View from the hill

MARCH 2017

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **28 February 2017.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	2.3	5.9	22.1	6.5
Smaller companies	1.3	2.4	16.8	5.1
International shares (unhedged)	1.5	3.5	12.4	10.8
International shares (hedged)	3.2	7.7	23.7	10.1
Emerging markets (unhedged)	1.8	4.7	20.3	6.6
Property – Australian listed	4.1	5.9	8.2	15.9
Property – global listed	3.2	6.8	12.4	11.5
Australian fixed interest	0.2	0.6	1.4	4.8
International fixed interest	0.9	1.0	3.1	5.7
Australian cash	0.1	0.4	2.0	2.3

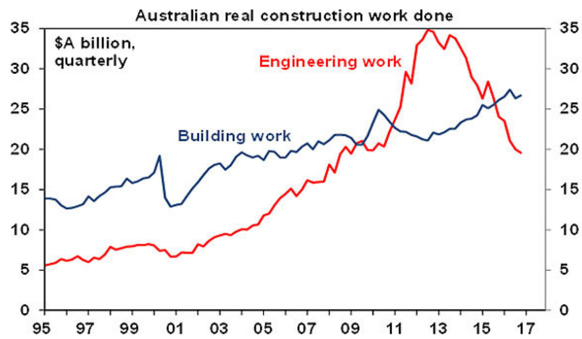
Overview & Outlook

February was dominated by political news from the United States and more recently the potential for a rate hike in March, however in Australia the improving economic outlook as well as the recent reporting season received relatively little attention.

The Australian economy saw some good news with December quarter Gross Domestic Product, a measure of economic activity, rebounding 1.1% quarter-on-quarter, after the September quarter's negative reading. The rebound was broad-based across consumer spending, public demand as well as housing and business investment. While growth will likely reduce from the current buoyant level it may record close to 3% over 2017.

The economy does face some headwinds, two specifically are the ongoing decline in mining investment at around 30% p.a. and housing construction activity will most likely peak this year as significant supply (especially of apartments) is coming on stream in an environment of poor affordability and very levels of household debt.

However, there are some positives that should be kept in mind, first, the economy will continue to benefit from the last phase of the mining boom which is the significant increase in export volumes as complete and move into production. Second, the rebound in commodity and energy prices will boost national income which increases company profits and government tax revenue. Third, public infrastructure is increasing as the state's investment spending ramps up.

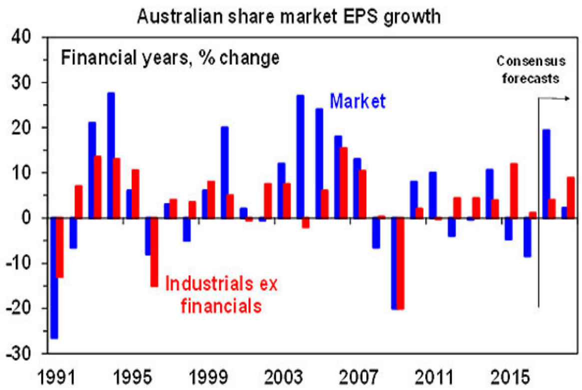


Source: AMP Capital

The Australian December half-year profit reporting season finished and saw company profits on track for an increase of around 19% for the financial year after two consecutive years of declines.

Notable the profit growth was largely driven by the resource companies which are expected to see a 150% profit increase this financial year reflecting higher commodity prices and volume increases enhanced by tight cost controls. The remainder of the market is likely to record earnings growth of approximately 5% in FY17 with some acceleration into the following year.

Over the reporting season 45% of companies exceeded earnings expectations while 59% saw profit increases. 80% of companies also held or increased their dividends, a positive sign for corporate confidence.



Source: AMP Capital

Into March the US Federal Reserve members commented that the Fed would most likely move "soon" to raise rates and market's moved to price in March hike rate with a probability of 94%. Given the improvement in US economic data over the last year the comments had little impact on equity markets. From here rate hikes are likely to be gradual given low wage growth and a rising US$.

Also notable over the month was the warning from the Organization of Economic Co-Operation and Development (OECD) warnings on domestic house prices, high household debt and the risk to the economy of this combination. Sydney house prices are up 73% over the last five years while wages increased 13%. Whilst there may be some decline in home prices once rates start to increase, a generalized home price "crash" is unlikely without much higher interest rates, a significant increase in unemployment and a surge in housing supply.

Share markets

The Australian market rose 2.3% over the month with most sectors recording increases with the exception being Telco's as Telstra results disappointed. Commodity prices took a breather over the month (except iron ore which rose 10%) which saw some profit taking in the Resources and Energy sectors.

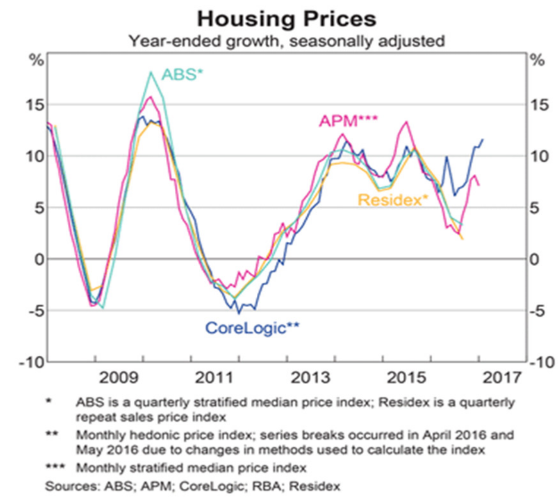
After falling 80% from its high of $US192/tonne in 2011 to its low of $US38 in November 2015 the iron ore price has surprised most and surged to more than $US90. A range of factors contributed to the price increase: stronger construction demand in China; a switch to higher quality iron ore to cut down on coking coal usage; reduced lower grade iron ore output from Chinese mines due to capacity closures and some supply disruptions and speculative activity on Chinese commodity exchanges. Some of these will reverse on a 12-month horizon but the surge does have a fundamental element and, with Chinese infrastructure projects still ramping up, the iron ore price could have more upside in the short term to maybe $US100 before the price settling lower.

International equity markets were buoyant over the month with the global MSCI up 3.2% in local currency with the US market up 4.0%. Most companies managed to beat earnings expectations and improved global outlook lifted sentiments despite concerns over Pres Trump's ability to execute stimulus plans.

Interest rates

Australian bond yields were flat over February with 10-year bond yields closing at 2.72%. The RBA held rates at its March meeting as the improved commodity prices are supporting economic activity and reducing the pressure for further rate cuts, as is the strength of $A, however continuing surge in credit growth to property investors and strength in house prices has become an increasing concern to RBA Governor Lowe. On this basis has largely moved to price out further rate cuts.

International bonds fell over the month with short-rates in Germany falling sharply as investors sought German bonds as a safe-haven as European political risk concerns increased ahead of the French and Dutch elections.



Source: RBA

Property

The AREIT sector posted sound returns in February supported by a small decrease in bond yields. The reporting season showed a difficult environment retail and specialty shops as the trend to online shopping continues. The office market remained strong with Dexus, one of the sector bell-weathers, reporting lease incentive falling in the first half, implying higher rental growth going forward. Similar trends were reported in the unlisted sector with foreign buying also notable in the sector.