Market Overview and Outlook

Economic Overview

After months of uncertainty, investors are positioning themselves for the monetary policies of the US Federal Reserve and European Central Bank (ECB) to diverge. Top US central bank officials have been saying for months that they believed the US economic recovery was nearly robust enough to withstand an increase in the benchmark rate from nearly zero. In contrast, the head of the ECB has indicated that the ECB is about to inject more monetary stimulus into the Eurozone economy.

The US economy grew at a healthier clip in the third quarter than initially thought, with GDP expanding at a 2.1% annual rate instead of the 1.5% rate that was earlier reported. US corporate profits after tax fell at a 1.6% rate in the third quarter after rising at a 2.6% pace in the second quarter. Profits, which have been undercut by the dollar's strength and lower oil prices, were down 8.1% from a year ago, the biggest decline since the fourth quarter of 2008.

Early indications of wage pressures in pockets of corporate America have begun emerging in recent weeks, suggesting labour costs could be a bigger headwind for US companies in 2016. Wal-Mart, the world's largest retailer, has said next year's earnings could decline as much as 12%, partly because of costs to raise entry-level wages. The current federal minimum wage is $7.25 an hour, compared with proposals for minimums of $12 to $15 an hour.

The French economy returned to growth in the third quarter, putting the country on track to deliver its strongest full-year performance since 2011. GDP rose 0.3% in the three months through September after stalling in the previous quarter. With low oil prices and monetary stimulus powering consumer spending and demand for services, the economy has advanced 1.1% in the first three quarters of the year. Output in Germany, the eurozone's largest member, also increased by 0.3%. That marked a slight slowdown from the 0.4% growth rate recorded in the three months to June, reflecting the impact of weaker demand for the country's exports from China and other large developing economies.

Japan will raise the minimum wage by 3% each year from next fiscal year as part of a package of policies aimed at strengthening consumer spending and boosting economic growth. Raising wages is an urgent task to ramp up consumer spending. Japan’s minimum wage is 780 Yen ($8.80) per hour, and so a 3% increase will be minimal in real terms. The Prime Minister hopes to raise the national average minimum wage to 1,000 yen per hour.

China's Purchasing Managers' Index hit 49.6 in November, its lowest reading since August 2012 and down from the previous month's reading of 49.8. This marked the fourth straight month of contraction in the sector. The IMF will add the Chinese yuan to its basket of reserve currencies. The IMF’s executive board, which represents the fund’s 188 member nations, decided the yuan meets the standard of being “freely usable” and will join the dollar, euro, pound and yen in its Special Drawing Rights (SDR) basket. SDR is not a currency, but a claim to currency held by IMF member countries for which they may be exchanged. SDR are held as reserves as an alternative to gold or the US dollar. It is the first change in the SDR’s currency composition since 1999, when the euro replaced the Deutsche mark and French franc. The addition will take effect Oct. 1, 2016, with the yuan having a 10.92% weighting in the basket. Weightings will be 41.73% for the dollar, 30.93% for the euro, 8.33% for the yen and 8.09% for the British pound.

China accounts for nearly half of the world's luxury consumption, but Chinese consumers do most of their shopping outside of the country. The Chinese are expected to spend US$116.8 billion on luxury goods this year, accounting for 46% of the world's total. However, US$91 billion worth of luxury purchases, or 78% of all Chinese luxury consumption this year, happens outside of China, up 12% from last year. Increased buying overseas has led to a 1 percentage drop in China's luxury market share in the world's total, to 10%. 83% of luxury brands have closed some of their retail outlets in China this year and closures will continue. It is predicted the existing shops will overhaul to focus on experience and service as more consumers opt to purchase online.

The OECD trimmed its global economic forecasts as slower growth in emerging markets spilled over into countries such as Germany and Japan. World output will expand 2.9% in 2015 and 3.3% in 2016, down from the 3% and 3.6% predicted in September. With Russia and Brazil in recession and China poised to deliver its weakest expansion in more than two decades, the economies that powered world growth in recent years are now slowing it down. The OECD barely changed its forecasts for Chinese output, pegging growth at 6.8% this year and 6.5% in 2016. Yet Brazil’s economy is now seen shrinking 3.1% this year and 1.2% next. Russian GDP is on track to drop 4% in 2015 and 0.4% next year.

Interest Rates & Currency

The governor of the Reserve Bank of Australia has predicted that global interest rates will remain low for the better part of this decade. There is a likelihood that the Federal Reserve will raise the fed funds rate in December or, if not then, pretty soon. Once it does, intense speculation will begin about a question much more important than the timing of the first increase, namely the timing of the second and, by extension, the future path of the funds rate. It is likely that the pace of increase will be very gradual. The ECB and the Bank of Japan are a long way from even thinking about higher interest rates; the ECB is openly contemplating further easing. So the average policy rate in major money centres may be very low for quite a while.

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Net issuance of US Treasuries will tumble 27% next year, according to estimates by dealers. The $418 billion of new supply would be the least since 2008 due to a falling budget deficit. The drop-off in longer-term debt supply may keep a lid on yields, providing another reason to believe the Federal Reserve can end an unprecedented era of easy money without causing a jump in borrowing costs.

Bank of England Governor Mark Carney said policy makers are debating when to remove emergency policy settings almost seven years after benchmark borrowing costs were cut to a record-low. Carney also said the U.K. will have low interest rates "for some time" and the pace of tightening will be "limited."

Bank of Japan (BOJ) Governor Haruhiko Kuroda repeated that the BOJ will continue its aggressive easing program until 2% inflation is anchored as the economy is still halfway toward the price target. The latest data showed that consumer prices excluding fresh food and energy rose 1.2% on year (in September), which is half of the 2% inflation target.

The RBA at its December Board meeting held the cash rate unchanged at a record low 2.00%, as expected (after cutting in May by 25 basis points). UBS' view is *"Amid low inflation, the RBA still left the door open for further easing, if needed to lend "support to demand". Hence, the pick-up in credit growth to a post-GFC high (and with economy-wide leveraging the fastest on record), combined with better jobs and business conditions data, suggest the RBA is likely reluctant to ease again, and hence we continue to see the RBA on hold next year."*

Unless economic conditions deteriorate significantly in Australia, it is unlikely the RBA will further reduce rates in the coming months. Our preference remains for both short dated fixed-rate and floating-rate securities of high investment grade corporates.

Closing Rates as at 30 November2015

	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	2.00%	2.00%	US Fed Funds Rate	0.1200%	0.1200%
90 Day Bank Bills	2.29%	2.12%	AUD/USD	71.89	70.99
180 Day Bank Bills	2.24%	2.00%	US 10 Year T-Bond	2.23%	2.14%
5 Year Govt Bonds	2.310%	2.070%	US 30 Year T-Bond	2.99%	2.92%
10 Year Govt Bonds	2.849%	2.629%	Japan 10 year yield	0.303%	0.313%

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

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

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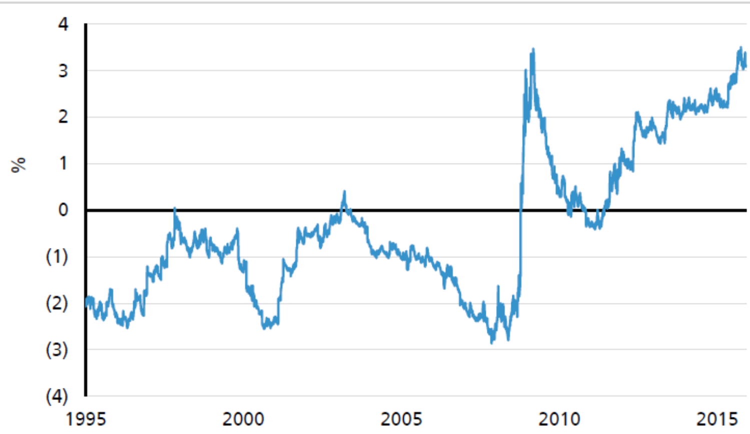
Australian Shares

UBS' view is, *"We expect Australian equities to edge higher in 2016 based on a moderate rise in global equities, a lower A$ and a benign but constrained growth outlook for the domestic economy. The beginning of a Fed tightening cycle has typically not been a bearish omen for global or local stocks from a 6-12 month return perspective. Earnings growth has been constraining the local market's performance with FY15E growth at -4% and FY16E growth of close to zero. We expect a return to mid to low single digit growth in FY17 though we see a considerable risk around resource sector estimates in particular. Earnings growth is looking better ex resources and banks, with this portion of the market tracking at a moderately above trend 7-8%, helped by the A$."*

Figure 27: Australian Market Dividend Yield less Cash Rate



Source: I/B/E/S, Datastream

Dividend yields are attractive compared to prevailing interest rates.

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

Closing Rates as at 30 November2015					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	5,218.2	5,288.6	AOX Earnings Yield	6.37%	6.37%
PE Industrials (2016)*	15.1x	14.9x	Div Yld Indust (2016)*	4.9%	5.0%
PE All Ords (2016)*	15.7x	15.7x	Div Yield All Ords (2015)*	5.2%	5.1%

*Source – UBS

Stance: Neutral – Underweight portfolios should look to add

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

International Shares

According to BlackRock, *"The U.S. stock market has experienced a nearly uninterrupted advance each year for the past six years. The strength of the rally has been notable for its duration, the near absence of volatility and the length of time between corrections. The advance in the S&P 500 took root in traditional fundamental factors, such as earnings growth and a sustained (although subpar) economic expansion, but it also took considerable support from an unusually accommodative monetary policy environment at a time when the market had become exceptionally cheap. These tailwinds have begun to fade with earnings growth slowing, the economic expansion aging and monetary policy poised to turn less accommodative. In addition, current stretched valuations would anyway indicate more limited upside for U.S. stocks."*

We expect geopolitical events occasionally giving rise to market volatility. Take advantage of market volatility, more reasonable valuations and better industry diversification compared to Australian shares to purchase international shares.

Closing Rates as at 30 November2015					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
US Dow Jones	17,719.92	17,663.54	Nikkei Dow	19,747.47	19,083.10
S&P 500	2,080.41	2,079.36	Hang Seng	21,996.42	22,640.04
FTSE 100	6,356.09	6,361.09	MSCI	1,694.4	1,705.8

Stance: **Neutral with positive bias**

Property

Sydney and Melbourne home values have posted their first quarterly decline since the start of the housing boom in 2012, according to CoreLogic RP Data. Sydney prices fell 1% in the three months to November and Melbourne declined 0.5%. Dwelling values fell in five of the eight capital cities in Australia over the month, taking the combined capitals index 1.5% lower.

The outlook for government long term bond yields is important because they are used as a point of reference for real estate investors for valuations in the broader property trust index. BT Investment Management's view is that *"The current lofty sector premium to net tangible asset backing doesn't look overdone if the expected cap rate compression flows through in the next six months. Under that scenario, the sector looks fair value in our view."*

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

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The yield advantage in owning the REIT sector is narrowing as long term bond yields increase. Earnings per share growth will be key in determining whether distributions can grow.

Closing Rates as at 30 November2015		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,261.1	1,299.2

Stance:

Commercial/Listed:	**Neutral and Trim if overweight**
Residential:	**Neutral, with a negative bias**

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