A volatile quarter ends with positive result for members

Results for the September quarter 2019 demonstrated how quickly markets react to both positive and negative news. A strong performance in July was followed by declines in growth assets during August and a subsequent recovery in September – highlighting the importance of maintaining a long-term investment outlook.

AustralianSuper’s Balanced option delivered a return of 2.24% over the September quarter and 8.35% for the year to 30 September 2019. The Choice Income Balanced option returned 2.45% over the quarter and 9.15% for the year. All AustralianSuper investment options provided positive returns during the quarter.

Australian and international shares provided the best returns in the portfolio and were significant contributors to the returns in the Balanced option this quarter. Returns from unlisted assets were also positive with Infrastructure, Property and Private Equity helping to lift performance.

Bond returns also supported this quarter’s performance, rising strongly in August when returns from shares were impacted by the uncertainty of global trade tensions – demonstrating the importance of a diversified portfolio during periods of market volatility.

The lowest returns this quarter were delivered by cash – driven largely by declines in Australian interest rates.

Factors underpinning September quarter performance

The September quarter continued to show elements of a decelerating economy with weakening labour and manufacturing figures. The geopolitical instability that has impacted markets over the last year, continued during the quarter. Central banks responded to economic and market conditions with monetary policies to stimulate growth and prevent an economic downturn.

Economy

The Australian economy remained under pressure as a result of consumer behaviour and business growth. Low wage growth has led to decreased consumer sentiment and lower consumption growth. Business investment growth has been contracting for mining and is low for non-mining sectors. These consumer and business developments have led to reduced GDP growth and low inflation. The Reserve Bank (RBA) responded with an interest rate cut on 3 July and an additional cut on 1 October leaving the official cash rate at 0.75%.

Globally, the topics of Brexit, trade negotiations and geopolitical instability continued throughout the quarter with no definitive outcomes. The quarter ended with continued uncertainty regarding whether a Brexit deal will be in place by 31 October. Trade tensions escalated between the US and China with the US announcing additional tariffs. China responded with tariffs on US imports and subsequent upward revisions of the US imposed tariffs.

Other geopolitical tensions during the quarter included drone strikes on Saudi Aramco oil facilities, Hong Kong riots, surprise election results in Argentina’s primary and the announcement of an impeachment inquiry into President Trump’s interactions with Ukraine.

Markets

The Australian share market benefited from the RBA’s supportive monetary policy and declines in interest rates, delivering a 2.6% return for the September quarter. Performance among consumer staples, healthcare and technology companies was strong while resources companies lagged during the quarter.

International share markets experienced strong gains in July, followed by declines in August when trade discussions between China and the US intensified. Markets rebounded in September on the news that new tariffs would be delayed until the 4th quarter. The performance in emerging markets was negative during the quarter, largely led by China.

Returns from Bonds edged higher during the quarter as short and long-term yields continued their downward trend and the Australian dollar weakened, largely as a consequence of lower interest rates.

<table>
<thead>
<tr>
<th></th>
<th>Balanced Option</th>
<th>Median*</th>
<th>Ranking</th>
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<tbody>
<tr>
<td>Quarter %</td>
<td>2.24</td>
<td>2.05</td>
<td>17/49</td>
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<tr>
<td>1 year %</td>
<td>8.35</td>
<td>6.89</td>
<td>4/49</td>
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<tr>
<td>3 years % pa</td>
<td>10.24</td>
<td>8.47</td>
<td>1/49</td>
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<tr>
<td>5 years % pa</td>
<td>9.55</td>
<td>7.83</td>
<td>1/49</td>
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<tr>
<td>10 years % pa</td>
<td>9.11</td>
<td>7.74</td>
<td>2/47</td>
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<tr>
<td>15 years % pa</td>
<td>8.28</td>
<td>7.51</td>
<td>1/29</td>
</tr>
<tr>
<td>20 years % pa</td>
<td>7.97</td>
<td>7.31</td>
<td>3/20</td>
</tr>
</tbody>
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* Source: SuperRatings Fund Crediting Survey September 2019, SR50 Balanced (60–76) Index
Portfolio insights
As an active manager, we continually focus on ways we can leverage our competitive advantages to achieve strong long-term investment performance outcomes for members. One of the ways we’re doing this is through our direct equity investment strategy.

Navitas
We recently partnered with Australian private equity experts BGH Capital to successfully acquire ASX listed education provider Navitas, taking it from public to private ownership. Navitas is an Australian company which has been delivering education programs since 1994. Now operating across Europe, Asia, North America and Australia, it provides university pathways, specialist education programs, internships and literacy, language and vocational training to more than 70,000 students.

AustralianSuper will hold more than 10% of the company through this investment. Partnering with a private equity specialist to change the ownership structure of Navitas has provided us with more oversight and the potential to unlock further value.

We plan to allocate more capital to our direct equity strategy over coming years as it provides greater opportunity to build meaningful investment positions, actively engage with companies and positively impact long-term performance for members.

Australian venture capital
Australian venture capital has demonstrated strong recent growth with a number of billion dollar start-ups created by Australian entrepreneurs. AustralianSuper is a large investor in Australian venture capital, with over $300 million invested or committed with Brandon Capital Partners, which supports the development and commercialisation of medical discoveries in Australia, and AirTree Ventures, which supports Australian start-ups in the technology sector. Over the past year, a number of successful technology companies have emerged from our Australian venture capital portfolio including, Athena, Canva, Pet Circle and Prospa. We plan to expand our presence in the Australian venture capital market, to tap into the growth of Australian start-ups.

Investment outlook
We anticipate on-going pressure on the Australian economy, with a weaker household sector, unemployment and wage growth. These conditions are expected to support the case for continued low interest rates in Australia for some time.

Along with APRA’s relaxation of investor loan requirements for banks, low interest rates have helped to stabilise the Australian housing market, which is a key driver of consumer confidence that may support Australian growth.

Infrastructure spending in Australia is also expected to support future economic growth.

On a global level, the unresolved geopolitical and trade events, along with weakening economic conditions, have the potential to negatively impact market returns.

The resolution of Brexit and how it impacts trading relations with Europe will end a long period of uncertainty. Continued trade tensions between the US and China are expected to suppress global GDP growth by reducing investment and productivity. As the US expands its trade tariffs to Europe, the impact on consumer and business spending could further weaken global economic growth. For companies relying on global trade, an increase in the cost of materials will either reduce corporate profit margins or increase costs for consumers.

Slowing US and European economies are leading to GDP expectations of less than 2% growth for developed markets. Countries in emerging markets have the potential to improve global GDP growth if their demand is boosted. These countries rely on a firm US dollar to provide financial stability and supportive accommodating policy from their own central banks.

Central banks are expected to continue to support global growth with policies designed to increase economic activity and lift consumer and business confidence.
Our strategy
Monitoring the risks of an economic downturn, as well as the responses of policy makers and central banks to manage these risks, is an on-going process for our investment team. This monitoring guides adjustments to our investment strategy and portfolio positions to maximise long-term returns for members.

Weakening Australian and global economic conditions as well as continued instability in global markets, stemming from geopolitical and trade tensions, lead us to remain cautious and maintain a more defensive portfolio position.

Here are the main changes we’ve made to the PreMixed options to reduce the impact of market volatility while continuing to seek long-term opportunities to provide value to members:

› We continue to hold a neutral position to shares and favour international over Australian shares. We also favour private equity assets given their potential to generate stronger returns compared to shares over the long-term.

› We have a higher weighting in fixed interest given the weaker economic outlook, expected rate cuts and continuing low inflation. Longer term bonds are preferred over cash as these provide a higher return in the low interest rate environment.

› We continue to favour infrastructure assets in our unlisted assets portfolio. With interest rates likely to remain low for some time and listed markets facing downwards pressure, we are seeking additional global opportunities. Infrastructure assets are expected to benefit member returns in the current environment.

A recent commitment to co-invest in India’s National Investment and Infrastructure Fund demonstrates that attractive return prospects are available in regions where high GDP growth and a growing middle class create investment opportunities in a country’s infrastructure.

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Balanced option asset allocation (Accumulation) | 30 September 2019 | 30 June 2019
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Australian Equities | 22.9% | 22.7%
International Equities | 34.4% | 33.9%
Private Equity | 4.1% | 3.8%
Direct Property | 7.1% | 7.2%
Infrastructure | 11.1% | 11.7%
Fixed Interest | 14.6% | 13.6%
Credit | 2.4% | 2.4%
Cash | 3.4% | 4.8%

The Trustee may alter the asset allocation or the composition of individual asset classes from time to time to suit prevailing market circumstances. Due to the Fund’s different cash flow management approaches for superannuation and retirement income accounts, there may be a slight difference in the asset allocations for these options at any given time. Investment returns are not guaranteed. Past performance is not a reliable indicator of future returns.

Returns from equivalent investment options of ARF and STA are used in calculating returns for periods that begin before 1 July 2006.