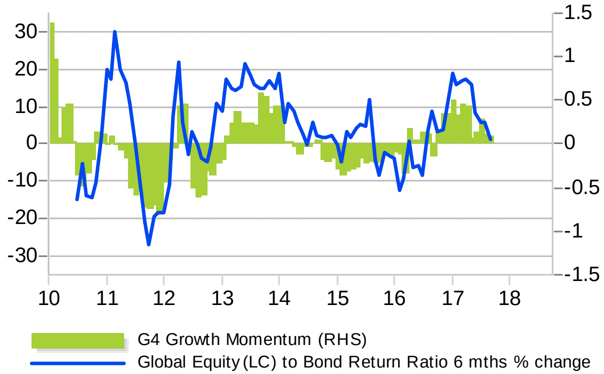
ASSET ALLOCATION AND INVESTMENT STRATEGY CHARTPACK

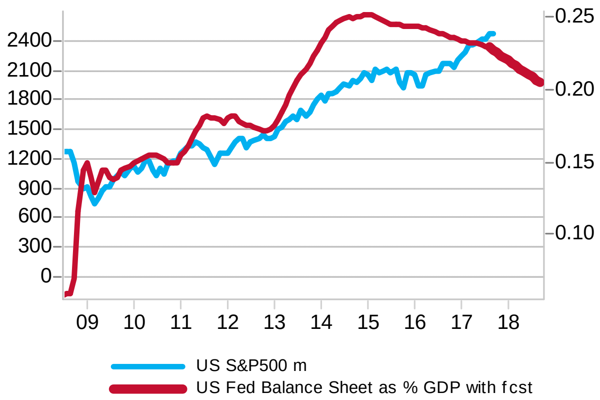
MONTHLY REPORT | ISSUED 15 SEPTEMBER 2017

MSCI-World(loc) v Bonds 6mths % chge
G4 Growth Momentum



Source:ISM,MSCI, using proxy updates

US S&P500 & Fed balance sheet



Source:BEA,St Loius Fed,S&P

Investment Summary

	Tactical View Indicator		Where we could be wrong
Developed Markets equities	positive	Global growth momentum, EPS growth and no need for central banks to slow economies. Valuations challenging.	Policy normalisation results in declining liquidity, sharply higher bond yields, China tightens too much, geopolitical risk/event
Emerging Market Equities	positive	Positive growth momentum, EPS growth, easing policy, weaker USD all positive, lower current account deficits. Valuations neutral.	Rising USD, declining liquidity, China tightens "too much", geopolitical risk/event
Australian Equities (large cap)	negative	Reasonable growth momentum, but lacking EPS growth. Valuations challenging.	China tightens "too much", Household debt risk associated with tighter financial conditions, low wages growth, geopolitical risk/event
Australian Small Cap Equities	positive	end of easing cycle, domestic growth recovery	China tightens "too much", Household debt risk associated with tighter financial conditions, low wages growth, geopolitical risk/event
A-REITs	neutral	drive for yield offset by expectation of rising bond yields, Amazon effect	sharp move in bond yields
Global Bonds	negative	Global growth rising but inflation low for now (wages growth weak). Expect policy normalisation. Expensive.	Growth rolls over in response to China weakness, geopolitical event risk and in any case yield upside is limited
Australian Bonds	negative	Global & domestic growth rising but inflation low for now (wages growth weak). Expect policy normalisation globally but RBA on hold for now. Expensive.	Growth rolls over in response to China weakness, geopolitical event risk or downturn in Australian housing. In any case yield upside is limited
Global HY Credit	negative	Priced off low default rate & zero recession probability	rates stay low, low growth(without recession) continues to push investors into high yield
Cash	positive	Extremely low but as policy is normalised will benefit in relative terms	rates stay low, low growth(without recession) continues to push investors into risk assets
AUD	=2	Momentum & carry positive, value negative	
USD	5	Momentum & carry neutral value modest negative	Growth & Fed surprises to upside
EUR	=2	Momentum & carry neutral, value neutral	
JPY	=2	Momentum & carry negative, value positive	
GBP	1	Momentum positive, value modest positive	Brexit concerns, growth slows

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Contents

"Generic" portfolio

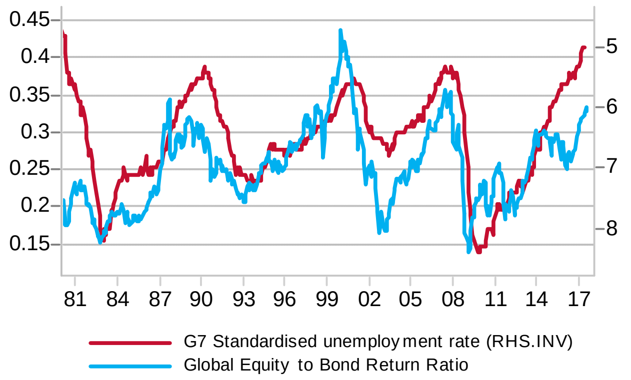
Scenario Likelihood	**35%**	10%	10%	5%	15%	**25%**	100%
(Previous)	***(35)***	*(10)*	*(10)*	*(5)*	*(15)*	***(25)***	

ASSET CLASSES	NORMALISATION	HIGHER INFLATION	CHINA HARD LANDING	US/EUROPE RECESSION	SUB PAR GRWTH EXPOSES AUST EXCESSES	SUB PAR GRWTH / LOW BOND YLDS / EXCESS LIQUIDITY	MEDIUM TERM RETURN(3 year) (%)	10 year return projections	TACTICAL WEIGHTING	CHANGE (%)	POSITION (%)
	HEURISTICS SCENARIO RETURN 12 MONTHS (%)										
Aust Shares	8.0	4.0	-15.0	-12.0	-5.0	5.0	5.3	6.50	neutral		0.00
Overseas Shares ACWI (USD)	7.0	3.0	-13.0	-15.0	4.0	4.5	4.8	6.25	overweight	0.50	1.50
REITS	4.0	-3.0	-10.0	-8.0	-2.0	5.0	5.0	5.00	neutral		0.00
Aust Fixed Interest	-2.5	-5.0	6.0	4.5	4.5	3.5	2.5	2.50	underweight	-0.50	-1.75
O/S Bonds (hedged) inc Credit	-2.5	-5.0	5.5	6.0	3.0	3.0	2.0	2.25	underweight		-2.50
Cash	2.0	2.0	1.3	1.3	1.3	1.5	2.5	3.00	overweight		2.75
AUD	3.0	6.0	-15.0	-13.0	-10.0	-5.0	-2.5		underweight		-1.25
Emerging Markets (USD)	8.0	6.0	-18.0	-10.0	5.5	5.5	7.0	7.50	overweight		
Credit Global	2.5	0.0	-5.5	-6.5	3.0	3.0	3.0	4.00	underweight		
Indexed Bonds	-2.0	-2.5	6.0	5.0	4.0	2.8	-0.5	2.0	neutral		

RELATIVE TO ASSET CLASS	TACTICAL WEIGHTING		CHANGE (%)	POSITION (%)
Developed Markets	overweight			0.50
Aust Large Cap	underweight			-0.50
Emerging Markets	overweight		0.50	1.00
Global REITs	neutral			0.00
A-REITs	neutral			0.00
Small Companies	overweight			0.50
Credit	underweight			-2.00
Indexed Bonds	neutral			0.00
Infrastructure	neutral			0.00
Gold	neutral			0.00
Commodities	neutral			0.00

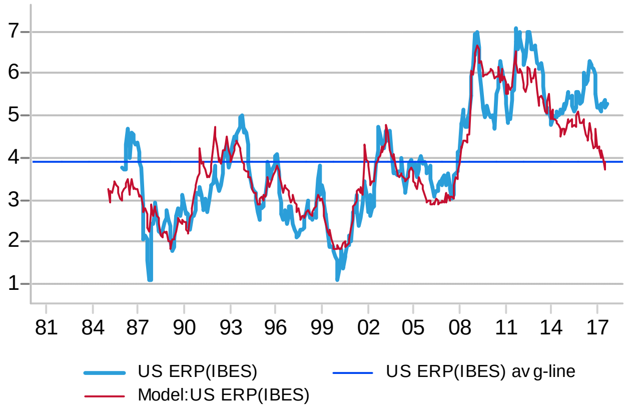
Focus: Macro positive, ERP attractive but watch QE tightening

Global Equity to Bond Return Ratio & Global unemployment



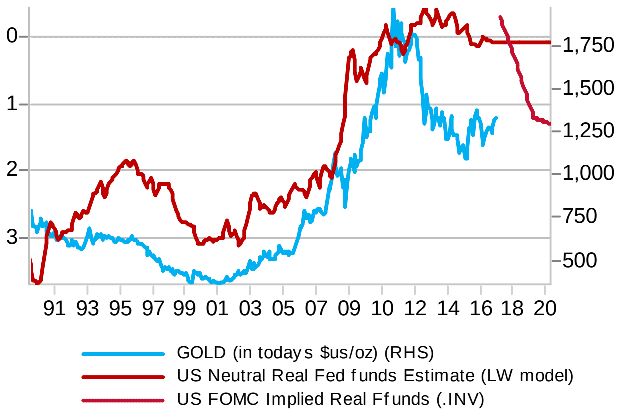
Source:,FED,St Loius Fed

US Equity Risk Premium & Model ERP



Source:FED,ISMRBA, using proxy updates

US Neutral Fed funds & gold

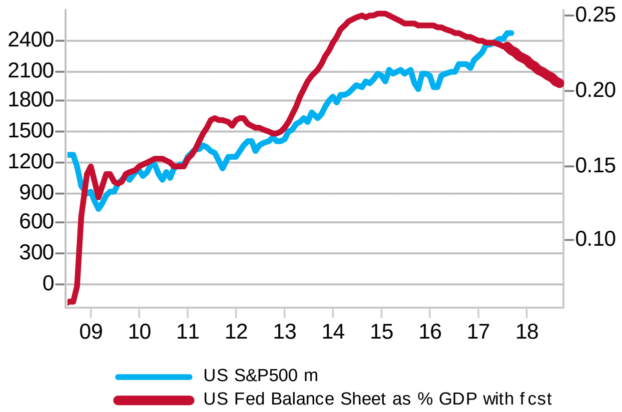


Source:Fed,BEA, using proxy updates

- The global equity to bond ratio (blue line rising means equities outperforming bonds) generally rises as unemployment declines and that remains the case globally.
- The US Equity risk premium (based on consensus EPS) suggests there is room for equities to continue to outperform bonds. The current ERP is estimated at 5.2% against a long term average of 4% and a model estimate of 4%. In other words, the equity market (assuming EPS assumptions unchanged) could cope with an "orderly" 100 bpt rise in 10 year yields.
- The US Fed's balance sheet is expected to be cut by US$300 bn over the next 12 months (taking it to US$4.1 trillion). Our model of the US bond (incorporating the Feds balance sheet) suggests this would send the yield up to 2.7%.

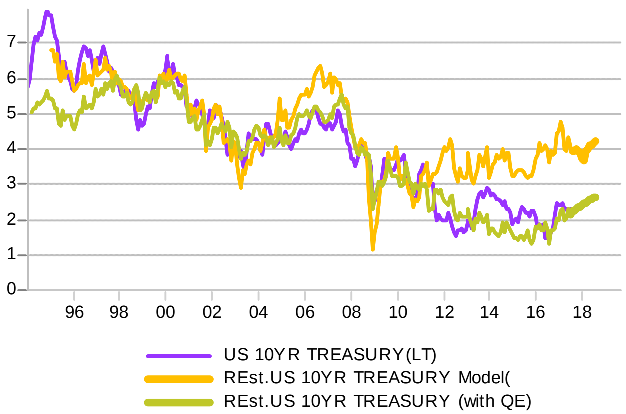
Finally, gold has enjoyed support on the back of Korean tensions.If Fed funds rise as expected this will undermine gold.

US S&P500 & Fed balance sheet



Source:BEA,St Loius Fed,S&P

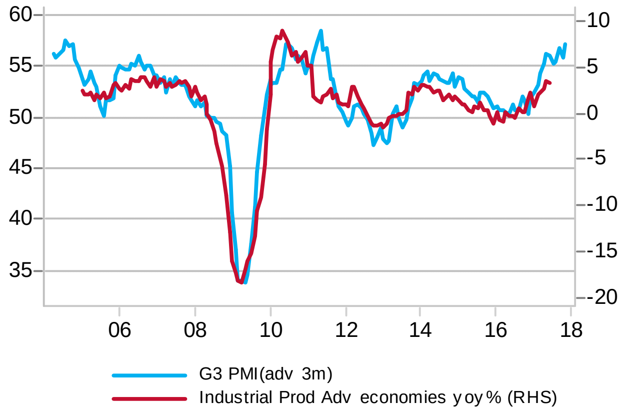
US 10YR TREASURY Model



Source: IRESS, HIS est.

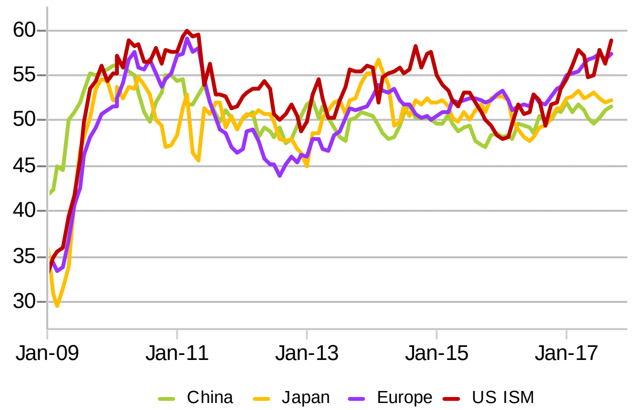
Global Growth

G3 PMI & OECD (G7) IP



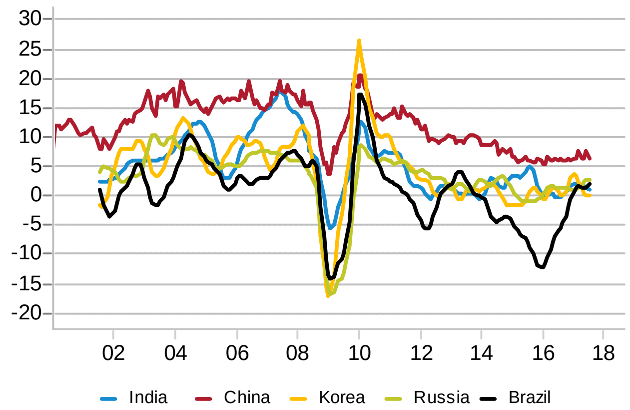
Source: ISM, Markit, OECD

Global PMI's



Source: Markit, ISM

Emerging Markets IP

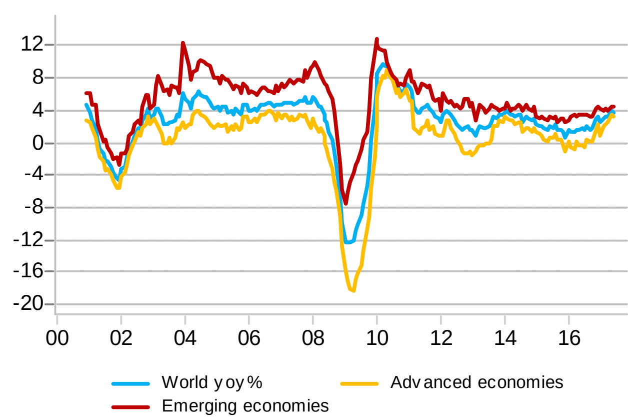


Source: OECD, China National Statistics

GROWTH BESTSINCE 2011-12

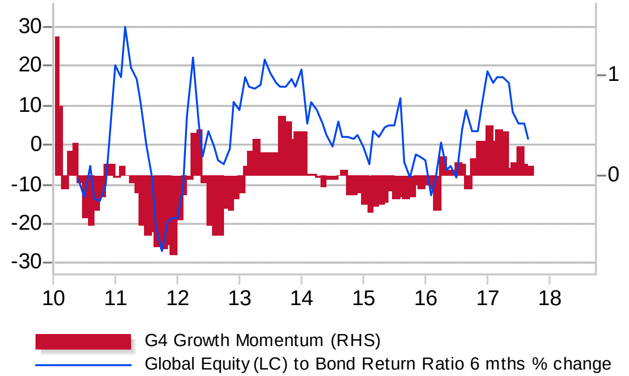
- Global industrial production growth is at its highest level since 2011-12. Global IP growth stood at 3.8% in June after falling below 2% for much of 2016. PMI readings are also at post 2011 highs in the US and Europe and are solid in China and Japan. Advanced economy growth has sustained the recent lift although emerging market growth has also recovered.
- The momentum in growth, however, is becoming increasingly difficult to sustain. The far right bottom chart shows the relationship between our measure of growth momentum and equity v bond performance. We can see the recent slowing in momentum and the declining equity outperformance.

Industrial Production World



Source: CPB

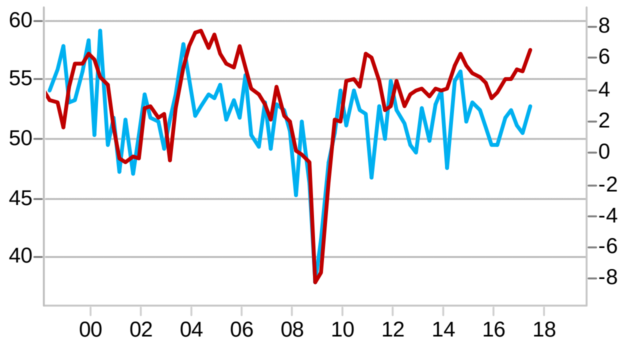
MSCI-World-LC v Bonds 6mths % change
G3 Momentum



Source: Markit, ISM, MSCI, using proxy updates

US Economy

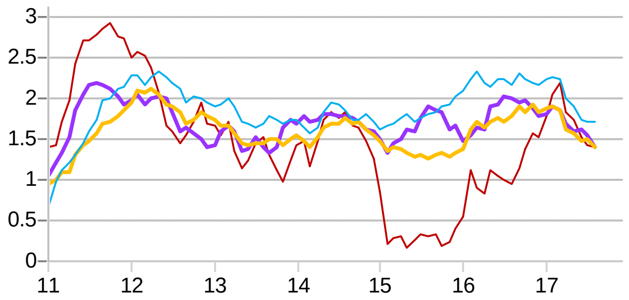
US REAL GDP & US ISM



US REAL GDP qtr ann (RHS)
US Composite ISM Index est

Source:,ISM, HIS, using proxy updates

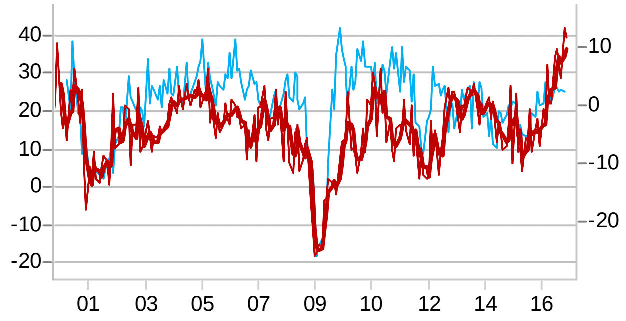
US Inflation measures



US PCE Price Index yoy%
US Trimmed Mean PCE inflation(6m ann)
US PCE Price Index (ex Food & Energy) %yoy
US CPI EX FOOD,ENERGY % yoy

Source: Dallas Fed

Phil Fed capex intentions & Capital goods orders



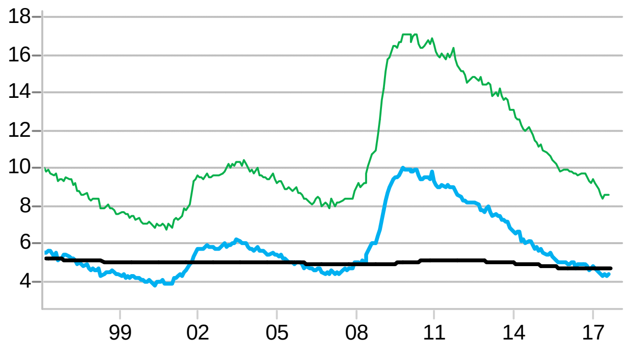
US MANUF ORDERS; NON-DEF EX AIRCRAFT 6m (RHS)
Phil Fed Future Capital Expenditures
Phil Fed Future Capital Expenditures 3m mav

Source: Phil Fed, Census Bureau

GROWTH SOLID WITH LITTLE INFLATION

- GDP was recently revised to 3%, closer to what had been suggested by the strong ISM results. Data for the quarter to date suggests that growth has been sustained.
- Despite the tightening labour market there is little evidence of higher wages growth or rising inflation at this point. Wages growth remains around 2.5% while core inflation measures have declined by close to 0.5% since peaking in February. The August core CPI was steady at 1.7%.
- There are signs that investment is set to bounce over coming quarters. Philly Fed capex intentions are elevated and capital goods orders have improved, pointing to sustained growth.
- Finally, USD weakness continues to be a dominant theme. Our currency indicator (based on valuation and momentum) continues to favour the euro over the USD.

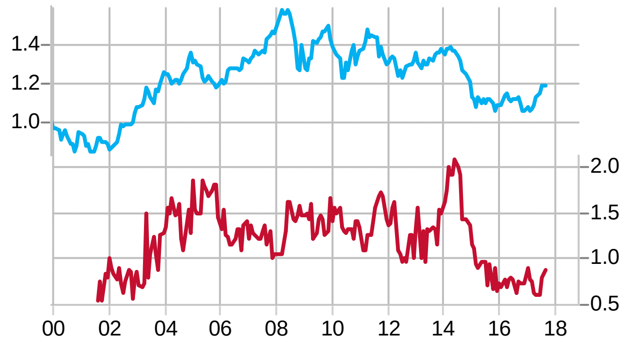
US UNEMPLOYMENT



US Unemployment Rate
US Underemployment rate
US NAIRU estimate

Source:,St Loius Fed

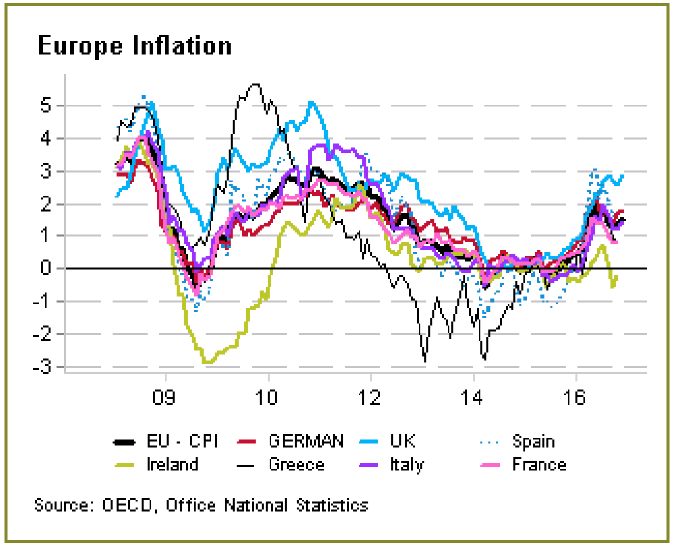
EUR/USD & Indicator

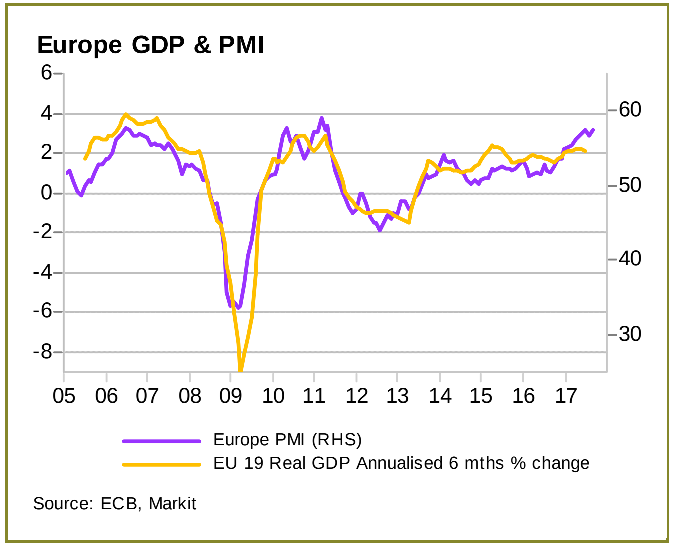


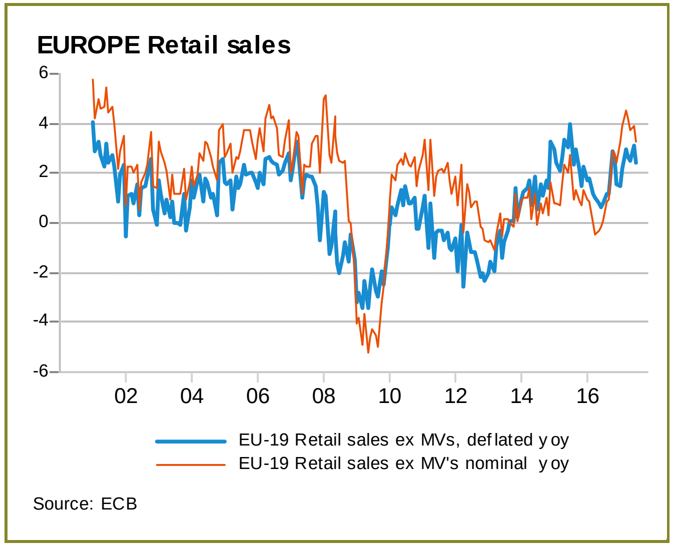
EUR/USD
USD/EUR Currency Scan (inc mom) (RATIO)(RHS)

Source: BIS, Heuristics

Europe Economy

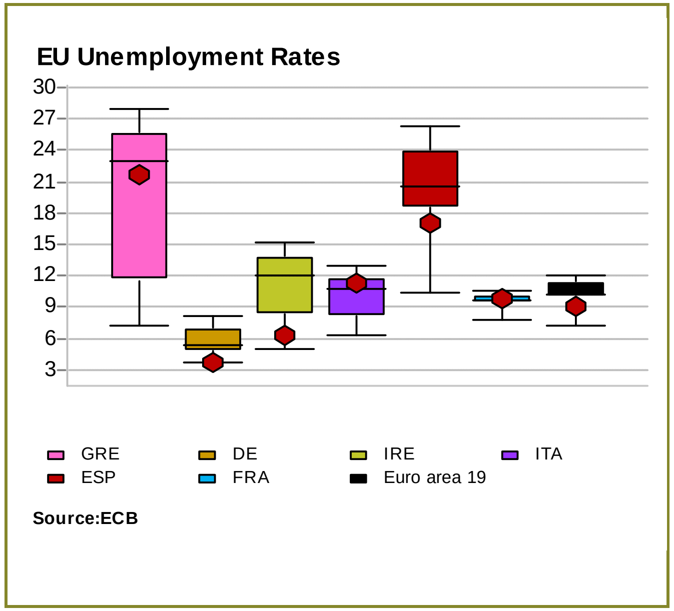


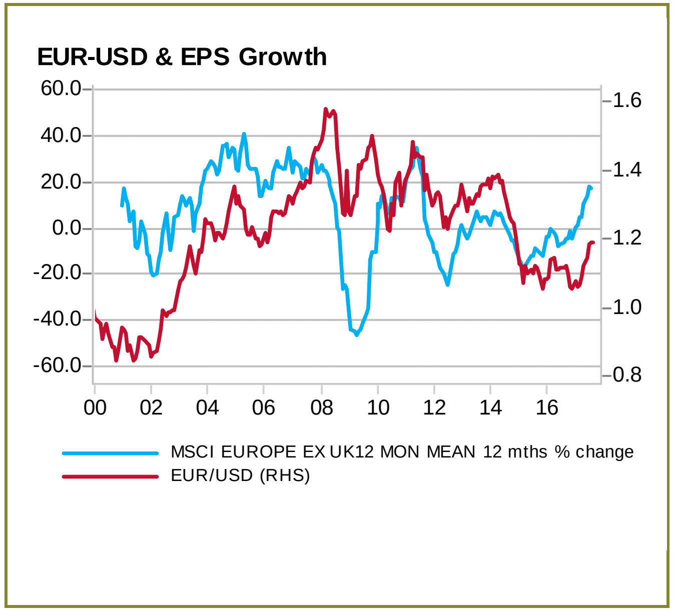




ECONOMY IMPROVING

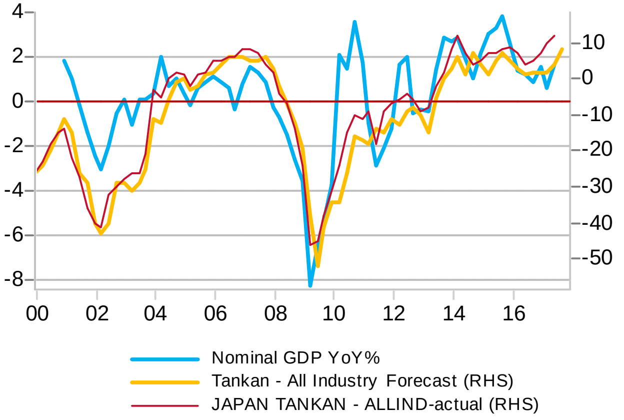
- The European economy continues to surprise to the upside with GDP growth of 2.1% over the year to June. The European and German manufacturing PMI are around 6 year highs.
- Retail trade is relatively solid across Europe with volumes up around 2.5% and sales by nearly 3.5%.
- European inflation picked up to 1.5% in August but is still well below the 2% seen in February, while core inflation was 1.3% (and rising). UK CPI rose to 2.9%.
- Unemployment rates are also continuing to come down from their highs.
- The rise in the PMI is consistent with a further improvement in EPS growth, although strength in the euro will begin to undermine expectations.





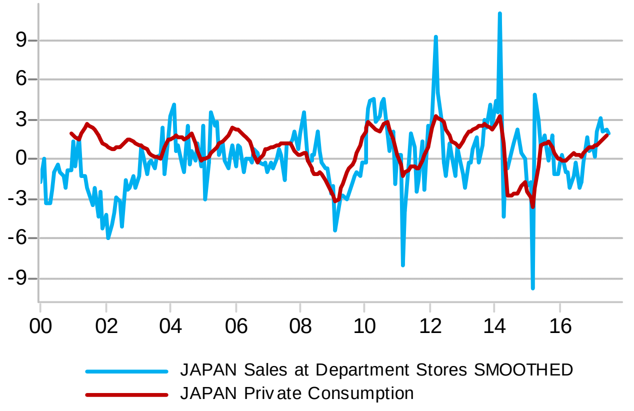
Japan

Japan: Nominal GDP & Tankan



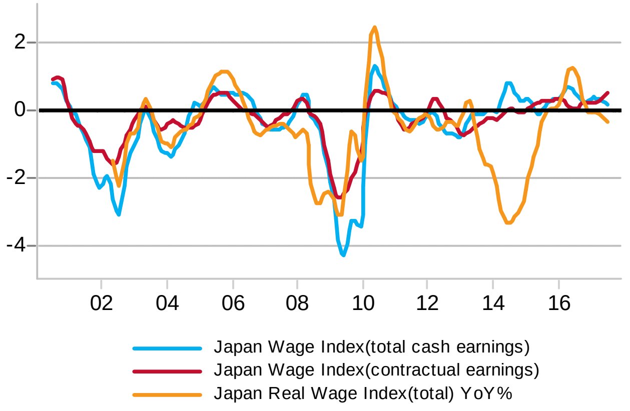
Source:,Japan Cabinet Office

JAPAN Consumer Spending



Source: Cabinet Office

JAPAN: Wage growth, real and nominal

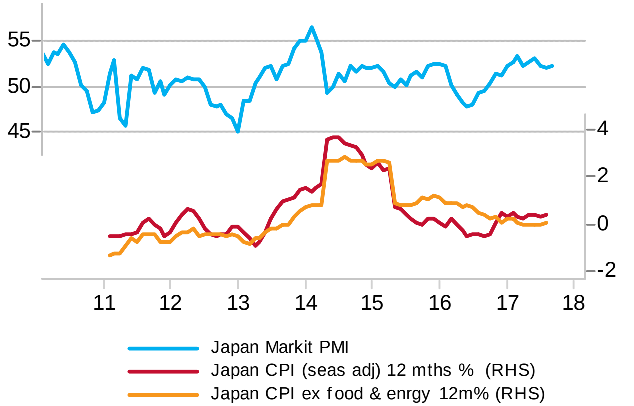


Source:ABSJapan Cabinet OfficeSt Loius Fed

EARNINGS IMPROVING

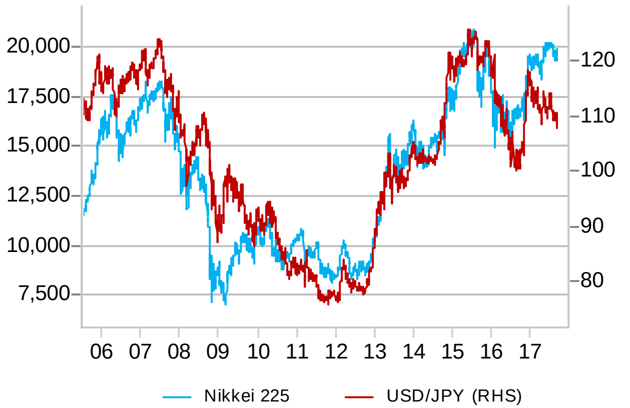
- The Japanese economy seems to be performing reasonably well. Real GDP growth for the June quarter was 0.6% or 2.5% annualised. Nominal GDP is also picking up, consistent with the higher TANKAN.
- Consumer spending has also picked up despite wages growth remaining very subdued. Indeed real wages continue to decline, making the task of generating higher inflation very difficult.
- Interestingly, the Nikkei has managed to hold on to its rally despite a strengthening yen. Rising geopolitical tensions tend to favour the yen.

Japan Markit PMI & CPI



Source:Markit

Nikkei & the yen



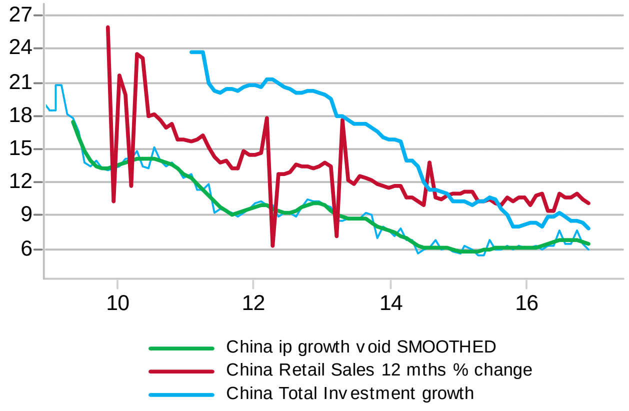
Source: IRESS

China Economy

STABLISATION ALLOWS MODEST TIGHTENING

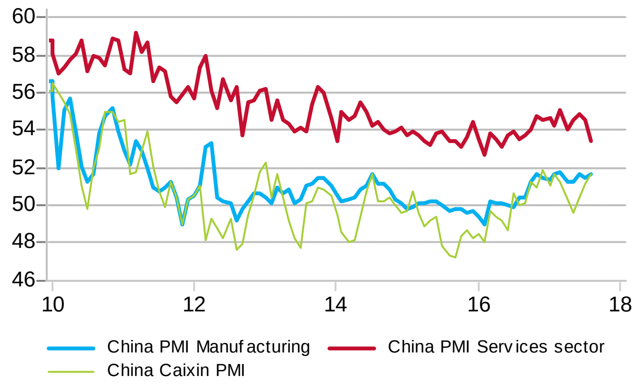
- The Chinese data is providing mixed messages of late. Recent PMI readings have been reasonable and while the latest IP, retail sales and investment figures surprised to the downside, overall the data has been consistent with stable growth. The leading indicator points to reasonable growth.
- However, as we have noted previously, the stabilisation in the economy has allowed a modest tightening in financial conditions and a clampdown on shadow banking credit growth. Narrow money supply growth has slowed and there has been a modest slowdown in the property sector and prices.
- 2018 still looms as a major test for the Chinese economy as the stimulus of recent year's washes through. For now the authorities will not risk a more significant slowdown in the lead up to the Party Congress in late 2017.

China Economic indicators



Source: National Statistics Office

China PMI Manufacturing & Services

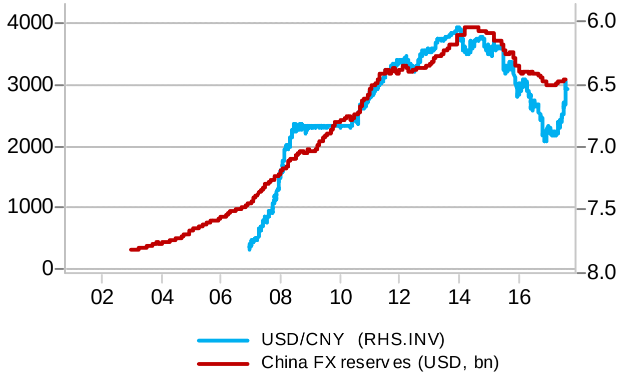


Source: NBS

China Money growth & Construction

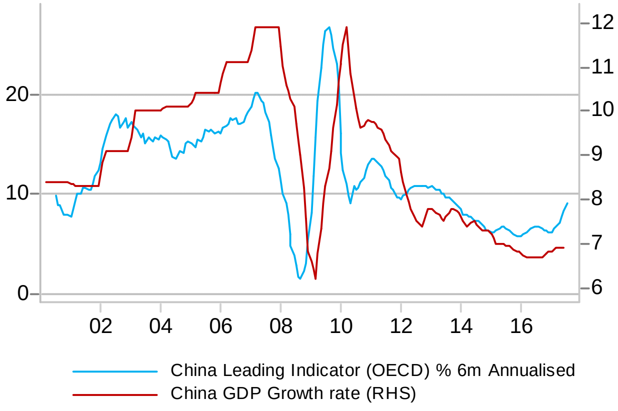
Source: NBS

Chinese FX reserves & yuan



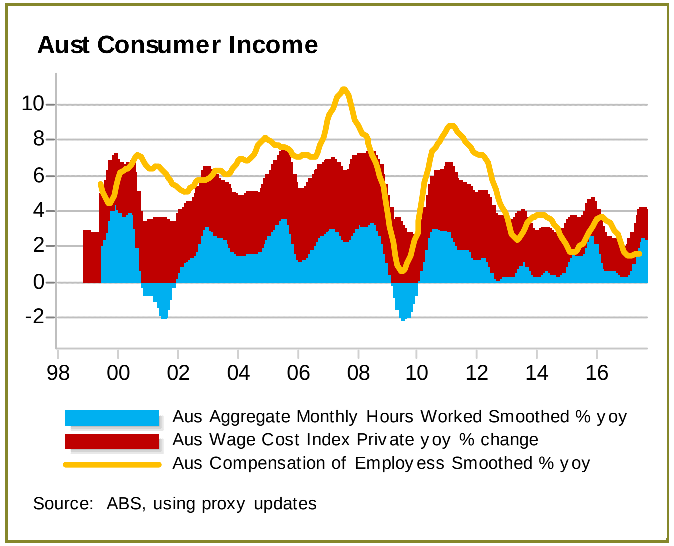
Source: US Treasury, PBoC

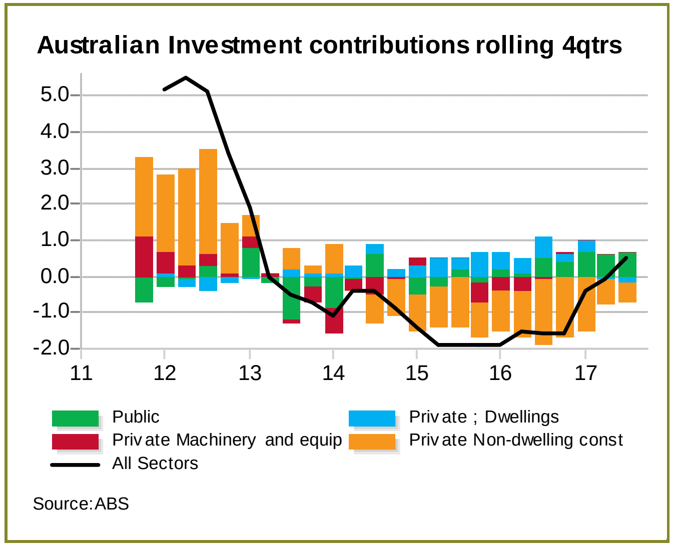
China GDP growth & Leading indicator (OECD)

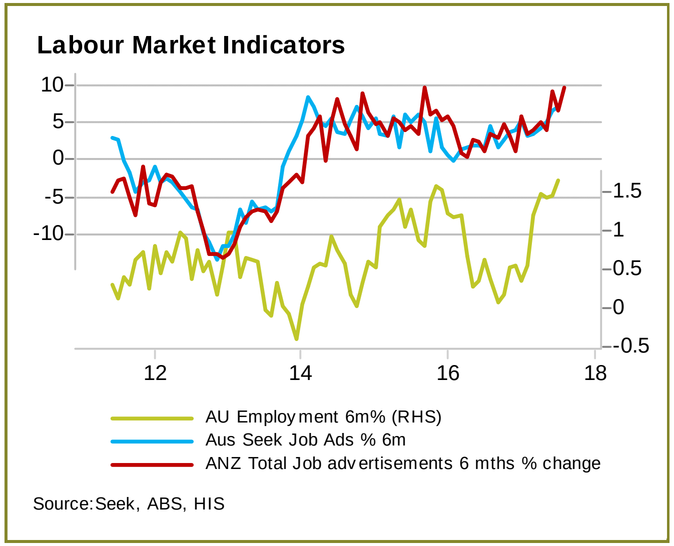


Source: OECD

Australian Economy

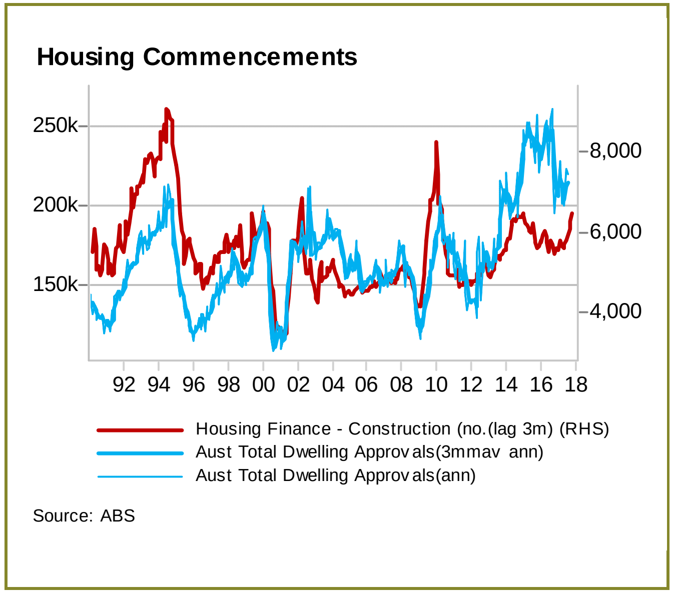


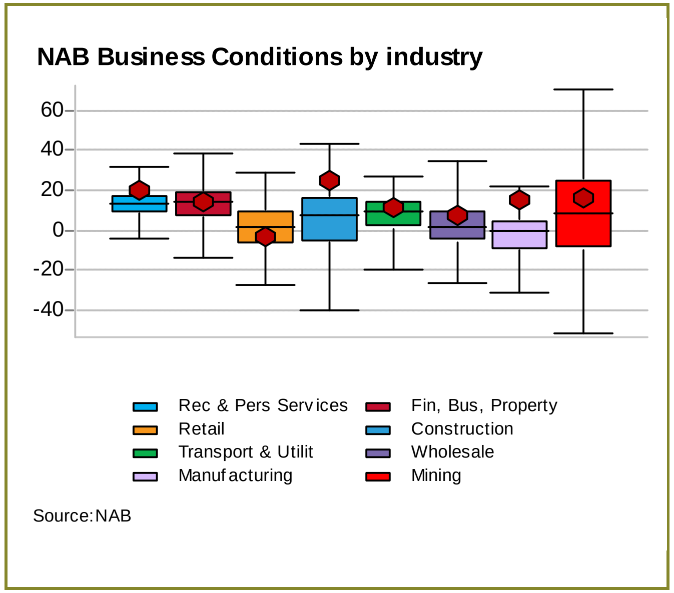




BUSINESS SOLID, CONSUMER WEAK

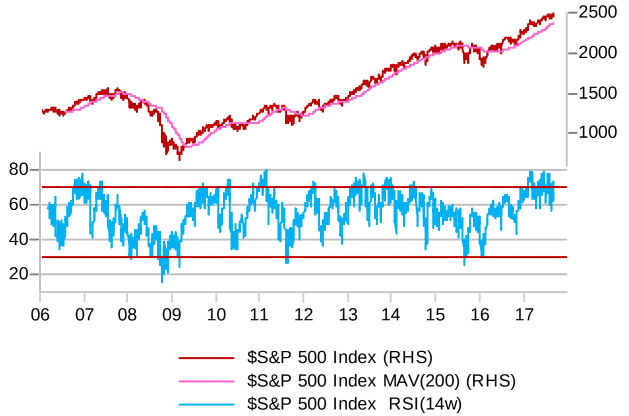
- The NAB business conditions moved up again in August and sits at post-GFC highs. Most industries are at the higher end of their longer term ranges with only retail at the lower end.
- The June quarter investment data was more promising. Investment is now contributing to growth, largely on the back of the lift in public sector investment now offsetting a reduced drag from mining and other capex.
- The labour market data has been strong. Almost 270,000 jobs have been added this year (the equivalent of the US adding 450-500,000 payrolls per month).ANZ and SEEK data are positive for jobs going forward.
- Meanwhile, housing data is proving resilient, especially for construction and first home buyers.





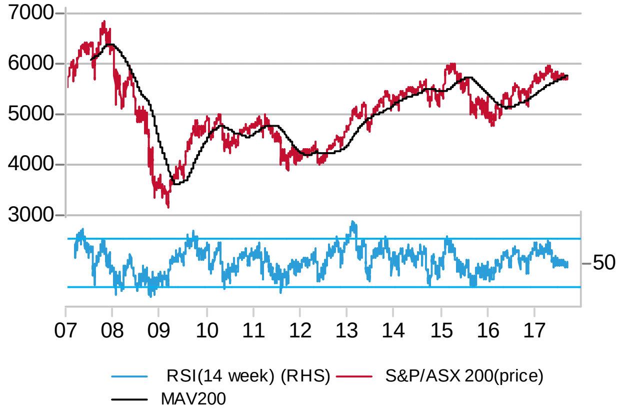
Market Performance: Equities

S&P 500 Index (RSI)



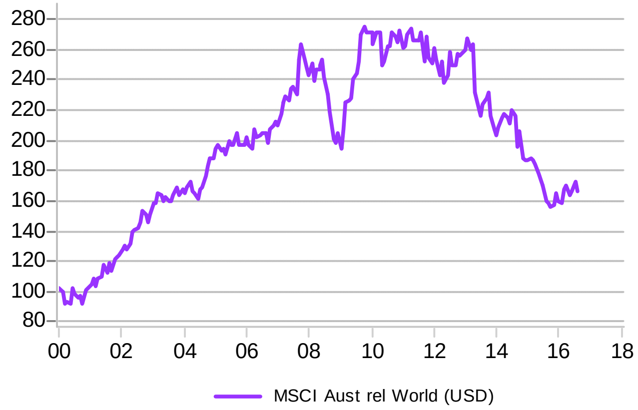
Source: IRESS, using proxy updates 14/09/2017

S&P/ASX 200(price) + RSI(w)



using proxy updates 14/09/2017

AUSTRALIA relative to WORLD EQUITIES

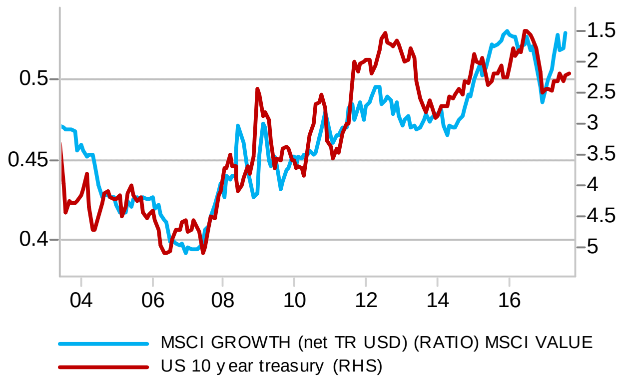


Source: MSCI, using proxy updates 14/09/2017

EQUITY MARKETS STEADY

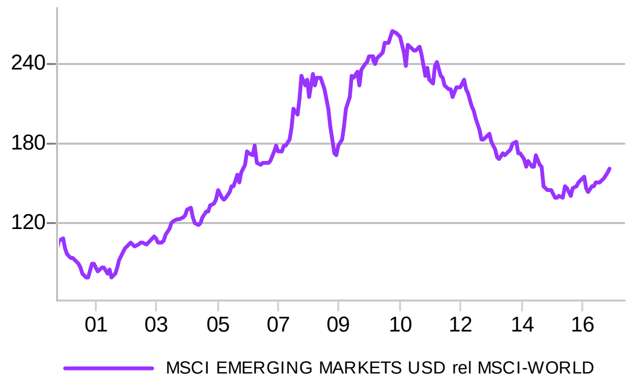
- Global equity markets were largely unchanged in August, with concerns over the escalation of tensions on the Korean peninsula offsetting the ongoing improvement in growth and earnings. Gold has been one of the beneficiaries of the ratcheting up of threats from both North Korea and the US while the USD has continued to soften. Global bond yields moved slightly lower on the back of surprisingly low inflation and partly because of the move towards safe havens.
- The MSCI World Index ex Aust (net, USD) rose just 0.2% in August taking the year to date return to 13.5%. In AUD terms, global equities moved 0.8% higher for the month and just 3.6% year to date. Australian equities market managed a 0.7% return in August and while it is up 3.9% for the year to date, the domestic market has essentially treaded water since early May. The market has been weighed down by concerns over a heavily indebted household sector against a backdrop of weak wages growth, tightening financial conditions.

MSCI GROWTH (net TR USD) v MSCI VALUE & US 10yr



Source:,MSCI,FED, using proxy updates

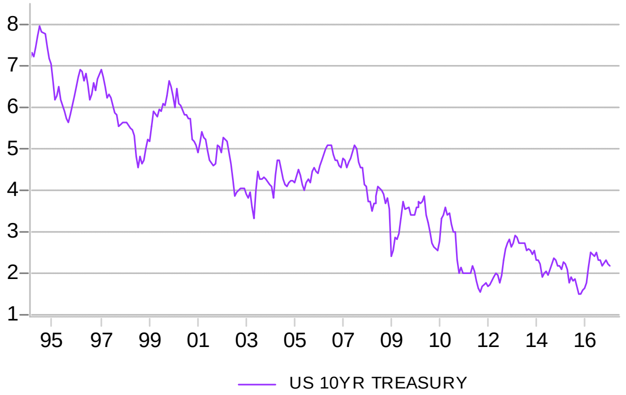
EMERGING MARKETS relative to WORLD EQUITIES



Source: MSCI, using proxy updates 14/09/2017

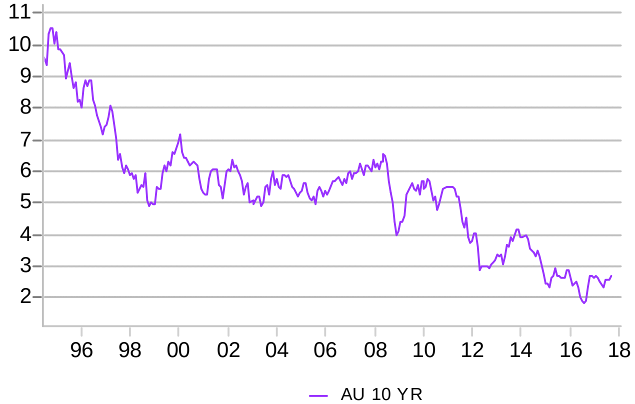
Market Performance: Bonds

US 10 year yield



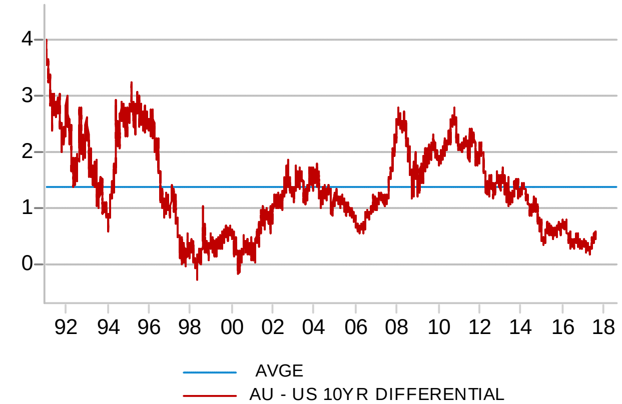
Source: IRESS, using proxy updates 14/09/2017

Australian 10yr



Source: IRESS, using proxy updates 14/09/2017

AU-US 10yr spread

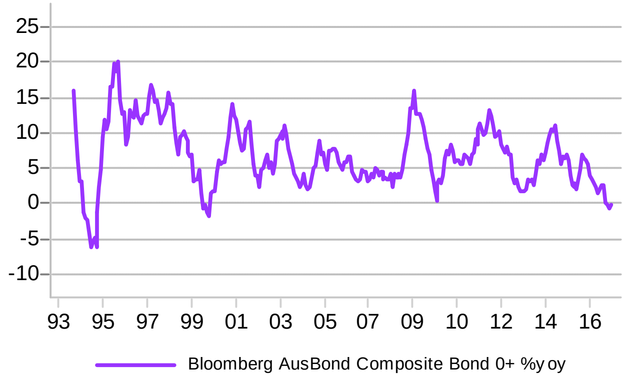


Source: RBA, ABS, IRESS, using proxy updates 14/09/2017

BOND YIELDS LOWER

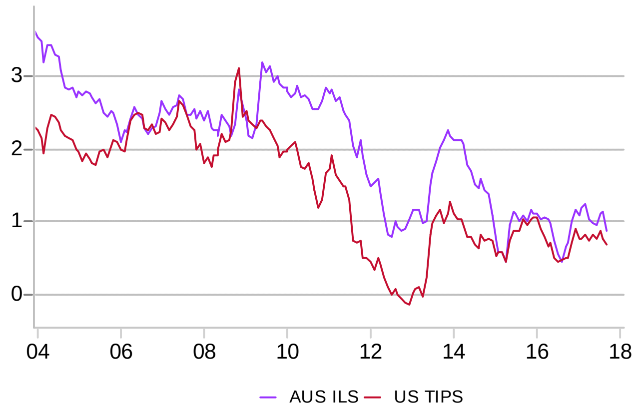
- Bond yields moved lower over the course of August as investors sought safe havens from the escalation of tensions around North Korea's nuclear program and the verbal "tit for tat" associated with it. Concerns over raising the US debt ceiling and the risk of a government shutdown also weighed on markets. US bond yields ended the month at 2.12%, down from 2.29% while German bond yields fell to 0.36% from 0.54%. Japanese 10 year yields pushed back below zero. The decline in bond yields has occurred despite relatively upbeat economic growth across most regions
- Australian bond yields traded in a very tight range in August, ending the month at 2.71%. The RBA kept rates at 1.5% at its August meeting with the minutes focussing on the outlook for the labour market. The RBA was relatively upbeat on the labour market, pointing to the 200,000 gain in jobs so far this year and the improvement in the leading indicators.

Bloomberg AusBond Composite Bond Index Returns



Source: IRESS, using proxy updates 14/09/2017

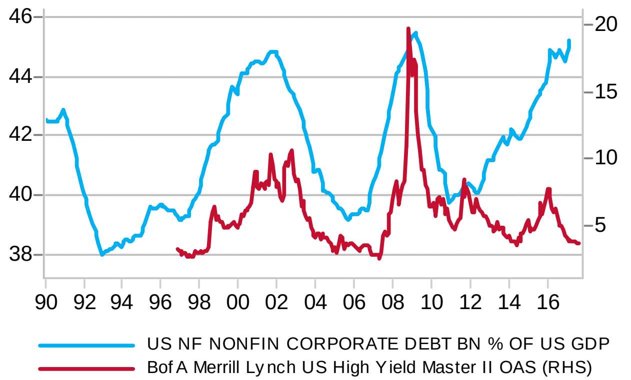
Indexed Bond yields



Source: RBA,US Fed, using proxy updates 14/09/2017

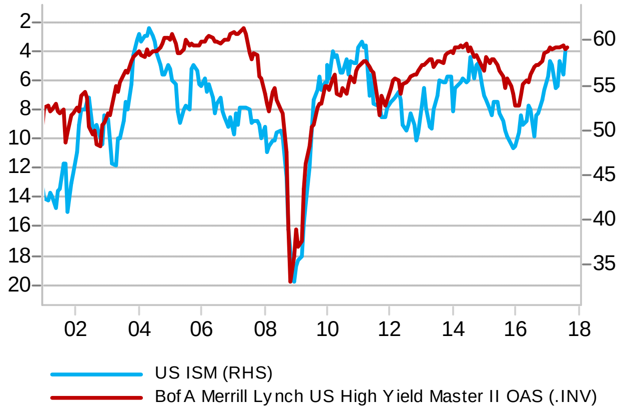
Credit

US Non Fin Corp Debt/GDP & US High Yield Spreads



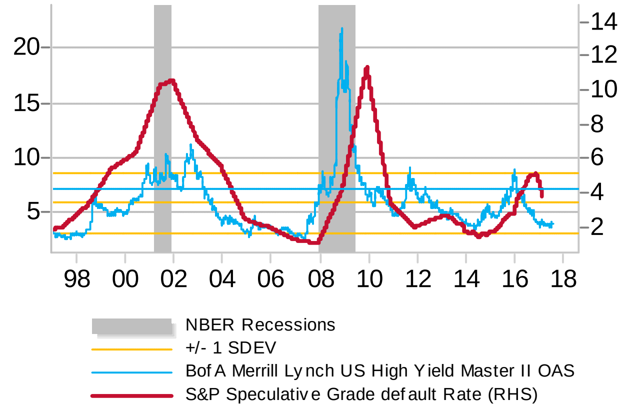
Source: FED, FED

US High Yield spreads & ISM



Source: ISM, Moodys, IRESS, using proxy updates

US High Yield spreads & Default rates

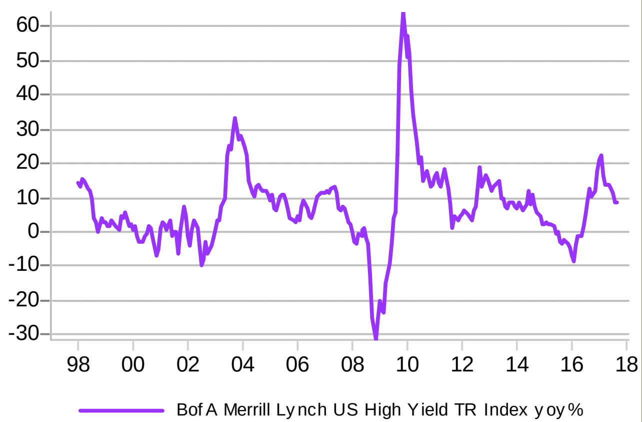


Source: St Louis Fed, BoA, S&P

CREDIT SPREADS CHALLENGING

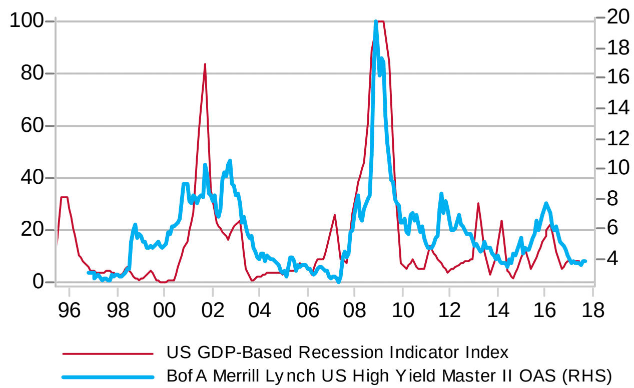
- Credit markets were slightly weaker over August. US high yield spreads rose from 361 basis points to 385 basis points. Nevertheless, US high yield has returned 6.1% year to date.
- The sector is effectively pricing in a default rate of 2% or below (i.e. 0% chance of recession). There would not appear to be much left for the sector.

US High Yield Returns



Source: St Louis Fed, BoA, using proxy updates 14/09/2017

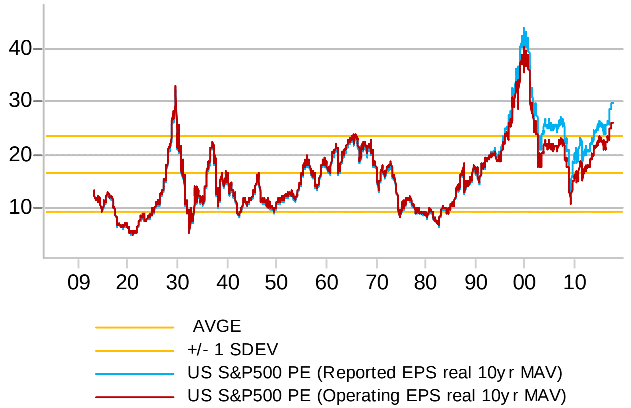
High Yield spreads & US GDP-Based Recession Indicator



Source: FED, St Loius Fed

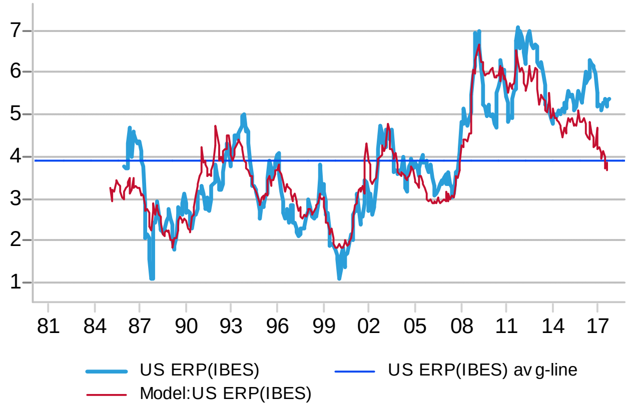
Valuations: Equities

US PE (real reported & operating 10yr mav EPS)

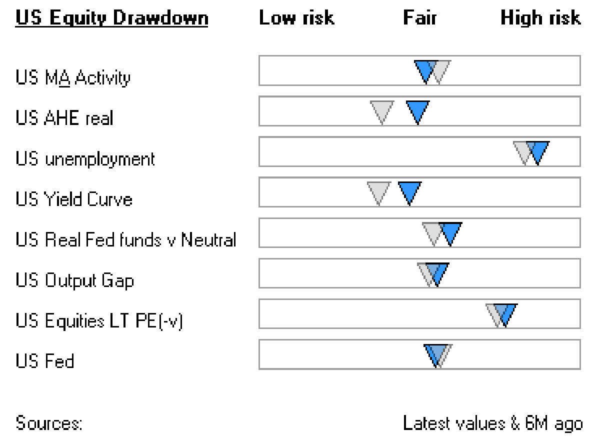


Source: IBES, Shiller, using proxy updates 14/09/2017

US Equity Risk Premium & Model ERP



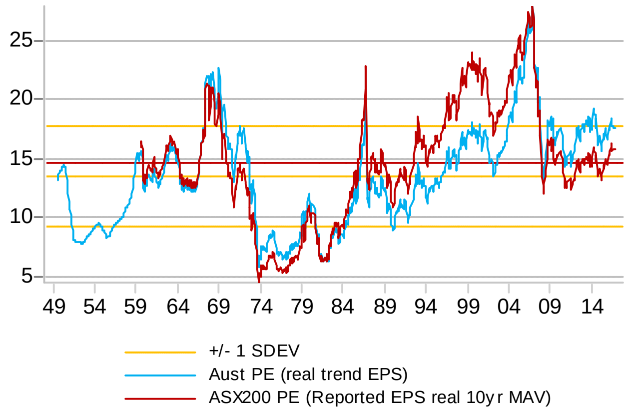
Source:FED,ISMRBA, using proxy updates



ABSOLUTE VALUATIONS STRETCHED BUT ERP PREFERS EQUITIES OVER BONDS

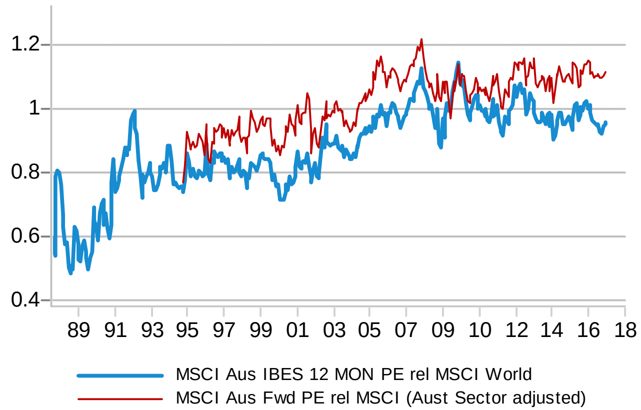
- Overall our global equities valuation indicator is negative, i.e. markets are expensive. Shiller PE's suggest longer term returns from US equities should be 40% below longer term returns. Australian equities also appear to be expensive on a longer term basis, though less so.
- On an ERP basis US equities appear reasonable value compared with bonds. US equities could withstand a rise in bond yields to around 3%. Australian equities on an ERP basis are slightly cheap to bonds.
- Relative to global equities Australia is towards the bottom end of the range over the last 10 years but on a sector-adjusted basis the domestic market is more neutral.
- Our US equity drawdown indicators are above average, driven by high valuation, low unemployment and rising real Fed funds.

Aust PE (real trend EPS)



Source:,IBES, RBA, ABS, using proxy updates 14/09/2017

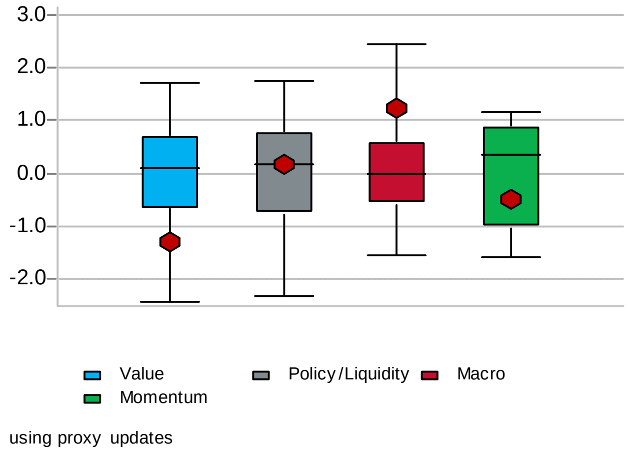
Australia PE rel World PE



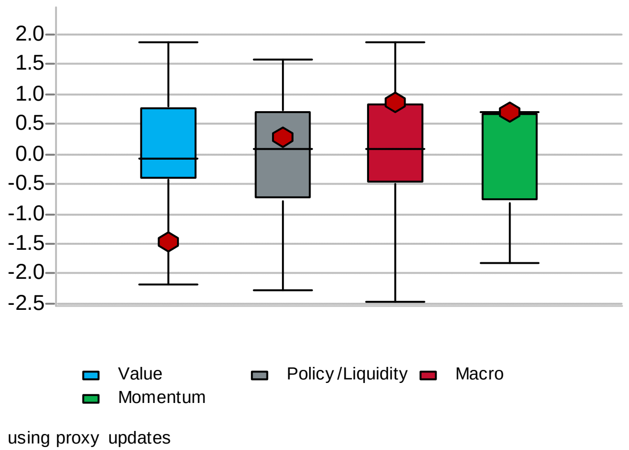
Source: IBES, using proxy updates

Indicators

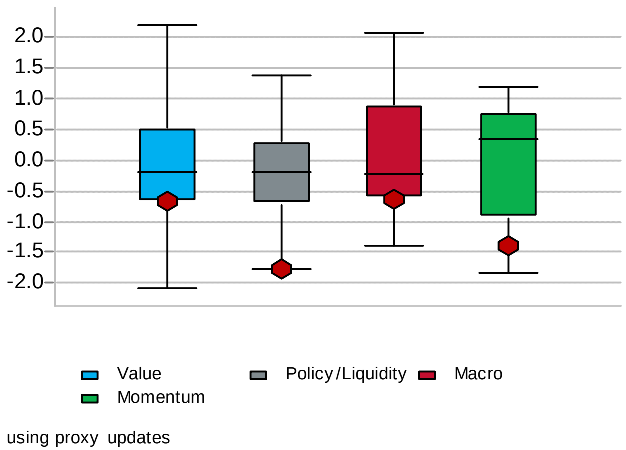
Aus Equities Indicators



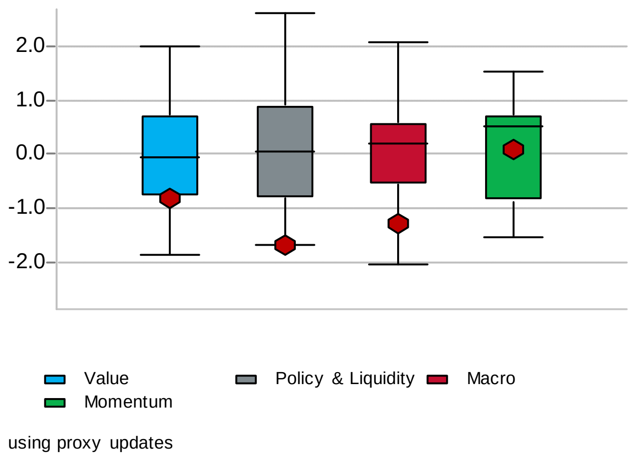
Global Equity Indicators



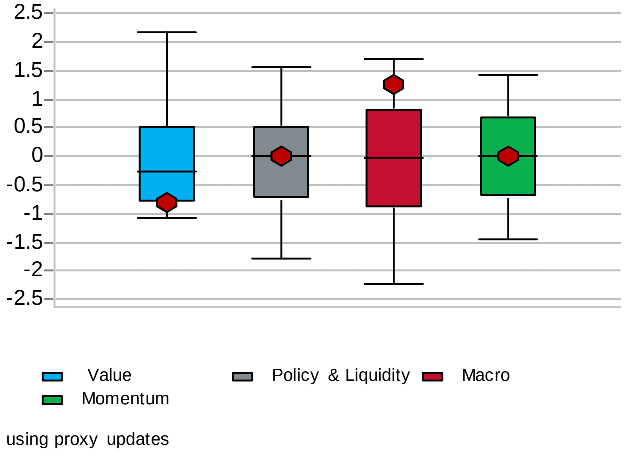
Australian Bond Indicators



Global Bond Indicators



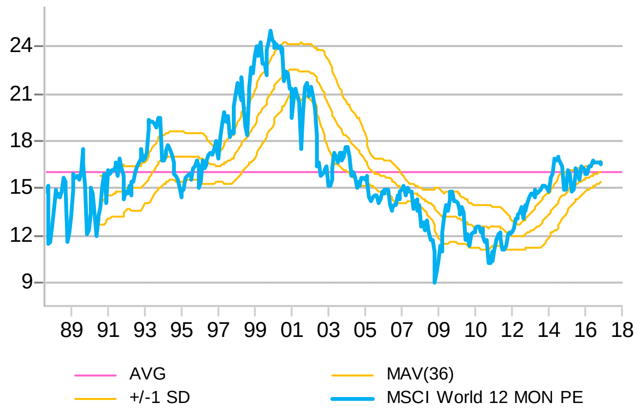
High Yield Indicators



- The macro indicators are positive for equities driven by an existing global output gap, positive growth momentum (though easing) and positive EPS revisions. Policy indicators for equities have become more neutral reflecting the declining global excess liquidity measure while valuations in absolute terms are stretched.
- Bond indicators remain negative while the high yield indicators are mixed with macro positive being offset by poor valuations and neutral liquidity readings.

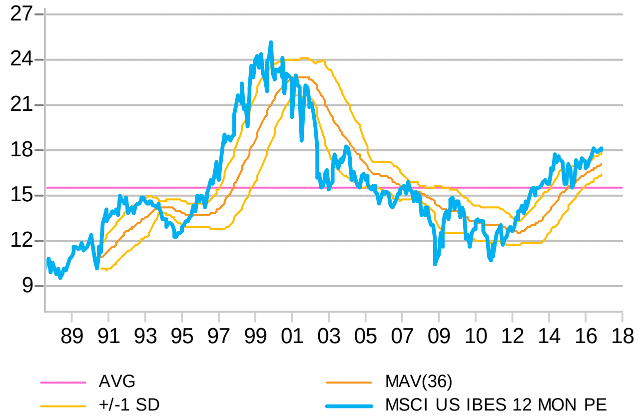
Valuations: Forward PEs

World Forward PE



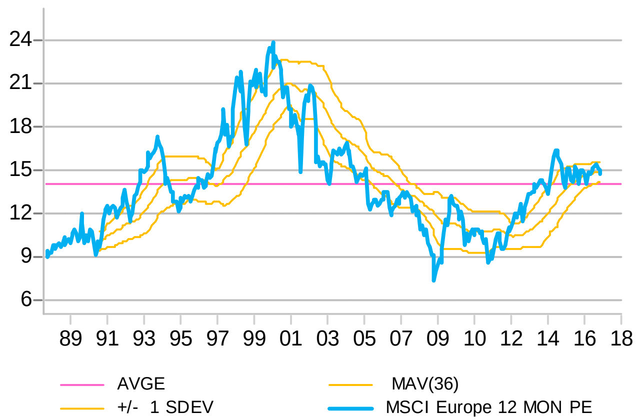
Source: IBES, using proxy updates 14/09/2017

MSCI US Forward PE



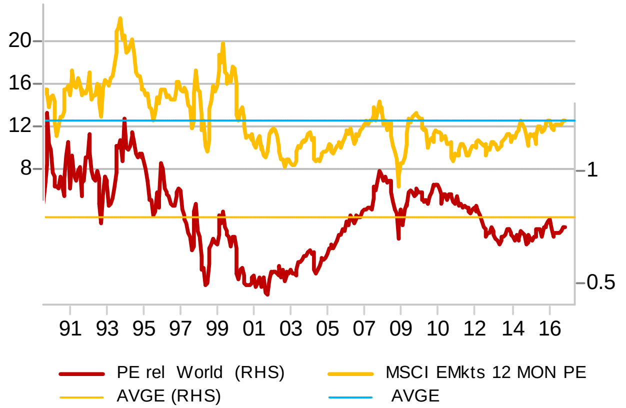
Source: IBES, using proxy updates 14/09/2017

MSCI Europe Forward PE



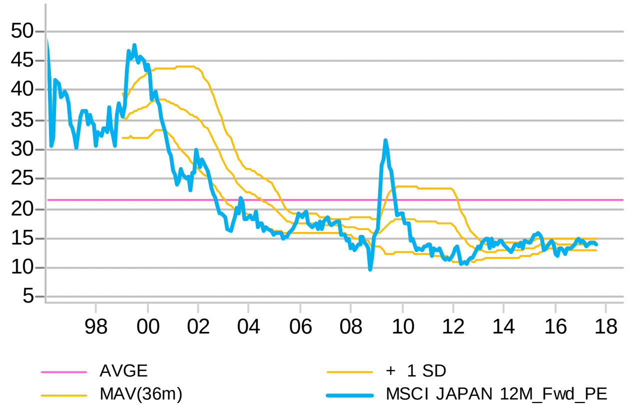
Source: IBES, using proxy updates 14/09/2017

Emerging Mkts Fwd PE



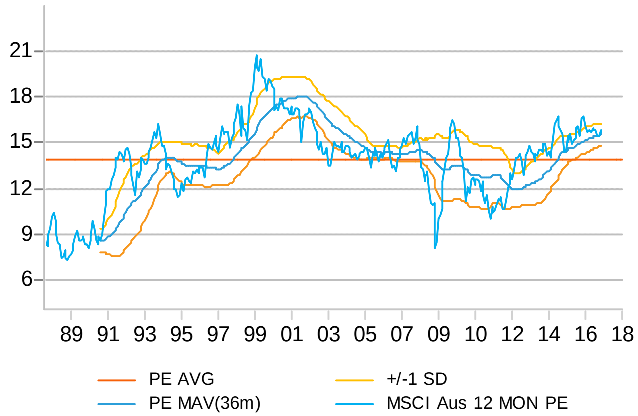
Source: IBES, using proxy updates 14/09/2017

MSCI JAPAN Forward PE



using proxy updates 14/09/2017

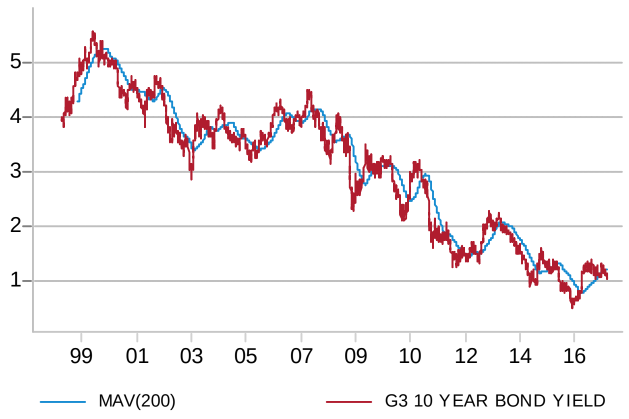
Australian Forward PE



Source:ABSSt Loius Fed,IBES, using proxy updates 14/09/2017

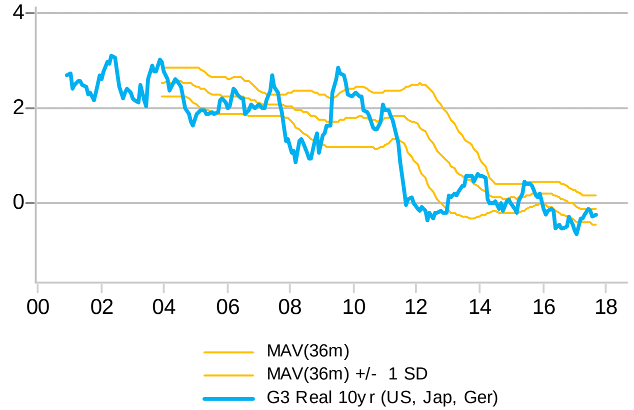
Valuations: Bonds

G3 10yr Bond



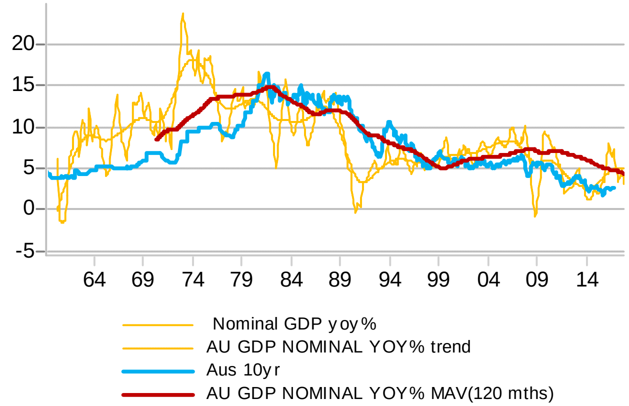
Source: IRESS, HIS est., using proxy updates 14/09/2017

G3 Real 10 year yield



Source: US Fed, IRESS, HIS est., using proxy updates

Australian 10 year & Nominal GDP

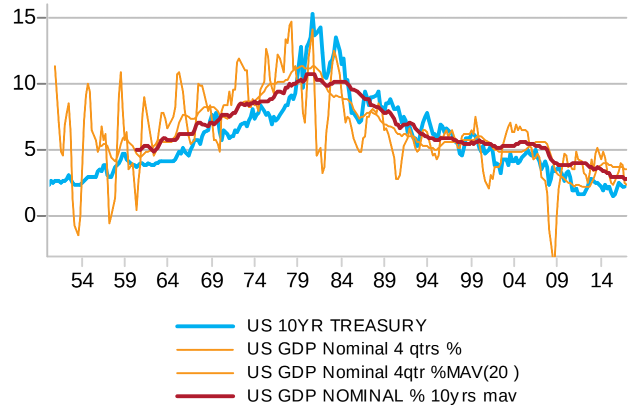


Source:ABSSt Loius Fed,RBA, using proxy updates 14/09/2017

BONDS STILL AT RISK OF QE TIGHTENING & NORMALISATION

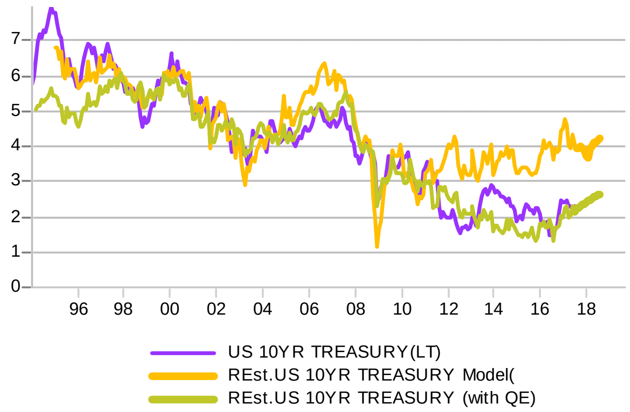
- Relative to trend nominal GDP growth of 3.6% in the US, US 10 year bonds at 2.2% are well below what is considered to be "fair value".
- At 2.7% Australian bonds are reasonable value if you believe nominal GDP growth will remain around the 5-year average of 3% but very expensive if we use the 10-year average of 4.5%.
- Our model of the US 10 year suggests that fair value should rise towards 2.75% over the year as QE tightening begins. The Fed is projected to reduce its balance sheet by US$300 bn over the next 12 months and up to US$600 bn in coming years.

US 10YR & US NOMINAL GDP



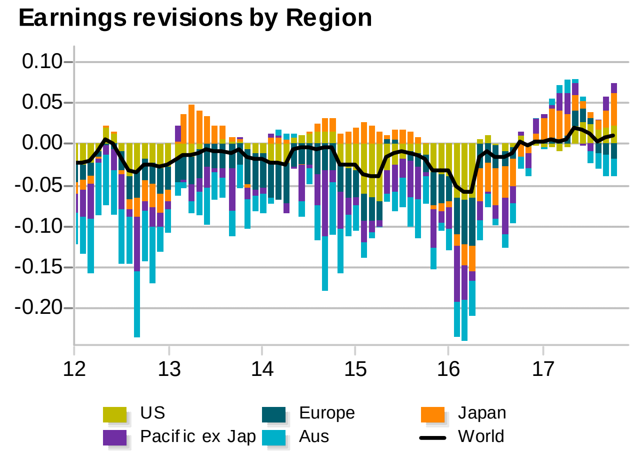
Source: BEA, US Fed, using proxy updates 14/09/2017

US 10YR TREASURY Model

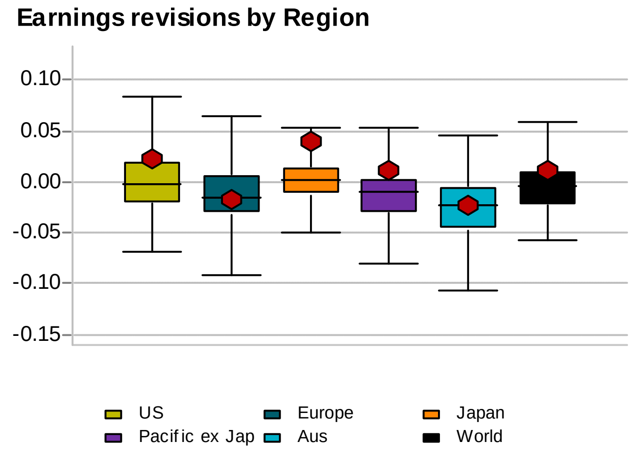


Source: IRESS, HIS est.

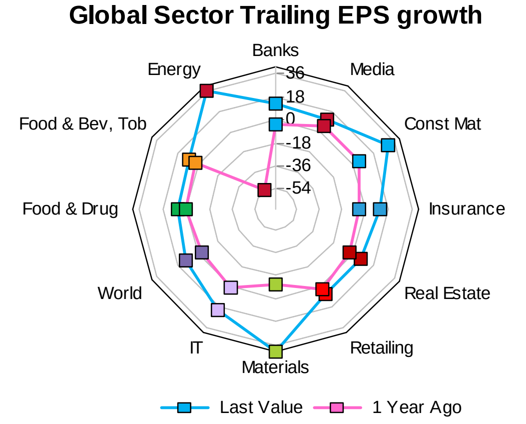
Earnings



Source: IBES



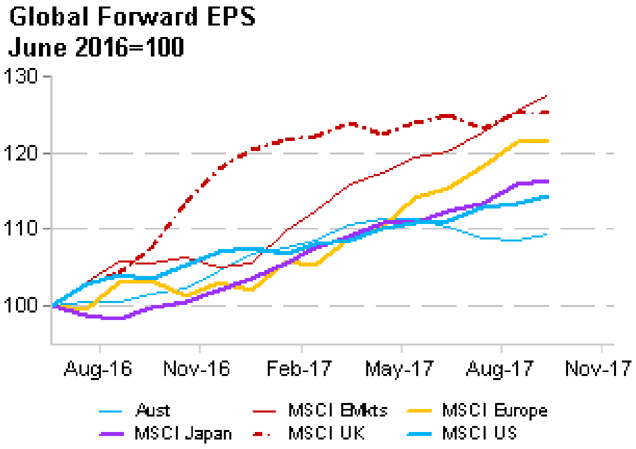
Source: IBES



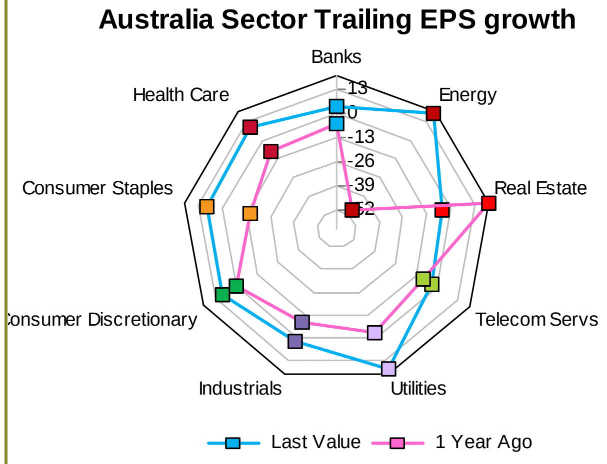
Source: IBES

EARNINGS REVISIONS POSITIVE

- The global EPS revision ratio is close to its highest level in seven years and earnings are being revised higher across all regions, except Australia and Europe just recently.
- On a sector basis trailing EPS is up across the board, more so globally than in Australia.
- Forward EPS estimates since mid-2016 have lifted the most in EM followed by the UK (recently flat) while Europe has been strong. Australia has lagged.



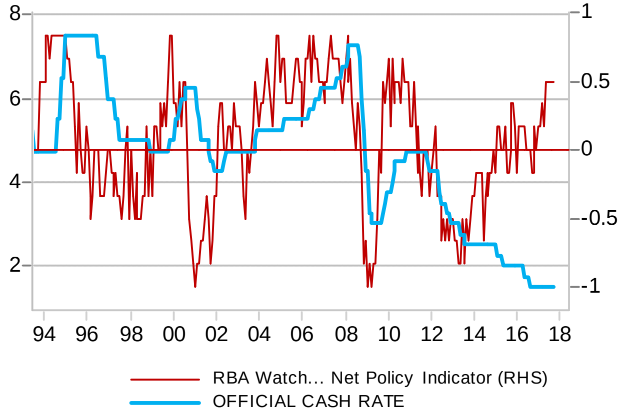
Source: IBES



Source: IBES

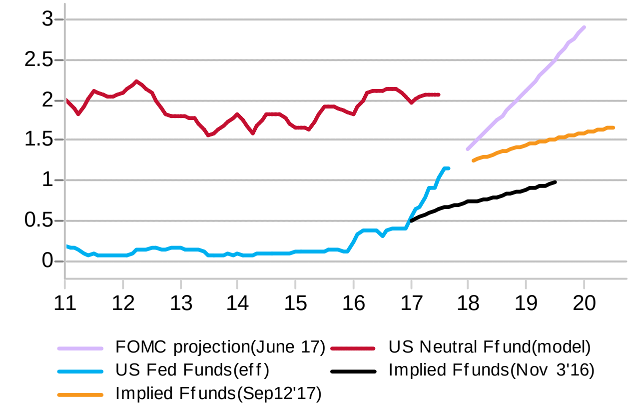
Policy and Liquidity

RBA Policy Indicator & Cash rates



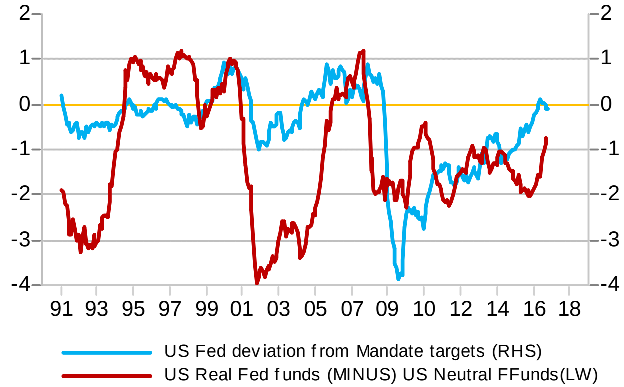
Source: RBA, IRESS, ABS, NAB, using proxy updates

US Fed Funds Projection



Source:,St Loius Fed,CME,FED

US Fed funds v Neutral & Fed Dual Mandate

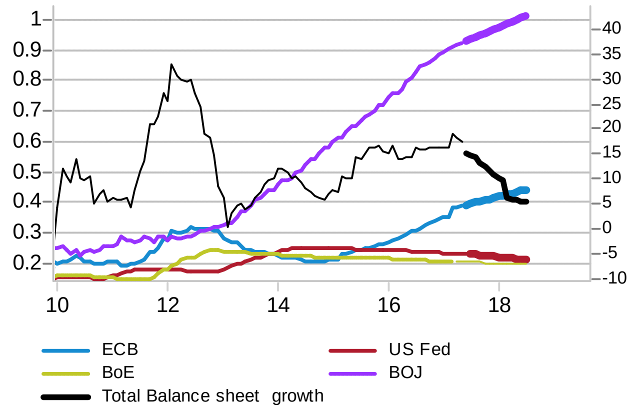


Source:Fed,BEA

RBA BIAS CHANGING, GLOBAL LIQUIDITY PAST ITS PEAK

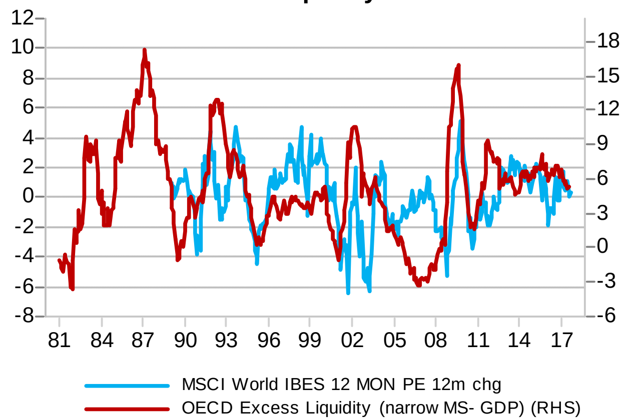
- Our RBA indicator suggests the RBA should have a tightening bias. Recent strong employment growth and NAB business conditions have driven the indicator higher and this requires watching. Our base is for no change this year with any tightening undertaken by the banks. The "only" indicator in this measure holding back the RBA is the low level of inflation expectations. (read wages, inflation)
- In the US the futures market has the Fed funds (mid-point) at 1.25% at the start of 2018, suggesting a 50% chance of another move this year. It has 1.45% priced for end-2018 and 1.6% for end-2019. This is below the FOMC at 2.15% and would still be below neutral (estimated at 2.25%)
- Global excess liquidity has supported PE expansion but growth in central bank balance sheets will diminish in 2018.

Central Bank Balance Sheets % of GDP



Source: US Fed, ECB, BOJ, BoE

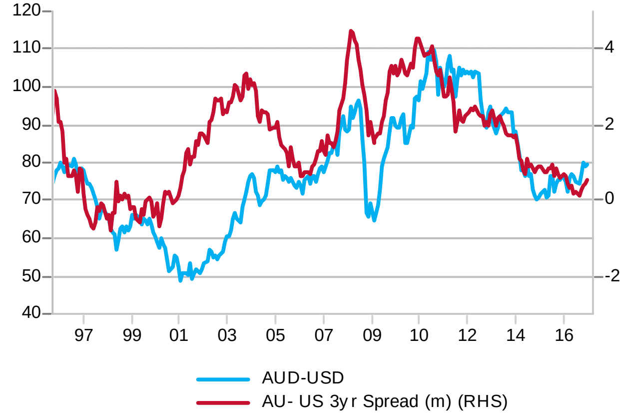
Global PE's & Excess liquidity



Source:IBES, OECD, using proxy updates

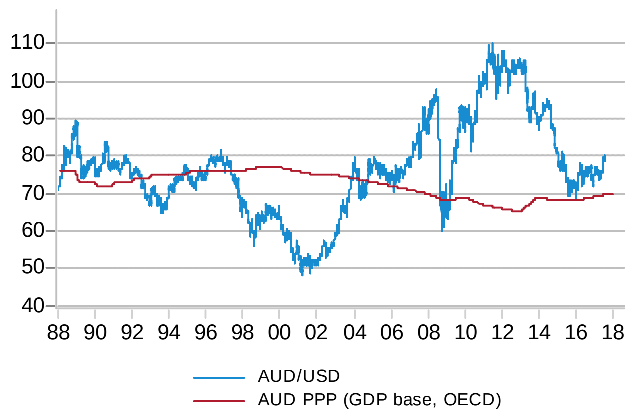
AUD

AUD-USD & AU- US 3yr Spread



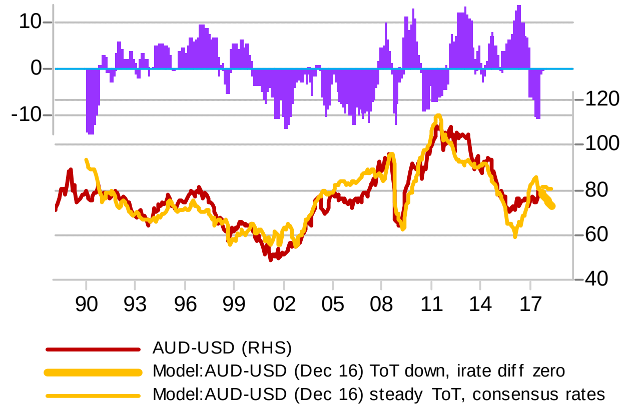
Source: IRESS, RBA, using proxy updates

AUD PPP & AUD-USD



Source: OECD, IRESS

AUD Deviation from model



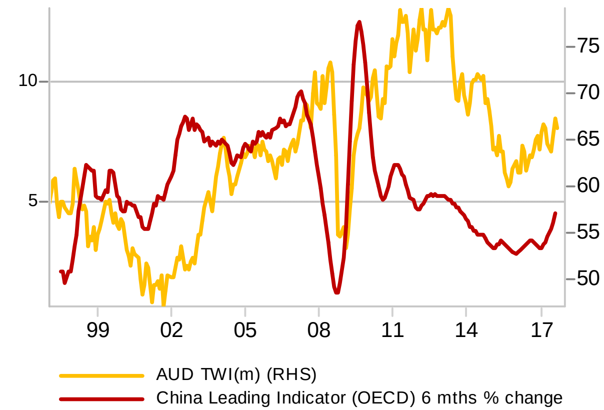
Source:,ABS,RBA,FED,IRESS,CBOE, using proxy updates

AUD BENEFITS FROM HIGHER SPREADS, GROWTH

- The AUD at around 80 cents is fair value if iron ore is sustained at current levels and interest rate differentials remain steady. If iron ore drops back to US $55-60 a tonne (consistent with a 10% decline in the Terms of trade) and US rates move above Australian rates fair value would be in the low-mid 70 cent range.
- The AUD is slightly expensive on a PPP basis.
- Compared to the range of major currencies, using our attribute screen, the GBP is favoured relative to the USD. There other currencies are at similar levels. From a momentum perspective the AUD is favoured. On a valuation perspective the yen is favoured.

	Currency Rel Int rates	Currency Value	Currency Macro Momentum	Currency Price Momentum	Rank Value
weight Term = 55 Yrs	16.66	50	16.66	16.66	
GBP	0.56	0.72	0.40	0.55	0.67
JPY	0.28	0.94	0.20	0.45	0.60
EURO	0.48	0.68	0.60	0.60	0.60
AUD	1.00	0.20	1.00	0.90	0.60
USD	0.68	0.46	0.80	0.50	0.53

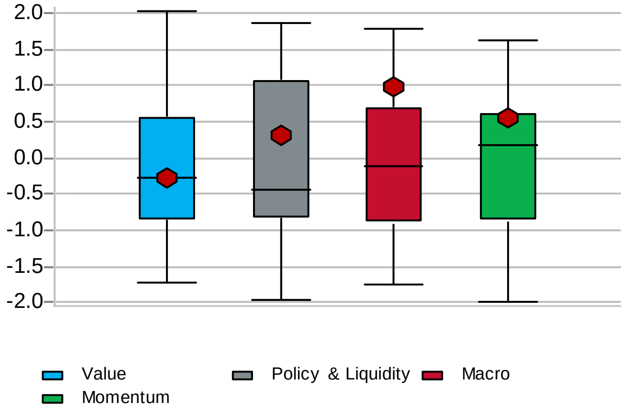
AUD & Chinese Growth



Source: IRESS, OECD, HIS

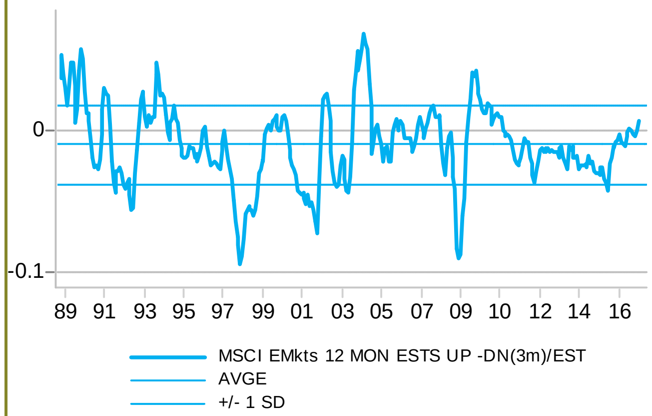
Emerging Markets

Emerging Markets Indicators



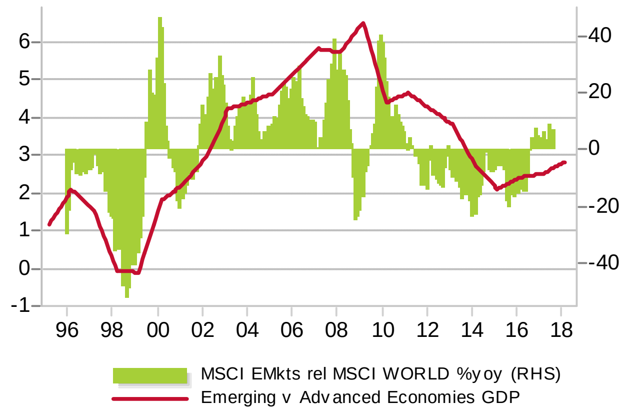
using proxy updates

Emerging Markets Earnings Revisions



Source: IBES

EM GDP v World & relative performance

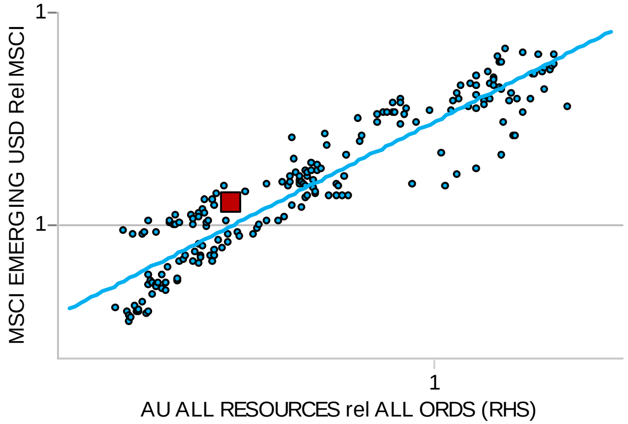


Source:,OECD, IMF

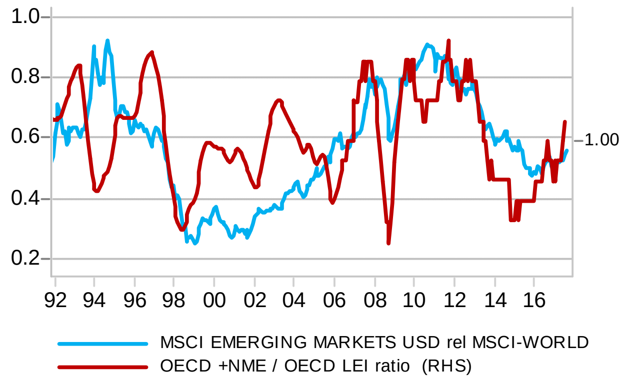
MACRO FACTORS SUPPORTIVE

- Our overall composite indicator for emerging markets has modest positive reading, with the macro indicator being supported by rising growth momentum and a rising leading indicator. The EPS component has deteriorated. The policy and valuation signals are reasonable.
- More fundamentally, EM growth is improving, rates are easing and margins are expanding.
- USD weakness and stronger commodity prices have also supported EM.
- It does not have the valuation risk of other markets but is clearly susceptible to a change in the direction of the USD (which could come into focus as the Fed starts normalising).

MSCI EMERGING USD (Rel MSCI) & RESOURCES rel ALL ORDS

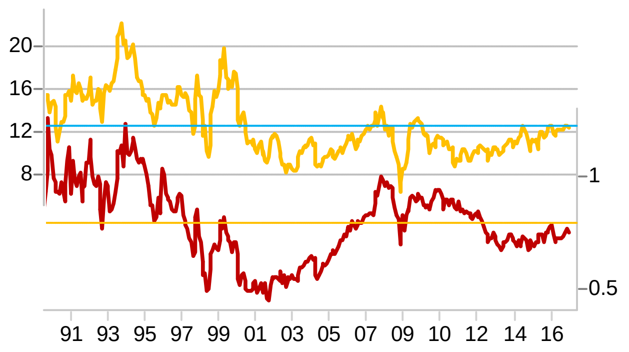


MSCI EMERGING MARKETS USD rel MSCI-WORLD & OECD + NME to OECD LEI Ratio

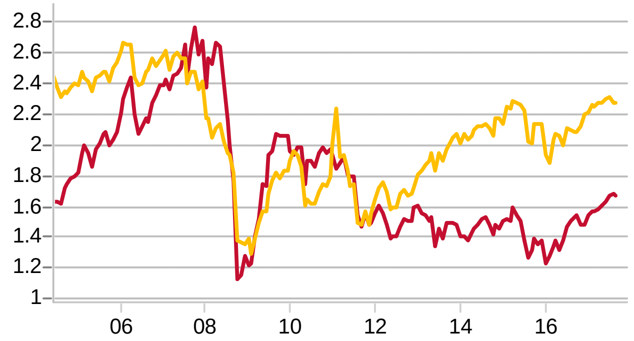


Source: IBES. OECD, using proxy updates

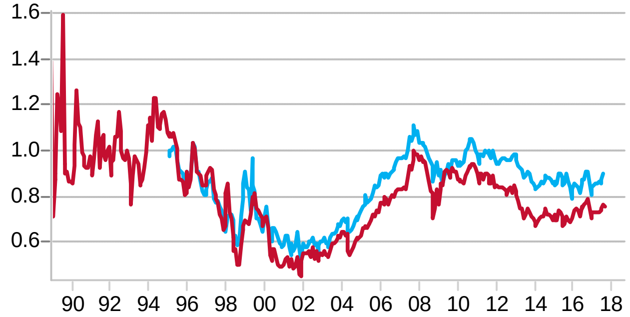
Emerging Markets



Source: IBES, using proxy updates



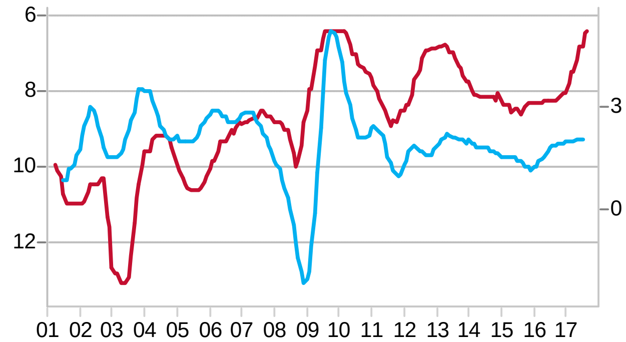
Source:IBES



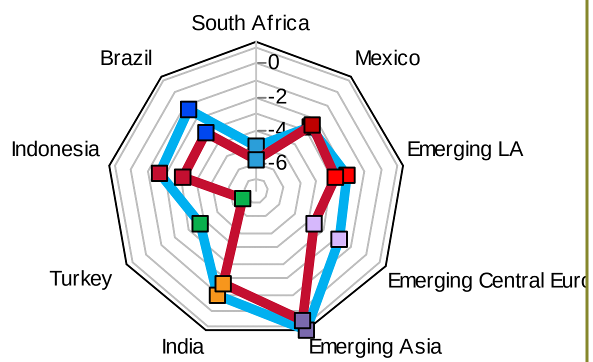
using proxy updates

VALUATIONS & EARNINGS

- Valuations are reasonable, both in absolute terms and relative to global equities.
- Policy is also being eased as lower inflation and more stable current accounts and currencies allow the focus to return to domestic fundamentals. This should support growth going forward.



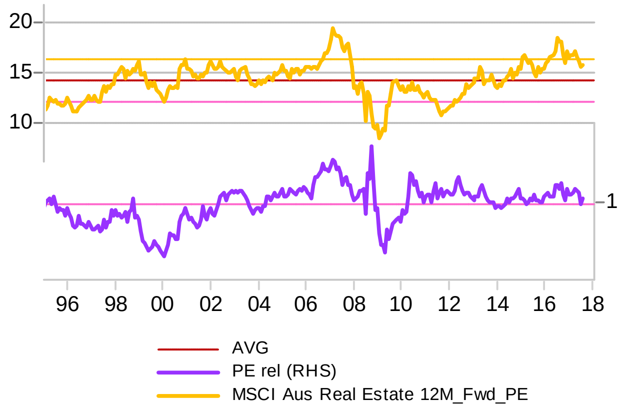
Source:,OECD



Source:IMF

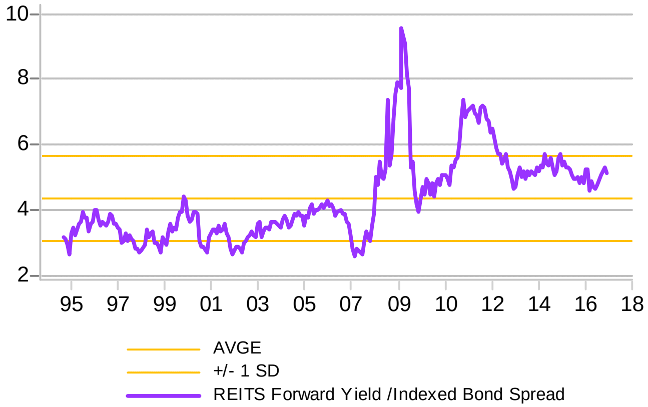
REITs

MSCI Aust Real Estate Forward PE



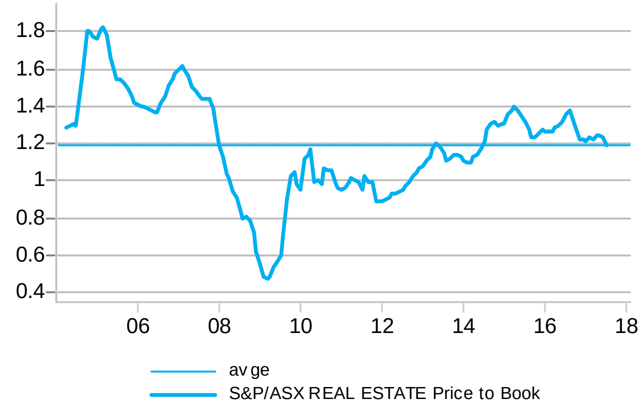
Source: IBES, using proxy updates

REITS Forward Yield less 10yr Real



Source: IBES, IRESS, using proxy updates

S&P/ASX REITs Price to Book

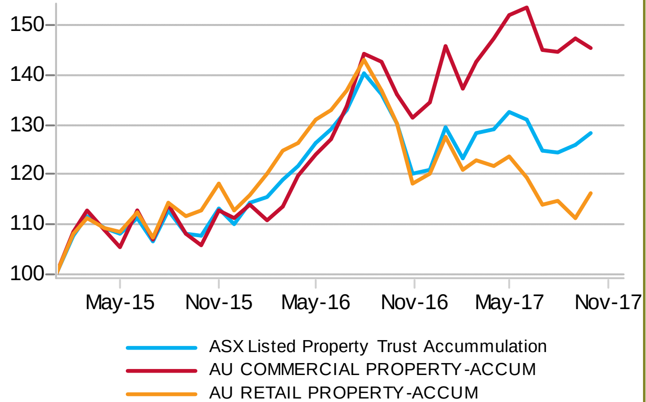


Source:IBES, using proxy updates

NEUTRAL IN ABSOLUTE TERMS, VERY SENSITIVE TO BONDS

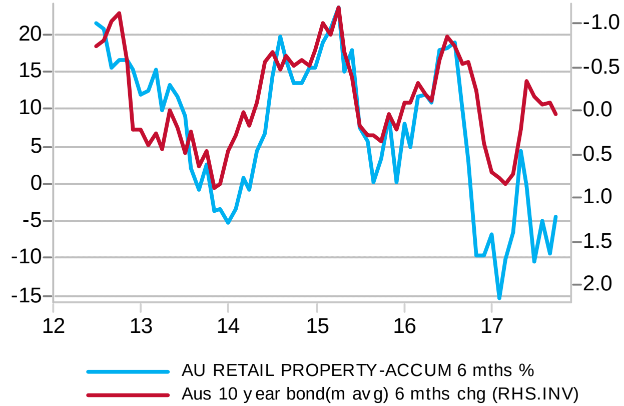
- Valuations appear to have come back to neutral and relative to bonds the sector is beginning to look interesting.
- The ongoing poor performance of retail REITs, suffering under the weight of concerns over retail spending and online growth, has seen the relationship with changes in bond yields break down.

REITs sector performance



Source:IRESS, using proxy updates

Retail REITs & Bonds



Source:IRESS,RBA, using proxy updates

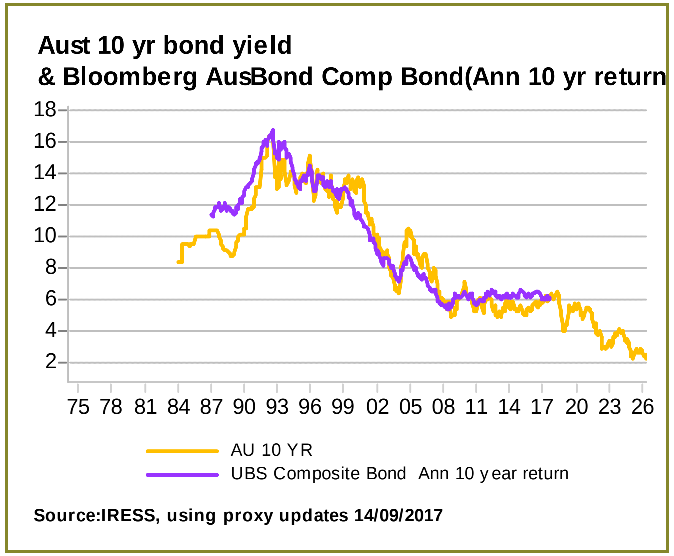
Appendix 1: August Asset class returns

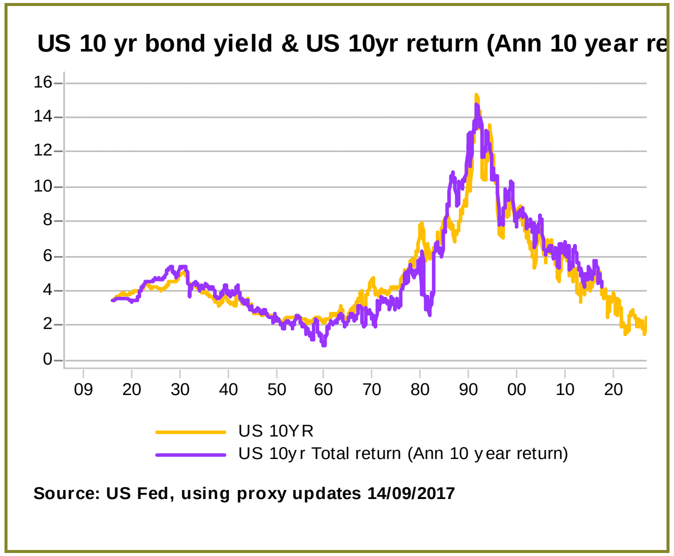
ASSET CLASSES	MONTH % CHG	3MNTH % CHG	6MNTH % CHG	YTD % CHG	1 YR % CHG	3YR RETURN PA	5YR RETURN PA	10YR RETURN PA
ASX 200 Accumulation	-0.01	-2.59	3.97	3.15	7.33	5.11	10.88	3.83
MSCI World ex Aust ,net, AUD	-1.67	-1.63	5.25	2.76	10.60	12.43	18.21	5.22
MSCI World ex Australia 100% hedged AUD (Net)	1.51	3.42	9.14	10.69	17.54	10.46	15.43	6.74
S&P/ASX 200 - Property Trusts (TR)m	-0.07	-5.92	1.16	-3.74	-11.14	10.15	12.88	0.56
S&P Global REITs (AUD hedged)	0.82	0.64	1.81	1.99	-7.18	5.17	na	na
Bloomberg AusBond Bank Bill Index	0.15	0.44	0.87	1.03	1.79	2.19	2.49	3.85
Bloomberg AusBond Composite 0+ yr Index	0.25	0.51	1.88	2.51	-0.24	4.24	4.30	6.18

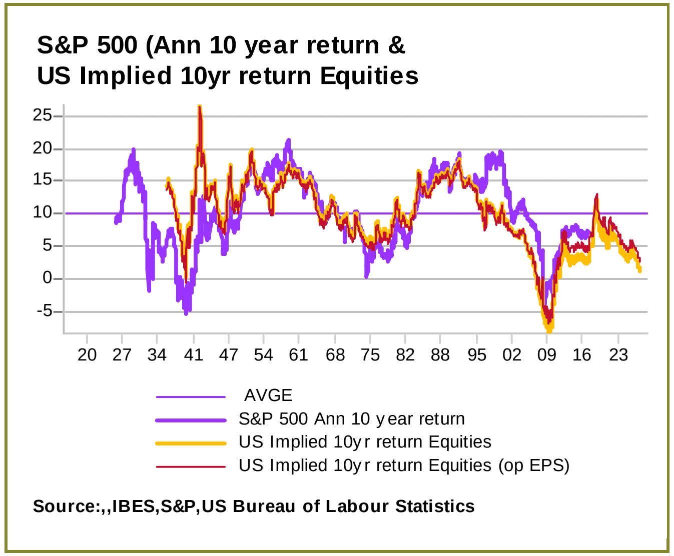
SUB ASSET CLASSES	MONTH % CHG	3MNTH % CHG	6MNTH % CHG	YTD % CHG	1 YR % CHG	3YR RETURN PA	5YR RETURN PA	10YR RETURN PA
S&P 500 Total Return Index	2.06	4.14	9.51	11.59	16.04	10.87	14.78	7.74
ASX Small Ords Accum (Ex 100)	0.34	0.24	4.00	1.45	-1.09	5.55	5.77	-1.75
MSCI Small Cap Index (USD, net)	2.27	4.52	9.69	12.21	17.18	8.01	13.49	6.13
MSCI World Small Caps ex Aust (NI) AUD	-1.53	-2.23	3.90	1.64	10.62	13.93	20.29	7.09
MSCI Emerging Markets (USD)	5.48	9.03	17.27	23.65	22.07	0.01	2.28	-0.43
MSCI Emerging Markets (AUD est)	1.59	2.04	11.10	12.03	14.96	5.31	8.09	0.28
Bloomberg AusBond Infl Govt 0+ yr Index (d)	-0.17	-0.70	1.08	1.73	-2.21	3.50	3.26	6.06
AUD-USD (m)	3.84	6.85	5.55	10.38	6.18	-5.03	-5.37	-0.70
AUD TWI (m)	2.75	4.34	2.28	5.32	6.32	-2.00	-3.13	-0.22
USD Major Currency Index Nominal	-2.29	-4.61	-5.28	-6.03	-1.36	5.52	3.57	1.45
US 10yr Total Retrun Index Est	0.24	0.46	2.59	2.68	-5.40	2.79	0.65	4.66
BofA Merrill Lynch US High Yield Master II TR Index	1.15	2.20	4.71	6.12	11.26	5.34	6.75	8.00
Bloomberg AusBond Credit Bond Index (d)	0.55	1.04	2.58	3.40	2.81	4.57	5.26	6.58
CRB Index	4.50	0.50	-4.89	-5.13	0.90	-14.72	-9.42	-5.57

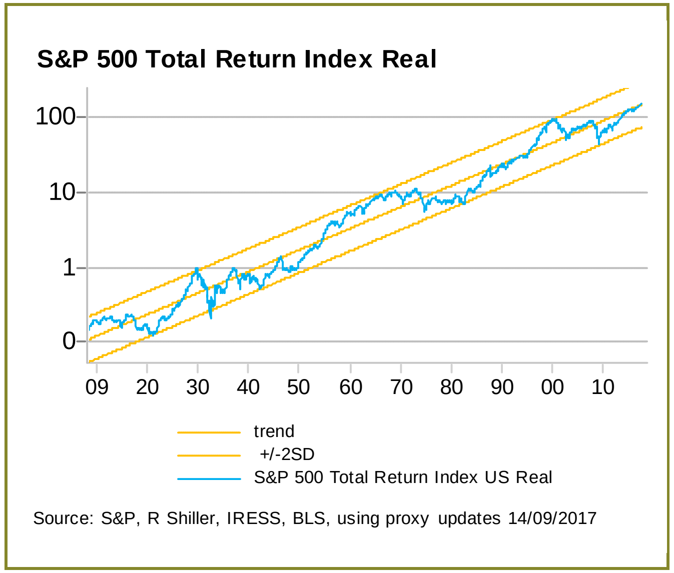
CREDIT	MOM CHANGE	3 MNTH CHG	6 MNTH CHG	YTD CHG	YOY CHANGE
AU 10YR SWAP SPREAD INDEX	-0.05	-0.05	-0.03	0.00	0.07
BofA Merrill Lynch US High Yield Master II OAS	-0.16	-0.14	-0.39	-0.60	-2.00
BofA Merrill Lynch US Corporate Master OAS	-0.07	-0.13	-0.17	-0.20	-0.42
BofA Merrill Lynch US Corporate BBB Effective Yield	-0.09	-0.13	-0.28	-0.30	0.22
GERMAN - US 10yr Spread	0.08	0.21	0.26	0.49	-0.18
France - German 10 yr Bond spread	0.09	-0.29	-0.14	-0.25	0.00
Italy - German 10 yr Bond spread	0.05	-0.25	0.08	-0.04	0.32

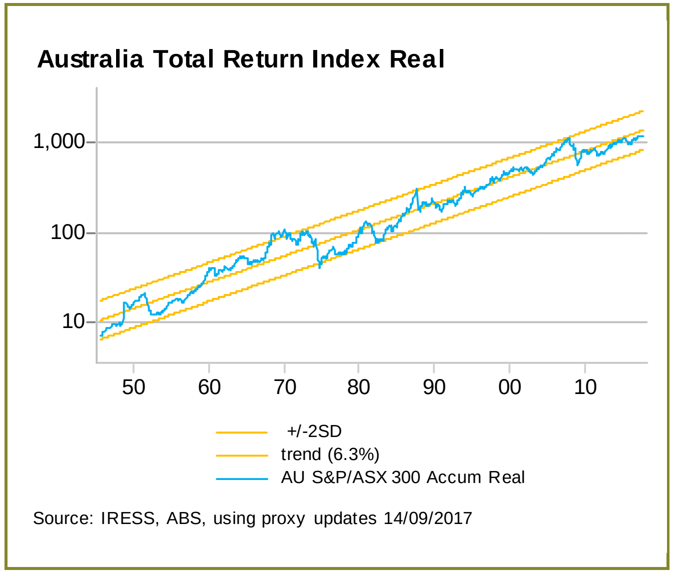
Appendix 2: Long Term Returns

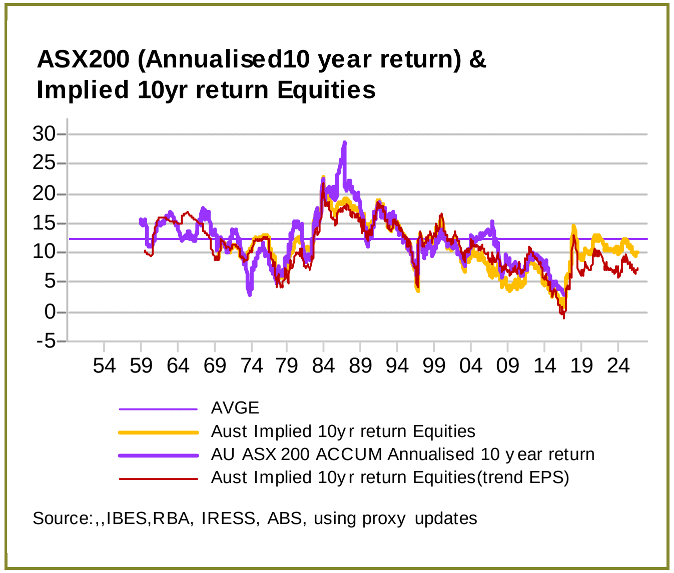






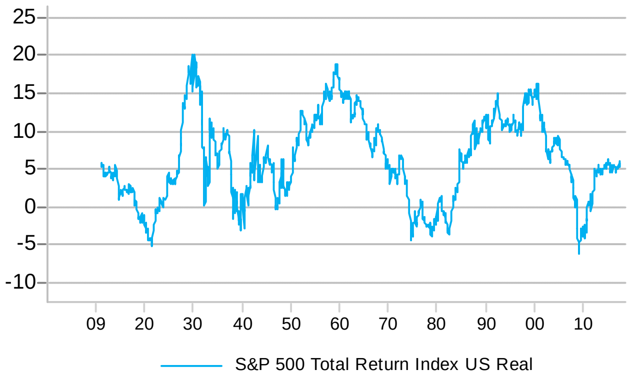






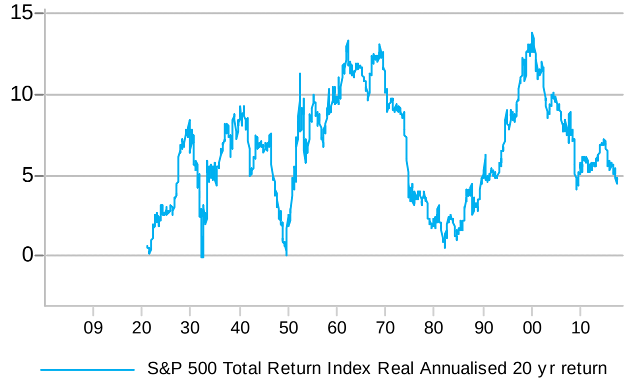
Appendix 2: Long Term Returns *(cont'd)*

S&P 500 Total Real Return Index (Annualised 10 year return)



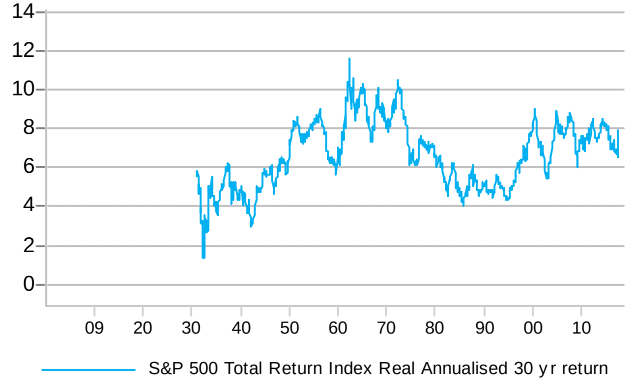
Source: BLS, S&P,, using proxy updates 14/09/2017

S&P 500 Total Real Return Index (Annualised 20 year return)



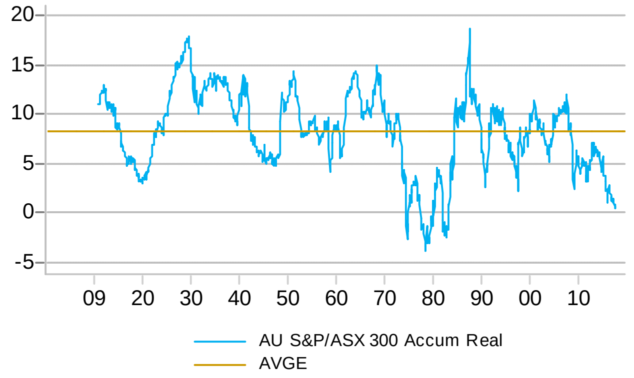
Source: BLS, S&P, using proxy updates 14/09/2017

S&P 500 Total Real Return Index (Annualised 30 year return)



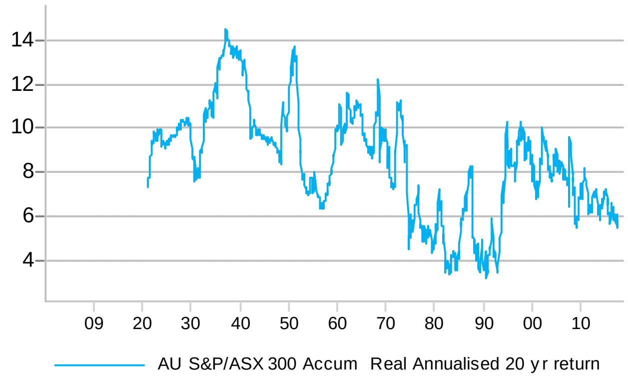
Source: BLS, S&P, , using proxy updates 14/09/2017

Aust Total Real Return Index (Annualised 10 year return)



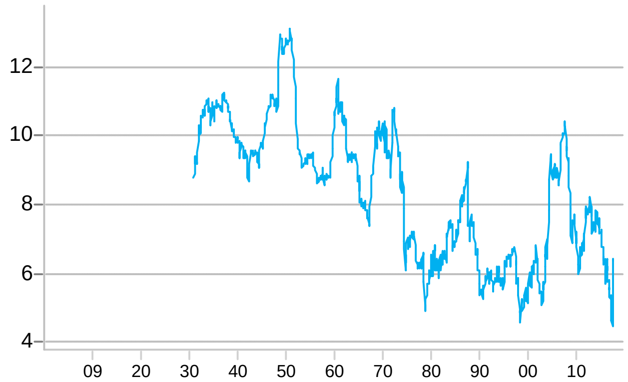
Source:,ABS,,St Loius Fed, using proxy updates 14/09/2017

Aust Total Real Return Index (Annualised 20 year return)



Source: ABS, RBA, IRESS, using proxy updates 14/09/2017

Aust Total Real Return Index (Annualised 30 year return)



Source: ABS, RBA, IRESS, using proxy updates 14/09/2017

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