Monthly commentary - January 2017

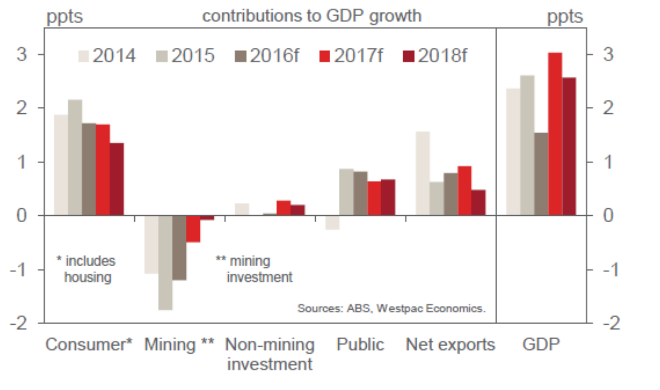
No doubt the story in 2017 will have its own twists and turns – political, market-related and economic – and expectations may shift, particularly as we start to get more detail around prospective policy changes in the US and a better sense of their ramifications globally. But as it stands, the mood as we move deeper into 2017 looks to be on a better footing than we have seen for many years. This month we look at the year in review, what has happened over January, and the outlook for 2017.

Developments in the global economy

Australia

The Australian economy stumbled in 2016, after what had been a resilient performance in a challenging environment and a difficult growth transition. In the September quarter, output contracted by 0.5%, the first fall since the floods of March 2011. We do not see this number as portending a sharp deterioration in the Australian economy. Westpac economics is cautiously comfortable with their forecast of 3.0% real GDP growth for the year to December 2017. However, downside risks remain, particularly around employment and consumer spending. Westpac economics expects to see the AUD tracking gradually lower through 2017 and 2018 to eventually reach USD0.68, and the RBA firmly on hold.

Chart 1: GDP contributions by sector



Source: Westpac economics

With the solid employment report locally and potential rate moves in the US, markets have effectively priced out the possibility of further rate cuts in Australia. They are now focusing on a potential rate hike in Australia with a 100% probability of a hike priced in by mid-2018.

US

As 2016 drew to a close, we again see the FOMC expecting to hike the Fed Funds Rate on multiple occasions in the coming 12 months. To this view, Committee members arguably believe that risks are skewed to the upside. The consumer remains key to the growth outlook. Westpac continues to see two hikes being delivered in 2017 to be followed by another two in 2018.

Subsequently, US rates have firmed, including expectations for a more aggressive US Federal Reserve. Markets are now pricing a probability of around 100% that the US Federal Reserve will raise the Federal Funds rate by 50bps to 1.125% by end 2017. That compares to just 50% before the US elections. The US election result in November also wrong-footed most and is bringing its own upheaval. President Trump highlighted infrastructure investment and wider fiscal stimulus as the first order of business for what will be the first Republican President in over a decade to also have party majorities in both the House and Senate. US trade and foreign relations look set to see major changes as well. Style-wise, the President has already demonstrated a starkly different approach to his predecessors.

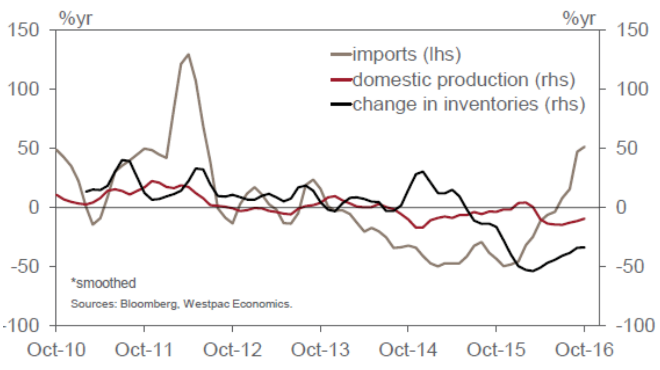
China

After a challenging start to the year, 2016 proved to be a positive one for China. Underlying growth showed itself to be more robust and diversified than anticipated. With the all-important 19th National Congress scheduled for next November, it is expected that authorities continue to ensure robust growth through 2017.

Any changes in the availability of funding for non-residents to purchase apartments in Australia or in the freedom of foreign developers to invest offshore will have a significant direct influence on Australia's construction profile. The emergence of a two tier housing market where new dwellings command a (foreign buyer) premium does significantly increase the vulnerability of the housing market to offshore shocks.

As 2017 begins, so far so good. Certainly for the next year we expect the Chinese authorities to maintain a strong fiscal stimulus to ensure a vibrant economy ahead of the 19th National Congress in November next year when Mr Xi expects to assert greater influence on the Politburo and cement power possibly beyond 2022.

Chart 2: Source of Chinese coal



Source: Westpac economics

Europe

The European Central Bank (ECB) left policy unchanged at its January meeting, but indicated it was extending its current quantitative easing program until at least December 2017.

Inflation showed signs of improvement, following a 1.1% rise in December that beat estimates, albeit mainly driven by higher energy prices. Core inflation, that excludes energy, food, alcohol and tobacco, came in at 0.9%. This translated to a 1.8% year on year increase across the region which is the highest rate since 2013.This good news was also supported by a 0.5% increase in GDP, which helped the whole of 2016 GDP number come in at 1.7%, beating the US for the first time since 2008.

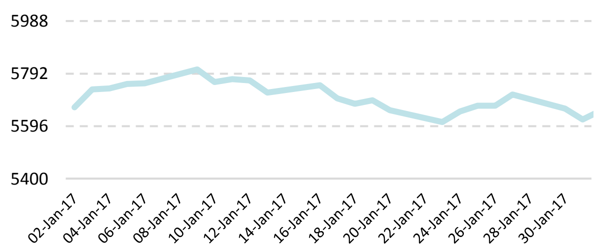
In terms of unemployment, the EU in December reported its lowest rate since May 2009 at 9.6%. This is down from 10.5% a year ago.

Developments in financial markets

Australian shares

Australian shares finished marginally down in January (-0.8%), somewhat driven by uncertainty over the effects of US President Trump's proposed economic policies and renewed Brexit fears. Positive, however was the mining sector that saw solid gains as a result of strong data out of China which in turn buoyed commodity prices.

Chart 3: ASX 200 return over the month - January

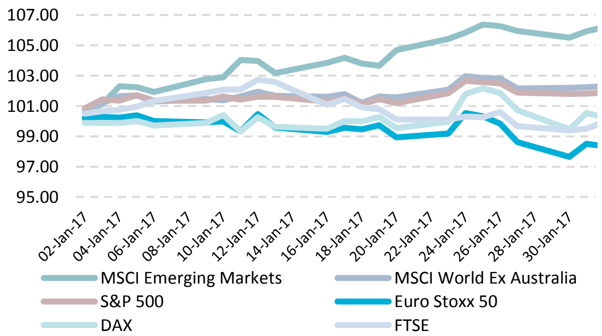


Source: Bloomberg

International shares

After his inauguration in January, the new US President created almost instant controversy with a number of immediately implemented policies. The markets in general chose to ignore these concerns, as the Dow Jones Industrial Index passed 20,000 for the first time, finishing 1.8% up for the month. Eurozone shares, on the other hand, despite positive economic data, finished in negative territory for reasons of uncertainty with upcoming elections and Brexit worries.

Chart 4: Major Market Indices – January 2017



Source: Bloomberg

Fixed interest

Domestic 10-year government bond yields fell over the month off the back of a surprise lower than expected CPI announcement for the December quarter, which showed the annual inflation rate of just 1.5% for calendar year 2016.

The U.S. 10 year Bond yield was little changed over the month, with European and U.K. 10-year bond prices rising on strong economic data, as well as political uncertainty arising from the upcoming French presidential election and Brexit worries.

Currencies

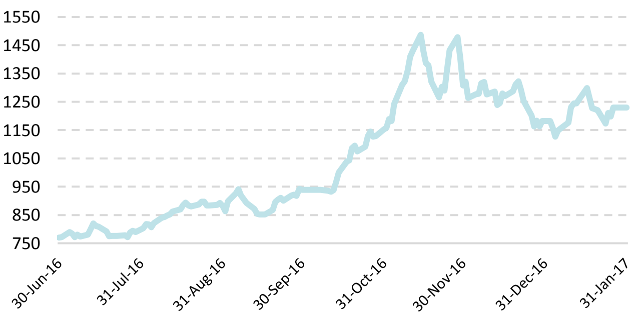
Behind the USD driving its uptrend has been a strong belief amongst participants that Trump's policies will beget growth and inflation, resulting in numerous rate hikes.

Ahead of the meeting, December's 25bp hike in the Fed Funds rate was fully priced. Now, on the back of the FOMC's confident tone, three further rate hikes have been priced in by the market before June 2018. This is consistent with the long-held view of rate hikes in June and December 2017 to be followed by another two moves in 2018 – again most likely in June and December.

Commodities

Commodity prices rallied strongly into the year end. Metallurgical (met or coking) coal prices have soared 230% in the last six months to be up four-fold for the year-end. Iron ore has had a smaller but still significant 48% rally in six months and has more than doubled in the year. This rally was not limited to just the bulk commodities with oil prices also up almost 50%yr, copper gaining over 20%yr, nickel and lead lifting around 30%yr and zinc rocketing almost 80%yr.

Chart 5: Spot Coal price increase – last 6 months



Source: Bloomberg

Resources demand through 2016 had been better than expected with activity in China surprising to the upside and data becoming increasingly positive towards year end. As we move through 2017 Chinese authorities have both the capacity and determination to keep investment by the public sector growing ahead of November's all-important 19th National Congress.

Funds update

Advance Diversified Multi-Blend Funds

The Diversified funds although producing negative returns over the month of January, all outperformed their benchmarks. The negative absolute performance was primarily driven by mixed asset market performances off both equities and bonds, and a general 'unwind' of the 'Trump reflation' trade which lifted markets into 2016 year end. Australian Shares, Australian Small Companies, International Shares (unhedged) and Listed Property retraced -0.54%, -1.69%, -1.46% and -1.95% respectively. Along with the positive sector fund contributors for the month being, commodities (+1.94%) and Australian Fixed Interest (+0.68%), the Diversified funds' active investment manager approach helped limit losses over January.

Advance Australian Shares Multi-Blend Fund

The Fund outperformed its benchmark in January, though Australian shares retreated on an absolute basis. The strongest performing large cap managers were Alphinity and Schroders who both benefitted from the continued rise in commodity prices with the major source of alpha at the sector level coming from overweight positions in Materials. The allocation to smaller companies detracted during the month, with the Small Ords Index losing 2.4%.

Advance International Shares Multi-Blend Fund

The Fund outperformed its benchmark in January with all managers, with the exception of Lansdowne, contributing to positive alpha. T. Rowe Price was the strongest performer as result of stock selection in Information Technology and Consumer Discretionary stocks as well as benefiting from an overweight in these sectors as well. River & Mercantile was not far behind helped by an overweight position in Materials. At the fund level, an overweight to Health Care and Consumer Discretionary was a major source of alpha.

Advance Property Securities Multi-Blend Fund

The Fund fell marginally behind its benchmark in January. The overweight to AREITs was negative for the Fund as they underperformed GREITs. However, AREIT manager Phoenix was the best performer on a relative sense, outperforming its benchmark. Performance in GREIT managers was mixed with Blackrock outperforming its respective benchmark while Principal and Heitman underperformed for the month.

Australian Fixed Interest Multi-Blend Fund

The Fund outperformed its benchmark in January gross of fees. Pleasingly, all managers delivered above benchmark performance gross of fees for the month. Credit positioning was the main driver of excess performance on the back of a broad-based narrowing of credit spreads. Performance in interest rate strategies was mixed across managers but overall it was also a positive contributor to Fund performance.

International Fixed Interest Multi-Blend Fund

The Fund outperformed its benchmark in January gross of fees. At the manager level, all managers outperformed their respective benchmarks with Standish the stand out performer for the month. Gains were broad based with active strategies in security selection, sector allocation and interest rate strategies all contributing to excess performance.

In early January, we formally terminated Franklin Templeton in order to better align the Fund's defensive risk characteristics. Franklin Templeton was a minor allocation within the Fund accounting for less than 10% of overall AuM. This allocation will be redistributed across the incumbent managers and we expect the transition to be finalised in February 2017.

Defensive Yield Multi-Blend Fund

The Fund returned positive performance in January, outperforming its cash benchmark. Both Standish and Kapstream delivered solid results whilst BTIM fell marginally short of its benchmark albeit still delivering positive absolute returns.

As was the case with the other defensive sectors, credit positioning aided positive performance with Standish and Kapstream benefiting the most from the broad narrowing of credit spreads. Interest rate strategies was the main driver of BTIM's underperformance for the month

Diversified Fund Performance

Net (after fee) Wholesale performance of the Advance Diversified funds to January 2017 against benchmarks are as follows.

	1 MONTH (%)	3 MONTH (%)	6 MONTHs (%)	1 YEAR (%)	3 YEARS (% pa)	5 YEARS (% pa)
Defensive Multi-Blend	-0.11	1.25	0.01	4.65	3.65	4.9
Benchmark	-0.28	1.04	-0.51	5.26	4.94	5.68
Moderate Multi-Blend	-0.25	2.42	0.68	6.59	4.7	6.57
Benchmark	-0.49	2.39	0.45	7.67	6.04	7.42
Balanced Multi-Blend	-0.41	3.74	1.62	8.59	5.65	8.16
Benchmark	-0.74	3.85	1.57	10.02	7.06	9.04
Growth Multi-Blend	-0.49	4.65	2.17	9.77	6.05	8.98
Benchmark	-0.85	4.96	2.44	11.84	7.72	10.11
High Growth Multi-Blend	-0.56	5.28	2.61	10.54	6.85	10.22
Benchmark	-0.96	5.85	3.06	13.5	8.49	11.38

January Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	-0.79%	6.65%	17.34%	7.40%	10.57%
S&P/ASX 200 Industrials	-1.95%	4.31%	5.76%	4.38%	9.45%
S&P/ASX 200 Resources	5.16%	12.94%	60.89%	-4.58%	-6.13%
S&P/ASX 200 Property Trust	-4.88%	0.91%	1.74%	10.30%	10.13%
S&P/ASX Small Ords	-2.44%	-0.13%	16.35%	6.36%	2.81%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia A$	-2.36%	6.60%	8.88%	11.10%	17.74%
EPRA/NAREIT Developed Index Hedged A$	-0.50%	1.71%	9.41%	10.38%	12.45%
STOXX Europe 600	-0.36%	6.24%	5.22%	3.74%	7.20%
S&P 500 Composite	1.79%	7.18%	17.45%	8.53%	11.67%
Nikkei 225	-0.38%	9.28%	8.69%	8.48%	16.69%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.16%	0.45%	2.03%	2.34%	2.74%
Barclays Global Aggregate TR Hedged A$	-0.26%	-1.53%	3.26%	5.60%	5.79%

Commodities	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	0.09%	3.17%	13.43%	-11.44%	-9.48%
Generic Brent Crude Oil	-1.97%	15.32%	60.33%	-19.41%	-12.88%
Generic WTI Crude Oil	-1.69%	12.70%	57.08%	-18.48%	-11.72%
Gold US$/oz	4.99%	-4.95%	8.39%	-0.82%	-6.90%
Iron Ore	5.67%	29.45%	99.76%	-12.17%	-10.10%

Currencies	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	4.89%	-0.50%	6.92%	-4.71%	-6.51%
EUR/USD	2.25%	-1.63%	-0.54%	-7.23%	-3.77%
USD/JPY	-3.12%	7.63%	-6.57%	3.40%	8.17%
GBP/USD	1.82%	2.80%	-11.62%	-8.59%	-4.41%

For more information on market activity and investments, please contact your BT relationship manager.