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Financial Markets – September Quarter 2017 Review

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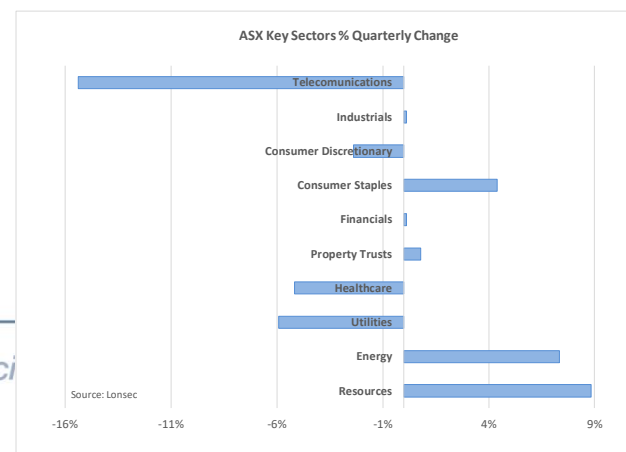
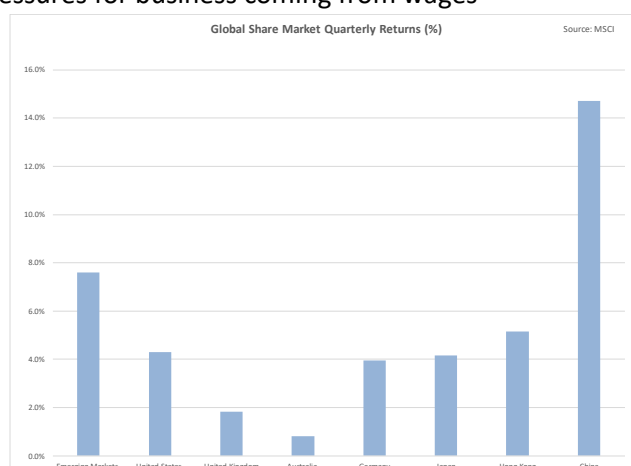
It was another generally positive quarter for investors, with only the Australian Fixed Interest asset class failing to produce a positive return. In summary, the September quarter produced the following:

- A continued positive and stable global economic backdrop
- Strong gains in global equities, with the U.S. market reaching new record highs.
- Further gains in commodity prices
- Flat returns from Australian equities, with large swings in individual stock prices.
- A significant lift in longer term interest rates towards the end of the quarter.

The strong positive momentum on global equity markets continued over the September quarter. Developed market equities, as represented by the MSCI World ex Australia Index, rose 4.3% in currency hedged terms. The annual gain on global equity markets is now just under 20%. The appreciation on global markets was relatively consistent with the United States (up 4.3%), Germany (up 4.0%), Japan (up 4.2%) and Hong Kong (up 5.2%) all producing similar sized gains. The United Kingdom was slightly weaker, but remained in positive territory with an increase of 1.8%. A common theme providing a source of positive sentiment across markets was the ongoing bright outlook for economic growth, with minimal cost pressures for business coming from wages growth or interest costs. Additionally, a further escalation in military activity from North Korea failed to materially dent investor confidence last quarter.

It was also a positive quarter for the share markets of emerging economies, with the MSCI Emerging Market Index gaining 7.6%. Emerging markets were led higher by China, which posted an impressive appreciation of 15%. In response to some increase in Chinese inflation and renewed growth in Chinese property prices, authorities tightened aspect of credit policies over the quarter. Emerging markets were also boosted by further increases in commodity prices with base metal prices, in particular, showing strong growth. Related to the improvement in commodity prices was an appreciation in the level of the Australian exchange rate, which crept over U.S. 80 cents during the quarter. The \$A subsequently pulled back in the month of September, but closed the quarter U.S. 1.5 cents higher at U.S. 78.4 cents.

Asset Class Return	Sep Qtr	Annual
Australian Equities	0.7%	9.2%
Global Equities - Unhedged	2.5%	15.4%
Global Equities - Hedged	4.3%	19.6%
Australian Listed Property	1.9%	-2.0%
Global Listed Property	0.5%	-1.0%
Global Listed Infrastructure	1.7%	12.3%
Australian Fixed Interest	-0.1%	-0.8%
Global Fixed Interest	0.9%	0.5%
Cash	0.4%	1.8%



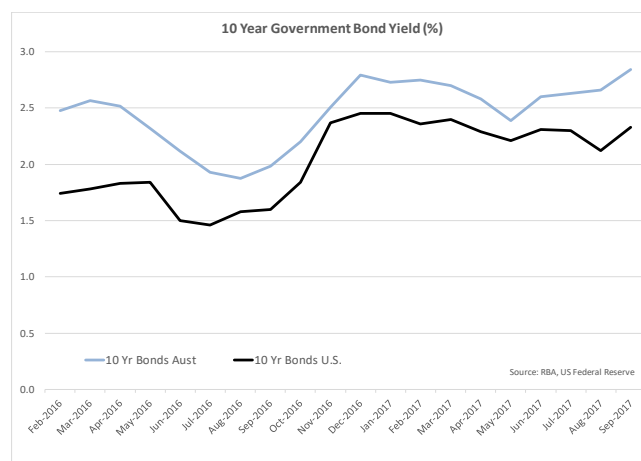
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The higher commodity prices contributed to strong gains on the Australian share market in the resource (up 8.8%) and energy (up 7.3%) sectors. However, elsewhere the Australian market lagged global averages with profit reporting resulting in large movements in specific stocks. Telstra had a material impact on the overall market, with the stock sold heavily following news of its decision to lower dividends. Largely due to the weakness of Telstra, the telecommunications sector fell by 15% over the quarter. Rising local bonds yields also had a negative impact on the Australian share market, with the interest rate sensitive utilities sector the most impacted, with a decline of 6%.

Global bond yields finished largely unchanged over the quarter, after declining in August and bouncing back in September. Commentary from overseas central banks in September indicated a possible willingness to tighten monetary policy earlier than had previously been indicated, which led to an increase in bond yields over the month. Australian bond yields trended higher over the quarter, with the 10-year Government bond yield rising from 2.60% to 2.84%. This rise in yields resulted in lower bond prices and slightly negative returns for Australian fixed interest investors. Negative returns from longer duration (interest rate term) bonds were offset to some extent by further gains in the value of corporate debt and high yield securities. Generally positive sentiment around the outlook for corporate profitability has continued to push the value of credit securities higher, reducing the interest rate margins available for future returns.



Portfolio Positioning

The underweight position to interest rate sensitive assets is being maintained in our portfolios. With the labour market in the United States continuing to tighten (as unemployment falls further), the probability of some wage related inflation has firmed. Signs of higher inflation are likely to be accompanied by central bank policy tightening, which will push interest rates higher and bond prices lower. This is also likely to have implications for other interest rate sensitive asset classes, such as property, infrastructure and some more defensively positioned equities. With the local economy remaining relatively soft, prospects for higher interest rates overseas are stronger, which raises the probability of a decline in the \$A.

Important Information

The following indexes are used to report asset class performance and calculate the benchmark returns for this model portfolio: ASX S&P 200 Index, MSCI World Index ex Australia net AUD TR (composite of 50% hedged and 50% unhedged), FTSE EPRA/NAREIT Developed REITs Index Net TRI AUD Hedged, Bloomberg AusBond Composite 0 Yr Index, Barclays Global Aggregate (\$A Hedged), Bloomberg AusBond Bank Bill Index, S&P ASX 300 A-REIT (Sector) TR Index AUD, S&P Global Infrastructure NR Index (AUD Hedged).

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