# Five questions for the Chief Investment Officer—May 2017

***Video transcript***

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**Danielle Clarke (DC)**: Welcome to *Five questions for the CIO*. I'm Danielle Clarke, UniSuper's Communications Manager, and I'm here with our Chief Investment Officer, John Pearce.

John, like many UniSuper members, I'm a regular news consumer and I've seen some of our top holdings in the spotlight lately. I'm keen to pick your brain about some of them, starting with Telstra. Do you agree with some of the commentators who think that Telstra's gone from market darling to now somewhat of a pariah?

**John Pearce (JP)**: Well I guess the share price speaks for itself, Danielle. You would recall that the government has had three large sell-downs of Telstra stock, so Telstra is always a topical subject for retail investors. Here's the performance of the Telstra share price since the initial public offering back in 1997, and the experience of an investor will depend on what the entry point was. If you were an investor in the first tranche, it's been a pretty good experience. At $3.30, if you include dividends, the return per annum has been around 9%. T2 has been a completely different experience, with the returns around 2%.

Since T2, Telstra over a decade or so has basically been in long-term decline—in terms of share price—until the NBN was announced. Now, the market perceived that the NBN deal that Telstra did with the government was pretty good. It was very well-received, and then you saw a tick up in the share price. But then that euphoria has since been overtaken by fears of fierce competition in the mobile market, and this is Telstra's main profit pool that's under threat here.

Recently, we've had TPG enter the market by winning mobile spectrum, so that's heightened everyone's fears. However, last week, we had one piece of good news. The competition watchdog, the ACCC, has ruled that Telstra does not have to share its network in the bush with its competitors—so it can still say that it has the best network coverage in Australia. The bottom line is Telstra still ticks many boxes for a superannuation investor, particularly with the yield. So at the right price, we're still happy to accumulate the stock.

**DC**: What about Sydney Airport, John? Given that UniSuper is its largest shareholder, what's your comfort level with it declining the recent opportunity to build and manage a second airport at Badgerys Creek?

**JP**: It was definitely the right decision. We're talking about a nation-building piece of infrastructure here, but given the risk involved, the numbers just didn't stack up for superannuation fund at this point in time. The question then becomes 'is this going to represent significant competition for Sydney Airport?' And once again, we are pretty comfortable for a few reasons. Firstly, we don't expect Badgerys Creek to be operational at least until 2026, and I think that would be fairly optimistic. Secondly, Sydney Airport, where it's located, will always have a competitive advantage because of proximity to the CBD. But I guess, most importantly, eventually, there'll be enough traffic so that both airports can be profitable in their own right.

I'll give you an interesting statistic. We pride ourselves on being a great tourist destination in Australia. It might come as a surprise to you, we are terrible underachievers in this regard, particularly relative to our other export industries. You know, if we look at the Chinese tourist now, which is our biggest source of tourism—in 2016, we were only the thirteenth-ranked destination for Chinese tourists. We had a country like the Maldives—population of less than 400,000—outranking us. So, suffice to say, I think there's a lot of upside.

**DC**: I've also been reading about Amazon getting ready to launch here in Australia. With our big holdings in shopping centres locally, do you think that poses any threat?

**JP**: Well have a look at firstly at the US experience, Danielle. It's clear that Amazon has been an irresistible force. It now accounts for something like 35% of e-commerce in the US, and sales last year of about $120 billion. We've seen what's happened to bookstores in the past, there's now fears that Amazon is going to eat into the profits of the likes of a JB Hi-Fi, a Harvey Norman, a Myer—these types of retail outlets. Whether that happens, that's yet to be seen.

In terms of UniSuper's positioning, we don't have big positions in individual retailers, we've got big positions in the big shopping centres—the Scentres, Vicinities and the GPTs. Ultimately, these so-called destination centres, if you look what they've done over the last couple of decades, they've transformed themselves from being primarily a place where you conduct transactions to now a place where—hopefully—you enjoy experiences. One thing Amazon can't do is replace a good personal experience. So it's incumbent upon these shopping centres to continue to reinvent themselves to stay ahead of Amazon.

We're pretty confident, given their track record, the quality of their management—the positioning of the centres themselves holds them good stead, and they can stay very competitive. However, I still hold fears for some of the individual retailers. It's clear to me that their business models will be under threat, and some of them will be put out of business.

**DC**: I recently saw some commentary on DUET, one of our large investments, which sounded quite positive. Can you talk us through their latest news?

**JP**: DUET is an Australian infrastructure company, or maybe I should say it *was* an Australian listed infrastructure company. The DUET investment has been a terrific story for UniSuper members because it's a classic example how we've been able to use our competitive advantage of scale and in-house management capability.

We started investing in DUET in about 2015. They were looking at a fairly large capital-raising and they needed to raise the funds pretty quickly. And we were in a unique position to take advantage of this, to the point where, out of a $550 million raising, we took $400 million at a price that was a significant discount to the market at that time, around $2.00.

Subsequent to that, we've made further purchases of the stock at attractive prices. We've received dividends of around 36.5 cents, and later, we accepted a takeover offer by CKI at a price of $3.03. So you could do the maths pretty quickly, and that's a pretty good deal. Now, DUET is somewhat unique because it's happened so rapidly, but there have been many other examples where we've used our scale and execution capability to do these sort of deals.

**DC**: So looking a little more broadly now, the Australian stock market index, or ASX 200, keeps getting really close to that magical 6,000 mark but never quite hitting it. What's it gonna take?

**JP**: There's the easy way and a hard way. The easy way will be the situation where global markets rise and the Australian market just rises in tandem. The hard way, but more sustainable in the long run, is to see growth in Australian company earnings. And very important here will be the performance of our banks.

Our banks still constitute about 30% of the index. Over the last couple of weeks, three of the major banks have reported their semi-annual results. And I must say they were underwhelming. There certainly wasn't any positive surprises. So to my mind, the banks are certainly not going to get us over that magical 6,000 mark, at least in the short run. We'll have to wait for a few more months when the whole market reports its earnings, and hopefully we have some more positive surprises then.

Now, back to the 6,000—the market's always fascinated by big round numbers. From a pure investment perspective, the reality is it's not that significant. The other thing to bear in mind is 6,000... the ASX 200 is a *price* index. And a price index does not include dividends. If you look at the performance of this index, we've seen that it's still yet to reach its pre-GFC highs—seemingly bad news.

However, to me, the more important index to look at is the ASX 200 accumulation index, which *does* include dividends. Now, if you look at this index, it tells you a different story. That's the blue line there, and that shows you that we are at all-time highs. It illustrates the importance of dividends in the context of the Australian market. It also tells you why UniSuper is so attracted to companies that pay sustainable dividends and can grow them.

**DC**: Thanks, John. If you have any questions for John or feedback for us, please email us at **superinformed@unisuper.com.au**. Thanks for watching.

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