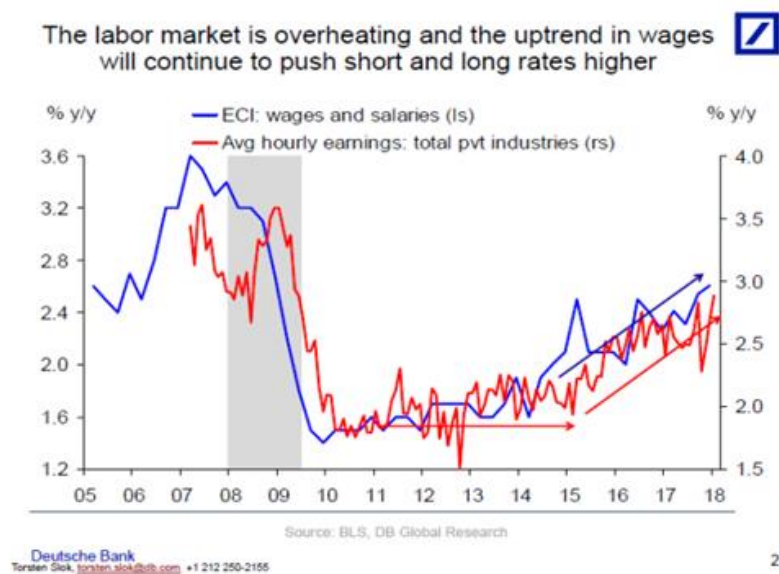


Economic Overview

Some investors believe that because the current bull market and economic expansion have gone on for some time, a bear market and a recession will take place soon. At this stage, there are no signals that usually warn of a coming recession, such as a loss of economic momentum or an inverted yield curve. A market correction could still happen at any time, because of the overly optimistic sentiment. Whilst central banks continue to unwind their quantitative easing policies, politics have generally become more favourable to the economy. Politics has moved from fearing debt and deficits, to using fiscal policy to support growth, as seen in the US where tax cuts have just been legislated.

Inflation would be a keenly watched indicator this year. Last year inflation did not accelerate as much as expected as the stabilisation in oil prices and moderate wage growth saw headline inflation growing at a moderate level. The question this year is whether the tight labour market in the US leads to an acceleration in wages and core inflation. The US unemployment rate has fallen to around the historical tipping point that has led to rising wages and inflation. The change in inflation expectations would lead to volatility to rise sharply as markets adjust to the new regime. As the economic fundamentals remain positive, the volatility may present buying opportunities.

In the US, the January change in nonfarm payrolls was above market at 200,000 (vs. 180,000 expected), while average hourly earnings growth also increased at a faster than expected rate of 2.9% year-on-year (vs. 2.6% expected) - the highest annual pace since June 2009. The unemployment rate was in line and steady for the fourth month at 4.1%. Based on the chart below, the higher wage increase number is not just a one-off event. Instead, it is a continuation of the trends we have seen in recent years both in employer labour costs and take-home pay for workers.



The number of American workers voluntarily quitting their jobs jumped in December to the highest level in nearly 17 years, in a strong show of confidence in the labour market which further bolsters expectations of faster wage growth this year. The number of workers willingly leaving their jobs increased by 98,000 to 3.259 million, the highest level since January 2001. That lifted the quits rate to a 2.2% from 2.1% in November. This rate, which the Federal Reserve looks at as a measure of job market confidence, has rebounded from a low of 1.3% in late 2009.

The GDP of the European Union area expanded by 2.5% in 2017, the most rapid rate of growth since a 3.4% expansion in 2007, the year before the global financial crisis broke. Inflation in the 19 countries sharing the euro dipped to 1.3% in January from 1.4% in December, in line with expectations and reinforcing projections that any rise in the months ahead will be slow, at best. The Euro area January PMIs were revised slightly higher, with composite PMI up 0.2 to 58.8 and services PMI up 0.4 to 58.

Romania was the fastest growing economy in the EU last year, with an estimated GDP growth rate of 6.4%. Poland, the Czech Republic and Hungary are also growing more quickly than major economies in Western Europe and boast low unemployment. Of the 12 EU members forecast to grow by 3% or more this year, nine are former communist countries in the east of the continent.

UK consumer price inflation fell from 3.1% in November back to 3% in December. This was the first decrease recorded for six months, with the fall fuelling hopes that inflation has peaked following a near six-year high.

Japan's wholesale prices rose 2.4% in 2017, increasing on an annual basis for the first time in three years amid soaring energy costs. However, the upward trend in wholesale prices has been slow to translate to inflation gaining momentum toward the Bank of Japan's 2% target, as businesses remain wary of raising the prices of their products and services for fear of chasing away frugal consumers. Core consumer prices, minus volatile fresh food prices, rose just 0.9% in November from a year earlier.

China's economy grew faster than expected in the fourth quarter of 2017, as an export recovery helped the country post its first annual acceleration in growth in seven years. China's gross domestic product grew 6.8% in the October to December period from a year earlier. Growth for the 2017 full year picked up to 6.9% year-on-year, the first annual acceleration for the economy since 2010. China's manufacturing PMI for January fell slightly to 51.3 from 51.6 the month prior.

The International Monetary Fund revised up its forecast for world economic growth in 2018 and 2019, saying sweeping US tax cuts were likely to boost investment in the world's largest economy and help its main trading partners. However, the IMF, in an update of its World Economic Outlook, also added that US growth would likely start weakening after 2022 as temporary spending incentives brought about by the tax cuts began to expire.

Economic gains from the tax cuts would be partially paid back later in the form of lower growth as temporary spending incentives, notably for investment, expired and as rising federal debt took a toll. The IMF now expects US to expand by 2.7% in 2018, much higher than the 2.3% the fund forecast in October. U.S. growth was projected to slow to 2.5% in 2019. The IMF forecasted Eurozone growth to 2.2% (+0.3ppt) and China to 6.6% (+0.1ppt). The IMF cautioned that higher inflation could prompt the Fed to raise its cash rates faster than expected, leading to a tightening in financial conditions around the world. Hence, policy makers should take steps to raise potential growth and increase resilience to shocks, such as reforms to lift productivity and proactive financial regulation.

Interest Rates & Currency

As widely expected, there was no change in US rates in February but the statement from the Federal Reserve Open Market Committee seemed to consolidate the view that more rate hikes are possible. The committee expects that *“economic conditions will evolve in a manner that will warrant further gradual increases in the federal funds rate”*, with the word “further” being added. Inflation is *“expected to move up this year and to stabilise”* around the goal.

The European Central Bank (ECB) reaffirmed its ultra-easy policy stance, promising to keep rates steady until well after the end of its bond buys and maintaining a pledge to boost the purchases, if necessary. It kept rates at record lows, confirmed that monthly bond purchases would continue at 30 billion euros (US\$37.16 billion) a month until the end of September, and said it stood ready to expand or lengthen its asset-purchase programme if the inflation outlook worsens. On rates and inflation, Mr Draghi, who is the ECB president, noted that *“while our confidence that inflation will converge toward our aim of close to 2% target has strengthened, we cannot yet declare victory”*. Further, he added *“monetary policy will evolve in a fully data-dependent and time consistent manner”* and that *“...patience and persistence with regard to monetary policy is still warranted for underlying inflation pressure to build up”*.

The Bank of England (BoE) is turning its focus back to the more conventional business of bringing down inflation as Britain’s economy showed it was getting over the damage wrought by the 2007-09 financial crisis, Governor Mark Carney said. Carney said wages were gradually rising, something the central bank wants to see as it considers when to follow up on November’s first rate hike in a decade. Wages should soon start growing faster than inflation, Carney added. *“The firming of the labour market and the pick-up in wages over the course of the next few years appears to be on track, so there is a prospect of a return of real income growth later this year.”* Economists mostly expect the next BoE rate hike in the second half of 2018.

The Bank of Japan (BOJ) acted decisively in early February to curb a rise in bond yields, offering “unlimited” buying in long-term Japanese government bonds (JGBs). Heavy buying of JGBs raises the price of bonds to force down their yield, an essential element of the BOJ’s

ultra-loose yield curve control policy. It was the first time in more than six months that the BOJ has conducted special operations to buy bonds to achieve the yields it wants to see, rather than the auctions used in regular operations. On top of that, the BOJ increased the amount of its planned buying in five- to 10-year JGBs to 450 billion yen from the 410 billion amount it has favoured since late August. Japanese Prime Minister Shinzo Abe said he hoped the central bank would continue to promote “bold” monetary easing, as the economy has yet to emerge decisively from deflation.

The RBA's February board meeting again held the cash rate at 1.50% as widely expected. Its policy outlook remains ‘neutral’, keeping the conclusion 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”*. UBS view is *“We still expect the RBA to keep the cash rate on hold until 2019, despite our modestly more positive growth outlook, given we think the RBA will wait for inflation to follow growth before hiking.”*

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 investment grade corporates.

Closing Rates as at 31 January 2018					
	Rate	Rate (Prev) ¹		Rate	Rate (Prev)
Cash	1.50%	1.50%	US Fed Funds Rate	1.4200%	1.4200%
90 Day Bank Bills	1.775%	1.795%	AUD/USD	80.73	78.37
180 Day Bank Bills	1.77%	1.80%	US 10 Year T-Bond	2.71%	2.41%
5 Year Govt Bonds	2.410%	2.368%	US 30 Year T-Bond	2.96%	2.74%
10 Year Govt Bonds	2.800%	2.666%	Japan 10 year yield	0.085%	0.047%

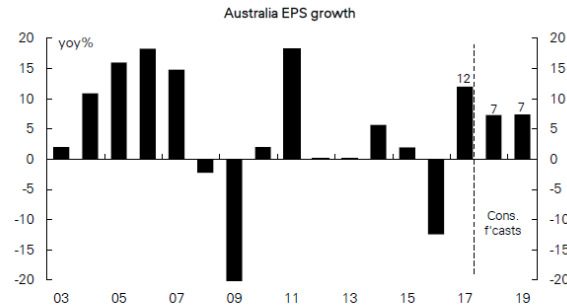
Stance: **Corporate** - **Positive variable rate and investment grade**
 Government - **Underweight**

Australian Shares

Deutsche Bank’s view is *“After five lean years, earnings growth staged an impressive return in FY17. Analysts expect another year of good growth in FY18. Of course, analysts always expect good growth, but pleasingly FY18F earnings have proved resilient in the past six months, which inspires confidence.”*

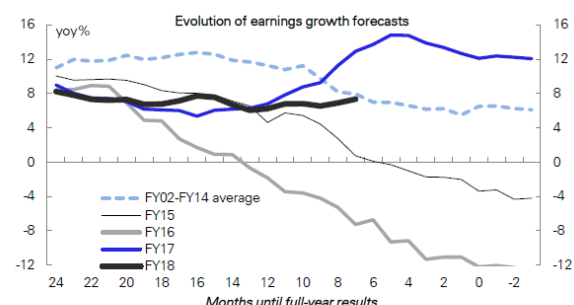
¹ Previous rate or level represents the rate or level as at the end of the previous month.

Figure 1: Analysts are forecasting high single-digit earnings growth in FY18



Source: IBES, Datastream, Deutsche Bank

Figure 2: FY18 eps growth forecasts have proved resilient in the past 6 months, which inspires confidence



Source: IBES, Datastream, Deutsche Bank

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

Closing Rates as at 31 January 2018					
	Level	Level (Prev) ¹		Rate	Rate (Prev)
All Ordinaries	6,146.5	6,167.3	AOX Earnings Yield	6.21%	6.29%
PE Industrials (2018)*	16.5x	16.7x	Div Yld Indust (2018)*	4.6%	4.6%
PE All Ords (2018)*	16.1x	15.9x	Div Yield All Ords (2018)*	4.4%	4.5%

*Source – UBS

Stance: Neutral

International Shares

Deutsche Bank's view is "Global equity revenue growth has been quite strong, for the first time since 2011. Median growth was below inflation in both 2015 and 2016; when nearly half of large-cap companies reported declining sales. 2017 marked a break from this trend. Median revenues of global equities are expected to grow by 4.1% in 2017—low by historical standards perhaps, but still the fastest for over five years. Moreover, revenue growth forecasts actually rose over the course of the year, the first time since 2010."

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

Figure 3: Revenue growth by region

	2015	2016	2017E	2018E	Δ in 2017 since Outlook
US	0.1%	2.1%	4.4%	3.6%	+0.9%
Europe	3.8%	1.8%	4.1%	3.0%	+0.8%
Japan	1.5%	-3.6%	4.8%	2.4%	+2.4%
GEMs	1.2%	0.6%	3.0%	4.3%	-1.2%
Global	1.5%	1.1%	4.1%	3.3%	+0.7%

Source: Deutsche Asset Management and CROCI. The table shows median revenue growth of companies covered by CROCI by regions. Data as on 26 October 2017.

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 inflation unexpectedly rises.

Closing Rates as at 31 January 2018					
	Level	Level (Prev) ¹		Rate	Rate (Prev)
US Dow Jones	26,149.39	24,719.22	Nikkei Dow	23,098.29	22,764.94
S&P 500	2,823.81	2,673.61	Hang Seng	32,758.73	29,919.15
FTSE 100	7,533.55	7,687.80	MSCI	2,213.2	2,103.47

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

Property

Home prices across Australia's major cities fell further in January as weakness spread out from the Sydney market in the face of tighter rules on investment lending. Property consultant CoreLogic said its index of home prices for the combined capital cities slipped 0.5% in January, after a drop of 0.4% in December.

Global REITs are down 4% on a total return basis in 2017 whilst global equities have delivered a 25% total return. JP Morgan believes the underperformance of REITs versus the broader market will continue in 2018. This is based on a backdrop of higher forecast GDP growth, lower US tax rates, and central bank normalisation. The prospective of higher long

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

term bond yields should see equity investors prefer exposure less correlated with bonds as REITs have traditionally been viewed as bond-proxies.

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 January 2018		
	Level	Level (Prev) ¹
S&P/ASX 200 A-REIT	1,358.1	1,404.90

Stance:

Commercial/Listed: Neutral
Residential: Neutral, with a negative bias

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