View from the hill

JUNE 2015

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **31 May 2015.**

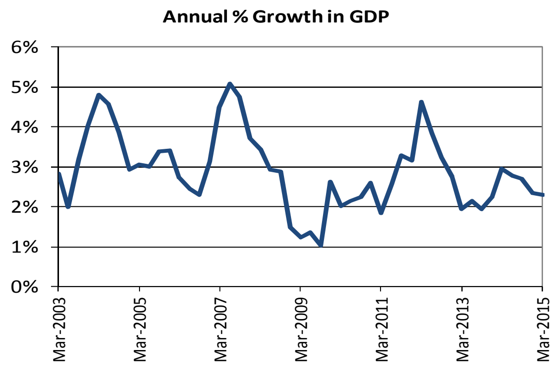
Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	0.4	-1.4	9.9	17.4
Smaller companies	2.4	2.0	7.7	3.6
International shares (unhedged)	3.6	3.3	29.2	27.6
International shares (hedged)	1.4	2.4	15.7	22.6
Emerging markets (unhedged)	-0.9	4.0	22.0	15.2
Property – Australian listed	2.7	-0.3	29.3	21.6
Property – global listed	-0.3	-2.7	16.8	18.3
Australian fixed interest	0.0	-0.3	7.5	5.1
International fixed interest	-0.3	0.2	7.3	6.4
Australian cash	0.2	0.6	2.7	2.9

Overview & Outlook

The mood on financial markets was one of caution over May, as further increases in United States bond yields and the lack of resolution in government debt management arrangements in Greece weighed on confidence. None-the-less, equity markets still managed to record modest gains against a backdrop of reasonable economic data. The economic outlook remains mildly positive across the U.S., Japan and Europe.

Locally, much of the focus was on the impact of the Commonwealth Government Budget Statement, which showed a small reduction in the expected underlying cash deficit from $41.1 billion to $35.1 billion between 2014/15 and 2015/16. Although appearing to have an initial positive impact on consumer sentiment, the small magnitude of change in the fiscal policy setting is unlikely to have any significant impact on the macro- economic environment.

Australian economic growth data for the March quarter was stronger than expected, with the expansion in Gross Domestic Product being 0.9% for the quarter. In annual terms, though, economic growth is still well below the longer term trend at 2.3%. Higher export volumes have provided the main source of growth over the past 3 months, with resource exports being the beneficiary of the expansion in mining production capacity over recent years.



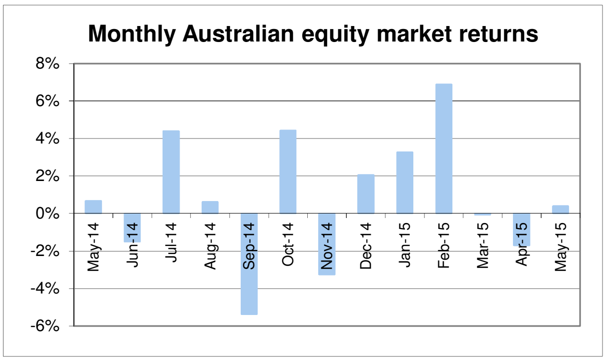
Source: Australian Bureau of Statistics 5206.

More concerning was a rise in business inventories over the March quarter (suggesting that production may be running ahead of demand) and further declines in business investment spending. The National Accounts did, however, confirm a significant rise in residential construction activity with spending on dwelling construction rising 4.7% over the quarter and 9.2% over the past year.

Whilst the recent rise in export volumes and housing construction have provided solid growth contributions, share market investors will be looking for evidence of more broad based growth over the remainder of 2015 to create opportunities for company earnings growth. This earnings growth may become increasingly important in neutralising any valuation effects from rising overseas bond yields.

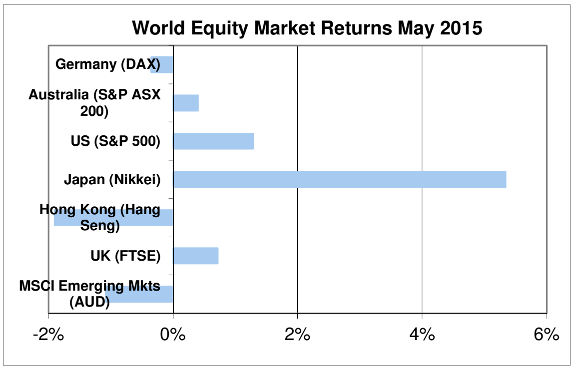
Share markets

Following two months of negative returns, the Australian share market limped into positive territory over May (once dividends are taken into account). The S&P ASX 200 Index moved 0.4% higher, bringing the annual return to 9.9%.



Source: S&P ASX 200 Index

The gains on the local market came despite a sell-off in banking stocks. Ongoing concerns over high share price valuations, and the prospect that banks may have to raise more capital to meet future regulatory requirements, saw the financial sector decline by 1.7% last month. Also recording a fall in price was the consumer staples sector, which finished May 2.2% lower. This decline was largely attributable to Woolworths, which dropped more than 4% after disappointing March quarter sales results. In contrast, the consumer discretionary sector was one of the better performers with an average price gain of 1.7%. The sector did benefit from the Federal Budget announcements providing incentives to small businesses to bring forward expenditure on capital equipment.



Source: Index as shown.

Overseas markets recorded mixed results last month. Returns for investors with hedged currency positions were positive 1.4%. Investors with unhedged currency positions experienced a better return of 3.6%, as a result of a lower currency. The $A dropped from U.S. 79.6 cents to U.S. 76.6 cents over the month.

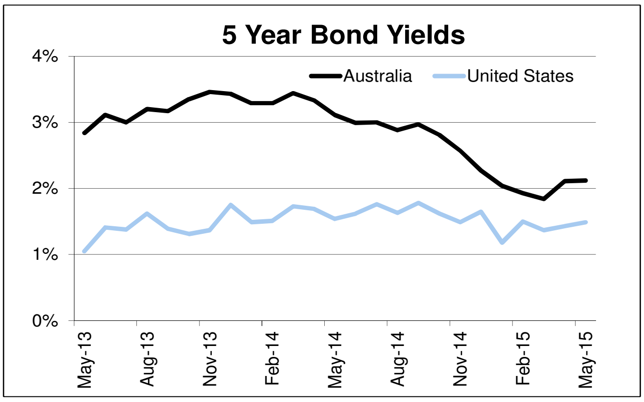
The continued positive economic backdrop in the U.S. encouraged buyers to push the S&P 500 Index 1.3% higher. A solid result was also recorded in Japan, where the Nikkei Index advanced 5.3%.

Investor confidence in Europe, however, was less positive given the lack of resolution over the repayment due on Greek Government debt. Both the French and German markets finished the month in negative territory, falling less than 1%.

After a strong result in April, Emerging Markets underperformed in May, declining on average by approximately 1%. Losses were experienced across most emerging regions, with China pulling back from recent highs. There were also significant declines recorded in the commodity sensitive markets of Brazil and Russia.

Interest rates

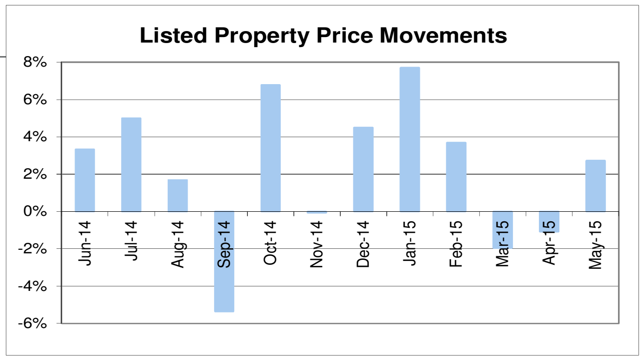
Following the 0.25% reduction in the cash interest rate in May, the Reserve Bank held interest rates steady following its Board meeting in early June. Longer term yields finished marginally higher last month. The U.S. 5-year Government bond yield climbed 0.06% to 1.49%, with the Australian equivalent rising just 0.01% to 2.12%. This followed a more significant 0.3% jump in Australian yields over the previous month.



Source: Reserve Bank of Australia. US Federal Reserve.

Property

Following two months of negative returns, the Australian listed property sector bounced back over May, with a strong 2.7% gain. Bunnings Warehouses made a standout contribution to this result, with an increase of more than 7%.Global property, however, continued to pullback from recent highs with the UBS Global Investors Listed Property Index dropping 0.3%.



Source: S&P ASX 200 A-REIT Acc Index.