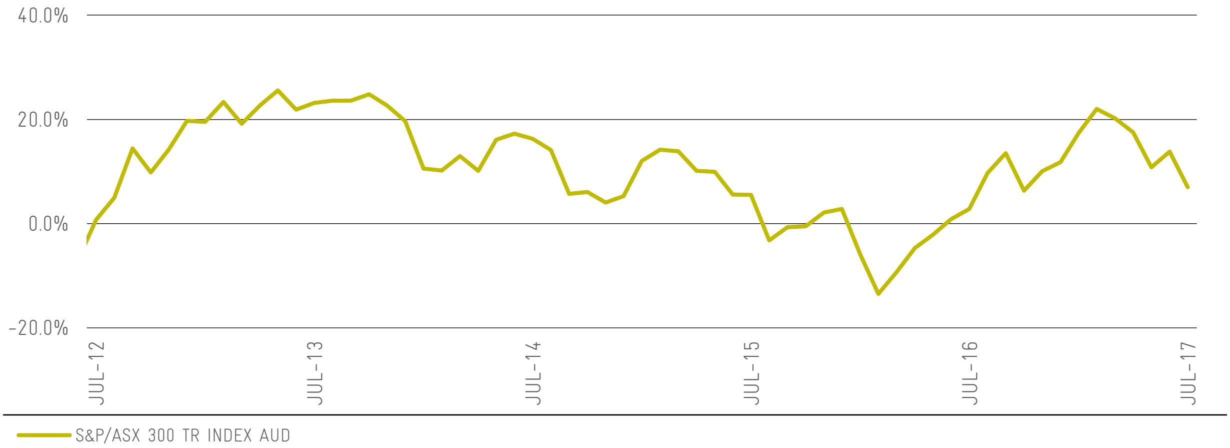
ISSUE DATE: 25-08-2017

Market Update

Australian Equities – Rolling 1Y returns (% p.a.)



Source: Bloomberg, Lonsec
For the Period Ending 30/07/2017

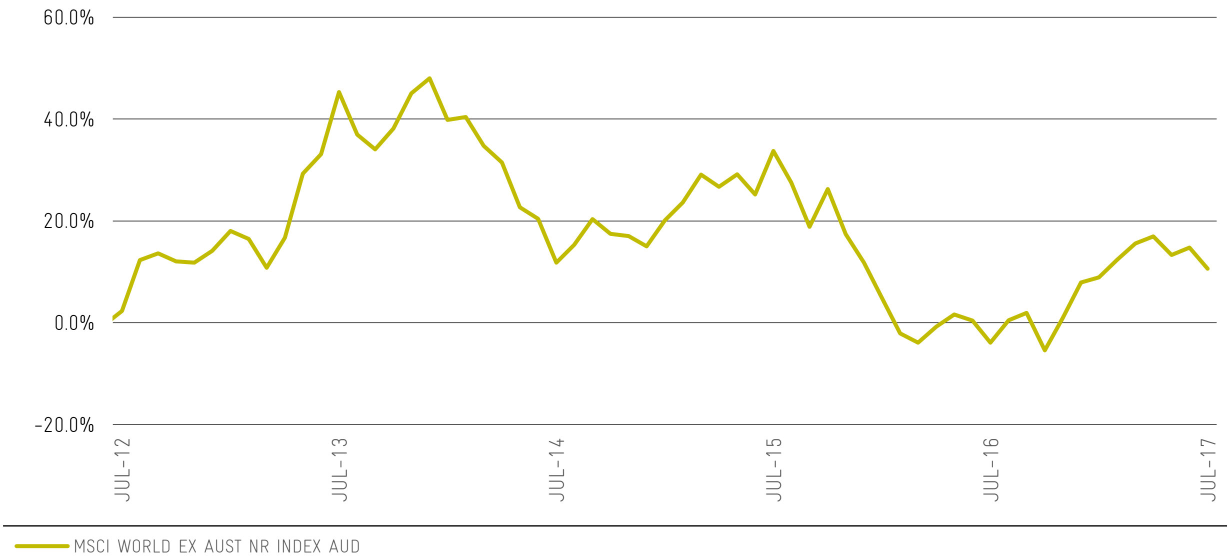
The Australian market had another flat month in July, down 0.01%, with gains from the Materials (+3.57%) and Financials (+1.25%) sectors propping up the index. Within the Financials sector, big four Westpac (+4.29%) and ANZ (+3.17%) enjoyed positive gains, while nonbank lenders FlexiGroup (+5.75%) and recently listed Eclipx Group (+3.92%) rose after reaffirming earnings guidance for FY17. Gold miner Saracen Mineral Holdings (+14.96%) led the gains for the Materials sector, announcing strong drilling results at its Carouse Dam and Thunderbox mines.

Healthcare, which added 23.48% in H1 2017, was down in July, falling 7.47%. Mayne Pharma (-11.52%) was the hardest hit, with further underperformance of its $900m generic portfolio acquisition from Teva Pharmaceutical Industries. Bucking the trend was Sigma Healthcare (+7.26%), which reached a negotiated settlement with Chemist Warehouse Group over a disputed supply agreement. Australian small shares managed a small positive gain, with the S&P/ASX Small Ordinaries Accumulation Index returning 0.34%.

ISSUE DATE: 25-08-2017

Market Update

International Equities – Rolling 1Y returns (% p.a.)



Source: Bloomberg, Lonsec
For the Period Ending 30/07/2017

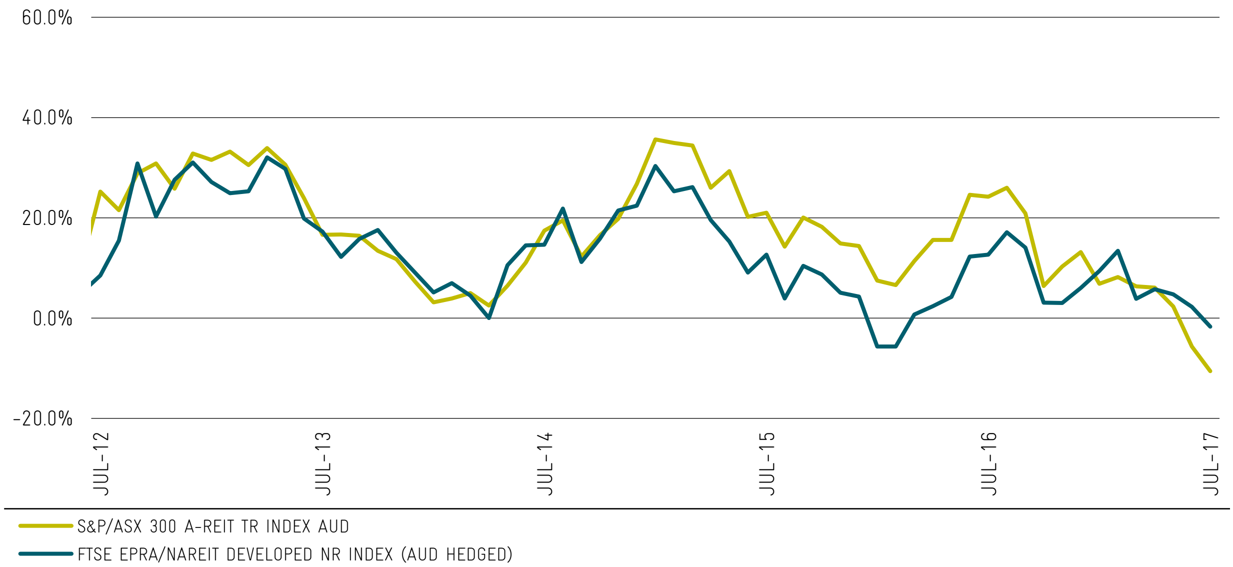
The S&P 500 gained 1.93% in USD terms and pushed to a new record high, but fell 1.94% in AUD terms as the USD weakened. Telecommunications (+2.34%) and Information Technology (+0.39%) were the only sectors to gain in AUD terms. Heavyweight Verizon Communications posted 5.66%, while Facebook Ashares rose 7.86% and GPU manufacturer NVIDIA gained 8.16%. The Dow Jones Industrial Average pushed above 22,000 points for the first time, with no small thanks to Apple, which jumped 3.27% in USD terms before hitting a new record high in early August. Reinforcing the aura of invincibility for US shares, the VIX, otherwise known as the 'fear index', closed at its lowest level ever in July at 9.36, and even hit an intraday reading of 8.84 (the first time the VIX has ever fallen below 9).

Globally, the MSCI World Index lost 1.59% in AUD terms, with the Japanese and German markets the main drags. The Euro Stoxx 600 Index fell 0.77%, with gains from the Resources (+7.74%) and Insurance (+2.89%) sectors helping to stem the tide. The DAX fell 3.90% as a crisis erupted in Germany's automotive industry, with the big five (Audi, BMW, Daimler, Porsche and VW) threatened with multi-billion euro fines for cartel behaviour by the European and German competition authorities. The French CAC 40 eased 0.95%, while in the UK the FTSE 100 Index fell a further 1.65% after dropping 4.73% in June. In Asian markets, the Nikkei 225 Index fell 2.62% while the Shenzhen CSI 300 Index was down 1.33%. The MSCI Emerging Markets Index rose 1.81%, supported by Chinese and Indian shares.

ISSUE DATE: 25-08-2017

Market Update

Australian Listed Property Trusts — Rolling 1Y returns (% p.a.)



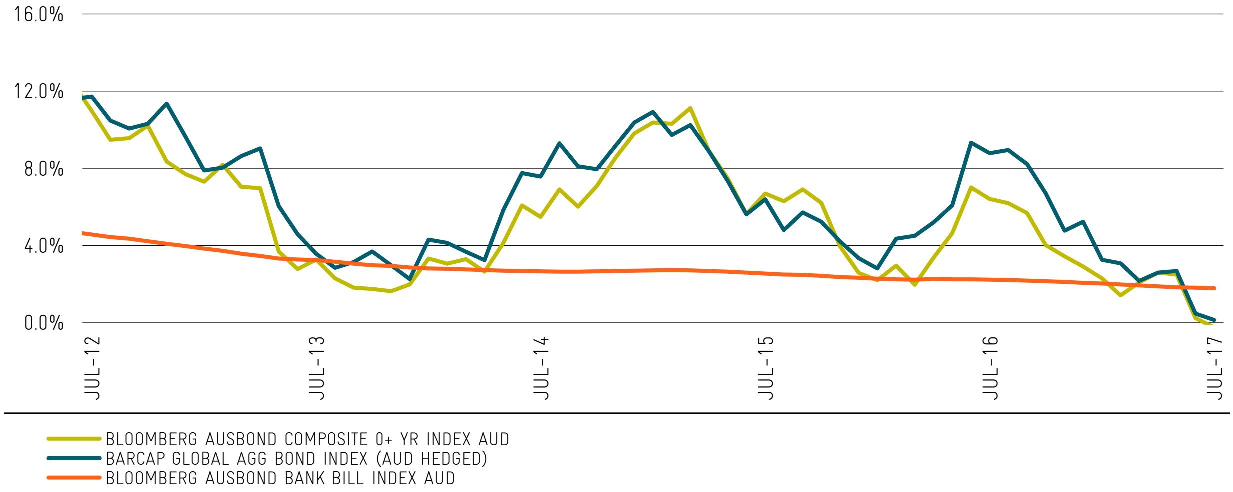
Source: Bloomberg, Lonsec
For the Period Ending 30/07/2017

The S&P/ASX 300 A-REIT Accumulation Index had another tough month in July, losing 0.15% with a rise in bond yields placing some pressure on the sector. Retailfocused REITs were mixed, with Westfield Corporation (-4.63%) down while Vicinity Centres (+7.00%) and Scentre Group (1.98%) were able to shake off the Amazon blues. Australia's largest residential developer Stockland lost 4.11%, with cap rates on recent major deals tightening. The best performing A-REIT in July was popular dividend share Rural Funds Group (+8.13%), with diversified farmland property and attractive rental agreements. A-REITs are offering a current-year distribution yield of around 4.9%.

Global REITs were slightly higher in July, with the S&P Global REIT NTR Index returning 1.00% (in AUD hedged terms), while the FTSE EPRA/NAREIT Developed NR Index managed a more modest gain of 0.88%. Stronger than expected earnings across the US REIT sector supported gains, including from the beatendown retail space, helped along by weaker earnings from Amazon. Halfway through earnings season, apartment, shopping centre, industrial and data centre REITs have been the clear winners. Volumes from office and retail REITs remain low due to slow employment growth from offices taking up leases.

Market Update

Fixed Interest — Rolling 1Y returns (% p.a.)



Source: Bloomberg, Lonsec
For the Period Ending 30/07/2017

Global yields were mixed in July, with long-term yields in Europe generally rising and spreads narrowing, while in the US and UK yields were down slightly. The US 10-year Treasury yield fell from 2.31% to 2.30% after rising to an early high of 2.39%. The return on US corporate investment grade bonds was 0.76% in July, with the index reaching a new record high, while US high-yield debt returned 1.15%, with the index similarly near record high levels.

The BofA Merrill Lynch US High Yield OAS narrowed slightly in June from 3.77% to 3.61% and reached a high of 3.85%. Global bonds, measured by the Barclays Global Aggregate TR Index, returned 0.37% in July (in AUD hedged terms), with a number of developed market indices pushing to new record highs. Returns on Australian corporate bonds were 0.17% while government bonds returned 0.55%. The Australian 10- year Treasury yield rose from 2.66% to 2.68%, hitting a three-month high of 2.75%. The UK 10-year Gilt yield rose from 1.26% to 1.23% in July. In contrast, the German 10-year Bund yield rose from 0.46% to 0.54%.

Market Update

Many market commentators, including us, have commented on the low level of volatility in the market. The CBOE VIX index, which measures the implied volatility for S&P 500 options, is currently at very low levels, suggesting that the market is pricing in a low level of risk. At the same time, market momentum has been strong. This can be seen by looking at simple price momentum indicators such as the 50- and 200-day market moving averages as well as market trade volumes. Both measures indicate that market momentum is positive.

Valuations, while not at extreme levels, are certainly not cheap, and the equity-bond yield differential has also narrowed, making allocating capital increasingly challenging. As discussed in previous editions of the *Investment Outlook Report*, we have seen an improvement in economic indicators, however over the past month economic signals have been mixed, particularly in the US. We believe that in the short term, markets may continue their upward trajectory, however environments characterised by strong momentum and low expectations of risk can by symptomatic of risk being mispriced and the risk of a tail event increasing. In such environments, we encourage investors to be cautious and to be selective in their investment decisions.

Our asset allocation tilts have not changed since last quarter. We continue to hold a slight underweight exposure to equities and listed property, and an overweight exposure to alternatives and cash.

Key Economic and Market Risks

- **Global deflation pressures intensify (negative)**

  Excess global capacity and deficient demand growth have contributed to the weakness in wages growth, declining commodity prices, weak world trade and unusually weak service sector prices. China exports deflation as it seeks to lower its currency to deal with excess investment and capacity. Protectionism and currency wars further undermine growth and confidence. President Donald Trump winds back free-trade agreements, applies tariffs to China, leading to retaliatory actions.

- **Chinese “hard landing” (negative)**

  A downturn in the property market exposes high levels of local government debt, the yuan is allowed to depreciate and capital flows intensify. This leads to GDP growth well below 5%. Negative for the global economy but particularly the Australian economy, equities, commodity prices, emerging markets and particularly resources and the AUD. Bonds outperform.

- **Stronger global growth (mixed)**

  China stabilises growth around 6.5% while US domestic demand surprises to the upside on the back of sustained employment growth and fiscal expansion under President Trump, as well as an overdue lift in wages growth and investment. Europe and Japan continue to improve, supported by extremely easy policies. EM economies continue to recover. AUD rises, bond yields sell off sharply, undermining interest rate sensitive assets and sectors. Equities remain flat. Positive for cyclical exposures.

- **European political risk (negative)**

  Significant political risks remain. In the aftermath of the “Brexit” vote there is concern over the rise of the populist parties across Europe broadly supporting reduced immigration and some “backtracking” on globalisation. France holds elections in May 2017. The threat of deflation remains given growth and incomes remain subdued and unemployment and debt levels are extremely high. Debt to GDP ratios are still extremely high and difficult to stabilise while growth and inflation are low. Equity markets suffer, defensive assets outperform.

- **Trumpenomics fails (negative)**

  Following failure to repeal and replace Obamacare the Trump administration falls short on tax reform and infrastructure spending. Business and consumer confidence decline from elevated levels, taking growth expectations lower. Equities retreat while bond yields decline. Fed hike expectations are scaled back.

Market Update

- **US Fed tightening unsettles global capital flows and risk appetite (negative)**

  The Fed responds to the stronger US growth environment and fiscal expansion catching markets under-prepared for a series of tightenings. Markets adjust, particularly those that have previously benefited from low US rates and a low USD. Potential risks in emerging markets, high yield. The USD rise undermines US growth. AUD falls sharply.

- **Low rates and stronger commodities (Positive)**

  With cash and mortgage rates at, or near, record lows and the currency at reasonable levels, Australian monetary conditions are accommodative. This, along with a sustained lift in commodity prices, eventually flows through to employment, incomes and domestic growth. Domestic equities markets lift.

- **Australian house prices weaken considerably (Negative)**

  Although house prices have risen over the past 12 months, a global economic shock would place the Australian economy at risk, particularly given the already low RBA cash rate and high levels of household debt. Similarly, a looming oversupply in the “high-rise” market could severely impact rents, prices, construction activity and employment. Funding conditions tighten. Economy at risk of recession and bank sector impacted. AUD down, equities down, bond yields lower.

- **Interest rate differentials (Negative)**

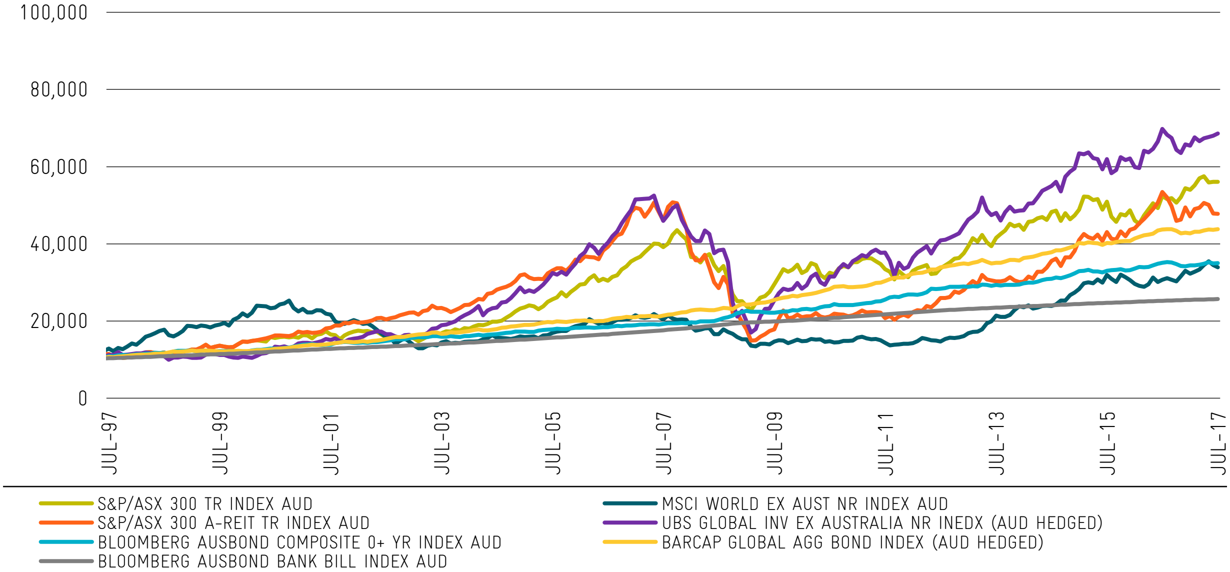
  Although interest rate differentials have halved, the level of rates in Australia is still attractive. A larger than expected Fed tightening would undermine the AUD.

Market Update

Asset Class Analysis — Long Term

The graph below shows the performance of various asset classes from July 1997 onwards. Some asset classes are noticeably more volatile than others in the shorter term but most asset classes have generally tracked upwards over the longer term. In general, investors are better placed by having a medium to longer term time horizon when investing in equities and downturns should be considered in the context of this time horizon.

Historical long term asset performance — Asset classes



Source: Bloomberg, Lonsec
For the period ending 30/07/2017