

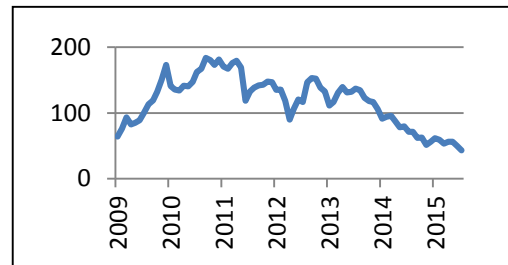


Economic and Investment Update – January 2016

During the December quarter, a number of factors weighed on markets to raise investor fears and market volatility. These factors included the long-awaited decision from the US Federal Reserve to lift interest rates, further falls in commodity prices, weakness in the high-yield credit market and uncertainty surrounding the pace of Chinese economic growth.

Chinese economic data remained weak with heavy declines in steel imports leading to iron ore prices falling a further 23% over the quarter. Oil also fell heavily, closing the quarter down 18% after OPEC surprised the market by effectively abandoning its strategy of limiting production levels in an attempt to drive out higher cost producers and gain market share.

IRON ORE PRICE PER METRIC TONNE



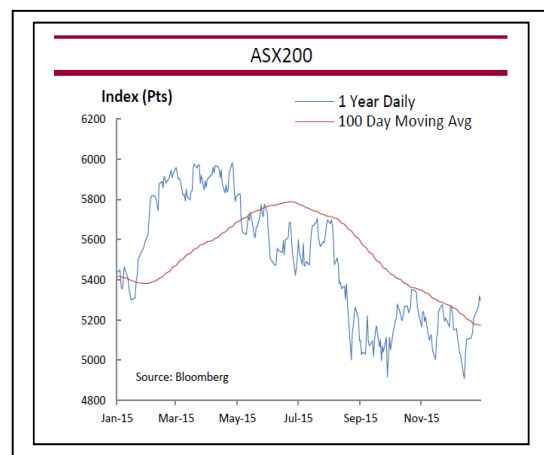
With US employment data pointing to an improvement in the US economy, the US Federal Open Market Committee lifted interest rates by 0.25% during the quarter- its first increase in close to a decade. This removed an element of uncertainty that had weighed on investor sentiment leading up to the event. The move followed the release of solid jobs figures over the quarter, with the US economy adding 654,000 positions and the unemployment rate falling to 5.0%.

In Europe, the European Central Bank moved in the opposite direction by cutting its bank reserve deposit rate to -0.30%. It also extended the life of its quantitative easing programme by six months, but disappointed investors by not raising the scale of purchases. This led to declines on European share markets in December and flowed through to broader global equity markets.

In Australia, despite the slowing resource sector, data released during the quarter suggested that the domestic economy was rebounding from weakness experienced earlier in the year. Employment data was the standout with the Australian Bureau of Statistics announcing the addition of 126,000 new jobs during the December quarter. Domestic growth was also above consensus, while retail sales growth and a lift in business confidence were also encouraging. The Reserve Bank of Australia left the cash rate unchanged at 2.0% with the Board noting that the economic outlook had improved.

MARKETS

The Australian equity market (as measured by the S&P ASX 200 Accumulation Index) finished up 6.5% over the December quarter and 2.6% over the calendar year. At a sector level, Consumer Discretionary (13.4%) was the top performer, while the Health Care (12.4%) and Financials ex-property sectors (11.6%) also generated solid returns. Energy (-1.2%) and Metals & Mining (-7.4%) underperformed once again as commodity prices endured further declines during the quarter.



Smaller company returns fared better compared to large companies and finished the December quarter up 11.3%, as both the smaller company industrial and resource sectors made material positive contributions.

Internationally, the MSCI World ex-Australia Index returned 6.6% for the December quarter and 3.8% over the last 12 months. Returns in Australian Dollar terms were 1.7% for the quarter and 11.8% for the calendar year as movement in the Australian Dollar reduced quarterly gains but enhanced the 12-month return.

During the December quarter, the best performing developed market was Germany (up 11.2%, as measured by the Deutsche Bourse) while Japan's Nikkei Index (up 9.5%) and the United State's Dow Jones Industrial Index (up 7%) recouped losses from the September quarter. While the Chinese share market, as measured by the Shanghai Shenzhen CSI 300 Index, finished the quarter up 16.5%, this only partially offset the significant falls that occurred earlier in the calendar year.

Domestic listed property rose by 6.0% over the December quarter as demand for direct property remained solid across all sectors. Global property also finished higher, up 5.1% over the December quarter and 4.3% over the calendar year.

Australian Government and global bonds were largely flat over the December quarter as bond yields rose marginally. Domestic bonds (as measured by the Bloomberg Composite Bond Index) returned -0.3% for the quarter whilst global bonds (as measured by the Barclays Capital Global Aggregate Index) returned 0.6%. Credit securities were also flat over the quarter, as credit spreads widened in December.

The table below (sourced from Lonsec) summarises the returns from a number of market sectors.

Sector	Index	3 mths (%)	1 year (%)	5 years (% p.a.)
<u>Equities</u>				
Australia	ASX/S&P 200 Accumulation Index	6.5	2.6	7.0
	ASX Small Ordinaries Acc Index	11.3	10.2	-2.5
International	MSCI World ex Aust Index (AUD)	1.7	11.8	15.5
	MSCI World ex Aust Index (AUD Hedged)	6.6	3.8	12.5
Emerging Mkts	MSCI Emerging Mkts (Net Div) (AUD)	-3.3	-4.5	1.9
<u>Listed Property</u>				
Australian	ASX 200 Prop Trust Accumulation Index	6.0	14.3	15.3
International	FTSE EPRA/NAREIT Dev Prop Index (Hedged)	5.1	4.3	11.8
<u>Direct Property</u>				
Australian	Australian Mercer Unlisted Property (pre-tax)	3.8	12.2	10.3
<u>Currencies</u>				
AUD v USD	Against US Dollar	4.1	-10.9	-6.5
<u>Fixed Interest</u>				
Australian	Bloomberg Ausbond Composite All Maturities	-0.3	2.6	6.6
	Bloomberg Ausbond Credit All Maturities	0.0	3.0	6.8
International	Barclays Capital Global Agg Index (AUD Hedged)	0.6	3.4	7.2
<u>Commodities</u>				
Gold	Gold – USD	-4.8	-10.4	-5.7
Oil	WTI Oil \$/b – USD	-17.9	-30.5	-16.5
Base Metals	RBA Index Base Metals (weighted currency)	-6.2	-21.3	-8.6

Economic & Investment Outlook

Global share markets have had a turbulent start to 2016, exhibiting extreme levels of volatility. Uncertainty around the strength of China's economy, as it attempts to transition away from an export based economy to a consumer based one, and misguided attempts by the Chinese government to control share trading activity on the Shanghai bourse, have stoked investor concerns.

Global currencies - from Russia's ruble to China's yuan - tumbled, raising fears of a global "currency war" where countries devalue their currency to stay competitive with their exports.

In the US, stocks have also fallen in January as investors struggled to see how U.S. companies could continue to grow strongly with the greater uncertainty in China and the associated impact on many emerging markets. While the interest rate rise in December 2015 was expected to be followed by a further four rate rises during 2016, recent mixed economic data, continued weakness in oil and a stronger US Dollar now make four rate rises seem increasingly unlikely.

In Europe, data suggests that Eurozone financial conditions and labour markets are improving with Germany, Italy and Spain growing strongly. However weakness in France, following the recent terrorist attack on Paris, political uncertainty, a slowing global economy and tensions with the influx of refugees is likely to dampen future European growth.

In Australia, while domestic economic data has been surprisingly strong, particularly employment, question marks remain over the accuracy of the data, making near term trends in the economy and earnings harder to predict. The Reserve Bank of Australia has the scope to ease monetary policy again if necessary as inflation remains relatively low, but the neutral policy bias remains in place at present.

Australian Shares

We suggest that investors maintain a neutral to overweight position in Australian Equities relative to their benchmark allocation.

While the Australian share market remains somewhat linked to developments in China, valuations are reasonably neutral, with the market trading at a price-earnings ratio of around 14.5 times (very close to its 20-year average) and a dividend yield of close to 5%.

Investors are expected to focus on earnings in coming weeks, with the next reporting season due to begin in early February. Outside of resources, where earnings are likely to struggle again this year given continued pressure on commodity prices, the earnings outlook appears reasonable for a large part of the Industrial sector. A weaker Australian dollar and solid retail sales expected to boost profits.

Global Shares

We suggest that investors maintain a neutral to underweight position to International Equities relative to their benchmark allocation.

With global market fundamentals mixed and many of the issues and uncertainties that affected global markets in previous months yet to be resolved, heightened volatility in global equities is expected to continue. As emerging market valuations are also high, we prefer developed markets over emerging markets.

From a regional perspective, our preference remains Japanese and European stocks over US stocks, partly due to more favourable valuations and partly due to the contrast in the trend in monetary policy settings between the US Federal Reserve relative to the European Central Bank and Bank of Japan.

Property

While low bond yields have driven property returns, due to the gap between bond and property yields, the general fundamentals for the listed property sector remain positive. Domestically, the sector is priced on a 2016 financial year dividend yield of 5.0% and a Price to Earnings ratio of 16.5 times earnings. Earnings and balance sheets are also stable with sector gearing currently at 29%.

However, future returns from both domestic and international property are expected to be dependent on movements in long term bond yields. With bond yields low, we recommend that investors take a cautious approach and maintain a neutral position to this sector.

While unlisted property trusts have provided investment opportunities, offshore buyers have pushed prices up in this area. We therefore advise investors to be wary and only invest in unlisted options where good value is apparent.

Fixed Interest

Within fixed interest markets, we remain cautious as most fixed interest securities are now considered expensive. However, some relative value exists in Australian Government bonds as well as global and domestic investment grade credit.

Although we recommend an overall underweight position to fixed interest, investors should consider some exposure to the above areas within this sector.

Sources: Lonsec, RBA

Please note that the information above is general in nature and does not take into account your personal circumstances, financial needs or objectives. Before acting on this information, you should consider its appropriateness having regard to your objectives, financial situation and needs. In particular, you should speak to Kevin Smith of The Professional Super Advisers on (02) 9955 5800 prior to acting upon this information.