Month in Review

Market Moves — as at 31•05•2016

RETURNS (%) P.A.	1 MTH	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR
AUSTRALIAN EQUITIES							
S&P/ASX 200 ACCUMULATION INDEX	3.09	11.60	6.46	-2.38	7.71	7.54	5.34
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	4.09	13.12	12.60	6.91	6.93	0.21	1.35
GLOBAL EQUITIES							
MSCI WORLD EX AUSTRALIA NR INDEX (AUD)	6.02	7.45	-0.12	1.62	17.20	15.33	4.96
S&P 500 INDEX (USD)	1.53	8.53	0.80	-0.49	8.74	9.29	5.14
FTSE 100 INDEX (GBP)	-0.18	2.19	-1.97	-10.79	-1.82	0.79	0.85
MSCI EMERGING MARKETS NR INDEX (AUD)	1.41	8.06	0.06	-12.97	4.36	2.80	3.52
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 200 A-REIT ACCUMULATION INDEX	2.63	8.04	16.79	15.31	16.80	17.09	3.34
FTSE EPRA/NAREIT DEVELOPED NR INDEX (AUD HEDGED)	1.46	8.35	4.72	4.22	9.90	10.89	5.61
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	1.26	1.30	3.95	4.64	5.41	6.57	6.50
BLOOMBERG AUSBOND BANK BILL INDEX	0.19	0.59	1.17	2.25	2.53	3.15	4.38
BARCLAYS GLOBAL AGGREGATE BOND INDEX (AUD HEDGED)	0.57	1.81	4.52	6.07	6.42	7.38	7.86

Data source: IRESS & Financial Express. Returns greater than one year are annualised
Commentary regarding equity indices below references performance without including the effects of currency (unless specifically stated)

Australian equities

Australian shares continued their run higher in May, with the S&P/ASX 200 Index finishing at 5378.56 points—its highest level since August 2015. Returns on Australian equities, as measured by the S&P/ASX 200 Accumulation Index, reached 3.36%, driven by large gains in the Health Care (9.47%), Information Technology (6.47%) and Consumer Discretionary (5.78%) sectors, with falls in Materials (-3.20%) and Energy (-1.85%).

The market was taken by surprise by the RBA's May rate cut, with Australian shares moving 2.30% higher on the day of the announcement. Lower rates were supportive of shares, as was a declining AUD.

Australian small cap shares outperformed in May, with the S&P/ASX Small Ordinaries Accumulation Index returning 4.09%, continuing its run of outperformance over one- and two-year periods. Health Care sector shares overtook Industrials as the best performer over a 12-month period, returning 17.84%. Primary care shares were boosted in May by the government's announcement that it would delay pathology bulk-billing if re-elected. The sector has also attracted investors due to large offshore income streams, which have benefited from a falling AUD.

Global equities

US equities rose late in the month on the back of April home sales data, which showed the largest monthly increase since 1992, lifting shares by 2.08% and reassuring investors that the economy can withstand higher interest rates. The S&P 500 Index closed the month 1.53% higher, amid speculation of a Fed rate hike as early as June.

European markets were mixed, with a disappointing first-quarter earnings season and economic data still presenting an unclear picture. The German Stock Index (DAX) gained 2.23% in May, while the FTSE 100 Index dropped -0.18%, with the Brexit issue still the cause of much uncertainty.

Earnings in Europe have been mostly in line or below expectations, with weak global demand and recent appreciations in the EUR taking a toll. The ECB is due to begin the purchasing of corporate bonds in June, reducing the cost of debt for Eurozone companies and possibly prompting share buybacks.

Crude oil prices neared US $50/b at the end of May, with implied volatility declining despite an increase in unplanned supply outages. The MSCI World ex Australia NR Index gained 6.02% in May, with mixed results from Asian markets. The Nikkei 225 Index gained 3.41%, the Shanghai Shenzhen CSI 300 Index gained a modest 0.41%, while Hong Kong's Hang Seng Index lost -1.20%.

REITs

The S&P/ASX 200 A-REIT Accumulation Index retuned 2.63%, underperforming the market but still an attractive source of yield for investors, helped by a dovish turn from the RBA. Concerns remain about excessive gearing and overpricing in some cases, driven by persistently low interest rates. With the Federal Reserve leaning towards a rate increase, and the resulting decline in the AUD, investors may be moving away from the yield trade, although the weaker US jobs data is likely to keep the funds rate on hold for longer.

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Globally, REITs returned 1.66% in May (in AUD hedged terms), while the FTSE EPRA/NAREIT Developed NR Index gained 1.46%. In the US, REITs returned 1.59%, remaining one of the most resilient high-yield sectors. While equity markets have been troubled by weak earnings, FFOs for US REITS continue to grow broadly across all property types, with the exception of multi-family REITS. The FTSE NAREIT PureProperty Index showed US investment real estate values grew 0.57% in May, with strong appreciation in the South region.

Fixed interest

Australian bonds returned 1.26% in May, with the RBA rate cut early in the month pushing Australian yields to record low levels. The Australian 10-year Treasury yield hit 2.22%, before ending the month slightly higher at 2.30%, significantly reduced from its 2.55% level prior to the rate cut.

Global bonds, as measured by the Barclays Global Aggregate Bond Index, returned 0.57% in May (in AUD hedged terms), with a modest expansion in investment grade yields. Monthly returns on global corporate investment grade and high yield bonds were -0.94% and 0.03% respectively. The Bank of America Merrill Lynch US High Yield Option-Adjusted Spread fell from 6.21 to 5.97 during May, alleviating recession worries.

Government bond yields underwent further compression in May, with central banks keeping rates on hold but maintaining flexibility. The US 10-year Treasury yield fell from 1.83% to 1.84%, and the UK 10-year Gilt yield fell from 1.60% to 1.43%. The German 10-year Bund yield fell from 0.27% to 0.14%, and the 5-year Bund yield moved lower from -0.29% to -0.38%. Japanese yields moved further negative, with the 10-year yield dropping from -0.08% to -0.12% since crossing the financial Rubicon in March.

ASX 200 Stock Movements

S&P/ASX 200 Stock Performance for the Month of May

BEST PERFORMERS	
SELECT HARVESTS	42.15%
CYBG	35.12%
PROGRAMMED MAINTENANCE SERVICES	28.67%
ARISTOCRAT LEISURE	28.60%
MACQUARIE GROUP	22.57%

WORST PERFORMERS	
FLIGHT CENTRE TRAVEL GROUP	-19.59%
WESTERN AREAS	-18.40%
SIMS METAL MANAGEMENT	-13.82%
FLEXIGROUP	-13.81%
SKY NETWORK TELEVISION	-13.58%

S&P/ASX 200 Stock Performance for the Year to May

BEST PERFORMERS	
ST BARBARA	459.57%
BELLAMY'S AUSTRALIA	223.23%
PACIFIC BRANDS	181.17%
REGIS RESOURCES	165.78%
ACONEX	159.20%

WORST PERFORMERS	
LIQUEFIED NATURAL GAS	-85.89%
MESOBLAST	-49.49%
ORIGIN ENERGY	-48.20%
SPOTLESS GROUP HOLDINGS	-45.39%
WHITEHAVEN COAL	-42.91%

Economic News

Australia

Despite the RBA's concerns about low inflation, Q1 GDP was strong, increasing 1.1% over the quarter and an above-trend 3.1% year-on-year. This was the fastest rate of expansion since Q1 2012, although growth remains reliant on the external sector, with exports contributing 1 percentage point to growth in the quarter. While headline growth shows that Australia is weathering the transition from mining investment well, the outlook is still unclear, especially in light of slower wage growth and shrinking net disposal national income, as well as inflation that remains below target.

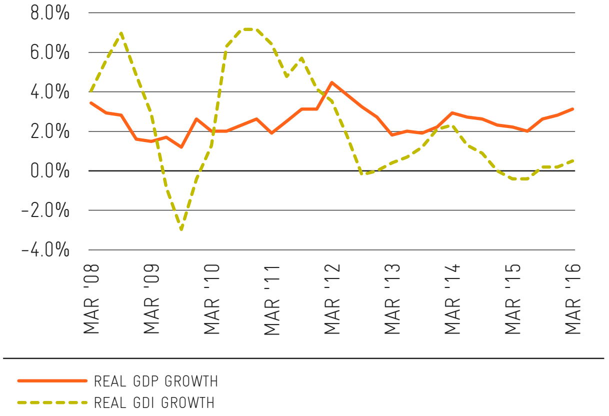
The RBA left rates on hold at the start of June, noting that growth is continuing despite a fall in business investment. The March quarter CPI figures showed an unexpected drop in inflation, prompting the RBA to cut the cash rate by 25 bps to a new historic low of 1.75%.

The Bank noted that accommodative monetary policy has been successful in supporting demand and a lower exchange rate, which has had a positive impact on Australia's export sector.

On 18 May, Treasury and the Department of Finance released the Pre-Election Economic and Fiscal Outlook (PEFO), with economic forecasts unchanged since the Budget. Real GDP is still forecast to grow by 2.5% in 2016-17, rising to 3.0% out to 2019-20. The underlying cash balance is estimated to be -$37.1 billion in 2016-17 and is projected to narrow to -$5.9 billion by 2019-20, although Treasury noted that a return to surplus will not be possible unless tax receipts as a proportion of GDP rise above 23.9% (the average since the introduction of the GST and before the start of the GFC), based on current spending levels.

Month in Review

Gross Domestic Product v Gross Domestic Income (growth y/y)



Source: Lonsec, ABS

The unemployment rate remained steady at 5.7% in April, following a fall from 5.8% in March. The number of unemployed persons rose by a marginal 400, although once again a significant rise in part-time employment offset falls in full-time employment. The participation rate fell by less than 0.1 pts to 64.8%, while monthly hours worked declined by 17.9 million hours. Unemployment rates were steady or falling in most states, with the exception of Queensland (from 6.2% to 6.5%) and Western Australia (from 5.5% to 5.6%).

On the consumer side, retail turnover rose 0.2% in April, following March's increase of 0.4%. All industry groups rose with the exception of food retailing (-0.3%), with significant growth in restaurants (1.0%) and clothing (0.5%). The Westpac Melbourne Institute Index of Consumer Sentiment jumped 8.5% in May from 95.1 to 103.2, with a reading above 100 meaning pessimists outnumber optimists. The index reached its highest level since January 2014, impacted primarily by the Budget and the RBA's May rate cut.

Australia's trade deficit narrowed further in April to $1.58 billion, down on March's deficit of $1.97 billion. Despite variable movements in the AUD, Australia's exports rose by $171 million, with gains in the value of rural goods (up $157 million), non-monetary gold (up $141 million) and travel services (up $81 million), while imports fell by $222 million, led by an increase in the importation of fuels and lubricants (up $294 million).

Global

The situation in the US remains mixed, with positive growth and manufacturing figures tempered by a poor jobs result. US non-farm payrolls showed the country added 38,000 jobs in May, the smallest gain since September 2010 and well below the expected 162,000.

The unemployment rate fell 0.3 percentage points to 4.7%, driven by expansion in the health care sector, although the number of persons employed part time for economic reasons further increased, and 1.7 million Americans remain marginally attached to the workforce.

US Q1 GDP was revised upwards in May to 0.8% from the advance estimate of 0.5%. While positive, the revision was slightly below the expected estimate of 0.9%, and still much reduced from the Q4 2015 growth rate of 1.4%. The improved GDP result reflected positive contributions from consumer spending (up 1.9% in Q1) and home building, as well as state and local government spending.

The ISM Manufacturing PMI rose from 50.8 to 51.3, beating expectations and recording the third consecutive above-50 reading. Inventories continue to shrink, although prices have increased steadily for the past three months, while new orders and production continue to grow, albeit at a slower pace.

While there was no FOMC meeting in May, the minutes of the April meeting reveal the Committee's concerns about growth, although participants agreed that labour market conditions were improving and global risks had receded. The minutes reflect the Committee's intention to increase rates gradually, but how this will play out in practice is still unclear. St Louis Fed President James Bullard commented at the end of May that the market appeared "well prepared" for a summer rate hike, although this seems less likely following the weak jobs data. US consumer prices rose 0.4% in April across all items, while core inflation (less food and energy) rose by 0.2%, which was in line with expectations.

US retail sales increased by 1.3% in April, following a reduction of -0.3% in March, driven primarily by auto dealers, gasoline stations, and non-store retailers. However, the CB Consumer Confidence Index fell to 92.6 in May from an upwardly revised 94.7 in April, taking the index to its lowest level in six months.

European markets continued to brace for the UK's Brexit referendum. With the 23 June vote nearing, the Bank of England again sounded concerns about the risks of a possible exit from the EU. In its quarterly Inflation Report, Mark Carney warned that recent weakness in UK growth reflected the upcoming vote and the surrounding uncertainty, warning that a vote to leave "could have material economic effects".

On 2 June, the ECB left its key rates on hold, with the rates on main financing operations, marginal lending facility and deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively. The Bank also announced that it will start making purchases under its corporate sector purchase program (CSPP) starting on 8 June.

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GDP in the Euro area grew by 0.5% in Q1 2016—an improvement on previous quarters but still precariously low. Deflation continues to plague the continent, and unemployment, while it has been reduced from its 2013 high, remains steady at 10.2%. Estimated inflation throughout the Eurozone rose in May, up from -0.2% to -0.1%.

German GDP grew by 0.7% in Q1 2016, up from 0.3% in the final quarter of 2015. The German Markit/BME Manufacturing PMI reached a four-month high, rising from 51.8 to 52.1 in May, driven by production growth and job creation. Although the index posted slightly above its long-run series average (51.9), growth has been mostly flat since 2013 and well below pre-2008 levels.

Early in May, Greece's parliament passed a package of pension and tax reforms designed to unlock additional bailout money. The vote caused significant division among governing Syriza members. While Greece has remained under the radar since last year, it will undoubtedly reappear.

The official Chinese manufacturing PMI showed a very modest expansion in manufacturing activity, remaining steady at 50.1 in May. The 'unofficial' Caixin China Manufacturing PMI still shows a consistent contraction in the manufacturing economy since March 2015, with the PMI falling further from 49.4 to 49.2. CPI for April remained relatively strong at 2.3% y/y, below the market's expectation of 2.4%.

In emerging markets, Brazil's economy contracted further in Q1 2016, with y/y growth recording -5.4%. Likewise, Russian GDP fell in the first quarter by -1.2% y/y, an improvement on the large fall of -4.6% in September 2015. Indian GDP growth remains robust according to official figures, accelerating to 7.9% in Q4 2015 (the highest since 2011).

Commodities

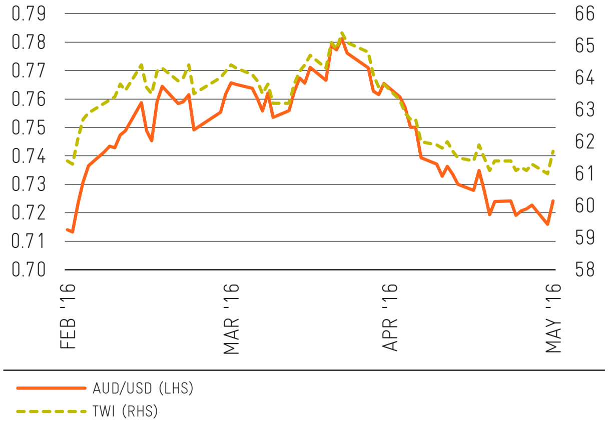
Energy prices continued their push higher in May, with the WTI crude oil spot price rising from US $45.98/b to $49.10/b (6.93%), and Brent crude rising from US $45.64/b to $49.26/b (7.93%). Oil shares remained bullish throughout the month amid hopes of an ever-elusive OPEC agreement to cut production.

Metals were down in May, with Aluminium (-7.3%), Copper (-7.5%), Lead (-5.8%), Nickel (-10.7%), Tin (-5.3%) and Zinc (-0.8%) all falling. Gold also fell, moving -6.1% to US $1215.32/oz. Iron ore resumed its price slide, with the price of iron ore delivered to Qingdao in China falling from US $66.24 to $50.15 per tonne (-24.3%), after shooting above $70 mid-way through April. Australia's May Budget forecast a price for iron ore of US $55, with the risk of a sustained fall threatening budgeted revenue.

Currencies

The AUD fell against the USD in May from 0.7603 to 0.7234 (-4.9%) after reaching a low of 0.7182 late in the month. In trade weighted terms the AUD fell -3.3%, losing against major currencies including EUR (-2.1%), GBP (-4.0%), JPY (-1.1%) and NZD (-1.9%).

AUD/USD and Trade Weighted Index



Source: Lonsec, ABS

The US Dollar Index closed May 3.0% higher, gaining against major currencies including EUR (2.9%), GBP (0.9%), JPY (4.0%) and CHF (3.5%). As Fed officials prepared the market for a possible rate rise as early as June, the USD strengthened as capital flowed back to the US (and away from emerging markets).

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