Above The Index Asset Management Pty Ltd

Fact Sheet

ATI Australian Equity Portfolio

Information as at 31 March 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 March 2016)	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Inception (% p.a.)
ATI Equity Portfolio (gross)	4.9	(1.9)	(10.7)	5.3	5.2	6.4
Benchmark Index	4.8	(2.6)	(9.3)	5.0	5.4	5.1
Relative Outperformance	**0.1**	**0.7**	**(1.4)**	**0.3**	**(0.2)**	**1.3**

*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 March 2016

Largest Holdings	Portfolio Weight (%)	Benchmark Weight (%)
Commonwealth Bank	9.5	9.4
Westpac	7.4	7.6
Telstra	7.0	4.7
ANZ Bank	6.8	5.2
National Australia Bank	5.9	5.1
CSL	4.5	3.5
Wesfarmers	4.3	3.5
AMP	2.7	1.3
Asciano	2.7	0.6
Lendlease	2.6	0.6

Sector Allocation	Portfolio Weight (%)	Benchmark Weight (%)
Financials	45.8	45.6
Healthcare	10.8	6.8
Telecommunications	9.9	5.4
Materials	9.3	12.8
Industrials	6.0	7.9
Consumer Staples	4.8	7.2
Energy	2.4	4.0
Utilities	2.2	2.3
Consumer Discretionary	2.3	5.0
Information Technology	1.8	1.2

Selected Portfolio Statistics as at 31 March 2016

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.

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Portfolio Performance

The ATI Equity Portfolio rose 4.9% in March compared with a rise of 4.8% in the benchmark index. Against this benchmark, ATI is producing excess returns on a monthly, quarterly, 3 year and since inception (Dec'05) basis.

The Best and Worst Performing Sectors

On a relative basis, the best performing sectors for the month were banks (+6.5%), materials (+5.5%), and technology (+5.3%) whilst the worst performers were healthcare (-0.5%), utilities (+0.5%) and telecommunications (+1.9%).

From a sector perspective, the relative performance of the ATI portfolio was most positively impacted from being underweight consumer staples (4.8% v benchmark of 7.2%) and underweight consumer discretionary (1.3% v benchmark of 5.0%), whilst it was most negatively impacted by being underweight industrial stocks (6.0% v benchmark of 7.9%) and overweight telecommunications stocks (9.9% v benchmark of 5.4%).

Attribution of Stocks

The portfolio performance during February was assisted by overweight positions in Primary Health Care (PRY), Mayne Pharma (MYX) and underweight Woolworths (WOW); and by not holding Ramsay Healthcare (RHC), Transurban (TCL) and Caltex (CTX). The three stocks in the portfolio that contributed most to its relative performance during the month were:

Primary Health Care (PRY) (+17.5%) PRY again outperformed the market following an announcement that it has sold its clinical software business Medical Director for $155m. The transaction multiple was 7.8x EV/EBITDA and whilst dilutive to earnings the balance sheet metrics are now improved. The proceeds will be used to pay off debt which should reduce group debt to ~$900m and gearing to ~26%. Earlier in the month it was revealed that Jangho Group was a holder of 14% of Primary's shares and raised the potential that the group may seek to take control of the business in much the same way as it acquired Vision Group last year. This followed a positive response to its 1H16 result released in February.
We maintain our overweight position as there is still valuation support at current price levels. We also note that there is still significant short interest in the stock (67M shares short representing 12% of the register and 5.4 days cover) and the increased possibility of corporate activity.

Mayne Pharma (MYX) (+21.4%) MYX outperformed the market following the release of its 1H16 result in late February. Revenues increased 114% to $127m and underlying NPAT increased 278% to $20.4m on the back of strong organic performance across its generics and metric services business. There was an increased Doryx contribution after MYX acquired the brand name (from Actavis) and brought distribution in-house in Feb 2015.
During March, there was also news that the US FDA has relaxed the safety monitoring requirements around the antiarrhythmic drug Tikosyn, a product that Mayne Pharma plans to genericise later this year. In addition recent volume data for Doryx, indicated solid growth in the new 50mg product and an accompanying price hike in the 200mg.
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, utlising a platform that is able to develop and produce molecules that competitors are finding difficult to manufacture.

Woolworths (WOW) (-2.7%) Relative outperformance was generated due to ATI's underweight position in WOW, one which we have maintained for the past 2 years. Material announcements were made in February, with a loss reported in its 1H16 result due to a $1.9B impairment of the Masters hardware business. It was announced in January that WOW would exit hard ware. It was also announced that the current head of the Food division, Brad Banducci, would be the replacement for former CEO Grant O'Brien who resigned in June 2015.
Despite there being valuation support, we still remain cautious about the earnings profile of the business. The turnaround in the Food operations is expected to take 3 to 5 years and EBIT margins may fall further from current levels. Competition from Aldi and Coles continues to be aggressive and the earnings profile of Big W, Hotels and the New Zealand supermarkets business is benign. WOW's credit metrics have deteriorated and may worsen when upon finalisation of the Lowes put option.

Positions that detracted most from the portfolio's performance during the month were from being overweight Redmed (RMD), Asciano (AIO), and Aurizon (AZJ); and from not holding Fortescue Metals (FMG), Medibank (MPL) and South 32 (S32). Stocks in the portfolio that detracted most from relative performance during the month included:

Resmed (RMD) (-8.2) RMD was weaker during the month following the Centres for Medicare and Medicaid Services (CMS) recently published the new payment amounts for regions captured in the recompete of Competitive Bidding Round 2. The new reimbursement amounts will be effective July 2016, and are on average 10%-15% lower than the original round 2 prices. Reimbursement for flow generators and mask categories will decrease by 11%-13%. For RMD's durable medical equipment (DME) customers, CMS currently comprises ~25% of OSA volumes, and the Round 2 regions make up 45% of the overall CMS market. This is in addition to the 5% impact of round 3 competitive bidding price reductions also effective in 2016. Although some of the more recent innovations in CPAP connectivity have resulted in revenue and/or cost benefits to some DMEs, we still expect RMD to face pressure in FY17 to provide DMEs with price concessions given the reduction in CMS reimbursement. We note that CMS reimbursement for round 2 and 3 regions is now largely fixed through to FY19.]
The market has also re-modelled the impact of the $800m acquisition of Brightree, a home healthcare software company with near term downgrades.

We reduced our positon during the month due to these concerns, but still maintain an overweight position and will monitor the position in the ensuing months.

Asciano (AIO) (+1.0%) AIO underperformed the market following the announcement that it had agreed to a revised bid by a consortium that included the original bidder Brookfield. This led to a stable shareprice as an increased bid is now unlikely. The Qube (QUB) and Brookfield consortium has made a $9.15 per share offer for AIO. QUB will enter into a JV for AIO's Patrick business paying $1.46b plus fees. The transaction will be funded by $800m in new equity and debt of ~$200m, in addition to $1.05b debt from Patrick (QUB share $525m). QUB retains the option to acquire 50% of AAT, pending ACCC approval. We feel the transaction is now largely de-risked subject to the machinations of the ACCC, at this stage are intending on holding position until the takeover is effected, expected to be in June. We have also taken a positon in QUB which will provide the opportunity to maintain the exposure to the Patrick business.

Aurizon (AZJ) (-2.7%) AZJ underperformed during the month as concerns by the market regarding the ongoing viability of a key customer Peabody, which represents ~9% of haulage volumes. The share price has been under pressure following a downgrade to guidance in December and then a weak 1H16 result.
We have reduced our position in AZJ but still maintain a slight overweight positon on the premise that its cost-out program is still on track and will assist in meeting the revised earnings expectations. Despite the write-downs and counterparty risk the balance sheet remains strong and the below rail business is performing to expectations. The current buyback with 29m shares still to be repurchased is expected to continue into June 30.

Portfolio Construction

The main portfolio weighting changes during March included: top-ups for our holdings in ANZ Bank (ANZ), CSL (CSL), PRY and Wesfarmers (WES); and some slight reductions for our holdings in ASX (ASX), AZJ, BHP Billiton (BHP), RMD, RIO Tinto (RIO) and Telstra (TLS).

Cash at the end of February was 4.3% and is below the 5% maximum threshold, similar to the 4.2% in February, 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 and 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 and RMD in combination with other opportunities that we feel have fundamental valuation support, such as Suncorp (SUN), Virtus Health (VRT) and WES. We are maintaining our holding in AIO due to our expectation that the 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 ~2.6% is similar to last month (~2.4%). 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 Ardent Leisure (AAD) in the portfolio over the past few months. At present, the main sources of portfolio risk are from overweight positions in AIO, PRY, and AAD.

General Market Commentary

The ASX200's 4.9% total return during March represented the strongest monthly return since October 2015. However, it was not enough to recoup the combined declines suffered through January and February with the ASX200 finishing down 2.6% for the quarter.

Politics remains a talking point with BREXIT (the possibility of the UK existing the EU) and US presidential elections continuing to dominate global headlines; at a domestic level the federal budget has been brought forward by a week, and the Senate has been recalled to consider legislation which could potentially trigger a double dissolution election in July.

Employment in February rose a weaker-than-expected 0.3k though the unemployment rate fell to 5.8% (consensus: 6.0%, previous: 6.0%).

Domestically, the release of 4Q15 GDP data revealed that the economy grew by 3.0%YoY. A decline in the household savings rate, to the lowest since 3Q08, supported household demand against a weak income backdrop. Whilst production (GDP) rose by 3.0%YoY, income (GDI) rose just 0.3%YoY, and continues to exert a strain on non-mining domestic sectors.

In the US, the FOMC halved their rate hike guidance (from four hikes in 2016 to two) at the March meeting, resulting in significant downward pressure on the USD. Fed President Janet Yellen noted that "developments abroad imply that meeting our objectives for employment and inflation will likely require a somewhat lower path for the federal funds rate than was anticipated in December".

China data was weak. Early in the month the official manufacturing PMI for February fell to a worse-than-expected 49.0 (consensus: 49.4, previous: 49.4) – the weakest reading since November 2011. Exports for February fell 25.4%YoY (consensus: -14.5%, previous: -11.4%) – the biggest decline since May 2009. Industrial production for January-February grew at a weaker than expected 5.4%YoY (consensus: 5.6%, previous: 5.9%) – the weakest growth since November 2008.

The US dollar weakened against most major currencies on an increasingly dovish Fed outlook. The Australian dollar strengthened against most major currencies. The A$ has appreciated 12.2% since its mid-January low of US$0.6827, to finish March at US$0.7657, its highest level against the US dollar since July 2015, on higher commodity prices and an improving outlook for interest rate differentials.

Commodity prices were generally higher during the month, likely due in part to the weakening US dollar. The iron ore price rose strongly through most of the month, posting its biggest ever single day gain of 19% on 7th March, before peaking on 23rd March then retracing to finish the month up 9%.

Outlook

As we have become accustomed to over the quarter, share prices remained volatile, reflecting nervous sentiment rather than sustained changes in economic or earnings fundamentals. A dovish shift by the Federal Reserve set equities and emerging market risk assets on a higher path into the final day of the month (the ASX200 rose 1.4%), but it was strength in the commodity based sectors – Energy and Materials – that provided the positive platform for the overall market return through March.

Banks led an intra-month sell-off on the back of ANZ's announcement of a worse-than expected resources sector impairment charge. Whilst resources (basic materials + energy) represent ~1.5% of major bank loan exposures it potential for other corporate issues to emerge that has concerned the market. Coming just five weeks after their 1Q16 trading update on 17 Feb, recent credit events for single names appear to be the catalyst, namely Peabody, and Arrium's recapitalization plan announced 22 Feb. We note that ANZ is not alone in these exposures, with further risk across the sector associated with Aurizon, Dick Smith and Slater & Gordon.

On the back of these announcements, we expect the major bank share prices to remain under pressure heading into 1H16 reporting season kicking off in early May. The sector's ~10% re-rating in recent weeks had seen the major banks moving out of our top 20 ranked stocks. However, the re-introduced earnings uncertainty with the latest round of 'confessions' will likely see subdued share price performance in the lead up to reporting season next month. We remain overweight banks but have reduced the extent of the overweight. We still believe valuations for the sector are attractive and even with the bad debt cycle moving towards mid-cycle levels on our modelling dividends yields are sustainable looking out 12 – 18 months.

We continue to remain underweight mining and neutral energy as we see the recent spike in the oil and iron ore prices as vulnerable to some retracement on weaker Chinese demand and economic data and a higher AUD.

There are signs that the threat of an early election has driven an increased level of uncertainty amongst consumers. Consumer sentiment weakened in March, and there was a major souring of consumer appetite for real estate investment on speculation of changes to the current arrangements in relation to negative gearing.

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. Outside of the financials, we also remain overweight the healthcare, telecommunications and utilities sectors.