Economic and Investment Update – April 2016

The March 2016 quarter was again dominated by share market volatility with significant falls in January and February followed by a modest recovery in March. Political factors such as the US Presidential primaries and the "Brexit" referendum have not helped.

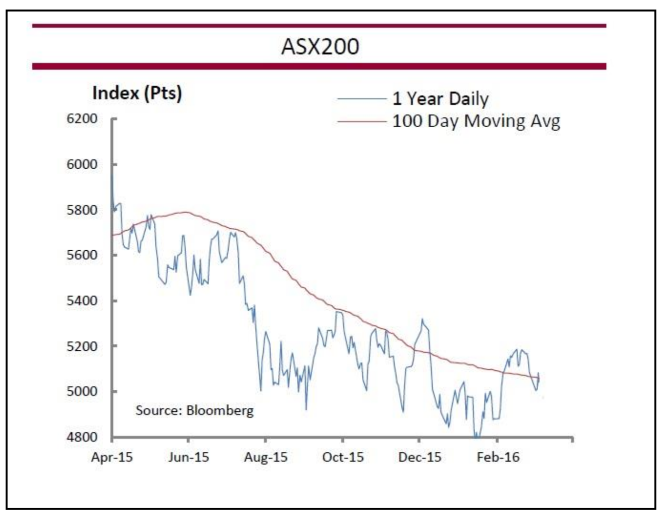
In the US, the Federal Reserve had been expected to increase rates four times in 2016. However, weak economic data and global market turmoil resulted in a more "dovish" stance with the projected number of increases in 2016 reduced to two. This led to a weakening in the US Dollar and a rally in the yen, emerging market currencies and commodity currencies, such as the Australian Dollar.

In Australia, the RBA official cash rate has been on hold at 2% for the past 12 months. Surprisingly strong March economic data gave support to the RBA's projected annual growth rate of 3%. However, a stronger Australian Dollar, a declining inflation rate and the economic transition away from the commodity sector, indicate a bias towards lower rates.

Chinese economic growth continued its structural decline but is being guided to a soft landing via monetary and fiscal stimulus. Loosening bank reserve requirements and six interest rate cuts over the past year led to a surge in credit as new loans rose over 25% for the year. Consequently, there has been an upturn in the housing sector as well as a lift in infrastructure investment. However, the Chinese GDP growth target of between 6.5 and 7% may be hard to sustain.

Stimulatory monetary policy from the European Central Bank in the form of lower interest rates has started to hurt savers. Conversely, unemployment rates fell to 4.3% in Germany and 20.4% in Spain (down from a high of 26%). A slight fall in the unemployment rate to 10.2% was also recorded in France whilst a marginal rise to 11.7% was recorded in Italy (previously as high as 13%). Sluggish growth rates (overall at 1.6%) were attributed to lacklustre demand accompanied by falling prices.

MARKETS



The Australian equity market (as measured by the S&P ASX 200 Accumulation Index) finished down 2.7% over the March quarter and down 9.6% for the year to March 2016. At a sector level, Industrials (5.3%) was the top performer, while Materials (5.2%) also generated solid returns. Financials (-7.1%) underperformed, as bank shares retreated significantly from recent highs.

Smaller company returns again fared better compared to large companies and finished up 1.0% for the March quarter and 3.7% for the year.

Internationally, the MSCI World ex-Australia Index returned -1.8% for the March quarter and -3.1% over the last 12 months. Returns in Australian Dollar terms were -5.8% for the quarter and -3.9% for the last 12 months as movement in the Australian Dollar enhanced falls, particularly over the last three months.

During the March quarter, the best performing developed market was the US (up 1.5%, as measured by the Dow Jones Industrial Index) whilst large falls were recorded in Japan (down 12%, as measured by the Nikkei Index) and China (down 13.7% as measured by the Shanghai Shenzhen CSI 300 Index). The Shanghai Index has endured a volatile ride with a loss of over 20% for the 12 months to 31 March 2016, a gain of 8.9% p.a. over 3 years and a flat return (0.0%) over 5 years.

Domestic listed property rose by 6.4% over the March quarter, supported by low interest rates and overseas demand. Global property also finished higher, up 3.3% over the March quarter and 0.7% over the year to 31 March 2016.

Australian Government and global bonds produced gains as bond yields fell. Credit securities also finished higher over the quarter. Domestic bonds (as measured by the Bloomberg Composite Bond Index) returned 2.1% for the quarter whilst global bonds (as measured by the Barclays Capital Global Aggregate Index) returned 1.4%.

The oil price (as measured by the West Texas Intermediate price in USD) recovered slightly from recent falls, up 3.5% for the quarter but down 19.5% for the year to 31 March. As discussed above, the US Dollar weakened, resulting in a 5% rise in the Australian Dollar (against the USD).

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.)**
Equities				
Australia	S&P/ASX 200 TR Index	-2.7	-9.6	5.7
	S&P/ASX Small Ordinaries TR Index	1.0	3.7	-2.1
International	MSCI World ex Aust NR Index (AUD)	-5.8	-3.9	13.3
	MSCI World ex Aust NR Index (AUD Hedged)	-1.8	-3.1	11.0
Emerging Mkts	MSCI Emerging Mkts NR (AUD)	0.0	-12.6	1.7
Listed Property				
Australian	S&P/ASX 200 Prop Trust TR Index	6.4	11.3	15.9
International	FTSE EPRA/NAREIT Dev Prop NR Index (Hedged)	3.3	0.7	11.8
Direct Property				
Australian	Australian Mercer Unlisted Property (pre-tax)	3.5	13.3	10.5
Currencies				
AUD v USD	Against US Dollar	5.2	0.7	-5.7
Fixed Interest				
Australian	Bloomberg Ausbond Composite All Maturities	2.1	2.0	6.6
	Bloomberg Ausbond Credit All Maturities	1.4	2.2	6.6
International	Barclays Capital Global Agg Index (AUD Hedged)	3.7	4.5	7.7
Commodities				
Gold	Gold – USD	16.2	4.2	-3.0
Oil	WTI Oil $/b – USD	3.5	-19.5	-18.5
Base Metals	RBA Index Base Metals (weighted currency)	4.4	-15.2	-8.4

Economic & Investment Outlook

Since the end of the quarter, markets have continued to rally off the back of a short term rise in oil prices coupled with positive news out of China, with trade numbers exceeding expectations.

In the US, economic news remains mixed. Eyes are on the upcoming reporting season where strong company earnings figures are required to underpin share price growth.

It is likely that Europe, Japan and probably China will continue on their monetary easing path. However, central bank policy is losing some of its impact.

With global growth in limbo, the expectations are for continued periods of market volatility interspersed with periods of relative market calm.

The recent rise in the Australian Dollar is likely to be supported by an improvement in our terms of trade given the recent 50% recovery in the iron ore price. The continued strength of the Australian Dollar against the US Dollar is however dependant on the US Federal Reserve maintaining its dovish stance (i.e. "lower for longer" interest rates).

Australian Shares

We recommend investors hold a neutral position in Australian Equities with the market currently trading in line with its 15 year average.

However, equity valuations do not look particularly compelling particularly in the top 20 stocks where earnings growth has been subdued. As such, it is becoming more of a stock pickers market.

Although small cap stocks have continued to outperform the bigger end of town, a cautious approach to small cap stocks should be adopted going forward due to increased risk of volatility.

Global Shares

We maintain our recommendation for investors to hold a neutral to underweight position to International Equities relative to their benchmark allocation.

As emerging market valuations remain high, we have a preference for developed markets.

The risk return profile in Europe looks attractive although a stronger Euro poses a threat to the earnings outlook. A similar prognosis can be attributed to the Japanese market. Conversely, a slower than expected recovery in the US may receive some impetus from a weaker US Dollar.

Property

We maintain our neutral stance to property with a caution to investors to trim back any overweight positions.

As previously noted, future returns from both domestic and international property are expected to be dependent on movements in the long term bond yields. At some point in the future, global bond yields will normalise (e.g. rise) and leveraged positions (e.g. REITS and unlisted syndicates) will suffer.

However, for the time being, the global macroeconomic climate is more conducive to the maintenance of relatively low interest rates. Furthermore, in Australia, the official cash rate is more likely to fall rather than rise. As such, property offers some short term attraction.

Fixed Interest

Global bond rates rallied over the quarter and we maintain our recommendation to hold an underweight position across most fixed interest sectors, relative to benchmark.

However, global credit appears relatively more attractive albeit that market volatility and economic uncertainty pose a risk to investors.

Sources: Lonsec, RBA, Blackrock