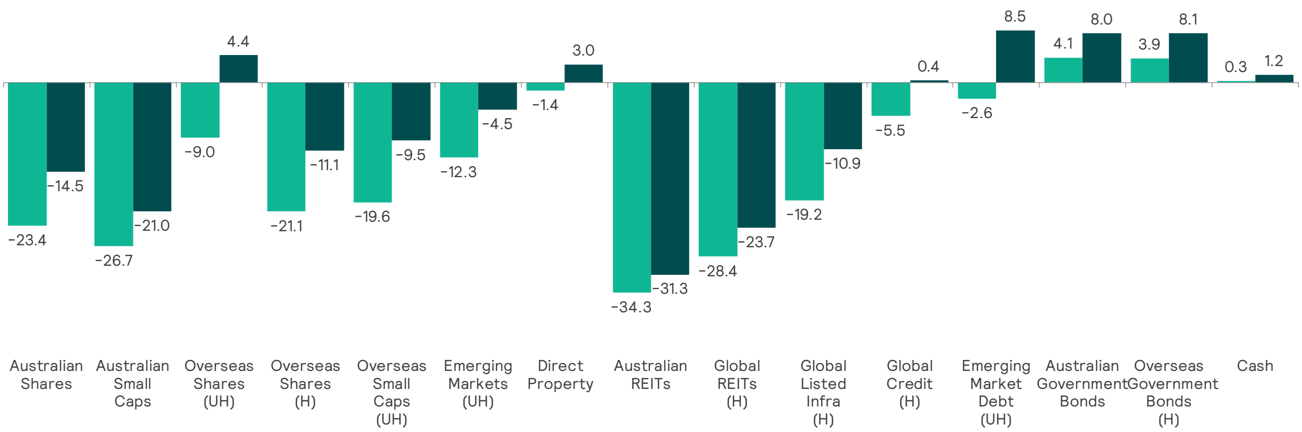
Q1 2020

MARKET AND ECONOMIC CONDITIONS

SELECTED MARKET INDICATORS COMMENTARY

ASSET CLASS RETURNS (%) AS AT MARCH QUARTER 2020



Data source: Thomson Financial Datastream; MSCI. Data provided 'as is'. Details on chart constituents can be found at the end of the commentary.

Markets have responded negatively to the rapid spread of the Coronavirus around the world, which was declared a global pandemic by the World Health Organisation. This caused a sharp decline in risky assets from all-time highs in mid February, with Hedged Overseas Shares returning -21.1% whilst its Unhedged counterpart returned -9.0% over the quarter, outperforming Emerging Markets shares (UH) (-12.3%). In anticipation of the economic growth fallout, S&P Global Ratings lowered its forecast for global growth to 0.4% in 2020 with a rebound to 4.9% in 2021.

Coronavirus fears sparked a flight to defensive assets over the quarter as credit spreads widen. Australian Government Bonds and Overseas Government Bonds (H) both returned 4.1% and 3.9% respectively whilst global credit (hedged) returned -5.5%, indicating investors favoured less risky sovereign bonds. The spread between Treasuries and investment-grade corporate bonds increased 149bps to 2.72%. Credit spreads for high yield bonds rose 380bps during March and the yield difference between high-yield and US government bonds ended the quarter at 8.80%. Australian 10-year bond yields decreased by 61bps and five-year bond yields decreased by 63bps following the RBA's rate cut in March.

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To battle the spread of the coronavirus governments introduce measures such as forced closure of businesses in order to facilitate social distancing. As a result, central banks and governments worldwide announced fiscal and monetary rescue packages to stimulate the economy as unemployment spiked. Alongside China, many other emerging market central banks, including Argentina, Brazil and Russia cut benchmark rates over the quarter. The US fiscal stimulus package approved by the Senate totals US$2.2 trillion, which represents 10% of the US GDP. Whilst the Australian government announced a A$130 billion JobKeeper package to help keep Australians in jobs. Other packages were released in Japan, Singapore and the European Union (EU). With current media attention largely being devoted to Coronavirus, geopolitical risks have lessened with US and China trade risks now moving into the background. Nonetheless, Russia and Saudi Arabia has suffered losses resulting from an oil price war. The US election season continues with Joe Biden securing the Democratic Party nominee.

Over the quarter, overseas share sectors Healthcare (+1.7%) and Information Technology (-0.3%) were the top performing sectors. Whilst Energy and Financials were the largest detractors, returning -36.6% and -21.7% respectively. Factor performance signalled solid risk aversion as investors favoured low volatility and low beta stocks as well as growth stocks over the quarter.

The Australian share market underperformed its hedged overseas counterpart, as the S&P/ASX300 returned -23.4% over the quarter. The S&P/ASX 50 was the best performer returning -22.3% over Q1, whilst S&P/ASX Mid 50 was the greatest detractor to the S&P/ASX300 return, returning -27.0%. Healthcare (+1.5%) and Consumer Staples (-3.7%) were the strongest sectors, whilst the weakest performing sectors were Energy (-48.2%) and Real Estate (-34.8%), driven by the coronavirus pandemic.

SIGNIFICANT DEVELOPMENTS

- The Reserve Bank of Australia (RBA) decided to lower the cash rate by 50bps to 0.25% over the first quarter of 2020. During its meeting in early April, the Board reaffirmed the 0.25% cash rate and the yield on 3-year Australian government bonds of 25bps, as well as the other elements of the policy package announced in mid-March. RBA Governor, Philip Lowe, noted that the coronavirus is having very significant effects on economies and financial markets globally, with large increases in unemployment expected.

  Once the virus is contained, the large fiscal packages and easy monetary policy is expected to support the global economic recovery. The RBA has injected substantial liquidity into the financial system through its daily open market operations to support credit and maintain low funding costs in the Australian economy. There remains considerable uncertainty around the near-term outlook for the Australian economy. Much will depend upon the success of the efforts to contain the virus and how long the social distancing measures remain in place. A large economic contraction is expected for the June quarter and the unemployment rate is expected to reach its highest level for many years. RBA Governor, Philip Lowe, noted that the Australian financial system is resilient, well capitalised and in a strong liquidity position. The Board has noted that it will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will remain sustainably within the 2-3% target range.

- Australian seasonally adjusted employment increased by 12,900 (revised) in January, above expectations for a 10,000 rise, while in February employment increased by 26,700, above expectations for a 6,300 rise The unemployment rate decreased from the previous quarter's 5.2% in November to 5.1% in February. The participation rate has remained at 66.0% from the previous quarter. Part time jobs decreased by 32,300 (revised) and full time jobs increased by 45,200 (revised) in January and in February part time jobs increased by 20,000 and full time jobs also increased by 6,700.

- Australian house prices increased by 3.9% in the fourth quarter of 2019, taking it 2.5% higher from a year earlier, below expectations for 4.5% quarter-on-quarter (QoQ) and 3.0% year-on-year (YoY). Building approvals increased 19.9% month-on-month (MoM) to February, above expectations for an increase of 3.0%.

- US Non-Farm Payrolls decreased by 701,000 in March, below the previous 275,000 increase (revised) for February and below the previous 214,000 increase (revised) for January. The unemployment rate increased to 4.4% in March from 3.5% in the previous quarter.

- The Institute for Supply Management (ISM) Manufacturing Index recorded 49.1 in March, above consensus for 44.5, and below the 50.1 recorded in February. Of the 18 manufacturing industries, Printing & Related Support Activities and Food, Beverage & Tobacco Products were the top contributors, whilst Petroleum & Coal Products and Textile Mills were the largest detractors over the month. The ISM Non-Manufacturing Index recorded 52.5 in March, above consensus for 43.0 and below the 57.3 recorded in February.

Of the 18 non-manufacturing industries, the top performers in March were Health Care & Social Assistance and Real Estate, Rental & Leasing, while Arts, Entertainment & Recreation and Transportation & Warehousing were the two industries, which reported the largest decreases over the month.

- US gross domestic product (GDP) third estimate for Q4 2019 is 2.1% quarter on quarter (QoQ) annualised, both in line with expectations and the third estimate for Q3 2019.
- US headline consumer price index (CPI) decreased from 0.1% MoM in January to -0.4% MoM in March and decreased from 2.5% YoY in January to 1.5% YoY in March.
- The Caixin Manufacturing PMI in China recorded 52.0 for March, above expectations for 44.8.
- Chinese GDP increased 6.0% YoY for Q4 2019, in line with expectations. Seasonally adjusted GDP increased 1.5% QoQ for Q4 2019, above expectations for 1.4%.
- A preliminary estimate of the European Core Consumer Price Index (CPI) recorded 1.0% over the year to March, in line with expectations. The unemployment rate increased to 5.4% over the second quarter of 2020.
- The Eurozone composite PMI decreased to 29.7 in March, below expectations for 31.4.
- The Eurozone's final estimate recorded for seasonally adjusted GDP over Q4 2019 was 1.0% year-on-year (YoY) and 0.1% QoQ.

AUSTRALIAN EQUITIES

Australian shares were negative over Q1 2020 as the S&P/ASX 300 Index returned -23.4% for the period. There were negative movements across the market cap spectrum, with the best performer being the S&P/ASX 50; returning -22.3% for the quarter while the worst performer was the S&P/ASX Mid 50; returning -27.0%. The best performing sectors were Healthcare (+1.5%) and Consumer Staples (-3.7%), while the weakest performing sectors were Energy (-48.2%) and Real Estate (-34.8%). The largest positive contributors to the return of the index were CSL, Woolworths and Coles with absolute returns of 7.8%, -1.7% and 4.3% respectively. On the other hand, the most significant detractors from performance were Woodside, Westpac and Macquarie with absolute returns of -46.3%, -30.5% and -37.0% respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) decreased 21.1% in hedged terms and decreased 9.0% in unhedged terms over the quarter, as the AUD depreciated against most major currencies over the period. The strongest performing sectors were Healthcare (+1.7%) and IT (-0.3%), while Energy (-36.6%) and Financials (-21.7%) were the worst performers. In AUD terms, the Global Small Cap sector decreased 19.6%, whilst Emerging Markets (NR) returned -12.3%.

Over the March quarter, the NASDAQ decreased 14.2%, the S&P 500 Composite Index decreased 19.6% and the Dow Jones Industrial Average decreased 22.7%, all in USD terms. European markets also experienced negative returns, with the FTSE 100 United Kingdom (UK) decreasing 23.8%, the DAX 30 (Germany) decreasing 25.0% and the CAC 40 (France) decreasing 26.1% over the period, all in local currency terms. Equity returns were also negative across Asia as the Indian BSE 500 decreased 29.2%, the Hang Seng decreased 15.9%, the SSE Composite (China) decreased 9.8% and the Japanese TOPIX also decreased 17.5%, all in local currency terms.

REAL ASSETS

Global and Domestic listed property experienced negative results over the March quarter. Unhedged domestic Real Estate Investment Trusts (REITs) were down 34.3% and hedged Global REITs decreased 28.4%. The unlisted property sector (NAV) fell -1.4% over the quarter. Meanwhile, Global Core Listed Infrastructure 50/50 index decreased 19.2% for the quarter in hedged terms.

FIXED INTEREST

Global sovereign bonds produced positive returns over the March quarter for hedged Australian investors. Ten-year bond yields decreased in the US (-125bps to 0.67%), UK (-52bps to 0.31%) and Germany (-27bps to -0.46%), but increased in Japan (+4bps to 0.02%). Two-year bond yields decreased in the US (-133bps to 0.25%), Japan (-1bp to -0.14%), Germany (-11bps to -0.71%) and the UK (-40bps to 0.13%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index increased 1.3% and the FTSE World Government Bond (ex-Australia) Index increased 3.9% over the March quarter, on a fully hedged basis.

Domestically, Australian 10-year bond yields decreased by 61bps to 0.77%, five-year bond yields decreased by 63bps to 0.42% and two-year bond yields decreased 68bps to 0.25%. Bloomberg Ausbond indices were broadly positive over the quarter, with the Bloomberg Ausbond Treasury Index achieving the highest return at 4.1%, and the weakest being the Bloomberg Ausbond Inflation Index returning -2.0%.

CURRENCY MARKETS

The AUD depreciated against most major currencies, over the March quarter, finishing at US$0.612 with a Trade Weighted Index of 54.7. It depreciated against the Pound Sterling (-6.3%), USD (-12.9%), Japanese Yen (-12.2%) and the Euro (-10.4%). On a trade-weighted basis, the local currency depreciated 9.3% over the quarter.

COMMODITIES

The S&P GSCI Commodity Total Return Index decreased by 33.8% over the quarter. Gold prices finished the quarter at US$1,612.1 per ounce for a 6.0% increase over the period. While the oil price decreased by 65.9% to US$22.6 per barrel and Iron Ore prices also decreased by 8.7% to US$84.0 per metric tonne over the March quarter.

CHART CONSTITUENTS

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

ASSET CLASS	BENCHMARK	DATA TYPE
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Barclays Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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