



Defensive global shares strategy

Investment update to 30 June 2019

Our defensive global shares strategy's role in MLC's multi-asset portfolios is both to increase the range of approaches we use for investing in global shares, and to help preserve investors' capital in adverse markets while maintaining the potential to generate returns. We also expect that due to our focus on preserving capital, the strategy will produce a different pattern of returns to a shares-only strategy, but will be more resilient in difficult share market conditions. Overall, the defensive global shares should contribute to a smoother pattern of returns for investors in these portfolios.

The defensive global shares strategy in MLC's Inflation Plus Conservative and Moderate portfolios is currently managed by International Value Advisers LLC (IVA). In addition to IVA, Walter Scott manages approximately 10% of the defensive global shares strategy in the MLC Inflation Plus Assertive Portfolio. This update focuses on IVA, the strategy's principal manager.

MLC Inflation Plus portfolios' allocations to the defensive global shares strategy are shown in Table 1. MLC Horizon portfolios have an indirect allocation through their investment in the MLC Inflation Plus strategies.

Table 1: MLC Inflation Plus portfolios' target allocation to defensive global shares as at 30 June 2019

MLC MasterKey Super & Pension Fundamentals	Defensive global shares %	MLC Wholesale	Defensive global shares %
MLC Inflation Plus Assertive Portfolio	37.5	MLC Wholesale Inflation Plus Assertive Portfolio	44.0
MLC Inflation Plus Moderate Portfolio	19.0	MLC Wholesale Inflation Plus Moderate Portfolio	21.0
MLC Inflation Plus Conservative Portfolio	10.0	MLC Wholesale Inflation Plus Conservative Portfolio	11.0

Source: NAB Asset Management Services Limited. Based on the portfolios' target allocations.

An explanation of how fees are deducted from returns is in Appendix 1.

Investment objectives

The strategy has two objectives:

- to preserve investors' capital in the short term (12 to 18 months), and
- to provide returns over three to five years that are similar to those from the global share market, but less volatile.

To achieve these objectives, IVA invests wherever in the world it sees the best opportunities. Its investments aren't limited to global shares but can include bonds, cash and gold. It looks for high quality companies that it believes are trading significantly below their true 'intrinsic' value.

About the manager

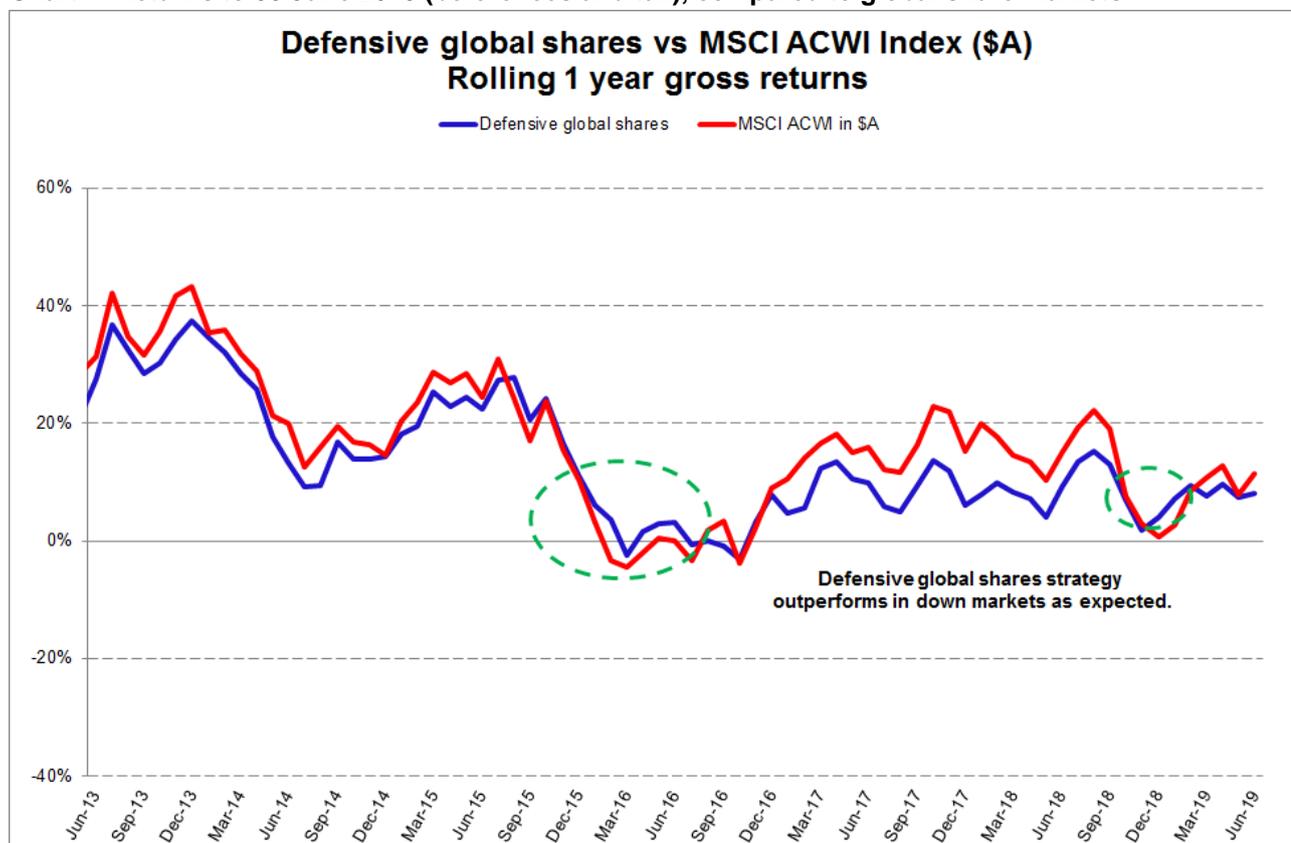
New York-based IVA was established in 2007. It has managed the defensive global shares strategy for MLC since 2012.

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Performance

Chart 1: Returns to 30 June 2019 (before fees and tax), compared to global share markets



Source: NAB Asset Management Services Limited. Defensive global shares strategy returns are before deducting fees and tax. Returns are for the defensive global shares strategy in MLC Inflation Plus Conservative and Moderate portfolios. Past performance is not a reliable indicator of future performance.

Chart 1 demonstrates the success of defensive global shares in smoothing the pattern of returns from global share markets. While the strategy tends to underperform when share markets are strong, as in recent years, it has generally outperformed in most weak markets. It's worth highlighting that during the December quarter the strategy outperformed global share markets. This outperformance is reflected in the above rolling 1 year return graph and highlighted with the second green circle. This solid performance from the strategy was expected given the market volatility and decline of share markets experienced during the quarter. It is in these weak and adverse markets that the strategy's defensive nature helps to preserve investors' capital.

Table 2: Returns to 30 June 2019 (before fees and tax)

	3 mths %	1 year %	2 years % pa	3 years % pa	5 years % pa	7 years % pa
Defensive global shares strategy	3.5	8.2	8.7	9.1	10.4	13.1
MSCI All Country World Index	4.9	11.3	13.2	14.1	13.0	16.4
Excess return	-1.4	-3.1	-4.5	-5.0	-2.6	-3.3

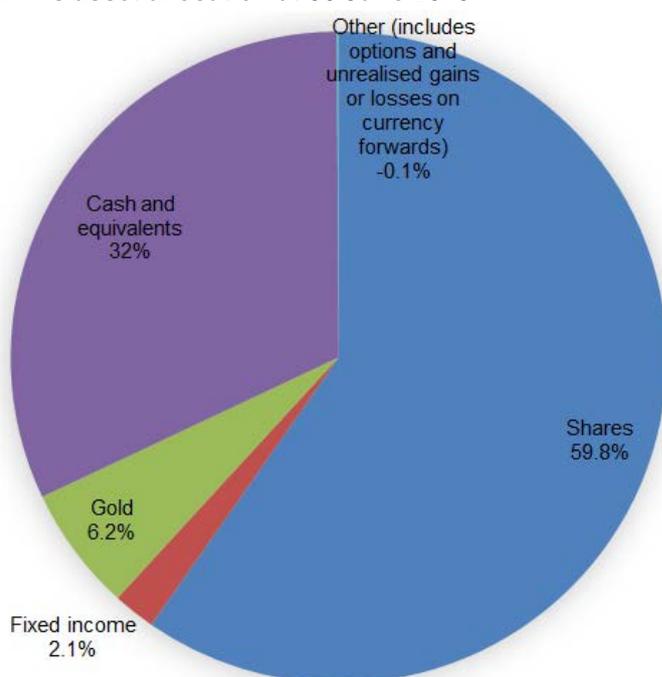
Source: NAB Asset Management Services Limited. Defensive global shares strategy returns are calculated before deducting fees and tax. Returns are for the defensive global shares strategy in MLC Inflation Plus Conservative and Moderate portfolios. Past performance is not a reliable indicator of future performance. The value of an investment may rise or fall with the changes in the market. Figures are rounded to one decimal place.

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Asset allocation

Chart 2: IVA's asset allocation at 30 June 2019



Source: IVA. Figures have been rounded to one decimal place.

Over the quarter, IVA increased its fixed income, gold and cash exposures and decreased its exposures to shares.

Portfolio characteristics and top 10 holdings

Table 3: Portfolio characteristics at 30 June 2019 (US\$)

Number of holdings	84
Median market cap (millions)	\$6,098.7
Weighted average market cap (millions)	\$103,435.1
Dividend yield	2.3%

Source: IVA.

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Table 4: Top 10 holdings at 30 June 2019

	Name	Sector	Country	% of total
1	iShares Gold Trust	Gold	N/A	6.2
2	Berkshire Hathaway, Inc. Class A; Class B	Holding Company	United States	4.1
3	Compagnie Financiere Richemont SA	Consumer Discretionary	Switzerland	2.7
4	Bayerische Motoren Werke AG	Consumer Discretionary	Germany	2.6
5	Bank of America Corp.	Financials	United States	2.6
6	Bureau Veritas SA	Industrials	France	2.5
7	Samsung Electronics Co., Ltd.	Technology	South Korea	2.3
8	Astellas Pharma, Inc.	Health Care	Japan	2.2
9	AIB Group PLC	Financials	Ireland	2.1
10	Nestle SA	Consumer Staples	Switzerland	2.0
			Total	29.3

Source: IVA.

Current portfolio commentary and positioning

Returns are before fees and tax

IVA notes the second quarter was a tale of two market moods. While generally happy in April, in May the market was depressed and volatile, nervous about slowing economic growth and irritated by multi-front trade tensions. Most every asset class saw a significant slide. In June, the mood quickly shifted when the US Federal Reserve (Fed) showed up with the long-promised cavalry. They turned words to action with a rate cut that, again, made markets happy. In concert, the European Central Bank continued its rhetoric, supportive of low rates and additional stimulus if need be. Shares and fixed income all rallied in June reversing the weakness in May and resulting in most asset classes having a good first half of the year.

During the quarter, the strategy's shares results in both April and June were roughly in line with the index performance. In May however, the shares allocation did worse than the index. Underperforming on the downside is not something IVA expects. Quite a few of the strategy's top holdings were weak, especially in May - including Berkshire Hathaway, Bank of America and AIB Group. The good news is that in most cases IVA considers these price drops to be temporary, and are still happy to hold on to them.

The strategy's shares failed to keep up with the benchmark returning 2.7% for the quarter vs 3.6% for the index. Consumer Discretionary names contributed the most to return by sector adding 0.9% led by high end watch and jewellery company Compagnie Financiere Richemont, followed by Industrials adding 0.6%. The strategy's Energy exposure hurt the portfolio by -0.4% with two of its larger holdings Cimarex Energy Co. and Schlumberger NV having a bad quarter. Health Care also detracted from results by -0.2%. Switzerland was the strategy's top performing country adding 0.7%. Despite continuing Brexit worries, the UK contributed 0.5% due to good news on Millennium and Copthorne Hotels. City Developments substantially raised its bid to take the company private, thus more in line with IVA's assessment of the company's value - resulting in the stock price to rise by over 46% during that quarter. The strategy's China exposure hurt performance by -0.4%, as did exposure to Ireland, -0.2% due to a difficult quarter for the AIB Group.

In terms of asset class contribution, gold showed some sparkle contributing 0.5%, as real interest rates remain low and new expectations of the Fed cutting interest rates arose, resulting in the US dollar showing some weakness. The strategy's gold exposure increased slightly to 6.2% through appreciation. The fixed income portion of the portfolio remains small at 2.1% and detracted slightly during the quarter at -0.1%. The strategy's fixed income holdings are primarily high yield energy related names.

Due to a weaker US dollar, the strategy's hedges detracted -0.04% over the quarter. The biggest changes in the currency hedges were in mid-May when it initiated a hedge of 50% vs the British pound to protect the strategy from currency swings as it waits for the transaction on Millennium and Copthorne to finalise. The strategy also increased its hedge vs the Korean won from 40% to 50%. The rest of the hedges remain largely unchanged: Australian dollar 41%, euro 10%, Japanese yen 26%.

The strategy's shares exposure came down from 60.8% at the start of the quarter, to 59.8% at 30 June 2019. This is due to some trimming of top quality names that have reached IVA's assessment of their intrinsic value. Names like Mastercard, Bureau Veritas,



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Airbus, Sodexo, and Nestle have had great performance and the strategy is happy to hold on to some of these positions, but for risk control purposes think it's prudent to keep position sizes in line. As such the cash position inched up to 32.0%, a slight increase from the end of the March quarter.

IVA notes that today's investment landscape certainly does not make it easy to be a value investor! The gap between value and growth reminds the manager more and more of the late 1990's. Of course, history does not repeat itself but often rhymes. As IVA looks over the strategy's holdings they believe there are genuine discounts which should be eventually recognised. IVA continues to believe that caution remains in order, though they acknowledge that the party could certainly go on for an unspecified amount of time. With China remaining as worrisome as ever, valuations continuing to be pushed up, and signs of economic weakness starting to percolate, IVA believes relying on time tested analysis one company at a time still makes the most sense.

Stock story

IVA provided the following observation in their quarterly commentary, which you may find interesting:

"When IVA analyses performance, they are struck by the dichotomy between both value vs growth, and also small vs large stocks. Market momentum is being driven by expectations of low rates and stimulus to continue. This makes value investing especially difficult. IVA is finding more and more valuations being pushed up by low rates. Those securities that appear cheap most likely have warts - either they are heavily cyclical, their space is being disrupted or the business is in bad shape. Thus, IVA remains cautious, patient and ready to pounce when good value presents itself."

Note: As our investment managers are constantly reviewing and making changes to their holdings, these investments may no longer be included in the portfolio.



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Appendix 1: Understanding fees that are deducted from returns in this investment update

As MLC Horizon and Inflation Plus portfolios invest in the defensive global shares strategy and a range of other asset classes and strategies, only some of the fees disclosed in the Product Disclosure Statements (PDSs) relate directly to the management of the defensive global shares strategy. Therefore, the defensive global shares strategy performance is reported before deducting most of the fees and taxes disclosed in the PDSs.

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