Market Overview

Australian Shares

- Australian shares have continued to drift sideways and are still close to where they started the Financial Year:
  - Financial Year to date, the S&P/ASX 200 Accumulation Index was up a marginal 0.68%
  - Resources (9.26%) benefited from higher export prices
  - Telecommunications, Health Care and Utilities held back overall performance, as have shares linked to consumer discretionary spending

International Equities

- World equity markets took a hit in August as geopolitical tensions heightened about North Korea's nuclear weapons programme, but recovered in September despite the ongoing issues:
  - Financial Year to date the MSCI World Index of developed markets equities is up 2.49% in Australian Dollar terms
- The U.S. market has led the developed markets, with the S&P500 Index up 4.48%:
  - American shares have benefited from the ongoing growth of the U.S. economy, but have also been helped by strong investor interest in two sectors where American companies are dominant: tech and biotech
  - The NASDAQ Exchange, which has many computer-related and biotech stocks, was up 6.06%
  - European shares have generally done well, particularly since the end of August, on accumulating evidence of stronger Eurozone economic growth
- Emerging markets have been stronger again, with the MSCI Emerging Markets Index up 5.47% in Australian Dollar terms:
  - The key BRIC markets have done very well
    - Brazil's share market has been exceptionally strong, and Indian shares are not far behind
    - China's Shanghai Composite Index has also performed well

Australian Property

- The A-REITs have been strongly affected by investors' assessment of the outlook for bond yields:
  - For the A-REITs, however, the reassessment of relative value was particularly brutal in late June (and the first half of July), when investors finally decided that central banks were starting to change course
  - As a result, the Index produced a loss of 6.26% for the Financial Year

Australian Cash and Fixed Interest

- Yet again, short-term interest rates have remained unchanged, with the 90-day bank bill rate continuing to trade at around 1.75%:
  - The stability reflects the unchanged stance of monetary policy, with the Reserve Bank of Australia, or RBA keeping the target cash rate at 1.5% at its most recent policy decision on September 5
  - Somewhat oddly, the normal pattern of longer-term interest rates following the evolution of U.S. bond yields has broken down in recent weeks
  - In the U.S., yields fell in later August and early September on "safe haven" buying by investors concerned about North Korea, but have risen again more recently as investors became less uncomfortable
  - Locally, however, there was very little variation in the 10-year Commonwealth bond yield, which was trading around 2.60% in early August, and was only marginally lower (at 2.55%) on September 8 when global fears were at their height:
    - It ended the quarter at 2.7%.

Market Overview

International Fixed Interest

- The biggest influence on global bonds in recent weeks has been the tension over North Korea, which has led during more nervous periods to “safe haven” buying of government bonds:
    - In the U.S., for example, the yield on the benchmark 10-year Treasury note had been trading around the 2.25% mark in the first half of August, but got as low as 2.04% on September 7
    - There were similar North Korea-induced declines in other major bond markets, with the yield on the 10-year German government bond falling to a low of 0.30% (also September 7) and the yield on the Japanese equivalent dropping below zero (September 8)
- More recently bond markets have become somewhat less worried about North Korea and yields have risen again with the U.S. benchmark yield now at 2.33%, not quite back to its levels before the tensions emerged

Australian Dollar

- The Australian dollar has strengthened Financial Year to date:
    - It has been particularly strong against the globally weak U.S. dollar—at USD 0.784, it is up 8.3% for the Calendar Year to date

Australian Shares

We retain a cautious outlook on Australian equities. It is our view that investors in the Australian market will need to be increasingly pro-active to deliver superior risk-adjusted returns. This involves applying a diligent investment process and an open mindset to moving away from an Index-like exposure.

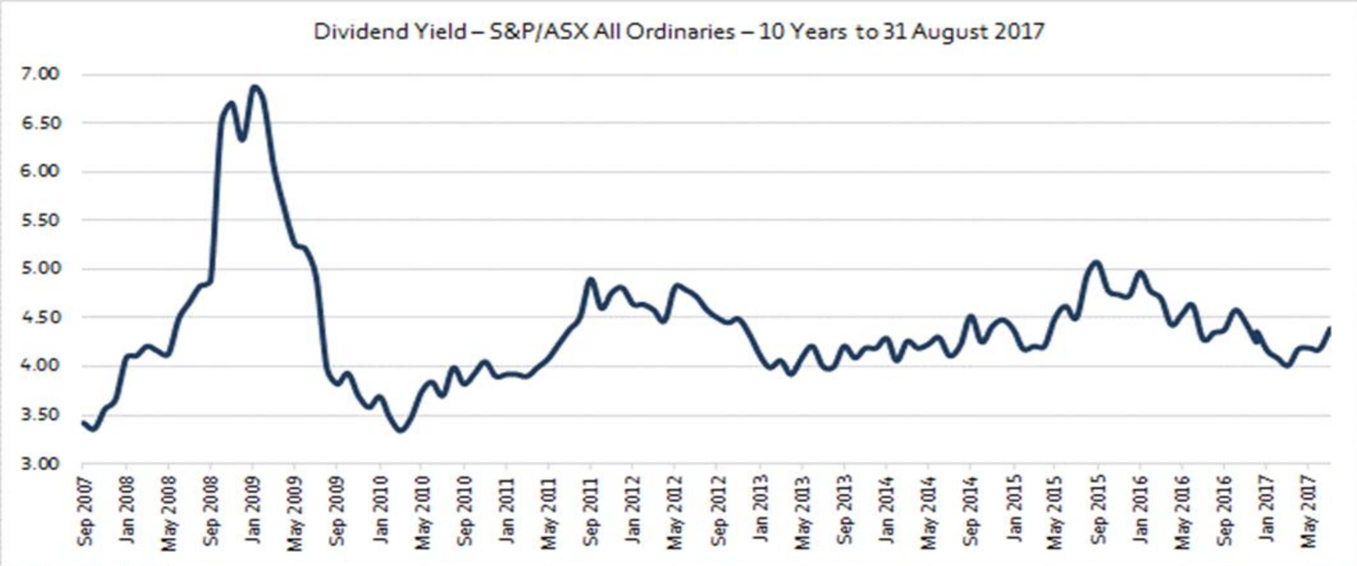
The latest economic indicators have been mixed and business surveys are not showing a clear picture. The Australia Industry Group’s purchasing manager indices, or PMIs, of manufacturing, services and construction would suggest that all three sectors accelerated in August with manufacturing in particular doing very well. As AIG noted, this was the highest monthly result for the Australian PMI since 2002. On the other hand, the very similar style surveys of manufacturing and services run by the Commonwealth Bank found that both sectors, while still growing, had slowed down in August, and the CBA manufacturing survey found nothing like the surge in the AIG one: growth of Australia’s manufacturing sector was sustained during August, but at the slowest rate for a year.

NAB’s August business survey also had mixed results. On the positive side, actual business conditions (trading, employment, profits) have been sound. But the sharp drop in business confidence this month is somewhat concerning.

It has not helped that consumer confidence remains underwhelming. The latest (September 12) ANZ Bank/Roy Morgan Consumer Confidence Rating found confidence had slipped, and that the weakness was broadly based, with a sizeable decline in households’ perceptions of the economic outlook driving the deterioration in sentiment. Similarly, the September Westpac/Melbourne Institute consumer survey found the consumer mood remains downbeat.

It is possible that, underneath the mix of economic signals, the economy may be improving. August’s jobs news was certainly very positive. There was a 54,200 increase in employment in the month, which was well above the modest 15,000 or so that economists had expected. The unemployment rate held steady. However, for the time being, the share market’s sidewise trading still accurately reflects an economy that has failed to break definitively out of its post mining boom slow patch. It will take some stronger evidence of a clear acceleration in business activity before Australian equity investors are likely to see improved outcomes.

In this respect, it is worth noting our observations regarding the outlook for Australian financials, the biggest sector in our market. While the bank levy served as an unexpected catalyst, the move lower in the share prices of the big four banks was justified given expensive valuations. While APRA’s capital requirements appear less onerous than first feared, the bank levy is a prudent reminder of the heightened regulatory environment within which the banking sector must navigate. Indeed, banks continue to divest noncore assets (like insurance and in some cases, wealth management), yet may well still need to raise capital to meet current requirements, let alone what future discussions around the risk-weighting of mortgages may bring. In addition, policy aimed at limiting lending to property investors appears to be having the desired effect, resulting in increasing concerns over the outlook for Australian residential property.



Dividend Yield – S&P/ASX All Ordinaries – 10 Years to 31 August 2017
7.00
6.50
6.00
5.50
5.00
4.50
4.00
3.50
3.00
Sep 2007
Jan 2008
May 2008
Sep 2008
Jan 2009
May 2009
Sep 2009
Jan 2010
May 2010
Sep 2010
Jan 2011
May 2011
Sep 2011
Jan 2012
May 2012
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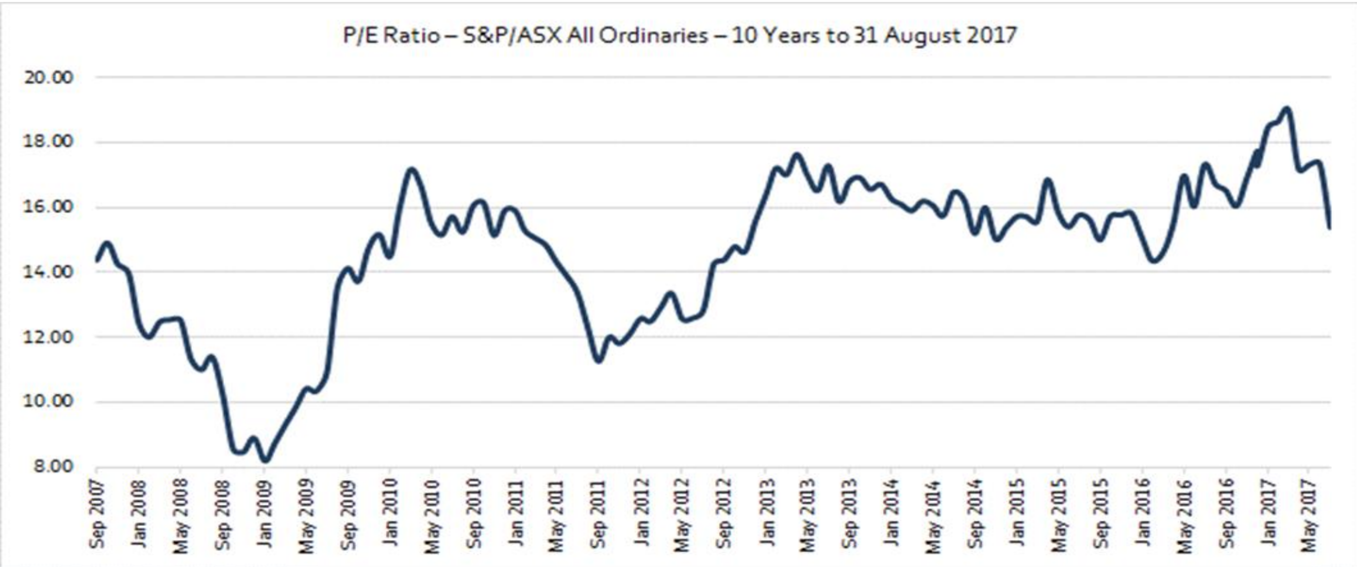
May 2016
Sep 2016
Jan 2017
May 2017



P/E Ratio – S&P/ASX All Ordinaries – 10 Years to 31 August 2017
20.00
18.00
16.00
14.00
12.00
10.00
8.00
Sep 2007
Jan 2008
May 2008
Sep 2008
Jan 2009
May 2009
Sep 2009
Jan 2010
May 2010
Sep 2010
Jan 2011
May 2011
Sep 2011
Jan 2012
May 2012
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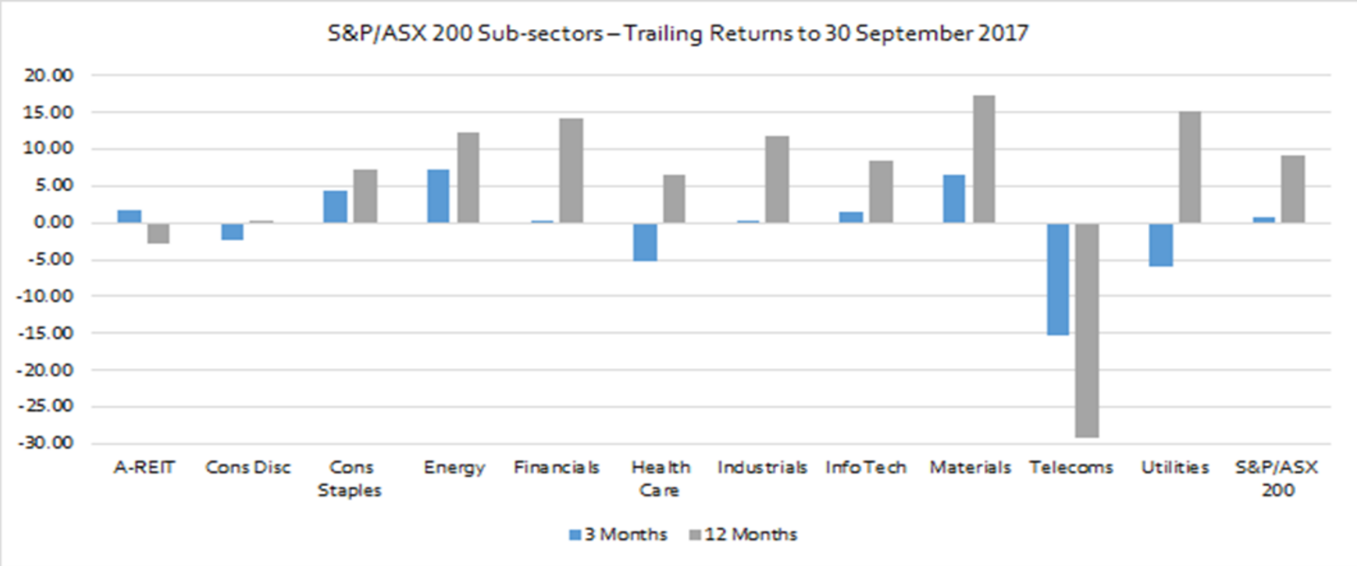
May 2016
Sep 2016
Jan 2017
May 2017


S&P/ASX 200 Sub-sectors – Trailing Returns to 30 September 2017
20.00
15.00
10.00
5.00
0.00
-5.00
-10.00
-15.00
-20.00
-25.00
-30.00
A-REIT
Cons Disc
Cons Staples
Energy
Financials
Health Care
Industrials
InfoTech
Materials
Telecoms
Utilities
S&P/ASX 200
3 Months
12 Months

International Shares

On the economic front, the global outlook remains positive. The latest (August) J P Morgan Global All-Industry Output Index shows a good pace of global economic activity. Overall growth was the quickest since April 2015, underpinned by expansions across the six main categories of manufacturing and services covered by the survey. By sector, the Index also showed that technology, and pharmaceuticals and biotechnology, in particular, are the fastest growing sectors, which shows that there is a fundamental underpinning for these sectors' recent popularity with investors.

Forecasters are also upbeat. The Economist in London surveys a panel of international economic forecasters every month, and its September poll showed that every one of the 25 countries in the survey is expected to grow in 2018. The emerging markets are expected to be particularly strong, with India expected to grow by 7.5% (up from an already impressive 7.0% for this year) and China by 6.5%. The Economist also makes its own forecasts for countries outside the most important 25: every single one of them is expected to grow in 2018, other than grossly misgoverned Venezuela.

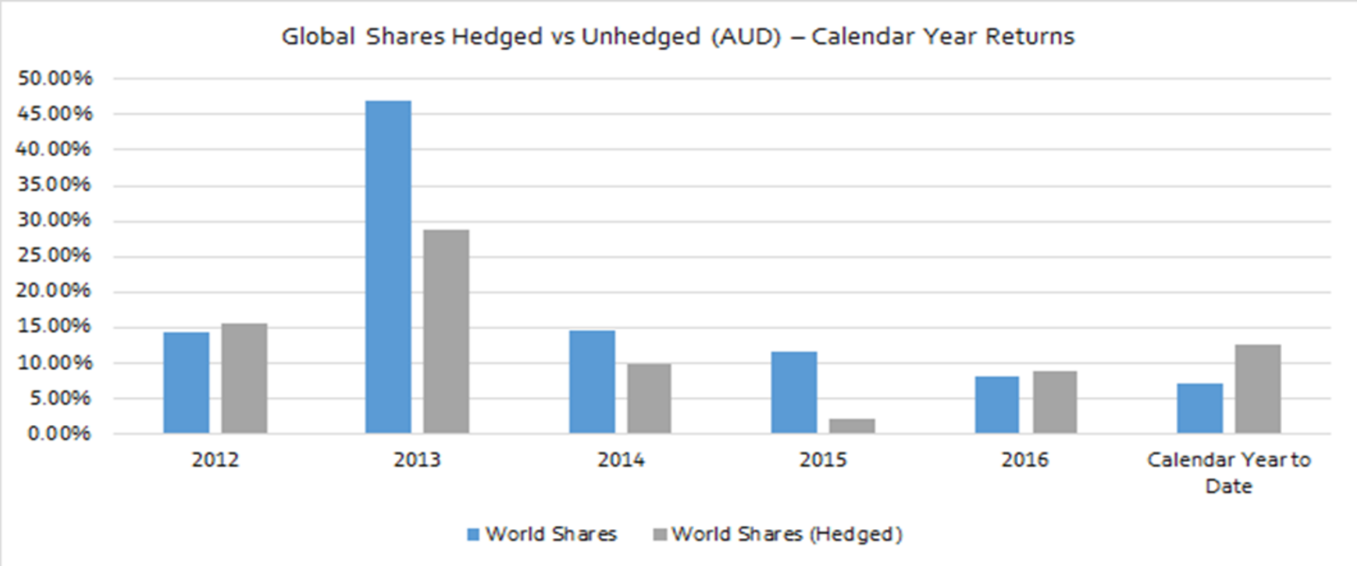
These conditions would normally be clearly supportive for global equities, but one significant qualification is that the positive outlook is already well built into prices, particularly in the U.S. which appears the most expensively valued of the major markets. Currently, the share market analysts surveyed by U.S. data company FactSet have ambitious expectations for American shares in that they expect profits for the companies in the S&P500 Index to grow by 11.0% in 2018, and the Index to rise by 10% over the next year. This is achievable given the ongoing growth in the U.S. economy, but it also leaves little leeway for earnings disappointments if companies, or the economy more generally, do not live up to expectations. One possible flashpoint could be Congressional impasse over the government's debt ceiling. Dysfunctional politics have managed only a short-term patch to the end of December and the threat or reality of inadvertent fiscal tightening could become a problem for investors later this year.

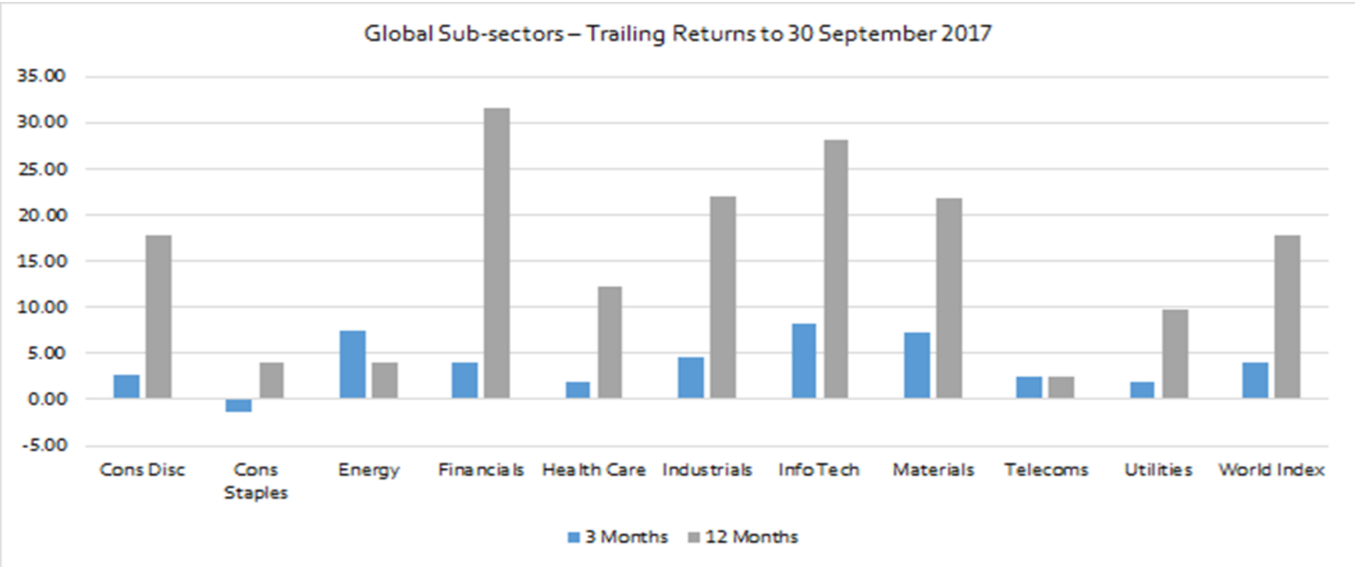
Another potential issue is mis-steps by one of the major central banks in withdrawing the current degree of monetary stimulus. As noted earlier, all the central banks look to be approaching the process with a high degree of caution and care, but this may take a back seat to geopolitics in coming months. Nobody knows how the current North Korean difficulties will play out, but equity markets have showed remarkably small levels of alarm given the potential threats from a nuclear-armed, hostile and erratic North Korean regime.

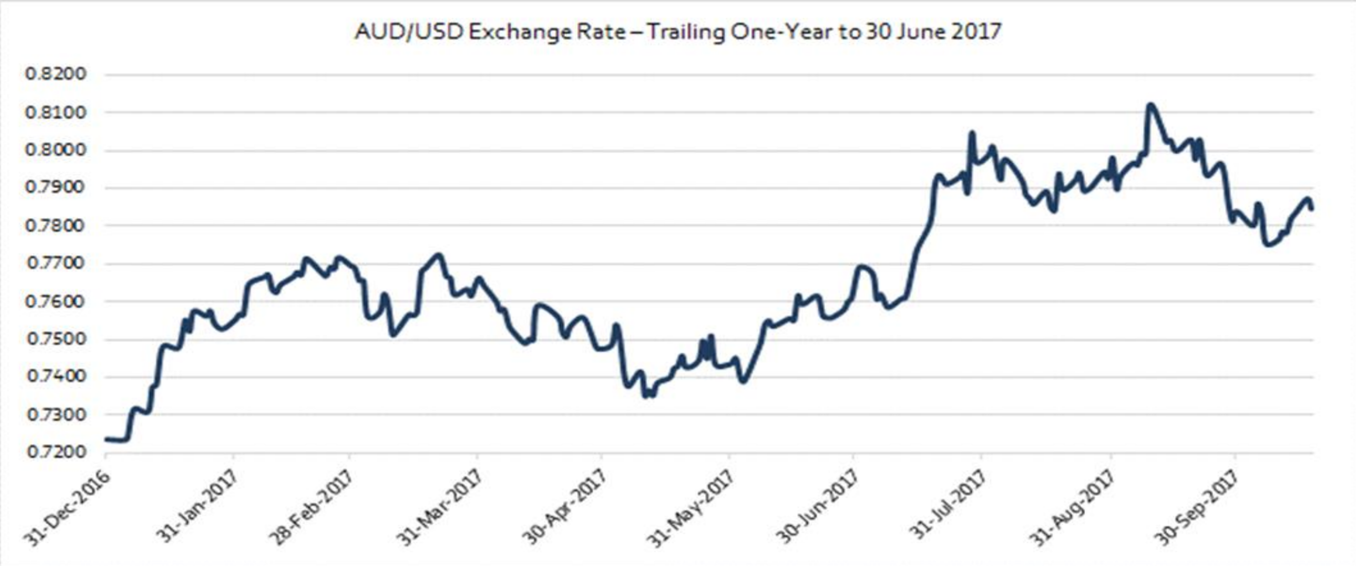
All going well, the clear evidence of a strengthening world economy will carry the day, and global shares will are well positioned to make further gains.

We continue to view the Australian dollar as being increasingly overvalued versus the U.S. dollar. This is particularly relevant as the market focuses on the risk of rising inflation and interest rates in the U.S. in contrast to the relatively weakened outlook for the domestic economy.

Given this, we favour a largely unhedged currency position across our global equities allocations.


Global Shares Hedged vs Unhedged (AUD) – Calendar Year Returns
50.00%
45.00%
40.00%
35.00%
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
2012
2013
2014
2015
2016
Calendar Year to Date
World Shares
World Shares (Hedged)


Global Sub-sectors – Trailing Returns to 30 September 2017
35.00
30.00
25.00
20.00
15.00
10.00
5.00
0.00
-5.00
Cons Disc
Cons Staples
Energy
Financials
Health Care
Industrials
Info Tech
Materials
Telecoms
Utilities
World Index
3 Months
12 Months


AUD/USD Exchange Rate – Trailing One-Year to 30 June 2017
0.8200
0.8100
0.8000
0.7900
0.7800
0.7700
0.7600
0.7500
0.7400
0.7300
0.7200
31-Dec-2016
31-Jan-2017
28-Feb-2017
31-Mar-2017
30-Apr-2017
31-May-2017
30-Jun-2017
31-Jul-2017
31-Aug-2017
30-Sep-2017

Australian Listed Property (REITs)

The ongoing slower-than-usual pace of national economic growth is reflected in property outcomes, with some strong sectors and regions offset by weak conditions elsewhere. As Colliers' latest research report on the CBD office markets showed, for example, conditions vary from very strong in Sydney and Melbourne—Colliers believe that net effective rents for premium offices in Sydney will rise by 14.2% in the year to next June, and by 10.6% in Melbourne—to very weak. Colliers expects the office vacancy rate in Perth will still be over 20% in June next year, and vacancy rates will also be high in Adelaide (15.5%) and Brisbane (14.1%).

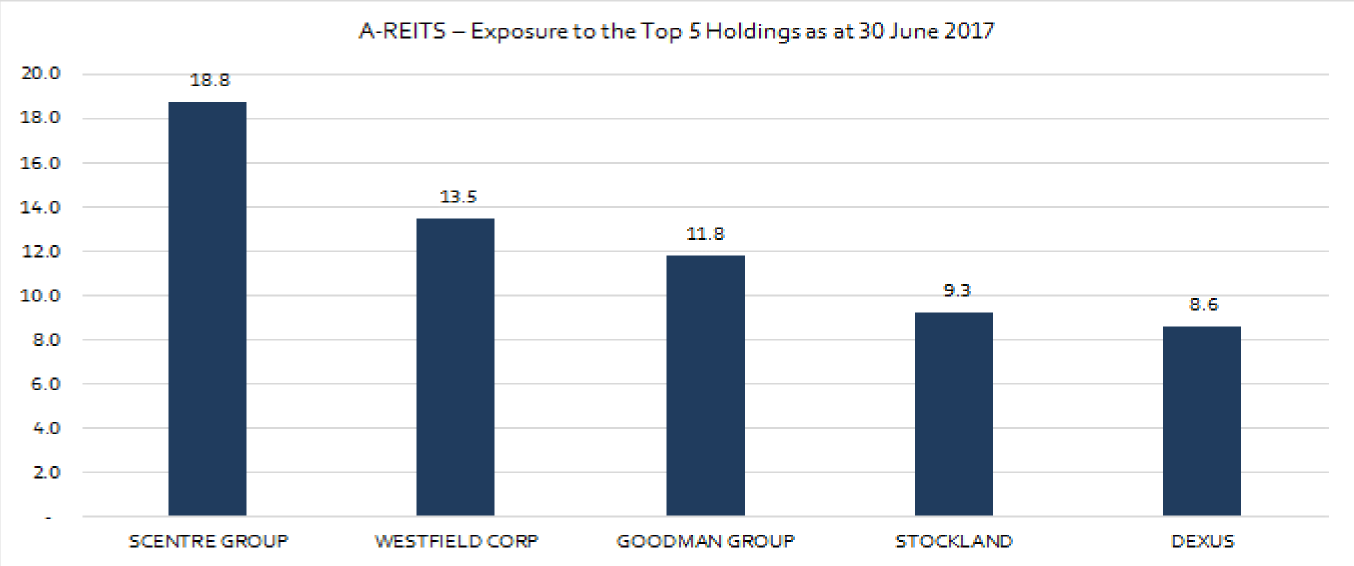
The subpar growth of the Australian economy is also holding back the retail sector. As Morningstar's September quarter Earnings Insights report said, "The issue facing mall owner Scentre Group and other retail landlords is the inability or reluctance of households to increase their... spending as they have in the past... households face challenges of rising indebtedness, reduced job security, and wages growth at an 18-year low."

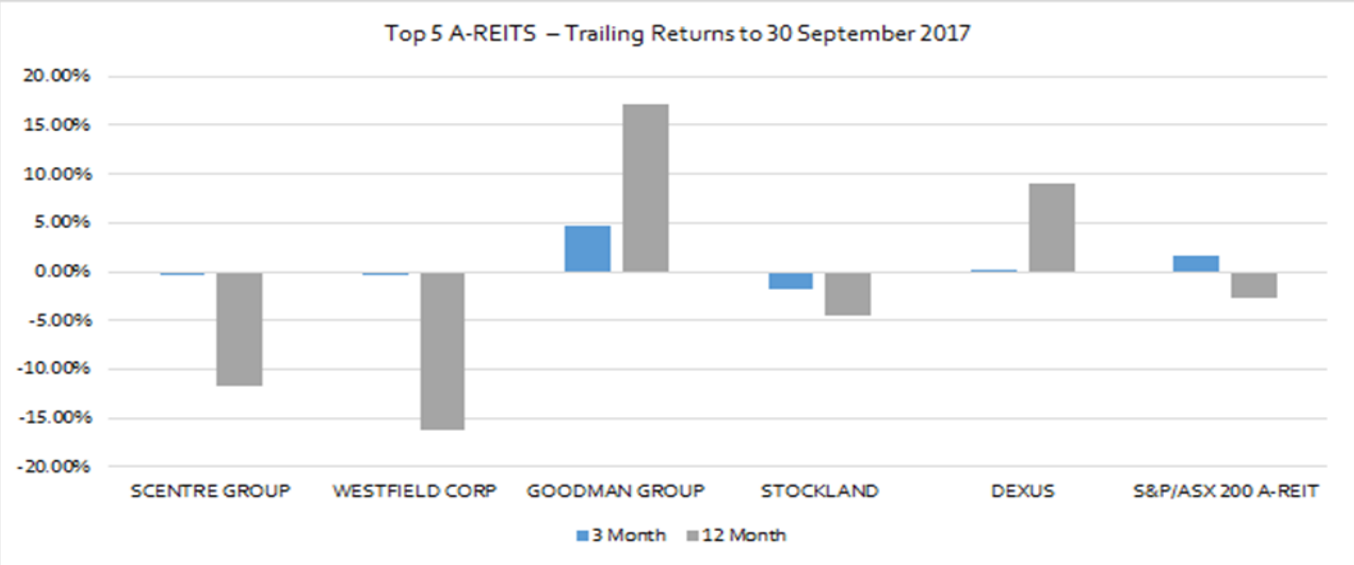
The outlook for Retail REITs is more clouded given the uncertainty as to long-term implications of the shift towards digital retailing. While this is only beginning to become a serious issue for the likes of Australian and New Zealand mall owners, it is at an advanced stage overseas, particularly in the U.S. The unrelenting march of digital retailers, particularly Amazon looms large, triggering a retracement in the share price of many retailers and their landlords over the past year. Doom merchants say bricks-and-mortar retail is dead, while landlords contend they can evolve. The answer is somewhere in the middle, but there will be significant disparity in the performance of malls with key determinants being location, size, tenant composition, competition and the rate of demographic change.

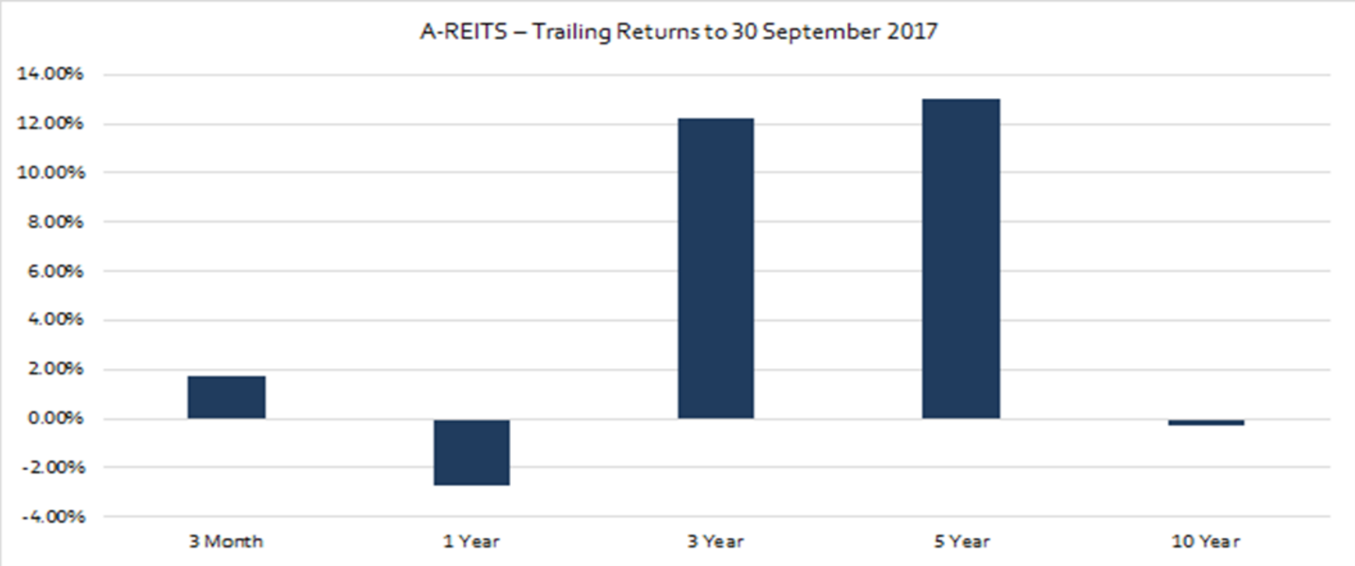
Even though there are significant pressures for bricks-and-mortar Retail REITs, it is probably not the death knell. There are a series of positives for retail landlords. First, the demographic trend towards living in smaller dwellings (primarily apartments) is a small tailwind for landlords as it increases population density and supports the transformation of malls to become town centres and natural hubs for people to gather. Second, achieving sales in the digital world is increasingly complicated. It is getting harder for retailers to get their brands in front of consumers as major brands are increasingly sophisticated in their marketing efforts. Consumers are being saturated with content and advertisement and it is harder and more costly to convert digital impressions to sales. Against this backdrop, malls offer a much more reliable means of getting in front on consumers. Third, premium or differentiated brands are harder to sell online as the product often has niche attributes that are difficult to convey online in contrast to a skilled salesperson in a luxurious showroom. At this point, luxury brands, particularly watches, jewellery and high-end fashion will be predominantly sold in physical stores rather than online.

The outlook for retail REITs is further muddied by up and downside catalysts. A key upside catalyst is landlords converting part of the mall site to a higher and better use, for instance, apartments. Conversely, a sharp lift in bond yields is a downside risk, with the low current settings making all yield style investments far more sensitive to changes in the yield curve profile than previously.

However, on most metrics, even with concerns about the Retail sector, A-REITs offer reasonable value. By historical standards, A-REIT prices are at fair value relative to the net tangible asset value of the properties they own; the price/equity ratio on the sector relative to the P/E ratio on the S&P/ASX 200 is on the cheap side, and the income yield relative to 10-year Commonwealth bonds is a bit more generous than usual.


A-REITS – Exposure to the Top 5 Holdings as at 30 June 2017
20.0
18.0
16.0
14.0
12.0
10.0
8.0
6.0
4.0
2.0
-
18.8
13.5
11.8
9.3
8.6
SCENTRE GROUP
WESTFIELD CORP
GOODMAN GROUP
STOCKLAND
DEXUS


Top 5 A-REITS – Trailing Returns to 30 September 2017
20.00%
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
-15.00%
-20.00%
SCENTRE GROUP
WESTFIELD CORP
GOODMAN GROUP
STOCKLAND
DEXUS
S&P/ASX 200 A-REIT
3 Month
12 Month


A-REITS – Trailing Returns to 30 September 2017
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
3 Month
1 Year
3 Year
5 Year
10 Year