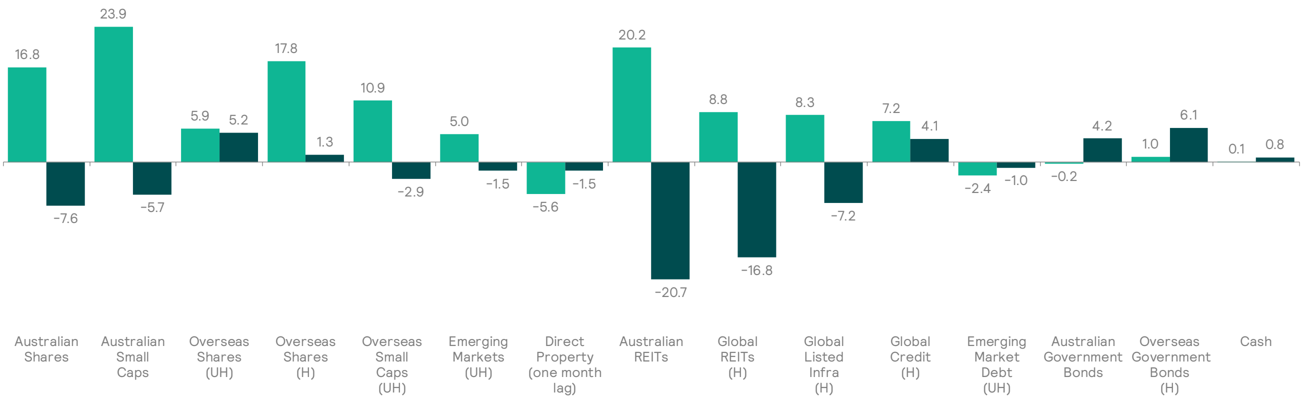
Q2 2020

MARKET AND ECONOMIC CONDITIONS

SELECTED MARKET INDICATORS COMMENTARY

ASSET CLASS RETURNS (%) AS AT JUNE 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 recovered over the June quarter from the sharp declines in March. Markets were encouraged by the gradual reopening across the developed world and economic activity indicators, as well as positive monetary and fiscal stimulus, with Hedged Developed Overseas Shares returning +17.8% and its Unhedged counterpart returning +5.9%. Whilst the sharp rebound in activity indicators exceeded market expectations, output and employment levels are not expected to return to pre-COVID levels until 2021 at least. Both the International Monetary Fund (IMF) and World Bank are now estimating global growth for 2020 to be around -5.0%.

Political tensions were an added distraction amidst the coronavirus pandemic during the quarter. This included protests across a number of US cities, a brief military confrontation between China and India, tensions between the US, UK and China over the new national security law in Hong Kong, and new tariffs being considered on the UK and Europe by the US.

Growth assets had a strong June quarter, led by strong returns across both developed and emerging regions. In Australia, the S&P/ASX 300 was up +16.8% and S&P/ASX Small Ordinaries was up +23.9%. Australian REITs were up by +20.2% for the quarter, but remain down by -20.7% in the 12 months to June period. Whilst Global REITs had a solid positive return over the June quarter they are also down by -16.8% over the past 12 months, as investors are still evaluating the immediate impact of the crisis on rent collection and the impact on long term demand fundamentals, especially within retail and office spaces.

MERCER

Defensive sovereign bonds were fairly muted in comparison over the June quarter, with Australian Government Bonds and Hedged Overseas Government Bonds both returning -0.2% and +1.0% respectively. Sentiment for corporate credit strengthened over the quarter, as the US Federal Reserve purchased US corporate debt in the form of investment grade bonds, resulting in Hedged Global Credit returning +7.2% for the June quarter. Nevertheless, the downturn is continuing to take its toll on companies as car rental company Hertz and 24h Fitness Worldwide have filed for bankruptcy.

Over the quarter, Information Technology (+16.6%) and Consumer Discretionary (+15.5%) were the top performing sectors within developed overseas shares. Utilities and Consumer Staples were the largest detractors, returning -5.6% and -3.4% respectively. Growth stocks remained in favour over the quarter.

The Australian share market marginally underperformed its hedged overseas counterpart, as the S&P/ASX300 returned +16.8% over the quarter. The S&P/ASX Mid 50 was the best performer returning 30.3% over Q2, whilst S&P/ASX 50 was the greatest detractor, returning +13.7%. Information Technology (+44.4%) and Consumer Discretionary (+30.8%) were the strongest performing sectors, whilst Healthcare (+2.9%) and Consumer Staples (+6.9%) were the weakest.

SIGNIFICANT DEVELOPMENTS

- The Reserve Bank of Australia (RBA) has maintained the cash rate at 0.25% over the second quarter of 2020. During its meeting in early July, the Board reaffirmed the cash rate and the 3-year yield on 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 global economy is experiencing a severe downturn as countries seek to contain the coronavirus. Many people have lost their jobs and there has been a sharp rise in unemployment since the March quarter. Whilst COVID-19 infection rates have declined in many countries, they still remain quite high and rising in other countries. Globally, conditions in financial markets have improved with a decline in volatility and large raisings of both debt and equity. In Australia, the government bond markets are operating effectively and the Bank's market operations are continuing to support a high level of liquidity in the Australian financial system.

  Whilst the Australian economy is going through a very difficult period, conditions have stabilised over the quarter and the downturn has been less severe than initially expected. Although there has been signs of a gradual improvement, the nature and speed of the economic recovery remains uncertain. It is likely that fiscal and monetary support will be required for some time. The Board will not increase the cash rate target until progress is made towards full employment, and it is confident that inflation will be sustainably within the 2–3% target band.

- Australian seasonally adjusted employment increased by 19,300 (revised) in February, above expectations for a 6,300 rise, while in May employment decreased by 227,700, above expectations for a 78,800 decrease. The unemployment rate increased from the previous quarter's 5.1% in February to 7.1% in May. The participation rate has decreased to 62.9% from the previous quarter's 66.0%. Part time jobs increased by 15,500 (revised) and full time jobs increased by 3,800 (revised) in February, whilst part time jobs decreased by 138,600 and full time jobs decreased by 89,100 in May.

- Australian house prices increased by 1.6% in the first quarter of 2020, taking it 7.4% higher from a year earlier, below expectations for 2.5% quarter-on-quarter (QoQ) and 8.1% year-on-year (YoY). Building approvals decreased 16.4% month-on-month (MoM) to May, below expectations for a decrease of -7.8%.

- US Non-Farm Payrolls increased by 4,800,000 in June, above the 2,699,000 decrease (revised) recorded for May. The unemployment rate decreased to 11.1% over June, below expectations of 12.5%.

- The Institute for Supply Management (ISM) Manufacturing Index recorded 52.6 in June, above consensus for 49.8, and above the 43.1 recorded in May. Of the 18 manufacturing industries, Textile Mills and Wood Products were the industries that reported the highest growth. Transportation Equipment and Primary Metals were the largest detractors over the month. The ISM Non-Manufacturing Index recorded 57.1 in June, above consensus for 50.2 and above the 45.4 recorded in May. Of the 18 non-manufacturing industries, the top performers in June were Agriculture, Forestry, Fishing & Hunting and Accommodation & Food Services. Mining and Other Services were the two industries, which reported the largest decreases over the month.

- US gross domestic product (GDP) third estimate for Q1 2020 is -5.0% quarter on quarter (QoQ) annualised, in line with expectations.

- US headline consumer price index (CPI) increased from -0.4% MoM in March to 0.6% MoM in June and decreased from 1.5% YoY in March to 0.6% YoY in June.
- The Caixin Manufacturing PMI in China recorded 51.2 in June, above expectations for 50.5 as manufacturing sector conditions continued to strengthen.
- Chinese GDP decreased 6.8% YoY for Q1 2020, below expectations for -6.0%. Seasonally adjusted GDP decreased 9.8% QoQ for Q1 2020, below expectations for -12.0%.
- A preliminary estimate of the European Core Consumer Price Index (CPI) recorded 0.8% over the year to June, in line with expectations. The unemployment rate decreased to 5.3% over the second quarter of 2020.
- The Eurozone composite PMI increased to 48.5 in June, above expectations for 47.5. Eurozone operating conditions has improved considerably relative to May.
- The final estimate recorded for Q1 2020 Eurozone seasonally adjusted GDP is -3.6% for quarter-on-quarter (QoQ) and -3.1% for year-on-year (YoY).

AUSTRALIAN EQUITIES

Australian shares were positive over Q2 2020 as the S&P/ASX 300 Index returned 16.8% for the period. There were positive movements across the market cap spectrum, with the best performer being the S&P/ASX Mid 50; returning 30.3% for the quarter, while the worst performer was the S&P/ASX 50; returning 13.7%.

The best performing sectors were IT (+44.4%) and Consumer Discretionary (+30.8%), while the weakest performing sectors were Healthcare (+2.9%) and Consumer Staples (+6.9%). The largest positive contributors to the return of the index were Afterpay, Macquarie and BHP with absolute returns of 224.4%, 40.0% and 24.5% respectively. On the other hand, the most significant detractors from performance were CSL, CBA and Telstra with absolute returns of -3.0%, 12.3% and 2.8% respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) increased 17.8% in hedged terms and increased 5.9% in unhedged terms over the quarter, as the AUD appreciated against most major currencies over the period. The strongest performing sectors were IT (+16.6%) and Consumer Discretionary (+15.5%), while Utilities (-5.6%) and Consumer Staples (-3.4%) were the worst performers.

In AUD terms, the Global Small Cap sector increased 10.9%, whilst Emerging Markets (NR) returned 5.0%.

Over the June quarter, the NASDAQ increased 30.6%, the S&P 500 Composite Index increased 20.5% and the Dow Jones Industrial Average increased 18.5%, all in USD terms. European markets also experienced positive returns, with the FTSE 100 United Kingdom (UK) increasing 9.1%, the DAX 30 (Germany) increasing 23.9% and the CAC 40 (France) increasing 13.5% over the period, all in local currency terms. Equity returns were also positive across Asia as the Indian BSE 500 increased 21.1%, the Hang Seng increased 4.7%, the SSE Composite (China) increased 8.5% and the Japanese TOPIX increased 11.2%, all in local currency terms.

REAL ASSETS

Global and Domestic listed property experienced positive results over the June quarter. Unhedged domestic Real Estate Investment Trusts (REITs) were up 20.2% and hedged Global REITs increased 8.8% (in AUD terms). The Australian unlisted property sector (NAV) fell 5.6% over the quarter on a one month lagged basis. Meanwhile, FTSE Global Core Infrastructure 50/50 index increased 8.3% for the quarter in hedged AUD terms.

FIXED INTEREST

Global sovereign bonds produced broadly positive returns over the June quarter for hedged Australian investors. Ten-year bond yields decreased in the US (-2bps to 0.65%), UK (-18bps to 0.12%) and Germany (-4bps to -0.50%), but increased in Japan (+1bp to 0.03%). Two-year bond yields decreased in the US (-9bps to 0.17%) and the UK (-22bps to -0.08%), whilst increased in Germany (+2bps to -0.69%) and remained flat in Japan (-0.14%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index increased 2.3% and the FTSE World Government Bond (ex-Australia) Index increased 1.0% over the June quarter, on a fully hedged basis.

Domestically, Australian 10-year bond yields increased by 11bps to 0.87%, five-year bond yields decreased by 1bp to 0.41% and two-year bond yields increased by 1bp to 0.27%. Bloomberg Ausbond indices were broadly positive over the quarter, with the Bloomberg Ausbond Inflation Index achieving the highest return at 3.7%, and the weakest being the Bloomberg Ausbond Treasury Index returning -0.2%.

CURRENCY MARKETS

The Australian Dollar (AUD) appreciated against the major currencies over the June quarter, finishing at US$0.69 with a Trade Weighted Index of 60.0. The AUD appreciated against the Pound Sterling (+11.6%), USD (+12.5%), Japanese Yen (+10.6%) and the Euro (+9.0%). On a trade-weighted basis, the local currency appreciated 9.7% over the quarter.

COMMODITIES

The S&P GSCI Commodity Total Return Index decreased by 1.8% over the quarter. Gold prices finished the quarter at US$1,783.7 per ounce for 10.6% increase over the period. Meanwhile the oil price increased by 82.5% to US$41.3 per barrel and Iron Ore prices also increased by 20.8% to US$101.5 per metric tonne over the June 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 (one month lag)	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

CONTACT: Mercer >IS<

Tel: +1800 512 947

Email: merceris@mercer.com

IMPORTANT NOTICES