Strategy update

Change in MLC Horizon portfolios' strategy

February 2016

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What are the changes?

- **Asset allocations to alternatives have increased.**
- **As a result, it is estimated indirect costs for impacted funds will increase marginally. We believe investors will benefit after deducting all fees.**

"Given the changes in recent years to the competitive landscape, combined with complex market environments, we believe increasing the allocation to alternative strategies provides our portfolios with a greater absolute return focus that will benefit our investors". Dr Susan Gosling

At MLC, we're always researching new ways to improve and evolve our investment strategies.

We frequently make asset allocation adjustments away from the benchmark in our MLC Horizon portfolios. These regular changes are necessary for us to keep risk at acceptable levels and to aim to achieve the portfolio's objective to outperform the benchmark.

Additionally every two to three years we review the benchmark asset allocation. We often introduce new asset classes and strategies as a result of benchmark reviews, as we identify opportunities to better manage risk or increase returns.

We've recently completed a review of the benchmark asset allocation and have made some changes. We believe the changes will both strengthen the defensive characteristics of our MLC Horizon portfolios and provide our investors with better returns for the level of risk we take.

The largest change is to alternatives, where we have consolidated and increased the allocation to real return strategies. This increase has generally come from fixed income and Australian shares.

Which funds are affected?

These changes affect MLC Horizon portfolios 2 to 6 and the National Australia Balanced Fund across our platform products.

Other multi-asset portfolios are not changing. However the benchmark asset allocation for our MLC Index Plus portfolios is under review and we will inform you of any changes when they occur.

How may investors benefit?

We believe these benchmark asset allocation changes will increase the likelihood of our portfolios providing:

- a greater ability to preserve investors' capital in volatile markets
- a better investment outcome after fees, and
- better returns for the risk taken.

What are the changes?

The main changes are:

- individual exposures to the multi-asset real return strategies (MARR), emerging markets strategy (managed by Capital International, Inc.) and defensive global shares will be gained more efficiently through consolidated exposure to our more diversified real return strategies (ie MLC Inflation Plus)
- increasing the allocation to real return strategies
- increasing the allocation to the low correlation strategy

- decreasing the allocations to shares (mainly Australian) and fixed income with longer maturities, and
- decreasing the allocation to Australian property securities in favour of Australian shares (IncomeBuilder) for the MLC Horizon 2 Income Portfolio.

As the managers in the low correlation and real return strategies invest in external funds, the indirect costs (or underlying investment costs) of the MLC Horizon portfolios have increased. Information on indirect costs is available in the section of this paper titled "Are there fee implications?".

There is no change to the PDS-disclosed investment fees (or management costs).

Why do the MLC Horizon portfolios have a benchmark?

The MLC Horizon portfolios are **market-oriented** portfolios which aim to achieve a return above a benchmark, while managing risk. Their benchmarks, known as composite benchmarks, are a combination of market indices weighted according to each portfolio's asset allocation. Composite benchmarks are a good way to track how a portfolio is performing compared with the markets it invests in.

The composite benchmarks' asset allocations seek to efficiently generate above-inflation returns over the long term as robustly as possible considering asset class return, risk and diversification characteristics. In setting actual asset allocations we take into account the specific investment conditions that prevail and the implications this has for future potential asset class returns. As the benchmark doesn't take into account the changing risk and potential returns of asset classes through time, actual allocations differ from benchmark asset allocations. Our frequent adjustments away from the benchmark asset allocation are based on our scenarios analysis (the Investment Futures Framework). The risk aware nature of our scenarios approach tends to mean that value is usually added through defensive positioning when market risk is high, potentially reducing our investors' exposure to losses.

To ensure our Horizon portfolios remain true-to-label, deviations from the benchmark are limited to defined ranges. In particular, these traditional multi-asset portfolios have constraints to the mix of fixed income and shares which they can hold. This provides certainty to investors about where their money is invested and means that portfolio returns and risk is highly reliant on investment market behaviour.

Why have the benchmark asset allocations changed?

We review the benchmark asset allocation regularly, generally every two to three years. Since our last review we've experienced complex market environments and changes in the competitive landscape. While not an explicit objective, the position of our Horizon portfolios versus our peers is an important consideration for us as we are constantly seeking opportunities to enhance our competitive advantage. And we are conscious that peer relative performance is important for many investors.

However, what ultimately matters to investors is their return above inflation. That's why we have a long history of focusing on enhancing real return reliability within asset allocation constraints.

Our periodic asset allocation reviews seek to increase the quality of underlying exposures and move the benchmark's asset allocation so that the portfolios' expected returns will be enhanced and, in particular, more reliable in many different scenarios. To achieve this we are replacing the multiple small allocations of MARR, emerging markets and defensive global shares with higher allocations to real return strategies (ie MLC Inflation Plus). These allocations are tailored to the objectives of each MLC Horizon portfolio.

Our real return strategies are focussed on achieving a consistent risk profile which we regard as the key to achieving robust returns above inflation. The strategies have fewer constraints than the MLC Horizon portfolios. Therefore they are expected to achieve a higher level of return for their level of risk. This means that allocating to these real return strategies within the MLC Horizon portfolios potentially increases risk return efficiency for investors.

We have also slightly increased the exposure to the low correlation strategy, our fund of hedge funds, in some portfolios.

The role of alternatives in our portfolios

We have meaningful allocations to our alternative strategies as they help increase diversification and smooth returns of our portfolios because their returns are more independent of what's happening in share markets. That's why our portfolios have had allocations to the following carefully selected alternatives for many years:

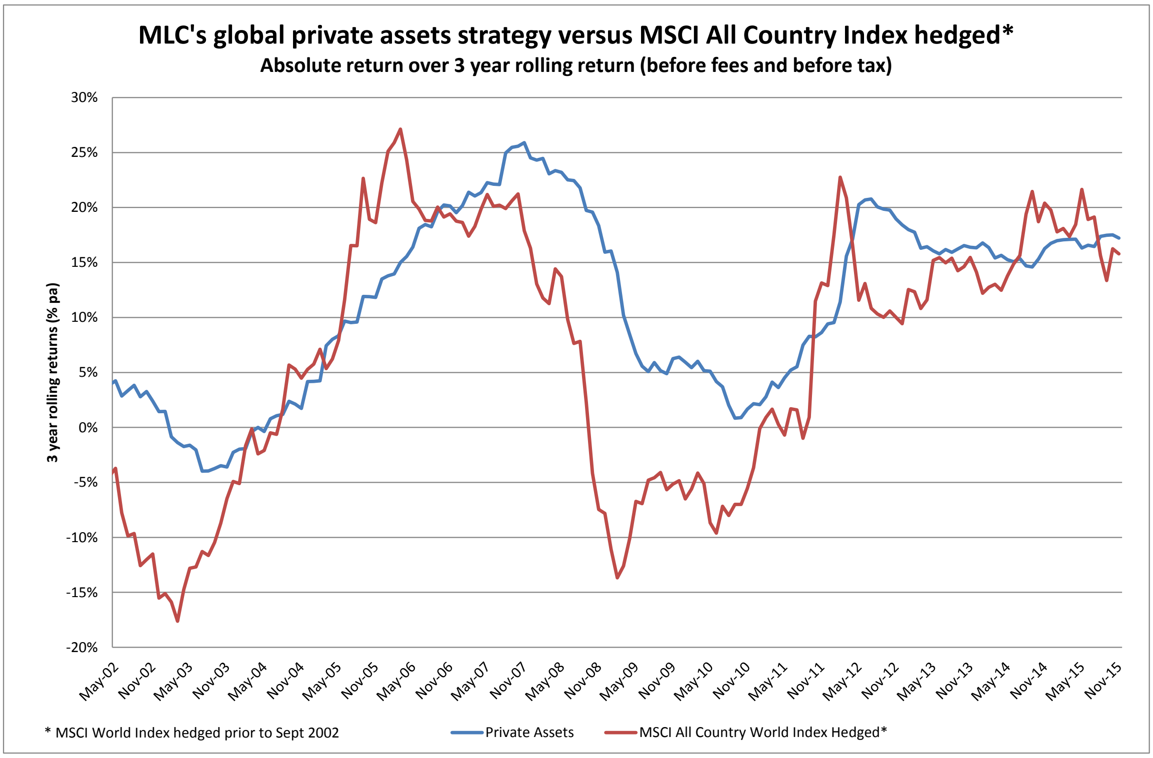
- **Real return strategies** - invest actively and flexibly in multiple assets and strategies to generate a return above inflation over a particular timeframe. This is achieved efficiently through consolidated exposure to our diversified MLC Inflation Plus strategies. Each MLC Horizon portfolio's exposure is tailored across three different Inflation Plus portfolios - Conservative, Moderate and Assertive. Through investments in these real return strategies, the MLC Horizon portfolios will gain additional exposure to alternatives including private assets[1], the low correlation strategy, multi-asset real return strategies, emerging markets strategy and defensive global shares.

- **Private assets**[1] - assets that aren't traded on listed exchanges eg investment in a private business. MLC has managed private assets portfolios dating back to 1997.
- **Low correlation strategy** - our fund of hedge funds strategy that aims to generate a return above cash and deliver returns that are mostly independent of share market performance. The managers in this strategy can invest in both mainstream and non-mainstream asset classes, and generally manage their investments using an absolute return approach.

These strategies have delivered beneficial long-term returns for investors, after fees, particularly in volatile markets.

Private assets, for example, are an important diversifier for a portfolio because they're not directly linked with the performance of listed global shares. This makes it a particularly helpful strategy in weak share markets. As illustrated in Chart 1, global private assets tend to outperform global shares over the long term, providing a significant cushion to performance during the global financial crisis.

Chart 1: MLC's global private assets strategy has consistently provided returns above listed share markets



Source: JANA Corporate Investment Services Limited; data source: MSCI. Past performance is not a reliable indicator of future performance.

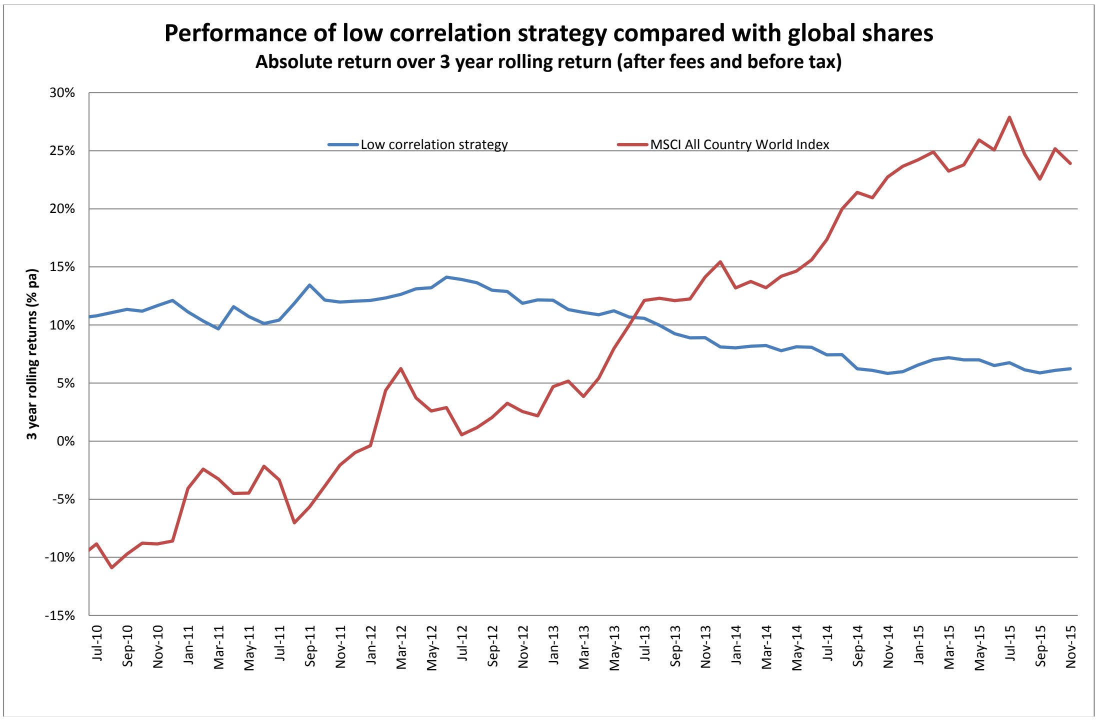
Private assets tend to underperform listed markets if share markets are rising strongly, and outperform when share markets are weak.

Taking into account indirect costs, the long-term excess return[2] from MLC's private assets strategy has, on average, far exceeded that of listed share markets.

Similarly, our portfolios benefit from investing in the low correlation strategy. Because its performance is largely independent of share market returns, this strategy is a useful way to increase diversification in a portfolio and reduce volatility, particularly during weak share markets (see Chart 2).

[1] Private assets are included in MLC Horizon portfolios in MLC MasterKey Super and Pension products.
[2] Past performance is not a reliable indicator of future performance.

Chart 2: Low correlation strategy performance is largely independent of share market performance



Source: JANA Corporate Investment Services Limited; data source: MSCI. Past performance is not a reliable indicator of future performance.

Some of our alternative strategies are unable to be accessed directly by advisers or investors as they tend to be only open to select institutions. For example, in the areas of private assets and hedge fund managers, we wouldn't invest with the average manager, but the returns of top quartile managers can be extremely attractive over long periods of time. When accessing these top managers, it helps us that we have a long track record in some of these strategies.

What are the new allocations?

The new benchmark asset allocations for MLC Horizon portfolios are shown in Appendix 1. We have used portfolios in the MLC MasterKey Super and Pension products and MLC Wholesale for illustrative purposes. New allocations will also impact "The funds affected by these changes*" in the Important Information section of this document (refer to page 7 for details).

The largest change is the increase to 'Alternatives', mainly due to the increased allocations to the real return strategy. This allocation has generally come from:

- consolidating the MARR, emerging markets and defensive global shares strategies and
- reallocating from fixed income and Australian shares.

For the MLC Horizon 2 Income Portfolio, we've also reduced the allocation to Australian property securities in favour of Australian shares (IncomeBuilder). We have been concerned for some time about the high concentration of the Australian property securities sector and recent market falls have boosted the attractiveness of the forecast dividend yields and franking levels for Australian shares. Increasing the allocation to Australian shares (IncomeBuilder) enables the portfolio to continue to focus on delivering income while better balancing the portfolio's risk and return characteristics.

The portfolios' overall mix between growth and defensive assets has not been impacted.

The benchmark asset allocations and ranges for all our portfolios are available on the Fund Profile Tool for MLC MasterKey Super and Pension products and MLC Wholesale.

The Fund Profile Tool on www.mlc.com.au/fundprofiletool has target and actual allocations for all our products and is updated monthly.

Are there fee implications?

As shown in Table 1, as a result of this strategy change there is no change to the investment fees (or management costs) but there'll be a marginal increase in indirect costs currently disclosed in the PDS (or underlying investment costs as defined in the MLC Wholesale and MLC MasterKey Unit Trust PDS). The increase varies within the range of 2 to 9 basis points depending on the portfolio. This is due to the increased allocation to real return strategies and the low correlation strategy which is different for each portfolio.

Indirect costs (explained below) are incurred when a portfolio invests in underlying investment funds. These costs are reflected in the unit price.

Table 1: Changes for the increase in indirect costs / underlying investment costs

a) MLC MasterKey Super & Pension Fundamentals

Portfolio	Indicative investment fee (no change) (%)	Current disclosed estimated indirect costs (%)	Expected estimated indirect costs (%)
MLC Horizon 2 – Capital Stable Portfolio	0.60	0.08	0.10
MLC Horizon 3 - Conservative Growth Portfolio	0.65	0.12	0.18
MLC Horizon 4 - Balanced Portfolio	0.70	0.16	0.23
MLC Horizon 5 - Growth Portfolio	0.73	0.17	0.24
MLC Horizon 6 - Share Portfolio	0.77	0.19	0.23

b) MLC Wholesale

Portfolio	Management cost (no change) (%) *	Current disclosed estimated underlying investment costs (%)	Expected estimated underlying investment costs (%)
MLC Horizon 2 – Income Portfolio	0.90	Not applicable	Not applicable
MLC Horizon 3 - Conservative Growth Portfolio	0.95	0.03	0.10
MLC Horizon 4 - Balanced Portfolio	0.99	0.04	0.12
MLC Horizon 5 - Growth Portfolio	0.99	0.04	0.13
MLC Horizon 6 - Share Portfolio	0.99	0.05	0.10

Note: MLC MasterKey Unit Trust and MLC Wrap expected estimated underlying costs will be similar to MLC Wholesale.
* This is the management cost currently disclosed in the PDS and is not reduced by the rebates paid to platforms and investors.

Fee impacts are an important consideration in our decisions. To approve a strategy change, we must expect it to benefit clients after taking into account the impact on fees.

Investment fees and estimated indirect costs are available in the Fund Profile Tool on [mlc.com.au](mlc.com.au) for superannuation products. For the MLC Wholesale and MLC MasterKey Unit Trust, the underlying investment costs are shown in the PDS.

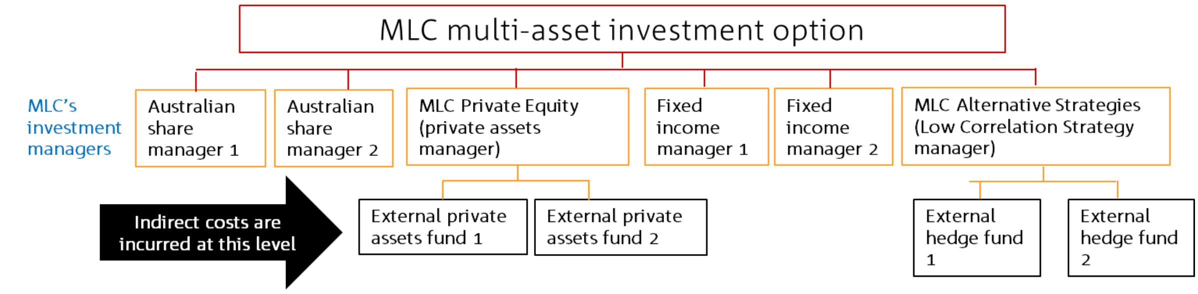
What are indirect costs?

Indirect costs are referred to as underlying investment costs in the MLC Wholesale and MLC MasterKey Unit Trust PDS. They aren't additional fees retained by MLC. They are costs incurred when investing in underlying investment funds, as shown in the diagram below. Indirect costs are reflected in the unit price of the MLC Horizon portfolio.

Indirect costs are variable, as they depend on the value of the investment in the external investment fund.

MLC Horizon portfolios' indirect costs are derived from investments made in the low correlation strategy and private assets.

For example, MLC's private assets manager (the MLC Private Equity team) may invest in an external private assets fund and incur the cost or fee charged by the fund. That cost is classified as an indirect cost and is reflected in the valuation of the unit price of the MLC Horizon portfolio.



Indirect costs have been disclosed to clients since 1 July 2014 in annual statements, PDSs and SOAs.

They are in addition to investment fees and management costs (which aren't changing as a result of this strategy change).

We believe the changes we are making to MLC Horizon portfolios will result in a net benefit to clients, after deducting these and all investment fees.

Further regulations have been released relating to fees and costs disclosures with a compliance date of February 2017. We are working through the impacts to disclosure.

How will your clients be informed?

To support your conversations with clients, the following table outlines the materials that will be available in early February 2016.

Table 2: Summary of supporting materials available for use with your clients

	Location of materials depending upon access point	
	MLC platform	**MLC Wholesale**
Investment Q&A - summarises the benchmark asset allocation changes and why they've been made	mlc.com.au (under 'News & Insights')	mlcinvestmenttrust.com.au (under 'Our investment approach' > 'Latest news')
Benchmark Asset Allocation table	mlc.com.au/fundprofiletool	mlcinvestmenttrust.com.au/fundprofiletool
Indirect cost estimate / underlying investment cost update	mlc.com.au/fundprofiletool	mlcinvestmenttrust.com.au/fundprofiletool

In addition, the 2016 Annual Statements for superannuation investors will notify existing investors of the updated indirect costs.

Please continue to educate your clients on the important role of alternatives and the substantial benefits they provide to their portfolio. This will enable your clients to appreciate that, after taking into account alternatives' higher indirect costs, we expect there to be potentially higher returns for the level of risk than from mainstream asset classes.

Important Information:

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The funds affected by these changes*

The following funds are affected by the changes to our MLC Horizon portfolio strategy. These funds appear on MLC's platforms and MLC Wholesale, in addition to a number of external platforms.

MLC Horizon 2 – Capital Stable Portfolio

MLC Horizon 2 – Income Portfolio

MLC Horizon 3 - Conservative Growth Portfolio

MLC Horizon 4 - Balanced Portfolio

MLC Horizon 5 - Growth Portfolio

MLC Horizon 6 - Share Portfolio

National Australia Balanced Fund

Appendix 1: New benchmark asset allocations

The new benchmark asset allocations for MLC Horizon portfolios are shown below. We have used portfolios in the MLC MasterKey Super & Pension Fundamentals and MLC Wholesale. New allocations will also impact the funds listed in the Important Information section of this document.

The benchmark asset allocations and ranges for all our portfolios are available on the Fund Profile Tool on [mlc.com.au](mlc.com.au)

Table 3 – New benchmark asset allocations for MLC MasterKey Super & Pension Fundamentals

	MLC Horizon 2 Capital Stable Portfolio		MLC Horizon 3 Conservative Growth Portfolio		MLC Horizon 4 Balanced Portfolio		MLC Horizon 5 Growth Portfolio		MLC Horizon 6 Share Portfolio	
	%	% change	%	% change	%	% change	%	% change	%	% change
Shares and property	**24.50**	**-0.50**	**39.00**	**-2.00**	**54.00**	**-3.00**	**65.50**	**-5.00**	**81.00**	**-4.00**
Australian shares	9.50	-1.50	18.50	-2.50	28.00	-3.00	32.00	-4.00	39.50	-1.50
Global shares (unhedged)	11.50	1.50	12.50	-0.50	15.00	-1.00	21.00	-1.00	30.00	2.00
Global shares (hedged)	2.00	0.00	5.00	1.00	7.00	1.00	8.50	0.00	9.50	-4.50
Global property securities	1.50	-0.50	3.00	0.00	4.00	0.00	4.00	0.00	2.00	0.00
Fixed income and cash	**60.50**	**-7.00**	**44.00**	**-4.00**	**27.00**	**-2.00**	**15.50**	**-1.00**	**0.00**	**0.00**
Cash	10.50	0.50	3.50	-1.50	1.00	1.00	0.00	0.00	0.00	0.00
Australian fixed income	33.40	-3.60	26.50	-0.25	16.00	-1.30	10.75	0.50	0.00	0.00
Global fixed income	16.60	-3.90	14.00	-2.25	10.00	-1.70	4.75	-1.50	0.00	0.00
Alternatives	**15.00**	**7.50**	**17.00**	**6.00**	**19.00**	**5.00**	**19.00**	**6.00**	**19.00**	**4.00**
Global private assets	2.00	0.00	4.00	0.00	6.00	0.00	6.00	0.00	7.00	0.00
Real return strategies[3]	10.00	8.00	10.00	7.00	10.00	6.00	10.00	7.00	10.00	6.00
Low correlation strategy	3.00	2.00	3.00	2.00	3.00	2.00	3.00	2.00	2.00	0.00
Defensive global shares	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	-2.00
Emerging markets strategies	0.00	-0.50	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	0.00
Multi-asset real return strategies	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	0.00
Total assets	**100.00**		**100.00**		**100.00**		**100.00**		**100.00**	
Total growth assets	*29.50*	*0.15*	*48.00*	*-0.70%*	*68.50*	*-0.20*	*80.75*	*-0.75*	*98.00*	*0.00*
Total defensive assets	*70.50*	*-0.15*	*52.00*	*0.70*	*31.50*	*0.20*	*19.25*	*0.75*	*2.00*	*0.00*

[3] Through the MLC Horizon portfolios' investments in real return strategies, in addition to the exposures shown in the table, the portfolios gain exposure to alternatives including global private assets, the low correlation strategy, insurance related investments, multi-asset real return strategies, emerging markets strategy and defensive global shares.

Table 4 – New benchmark asset allocations for MLC Wholesale, MLC MasterKey Unit Trust, MLC MasterKey Investment Service/Fundamentals and MLC Wrap

	MLC Horizon 2 Income Portfolio		MLC Horizon 3 Conservative Growth Portfolio		MLC Horizon 4 Balanced Portfolio		MLC Horizon 5 Growth Portfolio		MLC Horizon 6 Share Portfolio	
	%	% change	%	% change	%	% change	%	% change	%	% change
Shares and property	**29.00**	**-1.00**	**43.00**	**-2.00**	**60.00**	**-3.00**	**71.50**	**-5.00**	**88.00**	**-4.00**
Australian shares	15.00	3.00	18.50	-2.50	28.00	-3.00	32.00	-4.00	39.50	-1.50
Global shares (unhedged)	5.00	1.00	12.50	-0.50	15.00	-1.00	21.00	-1.00	30.00	2.00
Global shares (hedged)	2.00	1.00	9.00	1.00	13.00	1.00	14.50	0.00	16.50	-4.50
Australian property securities	2.00	-7.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Global property securities	5.00	1.00	3.00	0.00	4.00	0.00	4.00	0.00	2.00	0.00
Fixed income and cash	**59.50**	**-8.50**	**44.00**	**-4.00**	**27.00**	**-2.00**	**15.50**	**-1.00**	**0.00**	**0.00**
Cash	11.00	1.00	3.50	-1.50	1.00	1.00	0.00	0.00	0.00	0.00
Australian fixed income	31.70	-5.60	26.50	-0.25	16.00	-1.30	10.75	0.50	0.00	0.00
Global fixed income	16.80	-3.90	14.00	-2.25	10.00	-1.70	4.75	-1.50	0.00	0.00
Alternatives	**11.50**	**9.50**	**13.00**	**6.00**	**13.00**	**5.00**	**13.00**	**6.00**	**12.00**	**4.00**
Global private assets	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Real return strategies[4]	10.00	8.00	10.00	7.00	10.00	6.00	10.00	7.00	10.00	6.00
Low correlation strategy	1.50	1.50	3.00	2.00	3.00	2.00	3.00	2.00	2.00	0.00
Defensive global shares	0.00	0.00	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	-2.00
Emerging markets strategies	0.00	0.00	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	0.00
Multi-asset real return strategies	0.00	0.00	0.00	-1.00	0.00	-1.00	0.00	-1.00	0.00	0.00
Total assets	**100.00**		**100.00**		**100.00**		**100.00**		**100.00**	
Total growth assets	*32.00*	*1.40*	*48.00*	*-0.70*	*68.50*	*-0.20*	*80.75*	*-0.75*	*98.00*	*0.00*
Total defensive assets	*68.00*	*-1.40*	*52.00*	*0.70*	*31.50*	*0.20*	*19.25*	*0.75*	*2.00*	*0.00*

Some of the alternative assets and strategies are divided between growth and defensive assets, depending on their characteristics.

[4] Through the MLC Horizon portfolios' investments in real return strategies, in addition to the exposures shown in the table, the portfolios gain exposure to alternatives including the low correlation strategy, insurance related investments, multi-asset real return strategies, emerging markets strategy and defensive global shares.