



# Defensive global shares strategy

Investment update to 31 March 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 31 March 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	20.0	MLC Wholesale Inflation Plus Moderate Portfolio	22.0
MLC Inflation Plus Conservative Portfolio	11.0	MLC Wholesale Inflation Plus Conservative Portfolio	12.0

**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

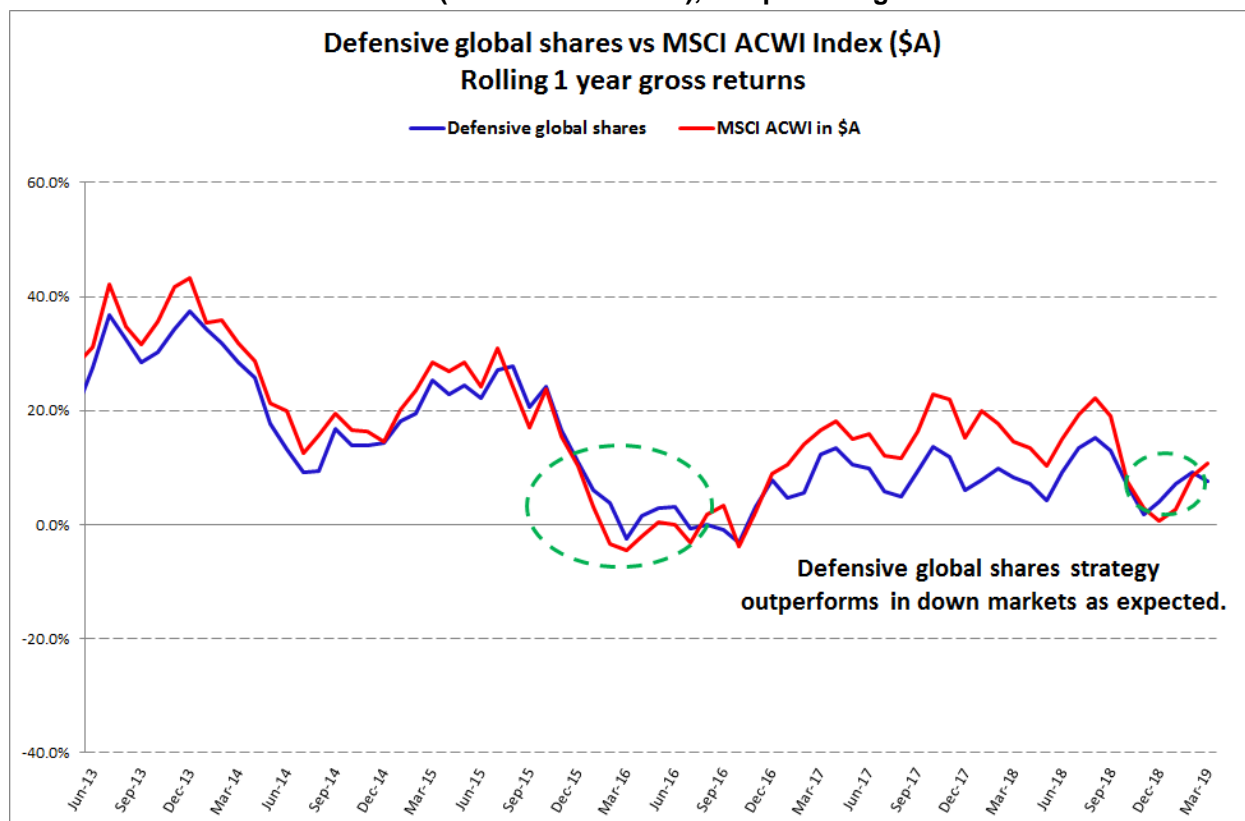
New York-based IVA was established in 2007. It has managed the defensive global shares strategy for MLC since 2012.

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## Performance

Chart 1: Returns to 31 March 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 31 March 2019 (before fees and tax)

	3 mths %	1 year %	2 years % pa	3 years % pa	5 years % pa
<b>Defensive global shares strategy</b>	5.5	7.6	8.0	9.4	9.9
<b>MSCI All Country World Index</b>	11.2	10.8	12.7	14.0	12.7
<b>Excess return</b>	-5.7	-3.1	-4.7	-4.6	-2.8

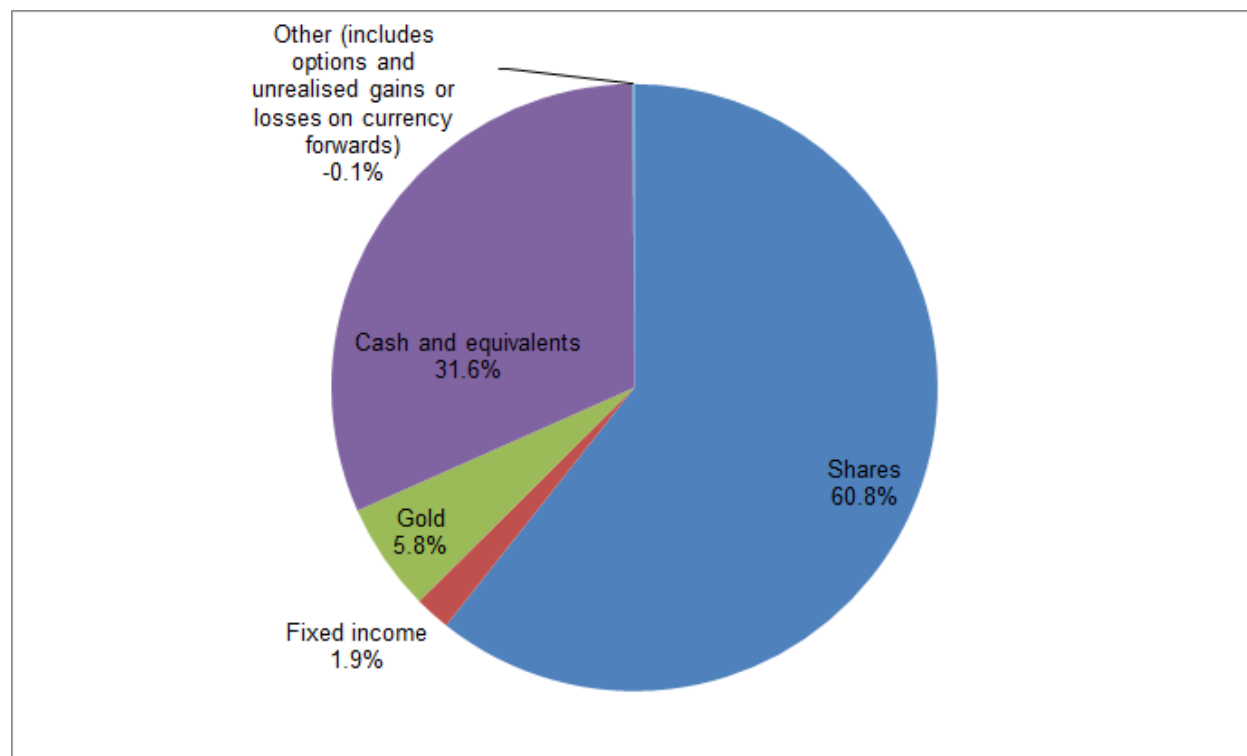
**Source:** NAB Asset Management Services Limited. Defensive global shares strategy returns are calculated before deducting fees and tax. Returns are for the defensive global shares strategy in MLC Inflation Plus Conservative and Moderate portfolios. Past performance is not a reliable indicator of future 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 31 March 2019



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

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

### Portfolio characteristics and top 10 holdings

Table 3: Portfolio characteristics at 31 March 2019 (US\$)

Number of holdings	86
Median market cap (millions)	\$6,855.5
Weighted average market cap (millions)	\$100,024.2
Dividend yield	2.4%

Source: IVA.

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**Table 4: Top 10 holdings at 31 March 2019**

	Name	Sector	Country	% of total
1	iShares Gold Trust	Gold	N/A	5.8
2	Berkshire Hathaway, Inc. Class A; Class B	Holding Company	United States	3.5
3	Samsung Electronics Co., Ltd.	Technology	South Korea	2.7
4	Bank of America Corp.	Financials	United States	2.6
5	Bayerische Motoren Werke AG	Consumer Discretionary	Germany	2.4
6	Bureau Veritas SA	Industrials	France	2.4
7	Sodexo SA	Consumer Discretionary	France	2.4
8	Astellas Pharma, Inc.	Health Care	Japan	2.4
9	AIB Group PLC	Financials	Ireland	2.3
10	Nestle SA	Consumer Staples	Switzerland	2.3
			<b>Total</b>	<b>28.8</b>

Source: IVA.

### Current portfolio commentary and positioning

#### Returns are before fees and tax

After a tumultuous close to 2018, the New Year brought with it a new wave of optimism which resulted in global markets registering their best quarter in nearly a decade. In many ways, the weakness toward the end of last year set the stage for the robust recovery so far in 2019. Despite signs of weakness in global economic growth and low inflation, the clouds that hung over the markets began to clear as the US Federal Reserve switched gears becoming more dovish and trade tensions between the US and China began to ease. However, IVA remains cautious as ever as valuations remain stretched. The US economy is in its 10<sup>th</sup> year of expansion, the second longest on record, and is finally showing some cracks including the recent yield curve inversion. IVA also remains cognisant of a number of risks and imbalances: growing government debt around the world, corporate credit excesses as a result of massive share buybacks in the US, dwindling liquidity, and continued geopolitical concerns.

Despite a strong start earlier in the quarter, the strategy's shares failed to keep pace with the Index and returned 9.6%. March proved to be a difficult month, particularly for value investors, as markets were again being led by more tech-heavy growth names. The strategy's share performance for the quarter was more on par with the MSCI All Country World Value (Net) Index which returned 9.9% for the quarter. By sector, Industrials was the top contributor adding 1.4%. Technology was the second largest contributor adding 1.1%; however, the strategy's lower exposure compared to the Index hurt its relative results. Communication services added the least to returns with a contribution of 0.3%. The strategy's best performance by country was the US with a contribution of 2.2%, followed by France which added 0.8% and Japan contributing 0.6%. Only three countries detracted from the strategy's return this quarter, namely Germany, South Africa and Uruguay (together taking away -0.2%).

The strategy's fixed income names were up 7.8% and contributed 0.2% for the quarter. The strategy's exposure to high yield remains minimal at 1.9% (coming down from 2.2% at year-end). Gold returned 0.7% and added 0.1% to performance for the quarter. The strategy's gold exposure came down to 5.8% from 6.2%. IVA still prefers bullion to gold mining shares.

The strategy's currency hedges added 0.1% to return. The strategy's hedges remain relatively unchanged at: 40% Australian dollar, 10% euro, 23% Japanese yen and 40% Korean won.

The strategy's shares exposure increased from 59.1% to 60.8% at quarter-end. In January, IVA added to US Financials and found a few new names over the quarter in France, Japan, and the US. However, as markets continued their upward trend the strategy also trimmed names in Health Care, Retail, Consumer Staples and Technology. The strategy's cash exposure came down from 32.6% to 31.6% at quarter-end.

IVA notes the strategy remains cautiously positioned and they believe international value investing remains relevant in today's environment.



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### Stock story

IVA provided the following stock story, which you may find interesting:

"In the December portfolio composition, BMW popped up in the top 10 positions; it is a heavily cyclical company. We bought them with some trepidation given the peakish nature of its respective cycle. Yet, we believe the price of this security at the time discounted an unlikely doomsday scenario.

Buying BMW now certainly is a contrarian call, especially as car sales are struggling, seemingly, in every large geography. Last year car sales dropped in China for the first time in decades, automobile sales are weak in Europe and the US as well. Yet, we believe the BMW share price today is compelling for investors.

Headwinds are real and well-flagged for the automobile industry in general and BMW in particular. Volumes sold by BMW (including the Mini and Rolls Royce) are peakish at 2.1 million cars worldwide in 2018. China, which may be experiencing a credit bubble, is a substantial part of the automotive profits, roughly a third. Research and development and capital expenditure are running very high and will continue to run high for the next couple of years because of powertrain electrification, self-driving innovation, and very stringent CO2 new emission rules in Europe. Trade tariffs are detrimental to margins; the recent BMW new models lack imagination in design, yet we believe that these headwinds are temporary and that BMW will remain a very strong car franchise 10 years down the road. Finally, BMW is also facing renewed competition with Tesla. Tesla currently enjoys a similar market capitalisation to BMW, yet BMW has 4x the revenues in its automotive division, and its profitability is 'best-in-class', while Tesla loses money."

**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.