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MEDIA RELEASE

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Economy remains ‘tenuous’, Fiducian says

Despite growth in the non-mining sector, the economy remains tenuous, says Conrad Burge, investment manager, Fiducian Investment Management Services Ltd.

The Australian economy slowed significantly in the June quarter, with GDP growth approaching stalling speed. However, a closer look at the national accounts shows that national income growth was even weaker, he says.

What the ABS calls ‘a broader measure of economic well-being’ (net national disposable income), actually contracted by 0.9% over the quarter, by 1.2% over the year and by a hefty 2.3% over the year in per capita terms.

‘The cause of this weakness was a significant fall over the year in the terms of trade, due to falling commodity prices (especially iron ore, coal and natural gas),’ Burge says. ‘If Chinese demand slows further, commodity prices could potentially go even lower.’

Business confidence slipped in the wake of some evidence of a growth slowdown in China and falling commodity prices, as well as a weakening of the domestic economy.

Offsetting this though has been what the NAB business survey for August termed a broadening in ‘growth momentum across the non-mining economy’, due to low interest rates and a falling $A.

‘However, the economic environment remains tenuous, held back by structural weaknesses, including union power, high company tax rates, minimum wage rates and electricity prices, as well as excessive regulation.,’ Burge says.

In light of this, Fiducian is currently:

1. underweight in bonds, Australian fixed-interest
2. neutral in Australian shares, listed property trusts
3. overweight in global shares

In the next 3 to 6 months, Fiducian’s likely direction of asset allocation change is:

1. underweight in international and Australian fixed-interest
2. neutral in Australian shares, listed property trusts, CPI fixed-interest
3. neutral to overweight in global shares
4. overweight to neutral in cash

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Fiducian Quarterly Investment Strategy Report

Conrad Burge, Investment Manager, Fiducian Investment Management Services Limited

ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy slowed over the first half of this year but is forecast by the International Monetary Fund (IMF) to gain more momentum next year. In the IMF's view though, 'downside risks to the outlook have increased, particularly for emerging market economies' (5 September). The IMF's prescription for putting the global economy back onto a stable keel includes 'continued accommodative monetary policy in advanced economies...and structural reforms to boost productivity.'

- **The global economy** slowed somewhat in the first half of this year, causing the International Monetary Fund (IMF) to lower its growth projections yet again for the 2015 calendar year. In its latest report (July), the IMF forecast global growth of 3.3% for this year, down from its 3.5% forecast in April and its 3.8% forecast made late last year. Better news is that the world economy is still expected to pick up speed next year, growing by 3.8%. The IMF though continues to counsel caution and at the conclusion of the Group of 20 (G20) meeting in Ankara on 5 September, Christine Lagarde, Managing Director of the IMF, declared that 'downside risks to the outlook have increased, particularly for emerging market economies'. She added that 'the major challenge facing the global economy is that growth remains moderate and uneven', adding that 'for both the advanced and emerging economies, productivity growth continues to be low'. The IMF head also emphasised that 'a concerted policy effort is needed to address these challenges, including continued accommodative monetary policy in advanced economies; growth-friendly fiscal policies; and structural reforms to boost potential output and productivity'.

The first economy to introduce very expansionary monetary policy after the start of the global financial crisis in 2008 was the US and the US has been the first to enjoy a return to strong growth, with a solid performance in the June quarter. However, elsewhere more time is going to be needed for full recovery.

- In the developed world, accommodative monetary policy remains very much in place, with the first mover, the US, now doing better than most other economies. The US rebounded strongly in the June quarter, with contributions to growth coming from household spending, private investment, net exports, inventory accumulation and government spending. On the other hand, the Euro zone slowed marginally, expanding at the paltry pace of only 0.3% for the quarter, while the Japanese economy actually contracted over the period (by 0.4%). The IMF though is still positive, pointing out that 'the underlying drivers for a gradual acceleration in economic activity in advanced economies – easy financial conditions, more neutral fiscal policy in the Euro area, lower fuel prices, and improving confidence and labour market conditions – remain intact'.

In many developing economies (most notably those highly dependent on commodity exports), this year's economic slowdown has been felt the most. Some of these, including Russia and the whole South American region, have been pushed into recession and recovery could require not only higher commodity prices but also significant structural reforms. In the special case of China, the IMF is confident that the country is moving towards a 'new normal of slower yet safer and more sustainable growth'.

- However, it is in the developing world where some economies have been hit the hardest, particularly commodity-dependent economies, with, for example, not just Brazil but the whole South American region expected to contract this year, as is Russia. As the IMF notes, 'the continued growth slowdown (in these economies) reflects several factors, including lower commodity prices and tighter external financial conditions, structural bottlenecks, rebalancing in China, and economic distress related to geopolitical factors'. Still classified as a developing economy, China is its own special case. In its 14 August special report on China, the IMF noted that 'China is moving to a "new normal" of slower yet safer and more sustainable growth. That involves giving the market a more decisive role in the economy'. There is disagreement though about the extent of the slowdown in China, with some analysts taking the view that China is growing at a rate of only 4% or 5%, while the IMF forecasts that 'China's growth is expected to be 6.8% in 2015, down from 7.4% last year' (and much closer to China's official target of 7%). Perhaps more importantly than a focus on China's actual growth rate, the IMF claims encouragingly that 'the recent stock market correction will not derail the ongoing adjustment to a slower yet more balanced growth path'.

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Europe, or at least the ECB, has been slow to admit that weak growth across the region would require more expansionary economic policy. From March this year though the ECB has been implementing a form of 'QE' with the injection of 60 billion Euros per month into the financial system. This appears to be already starting to bite, with money supply rising and bank lending to businesses and households growing.

- In the case of Europe, persistent slow growth has been an ongoing concern, particularly for the Euro zone. According to Mario Draghi, President of the European Central Bank (ECB), 'the latest survey indicators point to a broadly similar (and uninspiring) pace of real GDP growth in the second half of this year' (3 September). In the ECB's view, European growth has been held back 'in particular by the slowdown in emerging market economies, which is weighing on global growth and foreign demand for Euro area exports'. On the other hand, lower fuel prices have been a benefit, with 'the decline in oil prices providing support for households' real disposable income and corporate profitability'. Also positive is that the ECB intends to continue with its expansionary 'quantitative easing' policy, injecting 60 billion Euros into the region each month until at least September next year. This policy, initiated last March, has begun to have some positive effects, with money supply already expanding strongly and bank lending to businesses and households finally starting to grow (albeit slowly) rather than contract.

The global economy slowed in the first half but could soon gain momentum, with the US already back onto a strong growth path. Commodity-dependent economies could have to wait for stronger recovery in demand from China, Europe and Japan in particular.

In summary, after weathering a slowdown in the first half, the global economy is forecast to slowly gain momentum over coming months, with some regions expected to do much better than others. Notably, commodity-dependent economies are likely to take longer to recover, due to slower demand coming from China, Europe and Japan. The US has been stronger, but even so the US central bank may need to 'hasten slowly' in raising interest rates over coming months, given global uncertainties. Overall though, the cumulative effect of large-scale monetary stimulus now being administered is likely to lead to stronger growth next year, including for many developing economies.

REGIONAL ECONOMIES

The US economy staged a solid rebound in the June quarter, helped by a lift in spending by households, stronger housing investment and a hefty rise in spending by State and local governments. Early data for the September quarter also mostly points to further growth momentum, with the unemployment rate down to 5.1% and manufacturing indicators being positive. On the other hand, the 'new export orders index' for July was weak, suggesting that the export sector may already be feeling the negative effects of an elevated currency. This could weigh on the 'Fed's' desire to raise interest rates.

The US economy staged a solid turnaround in the June quarter, growing by 3.7% at an annualised rate), after barely expanding in the March quarter. Household spending grew strongly, as did private investment, boosted by strong growth in housing investment (up by 7.8%) and spending on durable goods (cars and large household items), which was up by 8.2% (all annualised rates). Early data has also mostly been positive for the September quarter, including the unemployment rate dropping to 5.1% in August, down from 6.1% a year earlier and down from over 10% at the height of the global financial crisis that began in 2008. The number of jobs added in August though did slip to a low 173,000 and the labour force participation rate has continued to decline (a long-term trend, partly due to retiring 'baby-boomers'). Some other early data for the first two months of the September quarter have been mixed, such as the Purchasing Managers Index (PMI) for manufacturing for August coming in at 53.0 (any measure over 50 indicating growth), while the 'new export orders index' fell to 46.5 in July, its lowest level since 2009, probably reflecting the inhibiting influence of a strengthening currency. This could be a concern for the US central bank (the 'Fed'), given that any premature increases in official interest rates could push the $US higher than warranted by the country's current level of international competitiveness.

The all-important housing sector (a large employer of labour and user of manufactured inputs) is continuing to recover and average house prices have continued to rise, although they remain well below highs set before the financial crisis. Mortgage lending conditions have recently begun to ease, which could boost the sector further, while housing affordability remains excellent and is better than it has been for over 30 years. Before the setback to the stock market in August,

Investment in the US housing sector rose by 8% at an annualised rate in the June quarter and according to the 20 City Case-Shiller Home Price Index, by end-June average house prices were up by 32% from their December 2011 low (although they were still 12% below their March 2006 peak). According to the 'Fed', 'recent data is indicative of continued recovery in the housing sector' (29 July). It was also noted that 'the easing of lending standards for residential mortgages was a factor likely to support further progress', particularly as this was a welcome shift away from tighter lending standards first introduced in the wake of the global financial crisis. Interest rates on 30-year fixed rate mortgages remain close to their all-time lows and, in consequence, housing affordability remains excellent, as shown by the household debt service ratio (the ratio of mortgage and consumer loan payments to disposable income). For the March quarter this ratio was around its lowest level in at least 30 years (9.92%, down from a peak of 13.2% in 2007). On the other hand, household net wealth

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household net wealth had reached record highs and consumer confidence had also been rising. By early September though, confidence had fallen back, with consumers waiting for more positive leads. Other measures remained broadly positive, including money supply and bank lending data but interest rate rises could be postponed until later in the year.

may have plateaued recently, after a 6.5% decline in the stock market in August (S&P500 index). Net wealth had reached $84.9 trillion in the March quarter, up by around $28 trillion since the start of the global financial crisis in 2008 and up 2% for the quarter (US flow of funds data) but this had been mainly propelled by a rising share market, although household liabilities had been kept in check, with many households still focused on decreasing overall debt levels and keeping savings levels elevated. Consumer confidence, which tends to reflect the 'wealth effect' had risen this year but then fell back with the August share market correction (University of Michigan sentiment index). The following features of recent monthly data shed further light on the current state of the US economy:

- Industry capacity utilisation (78.0% in July) was 2.1% below its long-run trend.
- Money supply (measured as M1) was growing by 6.3% (year-on-year) by July.
- Bank lending to businesses was up by 11.1% (year-on-year) by end-July.

The Euro zone continues to struggle to emerge from a prolonged period of near-recession, with growth of a mere 0.3% for the June quarter. Large-scale 'QE' is now being implemented and this has pushed the currency lower, thereby improving export competitiveness, especially for Germany. Japan moved back into negative growth in the June quarter, after having started the year more strongly. The economy was hit by lower exports to China, which also had a sluggish second quarter. On the positive side though, the Chinese central bank cut interest rates again in late August and provided more liquidity for the banking system. With more stimulus on the way, house prices have begun to rise again and credit growth has been accelerating.

The European economy appears to be still struggling to emerge from its prolonged stagnation, with the Euro zone growing by 0.3% in the June quarter (quarter-on-quarter). Although unemployment remains extremely high (10.9% in July and 21.9% for people under the age of 25), this has begun to slowly ebb. After flirting with deflation (prices fell in each month from December to March), consumer prices appear to have stabilised (up by 0.2% per annum in August), reflecting the ECB's implementation of a major program of 'QE" from March this year. This has also pushed the Euro lower, improving the competitiveness of the whole region and especially of Germany, which has been enjoying strong growth in exports but which still has the potential to lift domestic demand significantly and import more from its fellow EU member states. The **Japanese economy** contracted in the June quarter (by 0.4%), affected by falling exports to China and weak household spending on the back of a softer labour market. The country has also been warned by the IMF that it needs to reduce the size of its government net debt (currently estimated at 130% of GDP, with an annual deficit of 6.2% of GDP, according to IMF data). **China** too appears to be slowing and is forecast by the IMF to grow by 6.8% this year and 6.3% in 2016. On 25 August, in response to a domestic stock market collapse, the Chinese central bank cut the reserve requirement for banks by 0.5% (to 18%) thereby freeing up around an extra $US100 billion for banks to lend. It also cut the 1-year benchmark bank lending rate by 0.25% to 4.6% to lift the attractiveness of borrowing. Some positive data is already beginning to emerge, including evidence that house prices are beginning to rise again (at least in the major cities), credit growth is strong (reaching a 31-month high in July), money supply data is rising strongly and the trade surplus remains huge (over 5% of GDP in July).

AUSTRALIAN ECONOMY

The Australian economy slowed significantly in the June quarter, with GDP growth approaching stalling speed. However, a closer look at the national accounts shows that national income growth was even weaker. What the ABS calls 'a broader measure of economic well-being' (net national disposable income), actually contracted by 0.9% over the quarter, by 1.2% over the year and by a hefty 2.3% over the year in per capita terms. The cause of this weakness was a significant fall over the year in the Terms of trade, due to falling commodity prices (especially iron ore, coal and natural gas). If Chinese demand slows further, commodity

The Australian economy put in a weak performance over the June quarter, with GDP up by a statistically insignificant 0.2% for the period. For the whole 12-months to end-June, economic growth was a modest 2.0% and only 0.8% per capita because of the country's high rate of population expansion through immigration. It is useful though 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 as well as of depreciation of capital. This measure actually contracted by 0.9% for the quarter and also fell over the year (by 1.2% and by 2.3% on a per capita basis), reflecting what has been a severe decline in our export prices relative to the cost of our imports (the Terms of trade fell by 10.6% over the year to end-June and by 3.4% for the quarter alone). The main underlying reason for this decline in real purchasing power of income has been a decline in the international prices paid for our major commodity exports. In particular, this has been the case for our two largest merchandise exports, iron ore and coal. These have both experienced precipitous price declines since early last year, with iron ore down by around 60% in $US terms over the 20 months to end-August and coal down over 30% over the same period. Only the fact that the $A fell by around 20% against the $US over this time provided some amelioration of the effect

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prices could potentially go even lower.

of these price declines for our exporters. Despite the severity of these commodity price falls, further significant declines cannot be ruled out and the Terms of trade could therefore potentially decline further, shrinking the country's purchasing power even more, especially if Chinese demand remains muted for some time.

Business confidence slipped back in the wake of some evidence of a growth slowdown in China and falling commodity prices, as well as a weakening of the domestic economy. Offsetting this though has been what the NAB business survey for August termed a broadening in 'growth momentum across the non-mining economy', due to low interest rates and a falling $A. However, the economic environment remains tenuous, held back by structural weaknesses, including union power, high company tax rates, minimum wage rates and electricity prices, as well as excessive regulation.

According to the NAB Business Survey for August, 'confidence pared back further, unwinding the post budget gains and hitting its lowest level since mid-2013'. Furthermore, 'China growth concerns appear to have had an unnerving effect on business' and 'confidence eased in most industries'. However, while confidence remains muted, the good news is that 'there is increasing evidence that growth momentum is broadening across the non-mining economy – not limited to the dwelling sector – in response to the lower $A and lower interest rates'. In other words, the drop in the value of the $A, coupled with relatively low interest rates appear to be starting to underpin recovery in some of the non-mining sectors. Consumer caution too has begun to ebb, with the household saving ratio now around 8% of all household income, down from its peak a few months ago of over 10%. Consumer confidence appears to be slowly rising along with rising household net wealth, now at record levels. One consequence too of the deep slide that has occurred in the value of the $A this year is that it has helped to compensate for the deterioration in the country's international competitiveness brought about by our elevated company tax rates (compared with most of our competitors), a minimum wage level that is close to the highest in the world, electricity prices that have risen dramatically since 2007 and excessive regulation that restricts investment.

STRATEGY FOR FIDUCIAN FUNDS

STRATEGY OVERVIEW

Our economic analysis set out above indicates that although it appears that the global economy slowed over the first half of this year, next year could be a better story, with official forecasts pointing to stronger growth building into the new year. These forecasts though have the IMF's rider that 'the distribution of risks to global economic activity is still tilted to the downside' (9 July), indicating that much could still go wrong. The positive news though is that expansionary monetary policy has been kicking in at least in Europe and may already have done its job sufficiently well in the US, where sustainable and solid (if unspectacular) growth is now expected for the coming year. The introduction of large-scale 'quantitative easing' ('QE') in the Euro zone from March this year has been effective not only in lifting the region out of near-recession but also in ending the grip of deflation (a fall in the general level of prices for goods and services) which had begun to take hold across the Continent earlier this year but has been positive since April. More needs to be done but there is no doubt that the ECB will maintain its 'QE' program for as long as it is needed to achieve its goal of inflation of close to 2% (its current forecast is for inflation to reach 1.7% next year and 1.8% in 2017) and its goal of sustainably higher growth for the region. In the US, consumer price inflation was only 0.1% at end-June but data everywhere has been affected by huge falls seen over the past year in commodity prices and especially in the price of oil. As Mario Draghi, President of the ECB, claimed on 3 September, 'the causes (of low inflation) now mainly lie with the oil price changes'. This large drop in the price of oil (down by nearly 50% over the 20 months to end-August) has been caused by both increased global oil supply and by developments in China. In fact, the major deflationary force pushing commodity prices down over the past year has been a significant growth slowdown in China and despite recent moves to provide more stimulus to its economy, the IMF is forecasting that China is likely to slow further to growth of 6.3% in 2016, down from 6.8% this year.

Nevertheless, even this lower rate of Chinese growth remains impressive, given that China is now the world's second largest economy. Furthermore, the recent correction in the Chinese domestic share market and in global share markets more generally has more than likely removed any 'froth' that these markets had been experiencing. Certainly in the case of China, highly speculative activity had reached a frenzy, with much of the buying done this year being 'on margin' by borrowing against stock holdings. By early September, many markets had fallen back to or below levels held at the start of the year, providing much better value for investors and creating investment opportunities. At the same time, 'QE' is continuing in key jurisdictions, including the Euro zone, Japan, Sweden and other countries; while interest rates remain near zero per cent in the US, the Euro zone, Japan, the UK, Canada (and even below zero per cent in some countries) and have also been lowered in China and elsewhere. These expansionary policies have had several aims, including stimulating economic activity through increasing the benefits of investing in productive enterprises, as well as in some cases lowering currency (often referred to as 'currency wars') and also pushing up asset prices (especially stock markets), also with the aim of increasing investment in productive enterprises. Until the worldwide market correction of July and August, which was due to fears of a forced slowdown in China, stock markets had been recovering steadily. It is likely that once it is realised that China can continue to grow at a solid rate; most markets could be expected to resume an upward trajectory.

In fundamental valuation terms and assuming ongoing earnings growth, most share markets appear to be fairly valued, especially given the low interest rate environment that currently prevails. In contrast, most bond markets appear expensive, with bond yields (interest rates) at historically low levels. Most major sovereign bond markets rose in July and August as yields fell in response to rising investor concerns about the global impact of weaker Chinese growth. In valuation terms, as at end-August, the MSCI World Shares index was trading at around 14.1 times forward (12 months ahead) earnings, a little below its long-term average. 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 returned to a downwards trend in July and August, heading back towards historical lows. Any signs of global economic recovery though could start to push yields higher again. Despite this year's growth slowdown, most bond markets still appear expensive.

Government bond yields in most major markets returned to a downwards trend in July and August, reversing the direction set from February through to June. The earlier upwards trend in yields (and downwards movement in prices) had followed statements by the US 'Fed' that it could soon begin to raise official interest rates. The more recent rise in yields began with growing concerns from mid-year about the growth outlook for China and speculation that the 'Fed' would delay an interest rate rise. By 9 September, the yield on US 10-year Treasury bonds was 2.19%, low by historical standards (but up from its record low of 1.45% set in June 2012). Similarly, German 10-year Government bond yields were 0.68%, also historically low. With such low yields persisting, most bond markets still appear expensive.

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

Australian Fixed Interest

The domestic fixed interest sector has been moving in line with international trends. Despite a domestic slowdown, the sector still appears expensive compared with equities.

Australian bond markets have been moving in line with major international bond markets and have also attracted investors seeking supposedly 'safe' havens. 10-year bond yields have been consistently higher than in the US but otherwise have ebbed and flowed along with the US. With a sluggish domestic economy, there appears little to push yields up much, although signs of stronger global growth and higher inflation could push yields higher.

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 other bonds 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 has been volatile since the start of this year, at first moving up strongly for two months but then settling back for a time. By early September these gyrations had evened out and the market was flat for the period from the year's start. Once again the Resources sector was weak but value has been building up and the sector could respond well to any signs of a rebound in China. The rest of the market has been benefiting to some extent from low interest rates and a low $A. Overall, the stock market appears to offer better value for investors than bonds.

The Australian share market's downwards trend actually began in March after moving up strongly (by 10%) through January and February. By 9 September, for the whole period from the start of the year, the market (ASX200 Accumulation index, which includes dividend payments) was virtually flat (up 0.1%). This whole period once again witnessed a severe underperformance by the Resources sector (by around 10% relative to the broader index) that has been ongoing for some time. The Industrials sector was slightly ahead of the main index, while Financials performed in line with index and the Listed Property sector again out-performed (up 9% for the period). The outlook for the Resources sector, as always, hinges on the prospects for commodity prices, in particular for our two largest export items, iron ore and coal, and these mostly depend on the growth outlook for China and its demand for commodity inputs. The broader market though has been benefiting to some extent from a lower interest rate environment and a lower currency. By end-August the domestic share market had an estimated price-to-earnings ratio (PER) of around 14.2 times trailing earnings, which was its lowest level since August 2012. The stock market thus appeared relatively fairly valued, both in historical terms and when compared with other investment opportunities, notably bond and property markets. The average dividend yield was also attractive at 5.04%, the highest average yield since June 2012 (RBA data).

Exposure to this sector is currently around benchmark.

STRATEGY FOR FIDUCIAN FUNDS

International Shares

Global share markets this year have altered last year's pattern in which US markets did well and Chinese and Indian markets did exceptionally well, while European markets were subdued. This year, it has been European markets and the Japanese market that have out-performed, although the shine was taken off most markets by heavy declines from August through to early September. The booming Chinese and Indian markets have also experienced a comeuppance.

Global equities markets have this year have been highly volatile, especially in recent months. Over the period from the start of the year to end-July, most global markets were moving up and some were up strongly. The German, French and Japanese markets were up respectively by 15%, 19% and 18%, for example over this period and the Chinese domestic market was up 13%. In August, however, markets were rattled by poor manufacturing data out of China (reflecting some excessive tightening in both monetary and fiscal policy from late last year that it was feared could push commodity prices even lower). From end-July to 9 September, markets were mostly heavily down (including the broad US market down 8%, the German and Japanese markets each down 9%, the UK down 7% and China's Shanghai market down 12%). This hefty market correction took the shine off most stock markets, so that for the period from the start of the year to 9 September, the broad US market was down 6%, the UK was down 5%, and India was down 7%; while the German market was up 5%, France was up 9%, Japan was up 8% and the Chinese market was flat. The stock market booms that had been enjoyed by both the Chinese Shanghai 'A' domestic market (up over 50% in 2014) and India (up by 30% in 2014) appeared to be over, at least for the time being.

Share markets mostly appeared to be fairly valued by early September, especially compared with other liquid investment opportunities, such as bonds and cash.

In terms of valuations, by end-August, the PER for the **major world markets** as a whole (represented by the MSCI World index) was around 14.1 times estimated forward earnings (excluding stocks without positive earnings), below its longer-term average of around 15 times earnings. In general terms, most share markets were looking fairly priced relative to other investment opportunities, such as bonds and cash. Some emerging markets too no longer looked so stretched, notably the Chinese market, where a buying mania has ended.
Exposure to this sector remains above benchmark.

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 but still has a reasonable dividend yield and a fair price-to-earnings ratio.

The listed property sector surpassed the broader market in 2014 by a wide margin, returning 27% for the year (accumulation index) and has continued to outperform in 2015, returning 9% up to 9 September. There continues to be an improved perception of the sector by investors since its severe under-performance in 2008 and 2009. Since that time the structure of most listed property securities has improved, with lower average gearing and more stable earnings. By 9 September, the sector's average PER was around 15.5 times forward earnings with an earnings yield of 6.5% and a dividend yield of around 5.2% (2015-16 earnings, UBS estimate and based on an average pay-out ratio of 80%). However, the sector does now appear more fully valued than it was and trades at a premium to net asset value.
Exposure to this sector is around benchmark.

Australian Dollar

The $A has fallen this year against the $US and is closer to where the Reserve Bank would like it to be.

The $A has moved well below its July 2011 peak of around $US1.10. By end-2014 it had fallen to around $US0.82, after interest rate cuts and RBA hints that it wished to see a lower $A. By 9 September 2015 it was $US0.698, a level the RBA appeared to be satisfied with.

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 %	Mar 15 %	Jun 15 %	Previous 3 month activity
Australian Shares	15	8 – 19	16	15	↘
International Shares	10	6 –14	12	12	→
Property	5	3 – 8	5	5	→
International Fixed Interest	16	5 – 30	11	10	↘
CPI Fixed Interest	7	0 – 17	4	6	↗
Aust Fixed Interest	32	15 – 44	23	22	↘
Cash	15	5 – 42	29	30	↗

BALANCED PORTFOLIO	Benchmark %	Range %	Mar 15 %	Jun 15 %	Previous 3 month activity
Australian Shares	37	29- 45	38	37	↘
International Shares	23	15 – 32	26	26	→
Property	9	5 – 17	9	9	→
International Fixed Interest	7	4 – 12	5	5	→
CPI Fixed Interest	3	0 – 8	2	3	↗
Aust Fixed Interest	16	10 – 22	11	12	↗
Cash	5	3 – 40	9	8	↘

GROWTH PORTFOLIO	Benchmark %	Range %	Mar 15 %	Jun 15 %	Previous 3 month activity
Australian Shares	42	34 –50	43	42	↘
International Shares	28	20 – 36	31	32	↗
Property	11	5 –15	11	11	→
International Fixed Interest	5	0 – 14	3	3	→
CPI Fixed Interest	2	0 – 7	1	2	↗
Aust Fixed Interest	10	5 – 16	6	6	→
Cash	2	2 – 32	5	4	↘

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**

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