Quarterly commentary - June 2017

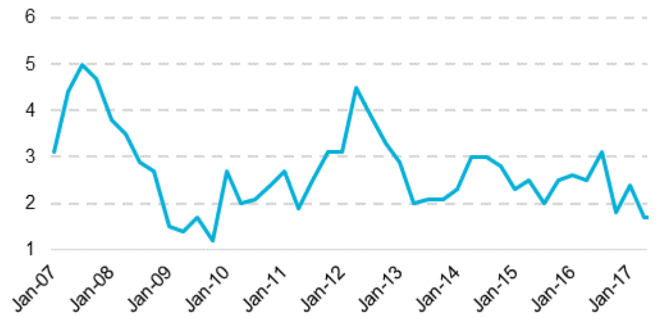
The June quarter was characterised by healthy gains across US markets, despite a late-quarter technology sell-off, indifferent performance from the European bourses and strong rises across Asia, with the exception of China's Shanghai Composite Index. The US Federal Reserve lifted interest rates for the second time in 2017, bringing rates to their highest level since 2008, and gave further details on the process of unwinding its US$4.5 trillion balance sheet.

Developments in the global economy

Australia

The Australian economy grew by 0.3% over the March quarter, after accelerating 1.1% in the December quarter, which was the fastest growth in five years. Annual economic growth eased from 2.4% in December to 1.7%, the slowest growth rate since the global financial crisis. The local economy has not experienced a recession (defined as two consecutive quarters of economic contraction) for more than 25 years, which gives Australia the title of the longest economic expansion by an advanced nation in the modern era.

Chart 1: Australian GDP Annualised – last 10 years



Source: BTIS/Bloomberg

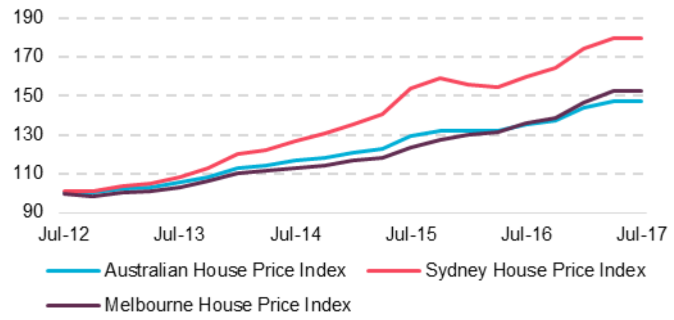
Household consumption, the largest part of the Australian economy at about 60% of GDP, grew by 0.5% for the March quarter, for an annual increase of 2.3%. Consumer spending is being hindered by record low wages growth and high levels of underemployment that have resulted in real household disposable income growth of just 0.4% over the last 12 months. With consumer spending growing more strongly than income, the household savings rate has come down to 4.7% from 6.9% a year ago. The year-on-year pace of retail sales came in at 2.1% in March, its slowest rate since mid-2013, but the April figure showed a surprising 1% lift.

Australia's annual exports to China reached a record high in April, at $122.3 billion, up 24% for the year. Exports to China represented 33.2% of Australia's total exports, a 33-month high. Australia's annual imports from China rose to a seven-month high in April, at $79.3 billion, down 2.2% year-on-year. Imports from China accounted for a record 23.45% of Australia's total imports.

Australia's unemployment rate tumbled to 5.5% as another 42,200 jobs were created in May, easily beating consensus forecasts of a net 10,000 gain in jobs and an unemployment rate remaining steady at 5.7%. May was the eighth consecutive month of rising full-time employment, with the economy creating 124,000 full-time jobs since September 2016.

According to Knight Frank, Australia' s house price index grew at an annual growth rate of 7.7% for the March quarter, compared to the international average of 6.5%. But data released in June by the Australian Bureau of Statistics showed that house price growth has started to cool, with house prices falling over the March quarter in Brisbane, Perth and Darwin, with apartment prices slipping in Melbourne, Adelaide, Perth and Darwin.

Chart 2: Australian House Prices – last 5 years (2011-2012=100)



Source: BTIS/Bloomberg

US

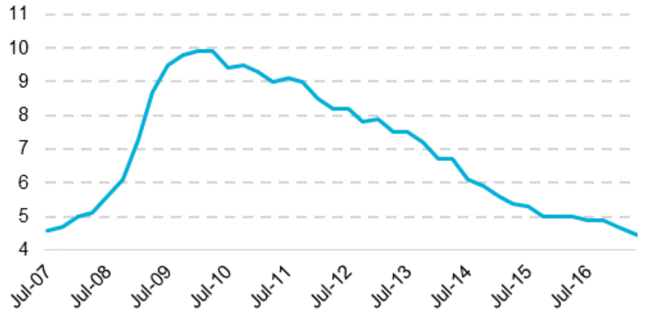
The US political environment grew increasingly divided over the quarter, with a seemingly never-ending string of controversies surrounding President Trump. For investors, concerns continued to mount that the Administration will be unable to push ahead with plans for tax cuts, infrastructure spending and deregulation, all of which were seen earlier in the year as boosting economic growth and corporate earnings. Over the quarter, however, the administration did manage to introduce some health insurance and financial-sector legislation.

Despite an initial estimate of GDP growth of 0.7% in the first quarter, which is known for being heavily weather-affected, the final print released by the Bureau of Economic Analysis showed a 1.4% annual increase in the first quarter.

Consumer spending, which accounts for two-thirds of US GDP, increased by 1.1%, exceeding an earlier estimate of a rise of 0.6%. Exports increased by 7%, improving over an earlier estimate of a rise of 5.8%. The ISM Manufacturing Index rebounded to hit 54.9 in May. Consumers remained upbeat, with the Consumer Confidence Index rebounding to hit 118.9 in June after going backward in May.

The March jobs figure was much weaker than expected, with just 98,000 jobs gained in the month. Despite this, the unemployment rate fell to 4.5%, the lowest figure since May 2007. Job creation in April rebounded with a gain of 211,000 while the unemployment rate fell to 4.4%. In May however, employment optimism was hit with a disappointing 138,000-jobs gain reported, not only below expectations, but accompanied by 66,000 in downward revisions to March and April figures. That left the average for the three months to May at 121,000, well down on 2016's 187,000 pace.

Chart 3: US Unemployment Rate Seasonally adjusted – last 10 years



Source: BTIS/Bloomberg

In May, the US Federal Reserve started the process of unwinding its US$4.5 trillion balance sheet, which grew from US$800 billion before the GFC, by outlining a proposed approach that would let increasing amounts of securities mature over time. The Fed plans to reduce that stimulus in a "gradual and predictable" manner so as not to worry the bond market. In June, the Fed delivered a 0.25% interest rate rise, with the federal funds target now between 1%–1.25%.

China

China experienced a mixed quarter of activity, hosting one of the largest international events seen in the modern era, with the official launch in May of its One Belt, One Road (OBOR) economic strategy, by which China proposes to link Europe economically to China through countries across Eurasia and the Indian Ocean, and also to link to Africa and Oceania.

The OBOR plan envisages the spending of more than US$1.42 trillion on infrastructure projects, enhancing China's global influence, with the added benefits of exporting the country's spare capacity, surplus domestic savings and labour, and bolstering domestic support for President Xi Jinping and the regime. The launch was one of the biggest events seen in Beijing, with attendees including the heads of 28 states and representatives from 100 countries.

The OBOR initiative is over seven times larger than America's Marshall Plan to rebuild Europe after the Second World War. China says its aim is to boost world trade by US$2.5 trillion in a decade.

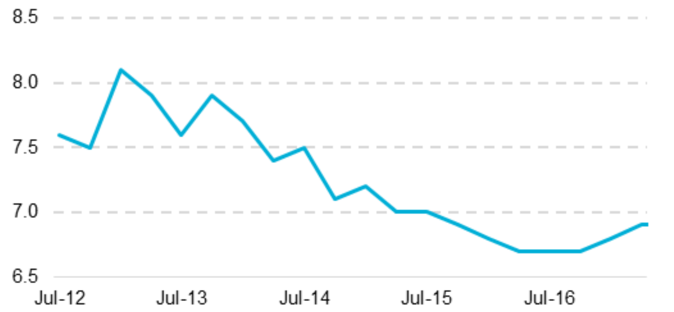
On the downside, in May ratings agency Moody's downgraded China's credit rating by one notch to A1 from Aa3, leaving S&P as the only ratings house to still have an AA- rating on the country.

MSCI announced in June that it would include Chinese domestic A-shares (shares that trade on the two Chinese stock exchanges) in its benchmark indices. This will come into effect in 2018.

Data in May showed that China's economy had slowed from its recent bounce, with retail sales, urban investment and industrial output all posting slower growth in April than the previous month. Industrial output was the biggest disappointment, growing at just 6.5%, down from 7.6% in March. Growth in the service sector slowed to 8.1% annualised, down from 8.3% in March, and the slowest rate since December. Exports in April rose 8% year-on-year in dollar terms, while imports rose 11.9%, both falling short of expectations.

The country's first quarter economic growth came in at a stronger-than-expected annual rate of 6.9%, the fastest rate since 2015. However, China has cut its economic growth target to around 6.5% this year, as it focuses on containing financial risk, after years of debt-fuelled stimulus. The People's Bank of China was careful not to unnerve markets, signalling that steps taken to reduce financial risks would not negatively impact market liquidity. In addition, currency strength eased fears surrounding capital flows and currency depreciation.

Chart 4: China GDP Annualised – last 5 years



Source: BTIS/Bloomberg

Data releases in June showed China's manufacturing sector expanded at its quickest pace in three months, buoyed by strong production and new orders, reassuring news for authorities trying to strike a balance between de-leveraging and keeping the economy on an even keel. The monthly purchasing managers' index (PMI) figure showed China's manufacturing activity accelerated in June to 51.7, from May's 51.2 reading, helped by stronger foreign demand for Chinese goods. It was the 11th straight month of improvement in this figure.

Official data also showed that China recorded a surplus in its capital and financial account in the first quarter, indicating net capital inflows as policymakers tightened supervision of outflows.

Europe

Politics was also in the spotlight in Europe. In France, Emmanuel Macron's independent political party, En Marche!, followed his individual win in the French presidential election by securing a strong parliamentary majority, barely a year after being formed. In the UK, the Conservative party, was stripped of its parliamentary majority in an election that Prime Minister Theresa May called with the aim of increasing her party's mandate, and strengthening the British government's hand in Brexit negotiations. The sudden increase in Brexit uncertainty contributed to the unnerved performance of European markets in June, and thus for the quarter.

However, solid company earnings and improving economic data provided some positive support for the indifferent markets over the quarter. UK manufacturing expanded in April at its fastest rate for three years, while the forward-looking IHS Markit Eurozone PMI rose again in May, to a six-year high.

The PMI readings for both France and Germany hit six-year highs, while in Germany, the Munich-based Ifo Institute for Economic Research's index of business sentiment reached in June its most bullish level since the country's reunification in 1991.

This was despite a weakening in June in Germany's manufacturing and services sector which accounts for more than two-thirds of its economy, along with business activity in France also easing, as growth weakened in the country's services sector. But with factory activity rising over the quarter to hit 57.3 in June from 56.8 in May, and IHS Markit saying the 19-nation Eurozone's manufacturing sector is enjoying its healthiest period in more than six years.

European company earnings have continued to outpace other markets. According to Thomson Reuters' collations, second-quarter earnings for European companies are expected to grow by 13.5% year-on-year, compared with 8% growth expected for S&P 500 companies and 6.4% for emerging markets in the Asia-Pacific Region.

Developments in financial markets

Australian shares

The Australian market struggled over the quarter, hit by a proposed levy to the major banks announced in the Federal Government's budget, which was then augmented by a proposed levy-on-a-levy from the South Australian state government, and mounting concerns around the Australian residential property market.

With the four largest Australian banks accounting for more than a third of the benchmark S&P/ASX 200 Index by market capitalisation, that placed heavy pressure on the market gauge, which responded with losses in May and June that resulted in a 1.6% decline for the quarter.

For the 2016-17 financial year, the S&P/ASX 200 Index benchmark gained 9.3%, or 14.1% with dividends included.

Chart 5: ASX 200 – one year

Source: BTIS/Bloomberg

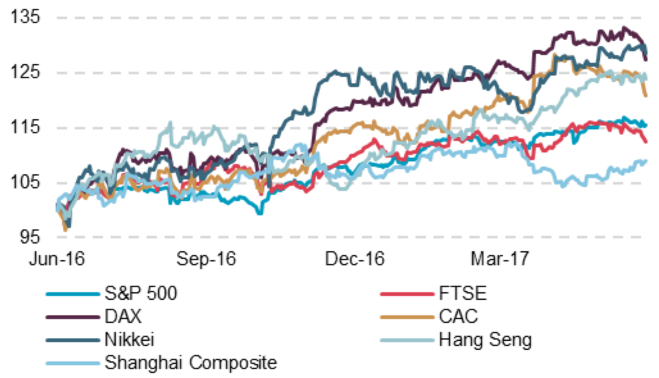
International shares

In the US, three winning months in the quarter pushed the broad S&P 500 index 3.1% higher, while the narrower Dow Jones Industrial Average gained 3.3%. Despite a heavy tech sell-off in June that took it to a losing month (down 0.9%), the Nasdaq Composite Index gained 3.9% for the quarter. It was the seventh straight winning quarter for both the Dow Jones and the S&P 500, while the Nasdaq banked its fourth quarterly rise in a row.

In Europe, markets weakened in June, undermined by a firmer euro and pound: the pan-European STOXX 600 on a total return basis lost 2.5% for June, its largest monthly loss for a year, and 1.2% for the quarter, leaving it still however with a solid 18.9% rise for the financial year to date. For the month, the German, DAX shed 2.3%, while the CAC 40 in Paris lost 3.1%. In London, the FTSE index lost 2.8%. For the quarter, the DAX gained 0.1%, the CAC 40 was down fractionally and the FTSE was in the red by 0.1%.

In Asia, the Japanese stock market was helped by strong company earnings. Net profit at Japanese companies for the March 2017 year-end climbed to a record high, with nearly 30% of firms reporting their highest-ever profit. The Nikkei index responded to this improving backdrop with three winning months, gaining 6.1% for the quarter. In Hong Kong, the Hang Seng index also posted three upward months, gaining 6.9% for the quarter, while China's Shanghai Composite Index lost ground in both April and May, before a 2.4% lift in June culminating in a 0.9% fall for the quarter.

Chart 6: Major market indices – one year (rebased to 100)



Source: BTIS/Bloomberg

Fixed interest

Bond markets were to a large extent bound to the world's major central banks and inflation expectations over the quarter. Political concerns in Washington saw bond markets reconsider expectations of Trump-driven reflation, pushing bond yields lower.

In the final days of the quarter, investors received clear indications from the Bank of England, the Bank of Canada and the European Central Bank that stimulatory settings would be unwound. This eroded some of the gains bond investors had made, pushing yields higher again. The net result was however a positive overall quarter for bonds.

US 10-year Treasury yields declined from 2.39% to 2.3% over the quarter, as did the 30-year, from 3.01% to 2.83%, while 2-year yields lifted from 1.25% to 1.38%. UK 10-year gilt yields surged from 1.14% to 1.26%, while German 10-year bund yields rose from 0.33% to 0.47%. Corporate bond indices also performed well driven by carry, as credit spreads broadly remained flat across the quarter.

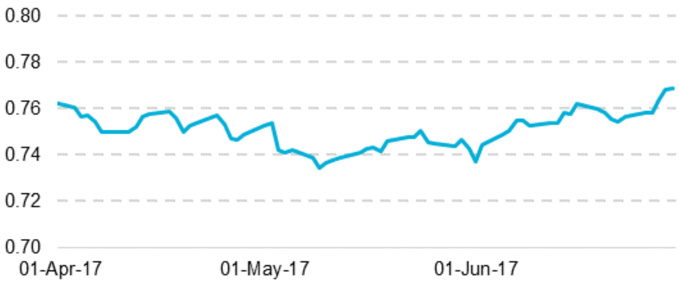
Currencies

In the foreign exchange markets, the standout story for the quarter was the US dollar, which experienced its worst quarterly decline against a basket of rival currencies in nearly seven years, pressured by tightening signals from foreign central banks, as well as doubts about whether the Fed would be able to raise interest rates again this year, and the extent to which President Donald Trump will be able to enact his pro-growth agenda.

The major beneficiary was the euro, which appreciated by 7.3% against the dollar over the quarter, for its biggest quarterly percentage gain since the third quarter of 2010. The US currency did manage to lift by 0.9% against the yen, but is losing against the Japanese currency year-to-date (down 3.9%), as it did in 2016 (down 2.8%).

The Australian dollar started the 2016-17 financial year buying just under 75 US cents, and finished it at just under 77 cents. Its highest point was on the eve of the US election, when it bought 77.8 cents, and its lowest was a few weeks later, in December, when it purchased 71.6 cents, as markets anticipated the new US President's reflationary agenda.

Chart 7: AUD/USD – 3 month



Source: BTIS/Bloomberg

Commodities

From an Australian point of view, the biggest story on the commodities front for the quarter was the 13.9% surge in iron ore in June. Although welcome, the strong June could not stop iron ore shedding 19.2% for the quarter, after steep losses in April (down 16.5%) and May.

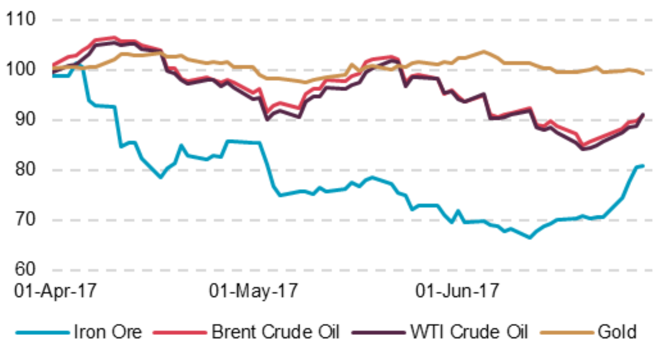
Crude oil slipped in the quarter (West Texas Intermediate down 9%, Brent down 9.3%), as the extent of US shale production growth surprised, as did the deal struck between OPEC and Libya and Nigeria. Because of repeated rebel attacks on oil infrastructure in those countries, they were exempted from the OPEC production cuts agreed in in November, a deal which was reiterated in May.

.

But with those attacks less frequent, Libya's output surged to more than one million barrels a day, up from 400,000 in October, while Nigeria's output rose to 1.6 million barrels a day, up from 200,000 barrels a day in October, according to JBC, a Vienna-based energy-industry consultancy.

Gold slipped 0.6% for the quarter in US dollar terms. After a strong start to the year, most of the base metals surrendered ground in the June quarter. The Bloomberg Industrial Metals Sub-index, which tracks aluminium, copper, nickel and zinc, made its first quarterly loss since 2015.

Chart 8: Iron Ore, Crude Oil and Gold – 3 months (rebased to 100)



Source: BTIS/Bloomberg

Funds update

Diversified Multi-Blend Funds

The Advance Diversified funds all provided positive absolute returns over the quarter, with each portfolio exceeding their gross return benchmarks.

This was despite the International Shares, Property Securities and both International and Domestic Fixed Interest sector portfolios delivering negative gross returns, being -2.4%, -0.55%, -0.16% and -0.87% respectively over the month of June. Overall the Diversified funds have benefitted from the strength of equity markets being we continue to be positioned neutral to their strategic asset allocation targets resulting in the quarter's outperformance being driven by manager selection across primarily Australian, Asian market equities and the broader International equity markets.

Australian Shares Multi-Blend Fund

The Australian equity market struggled over the quarter, with the ASX 300 falling 1.6%. The Fund however managed to deliver a positive return of 0.4% over the period, outperforming the benchmark by 2.0%. The strong performance was a result of all underlying managers generating alpha, with Bennelong being the main contributor to relative outperformance. Stock selection drove Bennelong's performance over the period, particularly an overweight allocation to Aristocrat Leisure which rallied 25.5% during the quarter after the company released a strong first half earnings result.

The Fidelity Future Leaders allocation delivered the largest absolute return over the quarter on the back of high convictions holdings in travel services provider Corporate Travel Management, which gained 14.5%, and asset manager Magellan Group, which advanced 22.0%. 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 1.5% versus a 0.4% decline in the Small Ords Index.

International Shares Multi-Blend Fund

Global equity markets extended gains during the June quarter, with the MSCI World ex Australia Index in AUD closing the period 3.6% higher. The Fund outperformed this benchmark by 1.6%, with a return of 5.2%. The strong performance was a result of all underlying managers generating alpha, with T.Rowe Price being the main contributor to relative outperformance.

Stock selection in financials contributed to the most to relative performance for T.Rowe Price with shares of discount broker TD Ameritrade Holdings rebounding strongly over the quarter. At the regional level, holdings in emerging markets supported relative returns, while holdings in North America detracted from relative performance.

Property Securities Multi-Blend Fund

Global REITs continued to climb over the quarter with the FTSE EPRA NAREIT Developed Hedged AUD Index advancing 2.1%. Domestically, the ASX 300 A-REIT Index moved in the opposite direction, slumping 3.1%. The Fund produced a positive absolute return during the quarter, up 1.4%, and outperformed its benchmark by 0.6%.

The primary drivers of relative outperformance were strong returns from BlackRock and Principal. BlackRock benefited from positive relative stock selection across the Americas, Asia Pacific and EMEA regions. Drivers of relative outperformance for the period included stock selection in US Office, US Retail, and US Residential, together with Japanese REITs and Hong Kong Developers.

Australian Fixed Interest Multi-Blend Fund

The June quarter was an uninspiring period for Australian Bond markets, characterised by rising bond yields and a lack of volatility in credit margins. In spite of these conditions, the Fund outperformed its benchmark during the quarter gross of fees. All managers exceeded their respective benchmarks for the quarter. 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. Over the month, the fund has increased its overall duration position to be now modestly overweight the benchmark.

International Fixed Interest Multi-Blend Fund

The Fund outperformed its benchmark in June and also remains on a solid footing for the year gross of fees. Standish was the main contributor to the fund's outperformance with most of its active strategies adding value. In particular, positioning in yield curve, FX, asset allocation and security selection was additive. The manager's underweight in duration versus the benchmark also contributed positively as bond yields retraced higher during the month.

Wellington performed marginally below its benchmark with positive contribution from the portfolio's credit positioning offset by underperformance across its macro and interest rates strategies. The Fund remained underweight longer maturity bonds relative to its benchmark whilst the credit quality of the portfolio remained at a stable A1 rating based on Moody's rating methodology.

Defensive Yield Multi-Blend Fund

The Fund outperformed the benchmark during the June quarter and for the year gross of fees. All managers outperformed their respective benchmarks for the quarter. Standish was again the primary contributor to excess returns with Kapstream also producing solid results.

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

Advance Diversified Multi-Blend Fund Performance

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

	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %
Defensive Multi-Blend	**-0.43**	**1.07**	**4.47**	**3.57**	**5.02**	**5.42**
Benchmark	-0.51	0.87	3.71	4.74	5.71	6.03
Moderate Multi-Blend	**-0.43**	**1.52**	**7.33**	**4.95**	**7.01**	**6.79**
Benchmark	-0.57	0.95	6.38	5.85	7.66	7.37
Balanced Multi-Blend	**-0.41**	**1.82**	**10.1**	**6.23**	**8.93**	**7.93**
Benchmark	-0.69	0.94	8.98	6.95	9.51	8.49
Growth Multi-Blend	**-0.43**	**1.99**	**12.04**	**6.84**	**10.01**	**8.48**
Benchmark	-0.71	0.99	11.18	7.7	10.77	9.23
High Growth Multi-Blend	**-0.5**	**2.22**	**13.46**	**7.88**	**11.57**	**9.27**
Benchmark	-0.78	1.07	13.01	8.56	12.27	10.01

June Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	0.17%	-1.58%	14.09%	6.63%	11.81%
S&P/ASX 200 Industrials Accumulation	0.61%	-1.41%	12.63%	8.83%	15.00%
S&P/ASX 200 Resources Accumulation	-2.10%	-2.50%	22.92%	-3.37%	-0.21%
S&P/ASX 200 Accumulation AREIT	-4.82%	-3.40%	-6.26%	11.98%	14.14%
S&P/ASX Small Ords Accumulation	1.99%	-0.35%	7.01%	7.13%	5.66%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	-2.64%	3.62%	14.73%	12.97%	18.24%
EPRA/NAREIT Developed Index Hedged $A	0.49%	2.08%	2.22%	7.76%	11.42%
STOXX Europe 600 Total Return	-2.48%	1.19%	18.85%	7.03%	12.28%
S&P 500 Total Return	0.62%	3.09%	17.90%	9.61%	14.63%
Nikkei 225 Total Return	2.14%	6.15%	31.07%	11.73%	19.48%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.14%	0.44%	1.82%	2.22%	2.52%
Barclays Global Aggregate TR Hedged A$	-0.22%	1.17%	0.47%	5.08%	5.51%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	82.6017	-0.27%	-3.22%	-7.02%	-15.03%	-9.41%
Generic Brent Crude Oil	47.92	-4.75%	-9.29%	-3.54%	-24.73%	-13.30%
Generic WTI Crude Oil	46.04	-4.72%	-9.01%	-4.74%	-24.12%	-11.53%
Gold US$/oz	1241.61	-2.15%	-0.61%	-6.07%	-2.20%	-4.92%
Iron Ore	64.95	13.91%	-19.21%	16.69%	-11.60%	-13.68%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.7689	3.49%	0.79%	3.19%	-6.59%	-5.57%
EUR/USD	1.1426	1.62%	7.27%	2.88%	-5.85%	-2.04%
USD/JPY	112.39	1.45%	0.90%	8.91%	3.51%	7.09%
GBP/USD	1.3025	1.05%	3.78%	-2.15%	-8.68%	-3.68%

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

This document has been created by Westpac Financial Services Limited (ABN 20 000 241 127, AFSL 233716). It provides an overview or summary only and it should not be considered a comprehensive statement on any matter or relied upon as such. This information has been prepared without taking account of your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation and needs. Projections given above are predicative in character. Whilst every effort has been taken to ensure that the assumptions on which the projections are based are reasonable, the projections may be based on incorrect assumptions or may not take into account known or unknown risks and uncertainties. The results ultimately achieved may differ materially from these projections. Information in this document that has been provided by third parties has not been independently verified and Westpac Financial Services Limited is not in any way responsible for such information. **Past performance is not a reliable indicator of future performance**.