# Fact Sheet

Above The Index Asset Management Pty Ltd

# ATI Australian Equity Portfolio

## Information as at 30 June 2016

### 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 2016) | 1 Month (%) | 3 Months (%) | 1 Year (%) | 3 Years (% p.a.) | 5 Years (% p.a.) | Inception (% p.a.) |
|---|---|---|---|---|---|---|
| ATI Equity Portfolio (gross) | (3.0) | 2.8 | (1.1) | 7.7 | 6.7 | 6.5 |
| Benchmark Index | (2.4) | 4.0 | 0.8 | 7.7 | 7.2 | 5.4 |
| Relative Outperformance | (0.6) | (1.2) | (1.9) | 0.0 | (0.5) | 1.1 |

*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 2016

| Largest Holdings | Portfolio Weight (%) | Benchmark Weight (%) |
|---|---|---|
| Commonwealth Bank | 10.5 | 9.0 |
| ANZ Bank | 7.8 | 4.9 |
| Westpac | 7.2 | 6.9 |
| Telstra | 6.6 | 4.8 |
| National Australia Bank | 5.8 | 4.7 |
| CSL | 4.6 | 3.6 |
| Wesfarmers | 3.9 | 3.2 |
| AGL | 2.6 | 0.9 |
| Vocus Comms | 2.5 | 0.3 |
| BHP Billiton | 2.4 | 4.2 |

| Sector Allocation | Portfolio Weight (%) | Benchmark Weight (%) |
|---|---|---|
| Financials | 45.8 | 44.8 |
| Healthcare | 11.3 | 7.1 |
| Telecommunications | 9.0 | 5.6 |
| Materials | 9.5 | 14.2 |
| Industrials | 5.2 | 8.1 |
| Consumer Staples | 3.9 | 6.8 |
| Energy | 4.5 | 4.1 |
| Utilities | 2.6 | 2.7 |
| Consumer Discretionary | 3.4 | 5.3 |
| Information Technology | 1.5 | 1.2 |

### Selected Portfolio Statistics as at 30 June 2016

| | |
|---|---|
| Inception Date | 23-Dec-05 |
| Number of Stocks | 39 |
| ATI Funds Under Management | ~ $400m |

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

## Portfolio Performance

The ATI Equity Portfolio fell 3.0% in June compared with a fall of 2.4% in the benchmark index. Against this benchmark, ATI is producing excess returns on a since inception (Dec'05) basis.

## The Best and Worst Performing Sectors

On a relative basis, the best performing sectors for the month were utilities (+4.8%), materials (+0.2%), and consumer discretionary (+0.0%) whilst the worst performers were info technology (-7.9%), financials (-5.0%) and healthcare (-2.5%).

From a sector perspective, the relative performance of the ATI portfolio was most positively impacted from being overweight healthcare stocks (11.8% v benchmark of 7.3%) and underweight consumer staples stocks (3.4% v benchmark of 6.8%), whilst it was most negatively impacted by being underweight materials stocks (8.7% v benchmark of 13.7%) and underweight consumer discretionary stocks (3.3% v benchmark of 5.2%).

## Attribution of Stocks

The portfolio performance during May was assisted by overweight positions in Mayne Pharma (MYX), AGL Energy (AGL) and Primary Healthcare (PRY); and by not holding QBE Insurance (QBE), Macquarie Group (MQG) and Clydesdale Bank (CYB). The three stocks in the portfolio that contributed most to its relative performance during the month were:

> **Mayne Pharma (MYX) (+27.0%)** outperformed the market in June following the announcement of a transformation transaction to acquire some of the generic drug portfolio as part of the acquisition of Allergan by Teva. MYX stated that it would acquire 37 products approved by the US Federal Drug Administration and five products with filings for approval before the FDA for US$637M. The deal will be funded via an A$888 million equity raising (US$652 million) and an extension of its debt facility. The acquired products include oral contraceptives, cardiovascular products and therapeutics for the central nervous system and are expected to results in sales of $237m at a gross margin >50%. The implied purchase prices is less than 6x EBITDA and is highly accretive to earnings. Management has proven its ability to integrate acquisitions following the successful Doryx transaction in February 2015. We continue to maintain an overweight position in the stock based on valuation support and confidence in a growth strategy that involves a pipeline of generic drug opportunities and utilising a platform that is able to develop and produce molecules that competitors are finding difficult to manufacture.

> **AGL Energy (AGL) (+3.8%)** outperformed during June due to the defensive nature of its operations during the macro uncertainty caused by the Brexit, Australian Elections and US interest rate moves. AGL is a defensive domestic stock whose earnings are not impacted by Britain's decision to exit the EU. The stock has not been impacted by any proposed legislative changes and is well positioned to benefit if there are changes in relation to increased use of renewable energy sources. Wholesale energy prices continue to rise and AGL's Macquarie Generation operations have been successfully integrated into the business and are benefitting from this thematic. We continue to hold the stock based on its defensive characteristic and ongoing valuation support underpinned by increasing wholesale pricing and an abatement of discounting in the retail market. The ability to finalise asset sales and a reduced capex profile also increase the possibility of capital management during FY17.

> **Primary Healthcare (PRY) (+1.8%)** outperformed during June due to the defensive nature of its operations during the Brexit uncertainty. It is a domestic stock whose earnings are not impacted by Britain's decision to exit the EU. The stock outperformed in May and this extended into June following: 1) a positive budget announcement from the government, proposing to legislate collection center rents which would offset some of the Medicare reimbursement changes 2) an announcement that the company had completed the sale of its Medical Director business with the $156m sale proceeds being used to pay down debt and 3) increased press speculation regarding Chinese investor Jangho's corporate intentions, following its move to 15% of the register in April. We maintain our overweight position as there is still valuation support at current price levels. In addition, the uncertainty regarding the election outcome is also likely to result in a status quo for Medicare and rather than further funding cuts. We also note that there is still significant short interest in the stock and the potential for corporate activity still remains.

Positions that detracted most from the portfolio's performance during the month were from being overweight Incitec Pivot (IPL), Vocus Comms (VOC) and Ardent Leisure (AAD); and from not holding Newcrest Mining (NCM), Fortescue Metals Group (FMG) and Transurban (TCL). Stocks in the portfolio that detracted most from relative performance during the month included:

> **Incitec Pivot (IPL) (-13.9%)** underperformed the market during June over concerns that earnings from the company's soon-to-open ammonia plant could be negatively impacted from both the significant jump gas prices and the drop in spot ammonia prices that occurred during the month. We will continue to monitor the situation as the plant enters production during the current quarter (3Q FY16), however at this point we remain confident that the plant will provide strong cash flow now that the US$850m+ project is 97% complete.

> **Vocus Comms (VOC) (-9.5%)** underperformed the market in June as they acquired 100% of Nextgen Networks (for A$700m), along with the North West Cable System (NWCS) project (for US$80m = A$107m upfront plus deferred consideration) and the Australia Singapore Cable (ASC) project for deferred consideration. Total consideration is A$807m upfront plus up to US$40m (A$54m) deferred for the two development projects. The purchase will be funded via a fully underwritten, accelerated, renounceable entitlement offer of around A$452m (1-for-8.9 at $7.55 per share and an

institutional placement of A$200m. The remainder will be funded from existing debt facilities. VOC estimates around A$30m of synergies from the purchase and it is expected to be accretive to proforma FY17 EPS in the "high single digits" range (including synergies).

**Ardent Leisure (AAD) (-5.2%)** underperformed during the month despite the company not making any material announcements. The macro environment was certainly not supportive of the stock as the slower growth now forecast in the US, combined with lower oil prices are both negative for the ongoing success of the Main Event rollout across the oil dependent states such as Texas. In addition, the poor east coast weather in Australia will have an immediate effect on attendance numbers at the Gold Coast theme parks and the failed auction of the marinas business still leaves the potential for more capital raisings to fund the capex required for the Main Event rollout. We still maintain our overweight position in the company and expect the running yield of ~7% should provide some support to further downside moves.

## Portfolio Construction

The main portfolio weighting changes during June included: new portfolio holdings in QBE Insurance (QBE), Sandfire Resources (SFR) and Western Areas (WSA); top-ups for our holdings in Ardent Leisure (AAD), Commonwealth Bank (CBA) and National Australia Bank (NAB); the removal of our holding in Ansell (ANN); and some slight reductions for our holdings in Insurance Australia Group (IAG) and Suncorp Group (SUN).

Cash at the end of June was 4.3% and is below the 5% maximum threshold, similar to the 4.3% in May, reflecting our view that the equity market has opportunities but some caution is required at present.

The ATI portfolio, with regard to its market capitalisation exposures, is differentiated to the benchmark index with ~88% of the portfolio (excluding cash) in the top 50 stocks (benchmark ~83%), ~9% in the next 100 (benchmark ~14%), and ~3% in the last 150 stocks (benchmark ~4%). The 10 largest holdings constitute ~63% of the portfolio (benchmark ~50%), the dividend yield is 4.8% (benchmark 4.6%) and the portfolio's historic or trailing PE is 14.5x (benchmark of 15.3x).

Whilst the portfolio's market cap bias intentionally 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, consumer staples and material sectors and overweight the financial, healthcare and telecommunication sectors.

We also continue to remain overweight in stocks we view as having industry structural advantages and/or the expected benefit of USD currency exposure from offshore earnings such as Brambles (BXB), CSL (CSL) and Resmed (RMD) in combination with other opportunities that we feel have fundamental valuation support, such as Suncorp (SUN), and Virtus Health (VRT). We are maintaining our holding in AIO due to our expectation that the Qube Logistics (QUB) consortium bid will be successful. In February we took a position in QUB to maintain the exposure to the Patricks' assets.

## Portfolio Risk

The current forecast tracking error of ~2.5% is similar to last month (~2.6%). We are continuing to be presented with a number of stock opportunities in the energy, financial, materials and consumer discretionary 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. However, we have taken steps to increase our weighting in the industrials with the additions of QUB and AAD in the portfolio over the past few months.

## General Market Commentary

British voters entirely surprised global markets in June, with an unexpected majority voting to exit the EU. In the run-up to the referendum on June 23rd, financial markets and the bookmakers were pointing to a comfortable win for the 'remain' camp. The result proved to be anything but comfortable, with the vote to end Britain's 43-year EU membership sending global markets into a tailspin. While an uneasy calm returned to markets at the end of the month, it wasn't enough to stave off a painful downdraft in performance with the ASX300 accumulation index falling 2.4%.

The Reserve Bank of Australia left the cash rate unchanged at 1.75% in June. The minutes of the RBA board meeting did not add much to the policy debate, plainly stating that following the reduction in the cash rate in May, the Board judged that leaving the stance of monetary policy unchanged in June would be consistent with returning inflation to target. The AUD appreciated 3.0% against the Greenback. The GBP declined to 1.3240 following the UK's momentous vote to exit the EU. The GBP's intra-day decline was the largest since 1990 and the GBP ended the month down 8.1% at 1.33

On the consumer front: the Westpac consumer confidence index fell from 103.2 to 102.2, but remains above the long-run average; the sub-index that measures whether households think it is a good time to buy a home fell from 106.6 to 103.7; expectations of family finances over the next year rose from 104.9 to 105.2; in the NAB business survey, confidence fell from +5 to +3, while conditions held steady at +10; employment increased 17.9k positions and in the survey details the composition of employment was skewed to part-time workers (+17.9k positions) as full-time employment was unchanged; year-to-date, part-time employment has risen 95.8k positions, while full-time employment has fallen 60.7k positions, whilst the participation rate was unchanged at 64.8% and the unemployment rate was also held steady at 5.7%; retail sales increased 0.2% and the headline measure was dragged down by food (-0.3%), with ex-food sales rising +0.5%; cafes and restaurants (+1.0%), clothing and footwear (+0.5%) and department stores (+0.4%) performed well; notably, the RBA's payments system data on ATM withdrawals and credit/debit payments, when aggregated, is growing faster than nominal retail sales; the ABS house price index dropped 0.2%, the first quarter of aggregate dwelling price declines since late 2012 and the annual run rate has slowed to 6.8% p.a.; Australian private sector credit rose 0.4% in May; business credit increased 0.3%; the annual rate of business credit growth dipped 0.3% to 7.1% p.a.; owner occupier mortgage growth increased 0.5% for the third consecutive month and is up 7.4% p.a.; investor mortgage growth moderated to 6.0% p.a, the slowest annual run rate since July 2013.

Base metals rallied over the month, with the LME Metals Index rising 5.5%. Nickel (+12.1%), zinc (+9.3%), aluminum (+6.4%), lead (+5.3%), tin (+4.6%) and copper (+3.0%) rose. Iron ore traded up 11.0% to $55.7/mt as the Chinese economic data continues to be modestly supportive of steel production. WTI fell 1.6% to $48.3/bb and Brent was unchanged at $49.7/bbl with the rebalancing process in oil markets has been accelerated largely by unplanned supply outages; notably in Canada and Nigeria. Gold rose 8.8% to $1,322/oz with spot gold reaching an intraday peak just shy of $1,360/oz. on a move driven by the uncertainty in the market surrounding Brexit and the Fed's actions over the coming months.

## Outlook

Over the course of the financial year we witnessed the re-rating of the industrials ex financials stock which seems attributable to some combination of superior earnings momentum than the broader market (which has been weighed down by resources and banks), falling discount rates and a falling A$. Even more interesting was the increasing P/E dispersion within the industrials-ex financials stocks, driven by the "high P/E" end – i.e. higher P/E ratio stocks continued to be rerated more. In addition, "defensive growth" stocks were aggressively re-rated and overall this has left the "high P/E" end of the market (a segment mostly populated with higher quality stocks) looking expensive versus history.

To open the new financial year we have seen a combination of the British EU exit vote and an unclear Federal election result in Australia, hardly the type of positive catalysts that the equity market thrives upon. Yet, the recent market declines were quite quickly recaptured and these macro events have not altered our view that the coming year will continue to see the outperformance of "yield" stocks as bond yields globally have tumbled to record lows. We are also aware that the performance of banks, traditionally considered a "yield" sector, decoupled during the year as the sector was hit by capital / regulatory concerns and weighed down by the underperformance of the banks sector globally. Yet, If banks can shrug off housing correction fears (as they have in the past), foreign investors could easily move to cover some of their record underweights and this could easily result in a rapid re-rating of our major banks. In addition, if we get some more certainty around capital and bad debts over the remainder of the calendar year then the ongoing low interest rate environment should provide a level of ongoing support for the sector.

Whilst the dramatic move in iron ore prices since early Dec-15 has driven up earnings expectations for the resources sector as a whole, we expect the pace of upgrades to moderate and potentially flat-line as key commodity prices hover at or even fall from current spot levels. Interestingly, BHP has enjoyed sharper upgrades than RIO, which can largely be explained by the helping hand offered by rising oil prices. Despite the sharpness of the upgrades across the sector, the rate of EPS movement has failed to keep pace with share prices, which has seen the sector one-year forward P/E multiple expand into expensive territory we remain still retain our underweight resources positioning.

We have taken profits on some our exposure to a weaker AUD/USD but still hold a number of stocks with USD earnings exposure. We are focused on high quality domestic industrials and other specific active sector positioning includes being underweight the industrials (still holding no mining services stocks) and consumer staples stocks. We have begun to increase our weightings in non-resource material stocks. We also remain overweight the healthcare, telecommunications and utilities sectors.