Monthly commentary - September 2017

Continued signs that the world economy is growing in synchronisation for the first time in 10 years buoyed world markets in September, with improving economic data in the US, Europe and Japan, while China's managed slowdown continues to be closely watched.

Developments in the global economy

Australia

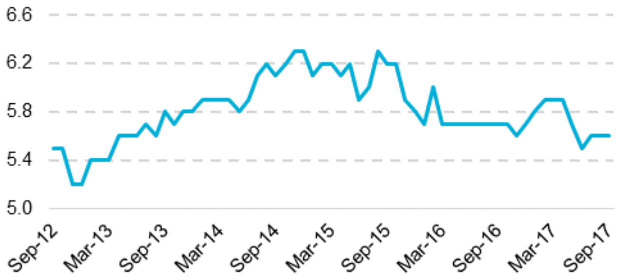
Australia's record economic expansion has moved into its 27th year, with September's national accounts showing GDP grew by 0.8% in the June quarter, for annual economic growth of 1.8%.

The GDP figures were a healthy rebound from the weak first-quarter number, when growth for the quarter was just 0.3%. The uptick was mostly due to a recovery in export volumes, and a lift in business investment, as non-mining investment recovers and the drag from the mining sector lessens.

Australia's exports to China surged by 28% in the year to July, to a record high of US$96.2 billion, and China now accounts for just under one-third of Australia's total exports. Australia's annual imports from China rose 1.6% to a 15-month high of US$61.6 billion in the year to July, representing 22.6% of the nation's total imports. Australia's exports to India hit a 5½-year high in the year to July, coming in at US$15.4 billion and up 61.3% on the prior year.

Employment rose for the 11th straight month in August, up by 54,200 in August after rising by 29,200 in July. Full-time jobs rose by 40,100 while part-time jobs rose by 14,100. In the most recent six-month period, the Australian economy has created 250,000 jobs, its best six-month performance in 17 years.

Chart 1: Australian Unemployment Rate – last 5 years



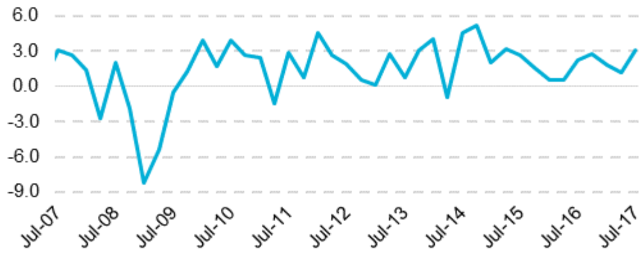
Source: BTIS/Bloomberg

The Reserve Bank of Australia kept the official cash rate on hold at 1.5% in September, re-emphasising rising household debt as its major area of concern.

US

The US economy showed a better growth rate than previously estimated in the second quarter, posting its fastest pace in more than two years at a 3.1% annual rate. In other economic data, US personal income rose 0.2% in August, while consumer spending was up 0.1%. The forward-looking Chicago Purchasing Managers Index (PMI) rose from 58.9 to hit 65.2 in September, a jump from the August reading of 58.9, showing surging optimism among firms about business conditions. (A PMI reading above 50 indicates expansion.)

Chart 2: US GDP Annualised – last 10 years



Source: BTIS/Bloomberg

In contrast, US consumer confidence declined in September, after hitting a seven-month high in August. The University of Michigan consumer sentiment index came in at 95.3 in September, down from the figure of 97.6 recorded in August, but the survey's compilers made a point of mentioning that 9% of respondents "spontaneously mentioned" concerns that Hurricanes Harvey, Irma, or both, would have a negative impact on the US economy.

In September, the US Federal Reserve announced that it would start to reduce the size of its balance sheet, having let it swell from US$850 billion prior to the Global Financial Crisis to US$4.5 trillion during its "quantitative easing" program. In October, the Fed will begin what must be called "quantitative tightening," as it stops replacing portions of the bonds that mature each month.

Janet Yellen's speech during the month was taken as hawkish in tone by the markets. Despite the Fed being confident in the continuation of the US economic recovery, she said that it could be risky "moving too gradually" on US interest rates. This bolstered the conviction for a December rate hike.

Asia

September saw more rhetoric from North Korea, kicking off the month by conducting a hydrogen bomb test, which was reported to be seven times stronger than the bomb the US dropped on Hiroshima in 1945.

Across to China, President Xi Jinping's upcoming 19th Communist Party Congress is to be held in late October. The once-every-five-years event is the major set-piece of Xi's reign, at which he will most likely be re-anointed leader for at least another five years.

Chinese industrial output rose 6% annually in August, down from expectations of 6.6% and July's 6.4%, and registered the slowest pace this year. Retail sales grew 10.1% from a year earlier, compared to an expectation of 10.5% and 10.4% in July. Fixed asset investment in urban areas rose by 7.8% in the first eight months of the year, the slowest rate since 1999. In contrast, the September manufacturing PMI rose by 0.7 points to 52.4, showing accelerated expansion.

Japanese industrial production rose by 2.1% month-on-month in August, while trade data showed that both imports and exports were strong. The Markit/Nikkei Japan manufacturing PMI showed that Japanese manufacturing activity in September expanded at the fastest pace in four months.

Europe

The Eurozone manufacturing PMI hit a six-year high in September, while the IHS Markit composite PMI figure defied a consensus estimate of a fall to rise to 56.7 in September from 55.7 in August, its highest level since May. The latest Eurostat figures showed the Eurozone economy grew by 0.6% in the second quarter, or 2.3% on an annual basis.

Germany's unemployment fell to a record low in September at 5.6%, as jobless claims declined more sharply than expected. Eurozone inflation in September was stable at 1.5%, missing forecasts of 1.6%. German exporters have become more optimistic about their business prospects as soaring demand from other Eurozone countries helps offset worries about the strengthening currency, according to the Munich-based Ifo economic institute.

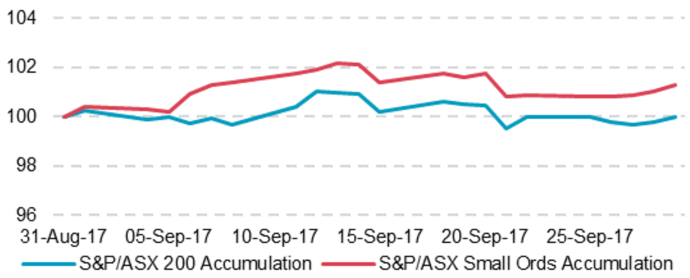
Elsewhere, strained Brexit negotiations continued between the United Kingdom and the European Union, with little progress evident, including calls for another UK vote. The lead-up to the Catalan independence referendum, which was self-mounted by the autonomous region's government and declared illegal by Madrid, brought further concern for the viability of the European project.

Developments in financial markets

Australian shares

The S&P/ASX 200 Index was down a fractional amount in September on a total return basis, once again assisted by its small-cap companies. The S&P/ASX Small Ordinaries Accumulation Index posted a 1.3% gain and the S&P/ASX Small Ordinaries Resources component did even better, gaining 2.4%, despite a spectacular 21.4% fall in the iron ore price. The index heavyweights, the S&P/ASX 20 Index, could only manage a 0.1% rise on a total return basis.

Chart 3: ASX 200 and ASX Small Ordinaries – September (rebased to 100)



Source: BTIS/Bloomberg

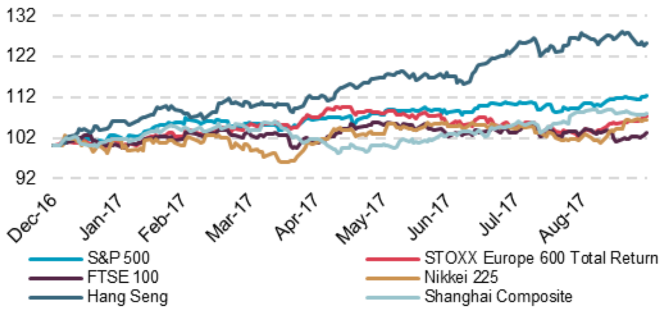
International shares

The US indices continued their strong gains in September, with the S&P 500 and the Nasdaq Composite Index closing September at record highs, and the Dow Jones Industrial Average just 7 points short of its previous record close. The S&P 500 added 2.1% on a total return basis, while the Dow Jones also gained 2.1% and the Nasdaq Composite was up 1.1%.

In Europe, the STOXX Europe 600 (total return) put on 3.9% for the month, fuelled by a 6.4% surge in the DAX in Germany and a 4.8% rise in the CAC 40 in France. In the UK, the FTSE 100 index eased 0.8%.

In Asia, Japan's Nikkei surged 4.3% on a total return basis, the Hang Seng in Hong Kong surrendered 1.5%, the South Korean KOSPI was up 1.3% and the Shanghai Composite Index gave up 0.4%.

Chart 4: Major market indices – year to date (rebased to 100)



Source: BTIS/Bloomberg

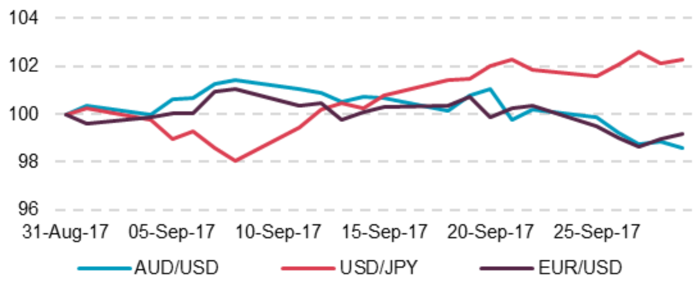
Fixed interest

In the US, the yield on 2-year bonds moved up 15 basis points to 1.48%, while 10-year bonds jumped 21 basis points to 2.33%, and 30-year bonds moved 13 basis points higher, to 2.86%. German 10-year yields rose 10 basis points to 0.46%, while the 2-year bunds remained in negative territory–0.69%. The 10-year Japanese government bond yield fell to a 10-month low of -0.015% early in September on North Korea concerns, and it averaged 0.021% over the month. In Australia, the 10-year bond yield increased by 16 basis points to 2.87%.

Currencies

The US dollar regained ground against the euro and the yen over September. The euro lost 0.8% against the dollar, while the dollar picked up 2.3% against the yen. The US unit also lost 4.0% against the sterling, while the Australian dollar continued to weaken against its US counterpart, to the tune of 1.4%. The Aussie also fell against the euro, giving up 0.6%.

Chart 5: AUD/USD, USD/JPY and EUR/USD – September (rebased to 100)

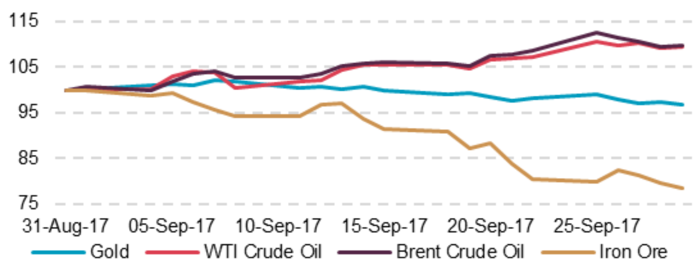


Source: BTIS/Bloomberg

Commodities

On the commodities front, gold lost 3.2%, while oil rebounded, with West Texas Intermediate crude gaining 9.4%, and Brent crude up 9.9%. Nickel lost 11.3% in the month, the biggest fall for any single commodity, while copper fell over 4%. The Bloomberg Commodity Index eased 0.2% for the month.

Chart 6: Major Commodities – September (rebased to 100)



Source: BTIS/Bloomberg

Funds update

Diversified Multi-Blend Funds

The Diversified Funds all achieved a positive absolute performance for the month, and have outperformed their benchmarks over the quarter with the exception of the Defensive portfolio. Fixed interest assets underperformed as did REITs as markets continued to focus on potential interest rate increases from the global central banks and the unwind of overcrowded high yield assets. The Australian dollar declined after gaining 6.5% over the previous 3 months helping unhedged assets outperform. Most notably International Equities rose 3.4% for the month, well ahead of domestic equities which were mostly flat. The strong rally in 2017 from Asian equities has continued in September though at a much more modest pace.

Manager outperformance from Australian equities drove positive relative performance of the portfolios over the month and quarter and more than offset marginal detractions from domestic and international fixed interest investments.

Australian Shares Multi-Blend Fund

The Fund delivered a gross return of 0.6% over the month of September, outperforming the benchmark S&P/ASX 300 Index which was unchanged over the period. The strong outperformance was a result of all the underlying managers delivering alpha during the month, with Fidelity, Bennelong and Schroders topping the leaderboard for gains. The Fidelity Opportunities strategy benefitted from shares in infant formula company A2 Milk and logistics software provider WiseTech Global which continued to rise, led by their robust growth momentum. Sentiment towards A2 Milk improved notably as the Chinese regulator approved its application to continue to sell infant formula products in the domestic market. WiseTech Global's earnings guidance for 2018 surpassed estimates and it announced the acquisition of two global freight companies to support its rapid growth.

The smaller companies allocation was also a strong positive contributor to overall performance, with the strategy delivering a gross return of 2.3%, which was 1.0% above the Small Ords Index.

International Shares Multi-Blend Fund

The Fund advanced 3.6% over September on a gross return basis, outperforming the benchmark MSCI World ex Australia Index in AUD by 0.2%. River & Mercantile and Ardevora were the primary drivers of outperformance during the period. River & Mercantile's strategy was helped by strong performance from a number of oil related stocks – Transocean, Noble Corporation, Tullow Oil and Marathon Oil. The offshore oil rig companies Transocean and Noble Corporation had fallen to multi-decade lows with rig rates declining to prices not seen since the mid-2000s, but even allowing for write-downs, River & Mercantile felt the market had valued their assets too low. Ardevora outperformed on the back of strong returns from holdings in Macau casinos, Galaxy and Wynn, together with semiconductor capital equipment players, Applied Materials, KLA-Tencor, and Lam Research.

Property Securities Multi-Blend Fund

The Fund declined 0.1% in September on a gross basis, underperforming the benchmark by 0.2%. Heitman and Phoenix saw decent returns during the month, climbing around 0.5% each, however this wasn't enough to offset declines across Principal and BlackRock. Heitman continued to generate strong relative performance due to its underweight towards retail as the woes in the US retail property market continue to reverberate around the globe. Looking ahead, Heitman believe that recent stories about data centres becoming obsolete are overdone, however this could cause some short term volatility for the data centre stocks.

Australian Fixed Interest Multi-Blend Fund

Despite recording negative returns on an absolute basis, the majority of the underlying managers in the fund were able to outperform the benchmark. In Henderson's case, excess performance over September was attributable to a combination of value added from interest rate and sector strategies. The Portfolio's overweight allocation to investment grade credit, primarily corporate debt, added value with the excess return from this sector largely reflecting the 'carry' associated with their yield advantage relative to government bonds. In BTIM's case, the portfolio's yield curve strategy benefited from an Australian front end curve steepener that had been adopted in the prior month. The duration strategy was also marginally positive with a long New Zealand front end position and a short position in the long end of the Australian curve. Aberdeen was the only manager to underperform the benchmark due to its overweight position in duration.

International Fixed Interest Multi-Blend Fund

The Fund delivered a modest negative return over the month of September but outperformed the benchmark in a relative sense. Both managers in the portfolio outperformed the benchmark with Standish being the main contributor. Wellington's credit strategies were positive contributors in September whilst macro and quantitative detracted. Overall, the Fund remains conservatively positioned with an average credit rating of A+. From a duration standpoint, the fund moved decisively in September to be currently positioned with an underweight towards duration (5.66 years) versus the benchmark (6.92 years).

Defensive Yield Multi-Blend Fund

The Fund outperformed the benchmark during the month of September with most managers outperforming their respective benchmarks. The contribution to outperformance was largely attributable to Kapstream and Standish. BTIM however underperformed with their relative value, cross-market and macro strategies being flat and the FX strategy detracting from performance.

Returns in the underlying portfolio were once again generated from a diverse source of active strategies including asset allocation, credit selection and interest rate strategies. The portfolio continues to generate strong income with an average current running yield of 2.94%.

Advance Diversified Multi-Blend Fund Performance

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

	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %
Defensive Multi-Blend	**0.24**	**0.79**	**3.69**	**3.74**	**4.45**	**4.94**
Benchmark	0.19	0.84	3.11	4.81	5.18	5.64
Moderate Multi-Blend	**0.62**	**1.29**	**6.29**	**5.22**	**6.35**	**6.23**
Benchmark	0.5	1.14	5.39	6.03	6.96	6.88
Balanced Multi-Blend	**1.03**	**1.77**	**8.92**	**6.63**	**8.22**	**7.35**
Benchmark	0.89	1.5	7.81	7.21	8.69	7.96
Growth Multi-Blend	**1.3**	**1.98**	**10.58**	**7.31**	**9.25**	**7.87**
Benchmark	1.17	1.76	9.74	8.07	9.86	8.66
High Growth Multi-Blend	**1.5**	**2.13**	**11.94**	**8.27**	**10.72**	**8.7**
Benchmark	1.39	1.96	11.32	8.88	11.27	9.44

September Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	-0.02%	0.68%	9.25%	7.08%	10.08%
S&P/ASX 200 Industrials Accumulation	0.27%	-0.93%	7.53%	8.55%	12.66%
S&P/ASX 200 Resources Accumulation	-1.39%	9.26%	18.46%	0.33%	0.39%
S&P/ASX 200 Accumulation AREIT	0.51%	1.72%	-2.75%	12.23%	13.01%
S&P/ASX Small Ords Accumulation	1.31%	4.41%	2.98%	8.15%	5.09%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	3.44%	2.53%	15.38%	11.82%	17.67%
EPRA/NAREIT Developed Index Hedged $A	-0.10%	1.04%	1.94%	8.67%	10.56%
STOXX Europe 600 Total Return	3.91%	2.75%	16.95%	7.70%	11.27%
S&P 500 Total Return	2.06%	4.48%	18.61%	10.81%	14.22%
Nikkei 225 Total Return	4.28%	2.34%	26.04%	9.96%	20.18%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.14%	0.43%	1.76%	2.14%	2.43%
Barclays Global Aggregate TR Hedged A$	-0.43%	0.89%	0.53%	4.77%	5.10%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	84.4599	-0.23%	2.25%	-1.03%	-10.72%	-10.67%
Generic Brent Crude Oil	57.54	9.85%	20.08%	17.28%	-15.29%	-12.53%
Generic WTI Crude Oil	51.67	9.40%	12.23%	7.11%	-17.24%	-10.93%
Gold US$/oz	1279.75	-3.15%	3.07%	-2.74%	1.94%	-6.30%
Iron Ore	62.05	-21.37%	-4.46%	11.08%	-7.36%	-10.23%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.7834	-1.42%	1.89%	2.22%	-3.61%	-5.47%
EUR/USD	1.1814	-0.81%	3.40%	5.15%	-2.20%	-1.68%
USD/JPY	112.51	2.30%	0.11%	11.01%	0.86%	7.61%
GBP/USD	1.3398	3.62%	2.86%	3.28%	-6.16%	-3.69%

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