Fact Sheet

Above The Index Asset Management Pty Ltd

ATI Australian Equity Portfolio

Information as at 31 August 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 31 August 2016)	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Inception (% p.a.)
ATI Equity Portfolio (gross)	(2.1)	0.3	6.5	5.9	9.0	6.7
Benchmark Index	(1.6)	2.1	9.7	6.6	9.4	5.7
Relative Outperformance	(0.5)	(1.8)	(3.2)	(1.3)	(0.4)	1.0

*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 31 August 2016

Largest Holdings	Portfolio Weight (%)	Benchmark Weight (%)
Commonwealth Bank	10.6	8.9
ANZ Bank	8.0	5.0
Westpac	7.4	6.9
Telstra	6.3	4.8
National Australia Bank	5.7	4.7
CSL	4.2	3.7
Wesfarmers	3.9	3.2
AGL	2.6	0.9
Vocus Comms	2.5	0.3
AMP	2.4	1.2

Sector Allocation	Portfolio Weight (%)	Benchmark Weight (%)
Financials	46.6	44.6
Healthcare	11.7	7.2
Telecommunications	8.0	5.2
Materials	9.4	14.9
Industrials	3.6	7.5
Consumer Staples	4.1	7.2
Energy	4.2	4.1
Utilities	2.3	2.6
Consumer Discretionary	3.4	5.5
Information Technology	1.6	1.3

Selected Portfolio Statistics as at 31 August 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 2.1% in July compared with a fall of 1.6% 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 technology (+4.5%), energy (+2.3%), and consumer staples (+0.8%), whilst the worst performers were telco's (-8.9%), utilities (-5.8%), and industrials (-4.9%).

From a sector perspective, the relative performance of the ATI portfolio was most positively impacted from being overweight financial stocks (46.6% v benchmark of 44.6%) and underweight consumer discretionary stocks (3.4% v benchmark of 5.5%), whilst it was most negatively impacted by being overweight telco stocks (8.0% v benchmark of 5.2%) and underweight consumer staples stocks (4.1% v benchmark of 7.2%).

Attribution of Stocks

The portfolio performance during August was assisted by overweight positions in Ardent Leisure (AAD), ANZ Bank (ANZ) and Virtus Health (VRT); and by not holding Transurban (TCL), Newcrest Mining (NCM) and QBE Insurance (QBE). The three stocks in the portfolio that contributed most to its relative performance during the month were:

> **Ardent Leisure (AAD) (+19.3%)** outperformed during the month following the release of a stronger than expected FY16 result. FY16 NPAT of $62.4m was up 11% on pcp as the recovery in the theme parks and bowling offset some short term slowdown in the rollout of the Main Event sites in the US. Included in the FY16 result was also the announcement that AAD had agreed to sell its gym clubs portfolio for $260m to private equity operator, Quadrant. The price received for the portfolio equated to an EBITDA multiple of ~9X and this was considered by the market to be a good price for these assets as in recent years the business had suffered from both the aggressive expansion of low cost, 24-7 options plus the disaggregation of fitness requirements amongst the customer base. Notwithstanding attempts to reinvigorate the business, this was consuming capital and the prospects of success were uncertain so the ability of AAD to redeploy the sale proceeds into the higher returning Main Event business without increasing its debt levels was seen positively.
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> **ANZ Bank (ANZ) (+4.1%)** outperformed during the month following the release of its 3Q16 update where net profit was $4.3b for the nine months through June and that compares with $5.04 billion nine-month profit reported by ANZ a year ago. Cash earnings was down 3% on the year at $5.2 billion on an adjusted basis to strip out about $780 million in non-cash items. Before provisions, profit was up 5% for the period as income grew faster than expenses and its net interest margin was stable against the 2.01% recorded at the end of March. Efforts to rebalance its institutional portfolio were offset by increased funding costs and heightened competition. Still, impaired assets were up 1.9% on-quarter for the three months through June, and the total provision charge at the end of the period had climbed to $1.4 billion, made up of $1.34 billion in individual provisions and collective provisions of $60 million. The market liked the fact that bad debts were not up as sharply as expected and the clear move to reduce the Asian exposure of the institutional bank. We remain overweight ANZ and expect the market to take comfort that the long held Asian expansion plans are no longer a priority for the future.
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> **Virtus Health (VRT) (+5.3%)** outperformed after posting a strong FY16 result. NPAT was up 11.9% to $32.9m on revenue of $262.2m (+11.5% on pcp) and benefited from growth in full service cycles in Australia and growth from its operations in Ireland with cycles up 24%. Domestic cycle and treatment numbers were up 6.6% and 10.6% respectively. Continued social driven shift in age of fertility for Australian women underpins a solid market together with favourable Government support. Affordable access supports high utilisation verses offshore peers and allows VRT annual price increases. Despite the recent outperformance we continue to maintain our overweight position in VRT due to: i) solid underlying industry growth which will underpin domestic earnings expectations for FY17; ii) the uncertainty and caution following the MYFEO and budget has now abated; iii) VRT is the largest operator in an industry with rational market behaviour, high barriers to entry and government Medicare reimbursements; and iv) further upside is expected from its offshore operations in in Ireland and its Singaporean ARS businesses is now profitable.

Positions that detracted most from the portfolio's performance during the month were from being overweight Vocus Comms (VOC), Mayne Pharma (MYX), and REA Group (REA); and from not holding Macquarie Group (MQG), Treasury Wine Estate (TWE) and Fortescue Metals Group (FMG). Stocks in the portfolio that detracted most from relative performance during the month included:

> **Vocus Comms (VOC) (-13.9%)** underperformed the market in August as they reported a result that was in line with recent guidance. With revenue of $830m and underlying EBITDA of $216m demonstrating strong growth in core markets, acquisition/merger integrations are progressing well, synergy targets are on track, and stronger than expected cash flow generation. There has been recent selling pressure on the stock with director James Spenceley selling down 3.2m shares out of his 4.2m to fund a new investment fund under the name MHOR in a joint venture with asset manager Gqary Rollo.
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> **Mayne Pharma (MYX) (-8.9%)** underperformed the market in August following a ~50% increase in the prior 3 months. For the FY16 result, underlying NPAT of $42.5m which was ahead of expectations. Revenue and EBITDA ranges were pre-announced at the time of the Teva/Allergan acquisition and showcased the successful Doryx relaunch, which was the major set piece delivered this year. Both US Generic and Contract Services businesses also produced solid performances. We continue to maintain our overweight positon in the stock. MYX has demonstrated a capacity to grow earnings through a combination of acquisitions, organic initiatives, pricing and the internalisation of key franchises to secure additional

margin. The long term growth strategy for MYX will continue to revolve around the distribution platform into the US and expanding its development and production of niche molecules (difficult to manufacture and therefore much higher margin). MYX's product pipeline is also full, with four products (including Doryx MPC) expected to launch in 1H17 (with target market gross sales >US$600mn) and 19 products filed and pending with the FDA (target market gross sales >US$1.8bn; this includes five acquired as part of the recent Teva transaction). MYX also added eight new pipeline products during FY16 bringing total products to be filed in the US to 20+ (target market gross sales >US$5bn).

REA Group (REA) (-10.2%) underperformed the market as they reported an in line result with net profit after tax rising 21% to a record $253m. Underlying NPAT (excluding $41 for iProperty non cash revaluation gain and $20m benefit Zillow settlement) was $212mm, still a record result and a respectable 11% increase on pcp. Although management did not provide formal guidance they did provide commentary pointing to a weak start for FY17 from a volume perspective, with uncertainty surrounding the election contributing to July listings being down 11% on pcp and 1H17 earnings are likely to be skewed to the second quarter.

Portfolio Construction

The main portfolio weighting changes during August included: top-ups for our holdings in Ardent Leisure (AAD), Commonwealth Bank (CBA) and National Australia Bank (NAB); and some slight reductions for our holdings in Insurance Australia Group (IAG) and Suncorp Group (SUN).

Cash at the end of August was 4.3% and is below the 5% maximum threshold, similar to the 4.3% in July, 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 16.0x).

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 VRT.

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

The ASX300 accumulation index fell 2.1% during August in a typically tumultuous reporting season, with extreme share price moves at both ends of the spectrum. At the top end of the ladder, Webjet (WEB) recorded the largest on-day gain of just over 20%, while the bottom-end (on-day) had some surprise occupants, including CSL and QBE. From a sector perspective, IT led the way, with Computershare's (CPU) sharp gains propelling the sector. Energy wasn't far behind, with Woodside Petroleum (WPL) providing the strongest updraft.

Earnings revisions for the market as a whole were negative (-0.4%), with energy and healthcare suffering the most severe earnings forecast cuts. Some material company announcements during the month included: CSL and QBE proved to be the most disappointing large cap stocks as both suffered sharp on-day share price falls, as well as deep negative earnings revisions. In contrast, the market provided a ringing endorsement to the likes of WEB, Treasury Wine Estate (TWE), JB Hi-Fi (JBH) and Orora (ORA), all of which leapt on results day and enjoyed an upswing in earnings expectations.

The RBA's battle to deal with an inflation rate that is holding well below the target range led to another interest rate cut. The RBA's target cash rate is now at an all-time low of 1.5%. The A$, however, seems impervious to ever-looser monetary policy; the currency held relatively steady through the month, trading in the 0.75-0.78 range. The upward pressure of a steadfastly high iron price and a rebounding oil price look to be the overwhelming forces holding the currency at a level that appears increasingly at odds with monetary policy settings.

On the consumer front: the Westpac consumer confidence index rose from 99.1 to 101, the increase moved the confidence measure to its highest level in almost three years; the sub-index that measures whether households think it is a good time to buy a home rose from 101.8 to 112.1; expectations of family finances over the next year increased from 102.3 to 106.7; employment increased 26.2k positions; the composition of employment was skewed to part-time workers (+71.6k positions) whilst full-time employment fell (-45.4k positions); the unemployment rate fell from 5.8% to 5.7% and the participation rate was unchanged; in the NAB business survey, confidence dipped from +5 to +4 and conditions pulled back from +11 to +8; in the sub-indices profitability decreased from +12 to +7; NAB noted that the survey measures on final price inflation are failing to keep pace with the rise in perceived input costs, which is eroding firms' profitability; the employment index remained at +4; retail sales disappointed, with nominal turnover unchanged on the month; department store sales were particularly weak – down 6% month on month; building approvals surged 11%, the move was attributable to a spike (+24%) in high density approvals; in contrast, single family dwelling approvals fell 0.6%.

Base metals declined over the month, with the LME Metals Index falling 3.3%. Nickel (-8.3%), copper (-6.3%) and aluminum (-2.5%) led the declines, while tin (+5.8%), lead (+4.7%) and zinc (+3.4%) rose. Iron ore inched down 0.7% to US$59.0/mt. China's activity indicators were generally softer than expected and inventories at ports rose above the long-term average on a days-of-supply basis and in absolute terms. Oil prices staged a strong recovery in August following July's swoon. Brent rose 10.8% to $47.0/bbl. A reason being posited for the sharp rally is an end to hedging activity being undertaken by Mexico. Gold traded down 3.1% to $1309.0/oz. Demand for bullion through exchange-traded products slowed and gold futures fell, which is the first August decline since 2009.

Outlook

The August results season disappointed in aggregate as earnings misses dominated and earnings growth forecasts again looking overly optimistic with market consensus growth ~10% for FY17 and ~8% for FY18. Given that the Australian equity market had outperformed most other markets in the eight months leading into reporting season, with no earnings growth to show the market took a breather. While better consensus earnings are again forecast in FY17, the usual trend is that growth is still unlikely to be that strong. Consensus is currently looking for ~7% earnings growth in FY17, which is quite a low number for this time of year as of course earnings tend to be downgraded over the year – at least that's been the case for the past six years in a row.

Much of the recent revision cycle in market earnings has been driven by resources, given the large swings in commodity prices and the leveraged impact that has on earnings. June half resource earnings were down ~25% year-on-year, which is not as bad as the December half. Whilst current spot commodity prices may imply some upgrades to consensus forecasts for the first time in years, we're not especially confident that spot pricing holds but this still highlights the reduced downside risk to earnings so at least the market revisions over FY17 may be less than last year.

Despite the absence of strong growth expectations, the market PE at ~16x has nonetheless moved back up, to around the top of its range over recent decades (outside of the tech boom of the early 2000s), with the impetus of the increasingly low interest rates in place. Whilst further rate cuts could provide the answer to supporting current market valuations a little more, we are relatively sanguine about expectations for the market in the next 12 months given our doubts about current earnings growth expectations.

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.