Investment Management

Fact sheet

Equity Strategies

December 2017

BT Wholesale MidCap Fund

ARSN: 130 466 581

About the Fund

The BT Wholesale MidCap Fund (**Fund**) is an actively managed portfolio of approximately 40 – 60 stocks in the MidCap universe. Investors benefit from the stock selection experience of the BTIM Australian Equities team, gaining access to a diversified portfolio of BTIM's best stock ideas in this part of the market capitalisation spectrum.

The MidCap universe generally comprises companies ranked between 51 and 150 of the S&P/ASX 200 Index. The Fund may also invest in equivalent companies listed on the New Zealand Stock Exchange.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the BT MidCap Custom Index over the medium to long term. The suggested investment timeframe is five years or more.

Investment Strategy

BTIM is an active manager of MidCaps employing a bottom-up valuation process. The investment strategy follows the same investment philosophy and process as applied throughout the stable of BTIM Australian equities funds. This allows us to capitalise on our strengths and investment style.

Fund Positioning

The Fund is designed to complement a conventional, core share portfolio by providing satellite exposure to select Australian MidCap equities with the potential for performance enhancement.

Investment Team

BTIM's Equities Strategies boutique is headed up by Crispin Murray who has extensive experience and a strong record in equities research. Andrew Waddington is the portfolio manager for the Fund.

A combination of the Australian equities large cap and small cap teams' research is used to construct the BT Wholesale MidCap Fund.

Investment Guidelines

Investable universe	ASX and NZX listed and soon to be listed companies, generally with a market capitalisation of A$0.5 billion to A$5 billion; derivatives; cash
Investment ranges	Australian shares 80 - 100% New Zealand shares 0 - 10% Cash 0 - 20%
Ex-ante tracking error	3 – 8%
Number of stocks	Typically 40 – 60
Absolute stock position	15%
Maximum active stock position	+/- 5%[1]
Maximum active sector position relative to index	+/- 10%[1]

[1] compared to benchmark.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	3.27	3.48	2.79
3 months	12.20	12.36	12.60
6 months	16.07	16.78	13.74
1 year (pa)	24.79	26.12	22.33
3 years (pa)	16.82	18.11	16.22
5 years (pa)	16.59	18.29	14.25
7 years (pa)	12.17	13.98	9.02
Since Inception (pa)	11.10	13.35	6.20

Sector Allocation (as at 31 December 2017)

Energy	3.0%
Materials	28.8%
Industrials	10.3%
Consumer Discretionary	16.5%
Consumer Staples	7.6%
Health Care	5.2%
Information Technology	4.7%
Financials ex Property Trusts	10.3%
Property Trusts	2.6%
Cash & other	11.0%

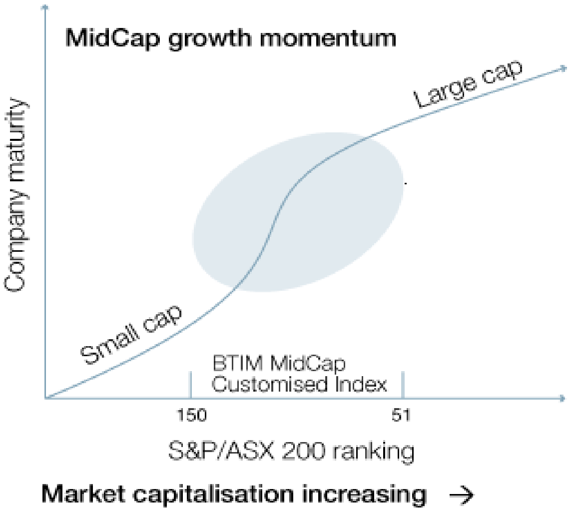
Top 10 Holdings (as at 31 December 2017)

Resmed Inc	5.2%
Metcash Trading Limited	4.7%
JB Hi-Fi Limited	4.1%
Bluescope Steel Limited	4.0%
Boral Limited	4.0%
Mineral Resources Limited	3.5%
Iluka Resources Limited	3.3%
CYBG PLC	3.0%
Orora Limited	2.7%
Bendigo & Adelaide Bank Limited	2.6%

The MidCap Opportunity

MidCap companies have assessed valuations which, over rolling investment cycles, have the potential to reap the benefits of capital expenditure, business expansion and acquisition based strategies.

Compared with small cap stocks, MidCaps generally have stronger balance sheets, deeper capital reserves and an attractive growth trajectory, as illustrated in the diagram below. Compared to large caps, MidCap stocks tend to be under-researched and under-owned.



Source: BTIM

Other Information

Fund size (as at 31 Dec 2017)	$444 million
Date of inception	June 2008
Minimum investment	$25,000
Buy-sell spread[2]	0.50% (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	BTA0313AU

[2] 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[3]

Issuer fee[4]	0.90% p.a.
Performance fee[5]	20% x the Fund's performance (before fees) in excess of the performance hurdle

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

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

[5] The Fund's performance fee is 20% of the Fund's performance in excess of the performance hurdle. The performance hurdle is the performance of the benchmark (BT MidCap Custom Index) plus the issuer fee of 0.90% pa. If a performance fee is payable, it is charged in addition to the issuer fee. The fee is calculated each Business Day based on the investment performance and value of the Fund on that day. If we are entitled to a performance fee, it is paid to us as at 30 June each year.

Risks

An investment in the Fund involves risk, including:

- **Market risk**: The risk that factors affecting one or more countries that can influence the direction and volatility of an overall market, as opposed to security-specific risks.
- **Security specific risk**: The risks associated with an individual security.

Please read the Fund's Product Disclosure Statement (**PDS**) for a detailed explanation of each of these risks.

Market review

It was another good month for the S&P/ASX 51-150 Accumulation index, which gained 2.8% in December. Sector performance was relatively strong across the board, with the majority of the sectors finishing the month in the black. The exceptions are Health Care (-0.5%), Real Estate (-2.3%) and Utilities (-2.3%). On the other side of the spectrum, Energy (+7.7%), Materials (+7.1%) and Consumer Staple (+4.4%) recorded the largest gains.

Within the index heavyweight Materials, steel manufacturer Bluescope (BSL) was the standout. The company got sold off in August when management reported underwhelming FY17 results, alongside a weak guidance for 1HFY18. The guidance was upgraded in December, as a result of higher steel prices and domestic volumes. The company will also benefit from the latest US tax reform as a partial US dollar earner. In conjunction, this saw BSL's share price advance by 12.9% over December. Also performing strongly was diversified miner, Independence Group (IGO, +13.3%). The rising copper price (+8%) over the month clearly lifted investor sentiment for IGO. In addition, it also announced the completion of the Stockman Project Divestment – the deal was first announced in June this year, which would see IGO receive a total proceed of A$47.2 m, comprising cash payments in majority, and the rest being net smelter return royalty. Last but not least, NZ building material manufacturer, Fletcher Building (FBU, +11.3%) rebounded in December, following consecutive selling sessions from the previous months. As a recap, FBU downgraded the earnings guidance on its Building and Interiors (B+I) business for the fourth time in October, which saw its shares sold off. The company finished the quarter in the red nevertheless.

Turning to Consumer Staple, performance was all positive except for dairy producer, A2 Milk (A2M, -2.9%). The company has run very hard this year, a 261% gain for CY2017, on the back on continuous earnings guidance upgrade following the booming demand from China for its infant formulas. The euphoria took a respite in December, possibly due to some profit taking which weighed on A2M. In contrast, grocery/hardware wholesaler Metcash (MTS, +13.5%) rallied in December. Metcash reported its 1H18 results early in the month, which saw EPS over the period increase by 14.8% compared to 1H17, as the benefits of the latest HTH acquisition started to flow in. The Food & Grocery business also performed better than expected on the back of continuous cost-out from the Working Smarter program, in spite of the negative ex-tobacco sales growth over 1H17. As the business continues to improve with better balance sheet and successful cost-out, buying support was evident across the year and MTS ended the year 42% higher.

On the other side of the spectrum, Iron Mountain (INM, -8.3%) was the largest detractor within Real Estates. The storage and information management solutions provider announced its acquisition of the U.S. operations of IO Data Centres, a leading colocation data centre services provider for $US 1.3b. The deal will be funded via additional equity raising as well as a new senior unsecured debt.

Finally on macro developments, the Federal Reserve finished its December hike, which had been well-broadcast leading up to the meeting. Investor sentiment more broadly was supported by the passing of much-anticipated US tax reform. Strong US data like ISM manufacturing, retail sales and GDP growth also helped support risk appetite. Economic releases were also solid in Europe and dovish messaging from the ECB was perceived positively. Meanwhile, in Asia Xi Jinping consolidated his power at the 19th Communist party assembly and emphasised quality over quantity for future growth. Data released during the period revealed the Asian giant grew at a healthy 6.8% over the year. Reasonable leading indicators and import figures were also encouraging. Elsewhere, pockets of geopolitical risks like Catalonia's push for independence, Merkel's coalition losing its majority and North Korean missile tests had little impact on markets.

Fund performance

The Fund enjoyed a strong December to cap a year of good absolute gains and outperformance of the Fund's benchmark index. Key non-consensus positions in Metcash and JB Hi-Fi made a good contribution for the month, while further gains in resource prices also played a role via our positions in Mineral Resources (lithium/iron ore), Whitehaven Coal, Iluka Resources (zircon/titanium), and Regis Resources (gold). Profit taking in health care company ResMed dragged on performance, although the stock remains a strong contributor to the Fund's outperformance over 2017.

Contributors

Metcash, overweight, +13.5%

Metcash (MTS, +13.5%) reported its 1H18 results early in the month, which saw EPS over the period increase by 14.8% compared to 1H17, as the benefits of the latest hardware HTH acquisition started to flow in. The Food & Grocery business also performed better than expected on the back of continuous cost-out from the Working Smarter program, in spite of the negative ex-tobacco sales growth over 1H17. Metcash remains one of our highest conviction stocks: from its half-yearly results, cash flow was evidently strong, whilst the release of inventory from the hardware acquisition demonstrates improved business efficiency. Debts were also brought down meaningfully, reflecting a business with much lower risks when compared to just a few years ago. The fact that the stock is still trading at 13-14x means that the market is yet to fully appreciate the quality of Metcash. With Aldi now approaching the end of its rollout in WA and SA, and the weak WA economy stabilising, MTS's negative ex-tobacco sales growth is expected to improve from here. That said, we are cognisant that the supermarket industry remains highly competitive.

Cochlear, not held, -5.3%

Hearing implant manufacturer, Cochlear (COH, -5.3%) retreated somewhat over the month of December. Whilst it was rather muted on the news front for COH, the market darling has run hard over the year, as its strong growth prospect garnered investor attentions. The stock rallied 42.4% for CY2017, and was trading at a hefty ~40x FY1 PE multiple, even after the December pullback. At this level of stock valuation, any disappointments in the company's headline growth could see the stock de-rate rather abruptly and swiftly. We continue to avoid holding COH as such.

Detractors

Qantas Airways, overweight, -11.1%

National airliner Qantas (QAN) extended its losses in December, finishing the month 11.1% lower amid surging global oil price. As previously communicated, we remain mindful that if oil prices remain elevated for a sustained period, it can begin to feed through into increased costs and remove some of the expected upside from here. However, we are not currently at that point and QAN's hedging immunises it against a significant surge in fuel costs in the near term. We believe the recent underperformance was no more than short-term noise, and Qantas remains a key position in our portfolio.

Resmed, overweight, -2.1%

Respiratory expert/mask manufacturer, Resmed (RMD, -2.1%) gave back some of the previous gains in December. The stock had run strongly during October/November after the company released its Q1 FY18 earnings, where revenue was 4% ahead of consensus as masks sales rose by 14%; and gross margin was 53 basis points higher than the previous corresponding period due to greater procurement efficiencies, better product mix (masks have higher margins) as well as some tailwinds from currency movement. We believe the December pullback is largely attributed to some profit taking, rather than anything related to the business fundamentals.

Outlook

Looking into 2018, we believe stock selection remains the crucial factor in midcap investing. The tide of liquidity which has supported the sector as a whole over previous years is no longer a supportive factor. Central banks around the world are generally tightening policy setting via higher rates, reduced QE, shrinking balance sheets, or some combination of these. While the pace is slow and, at this point, does not appear to present an imminent threat to the market's valuation rating, it does pose a risk to those midcap stocks which have been pushed to high valuation ratings. In the absence of liquidity support, even a slight disappointment of earnings can see a stock plummet, as we have seen several times in the last year as previous market darlings in tech, telecom, and healthcare have found themselves under pressure. As a result, it is just as important to avoid these pit traps as it is identifying the winners in the midcap space.

China remains crucial to equity market fundamentals and sentiment and also, more specifically, for the health of Australia's resource sector. The economic outlook remains stable at this point, with GDP growth expected to continue on its multi-year path of moderate deceleration. The government remains focused on corporate profitability to help address the country's debt problem and relieve stress on the financial system. The supply-side discipline this entails should continue to support commodity producers. Mining stocks make up around 11% of the midcap universe (including gold miners) and we have a mild overweight here.

The most recent Australian reporting season saw a modest tick up in business capex which, in combination with population growth and a bulging pipeline of infrastructure projects, should continue to support modest economic growth. This benign environment should continue to underpin corporate earnings. We also hold companies like Boral and Adelaide Brighton, which should be direct beneficiaries of the increase in infrastructure spending.

Perhaps the most significant market factor is the scale and pace of disruption facing a broad swathe of local industries. Whether it is driven by new technology, global competition, or greater political or regulatory intervention, the challenges to incumbent business models and industry structures provides both threats and opportunities for investors. The ability to differentiate between companies within an industry, in terms of their ability to respond to disruption, has been a key driver of our outperformance over the last few years.