NEWSLETTER

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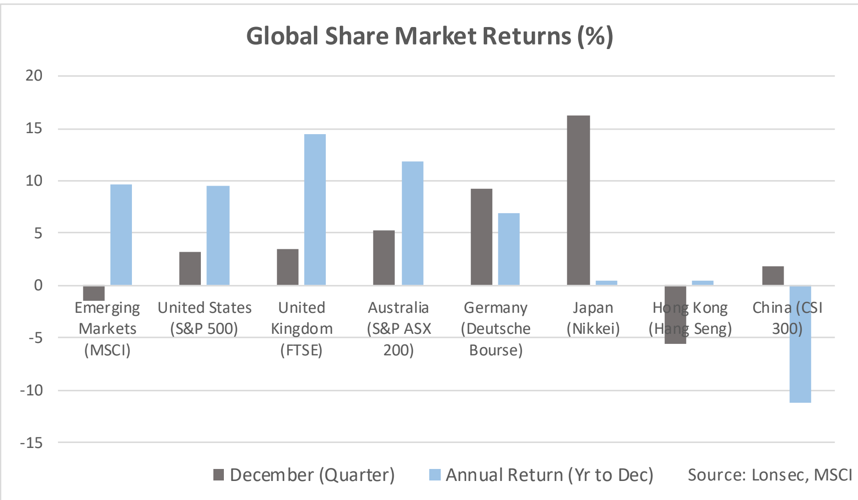
Financial Markets – December Quarter 2016 Review

Although the events surrounding the United States election were highly unusual, the reaction on financial markets was positive and in the direction of a normalisation of interest rates and inflationary expectations. In summary, the December quarter produced the following:

- Stronger equity markets across the globe and in Australia
- Increased inflationary expectations
- Higher longer term interest rates, producing negative returns for the fixed interest asset class and interest rate sensitive sectors such as property and infrastructure
- A stronger $US

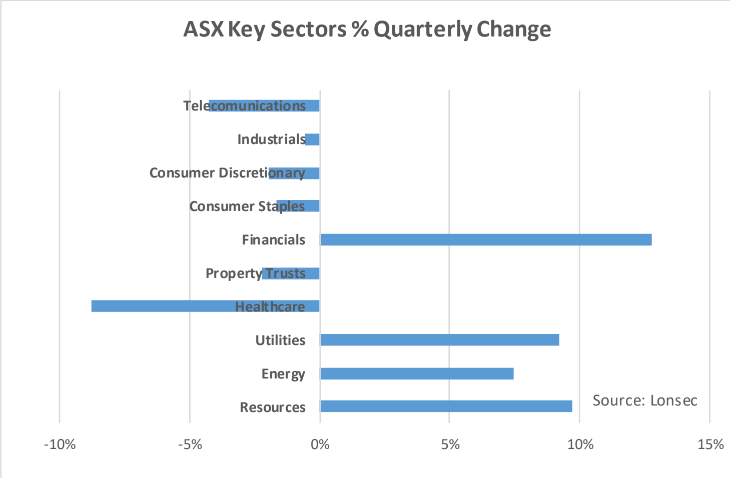
After a weak start to the quarter, share prices rallied in response to the Republican victory in the U.S. Presidential election. Hopes of increased government spending and reduced corporate taxation rates in the U.S. contributed to the post-election optimism on markets. The U.S. market reached new record highs during the quarter, with the S&P 500 Index gaining 3.3%. Significant increases were also recorded on the Japanese market, which rose by 16.2%. The post-Brexit gains also continued in Europe, where the U.K FTSE Index finished 3.5% higher and the German Deutsche Boerse Index was up 9.2%.

Returns from global equities for Australian investors with unhedged currency positions were given a boost over the December quarter by a weaker Australian currency. A rise in bond yields in the U.S. saw the $US gain buying support, thereby pushing other currencies lower. The $A declined U.S. 3.9 cents to U.S. 72.4 cents over the course of the quarter. Against various other currencies, however, the $A strengthened, rising 9.5% against the Japanese Yen and 1.0% against the Euro.



Emerging markets moved against the general trend. The MSCI Emerging Market Index fell by 1.4% over the quarter, with significantly lower

prices in China and India contributing to this decline. The possibility that a Trump administration may act to curb world trade volumes via increased trade protection (particularly in relation to China) may have negatively influenced emerging markets last quarter. Fears that a stronger $US, and rising U.S. interest rates, may result in a flow of funds from emerging economies to the U.S. could have also been a concern for investors.



Following a long period of under-performance, the Australian banking sector led the local share market higher during the December quarter, with the finance sector increasing 12.8%. Strong gains were also recorded by the energy (up 7.5%) and resources sectors (up 9.7%). The rise in energy stocks was assisted by confirmation that members of the OPEC cartel agreed to cut individual country production quotas. Further increases in the price or iron ore and coal once again boosted the earnings prospects of resource stocks. Outside of the finance and resources, there were few gains with negative results posted by several sectors. With the exception of the utilities sector, investors appeared to sell out of the previously well supported defensive sectors such as healthcare and listed property. Rising bond yields may have resulted in these sectors appearing expensive on a relative basis.

The positive performance of the large Australian banks and resource companies also appeared to trigger selling at the smaller company end of the market. The Small Ordinaries Index was 2.5% weaker over the quarter; but remains 13.2% ahead on an annual basis.

Consistent with the expectation of higher inflation following the U.S. election result, was the increase in longer term interest rates – both in the U.S. and elsewhere. The 10-year government bond yield in the United States

Asset Class	Dec Qtr % Return
Australian Equities	5.2%
Global Equities - Unhedged	7.7%
Global Equities - Hedged	5.2%
Australian Listed Property	-0.7%
Global Listed Property	-2.7%
Global Listed Infrastructure	-0.9%
Australian Fixed Interest	-2.9%
Global Fixed Interest	-2.2%
Cash	0.4%

rose from 1.60% to 2.45% over the course of the quarter. In Australia, the equivalent yield rose by a similar margin, increasing from 1.91% to 2.76%. Further entrenching a higher interest rate environment was the announcement of a cash interest rate increase by the U.S. Federal Reserve following its December meeting. In Australia, expectations of a further reduction in the overnight cash rate have faded, despite additional evidence of softness in the domestic economy. The jump in bond yields during the December quarter resulted in negative returns being recorded for the fixed interest asset class. Average losses in the Australian fixed interest sector were 2.9%, with a 2.2% fall being recorded by global fixed interest.

Portfolio Positioning

Our portfolios continued to benefit from their asset allocation positioning with underweight exposures to fixed interest and property reducing the impact of low and negative returns from these sectors. The bias towards global equities being held on an unhedged basis also added value over the quarter, with a lower $A increasing the value of foreign domiciled assets.

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).