Equities

Equity markets

At AustralianSuper our exposure to equities as an asset class, is the largest compared to the other asset classes. The Fund's investments in equities comprise the sub asset classes of Australian equities, international equities and private equity. Equities are growth assets that have the opportunity to earn high returns and have higher risk due to the potential for negative returns.

What is equity?

Equity investing involves ownership of a share of an asset, usually a company, which generates returns in the form of dividends or capital gains. When you buy ordinary shares you become a part owner of that publicly listed company, sharing in the profits and losses. As an equity owner you own the residual value of a company's assets after all liabilities, such as wages, taxes, accounts payable and debt, have been paid. The value of a company's share price is affected by numerous factors including the company's fundamentals (financial data), economic conditions and market sentiment. The size of a company, or market capitalisation, is the company's share price multiplied by the number of outstanding shares.

Listed equity

Listed equities trade on share markets and are a liquid investment. This means they are relatively easy to buy or sell quickly. There is transparency regarding valuation, as numerous investors determine the value of a company through the share price. However, share prices can also be affected by market sentiment and therefore may not always trade at a price reflecting their fundamental value.

Listed equity can be classified into ordinary shares and preference shares and another category called hybrid securities. These types of shares give the investor different rights such as the right to vote on decisions concerning the company. Voting rights are considered important as they allow a shareholder to exercise influence over their investment on topics such as director elections, remuneration plans, constitutional changes, mergers or acquisitions and shareholder resolutions.

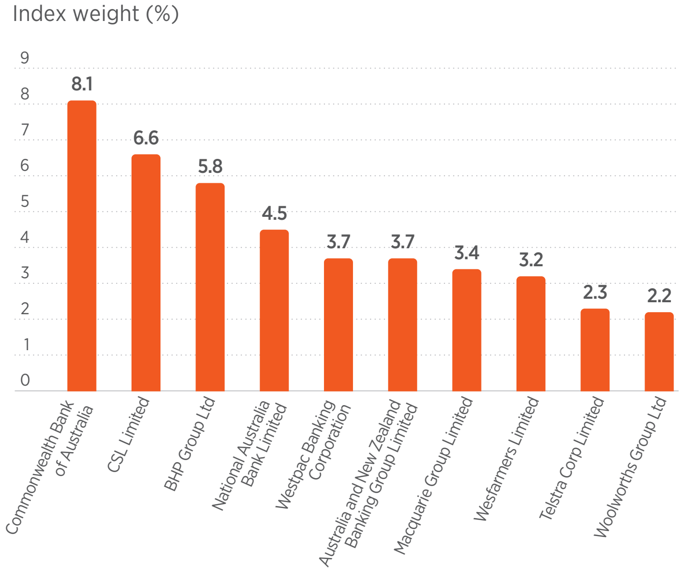
This document has been prepared and issued in April 2022 and is subject to change.

Australian equities

Australian listed equities include companies that are household names such as Woolworths and the four largest banks, also known as the 'big 4', which collectively make up a substantial component of the Australian market. Due to Australia being a continent rich in natural resources, historically a lot of our large listed companies have been traditional mining companies such as BHP. Another large Australian company by market capitalisation is CSL, a leading global biotech company with extensive research and manufacturing expertise, notable for the production of the flu vaccine.

AustralianSuper uses the S&P/ASX 200 Index as the performance benchmark for the Australian-listed equities in the portfolio. This index of Australian equities comprises the largest 200 ASX-listed companies by market capitalisation.

Top 10 companies in the S&P/ASX 200 Index
as at 31 December 2021



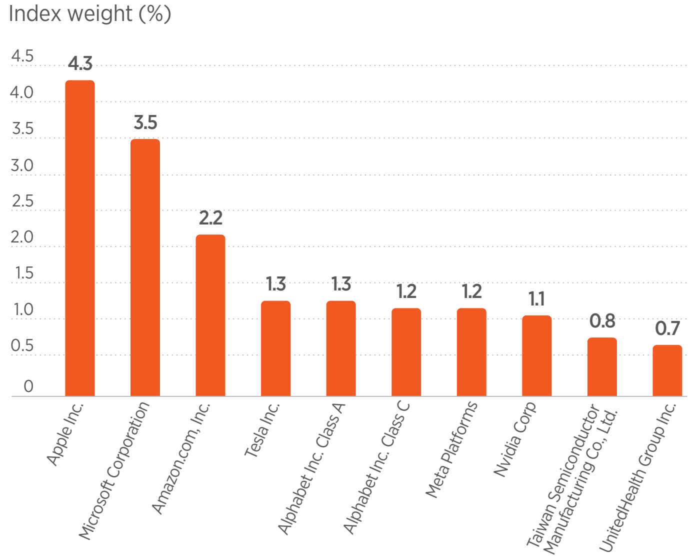
International equities

International listed equities are shares listed on securities exchanges outside Australia and include companies and brands we recognise, such as Microsoft, Amazon, Alibaba, Visa and Nestle.

International companies are identified by categories such as country, region or sector. These categories enable investors to understand the characteristics of the market and monitor a portfolio's investment exposure.

Investing in international equities benefits investors by providing additional diversification that improves the risk-return profile of a portfolio. Having exposure to a variety of share markets, economies and industries may reduce overall portfolio volatility and potentially improve portfolio returns.

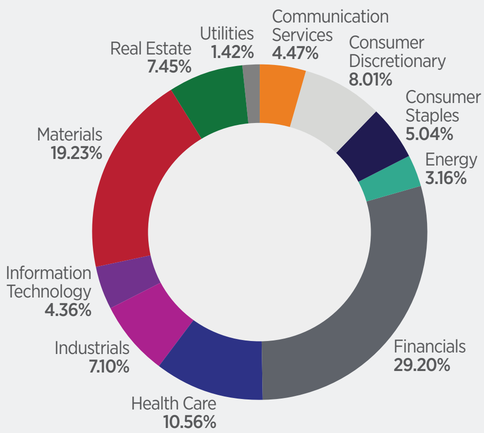
Top 10 companies in the MSCI All Country World ex Australia Index
as at 31 December 2021



GICS sectors

Australian and international companies have sector classifications based on their principal business activities. The definition of a sector follows the GICS system which stands for Global Industry Classification Standard. This standardisation provides consistent sector definitions, enabling comparisons of company characteristics across countries and regions.

GICS sectors of the S&P/ASX 200 Index
as at 31 December 2021



GICS sectors of the MSCI All Country World ex Australia Index
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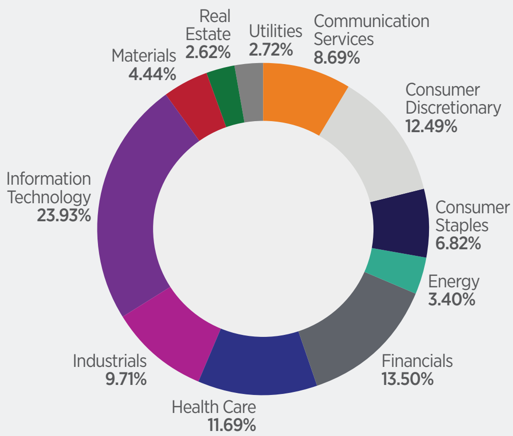


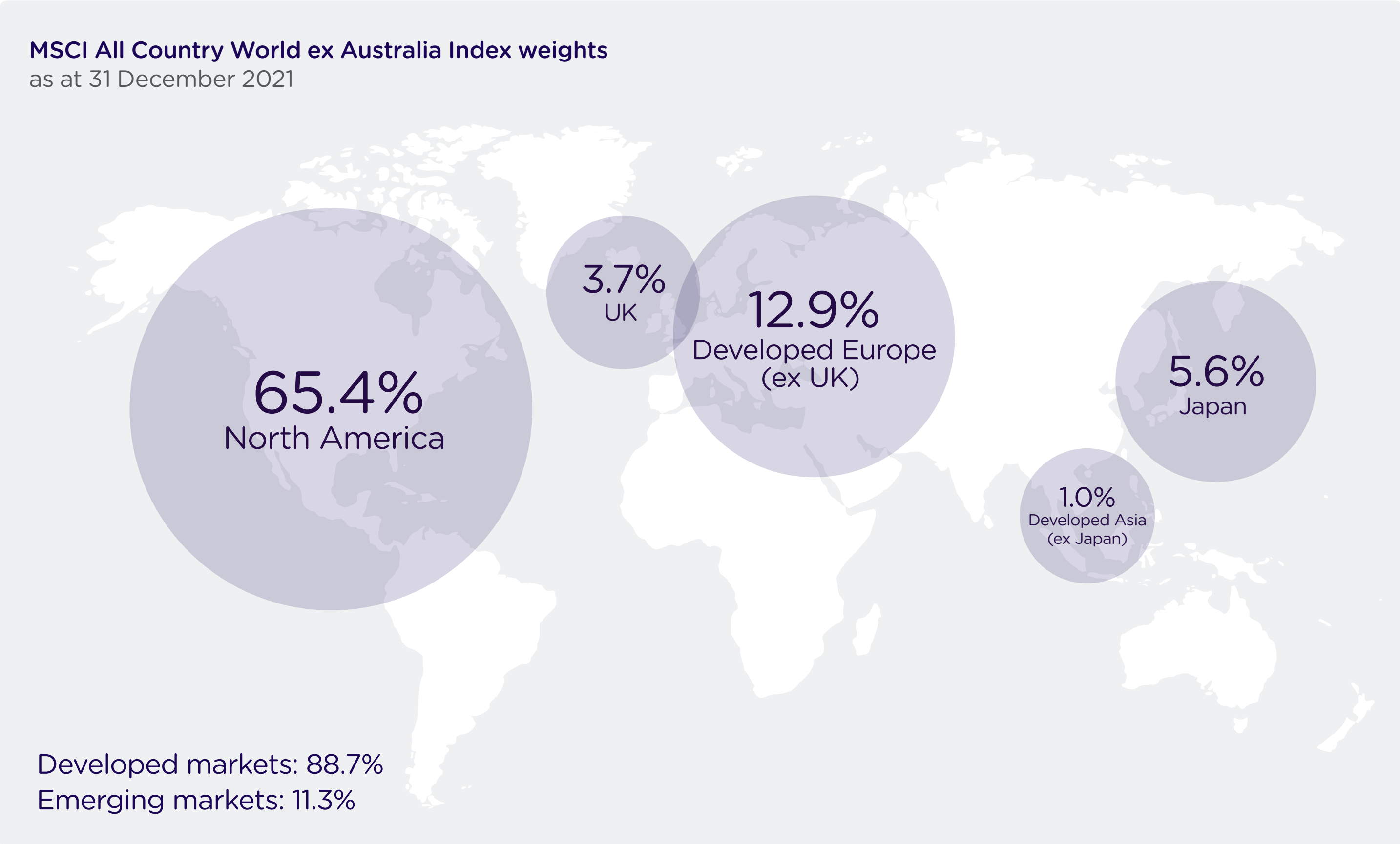
Source: RIMES

International equities – regional exposures

Developed and emerging markets are examples of regional international equities classifications.

Developed markets are countries considered to have a stable government, a high standard of living, relatively stable currency, mature markets and mostly free trade. Developed Markets include most of Western Europe, Australia, Canada, Japan, New Zealand and the United States.

Emerging markets are countries which have a lower than average per capita income, high economic growth potential, higher volatility, including volatile currency swings and less mature capital markets. Emerging markets includes countries such as Argentina, Brazil, Chile, China, Greece, India, Korea, Poland, Peru, Thailand and Turkey.



Source: RIMES

Securities exchanges and indices

Securities exchanges are centralised locations which allow for the fair and efficient trading of securities, including equities. A securities index is a way for investors to measure and track the performance of a market or segment of a market. As company earnings increase, the value of the company is reflected in an increasing share price and market capitalisation. As company share prices within an index increase, the securities index rises.

The MSCI All Country World ex Australia Index is a benchmark that tracks the performance of international equities. It is designed to represent broad equity market performance of approximately 2,900 securities worldwide. It includes companies from developed and emerging markets. As of 31 December 2021, the total market capitalisation of all the companies represented in The MSCI All Country World ex Australia Index was US$69 trillion (AUD$95 trillion). The countries representing the highest market capitalisation are the US (62.5%) Japan (5.6%), United Kingdom (3.7%) and China (3.6%). (Source: RIMES as at 31 December 2021).

In the United States, the S&P 500 comprises the largest 500 companies by market capitalisation and is a representation of the US share market. The Nasdaq Composite is an index that includes most of the companies traded on Nasdaq securities exchange and is heavily weighted towards technology companies, which includes familiar names such as, Meta Platforms, Alphabet, Amazon, Apple and Microsoft. The Dow Jones Industrial Average is the price weighted index of 30 companies traded on the New York Stock Exchange and the Nasdaq exchange across a range of industries.

Indices in other countries include the Nikkei in Japan, the Hang Seng in Hong Kong, the FTSE in the UK, the DAX in Germany and the CAC in France. The list of security indices around the world is long and diverse.

Private equity

Private equity involves investing in companies not publicly listed on a securities exchange. The size of an investment required to invest in a private company is usually large and therefore available only to investors with large amounts to invest, such as super funds, including AustralianSuper.

Private equity specialist fund managers build value in their portfolio of companies through their network of relationships, investment insights and financial and operational management expertise.

AustralianSuper invests in private equity by deploying capital through specialised private equity managers. We have also developed the internal capability to invest directly into private companies in partnership with our Private Equity managers (co-investments and co-underwriting).

Equity investment returns

Company earnings are the driver of equity markets and these are influenced by several factors. Fundamental analysis is the process of assessing these factors to identify the intrinsic value of a company. These factors may include:

- Economic conditions including current growth forecasts, economic drivers, and interest rates.
- Industry dynamics such as the position in the company cycle. Is it a start-up or a mature industry? Are there incumbent competitors or is it ripe for disruption?
- Company dynamics such as the capital intensity required, the health of the balance sheet and the company's competitive positioning.

An investor can earn a return from investing in equities through capital gains and dividends.

- A capital gain is achieved when shares are sold and the sale price is higher than the price paid.
- Dividends are a distribution of profit to shareholders.

The dividend payout determined by a company balances rewarding investors with a dividend or retaining capital to support future company growth. A company growing rapidly or focused on research and development, may reinvest company profits, thereby paying no dividends. An established, mature business may distribute profits as dividends to shareholders providing a higher dividend yield to shareholders.

Market capitalisation characteristics

Large caps refers to companies with large market capitalisations. Due to their size they are usually well-established companies operating in mature markets with a slower rate of growth, stable earnings and less volatile share prices.

Small caps refers to companies with smaller market capitalisations and can often be a relatively new, growing company. They may still be establishing their competitive advantage or niche in the market. They can offer potentially higher returns than large cap securities, however they come with higher risk due to earnings and price volatility.

Micro-caps refers to very small companies still establishing themselves and often experiencing rapid growth. They may also be referred to as emerging companies. Their returns are not correlated with large caps securities and therefore can provide diversification with associated higher risk. Often micro-caps are too small for large institutional investors to invest in as they often are characterised by low levels of liquidity and they are not big enough to provide a large enough exposure to impact the performance of a larger portfolio.

Investment management approaches

Quantitative investing is based on advanced mathematical modelling using computer systems and data analysis to determine the potential profitability of a trade. Once a model is created it is back tested using historical data and can be adjusted if required, depending on the preferred outcome. Examples include high frequency trading, algorithmic trading and statistical arbitrage.

Qualitative investing is based on assumptions determining quality, such as future cash flows, expected profits, the structure of the business, it's products or services, management and competitors. It requires judgements to be made on subjective factors. The benefits of investing in a quality company over the long term would be expected to outweigh the price paid for the investment.

How AustralianSuper invests

AustralianSuper invests in equity markets in Australia and internationally providing an opportunity for AustralianSuper members to share in the growth of companies.

The diverse nature of companies across geographies, sectors and industries, provides access to less correlated returns, increasing diversification and thereby reducing risk within equities as an asset class.

AustralianSuper seeks to maximise returns by investing in equities in multiple ways. These portfolio construction techniques enable the team to invest at scale and reduce costs and include:

- allocating funds between active and passive management;
- tilting the portfolio to areas that we believe are undervalued by the market and offer future growth potential;
- using a mix of internal and external managers to access specialist expertise;
- some regional tilting within the global equities portfolio.

AustralianSuper manages the equities portfolio primarily through active management, selecting assets expected to outperform the broader market and provide additional returns to the portfolio above the benchmark. Passive management is used for a small part of the investment portfolio, as a method to lower investment costs, provide portfolio liquidity or gain market exposure where active management opportunities may be smaller.

AustralianSuper's investment approach uses rigorous valuation frameworks and deep fundamental research to identify investment opportunities. These processes seek to identify high-quality businesses with sustainable competitive advantages that are expected to create long-term value.

Our experienced and well-established equities team manages a core part of the Australian and international equities portfolios internally. Internalising investment management provides a high degree of portfolio oversight, improves portfolio implementation efficiencies and reduces management costs, all of which improve returns for members. The internal investment teams are long-term investors focused on deep fundamental research of companies, industries and economies. Our internal management is supplemented with external managers specifically selected for their specialised expertise. External managers can sometimes be used for investing in niche strategies with concentrated portfolios that have proven investment processes and a historical track record.

Investment styles

This refers to the approach to investing and can include growth, value, quality or momentum styles of investing.

Growth invests in companies expected to generate high future profits and strong future earnings expansion, regardless of their valuation or their current trading price. The decision to buy is formulated on profit forecasts and future earnings per share where the price paid is less relevant due to the expected growth.

Value buys stocks when their valuation is cheap or undervalued relative to the overall market, other stocks or the sector. It is seen as the opposite style of growth as the decision to buy is determined on valuation grounds. Value investors often find their views are contrary to the rest of the market.

Quality invests in companies with stable earnings, strong balance sheets and efficient operations.

Momentum is categorised by the expectation high performing stocks will continue to perform well for a period of time. These stocks may be benefiting from a market trend demonstrating persistent performance.

Active and passive investing

This refers to investment management approaches used in portfolio construction.

Active investing refers to the active monitoring of the portfolio and involves proactively adjusting positions within the portfolio as required. The consistent review of the portfolio aims to add value and generate outperformance, getting a higher return than the market. Active investors usually have a strict process they follow when reviewing stocks within their portfolio which removes human emotions from decision making.

Passive investing refers to the tracking of an index, holding the same securities as the index with the aim to get the same return as the index. If the index moves higher, a passive investor experiences positive returns, alternatively, if the index moves lower, the investor will experience negative returns. This is a cheaper strategy to operate as there is no fundamental analysis required, and no active decisions to be made.

Summary

AustralianSuper invests in equities in Australia and internationally for AustralianSuper members to gain exposure to the growth of companies and the investment returns they generate. These returns feed directly into our investment option performance and member returns. While equities is classified as a growth asset class with a higher level of risk compared to other asset classes, the returns generated by equities are carefully weighed up by our investment team against the risk of the investment, in line with our investment objectives. Equities are a substantial and important component of the AustralianSuper portfolio driving returns for members to meet long-term performance objectives.

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