Monthly commentary - May 2017

Global equities rose over May amid signs of improving economic growth and healthy corporate earnings. Several key indices hit record highs as pro-European Union candidate Emmanuel Macron won the French presidential election. However, persistent questions about political stability in the US, Europe and elsewhere tempered those gains. Australian equities went into reverse, impacted by concerns of the Bank levy and softer commodity prices.

Developments in the global economy

Australia

May saw the Government present its Budget for the year ahead, which attracted mixed commentary from the market, particularly the Bank levy of which the 'real' effect is still to be thought through – albeit a general understanding that the end payer of the tax will be shareholders, depositors and borrowers. With the housing market beginning to cool, the strength of a buoyant housing market and consumption spending is now being impacted as the household sector has borrowed to the limits of what can be considered prudent at a time of record low annual growth in wages. The financial regulator (APRA) has tried to limit growth in lending for investment housing but in the process has added to banks' costs causing a drift upwards in lending interest rates.

The Australian bond market was softer in May, partly in step with the decline in the local share market but also reflecting the continuing pressure on Australian banks, singled out for the additional tax in the Budget and with some smaller financial institutions coming under negative scrutiny by credit rating agencies. Government bond markets rallied in May assisted by changing views that the US Fed might be slower in hiking rates than expected previously.

Chart 1: ASX 200 Financials ex AREITs – year to date

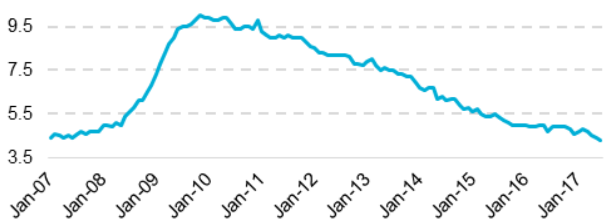
Source: BTIS/Bloomberg

US

The US earnings season concluded over May delivering solid earnings growth across all sectors. Profit numbers generally beat analyst estimates and earnings per share surprised even more, with over three-quarters of US companies beating revenue estimates. The earnings growth results seen across sectors indicates a broad-based higher earnings trend in the US.

The unemployment rate fell in the May labour market release to 4.4%, particularly good news after the disappointing payrolls report for the previous month. 211,000 non-farm jobs were added in April versus the 185,000 jobs expected. May also saw news of investigations into US President Donald Trump making headlines, and the US stock market experiencing one of its largest downward moves for the year-to-date. However, the move was not enough to deter the US index from rallying 1.4% for the month.

Chart 2: US Unemployment Rate Seasonally Adjusted



Source: BTIS/Bloomberg

China

China's economy continued to show signs of slowing with announcements in May that output had eased in the country's factories and mines. News however that likely stirred interest from Boeing and Airbus was that China's first domestically built passenger plane made its maiden flight in Shanghai. Of even more long term significance was the launch of China's 'Belt and Road' trade plan, which represents an investment of $US124bn in an ambitious economic plan to build ports, roads and rail networks. The plan, which aims to expand links between Asia, Africa and Europe, was first unveiled in 2013 and has been described as a new Silk Road.

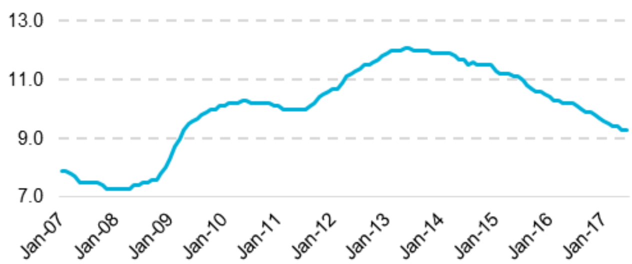
Ratings agency Moody's cut China's credit rating for the first time since 1989 on worries of the perceived 'debt mountain' within the Chinese economy. The rating was cut by one point from A1 to Aa3. The Shanghai Composite index duly took note, falling over 1% during the month.

Europe

European stocks advanced as investors cheered the outcome of the French presidential election. Centrist Emmanuel Macron's decisive victory over populist candidate Marine Le Pen helped to support a broad equities rally. Le Pen's defeat calmed investor worries that France might abandon the European Union and hasten a breakup of the 28-nation bloc.

The broader Eurozone continued to show signs of improvement, with the 19-country bloc's unemployment rate falling further down to 9.3%. Consumer confidence in the region hit a post-crisis high. The German Ifo survey on business sentiment reached its highest level since its inception in 1991.

Chart 3: Eurozone Unemployment Rate



Source: BTIS/Bloomberg

Developments in financial markets

Australian shares

Australian equities returned - 2.8% in May, in what was a sharp turn-around in fortunes compared to other global indices.

The market pullback was driven primarily by the perceived impact of the Government's bank levy that impacts the 5 largest banks, including Macquarie. This proposed measure alone detracted close to 8% from the Financials Sector. Mixed economic releases and weaker commodity prices further undermined the share market.

Over the month the RBA left the cash rate on hold at 1.5%, however restating concerns over low core inflation and low wage growth as key long term issues for the economy. Both however are expected to pick up as expectations of an improving economy comes to fruition.

Chart 4: ASX 200 – year to date

Source: BTIS/Bloomberg

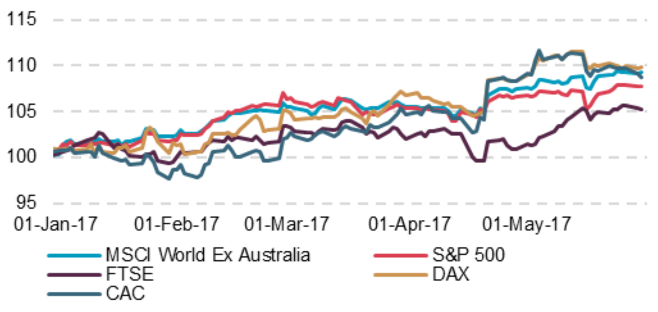
International shares

Global shares advanced in May to deliver a 2.8% return, supported by positive economic data and company reports, particularly out of the US and Euro regions.

In the US, the S&P 500 hit another record high, supported by the tailwinds of corporate profit results and optimism in the government's promise of substantial infrastructure spend, tax cuts and reform of the Dodd-Frank bill. US economic data improved with stronger retail spending and jobs growth.

European shares also made solid gains, with the German, UK and French markets hitting record highs. Supporting the rally was the election of Emmanuel Macron as French President and encouraging economic data across the Euro region.

Chart 5: Major market indices – year to date (rebased to 100)



Source: BTIS/Bloomberg

Fixed interest

Investment-grade bonds moved higher over the month, boosted by strong demand and waning concerns about inflation. Long-term interest rates declined, despite market expectations that the US Federal Reserve will raise short-term rates in June and may consider reducing its balance sheet later in the year.

Eurozone bonds rose modestly as senior officials at the European Central Bank expressed continuing support for the bank's aggressive stimulus measures. The ECB and the Bank of Japan held rates steady. Meanwhile, the US dollar declined against the euro and the yen.

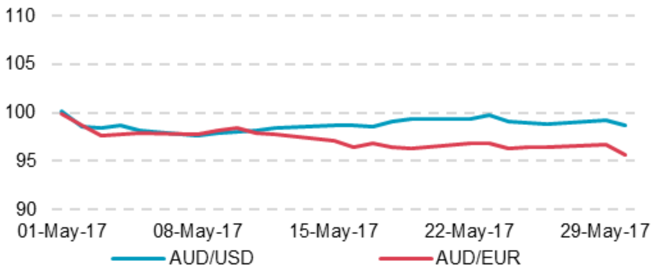
Currencies

The US dollar eased against most major currencies during May, mainly attributed to US political events, as well as recognition of the low real interest rates in the US. These concerns sent currency investors to the perceived safe haven of the Japanese yen and the US dollar lost 0.7% against the yen over the month.

The biggest currency story of the month was the Euro, which rallied against all major currencies as Emmanuel Macron comfortably won the final round of the French Presidential elections. The Euro gained 3.2% against the US dollar, and 3.7% against the pound, which weakened on jitters over the upcoming British general election.

The Australian dollar weakened against all of the major trading currencies during May as commodity prices fell and the yield advantage with the US dollar narrowed. The AU dollar fell 0.8% against the US dollar, and surrendered 1.1% in trade-weighted terms. The Aussie traded between 73.45 US cents and 75.36 cents during May, averaging 74.36 cents before closing the month at 74.30 cents.

Chart 6: AUD/USD and AUD/EUR – one month (rebased to 100)



Source: BTIS/Bloomberg

Commodities

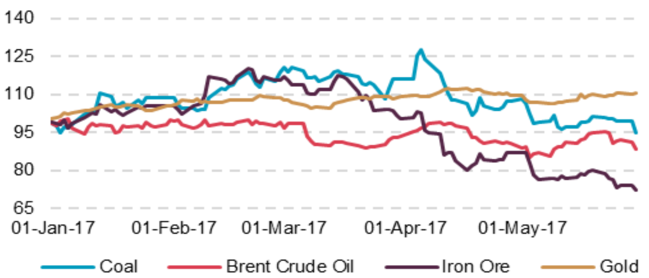
OPEC agreed mid-month to restrict output by 1.8 million barrels a day to lower mounting stockpiles, but the boost to prices was short-lived as traders had hoped OPEC would take a more aggressive stance against the chronic oversupply of oil. Contrary to this, US production hit its highest levels since August 2015, closing in on top producers, Russia and Saudi Arabia.

The iron ore price fell to its lowest level since October 2016 as stockpiles continued to grow to unprecedented levels at Chinese ports. Similarly, coking coal posted a double-digit price decline, as prices normalised from April's weather-induced peak.

Nickel lost 4.5% for the month, while copper, which is considered a bellwether for the global economy, was down 0.3%, after jumping late in the month on news of a strike at Indonesia's Grasberg mine. Copper is particularly sensitive to Chinese economic data.

Gold was barely changed in May, up 0.1%, while the Baltic Dry Index, a shipping index considered a useful proxy for the health of global trade, proved disappointing in May, plunging almost 21% to be 8.6% down in the year to date. However, this is after doubling in 2016.

Chart 7: Iron Ore and Coal –year to date (rebased to 100)



Source: BTIS/Bloomberg

Funds update

Diversified Multi-Blend Funds

The Advance Diversified Funds all performed strongly for the month, outperforming their respective benchmarks. Despite declines in Australian equities, most other assets made gains in May. Weak commodity prices particularly in base metals weighed on the Australian dollar seeing it move back within the broad 2017 trading range, resulting in unhedged international assets outperforming hedged.

The funds continue to be positioned neutral to their strategic asset allocation targets resulting in the month's outperformance being driven by manager selection across Australian and International equities whilst fixed income managers also moderately outperformed.

Australian Shares Multi-Blend Fund

The Australian equity market suffered its worst monthly loss since the China and oil induced meltdown of January 2016, with the ASX 300 slumping 2.7% on the back of a sharp 11.5% decline across the Banks. The Fund also finished the month in negative territory, with a loss of 1.7%, however this was 1.0% better than the benchmark. Relative outperformance was driven by Bennelong, who benefitted from positive stock selection, particularly in the consumer discretionary sector with an overweight allocation to Aristocrat Leisure which rallied 11.7% during the month after the company released a strong first half earnings result.

The Fidelity Future Leaders allocation was the only strategy to deliver a positive return during the month thanks to a selection of companies in the consumer discretionary and information technology sectors such as Corporate Travel Management and WiseTech Global which gained 8.2% and 24.5% respectively. The allocation to smaller companies was also a positive contributor to the relative performance of the Fund during the month, with the strategy delivering a return of 0.4% versus a 2.1% decline in the Small Ords Index.

International Shares Multi-Blend Fund

Equity markets around the world continued to climb in May, with the MSCI World ex Australia Index in AUD closing out the month up 2.8%, within a whisker of the all-time high reached in the lead up to the end of May. The Fund outperformed this benchmark by 0.3%, delivering a gain of 3.1%. Outperformance was driven by strong returns from T. Rowe Price, Lansdowne and MFS. T. Rowe Price's relative outperformance was driven primarily by stock selection, while sector allocation was also positive.

Shares in Japanese video game company Nintendo performed well as consumers reacted favourably to the release of the company's new Switch console, which has been consistently sold out since it hit the market in March. Consumer staples names also boosted returns, with Japanese snack manufacturer Calbee performing surprisingly well during the month despite issuing guidance that fell below market consensus. At the country level, holdings in North America and Japan supported relative returns, while holdings in developed Europe detracted from the relative performance.

Property Securities Multi-Blend Fund

Global REITs edged higher in May with the FTSE EPRA NAREIT Developed Hedged AUD Index up 0.5%. Domestically, the ASX 300 A-REIT Index moved in the opposite direction, losing 1.0%. The Fund produced a positive absolute return during the month, up 0.4%, and outperformed its benchmark by 0.3%.

The primary drivers of the relative outperformance were strong returns from BlackRock, Principal and Heitman. BlackRock benefitted from positive relative stock selection in Asia Pacific and North America, which overshadowed negative stock selection in Europe, Middle East and Africa. Drivers of positive relative performance for the period also included stock selection in US residential, US office, US healthcare, Japan REITs and Hong Kong developer.

Australian Fixed Interest Multi-Blend Fund

The Fund outperformed its benchmark in May gross of fees. All managers exceeded their respective benchmarks for the month. AMP was the standout performer with both credit positioning and active interest rate decisions contributing to outperformance. The Fund remains conservatively positioned with a bias towards high quality investment grade credit securities such as semi-government bonds, supranational bonds and select corporate credit. Interest rate positioning also remains modestly neutral relative to its benchmark.

International Fixed Interest Multi-Blend Fund

The Fund outperformed its benchmark in May and also remains on a solid footing for the year gross of fees. Standish was the sole contributor to outperformance with most of its active strategies adding value. In particular, positioning in yield curve, FX, asset allocation and security selection was additive. Wellington performed in line with its benchmark with positive contribution from the portfolio's credit positioning offset by underperformance across its interest rates strategies. The Fund remained underweight longer maturity bonds relative to its benchmark whilst the credit quality of the portfolio remained stable and conservative.

Defensive Yield Multi-Blend Fund

The Fund outperformed its benchmark in May and for the year gross of fees. All managers outperformed their respective benchmarks for the month. Standish was again the primary contributor to excess returns with Kapstream also producing solid results whilst BTIM was in line with its benchmark performance.

For Standish, outperformance was generated from a diverse source of active strategies including positioning in FX, asset allocation and interest rates. The coupon income from Kapstream's high quality physical portfolio accounted for a majority of outperformance for the month.

Advance Diversified Multi-Blend Fund Performance

Net (after fee) Wholesale performance of the Advance Diversified Multi-Blend Funds to end May 2017 against benchmarks are as follows.

	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %
Defensive Multi-Blend	0.55	2.26	5.10	3.82	5.23	5.46
Benchmark	0.42	2.02	4.59	5.04	5.92	6.12
Moderate Multi-Blend	0.55	3.14	7.15	5.12	7.22	6.72
Benchmark	0.29	2.56	6.67	6.14	7.92	7.36
Balanced Multi-Blend	0.50	3.80	9.10	6.32	9.15	7.74
Benchmark	0.15	3.06	8.75	7.24	9.83	8.38
Growth Multi-Blend	0.46	4.23	10.41	6.89	10.24	8.21
Benchmark	0.06	3.41	10.41	7.98	11.13	9.03
High Growth Multi-Blend	0.53	4.76	11.53	7.90	11.77	8.95
Benchmark	0.02	3.81	11.96	8.83	12.64	9.71

May Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	-2.75%	1.52%	11.10%	6.03%	11.92%
S&P/ASX 200 Industrials Accumulation	-3.48%	1.76%	8.42%	8.10%	15.44%
S&P/ASX 200 Resources Accumulation	1.19%	0.25%	28.12%	-3.29%	-0.68%
S&P/ASX 200 Accumulation AREIT	-1.10%	2.12%	1.98%	15.09%	16.28%
S&P/ASX Small Ords Accumulation	-2.05%	0.31%	3.55%	6.04%	4.22%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	2.75%	8.36%	13.33%	14.15%	18.72%
EPRA/NAREIT Developed Index Hedged $A	0.52%	0.05%	4.75%	7.96%	12.53%
STOXX Europe 600 Total Return	1.63%	7.33%	16.05%	7.75%	13.97%
S&P 500 Total Return	1.41%	2.57%	17.47%	10.13%	15.42%
Nikkei 225 Total Return	2.36%	3.50%	16.18%	12.32%	20.28%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.15%	0.45%	1.84%	2.25%	2.55%
Barclays Global Aggregate TR Hedged A$	0.64%	1.41%	2.68%	5.35%	5.59%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	82.8292	-1.41%	-5.60%	-2.94%	-14.78%	-8.39%
Generic Brent Crude Oil	50.31	-2.75%	-9.50%	1.25%	-22.82%	-13.16%
Generic WTI Crude Oil	48.32	-2.05%	-10.54%	-1.59%	-22.23%	-11.00%
Gold US$/oz	1268.92	0.05%	1.64%	4.41%	0.51%	-4.05%
Iron Ore	57.02	-17.12%	-37.53%	13.70%	-14.53%	-15.83%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.743	-0.77%	-2.96%	2.71%	-7.24%	-5.26%
EUR/USD	1.1244	3.20%	6.32%	1.01%	-6.22%	-1.88%
USD/JPY	110.78	-0.64%	-1.76%	0.05%	2.87%	7.18%
GBP/USD	1.289	-0.47%	4.12%	-11.00%	-8.37%	-3.50%

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