Economic Overview

For the first time in a decade, the world's major economies are growing in sync. All 45 countries tracked by the Organisation for Economic Cooperation and Development are on track to grow this year, and 33 of them are poised to accelerate from a year ago, according to the OECD. All the major developed world central banks – the US Federal Reserve, the European Central Bank and the Bank of Japan – have been buying government bonds as part of their quantitative easing (QE) programs. However, these programs are probably past their use-by date, with central banks now acknowledging their shortcomings. For example, the ECB asset purchases may have become counterproductive. By raising consumer savings, reducing income growth, lifting asset prices and harming bank profitability, QE in Europe has led to less lending to businesses. The question is whether central banks can unwind their QE programs if inflation is falling or low and stable. The coming months and years will see the tussle between cyclical inflation, which is driven by oil prices and the ongoing structural deflation headwinds of technology and globalisation.

US consumer confidence surged to a five-month high in August as households grew increasingly upbeat about the labour market while house prices rose further in June, suggesting a recent acceleration in consumer spending was likely to be sustained. The data also supported views that economic growth would accelerate in the second half of the year after a sluggish performance earlier.

The Conference Board said its consumer confidence index increased to a reading of 122.9 in August from 120.0 in July. That was the strongest reading since March when the index hit a 16-year high of 124.9. August was also the second highest reading since 2000. The S&P CoreLogic Case-Shiller composite index of house prices in 20 metropolitan areas rose 5.7% in June on a year-over-year basis after a similar increase in May.

US retail sales recorded their biggest increase in seven months in July as consumers boosted purchases of motor vehicles and raised discretionary spending, suggesting the economy continued to gain momentum early in the third quarter. Retail sales for June and May also were revised higher. Retail sales jumped 0.6% in July, the largest gain since December 2016. June's retail sales were revised to show a 0.3% gain instead of the previously reported 0.2% drop.

A basket of US employment indicators increased in August, suggesting solid job growth in the months ahead. The Conference Board said its employment trends index rose to 134.62 in August from its revised July reading of 133.60. The August figure represents a 5.6% increase from a year ago. The Conference Board's employment trends index combines eight market indicators, including industrial-production figures from the Federal Reserve, job openings from the Bureau of Labour Statistics and jobless claims from the U.S. Department of Labour. The index filters out volatility in data to more clearly reveal underlying trends in employment conditions.

US lawmakers reached a deal with President Donald Trump to extend the US debt limit and fund the government through to mid-December. The deal also included a Hurricane Harvey relief package. Economists expect President Trump and his fellow Republicans to pass tax-cut legislation by November 2018. However, the policy changes though are only expected to add 0.2 percentage point to the pace of gross domestic product expansion in 2018.

The euro-area economy grew 0.6% in the second quarter as more nations joined the recovery. Growth was supported by Germany, the region's largest economy, and the strongest Spanish performance in almost two years. The upswing is finally starting to spread across the 19-nation region. Exports and investment have led France to its strongest continuous expansion since 2011 and the Netherlands posted the fastest growth since the end of 2007. Italy, which has lagged the pickup of its peers, is starting to shake off its reputation as the sick man of Europe with an increase in gross domestic product that may top 1% this year for the first time since 2010.

Unemployment in the eurozone fell to 9.1% in June, its lowest figure since February 2009. Greece remained the EU country with the highest unemployment rate with 21.7% out of work, down 0.8 percent from May. Meanwhile, the lowest rates were recorded in the Czech Republic at 2.9%, while Germany had the second-lowest jobless rate at 3.8%.

Inflation in the eurozone picked up markedly in August. The annual inflation rate climbed to 1.5% from 1.3% in July. Consumer prices in Germany rose by 1.8% in August year on year. August's rate of inflation was 0.1 percentage points higher than in July. Euro-area economic confidence rose to the highest level in a decade. An index of industry and consumer sentiment increased to 111.9 in August from a revised 111.3 in July.

Britain's trade position with the rest of the world worsened in June as the sharp fall in the value of the pound since the Brexit vote failed to lift sales of UK-made goods abroad. The trade in goods deficit widened unexpectedly to £12.7bn, from £11.3bn in May, as exports fell by 2.8% but imports rose by 1.6%. It was the biggest deficit in nine months.

The Japanese economy grew at an annualised rate of 4% in the second quarter of the year ending in June compared to the previous year. The Japanese Manufacturing PMI rose to 52.2 in August of 2017, compared to a final reading of 52.1 in July. The marginal improvement was explained by better operating conditions and demand as output, new orders and employment all expanded. New work increased for the eleventh straight month and purchasing activity strengthened while delivery times lengthened for the sixteenth straight month.

China's official manufacturing PMI rose to 51.7 in August. Meanwhile, the official services PMI dropped to 53.4 in August, compared with 54.5 a month earlier. China formally laid down new rules on overseas investments, making explicit its de facto campaign against "irrational" acquisitions of assets in industries ranging from real estate to hotels and entertainment. The authorities set out three categories -- banned, restricted and encouraged -- outlawing investments in gambling and sex industries, while backing companies to support the nation's ambitious "One Belt and One Road" initiative backed by President Xi Jinping. Property, hotel, film, entertainment and sports investments will now be subject to restrictions.

- Banned: Core military technology, gambling, sex industry, investments contrary to national security
- Restricted: Property, hotels, film, entertainment, sports, obsolete equipment, investments that contravene environmental standards
- Encouraged: Investments that further the One Belt and One Road framework, enhance China's technical standards, research and development, oil and mining exploration, agriculture and fishing

Moody's Investors Service kept its forecast for G20 economic growth at just over 3% for this year and next, but warned of geopolitical risks, US protectionism and spill overs from global monetary tightening and China's deleveraging measures. The ratings agency said surprisingly strong data in the first half of the year prompted it to raise 2017 growth forecasts for China to 6.8% from 6.6%, for South Korea to 2.8% from 2.5%, and for Japan to 1.5% from 1.1%. It also expected the euro zone to accelerate in the rest of the year as suggested by robust sentiment indicators and revised upwards its forecasts for Germany, France and Italy. The agency cut its forecast for the United States, however, to 2.2% in 2017 and 2.3% in 2018 from a previous 2.4% and 2.5%, respectively, citing its weaker-than-expected first half performance and expectations of more modest fiscal stimulus than previously assumed.

Interest Rates & Currency

In the minutes released from the Federal Open Market Committee's July meeting, when central bank policymakers voted to hold the target rate to a range of 1% to 1.25%, one side preached caution in a low-inflation environment while the other side worries over the price of delaying. *"Some participants"* who counselled patience expressed *"concern about the recent decline in inflation"* and said the Fed *"could afford to be patient under current circumstances."* They *"argued against additional adjustments"* until the central bank was sure that inflation was on track. On the other side, more hawkish members *"worried about risks arising from a labour market that had already reached full employment and was projected to tighten further."* Backing off from a steady diet of rate hikes could cause the Fed to overshoot its employment target and cause financial instability, they said.

One area that seemed to draw strong consensus was in the plan to reduce the Fed's $4.5 trillion "balance sheet" of bonds it accrued during three rounds of stimulus that began during the financial crisis. Members agreed that the process of reducing the balance sheet should begin "relatively soon," with some members arguing for a more concrete date to be set. Fed watchers largely expect the central bank to announce the roll-off at the September meeting and begin shortly thereafter. Under the program, the Fed will set a cap for how much of the proceeds it receives will roll off each month, and then continue to reinvest the rest.

The Bank of Japan reduced the size of its purchases of Japanese government bonds (JGB) with a remaining life of 5- to 10-years to Y410 billion per operation from Y440 billion. The cut in JGB buying is aimed at preventing the 10-year bond yield from falling further amid continued tight supply-demand conditions. The 10-year bond yield fell to 0.020% Thursday, the lowest level since May 2. Under its yield curve control policy, the BOJ is targeting a 10-year yield of around zero percent.

The BOJ wants to slow the rise in its Japan government bond holdings to make an eventual unwinding of its aggressive easing policy smoother but is being extra careful to ensure that smaller JGB purchases do not ignite a rise in the yen exchange rate.

The RBA's September board meeting again held the cash rate at 1.50% as widely expected. Overall, the RBA policy stance remains broadly ‘neutral’ with an identical policy outlook concluding that *"holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time”*, and repeating the prefix the *“low levels of interest rates is continuing to support the Australian economy”*, which suggests a lack of urgency to hike rates. UBS view is *“They still see improving global growth supporting better domestic GDP & gradually higher CPI, with recent data providing them a bit more confidence. Looking ahead, we still expect the RBA to stay on hold until 2H-18; while more broadly they assess the impact of macroprudential policy tightening on housing, and the unusual divergence between gloomy consumers vs booming business conditions.”*

No change in the RBA cash rate is expected in the near term. Our preference remains for both short dated fixed-rate and floating-rate securities of high investment grade corporates.

Closing Rates as at 31 August 2017					
	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	1.50%	1.50%	US Fed Funds Rate	1.1600%	1.1600%
90 Day Bank Bills	1.76%	1.73%	AUD/USD	78.98	79.87
180 Day Bank Bills	1.77%	1.72%	US 10 Year T-Bond	2.15%	2.29%
5 Year Govt Bonds	2.244%	2.184%	US 30 Year T-Bond	2.76%	2.90%
10 Year Govt Bonds	2.721%	2.691%	Japan 10 year yield	0.009%	0.077%

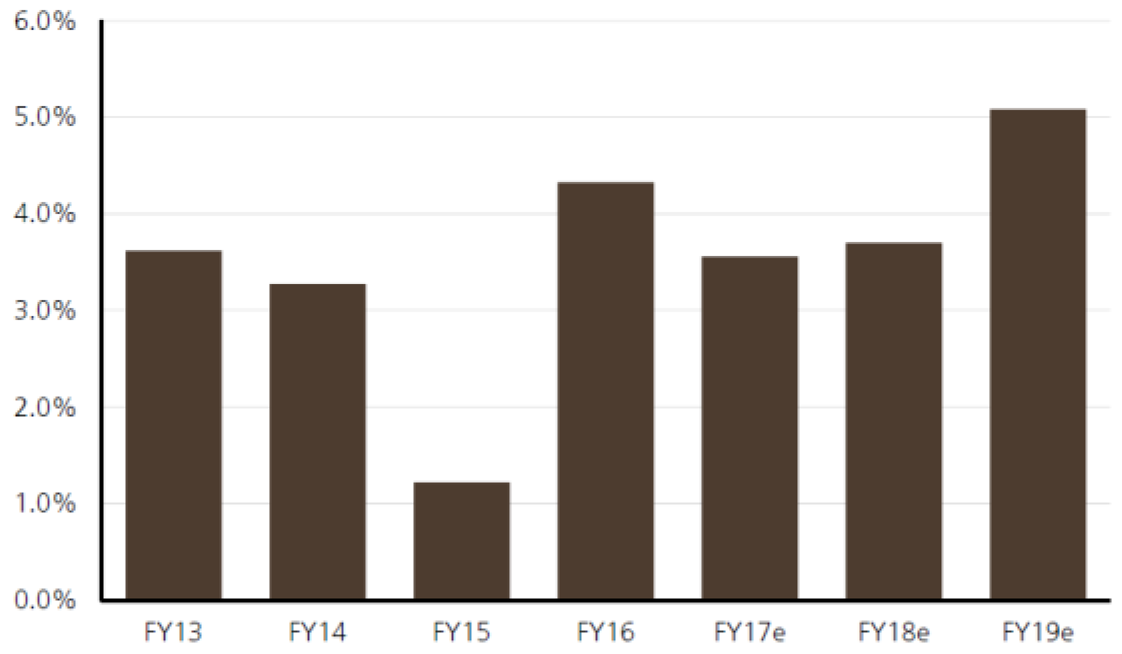
Stance: Corporate - Positive variable rate and investment grade
Government - Underweight

Australian Shares

According to UBS, *"Reporting season is now complete. Results and guidance have come in on the marginally disappointing side of expectations with FY18 estimates on average coming down 1-2% for stocks that reported. Size weighted market EPS growth for FY17 looks set to come in around 18%. This is skewed by the more than doubling of earnings in resource sector in FY17. Excluding resources, size weighted growth is around 6%. This drops to around 4% for the median or typical top 100 company. For FY18 growth estimates for the market are only around 2% due to the consensus assumption that resource sector earnings fall back again. While early days, at spot commodity prices there is currently significant upside to consensus resource sector estimate for FY18. The revision trend for the market ex resources is downward albeit the trend remains reasonably benign."*

[1] Previous rate or level represents the rate or level as at the end of the previous month.

Figure 2: Revenue Growth for Industrials (ex Financials)



Source: UBS

The franked dividend yield above the term deposit rate continues to provide support for equity valuations. With the low cash rate, we believe there should be continued support for equity valuations and gross yields from equities.

Closing Rates as at 31 August 2017					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	5,776.3	5,773.0	AOX Earnings Yield	6.41%	6.37%
PE Industrials (2018)*	15.7x	16.6x	Div Yld Indust (2018)*	4.7%	4.6%
PE All Ords (2018)*	15.6x	15.7x	Div Yield All Ords (2018)*	4.4%	4.4%

*Source – UBS

Stance: Neutral

[1] Previous rate or level represents the rate or level as at the end of the previous month.

International Shares

Betashares' view is *"Despite concerns over global equity valuations, good growth in corporate forward earnings has remained a major support factor over the past year – so much so that global price-to-earnings valuations have been broadly stable during the 2017 rally so far. With growth still solid in the US and improving in Japan, Europe and Emerging Markets, the global earnings outlook remains positive. At the same time, given low bond yields, overall global equity valuations are broadly in a fair-value range. With global inflation stubbornly low, moreover, central banks are likely to remain reticent to withdraw monetary stimulus quickly, which suggests bond yields may at worst rise only modestly over the next three to six months. That said, after consistently solid monthly gains since late 2016, global stocks seem due for a period of consolidation at least, if not a corrective pull back. While the specific catalyst for this pull back remains unclear, likely candidates include concerns over North Korea, government shutdown/debt ceiling concerns in Washington, or a more abrupt lift in bond yields."*

US equities have risen based on earnings growth, PE expansion and having priced in tax cuts and better business conditions. There is risk of a pullback, if earnings growth disappoint or if the tax cuts or additional infrastructure spending do not eventuate as initially proposed.

Closing Rates as at 31 August 2017					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
US Dow Jones	21,891.12	21,349.63	Nikkei Dow	19,925.18	20,033.43
S&P 500	2,470.30	2,423.41	Hang Seng	27,323.99	25,764.58
FTSE 100	7,372.00	7,312.72	MSCI	1,961.1	1,916.4

Stance: **Neutral, and take advantage of stronger AUD to purchase international shares if currently underweight international shares**

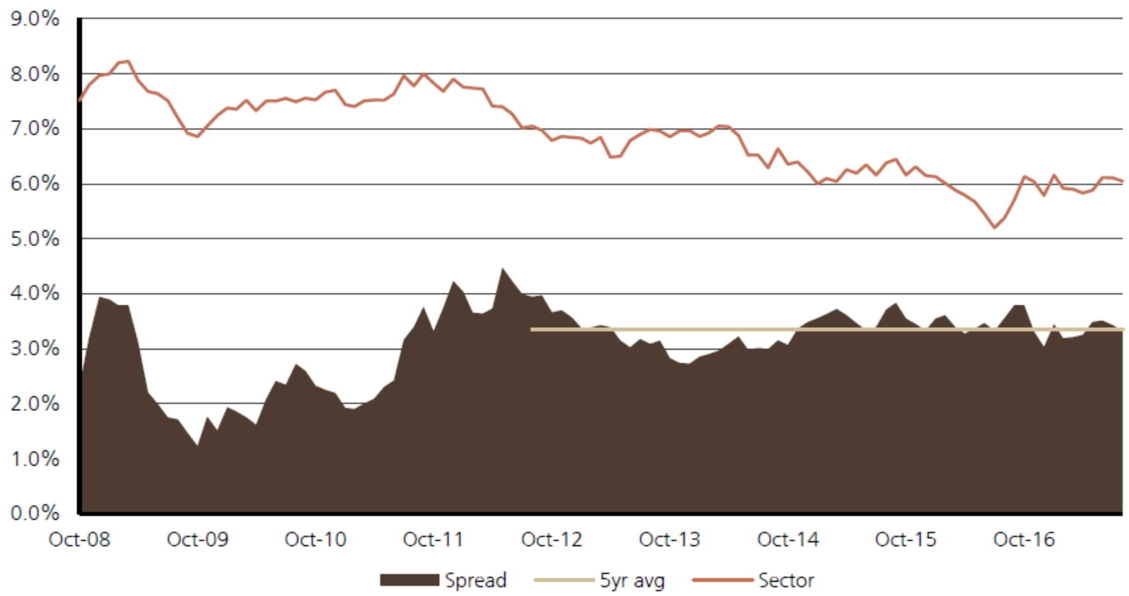
Property

National dwelling values remained flat during August as capital city values edged 0.1% higher and regional values slipped 0.2% lower, CoreLogic's index showed. CoreLogic head of research said that this "steady" result provides further evidence that the housing market has moved through its peak growth phase. Rental yields slipped to a new record low across Australia in August. Nationally, the gross yield on a dwelling reduced to 3.62% in August, down from 3.87% in August last year. While there was a reduction in gross rental yields across each of the capital cities over the past 12 months, only Melbourne (2.9%) and Sydney (3.0%) are recording rental yields at record lows.

[1] Previous rate or level represents the rate or level as at the end of the previous month.

UBS view for Australian retail REITs is that, *"We see the sector as a whole at a discount to fair value but there is considerable dispersion within. The sector is trading at a 5.8% discount to our blended price targets versus a 5% long term average discount. The growth in Australian property fundamentals has peaked (peak NTA growth, Sydney effective rent growth, slowing retail sales and slowing residential sales activity). However the valuation of the sector is not stretched as transactional activity continually supports NAV growth."*

AREIT property yield spread to bonds: Current spread is 330bps v 330bp 5yr avg



The REIT sector has been impacted by rising long term bond yields. Earnings per share growth will be key in determining whether distributions can grow.

Closing Rates as at 31 August 2017		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,315.9	1,309.9

Stance: **Commercial/Listed - Neutral**
Residential - Neutral, with a negative bias

[1] Previous rate or level represents the rate or level as at the end of the previous month.

IMPORTANT INFORMATION

Note that this is general advice that does not take into account the current financial circumstances or financial needs of any individual which should be considered when making investment decisions and in consultation with an appropriately qualified adviser.

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