NEWSLETTER

Financial Markets – June Quarter 2017 Review

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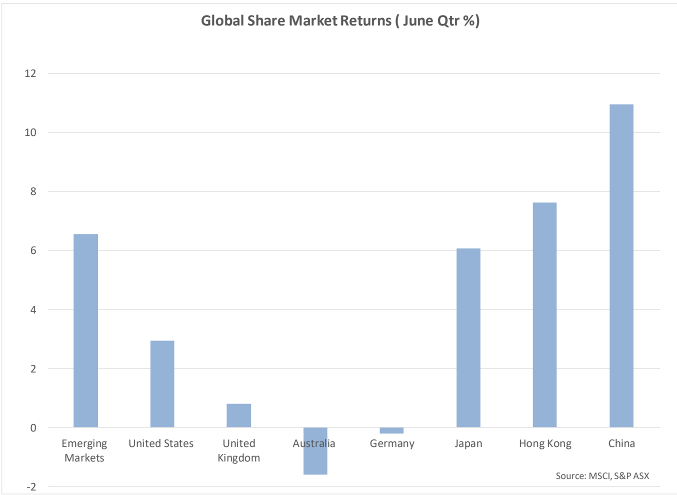
Most asset classes, with the exception of Australian equities and property, rose over the quarter. Global equities continued their push ahead, with emerging markets particularly strong and Japan benefitting from signs of an expanding economy. Long term bond yields dipped over the quarter, although a more hawkish tone from the world's central bankers at the back end of the period led to a rise in bond yields during June. In summary, the June quarter produced the following:

- Solid results from emerging markets benefitting from a weak $US.
- Developed market equities grinding higher with a focus on fundamentals, rather than Trump.
- Australian equity markets were a notable laggard as a number of sectors struggled.
- A more hawkish tone from the world's central bankers at the end of June.
- Continued weakness in key commodities, including iron ore and oil.
- The $A gained slightly against the $US, but was lower against the Euro and the Pound.

Asset Class Return	3 Months	Annual
Australian Equities	-1.6%	14.1%
Global Equities - Unhedged	3.6%	14.7%
Global Equities - Hedged	3.2%	20.6%
Australian Listed Property	-3.0%	-5.6%
Global Listed Property	0.9%	-1.6%
Global Listed Infrastructure	4.0%	13.4%
Australian Fixed Interest	1.0%	0.3%
Global Fixed Interest	1.2%	0.5%
Cash	0.4%	1.8%



Emerging market equities enjoyed strong gains over the quarter, rising 6.6% as improving global growth sentiment acted as a tailwind and some of the negativity towards the asset class at the start of the year started to wane. Concerns that President Trump's pro-growth agenda would lead to a strong $US and an outflow from emerging economies have not come to pass. In fact, the $US has been a poor performer this year and emerging market currencies strong. China's equity market rose 11%, ignoring widespread held concerns about a slowing economy and a clamp down on liquidity and leverage in the financial sector by Chinese authorities. Developed market equities, as represented by the MSCI World ex Australia Index, rose 3.6% in local currency terms and 3.2% in currency hedged terms. Japan (+6.1%) was a standout as its economy continued to show signs of expansion and government policy continued to be supportive.

In the US, some of the initial market enthusiasm for President Trump dissipated as implementation of key reforms proved to be somewhat harder than many expected. President Trump attracted ongoing controversy with the sacking of FBI director, James

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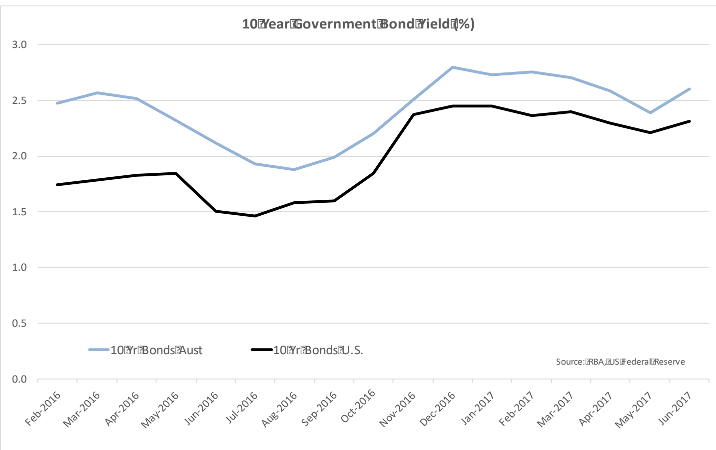
Comey, in May. Nonetheless, US equities moved higher over the quarter with a 3.0% return, putting to one side these controversies and focusing on stock fundamentals.

Quarterly U.S. earnings results highlighted traditional retailers as one of the weaker areas, with declining sales caused by the ongoing structural shift to on-line purchasing. This led to a sell-off in the department store sector. While the FAANG (Facebook, Apple, Amazon, Netflix, Google) stocks continued to gather momentum early in the quarter, this slowed during the period with a rotation back to Financials. This move to Financials was partly valuation driven, but also supported by the Federal Reserve raising its funds rate 0.25% to 1.25% at its mid-June policy meeting - the fourth hike in the current tightening cycle. In addition, the results of annual bank stress testing, which saw every major institution pass for the first time, was also viewed positively by the market providing a further tailwind to financials.
Within Europe, markets were mixed over the quarter, initially buoyed by the election of centrist Emmanuel Macron as French President on May 7th; having comfortably defeated the right wing, Marine Le Pen. The election of Macron should, for now, ease concerns about the future of the Euro with both himself and Germany's, Angela Merkel, following a pro-European agenda. A statement from the typically dovish European Central Bank (ECB) President, Mario Draghi, in the final week of June signalled a possible end to the deflation threat in the Eurozone. This led to a jump in bond yields in the region and speculation that the ECB would end its bond buying program sooner than expected. Similarly, a statement from the Bank of England's Mark Carney was seen as being more upbeat about the UK's prospects. Both statements appeared to signal a notable change in policy which had previously been broadly neutral to dovish. Combined with an increase in the Euro and Pound, these announcements created headwinds for European equities over the quarter. The UK equity market finished the quarter up just 0.8%, with the terror atrocities and the government's failure to return to office with the majority they had hoped for weighing on market confidence.

Australia was one of the weaker equity markets over the quarter, with a -1.6% return. This was due to a number of sectors coming under pressure, hiding strength in Healthcare (+7.2%) and Industrials (+8.9%). Preliminary data for the RBA Commodity Price Index indicated a decline of 17% in the June quarter. The fall in oil and iron ore prices clearly impacted returns in Energy (-5.7%) and Resources (-2.7%). Consumer stocks also struggled, following the news of Amazon's entrance into the Australian market. In addition, banking stocks came under pressure in May, with the S&P/ASX 200 Financials Index finishing the quarter down 4.4%. This was due to fears of an emerging housing bubble and the announcement in the 2017/18 Federal Budget of a levy to be imposed on the major banks.



Sovereign bonds gained over the quarter. The 10-year government bond yield in the United States fell from 2.40% to 2.31%. In Australia, the 10-year government bond yield declined from 2.70% to 2.60%. Both yields had been lower during the period but thanks to the more hawkish tones from leading central bankers, yields spiked in June. Lower yields likely had an impact on interest rate sensitive investments, such as global listed infrastructure, which was up 4% over the quarter. It is, however, worth noting that the statement from Australia's Reserve Bank at the start of July was notably more neutral than that of overseas central banks, a sign that Australia may be later than other developed markets in shifting away from the current exceptionally loose monetary policy.

Portfolio Positioning

Our portfolios continued to benefit from their asset allocation positioning with underweight exposures to fixed interest and property reducing the impact of lower returns from these sectors. The unhedged currency exposure has also provided a source of enhanced returns over the past three months. Our portfolios continue to be positioned around an expectation of higher inflation and higher interest rates in the U.S., which may place further downward pressure on the Australian dollar.