ATI·AM
Above The Index Asset Management Pty Ltd

# Fact Sheet

# ATI Australian Equity Portfolio

## Information as at 31 July 2014

### 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 July 2014) | 1 Month (%) | 3 Months (%) | 1 Year (%) | 3 Years (% p.a.) | 5 Years (% p.a.) | Inception (% p.a.) |
|---|---|---|---|---|---|---|
| ATI Equity Portfolio (gross) | 4.2 | 3.7 | 19.0 | 13.4 | 10.7 | 8.0 |
| Benchmark Index | 4.4 | 3.6 | 16.3 | 13.0 | 10.1 | 6.4 |
| **Relative Outperformance** | **(0.2)** | **0.1** | **2.7** | **0.4** | **0.6** | **1.6** |

*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 July 2014

| Largest Holdings | Portfolio Weight (%) | Benchmark Weight (%) |
|---|---|---|
| Commonwealth Bank | 9.0 | 9.6 |
| ANZ Bank | 8.7 | 6.6 |
| BHP Billiton | 8.0 | 8.8 |
| National Australia Bank | 7.9 | 5.9 |
| Telstra | 7.1 | 4.8 |
| Westpac Bank | 6.9 | 7.6 |
| Insurance Aust. Group | 3.4 | 1.0 |
| Wesfarmers | 3.2 | 3.6 |
| Suncorp Group | 3.1 | 1.3 |
| Woodside Petroleum | 3.1 | 2.1 |

| Sector Allocation | Portfolio Weight (%) | Benchmark Weight (%) |
|---|---|---|
| Financials | 50.0 | 45.1 |
| Materials | 13.1 | 17.4 |
| Telecommunications | 8.1 | 5.3 |
| Healthcare | 6.4 | 4.6 |
| Consumer Staples | 5.4 | 7.9 |
| Energy | 4.2 | 6.2 |
| Consumer Discretionary | 3.5 | 4.1 |
| Utilities | 2.1 | 1.7 |
| Industrials | 1.9 | 6.9 |
| Information Technology | 1.0 | 0.8 |

### Selected Portfolio Statistics as at 31 July 2014

| | |
|---|---|
| **Inception Date** | 23-Dec-05 |
| **Number of Stocks** | 35 |
| **ATI Funds Under Management** | ~ $400m |

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

## Portfolio Performance

The ATI Equity Portfolio rose 4.2% in July compared with a rise of 4.4% in the benchmark index. Against this benchmark, ATI is producing excess returns on a 3 monthly, 1 year, 3 year, 5 year and since inception (Dec'05) basis.

## The Best and Worst Performing Sectors

The best performing sectors for the month were Materials (+7.7%), Information Technology (+6.3%) and Telecommunications (+5.2%) whilst the worst performers were Utilities (+0.7%), Energy (+2.2%) and Health Care (+2.7%).

From a sector perspective, the relative performance of the ATI portfolio was most positively impacted from being overweight Financials stocks (50.0% v benchmark of 45.1%) and underweight Energy stocks (4.2% v benchmark of 6.2%), whilst it was most negatively impacted by being overweight Health Care stocks (6.4% v benchmark of 4.6%) and underweight the outperforming Materials stocks (13.0% v benchmark of 17.4%).

## Attribution of Stocks

The portfolio performance during July was assisted by overweight positions in Insurance Australia Group (IAG), National Australia Bank (NAB), and Orica (ORI); and by not holding Macquarie Group (MQG), Origin Energy (ORG), and Navitas (NVT). The three stocks in the portfolio that contributed most to its relative performance during July were:

**Insurance Australia Group (IAG) (+7.9%)** outperformed during July after upgrading its FY14 margin guidance to 18.0-18.3% (from 14.5% to 16.5%), largely driven by one-off factors: i) very benign natural peril claims being $85m below allowances; ii) reserve releases around 3% of net earned premium versus 1% long-run expectations; and iii) a $100m positive benefit from favourable credit spread movements. While margins continue to improve, revenues are softening, with FY14 premium growth guidance of 3% implying just 2% growth in 2H14, and less ex the benefit of a strong NZ$, reflecting the absence of cost inflation. IAG also revealed that its switch to a new simplified operating model should result in annualised pre-tax savings of $90m, to be realised over the next two-year period. Having basically pre-released the FY14 result, this provides us with greater comfort in relation to earnings transparency for IAG than most other stocks and we retain the portfolio's maximum overweight position as we head into the upcoming reporting season.

**National Australia Bank (NAB) (+7.8%)** outperformed during July after announcing that they had agreed to sell $1.2bn worth of distressed British commercial real estate loans to a New York based private equity firm, Cerberus Capital management. Whilst there are still over $3bn of residual distressed commercial assets from the UK operations that are still held on balance sheet, the ability to sell off a large portion of loans at slightly above the impaired book value has provided the market with some comfort that NAB will be able to exit the remainder of these assets at a faster speed than had initially been expected. As the problematic UK business has plagued NAB for several years now, the ongoing positive sentiment for the stock may well be maintained if the 1H14 result clarifies that the other material cost issues impacting the UK business, such as legacy product compensation claims, are finally deemed as having being provided for. In the interim, we remain overweight NAB as it currently ranks as the cheapest of the major banks and we feel that it should be able to outperform the market if the legacy issues that have plagued the stock recently are dealt with. The new CEO, Andrew Thorburn, should also bring a fresh set of eyes to dealing with the problems that have continued to offset the sound operating performance of NAB's Australian and New Zealand operations for the last few years.

**Orica (ORI) (+12.9%)** outperformed in July with the better performance reflecting some lesser market concern that falling commodity prices may result in less demand for explosives. Management recently provided a more cautious full year profit outlook based on both customer cost reduction and some pricing competition although they do expect modest volume improvement in the second half of the year, a view the market seems to have accepted. Internally, ORI is embarking on a further cost down and efficiency program reflecting the tougher external environment. Despite the recovery in the share price, ORI continues to trade at a discount to the broader market and offers an attractive yield, strong cash-flows, a lowly geared balance sheet and a "capex light" period ahead which all suggest some potential for capital management. There also continues to be ongoing discussion regarding the plan to separate the chemicals division from explosives and this may result in a better than expected outcome. Negatively however, it has been announced that a new South African competitor intends to enter the Australian market and this can only lead to further price and volume competition. For this reason, and despite our generally positive view on ORI, we have reduced our overweight position into this price recovery, but will look to increase positions again as appropriate should prices decline over the coming months.

Positions that detracted most from the portfolio's performance during the month were from being overweight AGL Energy (AGK), Ardent Leisure (AAD), and Ansell (ANN); and from not holding Fortescue Metals Group (FMG), Newcrest Mining (NCM), and Alumina (AWC). Stocks in the portfolio that detracted most from relative performance during the month included:

**AGL Energy (AGK) (-4.5%)** was weaker during the month of July after providing updated FY14 Underlying NPAT guidance of $561m, which was at the lower end of the previous guidance range for $560m-$580m. Due to the repeal of the carbon tax, AGK also downgraded its FY15 EBIT by $186mn; due to i) foregone compensation to Loy Yang A ($100m) and ii )the impact of declining wholesale electricity prices ($86m). Later in the month, it was announced that the ACCC would not to appeal the Australian Competition Tribunal's grant of conditional authorisation to AGK's proposed acquisition of Macquarie Generation. AGK had previously indicated a sale price of $1.5b that would be funded by a $1.2b entitlement issue and the balance in debt. We continue to hold an overweight position in AGK based on valuation support and an expected improvement in its earning profile and sentiment when the Mac Gen acquisition is finalised.

**Ardent Leisure (AAD) (-4.8%)** underperformed during July despite not releasing any material company specific news announcements. After the stellar absolute and relative performance of the stock over the last twelve months, it is not a great surprise to see the stock having a pull-back as we approach the 1H14 earnings release for the company. We are still expecting a positive result for 1H14 which should confirm the ability of AAD to continue growing both revenue and earnings in what has basically been quite a muted economic domestic performance for the past year. One of the driving forces behind the ongoing earnings growth continues to be the Main Event business in the US that continues to roll out its multi purpose entertainment venues at better than budgeted expectations. We continue to remain overweight AAD and will be in a better position to assess our earnings profile projections after the release of the 1H14 result in mid August.

**Ansell (ANN) (-4.0%)** underperformed during July as it announced that it had undergone its second organisational restructure in a little over four years, aiming to unlock organic growth by improving manufacturing productivity, increasing scale efficiencies and extracting additional synergies on the heels of its latest acquisition of BarrierSafe Solutions International. Specifically, products will be rationalised, headcount reduced, a more balanced and less economic-cycles-exposed new global business units structure put in place, the Shah Alam Medical manufacturing plant in Malaysia closed, and an SAP ERP system rolled out across EMEA and APAC in lieu the Oracle system. The total financial impact of these changes is US$124.7m (pre-tax). FY14 EPS guidance of US$1.10-1.16 was maintained, but targeting the bottom of the range, with cash flow and the dividend not adversely affected. Despite the lower FY14 guidance range provided, the attractive ranking in the ATI equity rankings means ANN remains an overweight portfolio holding.

## Portfolio Construction

The main portfolio weighting changes during July included: top-ups for our portfolio holdings in AMP (AMP), ANZ Banking Group (ANZ), Crown Resorts (CWN), Pacific Brands (PBG), NAB, Rio Tinto (RIO), Seven West Media (SWM) and Virtus Health (VRT); ceasing to hold a portfolio position in Incitec Pivot (IPL); and slight portfolio reductions for our holdings in BHP Billiton (BHP), Brambles (BXB), Commonwealth Bank (CBA), CSL (CSL), Orica (ORI) and Wesfarmers (WES). Cash at the end of July was 4.3% and near the 5% maximum threshold, slightly up from 4.1% in June, reflecting our view that the overall equity market valuation is looking quite stretched at these levels.

The ATI portfolio, with regard to its market capitalisation exposures, remains differentiated to the benchmark index with ~87% of the portfolio (excluding cash) in the top 50 stocks (benchmark ~83%), ~10% in the next 100 (benchmark ~13%), and ~3% in the last 150 stocks (benchmark ~4%). The 10 largest holdings constitute ~63% of the portfolio (benchmark ~55%), the dividend yield is 4.4% (benchmark 4.2%) and the portfolio's historic or trailing PE is 15.9x (benchmark of 17.2x).

Whilst the portfolio's market cap bias is currently tilted to the larger stocks compared to the benchmark index, its underlying sector positioning is not too dissimilar to that of the benchmark. The main point of differentiation is that the portfolio remains underweight the materials sector and overweight the financials sector. We remain comfortable holding positions in a number of resource stocks, particularly BHP & RIO, and copper exposure, Sandfire Resources (SFR), whose expected returns are sufficiently attractive to justify some additional portfolio risk at this stage. 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 BXB, Computershare (CPU), CSL, Resmed (RMD) and WES in combination with other opportunities that we feel have fundamental valuation support, such as Challenger (CGF), M2 Group (MTU), PBG, Suncorp Group (SUN) and Virtus Health (VRT).

## Portfolio Risk

The current forecast tracking error of ~2.3% is similar to last month (~2.3%). We are continuing to be presented with a number of stock opportunities in the materials, industrial and consumer staples sectors as a result of their recent market underperformance. At this stage we still feel that any further additional risk in the mining contractor stocks is unlikely to be justified in an environment with ongoing profit warnings and 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, Lend Lease (LLC), TLS, RMD, IAG, MTU and AAD.

## General Market Commentary

The Australian equity market rebounded from a weak June to post its strongest performance in 12 months that saw the market end July at a six-year high, its highest close since June 2008. The benchmark ASX300 accumulation index gained 4.4% in July with the local index being largely helped by the performance of the materials sector which had its best relative monthly return since July last year as mining stocks responded to better Chinese data and as iron ore prices confirmed the stabilisation seen in June after previous heavy falls. Most other major sectors struggled to keep up with the index and there was no clear pattern to sector performance as energy lagged whilst oil prices softened, and the banking sector also trailed the average.

The weakest major sector in July was utilities but this was mainly the result of a disappointing earnings outlook statement provided by AGL Energy (AGK) mid-month where the company confirmed that FY14 earnings would be at the lower end of earlier guidance. AGK was not alone in guiding down market expectations ahead of the looming FY14 reporting season as a number of companies

pre-announced their results with profit warnings issued from: QBE Insurance (QBE) pre-released elements of its 1H14 result citing problems including reserve increases in Latin America and downgrades to both gross written premium guidance and insurance margins; whilst Als (ALQ), Boart Longyear (BLY), and Cardno (CDD) all downgraded FY14 earnings expectations. Conversely, mining quarterlies were overall quite positive, particularly for larger players like BHP and RIO, as both reported record production results and upgraded guidance on the back of their ongoing productivity drives.

Corporate activity continued to be a market feature with material events including: the more upbeat market tone being reinforced by a solid debut for Healthscope (HSO), the market's largest share float since QR National (now Aurizon) listed in 2010; ongoing M&A activity that saw Wotif (WTF) and ROC Oil (ROC) receive takeover bids whilst Aristocrat Leisure (ALL), Calibre Group (CGH), Computershare (CPU) and Webjet (WEB) all announced material acquisitions in July.

The RBA left the cash rate on hold at 2.5% for a tenth consecutive meeting as widely anticipated. Of interest was that RBA Governor Glenn Stevens addressed a conference of economists in Hobart where he said that the market would be wrong to underestimate the risk that the Aussie dollar could fall significantly and added that the RBA had ammunition to move on policy if needed. The Governor's comments on the economy sounded more downbeat than before as he now believes that while low interest rates are working, the transition in the sources of growth is far from over. Pleasingly for Stevens, the Aussie did ease slightly against the greenback in July (-1.1%) and finished the month weaker at US$0.9296, compared to the previous month's close of US$0.9432.

With regards to domestic economic data releases, the general trends remained mixed but still slightly positive overall and included: The NAB June Business survey saw business confidence surprisingly resilient at +8% (+1 mom) whilst business conditions rose 3pts to +2 (but still below the +5 long-run average since 1997); CPI headline inflation printed 0.5% q/q in 2Q14 (consensus +0.5%) as the trimmed mean of 0.8% q/q beat expectations (0.6%) and the 1Q14 figure was revised up by 10bp to 0.6%; the Westpac-MI consumer confidence index for July rose 1.9% m/m, the biggest rise since November 2013 with the forward looking family finances index (+12.3% m/m) driving the surprise; the Australian economy added 16k jobs in June (consensus +12k), but full time employment fell by 4k; the unemployment rate rose to an 11- year high of 6% (consensus +5.9%) as the participation rate rose marginally to 64.7% (consensus 64.6%, May 64.6%); building approvals fell 5.5% m/m (consensus was flat) in June, with higher-density projects the main drag, multi-family dwellings plunged 10.5% m/m while single family dwellings fell by 2.2% m/m; retail sales declined 0.5% m/m in May (consensus flat) as Federal Budget announcements and a warmer-than expected start to winter impacted consumer spending.

Geopolitical tensions remained in focus with a number of Middle East and the Ukrainian situations rapidly escalating as the EU agreed to place more financial sanctions on broad sectors of the Russian economy. Despite this backdrop coal, natural gas and oil prices all lost ground during the month. Spot Brent crude oil plunged fell 5.6% in July, closing at $106/bbl, amid reports that supply constraints in war torn Libya and Iraq had eased as two oil terminals in Libya were re-opened as rebels reached an agreement with the government, and in Iraq the Kurdistan Regional Government secured two oilfields in the North that were left abandoned by the Iraqi army. With the Chinese economy showing signs of improvement, iron ore prices started to stabilise during the month and the benchmark spot iron ore contract rose for the second consecutive month (+1.9%). Chinese iron ore inventories, while high compared to history, fell -1% from the June level and end demand trends were encouraging (China's June steel production +7.2% y/y). Base metals were mostly firmer in July lead by zinc (+7.4%) and aluminium (+6.6%). The spot gold price failed to capitalise on continuing turmoil in the Middle East and Ukraine, giving back some of June's gain following a weaker than expected core inflation print in the US and a firmer USD saw the gold price dragged down -2.4% to end July at US$1,295 / oz.

## Outlook

Overall consensus analyst earnings expectations have taken a further step down as we lead into the FY14 reporting season following the impacts of a hit to consumer confidence after the Federal budget announcement, the resiliently high AUD and declining commodity prices. During the course of July, the consensus earnings growth outlook for our market in FY15 dropped below the 7% level. Despite this the Australian equity market seemed to be buoyed by improving growth prospects in the US and China, with some date releases in the two major economies surprising positively in July. It would appear that geopolitical risks have so far taken a back seat as the market continues to rally, but further escalation in the growing number of conflict areas in conjunction with a weaker than expected reporting season could easily see a reversal in the positive recent trend for domestic equities.

Whilst we are aware that higher yielding stocks remain susceptible to an increase in global interest rates, the current heightened levels of global geopolitical risk mean that we will remain overweight the financials sector in the near term as it continues to offer us a higher level of earnings certainty than many industrial and resource names as we head into the current reporting season. Our decision to remain underweight the materials sector seems appropriate at this stage as consensus aggregate EPS expectations for FY15 continued to trend lower in July and composite earnings growth expectations for FY15 having now actually turned negative.

Despite some warranted caution as we enter reporting season, the ongoing positive earnings expectations for the year ahead still provide some scope for further appreciation in the domestic equity market although we note that the current market levels mean that the shifting global macro and geopolitical backdrop still warrant a healthy level of investor caution. As a result, we remain positioned with a bias to the large cap stocks due to better relative transparency in their earnings forecasts, during times of global and domestic economic uncertainty. We also remain positioned with a number of stocks having USD earnings exposure that are likely to benefit from any 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

Goldman Sachs

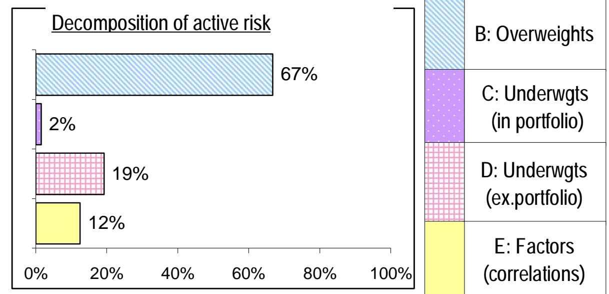
| Portfolio Name: | MyPort |
|---|---|
| Benchmark: | ASX300 |
| Date of Data: | 31-Jul-14 |
| Sector Type: | GICS1 |

| Model: | AE_PCA60M |
|---|---|
| Factor Analysis: | Multi-Factor |
| Timestamp of Analysis: | 6/08/2014 10:51:09 AM |

| | | Active Exposures: | | % |
|---|---|---|---|---|
| Historic portfolio alpha | 5.4% | Total: | 70.9% | 100.0% |
| Historic portfolio beta | 0.95 | Across sectors: | 29.2% | 41.1% |
| Raw return | 14.3% | Within sectors: | 41.8% | 58.9% |

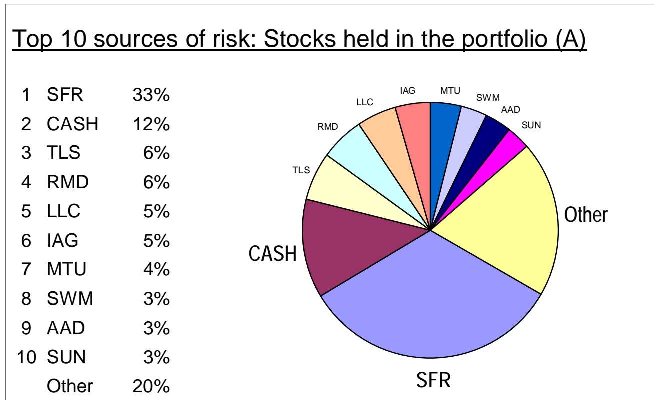
Forecast Tracking Error: **2.34 %** (active risk)

| | Source of portfolio risk | contribution to active portfolio risk | standard deviation | variance / covar. |
|---|---|---|---|---|
| A | Stocks held in portfolio (B+C) | 68% | 1.9 | 3.7 |
| B | Overweight positions | 67% | 1.9 | 3.7 |
| C | Underweight positions | 2% | 0.3 | 0.1 |
| D | Stocks not held in portfolio | 19% | 1.0 | 1.1 |
| E | Factors (correlations between stocks) | 12% | | 0.7 |
| F | Total (A + D + E) | 100% | 2.3 | 5.5 |



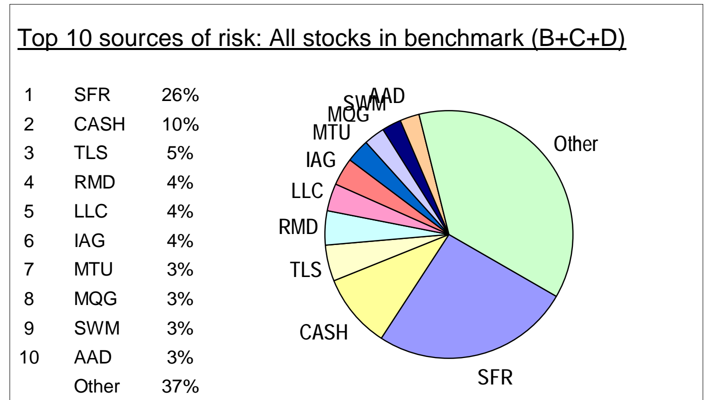

## Top 10 sources of risk: Stocks held in the portfolio (A)

| | | |
|---|---|---|
| 1 | SFR | 33% |
| 2 | CASH | 12% |
| 3 | TLS | 6% |
| 4 | RMD | 6% |
| 5 | LLC | 5% |
| 6 | IAG | 5% |
| 7 | MTU | 4% |
| 8 | SWM | 3% |
| 9 | AAD | 3% |
| 10 | SUN | 3% |
| | Other | 20% |




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

| | | |
|---|---|---|
| 1 | SFR | 26% |
| 2 | CASH | 10% |
| 3 | TLS | 5% |
| 4 | RMD | 4% |
| 5 | LLC | 4% |
| 6 | IAG | 4% |
| 7 | MTU | 3% |
| 8 | MQG | 3% |
| 9 | SWM | 3% |
| 10 | AAD | 3% |
| | Other | 37% |




## Active Weights