Morningstar Australian Shares Fund Q42016

All data and information as of December 31, 2016

Quarterly Performance Update

APIR Code (Class A)	INT0022AU
Inception	07 Jul 2000
Size $m	213.5
Unit Pricing	Daily
Distributions	Quarterly
Management Fee	Up to 0.46%
Buy/Sell Spread	0.10% / 0.10%
Minimum Investment	$500,000

Investment Objective

Aims to maximise outperformance relative to the benchmark (S&P/ASX 300 Accumulation Index) over rolling seven year periods, by investing predominantly in listed Australian shares.

Investment Strategy

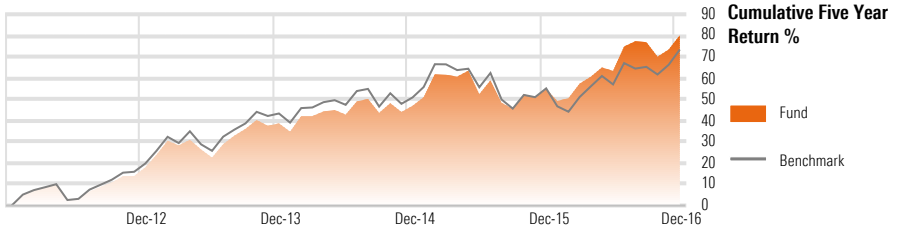
An actively managed Fund predominantly invested in Australian shares.

Available to wholesale investors, and indirectly to retail investors via select retail platforms.

Tax-effective strategies are used to increase the after-tax alpha to investors:

- Centralised Portfolio Management (CPM) techniques are included (where investment decisions for a number of the managers are aggregated at a centralised dealing desk) saving transaction costs and potential capital gains tax realisations; and
- A portion of the portfolio is allocated directly to tax-effective, value-orientated mandates.

Performance [1]



Total Return %	3 Months	6 Months	1 Year	3 Years (pa)	5 Years (pa)
Fund (Net of Fees)	1.84	10.27	16.42	9.12	12.49
Benchmark	4.93	10.43	11.79	6.57	11.64
Active Return	-3.09	-0.16	+4.62	+2.55	+0.85

Portfolio Analysis [2]

Market Capitalisation	Fund %	Bmark %
50 Leaders	26.2	78.3
51-100 Leaders	29.1	11.9
Ex-100 Leaders	43.3	9.7
Cash	1.4	0.0

Active Sector Positions	+/- Bmark %
Consumer Discretionary	+24.6
Healthcare	+6.6
Materials	+4.1
Industrials	+2.1
Information Technology	+1.8
Telecommunication Services	+0.2
Consumer Staples	-1.2
Energy	-1.2
Utilities	-2.0
Property Trusts	-7.9
Financial ex-Property Trusts	-28.4
Cash	+1.4

Top/Bottom 5 Divergent Stock Positions	+/- Bmark %
Resmed	+3.5
ASX	+3.4
Pact Group	+3.4
Coca-Cola Amatil	+2.9
Sonic Healthcare	+2.9
Commonwealth Bank of Australia	-9.3
Westpac Bank	-7.1
Australia and New Zealand Bank	-5.8
National Australia Bank	-5.3
BHP Billiton	-4.2

Notes

1. Performance measures are expressed after fees, costs and before taxes. Performance may not sum due to the rounding of individual components.
2. Allocations may not add up to 100% due to the rounding of individual components.
3. The Management fee is inclusive of GST (after taking into account Reduced Input Tax Credits) and can be negotiated for direct investors. The Fund also has exposure to underlying investment managers which charge performance fees and these are an additional cost to you and impact the return.
4. Please refer to the Product Disclosure Statement on the Morningstar website for more information on how to apply.

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How the portfolio performed

Consumer Staples and Information Technology shares were the key drivers of overall market performance. Material shares (South32, Fortescue and Independence Group) continued their strong rebound as scepticism developed towards the property, telecommunications and utilities industries. The fund was up 8.4% for the quarter, beating the benchmark by 3.2%. Our choice of shares and sector selection contributed positively to the relative outperformance.

JB Hi-Fi was the standout performer, with the share price rising by 23.2% for the quarter. JB Hi-Fi is a household name in regards to consumer goods and entertainment media. The company has enjoyed good market share in this space. The recent announcement that it had entered into a binding agreement to acquire privately owned competitor "The Good Guys" for AUD 894 million cements its place as Australia's largest retailer of home appliances and consumer electronics. At the time of inclusion in the portfolio, JB Hi-Fi's shares were trading at reasonable valuations. The company was generating decent cash flows, participating in share repurchases, paying dividends and reducing debt.

Coca-Cola Amatil (Amatil) also made significant positive contributions to the portfolio as the company's share price rose 27.3%. Amatil has significant market share in the Australian carbonated soft drink and sports drink markets. The company also has significant exposure to the bottled water and energy drinks markets. With the backing of Coca-Cola's widely recognized brand and advertising, Amatil is unlikely to be displaced from its lead in the carbonated soft drink market. The company generates attractive margins and cash flow, allowing the business to pay down debt and return cash to shareholders. Amatil's share price languished over the course of 2016. When we added the share to the portfolio, it was trading at a discount to its intrinsic value (i.e. our view of the company's 'true value') and still offering all the benefits of what we view as a quality company.

Exposure to Seven West Media (Seven) negatively impacted the portfolio's performance over the quarter. The share came under considerable pressure over the quarter, closing down 27.3% as the company's costs increased from the Rio Olympics telecast and the new AFL contract. Revenue growth was insufficient to offset these costs. With competition impeding the growth of television advertisement, it is easy to disregard Seven. However, the company maintains a leading position, with a 40% rating and revenue share of the commercial metropolitan free-to-air television industry in 2015. We find the company still trading at a discount to intrinsic value.

We believe the portfolio's focus on quality and reasonable valuations, along with holistic diversification, will continue to deliver substantial reward for risk outcomes for investors over the long term.

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Morningstar's Investment Principles

We put investors first. We believe the firms that put investors first win in the long term because their investors win.

Since 1984, Morningstar, Inc. has been helping investors reach their financial goals. Our fiduciary duty to our principals is paramount.

We're independent-minded. To deliver results, we think it's necessary to invest with conviction, even when it means standing apart from the crowd.

Our research shows that making decisions based on fundamental analysis, rather than short-term factors and sentiment, delivers better long-term investment results.

We invest for the long term. Taking a patient, long-term view helps people ride out the market's ups and downs and take advantage of opportunities when they arise.

Investing with a multi decade horizon aligns with investors focus on increasing their purchasing power over their lifetimes.

The long term is the only period where fundamental, valuation driven investing works.

We're valuation-driven investors. Anchoring decisions to an investment's fair value—or what it's really worth—can lead to greater potential for returns.

Valuation-driven investing through a long-term focus on the difference between price and intrinsic value enables investors to get more than they're paying for.

We take a fundamental approach. Powerful research is behind each decision we hold, and we understand what drives each investment we analyse.

Fundamental investing incorporates a focus on the future earnings of an investment and not its prospective price change.

We strive to minimise costs. Controlling costs helps investors build wealth by keeping more of what they earn.

Investment returns are uncertain, but costs are not.

Lower costs allow investors to keep more of their returns.

We build portfolios holistically. To help manage risk and deliver better returns, truly diversified portfolios combine investments with different underlying drivers.

Portfolios should be more than the sum of their parts.

True diversification can have a powerful impact on a portfolio's risk-adjusted returns – but simply holding more investments isn't the same as true diversification.