Fiducian Quarterly Investment Strategy Report

Conrad Burge, Investment Manager, Fiducian Investment Management Services Limited

ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy is forecast to gain a little momentum in 2017 but the advanced economies as a group continue to experience sluggish growth. On the other hand, growth continues to be stronger in key parts of the developing world.

- **The global economy** is forecast to gain some momentum over the coming year and is expected to grow by 3.4% in 2017, up from a sluggish 3.1% in 2016, according to the International Monetary Fund (IMF) in its October 2016 World Economic Outlook report. These figures though mask considerable differences between the developed and developing worlds. While the developing world as a whole is forecast to grow by a solid 4.2% in 2016 and an even better 4.6% in 2017, most of the major advanced economies continue to lag in growth terms and the developed world as a whole is forecast to grow by only 1.6% in 2016 and a still subdued 1.8% in 2017.

Expansionary monetary programs introduced in the aftermath of the global financial crisis that began in 2008 have proved insufficient on their own to return the world to pre-crisis growth rates. Investment and productivity growth remain too low and more needs to be done to restore investor confidence and lift growth and inflation.

- Such persistently low rates of growth across the developed world reflect underlying problems in most advanced economies, notably a low propensity to invest and historically low rates of productivity growth. Annual productivity growth in the US is currently below 1%, the lowest it has been in the post-war period, while it is, if anything, even lower across much of Europe and in Japan. To a considerable extent the effects of the global financial crisis (GFC) that began in 2008 and which caused the 'Great Recession' of 2009 are still being felt. Programs that were introduced in the aftermath of the crisis, including what were thought to be highly expansionary monetary policies involving historically low interest rates and 'quantitative easing' ('QE') have been insufficient, at least on their own, to propel growth back to pre-GFC levels and to lift inflation towards central bank targets of 2% and above.

Despite low growth across the developed world, the US central bank has embarked on a course of tightening monetary policy. On 14 December, the 'Fed' raised rates for the first time in a year, although admittedly only to 0.5%. Even this though could be premature, given that growth has been unimpressive, at least until the September quarter. Many obstacles remain to strong growth, including over-regulation, excessive taxation, growing under-employment and overspending on welfare by government. A focus on measures designed to lift investment & boost productivity is now needed.

- In fact, amongst the advanced economies, only the US has seen its central bank (the 'Fed') raise interest rates in recent years. In December 2015, the 'Fed' raised rates from 0% to 0.25% and on 14 December it again raised rates, albeit only to a still low 0.5%. Annualised growth in the US in the September quarter did appear to gain some momentum, while inflation rose steadily from July to October, giving the 'Fed' an excuse to act. However, obstacles to faster recovery in the US remain, including a corporate tax rate that is now the highest in the developed world, productivity that is being stifled by over-regulation, growing underemployment and over spending by government on 'entitlements' or welfare that is growing faster than the economy can sustain. As Alan Greenspan, ex-Chairman of the 'Fed' recently pointed out (27 May), welfare spending in the US is growing at over 9% per annum and is 'crowding out savings and hence, capital investment. Capital investment is the critical issue in productivity growth and productivity growth in turn is the crucial issue in economic growth'. It thus appears that fundamental issues, including how to boost investment and productivity, may need to be addressed before real economic recovery can be achieved, in which case any move by the 'Fed' towards a substantially higher interest rate regime could potentially be premature at this time, even for the US, where growth has been a little stronger than in Europe or Japan.

The need for a focus on measures to boost growth across the developed world has become urgent. In the words of Christine Lagarde, Managing Director of the IMF, the longer demand weakness lasts, the more it threatens to harm long-term growth as firms reduce production capacity...and critical skills are eroding'. As such 'forceful policy actions' are needed to avert the onset of a 'low-

- Christine Lagarde, Managing Director of the IMF, has also pointed out this year that delays in addressing the issue of low growth bring their own problems. On 1 September, she noted that 'the longer demand weakness lasts, the more it threatens to harm long-term growth as firms reduce production capacity and unemployed workers are leaving the labour force and critical skills are eroding'. Furthermore, as Maurice Obstfeld, Chief Economist of the IMF put it on 4 October, 'without determined policy action to support economic activity over the short and longer terms, sub-par growth at recent levels risks perpetuating itself'. In Lagarde's words, the developed world appears to be close to what she terms 'a low-growth trap'. As such, 'forceful policy actions' are now required,

ECONOMIC OUTLOOK

growth trap' for the advanced economies. Infrastructure programs are seen as one way for the US, Germany and other economies to lift growth.

according to her. While expansionary monetary policy no doubt continues to be important, Lagarde also notes that 'record-low interest rates make for an excellent time to boost public investment and upgrade infrastructure', something that now appears to be at least on the agenda for the US in particular, following the election of Donald Trump as President. Another candidate for a major program of infrastructure spending would be Germany, following the IMF's call (19 July) for 'greater reliance on measures to support domestic demand, especially in creditor countries with policy space' (the latter being a reference to Germany and also to China).

The developed world in particular is growing too slowly and, according to the IMF, could land itself in 'a low growth trap'. Forceful policy actions are needed, including cuts to welfare spending, lower taxes and structural reforms. Premature tightening of monetary policy needs to be avoided.

- **In summary**, the global economy needs more to be done to boost growth, particularly in most of the advanced economies, where economic activity remains sluggish. Further 'forceful policy actions' are required and ideally these actions would include cuts to welfare spending in both Europe and the US, although such cuts continue to be difficult to achieve politically. Private investment needs to be lifted, even if this requires hefty tax cuts and incentives for businesses. Infrastructure spending by governments could also have a role to play, while central banks must keep expansionary monetary policies in place and avoid any overly hasty moves to tighten policy prematurely.

REGIONAL ECONOMIES

The US economy managed something of a rebound in the September quarter after three straight quarters of very weak growth. Despite signs of recovery though, private investment remains weak, posing a challenge to policymakers. As Alan Greenspan, ex-Chairman of the 'Fed', recently explained private investment in plant and equipment is too low to generate solid productivity growth, which is the key to sustainable economic growth. In such an environment, the 'Fed' is likely to be cautious.

The US economy staged something of a rebound in the September quarter, growing by 3.2% at an annualised rate, after 3 consecutive quarters of very low growth. The main contributors to growth were household spending (up 1.9%), as well as net exports and inventory accumulation. Disappointingly, private investment (excluding inventory) detracted from growth for the fourth quarter in a row, while investment in housing (down 4%) contracted for the second quarter in a row after two years of growth (all rates annualised). This weakness in investment in plant and equipment poses a challenge to policymakers, with Janet Yellen, current Chair of the 'Fed', indicating on 14 December that 'business investment has remained soft and inflation has increased since earlier this year but is still below the Committee's 2 percent longer-run objective'. While these factors were enough to stay the 'Fed's' hand in November, the 'Fed' duly lifted interest rates in December and, furthermore, indicated that three further 0.25% hikes were likely over the course of 2017. However, much still depends on the pace of recovery and Yellen's concern about private investment remains a key focus, with productivity growth being essentially static over the year to end-September.

The other main focus of the 'Fed' and other key policymakers has been the labour market and here the news has been better than for some other economic indicators. In particular, the unemployment rate dropped to its lowest level in 9 years in November, although in recent years under-employment has grown. The construction sector, a big employer, could soon start to feel some effect from a slowdown in home price growth and in investment in the sector. The good news though is that despite rising mortgage rates, housing affordability remains reasonable and household net wealth has continued to reach new highs, while consumer confidence appears to have picked up

The Fed's other major focus is the labour market and the unemployment rate has continued to drop, reaching 4.6% in November (the lowest rate in 9 years), although the participation rate has declined in recent years (currently 62.7% of the labour force, well below its all-time high of 67.3% in 2000 and indicating a degree of under-employment in the US, reflecting some weakness in the economy). The housing sector has supported employment for some time but signs are growing that this may soon slow, with investment in the sector down. While house prices continued to grind higher in the September quarter (up 1% and up 5% for the year, according to the 20-city Case-Shiller Home Price index), mortgage rates jumped in November (the average 30-year fixed rate rose from 3.62% in early October, barely above its all-time low of 3.47% set in 2012 to 4.27% in early December). The catalyst for this lift seems to have been an assumption by investors that the new US President would soon begin to implement a massive infrastructure program that would put pressure on borrowing markets, along with signs that the 'Fed' remains intent on tightening monetary policy. This could also signal a coming end to the recent period of exceptionally affordable housing and probably not just in the US. The household debt service ratio (the ratio of mortgage and consumer loan payments to disposable income) has likely risen above the low level reached in the June quarter (9.98%, close to its lowest level in at least 30 years and down from a peak of 13.2% in December 2007). Household net wealth though has continued to grow, reaching a record

ECONOMIC OUTLOOK

in the wake of the Presidential election. Also positive for the economy more generally has been solid growth in bank lending to businesses, along with money supply growth

high in the September quarter ($90.2 trillion), up by around $36 trillion since the depth of the GFC in 2009 (US flow of funds data). Consumer confidence also jumped in November following Trump's election win (University of Michigan sentiment index), reaching its highest level in 2 years. The following features of recent monthly data shed further light on the current state of the US economy:

- Industry capacity utilisation (75.3% in July) was 5.1% below long-run trend.
- Money supply (M1) was growing by a hefty 10.0% (year-on-year) by end-October.
- Bank lending to businesses was up by 8.7% (year-on-year) by end-September.

Growth in most of Europe, as in the rest of the developed world, has been too weak for too long. The euro zone as a whole managed growth of only 0.3% in the September quarter, with France and Germany (the latter being the beneficiary of an undervalued currency) each managing growth of only 0.2% for the quarter. The ECB has announced an extension of its 'QE' program until at least the end of 2017, while Germany is being urged to lift infrastructure spending. In the case of Japan, the central bank is holding long-term bond yields at around 0% and is maintaining a large 'QE' program. Better news comes from China, where strong growth has pushed commodity prices higher and where growth is forecast to hold at over 6% for both 2016 and 2017.

The European economy has been struggling to avoid a 'low-growth trap' and, indeed, could already be in it. The whole euro zone managed growth of only 0.3% in the September quarter, after the same result in the June quarter and even the region's largest economies, Germany and France, only managed growth of 0.2% each for the quarter. Unemployment remains high across much of Europe (9.8% in October for the euro zone and 21% for people under the age of 25), although it has been slowly coming down. Also slowly improving has been inflation data, with consumer prices up 0.5% over the year to end-October, up from deflation (falling prices) as recently as May. Rising oil and other commodity prices could help to push the inflation rate closer to the 2% target of the European Central Bank (ECB), with a falling euro also helping in this. The euro could fall further over coming months as the ECB continues to run an expansionary monetary policy, announcing in early December that it would extend its 'QE' program to the end of 2017, although bond purchases would be reduced from 80 billion euros per month to 60 billion from April 2017. The **Japanese economy** too has been battling its own 'low-growth trap' and managed growth of only 0.3% for the September quarter (and an anaemic 1.1% for the year). Deflation has been difficult to shake off, forcing the Bank of Japan to persist with its expansionary policies – targeting low interest rates and keeping a large 'QE' program in place. In the case of **China**, growth was 6.7% (year-on-year) in the September quarter, indicating that stimulus measures (including interest rate cuts and reductions in the bank reserve requirement ratio designed to promote bank lending) continue to be effective. Fast rising property prices though have prompted lending curbs for housing to be re-introduced. Growth is expected to remain robust and is forecast to come in at 6.6% for 2016 and 6.2% for 2017 (IMF data).

AUSTRALIAN ECONOMY

The Australian economy contracted for the first time in 5 years in the September quarter (GDP fell 0.5% for the quarter but grew by 1.8% for the year). In contrast to GDP, national income growth did better, reflecting a better outcome for the terms of trade, which have been boosted by stronger commodity prices for some key exports in recent months, including $US price rises of 106% for iron ore, 42% for thermal coal and 10% for gold from end-January to 8 December. The $A though rose by 2% against the $US over the same period, partly due to its perception as a 'commodity currency' and partly due to high local interest rates. In consequence, our international competitiveness has been affected and the RBA may need to lower rates again soon.

The Australian economy hit a speed bump in the September quarter, with GDP contracting for the first quarter in over 5 years (down by 0.5% but up by 1.8% for the year). Growth on a per capita basis was down 0.8% for the quarter and up only 0.3% for the year because of the country's high rate of population expansion through immigration. It is also useful to look beyond GDP data to what the Australian Bureau of Statistics calls 'a broader measure of change in national economic well-being', known as real net national disposable income, which takes account of the effect on national purchasing power of movements in the terms of trade (the ratio of our export prices to our import prices) as well as of depreciation of capital. While over recent years commodity prices have fallen, pushing the terms of trade down for each of the last 4 financial years (by nearly 35% in aggregate) and thus compressing growth in national income, the September quarter saw a solid rise in the terms of trade (up 4.5%), following on from a rise in the June quarter, which has boosted this measure of 'economic well-being' (up 0.8% for the quarter and 3.2% for the year). Rising commodity prices have driven this turnaround, with Australia's largest export items, iron ore and coal, up 106% and 42% respectively in $US terms between the start of 2016 and 8 December. Other major export commodity prices have also risen strongly, including gold (up 10% over the same period), aluminium (up 14%), nickel (up 26%) and copper (up 23%). The Australian dollar (up 2% against the $US over this period) remains closely linked to these commodity price movements. Such a rise in the currency, however, has further hindered the country's international competitiveness and the Reserve Bank (RBA) may have to do more to take

ECONOMIC OUTLOOK

pressure off the $A by lowering official interest rates (set at 1.50% on 3 August), which remain above those of most developed economies.

The Liberal/National Party coalition that was narrowly returned to power in the July federal election is finding it difficult to have reforms passed by the Senate. As such, large Budget deficits can be expected to continue, along with steadily growing levels of government debt. There appears to be little on the horizon that might be able to kick-start stronger growth. With the housing cycle likely to peak soon, the RBA may have to act to support economic activity, lift inflation and at least marginally improve competitiveness by lowering official interest rates further and hopefully driving the $A lower.

The Liberal/National Coalition was returned to Government in early July after a narrow election victory but has since faced an adversarial Senate that is making it difficult to pass legislative changes that the economy requires, such as measures to reduce government outlays and tax reforms, including lower corporate tax rates. The federal government's deficit (projected to be $37 billion for the current financial year) could even rise, given the weak state of the economy revealed by the September quarter national accounts. With weak growth, the government's net debt position (currently around 20% of GDP) could also deteriorate further. As far as the more immediate outlook is concerned, the NAB Business Survey for November notes that the economy 'has softened enough to suggest that growth remains sub-trend. Furthermore, both the housing construction cycle and commodity exports are expected to peak in the relative near-term, compounding the challenge to growth further out'. With inflation still too low (only 1.3% for the year to end-September), the RBA has another reason to act again soon to lower interest rates. Positive news though has been an improvement in the trade balance (a deficit of 1.1% of GDP in the September quarter, down from 2.8% in the December quarter), as well as the current account balance (a deficit of 2.7% of GDP in the September quarter, down from 5.5% in the December quarter), although there is still much room for improvement in both accounts

STRATEGY FOR FIDUCIAN FUNDS

STRATEGY OVERVIEW

Our economic analysis set out above indicates that several of the major developed economies, with the possible exception of the US, are continuing to struggle to avoid what the IMF is deeming 'a low-growth trap'. The 'trap' is economic growth so low that it discourages investment, weakens productivity growth, disillusions employees and ultimately could have negative political outcomes. The IMF is calling for 'forceful policy actions' across the spectrum, including structural reforms to reduce bureaucratic regulation of business, lower taxation burdens, boost innovation, reinvigorate trade and liberalise labour markets. At the same time, the IMF and most other economic agencies want to see the continued implementation of expansionary monetary policies that, that to a greater or lesser degree, have been in place since the Global Financial Crisis and they want these policies to be complemented by fiscal expansion (especially through spending on infrastructure), despite the already historically high levels of government debt in most advanced economies. There have been signs that some progress is being made. Inflation, for example, has begun to rise on the back of higher commodity prices and the US, at least, is showing evidence of stronger growth. For Europe and Japan though, there is still a long way to go and there are roadblocks built into the structure of the European Union, particularly the euro zone, that prevent any easy path to recovery. As Mervyn King, ex-Governor of the Bank of England, explained this year (28 February), 'if the alternative is crushing austerity, continuing mass unemployment, and no end in sight to the burden of debt, then leaving the euro area may be the only way to plot a route back to economic growth and full employment. The long-term benefits outweigh the short-term costs'. Other than this, Germany could make things a little easier for the rest of Europe by lifting domestic demand, boosting imports and reducing its mammoth current account surplus (8.6% of GDP, IMF estimate for 2016).

While we conclude that monetary policy in most jurisdictions almost certainly has to remain highly expansionary for some time to come, there is a risk that both the ECB and the 'Fed' could start to 'taper' or tighten policy too soon and thereby choke off recovery before it has begun to lift investment and productivity growth. In fact, as described above, investment continues to lag badly and productivity growth remains minimal across the developed world. In such an environment, financial authorities have to be vigilant enough to tread the fine line between over-stimulus and tightening too early. The positive news is that Mario Draghi, President of the ECB, announced on 7 December that the bond-buying program of the ECB would be extended past March 2017 to the end of the year at least. The less positive news was that monthly purchases would be reduced from 80 billion euros to 60 billion, although Draghi also made it clear that the ECB stands willing to increase the size of its 'QE' program if this proves necessary. In the case of Japan, the central bank Governor, Kuroda, announced on 21 September that the bank would target 10-year government bonds at 0%, thereby preventing any potential for yields to rise. This is in contrast to the US, where long-bond yields began to rise immediately after the US election and where the 'Fed' appears set on pre-empting any lift in inflationary pressure by raising interest rates (lifted to 0.5% on 14 December), even if there are likely to be 'only gradual increases in the federal funds rate' (December). However, even the 'Fed' appears keen to note that 'the actual path of the federal funds rate will depend on the economic outlook' and overall, the environment still appears broadly supportive for equity market performance, at least for most of the major markets.

In fundamental valuation terms and assuming ongoing earnings growth and despite recent market appreciation, most share markets still appear to be fairly valued, especially given the low interest rate environment that continues to prevail. In contrast, most bond markets appear expensive, with bond yields (interest rates) still at historically low levels despite recent increases in the US in particular. In valuation terms, as at end-November, the MSCI World Shares index was trading at 15.4 times forward (12 months ahead) earnings, around its long-term average PE ratio of 15. Current tactical asset allocation strategies have been developed as set out below.

STRATEGY FOR FIDUCIAN FUNDS

International Fixed Interest

Sovereign bond yields in most major markets have been trending upwards since the US Presidential election on 8 November. Bond yields in most major markets, however, remain historically low and the sector continues to appear expensive, although in some cases yields are being held down by central bank buying to encourage economic activity.

Government bond yields in most major markets began a strong downwards trend in late December 2015, soon after the US 'Fed' initiated its first hike in interest rates since 2008. This trend reversed course between February and May but then continued strongly until July, assisted by central bank buying in the wake of the 23 June UK vote to leave the EU, by when historic lows were reached in many markets. After the US Presidential election, however, apparently on the assumption that an incoming President Trump would initiate major infrastructure spending programs while also lowering taxes significantly, bond yields began to rise strongly. By 14 December, the yield on US 10-year Treasury bonds was 2.58%, well up from its 8 July 2016 record low of 1.36%; while the equivalent German and Japanese yields were respectively 0.30% and 0.06%., up from negative yields in mid-2016.

Bonds appear to be over-valued and we remain under-weight this sector.

Australian Fixed Interest

Australian bond yields remain higher than for most major international bond markets but margins have been contracting in recent months as the domestic economy has slowed

Australian bond markets have been moving in line with major international bond markets for some time but have also attracted investors seeking supposedly 'safe' havens. 10-year bond yields have been consistently higher than in the US, although the margin has continued to decline, so that by 14 December Commonwealth 10-year bonds were yielding 2.79%. The margin above US yields could contract further if the domestic economy remains soft.

Domestic bonds appear to be over-valued and we remain under-weight this sector.

Inflation-Indexed Fixed Interest (CPI Bonds)

Inflation-linked bonds could out-perform if inflation rises over time.

These bonds tend to be less volatile than conventional issues but can out-perform in times of inflationary pressure, which could be expected to increase along with economic recovery.

Australian Shares

The domestic share market barely moved in net terms in 2016 up to end-October but then surged along with other markets in the wake of the US Presidential election. The Resources sector has been the outperformer in 2016, rising by 45% up to 13 December on the back of improved commodity prices. The Financials sector has been less strong, apparently reflecting a lack of confidence by overseas investors in the outlook for the domestic property market. However, low interest rates, strong growth in household net wealth and a very high immigration intake are likely to restrict the extent of any fall in this sector. Overall, the market's PE ratio was around average by end-November and the market still offered a good yield and appeared fairly valued.

The Australian share market barely moved during 2016 up to end-October, which followed a lacklustre 2015 as well (down 2% in price terms). From early November, however, along with other world markets, the domestic share market lifted strongly, so that from the start of the year to 13 December, the market was up 9.2% (ASX200 Accumulation index). The Resources sector has been the out-performer, rebounding along with commodity price rises and was up 45% over this period, after declining by 25% in 2015. Listed property has also had another solid year (up 8% to 13 December, the same increase as for Financials), while Industrials (up 4%) underperformed. The Financials sector has been affected for some time by concerns (especially by overseas investors) that the banks could soon be faced with a housing downturn. In fact, housing price appreciation for some years has been minimal outside Sydney and Melbourne (from January 2009 to November 2016, aggregate average price rises included 94% for Sydney, 77% for Melbourne but only 19% for Adelaide, 16% for Brisbane and 7% for Perth, CoreLogic data). Moderate price corrections in the case of Sydney and Melbourne could be expected but this would be unlikely to have a major effect on bank bad loan numbers as mortgage rates are likely to stay low for some time to come (currently only around 8.5% of household disposable income is spent on total interest payments, RBA data), household net wealth continues to rise to record levels and the net immigration rate (mostly focused on Sydney and Melbourne) remains close to the highest in the world. By end-November, the domestic market had an estimated price-to-earnings ratio (PER) of around 15.6 times trailing earnings, which was around its long-term average, while the average dividend yield remained attractive at 4.29% (RBA data). The stock market still appeared fairly valued in historical terms and relative to other investment opportunities.

Exposure to this sector is currently marginally above benchmark.

STRATEGY FOR FIDUCIAN FUNDS

International Shares

Global share markets reacted positively to the outcome of the US Presidential election in early November. By 13 December, the US market was up 11% and other markets were also stronger, reflecting investor optimism that the incoming US President would initiate a variety of business-friendly policies.

Global equities markets were mostly sluggish over the first ten months of 2016 but then enjoyed a spurt following the US Presidential election on the back of assumptions that the incoming administration would soon implement large tax cuts and other pro-business measures. Whether reality turns out to be so rosy is yet to be seen. However, up to 13 December, the broad US market (S&P500) was up 11%, while the UK market was up 12% (defying many analysts who had expected the vote by UK citizens to leave the EU to crash the stock market, although this rise was offset by a 14% decline in the value of sterling relative to the $US over the same period). Other markets were mostly up over this period, with the exception of the Chinese market which was down 11%, after a correction early in the year. Overall, the MSCI World index in $A terms was up 3.3% by end-November.

Major share markets still mostly appeared to be fairly valued by end-November, notably compared with other liquid investment opportunities, such as bonds and cash. Some emerging markets also looked attractive, including India.

In terms of valuations, by end-November, the PER for the **major world markets** as a whole (reflecting the MSCI World index) was 15.4 times estimated forward earnings (excluding stocks without positive earnings), around its longer-term average of 15 times earnings. In general terms, most share markets still appeared more attractively priced than other investment opportunities, such as bonds and cash. Some emerging markets too no longer looked as stretched as previously, including the Chinese and Indian markets.
Exposure to this sector remains above benchmark (aided by potential $A weakness).

Listed Property Trusts

The listed property sector is now more conservatively geared and better cashed up (after large capital raisings) than it was prior to the global financial crisis. The sector has become less attractive than it was and trades at a premium to net asset value but it has a reasonable dividend yield and a fair price-to-earnings ratio.

The listed property sector slipped slightly behind the broader market in 2016, returning 8% by 13 December, against a 9% return for the overall market. This followed outperformance by the sector in 2014 (27% up against 6%) and 2015 (14% up against 3%). Perceptions of the sector have greatly improved since its heavy falls in 2008 and 2009. The structure of most listed property securities is now much stronger, with lower average gearing and more stable earnings. By 14 December, the sector's average PER was around 16 times forward earnings with an earnings yield of 6.4% and a dividend yield of around 5.1% (2017-18 earnings, Macquarie estimate and based on an average pay-out ratio of 80%). However, the sector does appear more fully valued than it was and trades at a premium to net asset value.
Exposure to this sector is currently slightly above benchmark.

Australian Dollar

The $A reached a low in January but has since moved higher, which could require lower interest rates.

After falling from a high of $US1.10 in July 2011 to a trough of under $US0.69 on 17 January, the $A began to rise ($US0.75 by 13 December), due mostly to stronger commodity prices. However, interest rates may need to be cut again to push the $A lower.

Investors should always opt for well-diversified, professionally managed portfolios.

As always, we **recommend** that, to counter market uncertainties, investors should hold **diversified portfolios**. These should give investors the best opportunities for capital growth with risk minimisation over the medium term. Portfolio asset allocation decisions and short-term market timing are also often best left to fund managers who exercise these decisions on a professional basis with the benefit of all available information.

ASSET ALLOCATION FOR FIDUCIAN MANAGED FUNDS

CAPITAL STABLE, BALANCED AND GROWTH PORTFOLIOS

CAPITAL STABLE PORTFOLIO	Benchmark %	Range %	Jun 16 %	Sep 16 %	Previous 3 month activity
Australian Shares	15	8 – 19	16	16	→
International Shares	10	6 –14	12	12	→
Property	5	3 – 8	6	6	→
International Fixed Interest	16	5 – 30	9	8	↘
CPI Fixed Interest	7	0 – 17	5	5	→
Aust Fixed Interest	32	15 – 44	18	17	↘
Cash	15	5 – 42	34	36	↗

BALANCED PORTFOLIO	Benchmark %	Range %	Jun 16 %	Sep 16 %	Previous 3 month activity
Australian Shares	37	29- 45	38	38	→
International Shares	23	15 – 32	25	26	↗
Property	9	5 – 17	9	9	→
International Fixed Interest	7	4 – 12	5	5	→
CPI Fixed Interest	3	0 – 8	3	3	→
Aust Fixed Interest	16	10 – 22	11	10	↘
Cash	5	3 – 40	9	9	→

GROWTH PORTFOLIO	Benchmark %	Range %	Jun 16 %	Sep 16 %	Previous 3 month activity
Australian Shares	42	34 –50	43	43	→
International Shares	28	20 – 36	29	29	→
Property	11	5 –15	12	12	→
International Fixed Interest	5	0 – 14	3	3	→
CPI Fixed Interest	2	0 – 7	2	2	→
Aust Fixed Interest	10	5 – 16	6	6	→
Cash	2	2 – 32	5	5	→

Decrease ↘ Increase ↗ Hold Position (Less than 1% up or down) → Significant change (5% or more) ↑/↓

NEXT LIKELY DIRECTION OF ASSET ALLOCATION CHANGE

ASSET SECTOR	UNDERWEIGHT	NEUTRAL	OVERWEIGHT
Australian Shares		■	
International Shares		■	
Listed Property Trusts		← ■	
Intn'l Fixed Interest	■		
CPI Fixed Interest		■	
Aust. Fixed Interest	■		
Cash			← ■

Next likely direction in 3 to 6 months: → Increase ← Decrease