

## Bennelong Australian Equity Partners Investment Process

Bennelong Australian Equity Partners (BAEP) manage two large cap Australian equities strategies which primarily select stocks from the S&P/ASX 300 Index. The funds include:

- **Bennelong Australian Equities Fund**, which typically holds between 30-60 stocks; and
- **Bennelong Concentrated Australian Equities Fund**, which typically holds between 20-35 stocks.

### Investment philosophy

BAEP believe equity markets are effective, but not perfect whereby behavioural biases can lead to securities being mis-priced. Such biases can take many forms, but are generally a result of investment sentiment characterised by over-confidence, or under-appreciation of a particular investment opportunity. Market behavioural anomalies can occur as a result of investor sentiment being dominated by emotional biases, misinformation and portfolio constraints.

BAEP believe that stock prices ultimately represent a trade-off between earnings growth and valuation. It follows that stock prices are driven by the quality and magnitude of earnings growth. The team believes that investment opportunities arise when the market incorrectly assesses and prices a company's earnings growth prospects.

The BAEP investment philosophy dates back to 2002, developed by Mark East and Paul Cuddy during their extensive equity investing experience. The team's philosophy continues to emphasise the importance of an aversion to earnings risk and a bias towards quality through bottom-up, fundamental stock research. BAEP has augmented the process with proprietary investment tools that assist the investment team in the active management of their portfolios.

### Investment style

BAEP's investment style can be described as 'core' with an aversion to earnings risk and a bias towards the following attributes:

- strong franchises which are well managed;
- strong and reliable earnings growth;
- strong/improving capital return efficiencies; and
- stocks which are under-appreciated by the market.

### General investment objectives

BAEP's investment objectives are to:

- achieve the agreed risk/return objectives of clients;
- outperform the agreed client fund benchmark; and
- outperform peer managers (as measured by industry surveys).

## Fund objectives

**Bennelong Australian Equities Fund:** to outperform the S&P/ASX 300 Accumulation Index by at least three per cent over a rolling three-year period. Although the strategy is not managed to a tracking error, it is estimated that the ex-ante tracking error will be between 2-5%.

**Bennelong Concentrated Australian Equities Fund:** to outperform the S&P/ASX 300 Accumulation Index by at least five per cent over a rolling three-year period. Although the strategy is not managed to a tracking error, it is estimated that the ex-ante tracking error will be greater than the core fund.

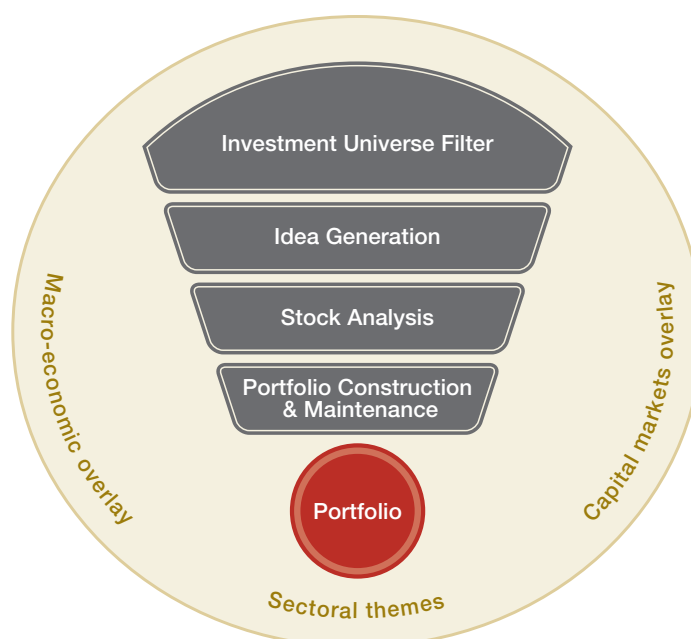
Variable	Core	Concentrated
Benchmark	S&P ASX 300 Accum	S&P ASX 300
Investment objectives	+300bp pa (3yrs)	Accum+500bp pa (3yrs)
Stock number (typical)	30-60 (35)	20-30 (25)
Tracking error (guide only)	2-5%	> 5%
Active stock limit	± 6%	± 10%
Cash limit	0-10%	0-10%

## Investment process

Consistent with BAEP's belief that stock prices are driven by the quality and magnitude of earnings growth, their investment process is designed to screen, analyse and construct portfolios of stocks that exhibit attractive style attributes. These can be measured in terms of:

- value;
- growth;
- capital; and
- quality.

BAEP's investment process seeks to identify and measure quality companies using a fundamental bottom-up active process which is supported by quantitative techniques and proprietary tools. There are four formal stages to the investment process, as illustrated below.



## Stage 1: Investment universe filter

BAEP apply a series of simple but important tests which must be satisfied before a stock is considered part of the investment universe. These tests relate to:

- market capitalisation typically above \$500m;
- an earnings history; and
- a reasonable liquidity in the trading of its shares.

## Stage 2: Idea generation

BAEP utilise a proprietary stock ranking tool to monitor and rank stocks according to a series of alpha sensitive factors. While ideas can be sourced from portfolio managers and analysts, this ranking tool systematically ranks stocks. The result is a list of buy and sell candidates that help direct the research effort.

## Stage 3: Stock analysis

BAEP's research effort is focused on rating stocks that will satisfy stringent quality hurdles and add value to portfolio performance.

Members of the BAEP team are allocated stocks by sector with each analyst responsible for generating an investment recommendation on stocks in their assigned sectors.

In order to ensure consistency in quality of the proprietary stock research, Paul Cuddy and Mark East head the research function. This involves management, mentoring and equity team co-ordination and direction. Each stock rating must be presented to the co-heads and approved before being considered for portfolio inclusion.

### **BAEP's focus**

Stock analysis involves the comprehensive assessment of the quality of a company and its earnings drivers. An assessment is made of the relevant company's:

- industry structure;
- industry positioning;
- business model;
- balance sheet strength; and
- management quality.

BAEP analysts have a strong focus on earnings and other risks at a stock level. There is an emphasis on understanding market expectations for earnings forecasts and where there may be potential for earnings surprises. At this stage, BAEP closely monitor broker forecasts for each stock and their key underlying assumptions.

Central to BAEP's research process is a program of company visitation. Their active company visitation program includes meetings with management, customers, competitors and suppliers. These contacts are an important part of assessing the quality of management and franchises, as well as enabling our team to make first hand assessments of the quality and magnitude of earnings generated.

Company visits generally focus on companies which rank strongly on BAEP's process and/or feature strongly as an active position in the team's portfolios. In the case of stocks with an active position or under consideration as an investment opportunity, the analyst will be accompanied by at least one portfolio manager.

BAEP has developed a *Stock Monitor* which houses the 'live' ratings for the S&P/ASX 100 plus highly ranking stocks in the ex-100 universe. These ratings reflect the analyst's recommended portfolio holding supported by an investment thesis and valuation. Analysts must present their stock ratings, which form part of the portfolio construction stage, to the co-head team for approval and sign-off.

The qualitative assessment is an important part of BAEP's stock analysis. Various qualitative factors for each company are assessed and scored by the analysts and must rank well on the qualitative assessment to be considered for inclusion in the portfolio.

#### **Stage 4: Portfolio construction and maintenance**

The investment process is focused on a constant search for quality and is formally incorporated in the quantitative screens used in Stage 2. Quality is also considered by the analysts and the portfolio managers in the research and construction phases (Stages 3 and 4).

#### **Macro-economic and capital market overlay**

During each stage of the process, BAEP monitor the broader economic and capital market conditions and highlight potential catalysts for earnings upgrades or downgrades. Key factors considered are:

- economic growth (domestic and global) and its impact on earnings;
- capital market sentiment (eg. index changes, fund flows, buy-backs);
- inflation and interest rates;
- consumer confidence and retail activity
- business confidence and capital spending trends;
- commodity prices; and
- currency and credit markets.

The investment universe and the portfolio of stock holdings are constantly monitored and tested to ensure consistency with the investment process and strategy. This ensures the portfolio is not subject to unintended risk outcomes.

**If you would like further information about BAEP's investment process, please contact Ciaran McAssey on (03) 9617 0499 or Andrew Aitken on (02) 8216 1730.**

#### **Disclosure and disclaimer**

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