Economic Overview

Anxiety among investors and in the market is greater than it has been for some time, despite the lack of substantive change in global fundamentals. Volatility has gone up, but remains well below panic levels. As with any market in which there are big price drops, opportunities are opening up, but having the conviction to act is another matter. Central banks remain key drivers of sentiment and asset prices so will probably need to provide further support via lower or even negative rates before buyers return to the market.

US job openings surged in December and the number of Americans voluntarily quitting work hit a nine-year high. Job openings, a measure of labour demand, increased 261,000 to a seasonally adjusted 5.61 million in December. It was the second highest reading since the series started in 2001. A total of 3.1 million Americans quit their jobs in December, the highest number since December 2006. That pushed the quits rate, which the Fed looks at as a measure of confidence in the jobs market, to 2.1%.

In the US, the National Association of Realtors said existing home sales increased 0.4% to an annual rate of 5.47 million units, the highest level since July. January's sales pace was also the second highest since 2007.

The US factory slump that began more than a year ago and accelerated toward the end of 2015 showed signs of easing in February. Improving demand in the US was helping overcome the hurdles of a strong dollar and weaker growth abroad that have hurt exports by American manufacturers, which account for about 12% of the economy. The ISM's factory index climbed to 49.5 in February, the highest since September, from 48.2 in January. While the reading was just shy of 50, the dividing line between contraction and expansion, February's improvement corroborates other industry reports that suggest manufacturing is gaining traction. For the first time since August, at least half of the industries expanded in February, with 9 of 18 showing growth.

Euro zone manufacturing activity expanded at its weakest pace for a year in February as deep price discounting failed to put a floor under slowing order growth. Markit's manufacturing PMI for the euro zone dropped to 51.2 from January's 52.3. Factories cut prices at the steepest rate since mid-2013, as the output price index slumped to 47.6 from 48.3. Euro zone inflation in February fell sharply to negative 0.2%, a huge drop from the positive 0.3% in January. Falling oil prices and slowing economic growth in China and other emerging economies are weighing on the headline rate of inflation. The sharp nosedive puts the euro zone inflation into negative territory for the first time since September last year.

Japan's population shrank by nearly a million during the past half-decade, an unprecedented drop for a society not ravaged by war or other deadly crisis, and one that helps explain the country's persistent economic woes. The population stood at 127.1 million in 2015, down by 947,000 04 0.7% in 2010. A shrinking population creates ripples that are felt from the economy to politics. With one of the lowest birth rates in the world and little immigration, Japan has seen this inflection point coming for years. The latest UN estimates suggest that Japan's population will fall to 83 million by the end of the century, down 40% from its peak.

China's manufacturing PMI dropped to 49 in February, the lowest since January 2009. The service PMI fell to the weakest in seven years to 52.7 in February from 53.5 in January. The People's Bank of China cut the reserve requirement ratio for banks by 0.5 percentage points to 16.5%, which is the amount of cash the banks have to hold as reserves instead of lending out. By cutting the ratio, this will immediately inject $139 billion into the banking system. Whether that money actually stimulates the economy is another matter. The impact depends on how much banks are willing to lend.

The OECD cut its 2016 economic growth forecast to 3.0% from 3.3% owing to disappointing data, sluggish demand, weak investment and a high risk of financial instability. It trimmed its outlook for this year as growth slows in many emerging countries and advanced economies only expected to achieve modest recovery. In its November outlook, the OECD had already downgraded its initial 2016 estimate, citing stagnating trade amid a slowdown in China. But it said it felt compelled to make a further downward revision both for this year while also revising downward an initial November projection for 2017 to 3.3% from 3.6%.

Interest Rates & Currency

Rising rents and healthcare costs lifted underlying US consumer price inflation in January by the most in nearly four-and-a-half years, providing support for the view that the US Federal Reserve could raise interest rates this year as forecast. The US Department of Labor said the Consumer Price Index (CPI), excluding the volatile food and energy components, increased 0.3% in January, the biggest gain since August 2011, following a 0.2% rise in December last year.

European Central Bank policy makers meeting in January debated whether the risk of a global slowdown warranted preemptive monetary stimulus, and at least one Governing Council member saw a need to overshoot the central bank's inflation goal for a "limited period." *"The point was made that, in a situation in which risks were predominantly on the downside and new downside risks were emerging, it would be preferable to act preemptively, taking emerging risks into account, rather than wait until after risks had fully materialized,"* an account of the meeting showed.

The Bank of England's nine-member Monetary Policy Committee unanimously voted to keep the key interest rate at its record low of 0.5%. While in previous months one member had voted for an increase, the unanimous vote indicates greater concerns about the effects on the U.K. of the recent slowdown in the global economy. With inflation at 0.2%, far below the 2% target rate, there is little pressure to raise rates.

Swedish interest rates have been pushed deeper into negative territory, as the country's central bank became the latest to deepen monetary stimulus. The Swedish Central Bank elected to cut its policy rate from minus 0.35% to minus 0.5%.

The yield on Japan's benchmark 10-year government bonds fell below zero for the first time, as the Bank of Japan's (BOJ) adoption of negative interest rates drive demand for the bonds. The 10-year yield has tumbled from 0.22% before the BOJ surprised markets with the decision in January to introduce a minus 0.1% on some of the reserves financial institutions park at the central bank.

The RBA at its March Board meeting kept the cash rate unchanged at a record low of 2.00%. This was widely expected. Overall, the RBA's post-meeting statement was little changed. UBS' view is *"If rates go anywhere this year, it is lower, but we continue to believe, on balance, the outlook is one that will more likely see the RBA hold."*

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.

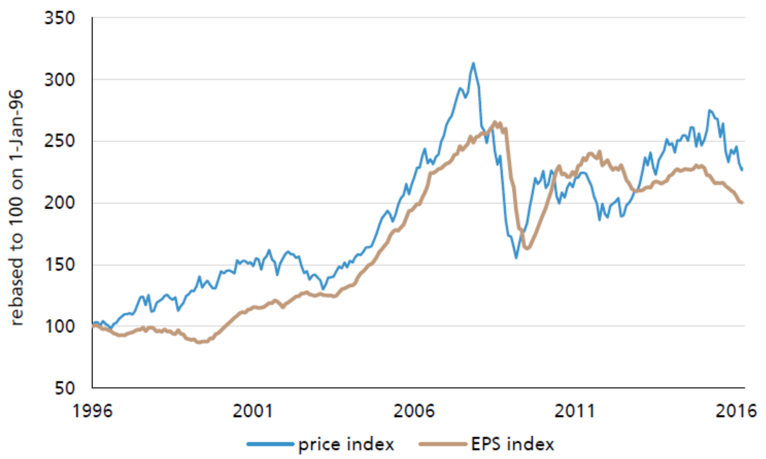
Closing Rates as at 29 February 2016					
	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	2.00%	2.00%	US Fed Funds Rate	0.3700%	0.3800%
90 Day Bank Bills	2.33%	2.29%	AUD/USD	71.40	71.00
180 Day Bank Bills	2.20%	2.18%	US 10 Year T-Bond	1.74%	1.93%
5 Year Govt Bonds	1.962%	2.136%	US 30 Year T-Bond	2.61%	2.75%
10 Year Govt Bonds	2.409%	2.628%	Japan 10 year yield	-0.058%	0.070%

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

Australian Shares

UBS' view is, *"Despite the better than feared reporting season at the stock level, the Australian market is on track for its second successive year of negative earnings growth. Growth ex-resources continues to track at a better but still anaemic 3-4%. On a median basis (ex-resources) FY16 growth is currently at 6% and rises to 9% for the industrials ex financials. Earnings trends for the "typical" company are therefore still reasonable with headline growth being dragged down by the large-cap end of the market. Therein lies the opportunity for stock pickers."*

Figure 6: Australian Market Performance versus Earnings



The market is struggling against weak overall earnings trends.

Source: Datastream

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

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.

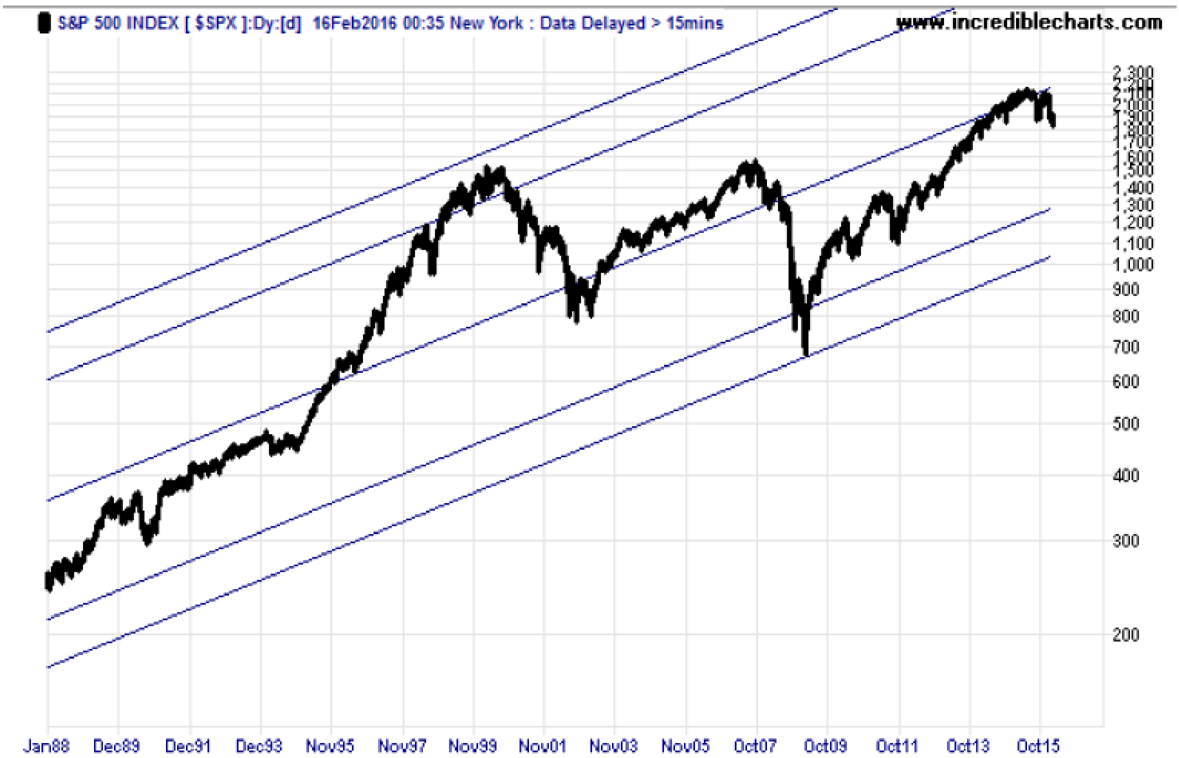
Closing Rates as at 29 February 2016					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	4,947.9	5,056.6	AOX Earnings Yield	5.99%	5.99%
PE Industrials (2016)*	14.4x	15.0x	Div Yld Indust (2016)*	5.3%	5.0%
PE All Ords (2016)*	16.7x	16.7x	Div Yield All Ords (2015)*	4.7%	5.0%

*Source – UBS

Stance: Neutral – Underweight portfolios should look to add

International Shares

The following chart is the US S&P 500 index since 1988 on a log scale. On this measure the American stock market is now slightly below its long term middle trend-line which would suggest it has further to fall if it is in a bear market such as 2000 and 2008.



We expect geopolitical events occasionally giving rise to market volatility. Take advantage of market volatility to purchase international shares, but to be aware of the rising risks of a price earning ratio (PE) contraction in the US market.

Closing Rates as at 29 February 2016					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
US Dow Jones	16,516.50	16,466.30	Nikkei Dow	16,026.76	17,518.30
S&P 500	1,932.23	1,940.24	Hang Seng	19,115.32	19,683.11
FTSE 100	6,097.09	6,083.79	MSCI	1,547.2	1,562.2

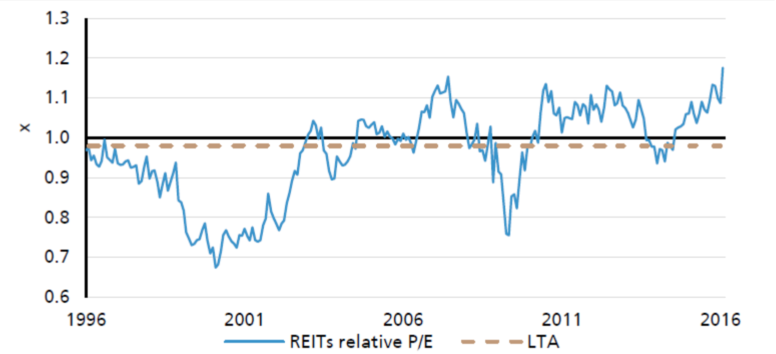
Stance: Neutral with positive bias

Property

Sydney property prices rose 0.5% in February. It was the second rise in 2016 for Sydney. The CoreLogic RP Data Home Value Index for February showed prices in Brisbane rose 1.8% and in Melbourne 0.3%, while Perth prices fell 1.1% and Darwin rose 0.4%. After a dip in late 2015, Sydney prices have stabilized, producing a fairly flat quarter to February.

According to UBS, *"REITs have been one of the key beneficiaries of the related themes of 'safety' and falling long bond yields. Sector-specific negatives in the yield-driven Banking and Telco sectors in 2015 have also likely contributed to REIT sector outperformance. Bottom up we are positive on selected real estate names including Westfield Corporation, Mirvac and Stockland, though top-down the expensiveness of the sector against the broader market keeps us underweight the sector. A significant rise in bond yields remains the key big picture risk for the sector though this appears reasonably remote at the current junction."*

Figure 32: REIT Sector Relative* P/E



...toward the top of its relative PE range

* Relative to Market-ex-Resources P/E

Source: Factset

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 29 February 2016		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,330.5	1,304.6

Stance:

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