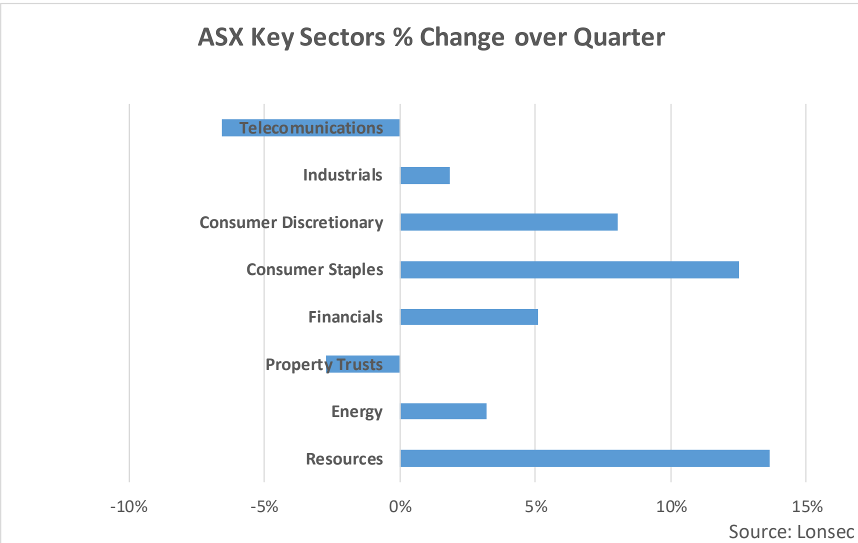
Financial Markets – September Quarter 2016 Review

NEWSLETTER

Phone: 1300 763 544 | Email: info@fmfinancial.com.au | Web: www.fmfinancial.com.au

The September quarter commenced with higher than normal volatility in the aftermath of the Brexit decision. Whilst the Brexit outcome failed to show any lasting impact on most major financial markets, the September quarter finished with a spike in uncertainty over global interest rates. By the end of the quarter, evidence was building that the low inflation-low interest rate spiral may be nearing its floor. The European Central Bank provided a hint that interest rate policy may be near exhaustion point when they failed to discuss the prospect of any further extension of their Quantitative Easing program in September. News of potential oil supply capping by OPEC created additional doubt over the sustainability of current monetary policy settings, as rising oil prices in September provide a potential counter force to the deflationary momentum that has been so dominant over recent years.

This lowering in the conviction around an outlook of continued excessively loose monetary policy resulted in some volatility in bond yields. The U.S. 10-year Government bond yield finished the quarter 0.10% higher at 1.60%, after falling by nearly 0.8% in the first 6 months of the year. In Australia, the equivalent yield actually declined slightly over the quarter from 1.98% to 1.91%. Higher bond yields in the U.S. were recorded despite the fact that the U.S. Federal Reserve decided to leave monetary policy unchanged. Following their September Committee meeting, the Board of Governors of the U.S. central bank stated that *"the case for an increase in the federal funds rate has strengthened but (the Committee has) decided, for the time being, to wait for further evidence of continued progress toward its objectives."* In contrast to the tightening bias in the U.S., cash interest rates were again lowered in Australia, with an easing of monetary policy in August resulting in the overnight cash interest rate dropping from 1.75% to a record low of 1.5%.



Uncertainty over the outlook for interest rates resulted in a significant sell-off in various interest rate sensitive equities

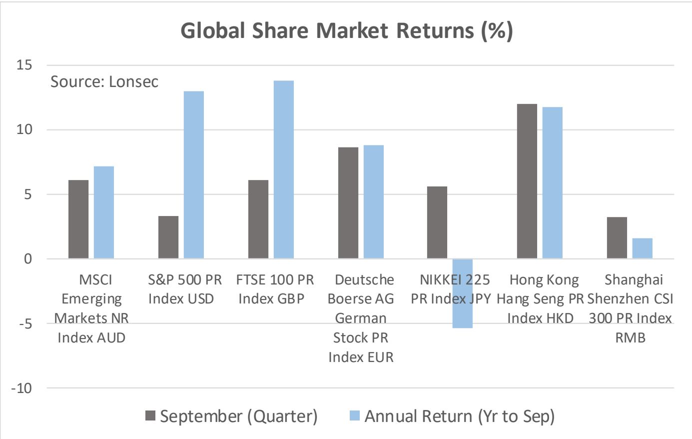
Financial Markets – September Quarter 2016 Review

over the September quarter. After being bid up strongly in price over recent years, equity sectors offering higher yields and steady cash flows declined in value last quarter. Listed property was a prime example, declining by 1.9% in Australia. It was also a negative month for the Australian utilities sector (down 2.4%) and the telecommunications sector (down 6.6%). These declines came against a backdrop of generally stronger equity markets.

In contrast to the property and utilities sectors, resource stocks led the local equity market higher with a jump of 14% in the September quarter, following further gains in commodity prices. Positive results were also recorded by the consumer staples sector (up 12.5%) and the finance sector (up 5.1%). As has been the case for much of the past year, smaller companies outperformed their larger counterparts during the September quarter, with the Small Ordinaries Index rising 8.5%. This compared favourably with the S&P ASX 200 Index increase of 5.1%. Over the past 12 months, smaller companies have significantly outperformed the largest 20 stocks on the Australian share market, with the former rising in value by 29.2% and the latter only 6.7% higher.

Asset Class	Sep Qtr % Return
Australian Equities	5.1%
Global Equities - Unhedged	2.0%
Global Equities - Hedged	5.6%
Australian Listed Property	-1.9%
Global Listed Property	2.1%
Global Listed Infrastructure	2.3%
Australian Fixed Interest	1.0%
Global Fixed Interest	0.8%
Cash	0.4%

As was the case in Australia, global share markets finished the September quarter in positive territory. For investors with hedged currency positions, the average return from global shares was 5.6% over the 3-month period. However, due to an appreciation in the Australian dollar, the average return received by investors with unhedged currency positions was less impressive at 2.0%. Supported by rising commodity prices, the $A jumped by U.S. 2.0 cents to U.S. 76.3 cents. A higher $A reduces the $A value of investments domiciled in foreign currencies (i.e. unhedged investments).



The U.S. market held back global averages over the September quarter, with the S&P 500 gain restricted to 3.3%. Stronger rises were recorded in the U.K. (up 6.1%), Germany (up 8.6%) and Japan (up 5.6%). It was also a strong quarter for emerging markets,

with the MSCI Emerging Market Index advancing 6.1% over the quarter.

Portfolio Positioning

The pattern of movement across asset classes emerging over the September quarter created areas of gains for our portfolios when with compared with standard market indexes. Underweight positions in Australian fixed interest and property protected portfolios against low returns in these sectors. A material allocation to smaller companies has also continued to provide a source of outperformance in recent months.

However, the above gains were neutralised by the fact the portfolios continue to hold international global equities on an unhedged currency basis. In recent months this positioning has detracted value from portfolios as the $A has appreciated, due in part to stronger commodity prices. None-the-less, the unhedged exposure may add relative value should commodity prices decline or interest rates in the U.S. increase in the months ahead. Both these scenarios may have negative implications for investment returns. As such, the unhedged currency exposure could help stabilise portfolios under either of these scenarios.

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).

FM Financial ABN 80 074 824 749 is an Authorised Representative of Hillross Financial Services Limited, ABN 77 003 323 055, AFSL 232705 The information in this article is not advice and is for general use only as it has not taken into account your objectives, financial situation or needs. If you have any questions on the article please contact your financial planner before taking any action.