Monthly commentary - August 2017

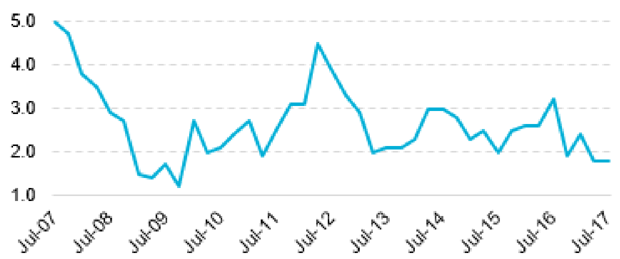
Geo-political concerns were front and centre over August, with North Korea ramping up its missile test program, and President Trump in turn ratcheting up the rhetoric on the US' preparedness to deal with threats to it or its North Asian allies. This saw 'safe haven' assets, in the form of gold, the Japanese yen, the Swiss franc and US Treasuries seeing plenty of action over the month. Despite these events, markets remained steady, focusing on the continued and gradual improvement across the major global economies.

Developments in the global economy

Australia

Over August the Reserve Bank of Australia (RBA) lowered its forecasts for economic growth for the medium term. The quarterly Statement on Monetary Policy from the RBA saw the bank forecasting 2.5% GDP growth by the end of this year, down from 3% in its previous update. The RBA said the high level of the Australian dollar was a factor in its outlook.

Chart 1: Australian GDP annualised – last 10 years



Source: BTIS/Bloomberg

With the official cash rate remaining at the current level, it was noteworthy that RBA governor Philip Lowe said it was "reasonable" to assume the next official rate move was likely to be up rather than down, but it would be "a long way out." Market pricing shows the market expects the cash rate to remain at 1.50%, but the chances of a rate rise in 2018 has become more probable.

Local economic news was mixed. Employment rose for the 10th straight month in July, easing the unemployment rate from 5.7% to 5.6%. But the 27,900 jobs created in July were due to a 48,200 rise in part-time jobs: full-time jobs fell by 20,300. There were also signs that wage growth, which has struggled in Australia, was on the rise, with wage growth up 0.5% for the June quarter and 1.9% year-on-year.

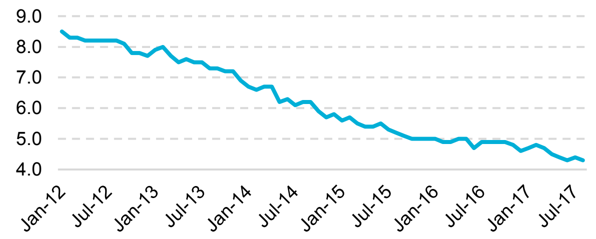
US

Data released in August showed that US economic growth hit a 3% pace in the second quarter, revised upward from an initial estimate of 2.6%, and representing the US economy's strongest pace of economic growth in more than two years. Consumer spending was the standout, rising 3.3% in the second quarter.

The July jobs number was very strong, with the US economy adding a better-than-expected 209,000 jobs. That pushed the unemployment rate from 4.4% to 4.3%, the lowest level in 16 years.

Economic growth will be affected by the damage wrought by Hurricane Harvey (and Hurricane Irma in its wake), which hit the southern United States in August. Early estimates put the damage from Harvey at up to $225 billion, given the region affected by Hurricane Harvey accounts for one-third of US crude oil refining capacity and about 3% of US GDP.

Chart 2: US Unemployment Rate Seasonally Adjusted – last 5 years



Source: BTIS/Bloomberg

Asia

China's official manufacturing PMI racked up its 13th straight monthly reading in expansionary territory, rising from July's figure of 51.4 to 51.7 and showing that factory activity remains strong.

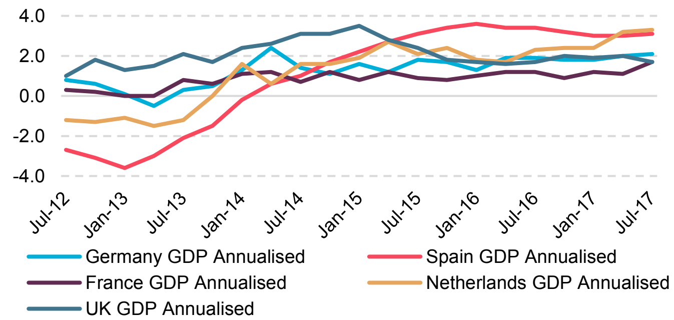
There was however, other data released during the month that missed expectations. China's official non-manufacturing PMI figure fell to 53.4 in August from 54.5 in July; industrial output for July rose by 6.4% year-on-year, missing analysts' expectations for a rise of 7.1%; and July retail sales rose by 10.4% from a year ago, missing the 10.8% forecast.

Preliminary numbers indicated the Japanese economy grew at an annualised rate of 4.0% in the June quarter, easily exceeding the 2.5% rise forecast in a Reuters poll. If confirmed, this will make six quarters in a row of growth, which will be the longest expansion in more than a decade. Rising domestic demand is the major contributor to growth. If the economy grows in the current quarter, that would represent Japan's best economic growth streak since 2001.

Europe

Preliminary figures showed the Eurozone economy grew by 0.6% in the June quarter, pacing the rate seen in the previous quarter, but year-on-year growth accelerated from 1.9% to 2.2%, to its fastest pace since 2011. Final figures showed German GDP grew by 0.6% in the most recent quarter, Spain posted 0.9% growth, France reported 0.5% and the Netherlands provided the biggest surprise, surging by an unexpectedly strong 1.5%. In contrast, UK GDP growth underwhelmed, reported at 0.3% for the June quarter, and 1.7% year-on-year.

Chart 3: European and UK Growth – last 5 years



Source: BTIS/Bloomberg

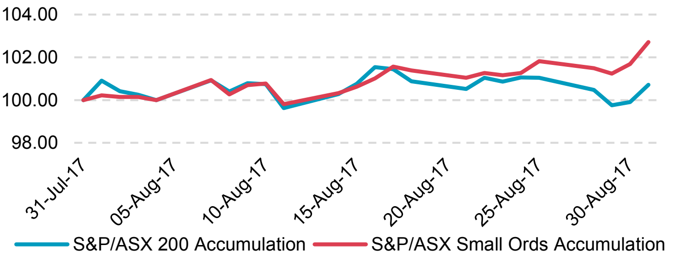
Despite economic data showing that Germany is on track for its strongest growth since 2011, potentially exceeding 2% in 2017, German business confidence slipped slightly in August – after posting three record highs in a row – largely on the back of the rising euro. But the wavering in business sentiment was offset by surprisingly strong consumer confidence, which reached its highest level since October 2001.

Developments in financial markets

Australian shares

The S&P/ASX 200 added 0.7% on a total-return basis over the month, a good result considering the S&P/ASX 20 was down 0.8%. The index was supported by the S&P/ASX Small Ordinaries which racked up a 2.7% gain to offset the large cap losses. This gain was powered by a standout 7.1% gain from the S&P/ASX Small Ordinaries Resources index, assisted by a 1.7% gain from the industrials component.

Chart 4: ASX 200 and ASX Small Ordinaries – August (rebased to 100)



Source: BTIS/Bloomberg

The FY2017 earnings reporting season concluded with 67% of companies reporting higher profits than a year ago, and 64% increasing dividends. Earnings per share growth came in at almost 18%, but that was powered by a more-than-doubling of resources companies' earnings. In the rest of the market, profit growth was about 6%, after two years of declines.

Positive surprises were not as prevalent as in previous years, and overall, the market felt that outlook guidance was not as buoyant as had been expected. As a result, expectations for earnings growth for the current financial year have been lowered.

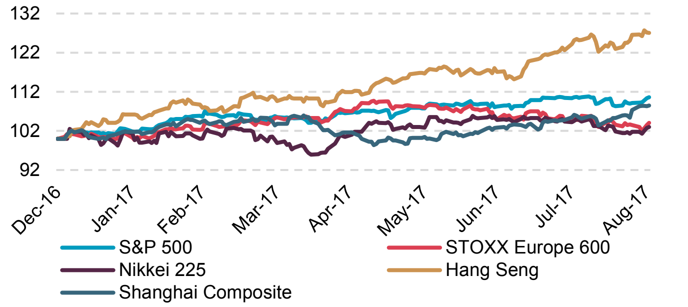
International shares

Tensions were high in North Asia from the outset, after North Korea's 14th missile test for the year, which seemed to bring the continental US into its range, and reports stating that Pyongyang now possessed a miniaturised nuclear warhead. Investors spent the month moving into perceived safe haven assets; gold, the Japanese yen, the Swiss franc and US Treasuries, and then out, as the war of words ebbed and flowed. Hurricane Harvey and the Federal Reserve's annual central bankers' symposium in the Rocky Mountains topped off the list of investors' concerns in August.

On a total-return basis, the S&P 500 Index was up 0.3% but the STOXX Europe 600 index shed 0.8%. On a price basis, the Dow Jones Industrial Average gained 0.5% and the Nasdaq Composite Index added 1.3%. In Europe, the DAX in Germany was down 0.5% and the CAC 40 in Paris fell 0.2%, while in the UK the FT-SE 100 was up 0.8%.

For the Asian markets, the Nikkei lost 1.3% on a total-return basis. On a price basis, the Hang Seng in Hong Kong was up 2.4%, the Shanghai Composite Index added 2.7% and the KOSPI index in South Korea dropped 1.6% for the month.

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



Source: BTIS/Bloomberg

Fixed interest

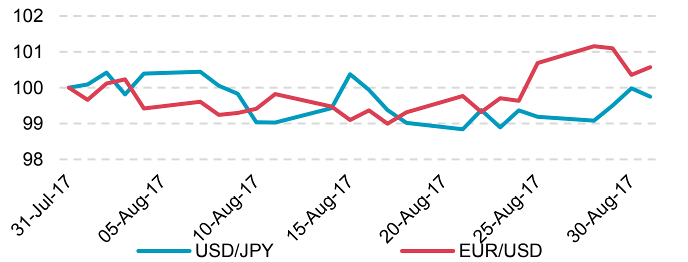
The North Korean weapons tests saw safe haven buying that pushed bond yields lower in most advanced economies. In the US, the yield on 2-year bonds fell 3 basis points to 1.32%, while 10-year bond yields dropped by 18 bps to 2.12%. In other major markets, German yields fell 18bps to 0.36%, French yields lost 15 bps to 0.66% and Italian yields fell 5 bps to 2.04%. In Japan, the 10-year bond lost its 7 bps of yield to officially hit 0.00%.

Australia bucked the global trend, with yields closing the month a few basis points higher. Yields on 3 year bonds increased 8 bps to 2.03%, 10-year yields edged 3 bps higher to 2.71%, and the 20-year bond yield added 1bps to 3.25%.

Currencies

The US dollar retreated 0.3% against the yen over the month and the Euro gained 0.6% against the US dollar. As the third round of Brexit negotiations between the Kingdom and the European Union made no decisive progress, the sterling fell over 2% over the course of August. The Australian currency lost 0.7% against the greenback, but strengthened against the euro, which gave up 1.5% against the A$.

Chart 6: USD/JPY and EUR/USD – August (rebased to 100)

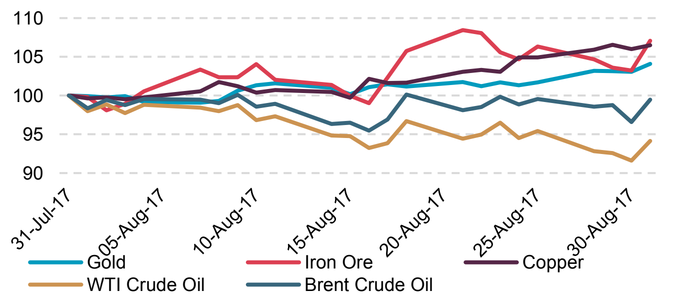


Source: BTIS/Bloomberg

Commodities

Gold gained 4.1% on safe-haven buying, while iron ore surged 7.1%, copper gained 6.5%, aluminium climbed 10%, zinc surged 13% – touching its highest price in a decade – and nickel put on 16%. West Texas Intermediate crude oil shed 5.9%, while Brent crude lost 0.5%. The Bloomberg Commodity Index put on 0.3% for the month.

Chart 7: Major Commodities – August (rebased to 100)



Source: BTIS/Bloomberg

Funds update

Diversified Multi-Blend Funds

The Diversified Funds all achieved a positive absolute performance for the month, with higher growth profiles outperforming. Generally all asset markets made gains over the month with little differentiation between returns received from either equities or bonds. Asian equities continues to perform well and was the strongest of the equity markets for the month. There were marginal differences between Australian versus global equities whilst domestic bonds underperformed global bonds.

The Australian dollar pulled back slightly during the month, after its multi-month ascent where it has appreciated 7% over the last 9 months against the US dollar. Manager outperformance across Australian equities, Asian equities, REITs and Alternatives drove the portfolios' positive excess returns across the higher risk profiles, though Fixed Interest managers performed more in line with the market.

Australian Shares Multi-Blend Fund

The Fund delivered a gross return of 1.5% over the month of August, outperforming the benchmark ASX 300 Index by 0.8%. The strong outperformance was primarily driven by positive contributions from Fidelity, Bennelong and Alphinity. The Fidelity Opportunities strategy benefited from stock specific drivers, with an overweight position in A2 Milk advancing on better than anticipated earnings growth following a series of upgrades to guidance, while positions in alternative asset manager Blue Sky Alternative Investments and logistics software provider WiseTech Global also buoyed performance, led by their strong earnings growth momentum.

The smaller companies allocation was also a strong positive, with the strategy delivering a gross return of 2.5%, which was roughly in line with the 2.7% gain across the Small Ords Index.

International Shares Multi-Blend Fund

The Fund advanced 0.8% over August on a gross return basis, performing in line with the benchmark MSCI World ex Australia Index in AUD which was also up 0.8%. Ardevora and AQR delivered solid outperformance over the month, offsetting relative underperformance seen from MFS, River & Mercantile and T. Rowe Price. Ardevora's strategy enjoyed positive contributions from stock, sector and country selection. At the sector level, excess performance was led by overweights in IT and Materials, while regionally, Europe, Japan and Rest of World generated excess contributions to the return. At the stock level, holdings in Arista Network, a US network switching business, saw its share price rise over the month on the back of a positive quarterly result, and Bakkafrost, which is a Norwegian salmon farmer, helped drive the positive return.

Property Securities Multi-Blend Fund

The Fund delivered a gross return of 1.1% in August, outperforming its benchmark by 0.5%. The primary driver of outperformance over the month was the allocation to Principal, with the strategy performing strongly on the back of positive stock selection, particularly in the United States and Europe. Top contributors to performance were a continued overweight to the structural growth story in non-benchmark towers and data centre stocks. The portfolio also benefitted from an overweight to both stocks involved in the merger announcement between Invitation Homes, Inc. and Starwood Waypoint Homes. Selection in malls contributed with an overweight to Simon Property Group, which relatively outperformed peers amidst the troubled retail landscape.

Australian Fixed Interest Multi-Blend Fund

In Australia, bond markets did not benefit as much from the risk-adverse mood as yields rose, particularly in the short dated segment. The above average readings in Australian business sentiment and employment growth contributed to the underperformance of Australian bonds, with 10 year yields sitting at 2.7% at month end, underperforming their US counterparts. Manager performance was split with BTIM and Henderson both outperforming their respective benchmarks whilst Aberdeen and AMP both detracted slightly. BTIM's performance was mainly attributable to the strategy's government and non-government bond exposures which performed strongly thanks to the long duration position in the New Zealand front-end. In Henderson's case, some alpha was derived from both duration and sector allocation decisions. Henderson continues to maintain a view that Australian bond yields are likely to fluctuate within a narrow range and hence continue to manage their duration within a modest range relative to the benchmark.

International Fixed Interest Multi-Blend Fund

Escalating geopolitical tensions between the US and North Korea and concerns about the legislative progress in Washington led to a spike in volatility during August, while global economic data remained strong. Most global government bond yields fell during the month as geopolitical tensions led to a flight to quality, benefitting perceived safe haven assets. Against this backdrop, the Fund delivered performance that was in line with the benchmark during the month of August. Wellington modestly outperformed the benchmark whilst Standish Mellon detracted after recording a number of solid performances in the previous few months. Wellington's macro and quantitative strategies were both positive contributors in August whilst credit detracted. Spreads widened as concerns of tight valuations and geopolitical risks dominated sentiment. Overall, the Fund remains conservatively positioned with an average credit rating of A+. From a duration standpoint, the fund is currently positioned with an underweight towards duration (6.63 years) versus the benchmark (6.92 years).

Defensive Yield Multi-Blend Fund

The Fund outperformed the benchmark during the month of August and all managers outperformed their respective benchmarks. The contribution to outperformance was broadly derived evenly across all 3 managers. Returns in the underlying portfolio were once again generated from a diverse source of active strategies including positioning in FX, asset allocation, credit selection and interest rate strategies. The portfolio continues to generate strong income with an average current running yield of 3.02%.

Advance Diversified Multi-Blend Fund Performance

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

	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %
Defensive Multi-Blend	**0.48**	**0.12**	**3.21**	**3.44**	**4.61**	**5.14**
Benchmark	0.51	0.14	2.75	4.48	5.34	5.79
Moderate Multi-Blend	**0.69**	**0.23**	**5.34**	**4.72**	**6.49**	**6.5**
Benchmark	0.58	0.06	4.65	5.43	7.11	7.1
Balanced Multi-Blend	**0.84**	**0.32**	**7.49**	**5.9**	**8.32**	**7.67**
Benchmark	0.65	-0.08	6.6	6.38	8.82	8.24
Growth Multi-Blend	**0.9**	**0.23**	**8.78**	**6.43**	**9.32**	**8.23**
Benchmark	0.67	-0.13	8.19	7.05	9.98	8.98
High Growth Multi-Blend	**0.98**	**0.11**	**9.85**	**7.35**	**10.79**	**9.1**
Benchmark	0.7	-0.22	9.46	7.78	11.38	9.81

August Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	0.71%	0.87%	9.79%	5.13%	10.56%
S&P/ASX 200 Industrials Accumulation	-0.25%	-0.59%	6.76%	6.57%	12.79%
S&P/ASX 200 Resources Accumulation	5.51%	8.48%	27.16%	-1.42%	1.93%
S&P/ASX 200 Accumulation AREIT	1.28%	-3.67%	-7.43%	10.00%	13.19%
S&P/ASX Small Ords Accumulation	2.71%	5.12%	3.20%	5.68%	5.72%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	0.81%	-3.49%	10.07%	12.13%	17.36%
EPRA/NAREIT Developed Index Hedged $A	0.26%	1.64%	0.76%	7.03%	10.88%
STOXX Europe 600 Total Return	-0.77%	-3.56%	12.46%	6.48%	10.64%
S&P 500 Total Return	0.31%	3.01%	16.23%	9.54%	14.34%
Nikkei 225 Total Return	-1.34%	0.24%	18.55%	10.38%	19.46%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.14%	0.43%	1.76%	2.16%	2.46%
Barclays Global Aggregate TR Hedged A$	0.96%	1.11%	1.04%	4.88%	5.34%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	84.6565	0.31%	2.21%	2.28%	-12.55%	-10.33%
Generic Brent Crude Oil	52.38	-0.51%	4.11%	11.35%	-20.23%	-14.49%
Generic WTI Crude Oil	47.23	-5.86%	-2.26%	5.66%	-21.05%	-13.31%
Gold US$/oz	1321.43	4.10%	4.14%	0.95%	0.88%	-4.82%
Iron Ore	78.91	7.07%	38.39%	33.81%	-3.43%	-2.53%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.7947	-0.70%	6.96%	5.72%	-5.24%	-5.10%
EUR/USD	1.191	0.57%	5.92%	6.74%	-3.20%	-1.09%
USD/JPY	109.98	-0.25%	-0.72%	6.33%	1.85%	7.01%
GBP/USD	1.293	-2.16%	0.31%	-1.58%	-7.99%	-4.01%

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