Quarterly commentary - March 2017

Over the quarter, we saw the majority of equity markets deliver solid gains, underpinned by improving economic data across most developed and emerging markets. The US equity market advanced to fresh all-time highs, with the Fed raising rates by a further 0.25%. Eurozone equities also delivered gains despite elevated political worries seemingly, for now pushing aside the 'unknowns' resulting from the UK triggering Article 50. In Australia, even with a strong balance of trade and positive manufacturing and consumer confidence survey results, we saw housing take centre stage that has elevated fears of rising household debt being a future catalyst for economic slowdown.

Developments in the global economy

Australia

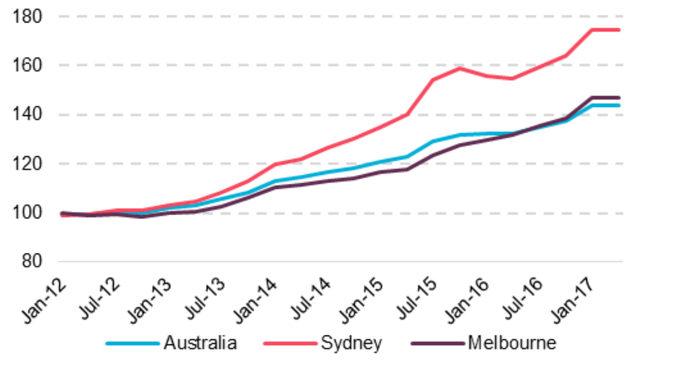
Australian GDP growth surprised on the upside in the 2016 December quarter, driving the annual rate up to 2.4%. This was a significant improvement on the prior quarter, despite it being below the long-run average rate of growth. The Australian economy's transition following the mining boom has been supported by low interest rates and a weaker Australian dollar. The comeback staged by commodity prices has further buoyed the economy by increasing income growth.

In contrast, the labour market has been subdued and is an ongoing source of concern. Jobs growth has been significantly skewed to part-time roles. More than 104,000 part-time jobs were created over the year, but full-time jobs contracted. The national unemployment rate reached its highest level in over a year in February, rising to 5.9%. The situation has been compounded by record low wages growth of below 2% per annum, though this is still just above inflation.

House prices continued to receive a lot of attention over the quarter. Prices have increased at a fast pace, especially in relation to incomes where we've seen sluggish wage growth. However, there is significant divergence between capital cities. Sydney prices jumped 18% in March compared to the prior year, while Melbourne prices increased by 16%.

The 2017-18 Federal Budget will be announced on May 9. There is a risk that Australia's sovereign credit rating may be downgraded, despite the Government's commitment to returning the Budget to surplus in 2021. Australia is currently rated AAA by the three major ratings agencies. If the trajectory to balancing the Budget is pushed out the likelihood of a ratings downgrade this year will increase.

Chart 1: Australian house prices – 2011-2012 = 100



Source: BTIS/Bloomberg

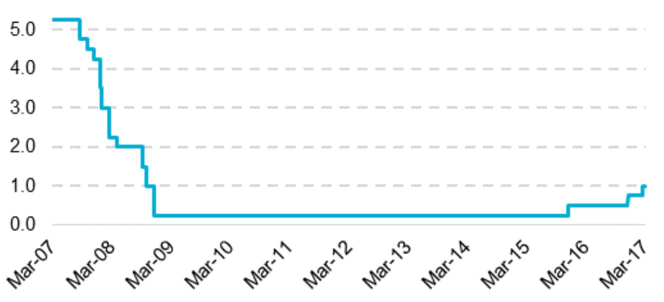
US

The US labour market's continued improvement has boosted economic activity through heightened consumption spending. There is a debate as to whether it is now at or near full employment, given the unemployment rate is currently at 4.5%. Medium term economic growth expectations have been lifted by promises of fiscal spending and tax cuts. Nevertheless, the recent failed attempt to repeal the American Health Care Act has weighed on these expectations.

The US Federal Reserve increased official interest rates by 25 basis points on March 15th to a target range of 0.75%-1.00%. Additionally, the Federal Reserve has indicated that it could raise official interest rates two more times throughout this year, which would total three rate rises this year. Some officials noted there is a risk that rates could increase faster than expected. The increased likelihood of tightening has been priced into financial markets, with the Fed funds futures fully pricing in a total of two hikes this year along with a reasonable chance of a third hike. This is compared to pricing of close to two hikes earlier in the year.

The core PCE posted a slight gain on a year on year basis, from 1.7% to 1.8%, however this remains below the Federal Reserve's 2% target.

Chart 2: US Interest rates



Source: BTIS/Bloomberg

China

Chinese economic growth picked up in the second half of 2016, driven by fiscal stimulus, the service sector and consumption. Authorities have withdrawn some of this stimulus, especially in the property sector, as concerns about financial stability risks have grown. Chinese authorities are targeting 6.5% growth over 2017, compared to 6.7% growth prior year, and are aware of the need to balance this with the high levels of debt seen in the economy. An unsustainable level of debt could result in a considerable downturn in economic growth at some point.

Australia is in a position to benefit from solid Chinese economic growth, along with any corresponding increases in commodity prices.

Europe

The political situation in Europe remains at the forefront of investors' minds, with Brexit officially underway and the French presidential and parliamentary elections, among others, quickly approaching. The UK took a key step in its divorce from the European Union by triggering Article 50 on March 29th. Meanwhile in France, the chances of election success for far-right candidate Marine Le Pen continues to ebb and flow, fuelling concerns that the surge in populism will continue to drive further departures from the European Union.

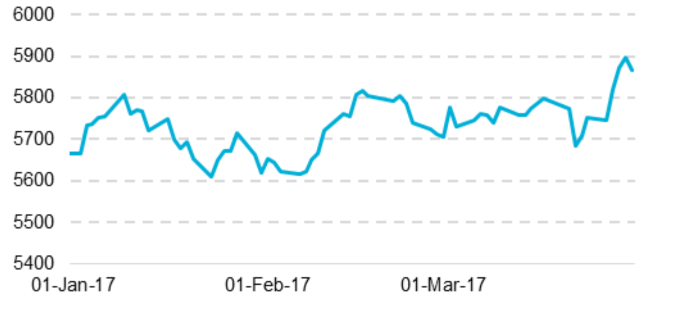
In April, the European Central Bank will start to cut back on government bond purchases. Headline CPI came in at 1.5% year on year in March, which was below expectations of 1.8%. Core CPI was also lower than expected at 0.7%.

Developments in financial markets

Australian shares

Australian equities had a solid quarter, particularly in the final week of March which saw the utilities and pharmaceutical / bio technology sectors gain around 6% for the month of March, with consumer durables gaining over 20% over the last 2 months of the quarter. In addition, strength in the iron ore price and increased demand for commodities buoyed the Australian market early in the quarter. The banks traded higher later on in the quarter, as profit expectations were boosted by interest rate increases on fixed rate and investment loans. With consumer and business confidence remaining positive, albeit with the backdrop of concerns over the impact of potential volatility from current political risks, the lower interest rate and dollar remain supportive of business conditions, mainly across construction, transport and utilities. This has, in turn had a positive effect on investor sentiment.

Chart 3: ASX 200 return – last quarter



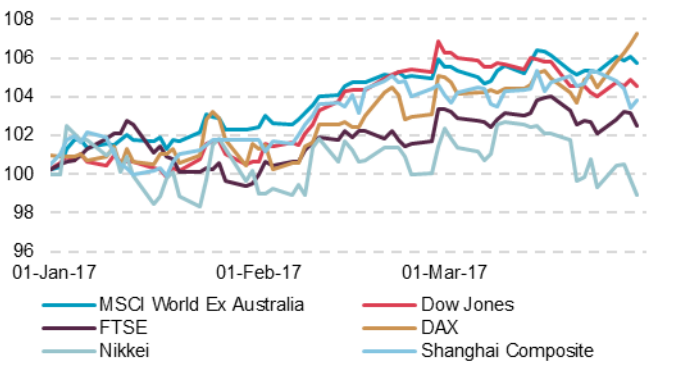
Source: BTIS/Bloomberg

International shares

Throughout the quarter, major international equity markets continued to be propelled by optimism surrounding potential fiscal spending and tax breaks in the US. However, the Nikkei tended to lag other markets.

The Dow finished the quarter with a solid 4.6% gain and the NASDAQ advanced by 9.8%, which was the highest quarterly gain since 2013. The durability of the US bull run may be tested if the Trump administration fails to implement key policies due to a lack of support from Republicans in Congress. The VIX ended the quarter at 12.37, which remains lower than long-term averages.

Chart 4: Major market indices – last quarter



Source: BTIS/Bloomberg

Fixed interest

Domestic bonds returned 0.44% over the quarter as government bond yields fell following the positive GDP result announced in February and the optimistic tone from the Reserve Bank suggesting that the RBA is not in the mindset to lower official interest rates any time soon. Over the quarter, the three year Australian Commonwealth Government bond yield fell from 1.96% to 1.91% per annum and the ten-year bond yield fell from 2.77% to 2.71% per annum.

Internationally, the Bloomberg Barclays Global Aggregate Bond Index (A$ hedged) returned 0.68% over the quarter, as bond yields fell in Germany and the United Kingdom as investors revised their views on the timing of the commencement of monetary policy tightening. In the US, 10-year Treasury bond yields fell from 2.44% per annum to 2.39% as investors confidence waned over concerns of the delivery of proposed policy changes from the Trump administration. Credit markets continued to perform well over the quarter with credit spreads on investment grade and high yield bonds falling further as investors priced in lower bond default rates over the next few years.

Currencies

The Australian dollar traded within a narrow range of less than 6% in the first quarter of 2017. Last year this range was slightly wider at around 10%. These ranges are relatively tight, given the range has averaged close to 20% over the last 10 years.

The Australian dollar appreciated against the US dollar, the euro and the pound over the quarter. Both upside and downside risks exist for the Australian dollar, and it may continue to be influenced by commodity prices.

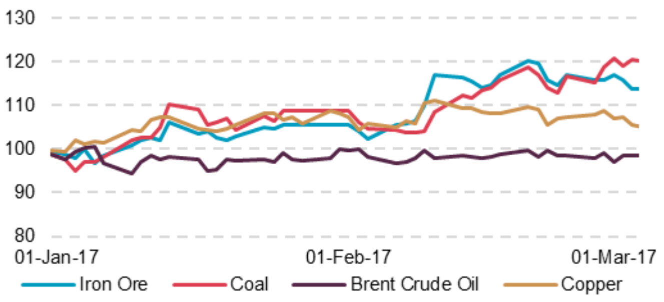
Chart 5: AUD/USD – one year

Source: BTIS/Bloomberg

Commodities

Commodity prices, particularly iron ore and coal, were supported over the quarter by relatively strong Chinese demand on the back of stimulus measures. Demand is expected to remain robust as Chinese authorities have indicated significant spending on infrastructure would continue. Copper prices rose over the quarter as a result of significant disruptions at the world's two largest mines. Coal prices continue to be supported by expectations China would continue is program of restrictive policies around limiting mining activity within their borders.

Chart 6: Commodities– last quarter



Source: BTIS/Bloomberg

Funds update

Diversified Multi-Blend Funds

The Diversified funds returned a positive absolute performance for the quarter with most financial markets up over the period. Underlying manger performances for the funds was strong across all asset classes resulting in solid outperformance against the Fund's benchmarks. Exposures to Asian and more broadly international equities helped drive positive excess returns though defensive assets also performed strongly over the period. Asset allocation positioning remained neutral to the Fund's strategic target.

Australian Shares Multi-Blend Fund

Australian equities enjoyed a strong quarter with the ASX300 gaining 4.7% and hitting a 12-month high towards the end of March in the process. The Fund performed roughly in line with its benchmark, delivering a return of 4.5%. Positive contributions came from Bennelong, BTIM and Alphinity who all delivered better than benchmark returns over the quarter. Bennelong topped the leaderboard of managers within the Fund thanks to overweight positions in CSL Limited, which rallied throughout the quarter after upgrading profit guidance in January and delivering a solid 1H17 result in February, together with Aristocrat Leisure, which saw its share price rise following the company's AGM in February where strong trading conditions were confirmed by management. BTIM benefited from its position in Qantas, which surged after the national carrier reported 1H17 pre-tax profit ahead of guidance and market consensus. Alphinity's overweight position in AGL Energy was one of its top contributors to outperformance as increasing wholesale electricity prices boosted the utility providers earning prospect.

Relative performance was hindered slightly by Schroders, who underperformed as a result of an overweight holding in Brambles which slumped on the back of a weaker than expected 1H17 result in February due to cost pressures in its North American business and a reduction in prices across Europe. Overweight exposure towards the Materials sector also hurt Schroders, with the sector finishing the quarter flat. Solid profits posted by metal and mining companies during reporting season, and subsequent earnings upgrades, were offset by a ~15% pullback in iron ore from February's peak and what appeared to be some profit taking. The allocation to smaller companies also detracted from the Fund during the quarter, with the Small Orders Index advancing by only 1.5%.

International Shares Multi-Blend Fund

International equity markets continued to edge higher during the quarter with the MSCI World ex Australia Index (in AUD) climbing 0.9%. The Fund outperformed this benchmark with a return of 2.2%. Strong alpha was delivered by T.Rowe Price where overall stock selection was the primary driver of relative outperformance within the strategy, while sector allocation was also positive. Regionally, holdings in North America proved beneficial for T.Rowe Price, however stocks held in developed Asia Pacific ex-Japan weighed on relative returns. MFS and Ardevora also provided positive contributions to the Fund.

Lansdowne was the major detractor to the Fund during the quarter, underperforming with a negative return as stock alpha proved hard to come by. An overweight position in JP Morgan weighed on relative performance, while holdings in BT and L Brands endured a challenging period.

Property Securities Multi-Blend Fund

Global REITs recovered some of their fourth quarter losses during the March quarter with the FTSE EPRA NAREIT Developed Hedged AUD Index up 1.5% as bond yields retreated. Domestically, the ASX300 A-REIT Index lost 0.1% as the ongoing rotation out of interest rate sensitive stocks overshadowed what was a relatively good reporting season with few surprises. The Fund outperformed its benchmark during the period with a return of 1.4%. The primary contributions to alpha came from Phoenix, Principal and BlackRock. The benchmark unaware strategy from Phoenix benefitted from an overweight position in Charter Hall Group, which delivered the best quarterly return among the Australian large cap names following the release of a much stronger than expected earnings figure for the first half. Heitman's unhedged strategy was the major drag on performance during the quarter as underperformance in Hong Kong and Japan impacted the manager's relative performance in Asia and offset positive contributions from North American and European exposures.

Australian Fixed Interest Multi-Blend Fund

The Fund outperformed its benchmark in March and also over the quarter gross of fees. It was a strong result with all managers delivering solid performance gross of fees. Credit positioning dominated managers' excess performance with credit spreads narrowing across the board. It was a relatively calm period for Australian Government bonds with yields ending the period marginally higher.

International Fixed Interest Multi-Blend Fund

The Fund outperformed its benchmark in March and also over the quarter gross of fees. Performance was somewhat distorted as February involved the transitioning of Franklin Templeton's portfolio following their formal termination in January. The transition was completed successfully with all assets transferred to Wellington.

Defensive Yield Multi-Blend Fund

The Fund outperformed its benchmark in March and over the quarter gross of fees. Both Kapstream and Standish Mellon posted positive results with broad credit positioning driving outperformance toward quarter end. Overweight positions in financials and select asset backed securities performed particularly well during the month.

Diversified Fund Performance

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

	1 Month %	3 Months %	1 Year %	3 Years %	5 Years %	7 Years %
Defensive Multi-Blend	0.74	1.52	5.52	3.80	4.80	5.07
Benchmark	0.63	1.35	5.39	5.10	5.64	5.82
Moderate Multi-Blend	1.15	2.12	8.29	4.99	6.43	6.05
Benchmark	1.02	1.88	8.44	6.30	7.35	6.82
Balanced Multi-Blend	1.52	2.65	11.18	6.12	7.97	6.83
Benchmark	1.40	2.32	11.50	7.44	8.92	7.60
Growth Multi-Blend	1.75	3.04	12.95	6.62	8.78	7.11
Benchmark	1.67	2.75	13.91	8.20	9.96	8.06
High Growth Multi-Blend	1.98	3.37	14.46	7.53	9.95	7.67
Benchmark	1.91	3.11	16.18	9.07	11.16	8.54

March Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	3.32%	4.82%	20.49%	7.53%	11.10%
S&P/ASX 200 Industrials	3.84%	5.31%	17.45%	9.84%	15.22%
S&P/ASX 200 Resources	0.66%	2.29%	40.54%	-2.80%	-2.96%
S&P/ASX 200 AREIT	0.62%	-0.28%	6.02%	16.69%	16.88%
S&P/ASX Small Ords	2.66%	1.46%	13.67%	6.44%	2.28%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia A$	1.82%	0.85%	15.55%	12.76%	16.43%
EPRA/NAREIT Developed Index Hedged A$	-1.51%	1.22%	3.85%	9.66%	11.54%
STOXX Europe 600	2.94%	5.46%	12.92%	4.47%	7.68%
S&P 500 Composite	-0.04%	5.53%	14.71%	8.06%	10.90%
Nikkei 225	-1.10%	-1.07%	12.83%	8.44%	13.40%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.15%	0.44%	1.94%	2.30%	2.65%
Barclays Global Aggregate TR Hedged A$	0.03%	0.68%	2.16%	5.59%	5.80%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	85.3508	-2.72%	-2.47%	8.28%	-14.07%	-9.67%
Generic Brent Crude Oil	52.83	-4.96%	-7.02%	33.41%	-21.15%	-15.53%
Generic WTI Crude Oil	50.6	-6.31%	-5.81%	31.98%	-20.73%	-13.25%
Gold US$/oz	1249.9	-0.51%	8.40%	1.42%	-0.97%	-5.60%
Iron Ore	80.39	-11.92%	1.93%	49.56%	-11.67%	-11.43%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.7646	-0.42%	5.94%	-0.33%	-6.22%	-5.93%
EUR/USD	1.0697	0.84%	1.42%	-6.01%	-8.08%	-4.31%
USD/JPY	111.31	-0.56%	-4.57%	-1.06%	2.60%	6.14%
GBP/USD	1.2542	1.01%	1.60%	-12.87%	-9.07%	-4.74%

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