

# Bennelong Australian Equities Fund

## Performance update

As at 28 February 2017

### Performance

	1 mth	3 mths	6 mths	1 Year	3 years pa	5 years pa	Since Inception** pa
Fund	1.58%	3.81%	0.63%	11.88%	6.22%	11.44%	13.27%
Benchmark*	2.18%	5.79%	6.94%	21.99%	6.43%	10.39%	10.89%
Value added	-0.60%	-1.99%	-6.31%	-10.10%	-0.21%	+1.05%	+2.38%

Performance figures are net of fees and expenses. \*Value added' calculation does not use rounded performance figures.

\*S&P/ASX 300 Accumulation Index

\*\*Inception date is 30 January 2009

### Portfolio positioning

Top Holdings
Westpac Banking
CSL
BHP Billiton
Aristocrat Leisure
National Australia Bank

Portfolio Sector Allocation			
Sector	Fund Weight	Benchmark* Weight	Active Weight
Discretionary	20.2%	5.0%	15.2%
Health Care	19.2%	6.7%	12.5%
Materials	20.3%	16.2%	4.0%
Liquidity	1.8%	0.0%	1.8%
Consumer Staples	6.3%	7.0%	-0.8%
IT	0.0%	1.3%	-1.3%
Industrials	5.1%	6.6%	-1.5%
Utilities	0.0%	2.6%	-2.6%
Telco's	0.7%	4.2%	-3.5%
Energy	0.0%	4.2%	-4.2%
REIT's	0.0%	8.4%	-8.4%
Financials	26.6%	37.8%	-11.2%

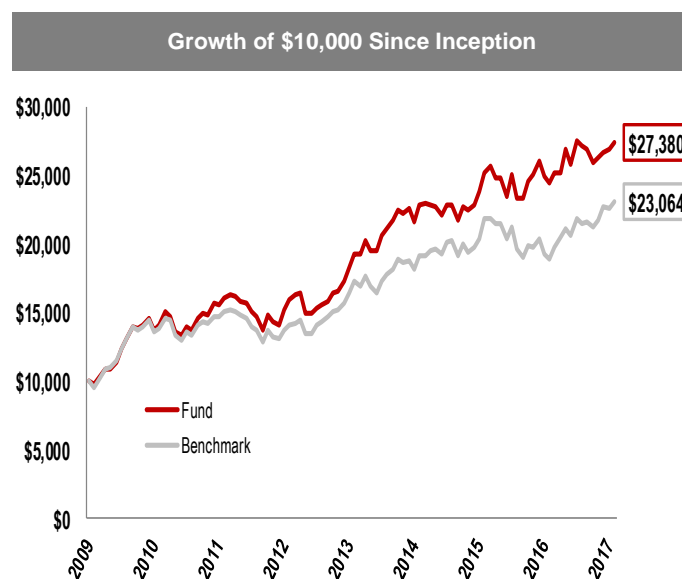
Source: BAEP. \*Benchmark is as for the Fund

### Portfolio characteristics

	Fund	Benchmark*	
Return on Equity	15.0%	11.9%	Premium Quality
Debt/Equity	15.5%	25.1%	
Sales Growth	5.4%	3.6%	Superior Growth
EPS Growth	10.1%	10.0%	
Price/Earnings	17.6x	15.9x	Reasonable Valuation
Dividend Yield	3.5%	4.6%	
Beta	0.99	1	
Active Share	67%	na	Genuinely Active
No. of Stocks	25	299	

Source: BAEP. \*Benchmark is as for the Fund.

### Long-term performance



Source: BAEP



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#### Performance review

The stock market had a reasonably strong month in February. In part, this reflected a modestly positive earnings season (see our overview below). The Fund itself trailed the market slightly, posting a reasonable return of 1.58% for the month. More importantly however, the Fund continues to outperform over the long term, delivering strong absolute returns for clients.

Reporting season was generally kind to the Fund's holdings. There were a number of solid results, such as CSL and Breville Group that beat expectations, and which were well received by the market. There were no majorly disappointing financial results reported, perhaps with the exception of Dominos.

Shares of Domino's Pizza Enterprises in fact fell quite significantly, and they were by far the largest detractor to the Fund's performance. The company actually reported a solid result in which earnings grew 31% on the prior December half. This included amazingly strong same-store-sales growth in Australia and New Zealand of 17.4%. The company also upgraded guidance for the full year, up from 30% earnings growth to 32.5%. The company has been quite consistently conservative in its guidance, and perhaps the market has caught up to this fact and thought they could have done more. In that respect, the results were arguably a little light. More important, however, was the market's focus on the media story in relation to franchisees' underpayment of staff in Australia. For what it's worth, the company addressed the facts in relation to the issue together with its half-year financial results. They showed only a small number of recalcitrant operators, especially in comparison to other similarly sized and structured franchise networks. Domino's, as the franchisor, has shown that it deals with infractions in a serious manner, including terminating franchisees where necessary. These issues are an inherent part of operating a franchise network and full compliance is hard to achieve. Meanwhile, investors have taken their focus largely off the long-term growth prospects in front of the company, particularly in Europe. In our view, the shares represent an attractive opportunity for long-term investors.

Aristocrat, one of the Fund's largest positions, was the largest contributor to the Fund's performance over the month. It held its AGM in February (it did not report financial results, as it has a 30 September year-end). At the AGM, it disclosed a strong first four months of its financial year, and as a result, it is guiding to very strong earnings growth of 20%-30% for the full year.

The Fund's positions in BHP and Rio Tinto detracted from its performance. Both companies reported very strong results. Yet, despite continued gains over the month in commodity prices, the stocks both lagged

the market. On the other side, Telstra and Brambles were two mega caps that helped the Fund's relative performance against the benchmark. Both stocks were sold down off the back of weak financial results.

#### Earnings season takeaways

February's half-year earnings season refocused the market from a Trump-obsessed macro world to what's happening on the ground in Australian corporate land.

In aggregate, the market is seeing very strong earnings growth, with expectations of 18% growth this financial year. Admittedly, this largely owes itself to the recovery in resource earnings, albeit there are a few pockets of growth elsewhere. Looking more broadly across the market however, the sluggish conditions of past years remain, particularly in the domestic economy. Corporates now seem to have accepted this reality and are well trained to deal with it. There are even signs of optimism with, for example, less hesitancy in guidance and outlook statements. Overall, the reporting season was modestly positive and slightly better than expectations.

There was of course the usual mix of good, bad and indifferent. Interestingly, these came from all corners of the market. Much has been made of the market's dramatic rotation over the last year - from defensives, growth, yield and small/mid-caps, to cyclicals, value and large caps. Over reporting season, each camp had their share of winners (CSL, Transurban, Bluescope Steel, Seven Group and Carsales.com) and losers (Telstra, Brambles, James Hardie and iSentia). Following its rotation, the market now looks evenly balanced in terms of the opportunity set, such that stock specifics will take on renewed importance, especially compared to macro narratives and style factors that dominated in the back-half of last year.

Resource results were always going to be a highlight, with very strong earnings growth predicated on years of cost-cutting, a low starting base and strength in commodity prices. Miners, however, still remain wary and are refraining from unnecessary capex. The current game plan is illustrated by BHP, which paid down US\$4 billion of debt over the half year and raised its interim dividend from 16 US cents to 40 US cents. There is a sense that the miners have it as good as it gets and the consensus is that commodity prices will fall. Perhaps reflecting as much, and despite higher commodity prices, the sector was the worst performer in February. Cash is starting to burn a hole in miners' pockets. Indeed, Rio Tinto announced with its results a US\$500 million share buy-back, of course at the higher prices that normally come when miners are flush with cash. Continued commodity price strength and the natural depletion of mines may encourage grander plans in time, but right now, the miners remain disciplined.



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Outside of resources, there are select pockets of growth within housing, tourism, healthcare and exporters. The Australian economy coped well with the end of the commodities boom as it transitioned away to these sectors. To take one example, housing construction is now at record levels, and this is clearly benefiting the likes of Bunnings (Wesfarmers), Harvey Norman, Lend Lease and Boral, which posted strong numbers this reporting season. The industry is a big economic driver and employer, and as a housing boom inevitably runs its course, the question becomes what next? The contractors, on the other hand, have suffered with the end of the commodities boom, particularly as mining and LNG-related project work dried up. What was encouraging this reporting season was the strength of contractors like Downer and CIMIC (the old Leightons) based on work in the infrastructure space, with a number of big projects now starting up. Perhaps infrastructure is the answer to what's next?

More broadly, things continue to look reasonably sluggish. Ex-resources, revenues are growing on average at about 2%, and earnings not much more. Things are worse in more mature, competitive industries. Thus, we saw earnings pressure at Telstra, most notably in its former-star mobiles division, as well as at Woolworths, Coles and a number of retailers (ironically, the very strong results of Bunnings and JB Hi-Fi partly reflect the failure and exit of Masters and Dick Smiths, respectively). Corporates are managing the sluggish environment with a continued focus on limiting costs and investment. Their conservative disposition generally remains, though some are starting to feel more confident. In the main, they are still unwilling to risk short-term profitability or the cash flows that support shareholders' beloved dividends. Positive dividend surprises from the likes of Transurban and AGL were very well received, and justify corporates' continued focus on them. Corporates are also building up cash and paying down debt, both of which now sit at remarkably conservative levels. And with little else to do with their cash, AMP, Coca-Cola Amatil, Sirtex and QBE announced share buy-backs that surprised. Two circular problems follow: first, you need to invest to grow; and second, someone's costs and capex are another's revenues or wages.

For most corporates, performance will depend in this sluggish environment on how they go on the cost front. Commonwealth Bank successfully held back cost growth below weak revenue growth, and this underpinned a well-received result, albeit earnings only grew 2%. CBA actually increased its interim dividend by 1 cent, which whilst not much, says something of the confidence within its boardroom and the sustainability of bank dividends more generally. Indeed, an increasing number of corporates are feeling more optimistic, or at least less cautious.

Some of them are even looking to growth and thinking about investing to do so. If confidence builds into action, this may get our broader economy out of second gear.

### Outlook

The market currently trades on a very reasonable PE multiple of just under 16x the next 12 months earnings. This equates to an earnings yield of 6.3%, which compares very favourably to the starting yields on other assets. While a lot has been made of the lift in interest rates, they remain at very low levels. The 10-year Government Bond for example yields approximately 2.8%, with no growth. In this context, there is a reasonable case to be made for the continued strength in equities. However, we believe that it will continue to pay to be selective.

As always, we remain focused on the company fundamentals, with an eye on value, but only in the context of what one receives in return in terms of the quality of the company and the earnings growth we perceive. Particularly in an environment of macro and political uncertainty, we believe it prudent to focus on these attributes.



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### About BAEP

Bennelong Australian Equity Partners (BAEP) is a boutique fund manager focused on Australian equities. It was founded in 2008 in partnership with Bennelong Funds Management. BAEP is a genuinely active fund manager with a consistent and disciplined investment approach.

BAEP's investment philosophy is to selectively invest:

- in high quality companies;
- with strong growth outlooks; and
- underestimated earnings momentum and prospects.

BAEP's investment process is research-intensive with a focus on proprietary field research and is supported by economic and quantitative insights.

### About the Fund

The Bennelong Australian Equities Fund typically holds 25-60 stocks across the entire spectrum of the Australian share market. It primarily holds stocks from the S&P/ASX300 Index, although it is not limited to holding stocks in this index.

### Benefits of the Fund

- BAEP is an award winning and highly rated equities fund manager with an experienced and performance-orientated team.
- BAEP is a genuinely active and high conviction fund manager, meaning potentially significant deviation from the benchmark and with prudently concentrated portfolios.
- The Fund has a track record of adding value by outperforming the market over the long term.
- The Fund is managed in accordance with BAEP's robust, disciplined and proven investment philosophy and process.

### The Fund at a glance

Feature	Fund facts
APIR code	BFL0001AU
Benchmark	S&P/ASX 300 Accumulation Index
Investment objective	2% p.a. above benchmark measured over rolling 3-year periods
Investment manager	Bennelong Australian Equity Partners (BAEP)
Active stock limit	± 6%
Cash limit	0-10%
Inception date	30 January 2009
Recommended investment period	Medium to longer term (five years plus)
Buy/sell spread	+/-0.25%
Entry/exit fees	Nil
Management Fee	0.95% p.a. of Net Asset Value of the Fund

### How to invest

The Fund is open to investors directly via the PDS, available on our website, or via a range of platforms.

#### Platforms

AMP (Elements Investment, Elements Pension, eWrap Investment Arc, eWrap Pension, iAccess, Investment Service, MyNorth, North, Pension Service, Summit, Super Service, Term Pension, Wealthview eWrap)

ANZ grow

BT Wrap

CFS (First Wrap)

Hub24, IOOF AET

Macquarie Wrap IDPS, Wealthtrac

Netwealth (Super Service, Wrap Service)

### Contact details

For more information, call 1800 895 388 (AU) or 0800 442 304 (NZ) or visit [baep.com.au](http://baep.com.au)

The Fund is managed by Bennelong Australian Equity Partners, a Bennelong Funds Management boutique.

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