Above The Index Asset Management Pty Ltd

Fact Sheet

ATI Australian Equity Portfolio

Information as at 31 May 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 May 2016)	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Inception (% p.a.)
ATI Equity Portfolio (gross)	3.4	11.2	(2.6)	7.7	7.1	6.8
Benchmark Index	3.1	11.7	(2.1)	7.7	7.3	5.7
Relative Outperformance	0.3	(0.5)	(0.5)	0.0	(0.2)	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 31 May 2016

Largest Holdings	Portfolio Weight (%)	Benchmark Weight (%)
Commonwealth Bank	9.5	9.2
ANZ Bank	7.9	5.2
Westpac	7.3	7.1
Telstra	6.8	4.7
National Australia Bank	5.9	5.0
CSL	4.6	3.7
Wesfarmers	3.4	3.2
BHP	2.6	4.2
AGL	2.5	1.0
Vocus Comms	2.5	0.3

Sector Allocation	Portfolio Weight (%)	Benchmark Weight (%)
Financials	46.7	45.8
Healthcare	11.8	7.3
Telecommunications	9.4	5.5
Materials	8.7	13.7
Industrials	5.6	8.0
Consumer Staples	3.4	6.8
Energy	3.7	4.1
Utilities	2.5	2.4
Consumer Discretionary	3.3	5.2
Information Technology	1.5	1.3

Selected Portfolio Statistics as at 31 May 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.

Portfolio Performance

The ATI Equity Portfolio rose 3.4% in May compared with a rise of 3.1% in the benchmark index. Against this benchmark, ATI is producing excess returns on a monthly and since inception (Dec'05) basis.

The Best and Worst Performing Sectors

On a relative basis, the best performing sectors for the month were healthcare (+9.4%), info technology (+6.5%), and consumer discretionary (+5.8%) whilst the worst performers were materials (-3.3%), energy (-1.8%) and consumer staples (-0.8%).

From a sector perspective, the relative performance of the ATI portfolio was most positively impacted from being underweight materials stocks (8.7% v benchmark of 13.7%) and underweight energy stocks (3.7% v benchmark of 4.1%), whilst it was most negatively impacted by being overweight financial stocks (46.7% v benchmark of 45.8%) 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 ANZ Bank (ANZ), Primary Healthcare (PRY) and Vocus Comms (VOC); and by not holding Fortescue Metals Group (FMG), South 32 (S32) and Orica (ORI). The three stocks in the portfolio that contributed most to its relative performance during the month were:

> **ANZ Bank (ANZ) (+5.0%)** outperformed the market in May after recovering from several months of underperformance. ANZ released their 1H16 result with cash earnings of $2,782m in early May which was well received by the market despite the fact that bad debts were about $100m higher than consensus expectations. ANZ clarified the increased provisioning was due to a few institutional names and that the majority of the book, being residential mortgages, was still performing very well. Post the 1H16 ANZ result we have revised down our profit forecast for FY16 by ~2% but the recent underperformance still means that ANZ remains relatively attractive in our equity rankings and we intend maintaining the overweight position at this stage.
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> **Primary Health Care (PRY) (+11.8%)** outperformed during May due to 1) a positive budget announcement from the government, proposing to legislate collection centre 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. The review on Pathology centre rents is positive for sentiment and has led to consensus earnings upgrades. We also note that there is still significant short interest in the stock and the potential for corporate activity still remains.
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> **Vocus Comms (VOC) (+9.0%)** outperformed during May as they signed a new supplier agreement with Telstra for fixed voice and broadband services on existing similar arrangements set to expire on 30 June 2019. During the month Vocus also extended its wholesale mobile agreements with Optus. Following a comprehensive and competitive tender process Vocus, through its subsidiaries, has also entered into a binding agreement with Optus Mobile Pty Ltd ('Optus') to extend the formal term of agreements with Optus for the supply of wholesale mobile voice and mobile broadband services. The agreement extends existing arrangements from their expiry date of July 2016, until 30 June 2019. Wholesale Mobile Services are resupplied by Vocus predominantly to retail customers under the Commander, iPrimus and Dodo brands.

Positions that detracted most from the portfolio's performance during the month were from being overweight AMP (AMP), Annsell (ANN) and Qube Holdings (QUB); and from not holding Macquarie Group (MQG), QBE Insurance (QBE) and Aristocrat Leisure (ALL). Stocks in the portfolio that detracted most from relative performance during the month included:

> **AMP (AMP) (-4.1)** underperformed the market during May after releasing a 3Q16 trading update that included some less than favourable aspects including lower than expected funds flows and a reversal in the recent positive experience for the life company book. The result of the quarterly update was that we and the market consensus have slightly reduced the FY16 profit forecast and this also flows through to some lower rebasing of numbers for the FY17 / 18 outer years. Despite the small earnings downgrades we still remain slightly overweight the stock.
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> **Annsell (ANN) (-4.1%)** underperformed the market in May after giving back some of the recovery in April, recovering most of the losses incurred after downgrading guidance from US$1.05 – US$1.20 to US$0.95 – US$1.10 in February and sequentially sold off. ANN recently has benefited from lower global latex and cotton prices and a small uptick in global PMI's. In the first half 2016 result ANN noted production capacity issues and excess waste levels in the process and we are awaiting an update to the market on progress.
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> **Qube Holdings (QUB) (-5.2%)** underperformed during the month following the release of a statement of issues by the ACCC in relation to its proposed takeover of Asciano. The ACCC said market participants had expressed concerns about the integration of Asciano's Patrick container-terminals business with two of the largest import-export container logistics providers in Australia, Qube and Australian Container Freight Services. ACFS partners with Asciano's Patrick ports business in a 50-50 joint venture. The ACCC is concerned that Patrick container terminals may provide preferential access to Qube and ACFS vehicles, and Qube regional export trains running into Port Botany, and raise rivals' costs. Qube and Brookfield will each own 50% of Patrick container terminals, and may have parallel incentives to favour their landside

logistics operations. The Commission has invited further submissions from industry participants and expects to make its final decision on July 21. We still maintain our Index weight position in the company and overweight position in AIO with the view that the consortium will address the ACCC concerns and the scheme of arrangement will proceed. We note that AIO shareholders approved the proposed scheme in June.

Portfolio Construction

The main portfolio weighting changes during May included: top-ups for our holdings in Ardent Leisure (AAD), AGL energy (AGL), PRY and Resmed (RMD); the removal of our holdings in QBE Insurance (QBE) and Woolworths (WOW); and some slight reductions for our holdings in Asciano (AIO), CSR (CSR), and Scentre Group (SCG).

Cash at the end of May was 4.3% and is below the 5% maximum threshold, similar to the 4.3% in April, 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 (CSL) and 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 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 Australian equity market had a strong month with the ASX300 accumulation index enjoying a 3.3% positive return to mark the best month of May since 2005 and now be up over 10% from the February low. The interest rate sensitive sectors (financials and utilities) did well over the month on the back of the shift lower in the bond yield term structure after a 25 basis point cut by the RBA and a rally in long rates which saw the domestic 10 year yield fall to an all-time intra month low of 2.23%.

Some material company specific announcements in May included: three of the major banks (ANZ, NAB & WBC) reported first-half results, with provisioning and asset quality very much in focus and with most delivering figures that were 'less bad' than expected, the sector outperformed the broader market for the month; Rio Tinto (RIO), the Government of Mongolia and Turquoise Hill Resources approved the development of Oyu Tolgoi copper and gold mine in Mongolia; Oil search (OSH) announced a proposal to purchase 100% of the equity in InterOil and subsequently sell 60% of the purchased assets to Total; JB Hi-Fi (JBH) announced it was in preliminary discussions with competitor The Good Guys; Mirvac Group (MGR) announced the purchase of Toombul Shopping Centre in Brisbane, as well as the sale of the Como Centre in South Yarra, Victoria and 16 Furzer Street in Phillip, ACT.

The Reserve Bank of Australia decided to lower the cash rate 25bp to 1.75% and as expected after this move, the AUD depreciated and eventually fell 4.9% against the Greenback over the month. In what appeared to be a major catalyst for the 25bp May rate cut by the RBA, Australia's 1Q16 CPI result was considerably weaker than expected, with both headline and core inflation below the RBA's target range. Headline inflation printed at -0.2% for the quarter, with the annual rate of headline inflation falling to its lowest ever level of 1.3% p.a. The core trimmed mean printed at 0.2%, the lowest level since 1997, with the annual rate of core inflation falling to 1.7%. In the statement announcing the decision, the RBA also softened their rhetoric around the outlook for the labour market and growth. In addition, the Australian Federal Treasurer Scott Morrison delivered his first Budget with the Federal Government forecasting a deficit of $37.1bn (~2.2% GDP), which is a small deterioration from the earlier estimates released and as such, the Budget shies away from big-ticket structural reform.

On the consumer front: the Westpac consumer confidence index rose from 95.1 to 103.2, with the headline index at its highest level since January 2014 and above the long-run average of 101.4; expectations of family finances over the next year rose from 97.9 to 104.9; this month's survey also included a question on perception of the 2016/2017 Federal Budget with the result being negative (-22.4%) so it is unlikely the Budget supported the leap in confidence this month; employment increased 10.8k positions with the composition of employment skewed to part-time workers (+20.2k positions); year-to-date, part-time employment has risen 74.1k positions, while fulltime employment has fallen 45.8k positions; the participation rate moved one-tenth lower to 64.8% on rounding, but the unrounded number was little changed; the unemployment rate was unchanged at 5.7%; in the NAB business survey, both confidence (+5 from +6) and conditions (+9 from +12) pulled back; Australia's 1Q business indicators were mixed with company profits falling 4.7% and most of the weakness was in export exposed industries, with mining (-10.0%) and manufacturing (-15.0%); mining profits have now contracted for eight consecutive quarters; single family approvals fell 1.9%; retail sales were a touch firmer this month – up 0.4%, the stronger outcome driven by food sales (+0.6%) and spending on apparel (+1.1%); Australian private sector credit rose 0.5% in April, with business credit increasing 0.8%, accelerating the annual rate of business credit growth to 7.4% p.a, the quickest run-rate since February 2009; housing credit increased 0.5% as owner occupier mortgage growth rose to 7.3% p.a and investor mortgage growth moderated to 6.5% p.a.

Base metals declined sharply over the month, with the LME Metals Index falling 6.9%. Nickel (-10.8%), aluminum (-7.5%), copper (-7.3%), led (-6.1%), tin (-5.4%) and zinc (-0.5%) declined. Iron ore traded down 24.3% to $50.15 / mt as the clamp down on speculative trading in iron ore futures on the Dalian Commodity Exchange underpinned the move. Brent and WTI established year-to-date highs, rising 3.2% and 6.9% respectively to $49.69 / barrel and $49.10 / barrel. Faster declines in mature, high cost, production areas underpin the rebalancing of the market, augmented by outages in Nigeria, Canada and Libya. Gold fell 6.0% to $1215 / oz with the most obvious reasons for gold's woes being the stronger US dollar and an increasing likelihood of a Fed rate hike.

Outlook

Whilst Australian equities have recovered over the course of calendar 2016, an expectation of a continued positive reversion rally may now be supported by the fact that the market is beginning to see an improvement in forecast earnings in an aggregate sense. Consensus EPS growth forecasts at last appear to be turning positive, with the 12 month forward consensus estimate rising by ~2% over the past two months and this marks the first meaningful upturn for the past year. The seemingly inexorable slide in commodity prices, coupled with growing headwinds for financials, had, until recently, exerted considerable downward pressure on consensus earnings expectations, with the one-year forward EPS growth estimates falling by ~10% between Jun-15 and Mar-16. In the past month, however, the positive EPS revisions have returned, with 86% of the 14 GICS sectors now forecast to have positive earnings growth in the year ahead.

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.

Market consensus earnings revisions for the banks also appear to be stabilising in the wake of recent round of 1H16 results, with some higher bad debt provisions for specific corporate exposures now in the numbers. Importantly, the consensus estimates for both ANZ and NAB – our two most overweight bank portfolio holdings – have now turned positive. The sector as a whole remains reasonable value in our view and the recent turn in wholesale funding conditions could also presage an upturn in earnings momentum over the course of 2016. In recent weeks, the wholesale funding environment has improved markedly, as evidenced by the movement in bank credit default spreads (CDS) and ANZ, for example, has seen its 5-year CDS narrow from 240 in late February to 159 currently. Given the RBA rate cut in the first week of May, we remain overweight the major banks as we feel the sell-off this year on a mix of global banking system concerns and local housing market concerns as overdone in light of a lower domestic interest rate environment. We believe valuations for the sector are attractive despite historically constrained EPS growth currently and the residential mortgage bad debt cycle continues to look very benign.

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.