds Under Management | ~ $400m |

| | |
|---|---|
| MER (est.) | ~ 0.90% p.a. |
| Tracking Error (forward estimate) | ~ 3% p.a. |

## Portfolio Performance

The ATI Equity Portfolio lost 4.5% in June compared with a fall of 5.3% in the benchmark index. Against this benchmark, ATI is producing excess returns on a monthly, three year and since inception (Dec'05) basis.

## The Best and Worst Performing Sectors

The best performing sectors for the month were Energy (+8.5%), Utilities (+2.0%), and Materials (-0.2%) whilst the worst performers were Financials (-5.9%), Information Technology (-4.0%) and Health Care (-4.0%).

From a sector perspective, the relative performance of the ATI portfolio was most positively impacted from being underweight materials (11.5% v benchmark of 15.4%) and industrial stocks (1.6% v benchmark of 7.2%) whilst it was most negatively impacted by being overweight health care (8.3% v benchmark of 5.9%) and financial stocks (48.0% v benchmark of 47.0%) stocks which both underperformed the market.

## Attribution of Stocks

The portfolio performance during June was assisted by overweight positions in Sandfire Resources (SFR), Pact Group (PGH), and National Australia Bank (NAB); and by not holding South 32 (S32), Flight Centre (FLT), and Fortescue Metals Group (FMG). The three stocks in the portfolio that contributed most to its relative performance during June were:

> **Sandfire Resources (SFR) (+7.7%)** outperformed the market after disclosing a promising exploration discovery on JV ground within 10km of its DeGrussa operation. The discovery of 16.5 metres grading 18.9% copper and 2.1g/t gold from 410m depth (down-hole, not true width) at the Springfield Project represents the most significant drilling result since the definition of the known mineralisation at DeGrussa. Whilst it is yet to be proven whether sufficient economic mineralisation exists to justify extraction, we are encouraged by the exceptionally high grade and similarity between these massive sulphides and those seen at DeGrussa. Further, we note with some satisfaction that the result goes some way to vindicating the company's exploration thesis which has targeted several repeating lenses of VMS mineralisation. That said, we note that during the month the market initially priced in over A$100m of additional market capitalisation to SFR on the back of one drill result, and despite SFR only earning into a 70% interest in the Springfield Project. Accordingly, whilst we are excited about the prospect of additional economic mineralisation in the DeGrussa area, and the possible impact this will have on extending the mine life, our sell discipline ensured that we took the opportunity to modestly lighten the portfolio weighting of SFR into the exceptional strength surrounding the release of the exploration results. SFR remains an overweight portfolio holding.
>
> **Pact Group (PGH) (+11.4%)** outperformed during the month of June as investors looked to buy defensive stocks with attractive yields and lower earnings multiples. PGH is most often compared with Amcor (AMC) and Orora (ORA) and compared favourably to these stocks on many financial aspects. PGH also announced the $80m acquisition of Jalco Group, a business competitor and customer where it is believed that the synergies of supplying common customers may enable an accretive IRR return with 3 years. However, following the price increase and relatively strong performance, PGH now ranks less attractively and it is likely that we will reduce our holdings prior to their full year profit result, which we expect to be negatively impacted by the rapid rebound in resin prices (a key raw material) in recent months. PGH is still relatively attractive in the ATI ranking system and we have maintained our overweight portfolio position.
>
> **National Australia Bank (NAB) (-2.9%)** outperformed during June after successfully completing the retail entitlement offer that was announced along with the 1H15 result and the institutional offer the previous month. As previously mentioned, we thought that the recent capital raising paved the way for NAB to finally exit the UK business and we expected the market to react positively to this over the year ahead as the divestment of poorly returning assets continues at a much faster than had been expected pace by the market. Given that the 1H15 result itself was in line with market expectations and combined with the offshore exit, this provides investors with a far cleaner and more transparent business model going forward. We took up our rights entitlement as NAB is still relatively attractive in the ATI ranking system and we have maintained our overweight portfolio position.

Positions that detracted most from the portfolio's performance during the month were from being overweight Virtus Health (VRT), Myer Holdings (MYR), and Lend Lease (LLC); and from not holding Macquarie Bank (MQG), Sonic Healthcare (SHL) and James Hardie (JHX). Stocks in the portfolio that detracted most from relative performance during the month included:

> **Virtus Health (VRT) (-30.8%)** significantly underperformed the market in June following a profit downgrade by the company. VRT has downgraded FY15 NPAT growth guidance from low to mid-teens percentage growth to low to mid-single digit percentage growth in NPAT as a result of lower than forecast cycles. VRT no longer expects volume growth in Australian ARS in 2HFY15. The company has been impacted by 1) discretionary spend declining (correlated with ARS volume); 2) growth of low-priced ARS volume at the expense of high-priced volume; and 3) the ongoing shift to lower-priced frozen cycles. Later in the month Medicare statistic released for May 2015, showed Assisted Reproductive Services (ARS) volume increased by 0.8% on the pcp. ARS benefits paid decreased by 2.0% on the pcp. This was in contrast to the 12-month growth rates where benefits paid for ARS decreased by 1.4% on pcp while ARS volume decreased by 0.4% on pcp. Despite this negative situation we continue to maintain an overweight position in VRT based on i) confidence in the industry demand drivers for Assisted Reproductive Services and the view that the current slowdown in volumes is cyclical rather than structural ii) VRT is the largest operator in an industry with rational market behaviour, high barriers to entry and

government Medicare reimbursements and iii) valuation support underpinned by a normalisation of industry growth and a positive contribution expected from its acquisitions in Ireland and Singaporean ARS businesses in the next few years.

**Myer Holdings (MYR) (-18.3%)** underperformed in June after announcing early in the month that it would be closing its Top Ryde store and three trial Myer exclusive stores. The company also announced that it had re-financed $600m of bank debt on more favourable margins and covenants. We continue to hold Myer on the basis that there valuation support underpinned by a sound 3Q15 result. The stocks trades at a ~30% to peers in the retail space which we feel is not justified. With a new management team in place and an upcoming strategy day we are comfortable holding our overweight position. We note that MYR is the second most shorted stock on the ASX (behind Metcash) and short interest increased during the month, so any positive catalysts may result in significant covering.

**Lend Lease (LLC) (-9.8%)** underperformed during the month of June after the market reacted negatively to potential earnings downgrades for FY15 based on the cancellation of the East West Link contract by the Victorian Government. LLC clarified the impact of the decision later in the month and reaffirmed that the market consensus NPAT range for FY15 earnings of $619m-$634m was still appropriate. Within the announcement, LLC also confirmed that the lower earnings in the contracting division would also be offset by the establishment of the wholesale fund for the third tower at Barangaroo and this saw the stock recover some of its losses towards month end. We feel that LLC is still relatively attractive and we have maintained our overweight portfolio position as the ongoing asset recycling from residential and commercial projects is expected to provide a high level of earnings continuity for the next few years.

## Portfolio Construction

The main portfolio weighting changes during June included: top-ups for our portfolio holdings in Commonwealth Bank (CBA), Dick Smith Holdings (DSH), Lend Lease (LLC) and Suncorp Group (SUN); the total removal of our holdings in Seven West Media (SWM); and slight portfolio reductions for our holdings in AGL Energy (AGL), SFR and Westfield Holdings (WFD). Cash at the end of June was 4.0% and is just below the 5% maximum threshold, lower than the 4.1% in May, reflecting our view that the equity market has become a little cheaper over the course of the last two months.

The ATI portfolio, with regard to its market capitalisation exposures, is only slightly differentiated to the benchmark index with ~86% of the portfolio (excluding cash) in the top 50 stocks (benchmark ~82%), ~11% in the next 100 (benchmark ~14%), and ~3% in the last 150 stocks (benchmark ~4%). The 10 largest holdings constitute ~61% of the portfolio (benchmark ~51%), the dividend yield is 4.7% (benchmark 4.5%) and the portfolio's historic or trailing PE is 14.9x (benchmark of 15.6x).

Whilst the portfolio's market cap bias remains tilted to the larger stocks, its underlying active sector positioning is not the same as that of the benchmark index. The main points of differentiation are that the portfolio remains underweight the industrial and material sectors and overweight the financial, healthcare and telecommunication sectors. We also continue to remain overweight in stocks we view as having industry structure advantages and/or the expected benefit of USD currency exposure from offshore earnings such as Brambles (BXB), Computershare (CPU), CSL (CSL) and Resmed (RMD) in combination with other opportunities that we feel have fundamental valuation support, such as CarSales (CAR), Insurance Australia Group (IAG), M2 Group (MTU), REA Group (REA), Suncorp Group (SUN), VRT and Wesfarmers (WES).

## Portfolio Risk

The current forecast tracking error of ~2.4% is similar to last month (~2.3%). We are continuing to be presented with a number of stock opportunities in the financial, materials, industrial and consumer staples sectors as a result of some recent relative market underperformance. At this stage we still feel that any overweight positioning in the resource stocks is unlikely in an environment with ongoing profit earnings downgrades, minimal forward earnings clarity and continued reductions in the expected mining capex spend of the larger mining companies over the next few years. At present, the main sources of portfolio risk are from overweight positions in SFR, RMD, MTU, RIO Tinto (RIO), LLC, IAG, and Telstra (TLS).

## General Market Commentary

Most global equity markets ended the month down as any gains made over the course of the month were swallowed up by a month-end sell-off as investors reacted to news of a breakdown in negotiations between Greek Prime Minister Alex Tsipras and the nation's creditors, increasing the likelihood of an exit from the European currency union. The Australian market suffered its largest monthly decline since September 2014 with the S&P/ASX300 Accumulation Index ending June down 5.3%. Whilst the Australian market opened the month with six straight sessions of declines, it did regain its footing mid-month only to sell off again as fears surrounding Greece's inability to service its debt obligations further heightened and the Chinese equity market began falling materially. All sectors ended the month down with telco's, banks and property trusts fairing best whilst the key laggards were consumer discretionary, the mining-heavy materials sector as well as consumer staples stocks.

In company specific news: IAG announced a strategic relationship with Berkshire Hathaway that included a 10-year, whole of account 20% quota share arrangement and $500m placement of IAG shares with Berkshire for a 3.7% stake; a number of material earnings downgrades were also announced pre reporting season and these included Flight Centre (FLT), Nine Entertainment (NEC) and Seek (SEK).

The RBA left the cash rate unchanged in June at 2.0 percent. The central bank noted that although the AUD had declined significantly against the US dollar over the past year, the depreciation was less pronounced against a basket of other currencies. The RBA stated that further depreciation seemed “both likely and necessary” though no real guidance as to future rate decisions was provided with the central bank, instead, adopting a data-driven approach. The Aussie dollar ended the month largely unchanged versus the greenback during June, eking out a gain of +0.8% to close at US$0.7707.

Regarding domestic economic releases in June: the NAB business confidence index increased significantly in May to +7 from a reading of +3 in April as the month's reading coincided with both an RBA cash rate reduction as well as the Federal budget; the Westpac-MI consumer confidence index declined 6.9% m/m in June to 95.3, more than unwinding last month’s increase of 6.4% (102.4); the economy gained 42k jobs in the month of May (consensus +15k) compared with a loss of 2.9k in April; the participation rate held steady at 64.7% (consensus 64.8%) whilst the unemployment rate fell unexpectedly to 5.96% (consensus 6.2%); retail sales growth in April was flat despite expectation of a 0.5% m/m increase; private sector credit expanded 0.5% m/m in May; housing credit grew 0.5% m/m whilst business credit bounced back after a few softer months (+0.4% m/m) and personal credit moved slightly lower (-0.1% m/m).

Spot Brent crude posted a second month of declines, ending June down 4.0%. The commodity has lost 45.3% over FY15 but has gained 10.0% in the calendar year to date. Benchmark spot iron ore prices ended the month down 4.0% after two months of gains in April and May. During the month, Australia’s Federal Department of Industry and Science cut its price forecast for iron ore in 2015 by ~10% to US$54.40/t, citing a weak outlook for China's steel sector. Base metals as measured by the LME index ended the month down 4.9%. Tin was the worst performer (-10.6%) followed by lead (-9.8%), zinc (-8.5%) and nickel (-5.2%) which hit a six-year low. Copper (-4.2%) and aluminium (-2.9%) were the best performers. Spot gold ended the month down 1.5% despite ongoing uncertainty surrounding the possibility of a Greek exit from the Euro-zone.

## Outlook

Including the impact of some large cap stock downgrades in June and a faltering Chinese market, the recent equity weakness could easily extend further with a lack of progress in Greece over the next month or so. Whilst the overall earnings consensus growth expectations for the FY15 reporting season are low when compared to historical averages, this has been known for some time and in isolation should no be expected to drive our equity market lower. On the other hand, a disappointing reporting season and/or poor outlook and guidance statements could easily result in another leg down for the domestic equity market as the offshore uncertainty in Greece and China alone have resulted in the current market malaise.

Consensus earnings estimates have highlighted for some time that the Australian equity market is lacking in top-line growth and much of the earnings growth actually being generated in the last couple of years has often been driven by cost-outs. Whilst this highlights that inefficiencies had crept into corporate cost structures during the good years, there are now a number of companies who have this year either instituted new efficiency programs or up-sized existing programs for further cost reductions in the years ahead. The end result is that companies are still generally able to meet consensus earnings expectations with the assistance of the cost reductions whilst revenue growth remains quite a rare commodity for many businesses in this environment.

Despite the less than inspiring earnings expectations for the year ahead and the recent performance we continue to think that the Australian equity market’s relative yield advantage, to both domestic interest rates and global equity markets, should continue to be a recipient of investor support and this in turn is expected to limit the potential downside. This essentially underpins our ongoing preference towards greater earnings certainty, sustainable yield and some growth opportunities outside domestic sources as we feel that domestic EPS growth will be hard to achieve for many stocks as we head into the 2015 year end reporting season. In an environment of historically low interest rates and minimal domestic earnings growth, we feel that the major banks have actually become relatively more attractive as a result of the recent sell off by the market and we remain slightly overweight. Our decision to remain underweight the materials sector still seems appropriate at this stage as consensus aggregate EPS expectations for FY15 & FY16 have continued to trend lower with commodity prices and composite sector earnings growth expectations for resources in FY15 still remain negative.

We also remain positioned with a number of stocks having USD earnings exposure that are likely to benefit from any further weakness in the Aussie dollar and we also expect a stronger US economic outlook will continue to put pressure on the gold price and this is why the portfolio still has no direct exposure to gold. Other specific active sector positioning includes being underweight the industrials (including holding no mining services stocks), consumer staples and energy stocks. Outside of the financials, we also remain overweight the healthcare, telecommunications and utilities sectors.

# PORTFOLIO RISK SUMMARY

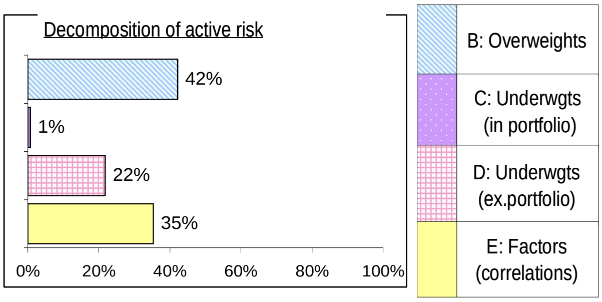
| | |
|---|---|
| Portfolio Name: | **MyPort** |
| Benchmark: | ASX300 |
| Date of Data: | 30-Jun-15 |
| Sector Type: | GICS1 |

| | | **Active Exposures:** | | % |
|---|---|---|---|---|
| Historic portfolio alpha | 7.4% | Total: | 72.7% | 100.0% |
| Historic portfolio beta | 0.94 | Across sectors: | 6.7% | 9.2% |
| Raw return | 14.8% | Within sectors: | 66.1% | 90.8% |

Forecast **Tracking Error**

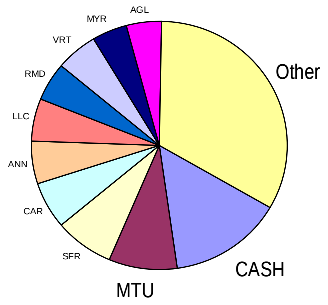
| **2.47 %** |
|---|
| (active risk) |

| | **Source of portfolio risk** | contribution to active portfolio risk | standard deviation | variance / covar. |
|---|---|---|---|---|
| A | Stocks held in portfolio (B+C) | 43% | 1.6 | 2.6 |
| B | Overweight positions | 42% | 1.6 | 2.6 |
| C | Underweight positions | 1% | 0.2 | 0.0 |
| D | Stocks not held in portfolio | 22% | 1.2 | 1.3 |
| E | Factors (correlations between stocks) | 35% | | 2.2 |
| F | Total (A + D + E) | 100% | **2.5** | 6.1 |



## Top 10 sources of risk: Stocks held in the portfolio (A)

| | | |
|---|---|---|
| 1 | CASH | 14% |
| 2 | MTU | 9% |
| 3 | SFR | 8% |
| 4 | CAR | 6% |
| 5 | ANN | 6% |
| 6 | LLC | 5% |
| 7 | RMD | 5% |
| 8 | VRT | 5% |
| 9 | MYR | 5% |
| 10 | AGL | 4% |
| | Other | 33% |



## Top 10 sources of risk: All stocks in benchmark (B+C+D)

| | | |
|---|---|---|
| 1 | CASH | 10% |
| 2 | QBE | 6% |
| 3 | MTU | 6% |
| 4 | SFR | 5% |
| 5 | MQG | 4% |
| 6 | CAR | 4% |
| 7 | ANN | 4% |
| 8 | LLC | 4% |
| 9 | RMD | 3% |
| 10 | VRT | 3% |
| | Other | 51% |