



Defensive global shares strategy

Investment update to 31 December 2018

The defensive global shares strategy in MLC's Inflation Plus Conservative and Moderate portfolios is 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 December 2018

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.

The 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 IVA's 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.

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

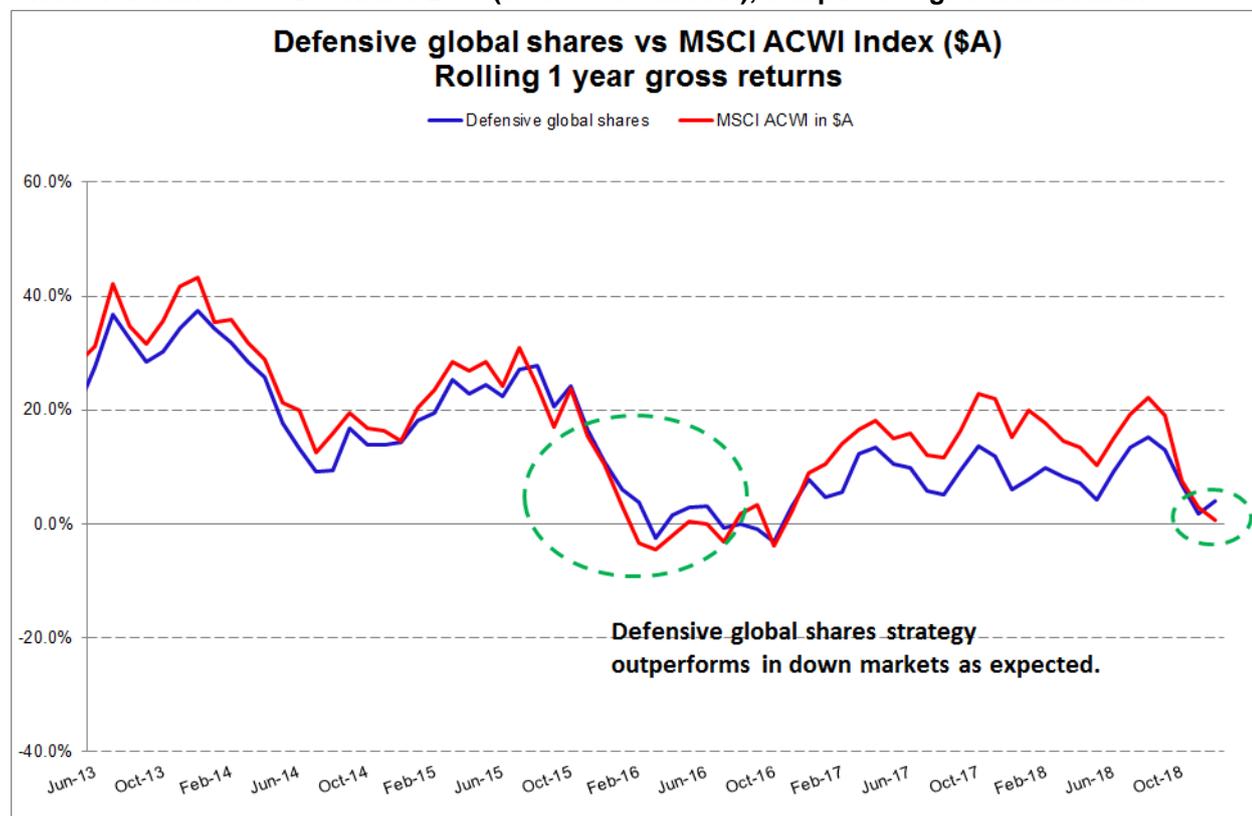
New York-based IVA was established in 2007. It has managed the defensive global shares strategy for MLC since 2012.

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Performance

Chart 1: Returns to 31 December 2018 (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 December 2018 (before fees and tax)

	3 mths %	1 year %	2 years % pa	3 years % pa	5 years % pa
Defensive global shares strategy	-5.1	3.9	4.9	5.9	8.5
MSCI All Country World Index	-10.3	0.6	7.7	8.1	9.8
Excess return	5.2	3.3	-2.8	-2.2	-1.3

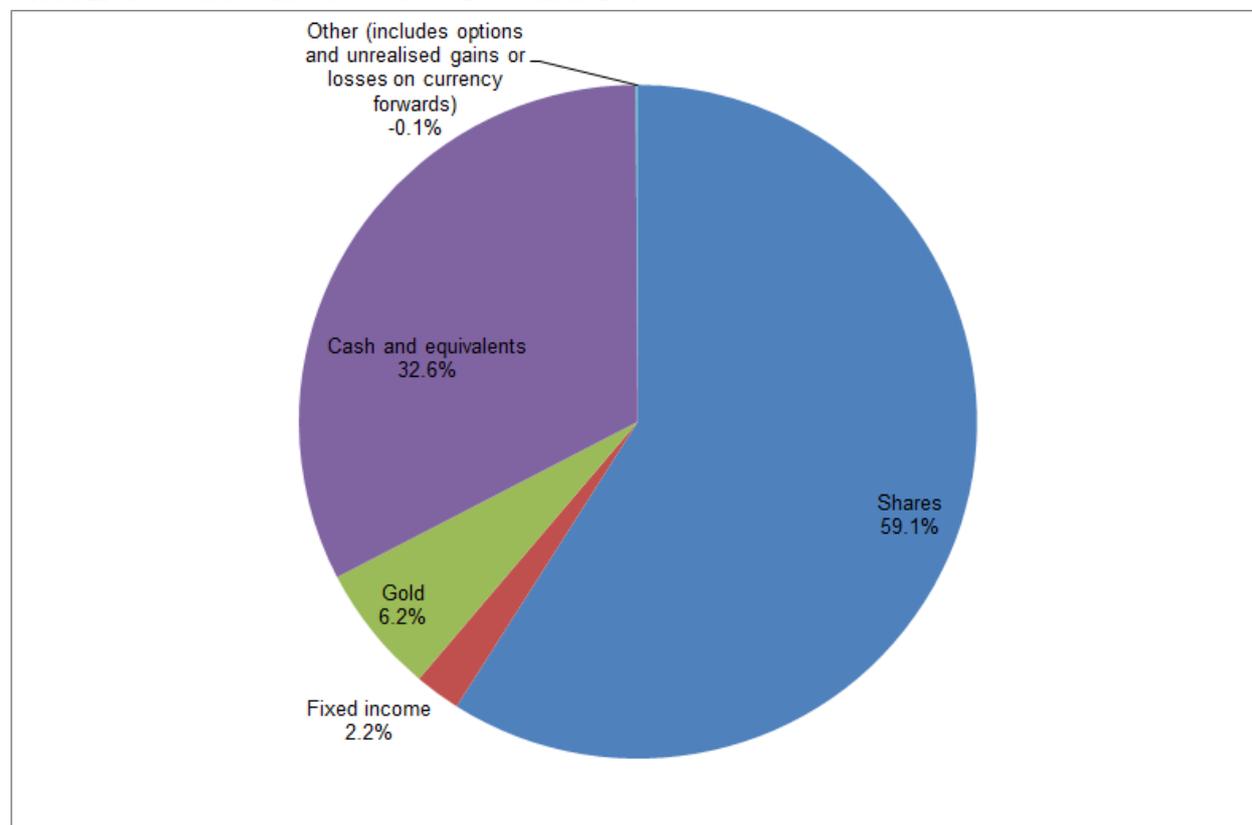
Source: NAB Asset Management Services Limited. Defensive global shares strategy returns are calculated before deducting fees and tax. Returns are for the defensive global shares strategy in MLC Inflation Plus Conservative and Moderate portfolios. Past performance is not a reliable indicator of future 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 31 December 2018



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

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

Portfolio characteristics and top 10 holdings

Table 3: Portfolio characteristics at 31 December 2018 (US\$)

Number of holdings	89
Median market cap (millions)	\$6,581.2
Weighted average market cap (millions)	\$93,022.1
Dividend yield	2.5%

Source: IVA.

Table 4: Top 10 holdings at 31 December 2018

	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	3.8
3	Sodexo SA	Consumer Discretionary	France	2.4
4	Nestle SA	Consumer Staples	Switzerland	2.3
5	AIB Group PLC	Financials	Ireland	2.3
6	Astellas Pharma, Inc.	Health Care	Japan	2.3
7	Samsung Electronics Co., Ltd.	Technology	South Korea	2.3
8	Bayerische Motoren Werke AG	Consumer Discretionary	Germany	2.2
9	Bureau Veritas SA	Industrials	France	2.2
10	Oracle Corporation	Technology	United States	2.0
			Total	28.0

Source: IVA.

Current portfolio commentary and positioning

Returns are before fees and tax

Global markets experienced a chaotic fourth quarter. In part triggered by signals from the US Federal Reserve (Fed) that monetary tightening would continue, global markets flailed in October - including US technology names which had led US share performance for most of the year. December was even more difficult as oil fell, US corporate earnings estimates grew increasingly worrisome, the Fed continued to raise rates and the US government entered a partial shutdown. Global markets reacted with extreme volatility to end the year.

Cash and gold helped dampen volatility in the strategy throughout the quarter. The strategy is also earning a return on its cash which contributed 0.2% for the quarter. Gold was up 7.5% and contributed 0.4%. In addition to acting as a buffer, cash also provided the 'dry powder' IVA needed to buy what it believed to be undervalued securities.

It was a difficult quarter for the strategy's shares, which were down -14.2%. However, there were many instances of what IVA believes to be temporary unrealised losses (IVA's assessment of value not being recognised by the market), which IVA acted on by adding to these positions. In addition, some of the strategy's long-term holdings hit high valuations, which enabled the strategy to take gains as IVA trimmed and in some cases eliminated these positions.

By country, the US was the largest detractor, taking away -3.5%, hurt most by the strategy's energy names. IVA has not revised its intrinsic value down on these names and actually added to the strategy's positions as they came down in price. Japan detracted -1.2% and France detracted -0.7%. In Japan, Astellas was the worst performing name and in France it was Bureau Veritas, both top 10 names in the strategy. By sector, Industrials was the largest detractor, taking away -2.0%. Technology and Energy both detracted -1.3%.

Fixed income detracted -0.2% and the strategy's currency hedges detracted -0.04%. Other than the strategy's hedge on the Korean won, which increased from 30% to 40%, the rest of the strategy's hedges remained relatively unchanged, ending the year at: 38% Australian dollar, 9% euro, 25% Japanese yen.

In addition to adding to existing names at discounted prices, IVA also found a few new names this quarter in Mexico, South Korea and Europe. Share exposure increased from 56.4% to 59.1% and cash decreased from 36.2% to 32.6%.

As we head into 2019 in an uncertain and volatile market landscape, IVA notes their strongest commitment, as always, is preserving the strategy's assets. The strategy will continue to focus on valuations and take advantage of market volatility as it attempts to preserve its capital and deliver positive absolute returns.



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Stock story

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

“At IVA we embrace volatility. Our wish for continued volatility in 2018 decidedly came true. The erratic moves of 2018 enabled us to buy what we believe to be undervalued securities. We found a few new names and added to some existing names that we like as their discounts widened. We also took gains on some of our long-term holdings when they hit our intrinsic value estimates.

Fortunately, there were few instances of permanent impairment of value (genuine investment mistakes). There were however many instances of what we believe to be temporary unrealised losses (our assessment of value not being recognised by the market). We acted on many of those opportunities and added to these positions...

But mostly, prices are divorced from fundamentals. That’s why we added more to quality companies such as luxury jeweller Compagnie Financière Richemont, AIB Group, and shares of Samsung Electronics. “These stocks have come down so much, they are pricing in a major downturn, but the downturn has barely started; it is unnerving”.

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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