Monthly commentary – December 2017

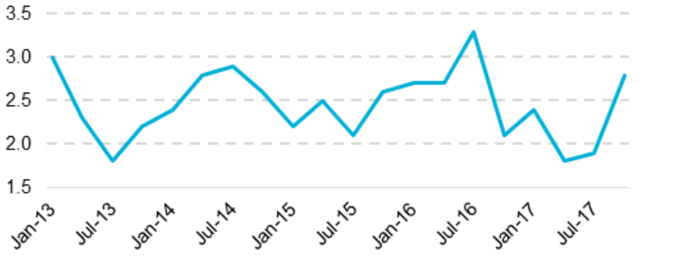
US equity markets surged into year-end, bolstered by strong global economic growth, healthy company earnings and the passage of President Trump's US$1.5 trillion tax-reform package, described as the biggest US tax overhaul since 1986. In Europe, political uncertainty stemming from the inconclusive German election and subsequent coalition discussions, and the victory of pro-independence parties in Catalonia's provincial election, weighed on stock markets, but economic news continued to impress.

Developments in the global economy

Australia

The national accounts showed that the Australian economy grew by 0.6% in the September quarter after rising by 0.9% (revised) in the June quarter. Annual economic growth rose to 2.8% from 1.9%, the strongest pace since June 2016, but was artificially boosted because of the negative September quarter in 2016. The domestic economy has moved into its 27th year of continued economic expansion, with the last recession occurring in 1991. The household savings rate rose to a 15-month high of 3.2%.

Chart 1: Australian GDP Annualised – last 5 years



Source: BTIS/Bloomberg

The November Labour Force report from the Australian Bureau of Statistics was very healthy, with 22,000 new jobs created in November. More importantly, monthly trend full-time employment increased for the 14th month in a row, with full-time employment rising by about 308,000 persons since November 2016. Full-time employment is growing at its fastest pace in a decade with a record 12.4 million employed. Australia's unemployment rate was steady at 5.4% for the third straight month, the lowest rate since January 2013.

The Reserve Bank of Australia (RBA) left the official cash rate at 1.5% in December, meaning the rate has not been changed since August 2016, when it was lowered by 0.25%. The minutes from the RBA's December board meeting showed that the central bank remains generally upbeat about the economy, and noted that positive business conditions, the improved outlook for non-mining business investment and the upswing in public infrastructure investment was also supporting economic growth.

Consumption was sluggish, amid weak wages growth, but the Westpac/Melbourne Institute survey of consumer sentiment rose by 3.6% in December to 103.3 (a reading above 100 indicates optimism), its best growth in four years.

The federal government's Mid-Year Economic and Fiscal Outlook (MYEFO) released in December projected real GDP continuing to grow, as the drag from the tail-off in mining investment diminishes. Real GDP is forecast to grow by 2.5% in 2017-18 and by 3% in 2018-19, compared to the 2% achieved in 2016-17. The Budget is forecasted to grow at a rate of 2.75% and 3% for 2017-18 and 2018-19 respectively.

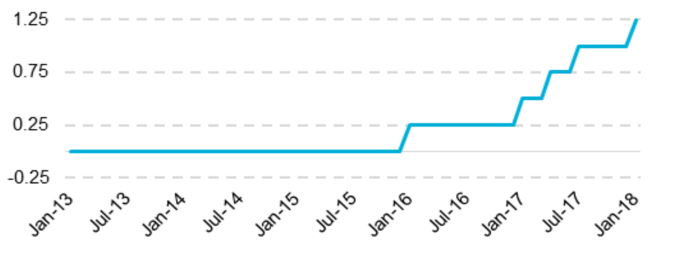
US

The final reading from the Bureau of Economic Analysis (BEA) showed the US economy growing at an annual rate of 3.2% in the third quarter of 2017, slightly below the second estimate of 3.3%, but the strongest growth rate since the first quarter of 2015. It was also the first time since 2014 that the economy grew at a rate of 3% or more for two consecutive quarters (3.1% was the final annual figure for second-quarter growth). The US economy has now been expanding for 101 months, since 2009, the third-longest growth phase on record.

The rate of growth in business investment in equipment was raised to 10.8%, the fastest in three years, from the previously reported 10.4%. There were also upward revisions to government spending and residential construction. However, growth in consumer spending, which accounts for more than two-thirds of the US economy, was wound back by 0.1 percentage points to a 2.2% rate in the third quarter.

The US Federal Reserve raised the Funds rate by 0.25% in December, to between 1.25% and 1.5%, in the third US rate hike in 2017. Absent any unexpected setbacks, the Fed is on pace for another three rate increases in 2018.

Chart 2: US Interest Rate – last 5 years



Source: BTIS/Bloomberg

The Chicago Purchasing Manager's Index (PMI), widely viewed as an indicator of the wider US economy, recorded a reading of 67.6 in December, its best figure since March 2011, and an increase on the 63.9 reported for November (a figure above 50 indicates manufacturing expansion).

US employers added a robust 228,000 jobs in November, with the unemployment rate remaining at a 17-year low of 4.1%. The unemployment rate in the US manufacturing industry fell to 2.6%, the lowest on record (the series dates back to January 2000). CNN reported that the US economy has gained jobs for 86 consecutive months, the longest streak in history, according to US Labor Department figures going back to 1939.

Economic analytics firm The Conference Board said its index of leading US economic indicators climbed by 0.4% in November, better than economists' expectations of a 0.3% rise, after surging by 1.2% in October. This was taken as suggesting that solid economic growth will continue into the first half of 2018.

Asia

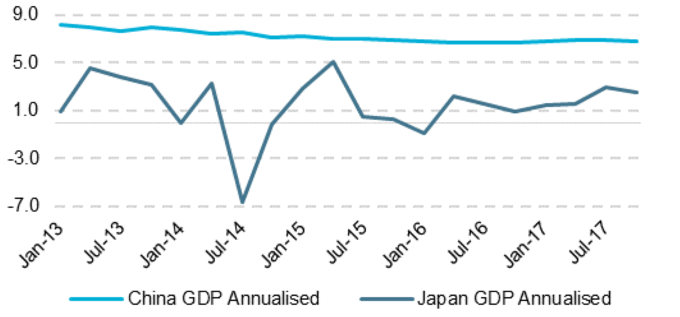
The latest figures show that China's economy grew by an annualised 6.8% in the third quarter of 2017, with full-year growth poised for its first acceleration since 2010. But the crackdown on financial risks is affecting growth and the country will keep its target for economic growth at "around 6.5%" in 2018, unchanged from last year. In December, Beijing released its economic blueprint for 2018, showing that high debt levels will be tolerated in a bid for higher growth.

The official manufacturing PMI came in at 51.6 in December, showing improving conditions, with new export manufacturing orders rising to a six-month high. The Caixin manufacturing PMI, which tracks smaller firms, beat all forecasts at 51.5 in December.

The quarterly survey of thousands of Chinese firms by China Beige Book International showed that overall wages and hiring slowed in the December quarter, with the retail sector suffering the biggest downturn. The results reinforce views that economic growth will ease in 2018. The Chinese Academy of Social Sciences forecasts the economy will grow by 6.7% in 2018, from an estimated 6.8% in 2017.

The Japanese economy grew for a seventh consecutive quarter, the longest streak in nearly two decades, according to the country's Cabinet Office. Third-quarter GDP grew by 2.5% in annual terms, much stronger than the preliminary estimate of 1.4% growth, but down from 2.9% in the second quarter. Haruhiko Kuroda, Governor of the Bank of Japan, said in a year-end speech that the duration of the current "recovery phase," which started in December 2012, likely reached 60 consecutive months in November 2017.

Chart 3: Chinese and Japanese GDP Annualised – last 5 years



Source: BTIS/Bloomberg

Manufacturing activity in December expanded at its fastest pace since February 2014, according to the Nikkei Japan manufacturing PMI. The Bank of Japan's Tankan Survey for December showed the large manufacturers' business confidence index reaching its highest level since December 2006, further evidence that the economy is gathering some momentum from exports and solid corporate profits.

Japanese households spent more than expected in November, helped by a 1.8% annual increase in wage earners' disposable income, while the jobless rate hit a 24-year low at 2.7%. The supply of jobs also improved, with 156 jobs available for every 100 job seekers (up from 155), the highest figure in almost 44 years. Household spending jumped by 1.7% in November from a year earlier, beating forecasts of a 0.5% increase. On the inflation front, the core consumer price index, which excludes volatile fresh food prices, rose 0.9% in November from a year earlier, marking it the 11th straight month of gains. But Japan's inflation rate remains well short of the Bank of Japan's 2% target, despite a growing economy. The bank left its accommodative monetary policy unchanged in December.

Europe

Political developments flowed heavily in December, weighing on investors' minds. In Germany, the month ended with coalition negotiations having failed to produce a government, and minority government by Chancellor Angela Merkel's Conservatives looming.

The Spanish province of Catalonia voted in a snap regional election that was widely viewed as another referendum on independence, and the combined pro-independence parties won a majority of seats, in a setback for Spanish Prime Minister Mariano Rajoy's government.

The European Commission launched an injunction against Poland for a "serious breach" of European common values and rule of law, for refusing to comply with European Union immigration quotas and changes to its judicial system. The European Commission claims that judicial reforms have put the country's justice system "under the political control of the ruling majority." The "Article 7" disciplinary measures, the so-called "nuclear option", is the EU's punishment clause, allowing it to discipline member states when there is a "clear risk of a serious breach" of the bloc's core principles. Until December, it had never been triggered.

Britain and the EU struck a deal for the UK to conduct its "Brexit," with a final exit bill of €40 billion–€45 billion ($61 billion–$69 billion). The UK will pay into the EU budgets for 2019 and 2020 as if it had remained in the bloc, and will also "contribute its share of the financing" for any EU liabilities incurred before the end of 2020 that fall due in future. The final figure for the settlement will not be set until all liabilities are honoured, a process that could take decades.

These political concerns over-shadowed strong economic data. The Eurozone ended the year with the fastest growth in business activity in nearly seven years, with the composite PMI (a private-sector survey) rising to an 82-month high, and the manufacturing PMI hitting 60.6 in December, its highest level since the surveys began in 1997.

German companies finished 2017 on a high note with the sharpest growth in business activity in more than six-and-a-half years, according to December's IHS Markit flash PMI survey. Moreover, the overall manufacturing sector performance was the best seen since data was first collected in 1996. The level of new orders received by German businesses showed the greatest rise since April 2011. However, German business confidence eased slightly in December, with the Munich-based Ifo Institute business climate indicator falling to 117.2 points from 117.6 points in November. To put that in context, the November figure was the strongest reading since Germany reunified in 1990.

In France, IHS Markit's PMI jumped to 59.3 in December, hitting a more than 17-year high. The dominant services sector also had a strong reading and the overall composite index came in 60.0 points, down from November's 60.3, but it is only the second time since May 2011 that the index reading had a 6 in it. In its updated forecast, the French national statistics bureau, Insee, lifted its estimate for 2017 GDP growth to 1.9%, above the government's 1.7% forecast, and expects the economy to be driven by strong domestic demand, notably corporate investment, despite a slowdown in household purchasing power at the beginning of the year.

Elsewhere in Europe, the Italian economy is expected to grow by about 1.5% in 2017, its best performance since before the Eurozone financial crisis. Italy's looming election stands as the next political headache for Europe, and on March 4, voters will head to the polls amid falling support for the ruling pro-EU centre-left Democratic Party and rising support for the Eurosceptic opposition. In Spain, 2017 ended with the lowest jobless figure since 2008, although the independence crisis in Catalonia, which accounts for about one-fifth of Spanish GDP, is a large political problem. The Netherlands has brought its unemployment rate down to 4.4%, the lowest level since June 2009.

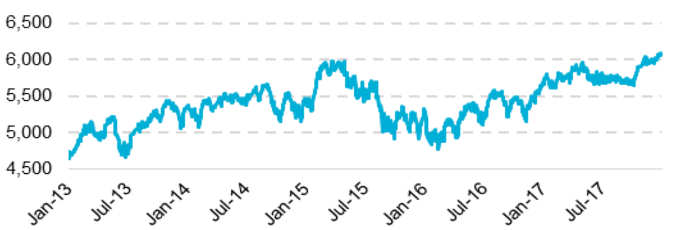
In the UK, manufacturing order books were close to a 30-year high in the December quarter, according to Confederation of British Industry. The Bank of England kept interest rates unchanged in December, as did the European Central Bank.

Developments in financial markets

Australian shares

Investors in the Australian market pushed the S&P/ASX200 index past the 6,000-point mark in December for the first time since the start of the global financial crisis. For the month, the Australian benchmark gained 1.8% on a total return basis. Its annual return of 11.8% was the second straight annual rise. Higher commodity prices saw the energy and materials sectors making the strongest gains and the S&P/ASX 200 Resources Accumulation index booked a stellar 7.2% rise, well ahead of the 0.6% return of the S&P/ASX 200 Industrials Accumulation index. The S&P/ASX Small Ordinaries Accumulation index added 3.2% for the month, culminating in a solid 20.0% return for the year.

Chart 4: S&P/ASX 200 – last 5 years



Source: BTIS/Bloomberg

International shares

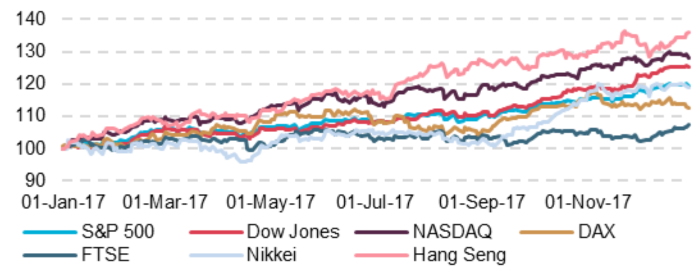
US stock markets reacted to generally strong economic data, and the boost to company earnings promised by the tax cuts, with another month of gains. The Dow Jones Industrial Average posted its 9th straight monthly gain, its longest winning streak since 1959, with a 1.9% rise in December taking it to a 28.1% gain for 2017 on a total return basis. The S&P 500 Index's 1.1% gain in December helped it to rise 21.8% for the year, while the tech-heavy Nasdaq Composite Index put on 0.5% in December, ending 2017 up 29.6%.

European markets were not as buoyant as their US counterparts, with politics weighing on investors' minds. Germany's DAX Index shed 0.8% in December, but delivered a 12.5% gain for the year. In Paris, the CAC 40 Index lost 1.1% in December, but was up 9.3% for the year. The Euro Stoxx 600 Index ran out of gas toward the end of the year, adding 0.7% during the month for a 2017 gain of 11.2% on a total return basis. In London, the FTSE-100 index's 4.9% gain in December helped it rise by 7.6% in 2017.

In Asia, the Nikkei added 0.3% in December to take its total return for 2017 to 21.3%, rising for a sixth year, the longest bull-run since the bursting of Japan's bubble economy in the early 1990s. Hong Kong's Hang Seng Index was up 2.5% for December, finishing 2017 a hefty 36% higher, and China's H-share index listed in Hong Kong rose 24.4%. The mainland's Shanghai Composite Index was far more subdued, slipping by 0.3% in December, on the way to a 6.6% gain for the year.

World stocks, as measured by the MSCI All-Country World Index, rose every month in 2017, marking the first year in its 49-year history without a single monthly decline. The index rose by 22% in 2017, adding US$9 trillion ($11.5 trillion) to the value of world markets.

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



Source: BTIS/Bloomberg

Fixed interest

The US 10-year bond yield was static at 2.41% in December, while its German counterpart gained 6 basis points to 0.43% and the UK 10-year gilt lost 14 bps to 1.19%. At the shorter end, the US 2-year yield moved from 1.78% to 1.88%, its UK peer eased 8 bps to 0.44% and the German 2-year bund added 5 bps to –0.63%. In Australia, the 10-year bond yield increased by 13 bps, to 2.63%, while the 3-year bond yield gained 23 bps, to 2.13%.

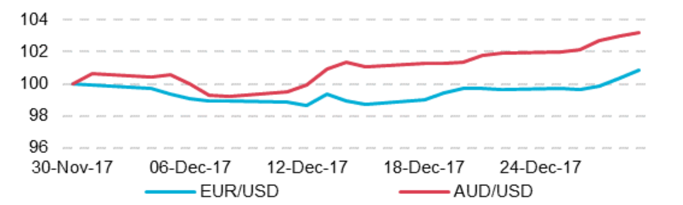
The benchmark Bloomberg AusBond Composite Index for all maturities showed a negative return, of –0.52% for the month, while the Bloomberg AusBond Bank Bill Index increased 0.1%. The Treasury Index for all maturities, which is the single largest contributor to the composite index, produced a –0.73% return, while the Credit Index generated a return of –0.21%.

Currencies

The US dollar lost ground against the euro, which gained 0.8%, although the greenback edged stronger against sterling and the yen, both by just 0.1%. The Australian dollar gained 3.2%, ending the month at 78.09 US cents.

The ICE US Dollar Index, a measure of the greenback against a basket of six major rivals, was down by 0.9% in December, extending its loss for 2017 to 9.8%. That was the index's first yearly loss since 2012, and its worst year since 2003, when it finished 14.6% lower.

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



Source: BTIS/Bloomberg

Commodities

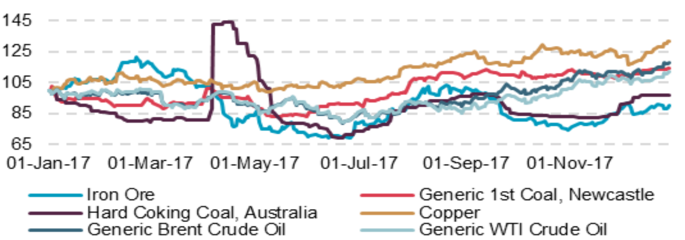
Iron ore continued its upward trajectory in December, though at a slower pace, rising on the back of renewed Chinese buying of high-grade ore. Iron ore has been more resilient to China's moves to curb pollution, by closing inefficient steel plants, than many had expected as the metal rose by 3.0% in December. Iron ore jumped 12.0% over the quarter, but fell 9.3% for the year, and prices were highly volatile.

Australian thermal (electricity) coal also had a healthy end to the year, gaining 4.1% in December to rise 14% in 2017. Australian hard coking (steelmaking) coal edged its thermal counterpart in December, rising by 6.5%, but for the year, the commodity went backward by 3%.

Copper surged almost 8% in December, reaching a four-year high of US$7,312.50 a tonne late in the month. For 2017, copper gained 30.8%, its strongest year since 2009. It was a buoyant year for other base metals including aluminium, zinc, nickel and lead.

Brent crude oil was up 5.2% in December, ending the year with a 17.7% surge, while West Texas Intermediate (WTI) oil added 5.3% last month, taking its 2017 appreciation to 12.5%. Oil prices reached their highest levels in two-and-a-half years in December, following a pipeline explosion in Libya, the latest supply disruption in an already tightening market. Gold added 2.2%, to finish the year 13.5% higher.

Chart 7: Major Commodities – year to date (rebased to 100)



Source: BTIS/Bloomberg

Funds update

Diversified Multi-Blend Funds

The Diversified Funds all achieved strong positive absolute performance for the month, with all funds outperforming their benchmarks, as a result of strong outperformance from the Australian, International and Property growth-orientated sector funds. Over the last 12 months the funds have all exceeded their benchmarks as a result of overall positioning bias towards equities, contributions from our active managers, and remaining relatively neutral with currency.

Australian Shares Multi-Blend Fund

The Fund delivered a positive gross return of 2.2% over the month of December, outperforming the benchmark S&P/ASX 300 index by 0.4%. Underlying managers Fidelity and Schroders were the primary drivers of outperformance during the month. Fidelity benefitted from preferred holdings in the IT sector, particularly positions in specialist software providers Aconex and WiseTech Global boosted performance. The former's shares rose sharply following the announcement of a takeover proposal by US technology firm Oracle. Schroders outperformed the benchmark on the back of positive sector and stock selection, specifically within the Materials sector and core overweight positions in the likes of BHP Billiton and Rio Tinto which enjoyed stronger commodity prices. The allocation to smaller companies was also a positive, with the strategy returning 3.8%, which was ahead of the Small Ords index return of 3.2%.

International Shares Multi-Blend Fund

The Fund declined 1.3% over the month of December on a gross return basis, however this was ahead of the benchmark MSCI World ex Australia index in AUD which lost 1.7% on the back of a strong appreciation of the AUD. The benchmark relative outperformance was driven by a positive contribution from stock selection, particularly within the Consumer Discretionary sector. River & Mercantile outperformed the most at the manager level on the back of positive stock selection across the Consumer Discretionary, IT and Materials sectors where stock holdings such as Tiffany & Co., Twitter Inc., and Anglo American plc all outperformed relative to their respective sectors and the broader market. At the country level, River & Mercantile benefitted from being underweight US equities and overweight towards China.

Property Securities Multi-Blend Fund

The Fund gained 1.4% in December on a gross basis, outperforming its benchmark return of 0.8%. The strong performance was a result of all the underlying managers outperforming their respective benchmarks during the month. BlackRock topped the leader-board for gains with positive relative performance for the period being driven by exposure to Australian REITs, Japanese REITs, US Retail and US Office. Detractors included Hong Kong Developers and Singapore REITs. Looking forward, BlackRock believe that despite a rally in retail in the fourth quarter, further upside remains for selected companies that operate well-located and well-curated retail real estate.

Australian Fixed Interest Multi-Blend Fund

Australian bonds were negatively impacted in December as bond yields moved higher in response to an overall improvement in economic data releases, most notably, a continued strengthening in the labour market.

The Australian bond market, as measured by the Bloomberg AusBond Composite 0+ Yr Index, returned -0.52% for December. The Advance Australian Fixed Interest Multi-Blend Fund marginally outperformed the benchmark, delivering a return of -0.50% gross of fees. The majority of underlying managers in the Fund outperformed the benchmark with Janus Henderson contributing to the majority of excess returns. Aberdeen was removed from the Fund in December as a result of a sector review.

International Fixed Interest Multi-Blend Fund

In December core global bond yields moved only marginally higher despite the Federal Reserve hiking interest rates and the US congress reaching a tax reform deal. Offsetting the rising yields, credit spreads continued to contract with both investment grade and high yield credit markets delivering positive returns for the month.

Against this backdrop, the Fund delivered a positive return of 0.14% over the month of December gross of fees, underperforming the benchmark by 0.10%. Wellington accounted for the vast majority of the Fund's underperformance, stemming mainly from negative performance within their interest rates strategies. Standish Mellon performed in line with the benchmark for the month.

Overall, the Fund remains conservatively positioned with an average credit rating of A+. From a duration standpoint, the Fund remains at approximately a year versus the benchmark of 6.92 years.

Defensive Yield Multi-Blend Fund

The Fund performed in line with the benchmark for the month of December. Kapstream and Standish Mellon both delivered solid relative performance driven by steady portfolio income and active country selection. However gains were offset by BTIM's underperformance as various active strategies including yield curve management and currency positioning detracted from relative returns for the month. The Fund continues to generate strong income with an average current running yield of 3.14%.

Advance Diversified Multi-Blend Fund Performance

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

	1 Mth %	3 Mths %	1 Yr %	3 Yrs %	5 Yrs %	7 Yrs %
Defensive Multi-Blend	**0.19**	**2.62**	**6.13**	**3.91**	**4.47**	**5.02**
Benchmark	0.14	2.57	5.74	4.86	5.30	5.77
Moderate Multi-Blend	**0.40**	**3.83**	**9.03**	**5.52**	**6.48**	**6.36**
Benchmark	0.25	3.69	7.85	6.24	7.15	7.06
Balanced Multi-Blend	**0.63**	**4.96**	**11.64**	**7.08**	**8.46**	**7.49**
Benchmark	0.36	4.82	9.89	7.61	8.99	8.16
Growth Multi-Blend	**0.74**	**5.71**	**13.30**	**7.92**	**9.57**	**8.01**
Benchmark	0.46	5.64	11.55	8.67	10.23	8.88
High Growth Multi-Blend	**0.86**	**6.51**	**14.94**	**8.91**	**11.18**	**8.84**
Benchmark	0.51	6.37	13.03	9.56	11.73	9.65

December Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	1.81%	7.64%	11.80%	8.63%	10.23%
S&P/ASX 200 Industrials Accumulation	0.64%	5.97%	9.00%	8.19%	12.33%
S&P/ASX 200 Resources Accumulation	7.18%	15.57%	25.94%	10.30%	2.30%
S&P/ASX 200 Accumulation AREIT	0.24%	7.90%	5.72%	11.00%	13.23%
S&P/ASX Small Ords Accumulation	3.20%	13.69%	20.02%	14.38%	7.39%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	-1.71%	5.81%	13.38%	11.01%	18.42%
EPRA/NAREIT Developed Index Hedged $A	1.03%	3.64%	8.20%	6.14%	9.82%
STOXX Europe 600 Total Return	0.75%	0.64%	11.22%	7.84%	10.41%
S&P 500 Total Return	1.11%	6.64%	21.83%	11.41%	15.79%
Nikkei 225 Total Return	0.32%	12.04%	21.33%	11.30%	19.07%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.14%	0.42%	1.75%	2.05%	2.34%
Barclays Global Aggregate TR Hedged A$	0.24%	0.90%	3.68%	4.09%	4.94%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	88.1674	2.88%	4.39%	0.75%	-5.46%	-8.71%
Generic Brent Crude Oil	66.87	5.19%	16.21%	17.69%	5.26%	-9.66%
Generic WTI Crude Oil	60.42	5.26%	16.93%	12.47%	4.29%	-8.03%
Gold US$/oz	1302.8	2.18%	1.80%	13.53%	3.23%	-4.91%
Iron Ore	70.78	2.98%	11.99%	-9.33%	0.71%	-12.86%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.7809	3.21%	-0.32%	8.34%	-1.52%	-5.56%
EUR/USD	1.2005	0.85%	1.62%	14.15%	-0.26%	-1.87%
USD/JPY	112.69	0.13%	0.16%	-3.65%	-2.01%	5.37%
GBP/USD	1.3513	-0.09%	0.86%	9.51%	-4.63%	-3.63%

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