BT Wholesale Core Australian Share Fund

ARSN: 089 935 964

About the Fund

The BT Wholesale Core Australian Share Fund (Fund) is an actively managed portfolio of Australian shares.

Fund objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 300 Accumulation Index. The suggested investment timeframe is five years or more.

Investment process

BTIM's investment process for Australian shares is based on our core investment style and aims to add value through active stock selection and fundamental company research. BTIM's core investment style is to select stocks based on our assessment of their long term worth and ability to outperform the market, without being restricted by a growth or value bias.

Our fundamental company research focuses on four key factors: valuation, financial risk, franchise and management quality.

Derivatives may be used to reduce risk and can act as a hedge against adverse movements in a particular market and/or in the underlying assets. Derivatives can also be used to gain exposure to assets and markets.

Investment team

BTIM's twenty-six member Equity Strategies team is one of the largest in the Australian fund's management industry. The portfolio manager for the Fund is Crispin Murray, who has more than 26 years' industry experience. Crispin is also Head of Equity Strategies.

Investment guidelines

Ex-ante (forward looking) tracking error	2.0% - 6.0%
Min/max stock position	+/-4%
Min/max sector position	+/-8%

Other information

Fund size (as at 31 Jul 2017)	$411 million
Date of inception	September 1992
Minimum investment	$25,000
Buy-sell spread[1]	0.50% (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	RFA0818AU

[1] The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

Management costs[2]

Issuer fee[3]	0.79% pa

[2] You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged.

[3] This is the fee for managing the assets of the Fund and overseeing the operations of the Fund. The Issuer fee is paid from the assets of the Fund and is reflected in the unit price of your investment.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	0.59	0.65	0.01
3 months	0.04	0.24	-2.51
FYTD	0.59	0.65	0.01
6 months	5.91	6.33	3.89
1 year (pa)	10.91	11.79	7.03
2 years (pa)	3.81	4.63	4.92
3 years (pa)	6.00	6.84	5.12
5 years (pa)	11.77	12.66	10.71

Asset allocation (as at 31 July 2017)

Energy	4.7%
Materials	22.1%
Industrials	6.6%
Consumer Discretionary	8.3%
Consumer Staples	4.8%
Health Care	7.2%
Information Technology	0.5%
Telecommunication Services	3.7%
Financials ex Property Trusts	34.7%
Property Trusts	4.9%
Cash & other	2.5%

Top 10 holdings (as at 31 July 2017)

ANZ Banking Group Limited	9.1%
BHP Billiton Limited	8.3%
Commonwealth Bank of Australia Ltd	7.5%
Westpac Banking Corporation	6.6%
Qantas Airways Limited	4.2%
CSL Limited	4.0%
National Australia Bank Limited	3.6%
Telstra Corporation Limited	3.6%
Amcor Limited	3.6%
Rio Tinto Limited	3.3%

Market review

July was seen to be another volatile month for the domestic share market: the S&P/ASX 300 Accumulation index was hovering around 1% towards the end of the month before a broad sell-off that was attributable to both a surging Australian Dollar during the month, as well as some profit-taking prior to the August reporting season sent the benchmark into the red. Some recovery was evident from the last trading session which saw the index finish the period flat.

Turning to sector specifics, the majority (7/11) of the sectors posted negative returns that were largely offset by good performance from both **Financials (+1.2%)** and **Materials (+3.5%)**. Within the former, the latest capital announcement from the APRA helped bolster investment sentiment in banks: the bank regulator stipulated a CET1 capital ratio of at least 10.5% for the "Big Four" in order to meet the "unquestionably strong" capital benchmark, which was much less onerous than the majority of the market had contemplated. The new threshold is now expected to be achieved organically by the major banks, without the need of raising additional equity capitals. This cleared up one source of uncertainty that foreign investors had been particularly wary of. All the "Big Four" finished up the month positively, from **+1.1% (CBA)** to **+4.3% (WBC)**. Further rebound of iron ore price occurred in July on the other hand helped buoyed the major minors and as a result benefited the Materials sector. The spot price of the commodity soared almost 20% on the back of strong Chinese GDP data. This saw the likes of **BHP Billiton (BHP, +11%), Rio Tinto (RIO, +4%)** as well as **Fortescue (FMG, +10%)** all finish the month meaningfully higher.

On the other side of the spectrum, **Health Care (-7.5%)** gave back all the gains from the previous month and finished the month in the red, being the largest detractor from the index's performance. The retreat of sector heavyweight **CSL (CSL, -8.7%)** was the main driver of poor performance from the sector - profit-taking from CSL, one of the strongest YTD stocks started to unfold during the month; whilst a surging Australian dollar over July also weighed on CSL as a foreign revenue earner. A similar pull-back was also evident in CSL's peers, including **Cochlear (COH, - 8.1%), Ramsay Health Care (RHC, -4.1%) and Sonic Healthcare (SHL, -8.0%)**. Outside Health Care, another key performance detracting sector was **Telecoms (-4.2%)**, as sell-offs continued at sector heavyweight **Telstra (TLS, -4.7%)**, due to concerns over weakened prospect of future earnings growth, and an increased risk of a dividend cut as a result of the former.

Finally on global macro developments, there were few changes in rhetoric from the world's central bankers. In the US, the Federal Reserve left rates on hold as widely expected. The FOMC's Statement indicated that it would begin normalising the bank's balance sheet "relatively soon". Later, testimony from Chairwoman Yellen suggested rate hikes would continue in coming years, but at a gradual pace. In turn, this left the USD to sag. Meanwhile earnings season helped lift share markets, particularly the tech sector. Additional support for risk assets stemmed from reasonable economic data including healthy jobs figures, as well as ISM Manufacturing and Consumer Confidence surveys. Outside the US, the ECB also left rates on hold and did not reveal any concrete plans to alter its asset purchase programme. The Board's communication did however indicate more bullish growth expectations, while acknowledging weaker inflation. Finally, strong Chinese GDP data and leading indicators restored faith in the Asian economic growth engine.

Fund performance

The Fund delivered decent outperformance in July, maintaining the strong momentum of the previous twelve months. Some of the best performing stocks of recent months – such as Qantas and Aristocrat Leisure – took a break amid profit-taking and dragged on relative performance. However this was more than offset by strength in resource stocks such as BHP and Rio Tinto as commodity prices bounced off their June lows, as China maintained its commitment to capacity reduction in several key over-supplied sectors. There was a recovery too in some of the retailers as data suggested some improvement in consumer spending following a soft patch and our position in JB Hi-Fi made a strong contribution to relative performance.

Contributors

BHP Billiton (overweight, +11.0%)

BHP Billiton (BHP, +11%) had a strong run over the month of July due to rebounds in both iron ore and oil price globally. The miner also reported 4QFY17 production results during the month, which saw the majority of its production lines meet guidance and market expectation, including iron-ore, petroleum, as well as coking coal. In particular, coking coal production hit the middle of guidance despite that Cyclone Debbie affected its Queensland Coal production. Some minor misses were present on copper and thermal coal, former of which was largely attributable to the strikes that occurred at BHP's Escondida mine in Chile earlier in the year. We believe outlook for the diversified miner remains positive for the time being – with its recent appointment of the new Chairman Ken McKenzie alongside greater shareholder scrutiny, better capital allocations to the miner is expected to be seen.

Metcash (overweight, +11.2%)

Metcash (MTS) maintained its strong momentum from June into July, and finished the month 11.2% higher. The wholesaler and hardware operator announced the appointment of former Tesco executive, Jeff Adams as CEO to succeed the retiring CEO Ian Morrice. Mr. Adams is equipped with 20 years of retail experience from various areas he managed at Tesco, and is expected to continue to lead Metcash on repositioning the business. MTS reported FY 17 results last month and reinstated dividends following the strong reporting – despite its recent rally over the past six months (+26.5%), it has not come to pass and we retain our conviction in the company's ability to continue surprising the market's muted expectations around earnings growth going forwards.

Detractors

Qantas (overweight, -7.0%)

The market took a respite from its recent buying frenzy of the national airliner, and some profit-taking over the month saw share price of Qantas (QAN) pull back by 7% in July. The stock has returned 75% over the past 12 months, and was one of the best performing stocks over the period. Despite the rally and this recent pull back which now see Qantas trading around $5.3, we retain our conviction in the company and it remains our largest active position within the portfolio. Self-help has been evident at Qantas where the underlying business continues to reduce costs/capacity against an improved industry backdrop. Strong cash flow alongside great capital discipline also implies significant future return to Qantas' shareholders. On the valuation side, the airliner remains attractive compared to its global peers on the EV/EBITDAR metric, with a strong capital return embedded.

Amcor (overweight, -5.4%)

Amcor (AMC) gave up most of the gains from the previous month, and finished the month 5.4% lower. A surging Australian dollar in July weighed on some of the foreign revenue earners, including the packaging company which derives the majority of its revenue from the U.S. The market has sold the stock off due to the AUD strength and traditional pre-result weakness, possibly exacerbated by weak tobacco and Latin American lines. However, given that the market has now factored in the AUD strength without factoring in the offsetting strength in non-USD currencies (~65% of PAT), we see potential valuation upside for the business. The company is also likely to recommence larger M&A soon which will in turn drive upgrades. Overall, we retain our conviction in it for now.

Outlook

We maintain a positive outlook for resources, underpinned by Chinese structural supply side reform. We remain mindful, however, that policy can change quickly and, with little transparency available, we must be ready to adjust this position. We tend to prefer the more liquid names – such as Rio and BHP – partly for this reason, although we also think that the combination of management change and increased shareholder activism at BHP could also result in improved capital allocation outcomes.

We have also been reducing our previous underweight in the banking sector. The outcome of APRA's review of capital provisions has proved largely benign; their 10.5% Core Tier 1 capital requirement negates any need for additional equity raising, removes pressure to cut dividends and, in ANZ's case at least, opening the door to capital return to the shareholder. While the sector remains challenged – not least politically - this removes a key overhang and could, in combination with signs of improvement in margins, open the door to a re-rating from reasonably low relative valuations.

We retain our belief that equities can continue to grind out low returns. The S&P/ASX 300 is above is historical average price/earnings – although no egregiously so given the low interest rate environment – and valuations continue to be supported by decent market liquidity. Nevertheless, it is hard to see what drives valuations any higher from here, given the muted outlook for domestic economic growth, while any withdrawal of liquidity does pose some downside risk.

This leaves earnings growth to drive markets. August's earnings season will be instructive in this regard, however the consensus expectation is that corporate Australia can deliver mid to low single digit growth, underpinning our expectation for equity markets.

This is a challenging environment in many regards, yet nevertheless it is one which rewards engagement and an active approach. There is a greater level of dispersion across and within industries than has been the case in previous years and the ability to invest in those companies which are responding well to disruptive threats, or which are demonstrating free cash flow and the ability to deploy capital at good returns – and to avoid those which are not – is crucial in delivering gains above the low return which we expect from the market.