View from the hill

MAY 2016

HILLROSS

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **30 April 2016.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	3.4	6.4	-4.9	5.0
Smaller companies	3.0	9.7	5.1	4.2
International shares (unhedged)	2.4	-0.4	-0.8	18.2
International shares (hedged)	0.9	4.7	-3.5	10.4
Emerging markets (unhedged)	1.4	5.4	-15.1	5.7
Property – Australian listed	1.5	9.9	13.7	13.4
Property – global listed	-1.1	6.4	6.5	9.0
Australian fixed interest	0.3	1.1	3.4	4.9
International fixed interest	0.3	2.3	5.2	5.8
Australian cash	0.2	0.6	2.3	2.6

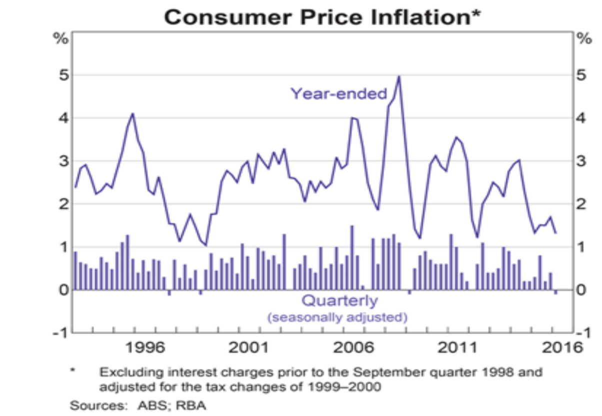
Overview & Outlook

The majority of asset classes' recorded lower, but still positive returns, in April, after the strong rallies in March, as investors reduced their expectations that a global recession was imminent. This adjustment was evidenced by the improved prices for most commodities, notably WTI Oil in A$, which rose 20.7%, and which saw the Resources Index increase 15.4%. BHP, the sector heavy-weight, rallied 22.6% over the month on the back of stronger oil and iron ore prices.

Source: Yahoo Finance

The improved sentiment around growth was despite the International Monetary Fund (IMF) reducing its expected global growth rate for 2016 to around 3.0% p.a. from 3. 2% p.a. Central banks were quiet over April with no changes in interest rates from the major economies. The Bank of Japan surprised as it elected not to take any further stimulus despite softer economic growth, very low inflation, a strong Yen and earthquakes.

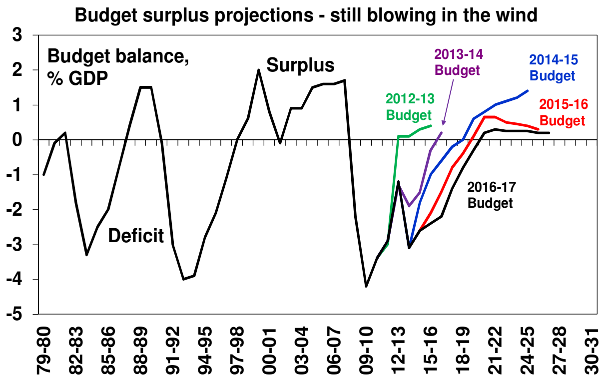
The RBA left rates at 2.0% in April with a continued bias toward easing, however it surprised market participants by reducing the cash rate to 1.75% on May 3 after the release of very weak inflation data for Q1. The domestic equity market rallied ~2.0% on the day of the announcement, with investors seeming to ignore the inflation data, and the signals it was sending regarding the state of the economy.



Source: ABS, RBA

The A$ was slightly lower over April after the strong rally in March, however it fell sharply in early May after the RBA cut interest rates. The rate cut left domestic interest rates less attractive, and also raised some concerns regarding the outlook for economic growth, leading to global investors to sell the currency. At current levels the currency appears fairly valued but sentiment is likely to see it trade lower.

Australian debt worries were also raised after Moody's noted that Australia's AAA sovereign rating may be under threat unless the budget deficit was reduced more aggressively than currently expected. The most recent budget did not show any progress in returning to a budget surplus and, as the chart below shows, the path back to surplus continues to be pushed back.



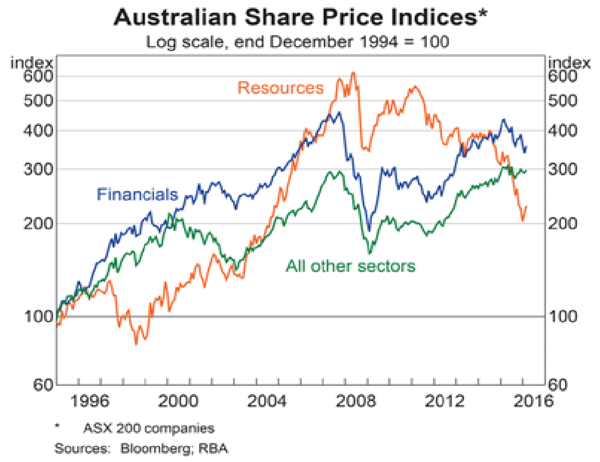
Source: Australian Treasury, AMP Capital Investors

Equity markets

International shares performed well throughout April, up 0.9% (hedged) and 2.4% for unhedged equities, as the $A was declined during the month. Investors continued to concentrate on company earnings and economic growth after the US reporting season, which was reasonable but with some disappointments, notably from the technology sector.

The Australian equity market rose in April with the S&P/ASX 200 Accumulation Index up 3.4%. The announcement of increasing Chinese infrastructure spending saw a strong resurgence in resource company prices with BHP, RIO and Fortescue, all up between 20% - 35% on their previously depressed prices. However, the profitability of the sector remains volatile with recent increases in iron ore prices not expected to endure. BHP's share price was severely hit on May 3rd, falling 9.4% after the announcement of a $A58bn civil suit against the company, as a result of flooding attributed to the company's Samarco operation in Brazil.

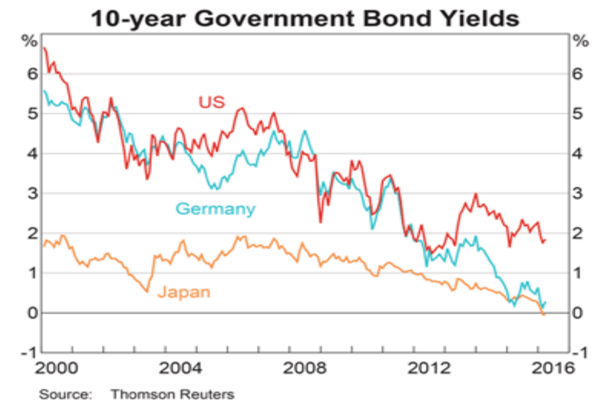
The best sector performances in April were Resources at 15.4%, Materials at 14.3% and Energy at 7.5%, driven by higher commodity prices with Consumer Discretionary the laggard at -1.7% dragged down by ongoing weakness in the Woolworths share price.



Source: Bloomberg, RBA

Fixed Interest

Bond yields were generally stable, albeit at very low levels with around 25% of global government bonds currently recording negative yields. Of interest were German 10 year bonds which ended the month with a yield of 0.26%, and the Japanese 10 year bond with a yield of -0.08%.



Source: Thomson Reuters, RBA

Domestic bonds were stable over the month, with Australian 10 year yields closing at 2.52%. However, the recent release of the 0.2% decline in inflation for the first quarter, bringing annual inflation to 1.3% p.a., saw bonds across all yield maturities drop sharply.

The 10-year bond had dropped 21 basis points, trading at 2.31% at the time of writing, whilst the 3-year bond was down 51 basis points, yielding 1.57%. These declines were notably large, with the 3 year rate now indicating that investors are pricing a low probability of rate increases in coming years and a possibility of short-term cuts.

Property

The AREIT market maintained a positive month returning 1.5%, with the annual return 13.7%, well ahead of the return from Australian equities at -4.9%. The AREIT sector has a major beneficiary of the demand for yield by investors as interest rates have fallen. The commercial sub-sector was again the stand-out, driven by the price rally of Dexus Property Group after the company's bid for Investa failed to secure the required majority.