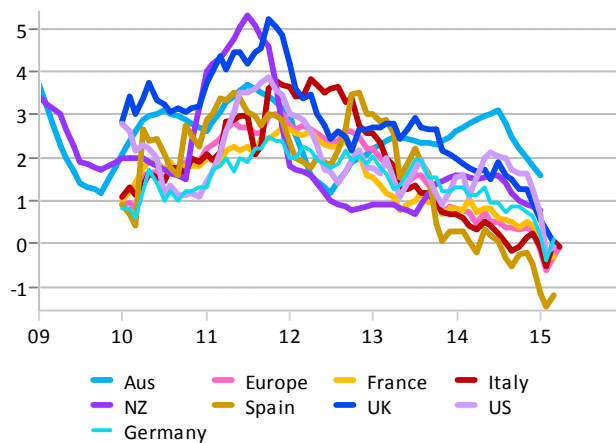


ASSET ALLOCATION AND INVESTMENT STRATEGY CHARTPACK

HEURISTIC INVESTMENT SYSTEMS
Generating Intelligence for Investment Decision Makers

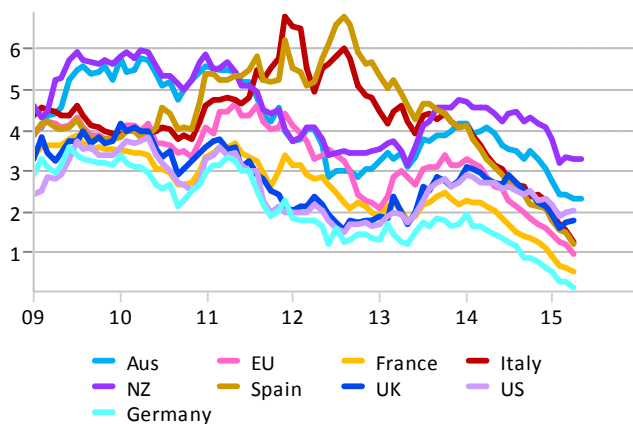
08 APRIL 2015

Global Inflation rates



Source:ABS,BLS,ECB,IRESS,ONS

Global Bond yields



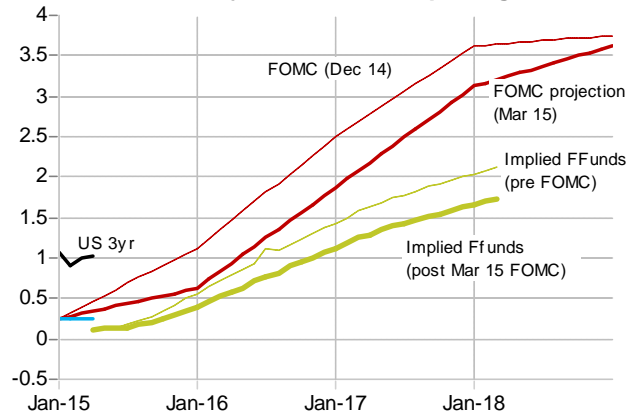
Source:ECB,IRESS,RBA

Investment Summary

The key themes and points this month are:

1. **Ongoing deflationary pressures in China, commodities, Europe and Japan. Continued disinflation in even the stronger performing countries such as the US and the UK.**
2. **Related decline in bond yields, further central bank easing and potential delay to US Fed tightening**
3. **Unwanted currency strength in this environment pressures central banks to ease/not tighten as aggressively**
4. **Reach for yield continues although the prospect of Fed normalisation has undermined this trade recently**
5. **Despite the Fed, overall central bank balance sheets will continue to expand in 2015, ordinarily supporting further PE expansion**
6. **But last 3-6 months have seen slower growth momentum globally, largely due to slowing in the US and China while Europe has improved**
7. **Related to this sales growth and EPS revisions have been poor outside Japan**
8. **China continues to weaken and importantly for Australia, iron ore continues to decline. Roughly each 10% off the iron ore price weakens the terms of trade by 2% so the 30% decline in iron ore could see a 5-7% decline in the terms of trade in the March quarter, putting a major dampener on domestic incomes and further downside in the AUD towards 70 cents.**
9. **There remains a strong likelihood of at least another rate cut in Australia.**
10. **Equity markets typically enjoy this stage of a normal business cycle...sub-par with the prospect of improving growth coupled with easy policy settings. Broadly this environment exists except that this is not an ordinary policy backdrop. With markets being priced off this environment of extremely low yields and excess liquidity**

US Fed Funds Projection v Market pricing



Source: CME, FED

even the smallest step towards normalisation could increase volatility. One could suggest that even though the US Fed may be “normalising” the rest of the world is going in the opposite direction (BOJ, ECB are engaging QE while many central banks are easing) and global excess liquidity is consistent with PE expansion. However, valuations have become extended in absolute terms. US and European markets (using forward PE’s for the past 25 years) have been more expensive than current levels only 20% of the time.

11. However, extremely low returns from cash, bonds and credit continue to benefit equity exposures.
12. How does it play out in 2015? We believe the Fed will err on the side of caution in tightening policy and that market pricing for this year is probably about right...i.e. the Fed will lift rates modestly. The USD is likely to strengthen further and accordingly these headwinds will undermine US equities. European and Japanese equity markets should continue to benefit from lower commodities, currencies and easier financial conditions.
13. For Australia, the further declines in commodities means lower growth but also probably, lower cash rates and a lower AUD. China presents a major downside risk.
14. Overall we believe the conditions still broadly favour equities but with the US and EM underperforming

Investment views

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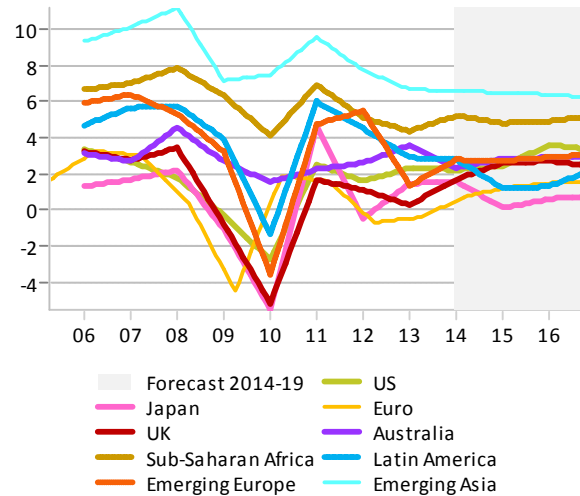
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Global Growth

Global Momentum	Weak	Avg	Strong	
G4 Momentum level				< trend
US ISM				back < trend
EU PMI				> trend & rising
German IFO				> trend & rising
Japan IP				weaker
China PMI				< trend

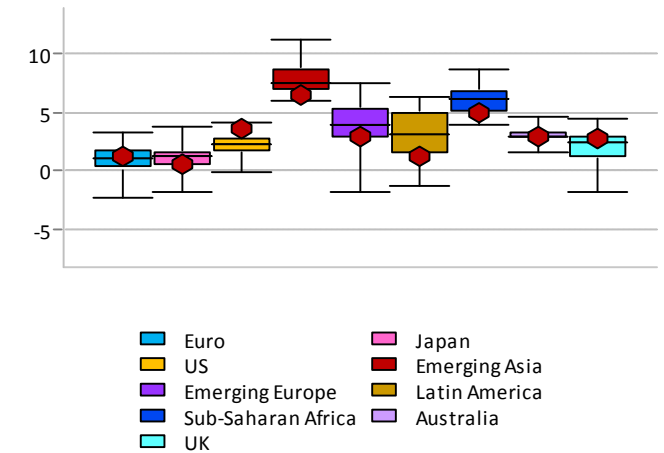
Sources: IFO, ISM, METI, Latest values & 3M ago

Global GDP & with IMF forecasts



Source: IMF, other

Global GDP 2015 forecast against 15 yr range

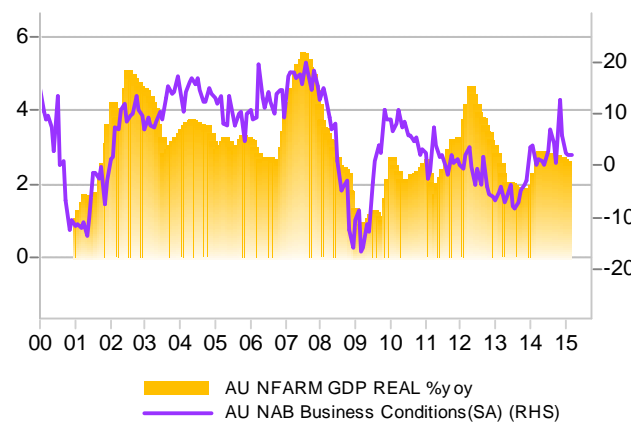


Source: IMF, other

GLOBAL ECONOMY TURNED DOWN IN MARCH QTR

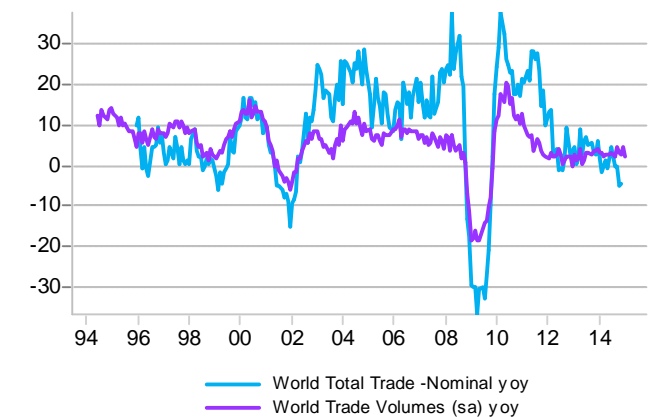
- The US continued to slow from its rapid growth of mid-late 2014 as weather conditions and other one-off factors impacted. **Now likely to see weaker jobs data but still expect US growth above trend.**
- EM growth slowing while US, Europe picks up.
- However, box-plot chart shows that with the **exception of the US and UK, GDP growth projections for 2015 are low compared with the 15 yr range.**
- Australian growth remains sub-par.
- China below trend with risks to the downside**
- World trade volumes showing modest growth but weak in nominal terms.

NAB Business conditions & AU GDP



Source: NAB, ABS

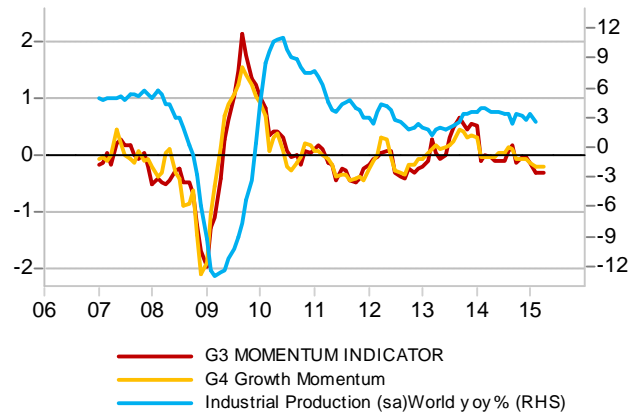
World Trade



Source: World Bank

Global Growth Momentum

G3 Momentum & Global IP

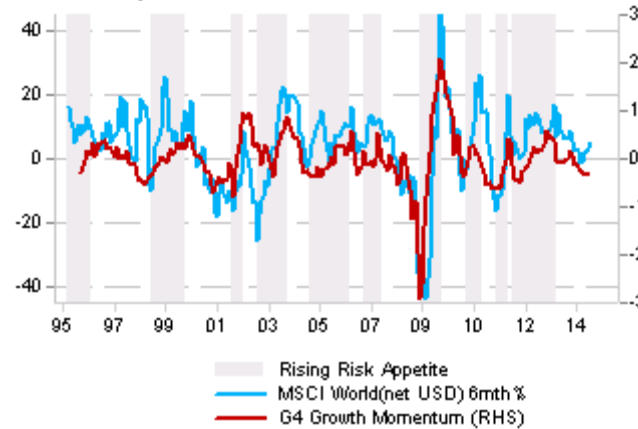


Source: OECD, Economist, IFO, ISM, METI

GROWTH MOMENTUM HAS BEEN FADING

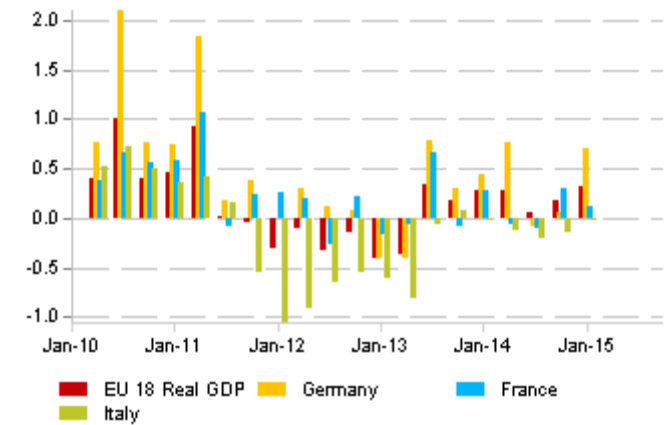
- **G3 and G4 momentum has been slowing since August 2014**, largely due to the US ISM coming off its peak but also because of deterioration in China and patchy Japanese data. Only Europe has been lifting momentum.
- It suggests the annual industrial production growth rates will continue to dwindle in the near term. The US needs to hold current levels and ideally rebound to alter the global momentum picture.
- **Growth in EM is still very weak.** Brazil remains very weak, as is Korea and China is struggling to offset the weakening construction sector. India is improving.

Global Equities & G4 MOMENTUM



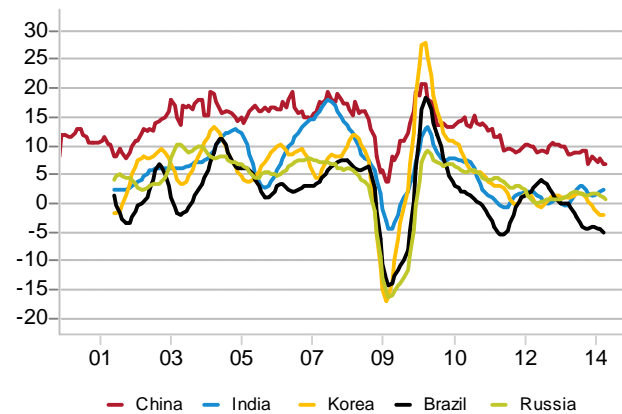
Source: MSCI, IBES, METI, ISM, IFO

Europe GDP Growth qoq



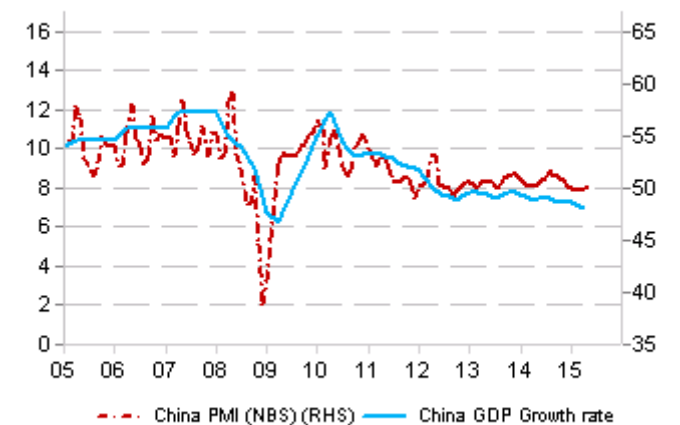
Source: ECB,

Emerging Markets IP



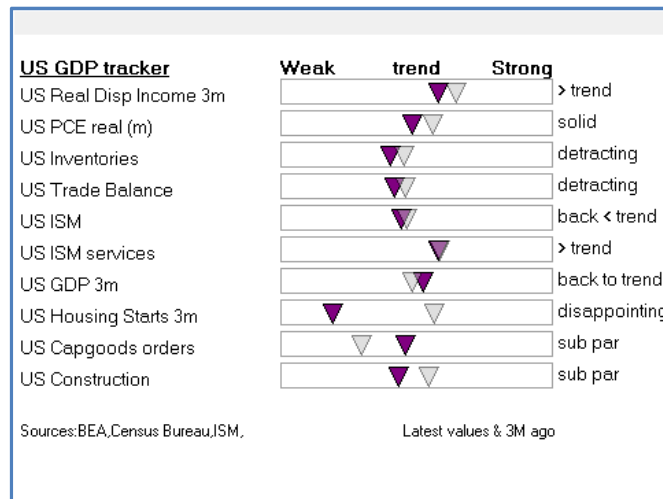
Source: OECD, China National Statistics

China GDP & PMI



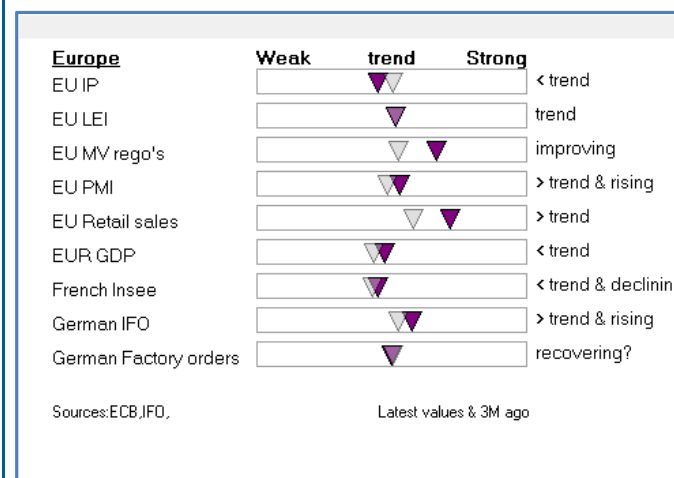
Source: National Bureau of Statistics, CLIC, CFLP

Global Growth Overview...cont...



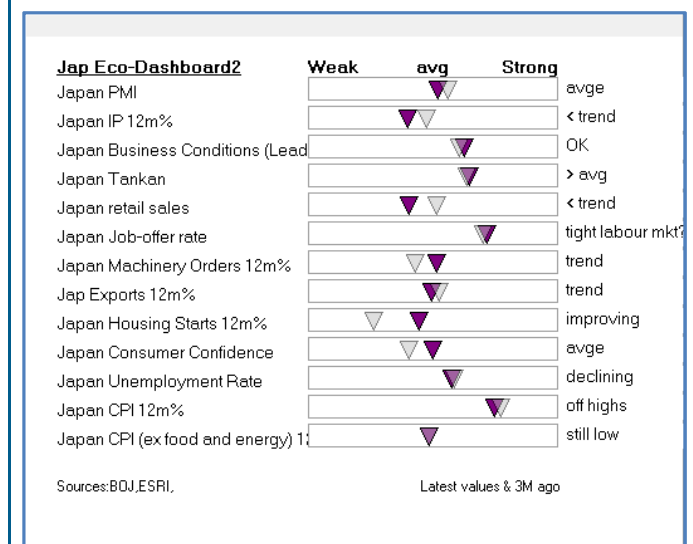
US: GROWTH SUB-PAR IN MARCH QTR

- Recent softening in the ISM, in the trade balance, housing, construction and inventories and ongoing softness in investment suggests the **March quarter was relatively weak**.
- However, **real disposable income growth is solid and the services sector is expanding suggesting the economy has more underlying strength**.



EUROPE: CONSUMER SPENDING UP

- Retail sales and motor vehicle registrations are firmer while the manufacturing PMI has also improved.
- Suggests the **European economy is recovering, albeit from a low base**.



JAPAN : MIXED

- Japan provides a very mixed picture.** The Tankan survey and the job-offer rate paint a solid picture of the economy. Exports and investment goods orders are around trend.
- However, consumer sentiment, housing and retail sales are sub-par.
- Inflation looks to be coming off as previous yen weakness subsides and oil prices decline.

US economy.. Fed policy

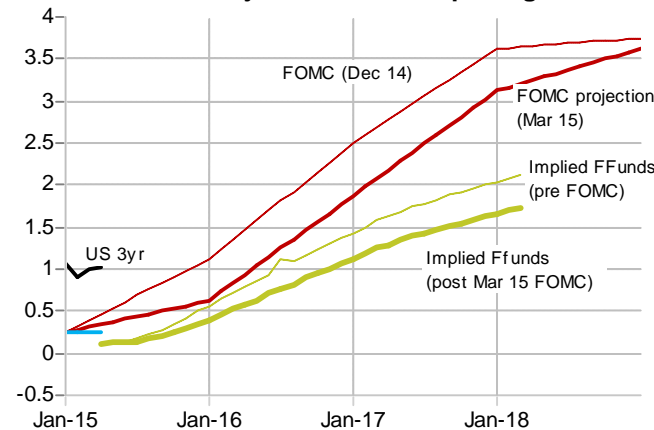
US Labour Market	Weak	trend	Strong
US payrolls			▼
US Layoffs			▼
US Job openings			▼
US CB More v less jobs	▼		
US unemployment			▼
US Underemployment			▼
US Hires		▼	
US Avg Weekly Hours		▼	
US Avge Hourly Earnings	▼		
US Quit rate		▼	
US Participation rate	▼		
US Long term Unemployed		▼	

Sources: BLS, IMF. Latest values & 3M ago

FOMC & MARKETS LOWER & DELAY FED NORMALISATION

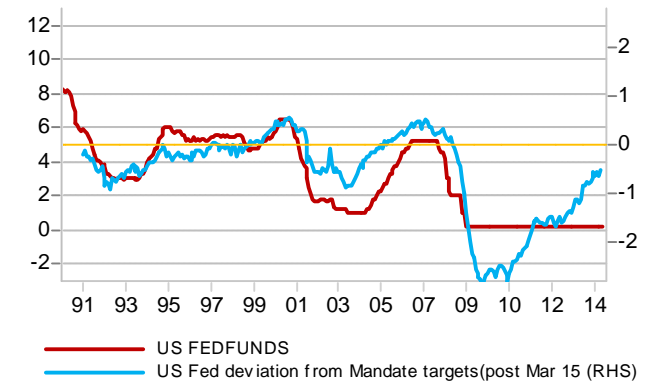
- The latest payrolls (126,000 in March) were well below the 12 month average of over 250,000. Hires and hours were also a little softer and this is not surprising given the recent softer activity data. Wages yet to rise!
- Nevertheless the **Fed is closing in on its mandate and market pricing for Fed action is still well shy of current (albeit reduced) Fed projections.** Market pricing is 150 bpts below FOMC projections by end-2017.
- The March FOMC meeting ended with the removal of the term "patient" from the minutes although Fed Chair Janet Yellen said that does not mean the Fed will be "impatient", with policy changes to be data dependent. The FOMC members lowered the median Fed funds projection to 0.625% for end -2015 (from 1.125%), 1.9% for end-2016 (from 2.5%) and 3.1% for end-2017 (from 3.6%). The market is priced for 0.4% for end-2015, 1.12% for end-2016 and 1.66% for end-2017 (from 2.1%).

US Fed Funds Projection v Market pricing



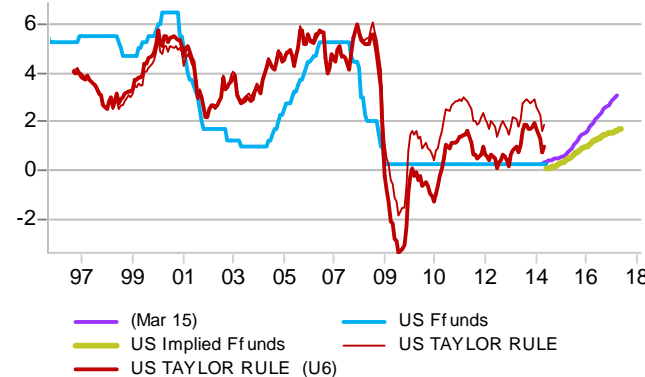
Source: CME, FED

US Fed funds & Fed Dual Mandate



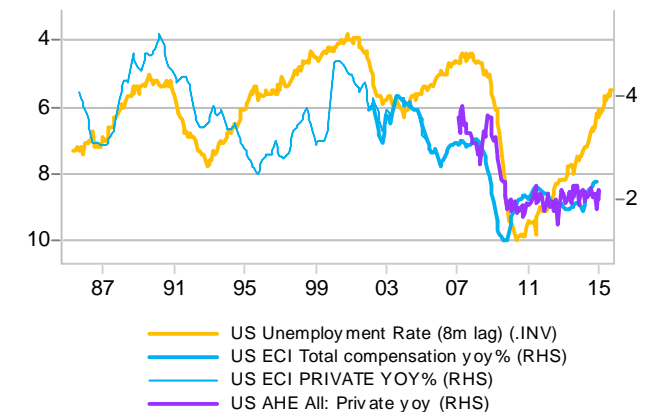
Source: Fed, BEA

US Fed Funds Projection & Taylor rule



Source: St Louis Fed, CME, FED

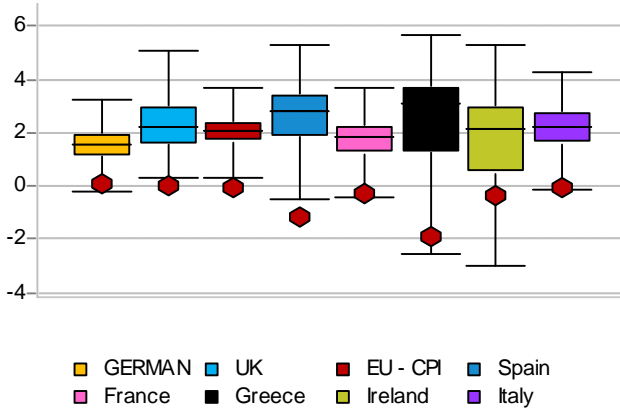
US Wages & unemployment



Source: NBER, Department of Labor

Europe economy

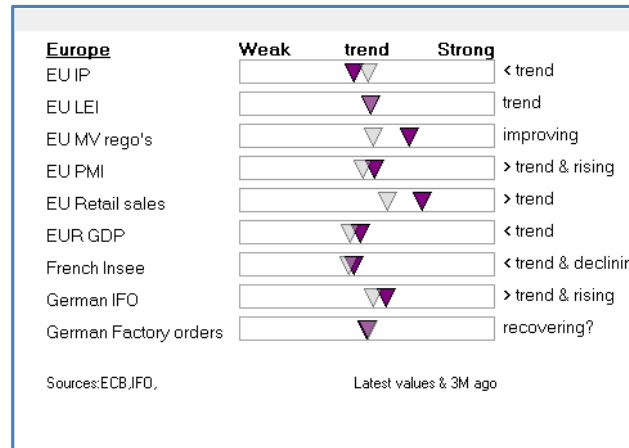
Europe Inflation



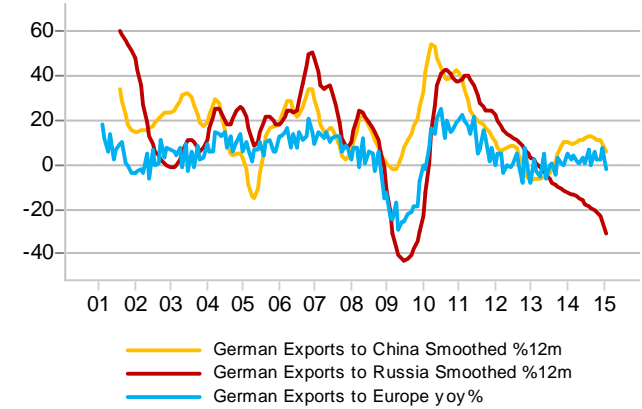
Source: ECB, OECD

INFLATION LOW, ACTIVITY PICKING UP

- The drop in inflation remains a major issue in Europe, a problem that is likely to get worse in the near term. The chart above shows **inflation is near zero or below and at the bottom of long term ranges in most countries in Europe.**
- However, **the IFO expectations index in Germany appears to have troughed in October and German factory orders have recovered.**
- The **ECB lending survey paints a relatively upbeat picture in terms of demand for credit from the corporate sector.**
- However, export growth, particularly for the export-dependent Germany, remains weak.

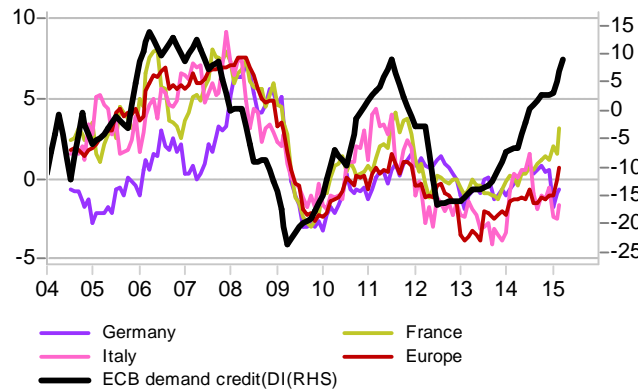


Germany Exports



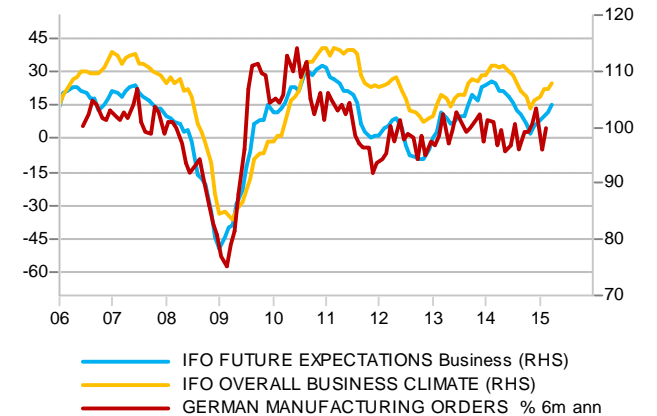
Source: Bundesbank

Europe Non-Financial corporations Loans 6m% & ECB survey Demand for Credit



Source: ECB

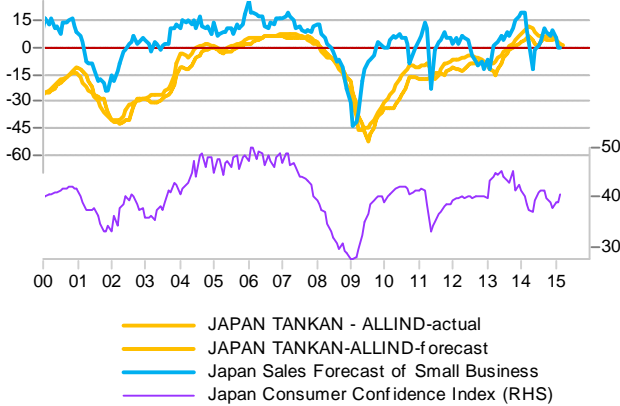
German IFO & Factory Orders



Source: Bundesbank, IFO

Japan economy

Japan Confidence Indicators

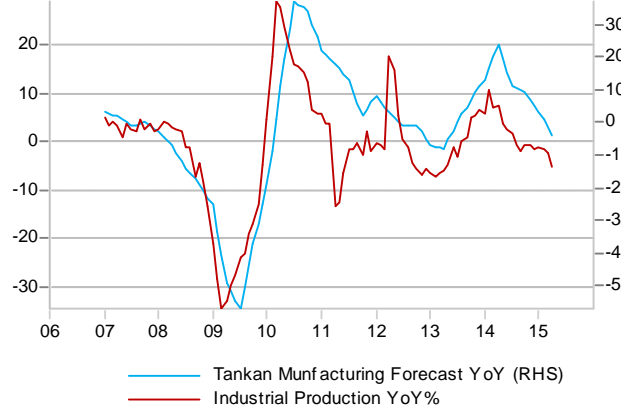


Source: BOJ, ESRI

MIXED SIGNALS

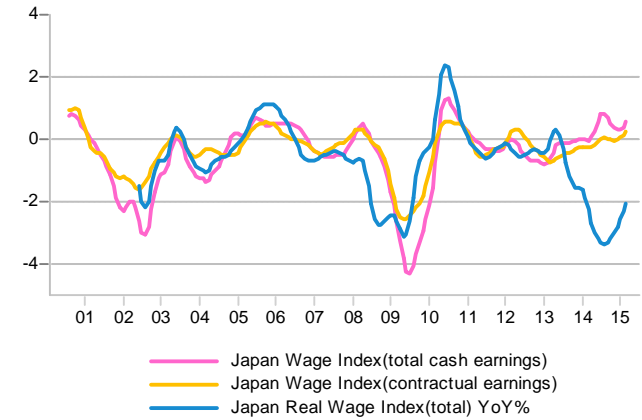
- The March Tankan survey showed a modest decline from previously solid levels and along with other confidence indicators for small business and consumers, suggests some moderation in projections.
- GDP expanded at a 2.2% pace in the December quarter following two negative quarters.
- The job-offer rate is at 23 year highs, suggesting a tight labour market. However, wages growth, especially in real terms remains weak at -2% yoy (even though nominal wages growth is close to 15 year highs).
- Japan has superior EPS growth (revisions) relative to other regions** and bond yields are still above trend nominal GDP. All other regions have yields below nominal GDP trends.

Manufacturing Forecasts vs IP



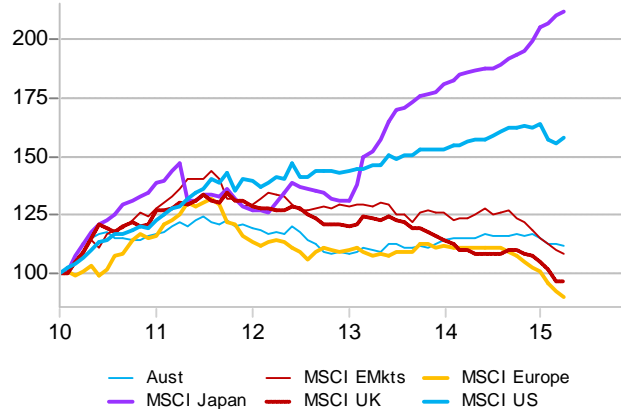
Source:BoJ

JAPAN Wage Costs



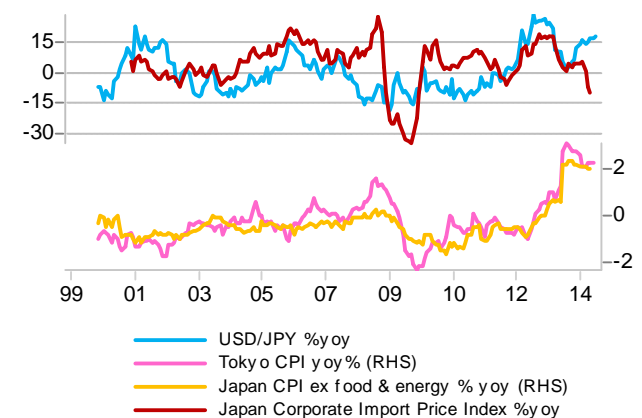
Source: Cabinet Office

Global EPS



Source:IBES

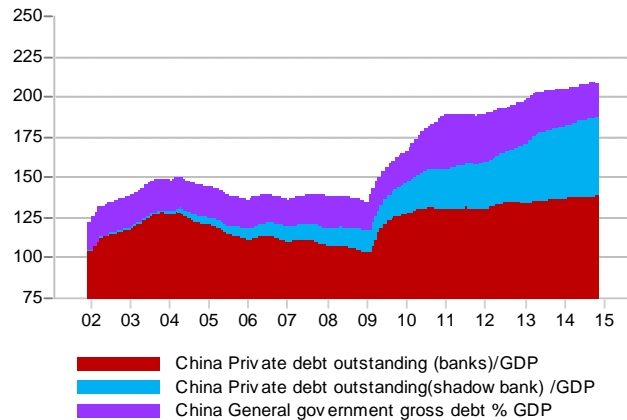
Japan Inflation, import prices & yen



Source:,NBS

China economy

China Total credit to GDP

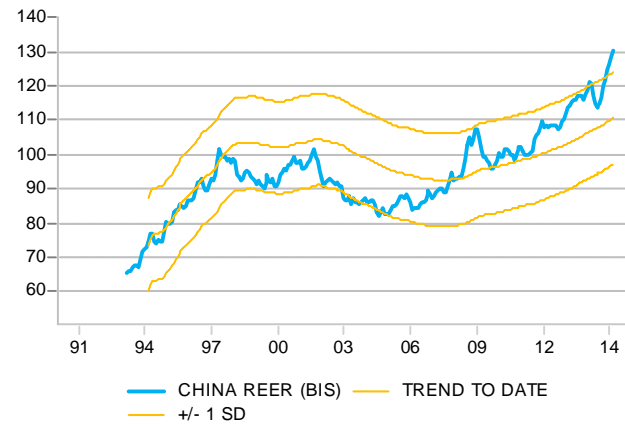


Source: National Statistics Office, World Bank

CHINA STILL DEFLATING

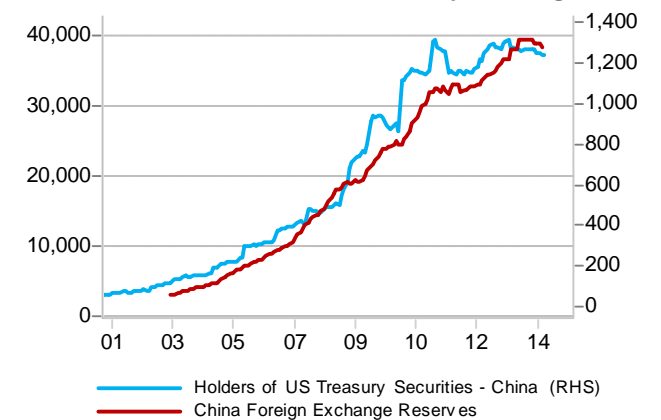
- The real estate sector continues to weaken. New activity is contracting and house prices are down more than 5% on a year ago.
- Total credit to GDP is well in excess of 220% and with stronger capital outflows at the same time as the Chinese real effective exchange rate continuing to rise, **financial conditions are tightening.**
- Producer prices have been declining for the past 3 years.
- The heavy industry sectors and construction paint a weaker picture. Steel production is contracting while other heavy industry sector IP growth is broadly in the low single digits at best or negative.
- We have long believed that **GDP growth is in a structural downturn and that growth could be closer to 6% than 7% in 2015.**

CHINA REER



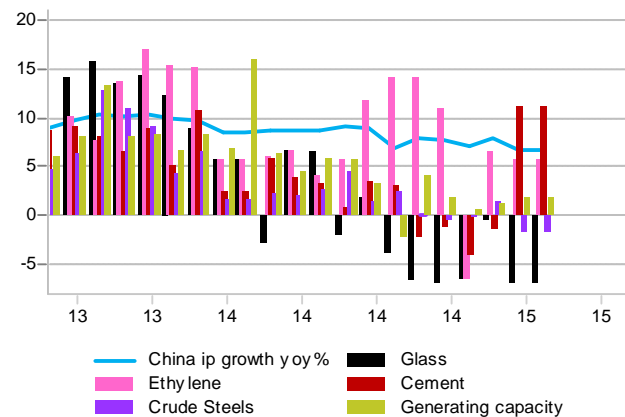
Source: BIS

Chinese FX reserves & US Treasury Holdings



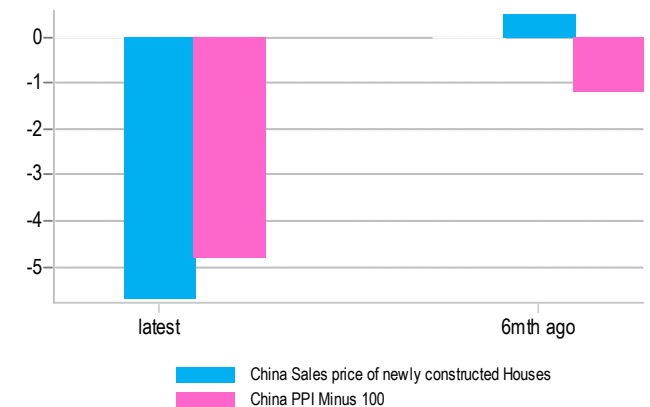
Source: US Treasury, PBoC

China IP growth



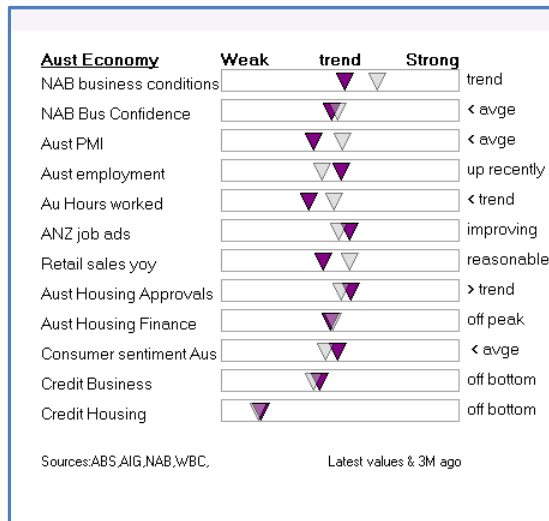
Source: National Bureau of Statistics, CFLP

China PPI & House prices



Source: National Bureau of Statistics of China, National Bureau of Statistics of China

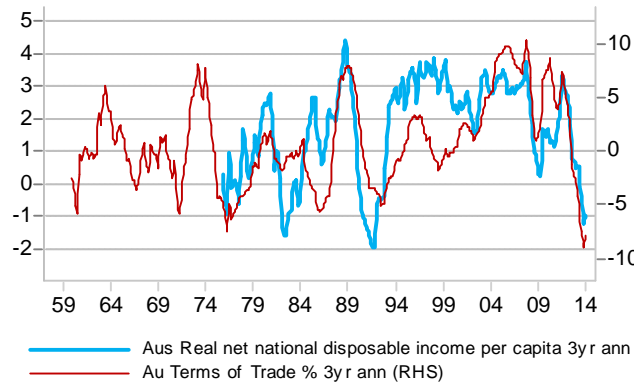
Australian economy



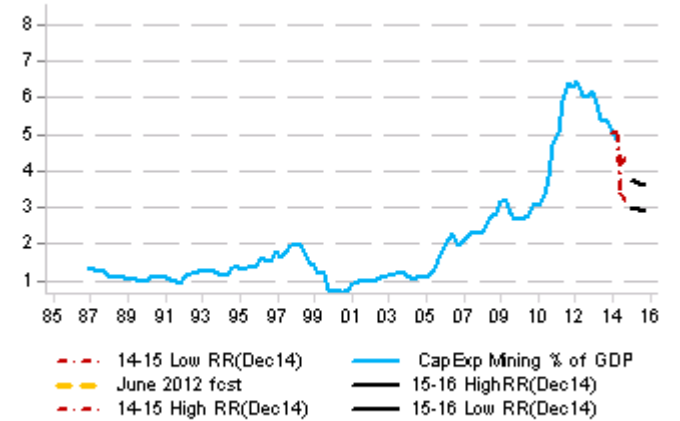
TERMS OF TRADE & MINING HEADWINDS

- Most indicators point to sub-trend growth.
- Mining investment set to decline to 3% of GDP from 5% currently based on worst case for 2015-15 expectations.
- With Chinese steel production contracting and iron ore prices down more than 20% in the recent 3 months, the terms of trade is set to decline by 3-5% over coming quarters. **This places downward pressure on real national per capita disposable incomes (already contracting by 1%pa over the past 3 years).**
- The upside to this is more declines in the currency and interest rates and more support for the housing sector.

Real net national disposable income per capita growth

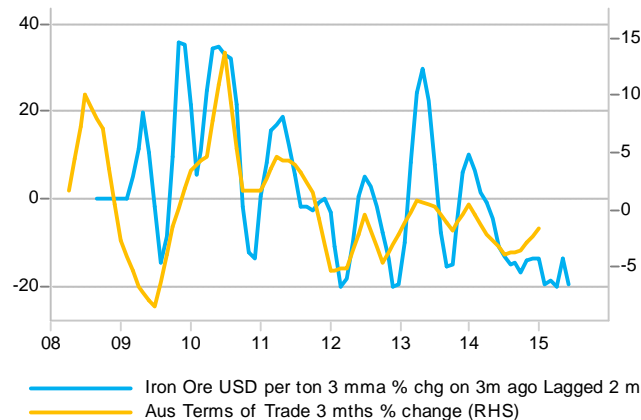


Aust Capital Expenditure- Mining % of GDP



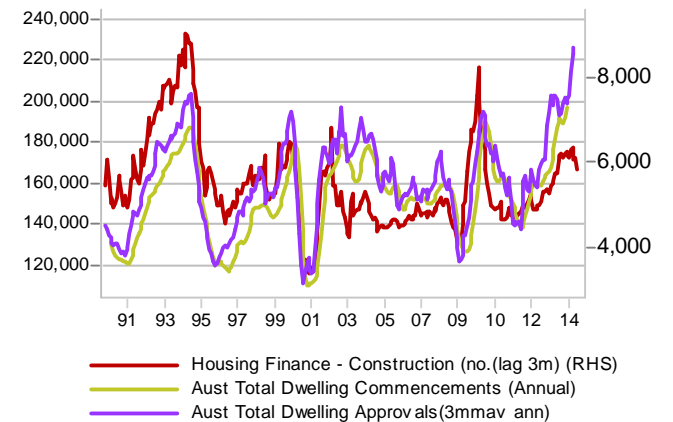
Source: ABS

Iron Ore & Terms of trade



Source: China NBS, IMF

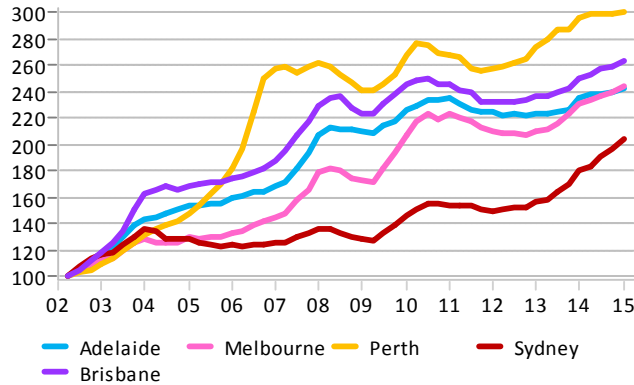
Housing Commencements



Source: ABS

RBA Policy

Australian House Prices 2002=100

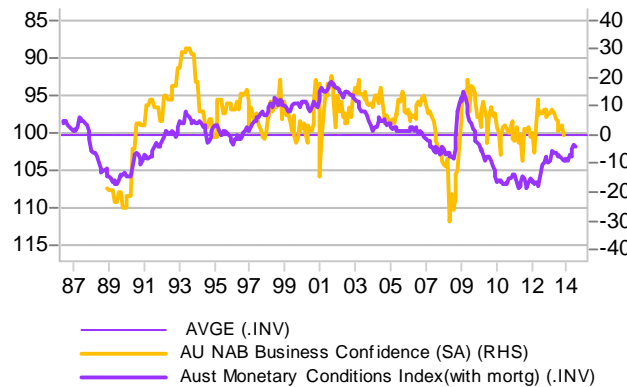


Source:ABS

FURTHER RBA CUT REQUIRED

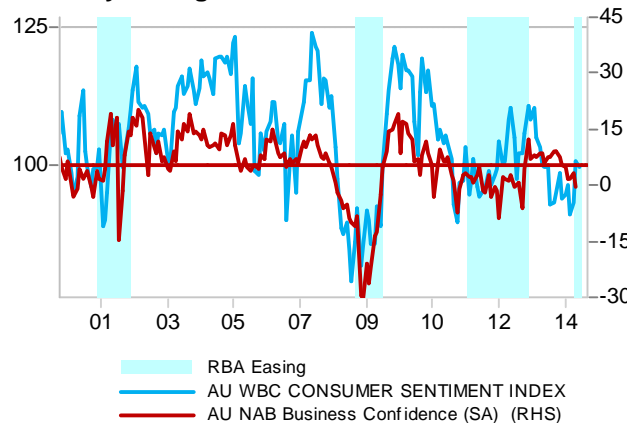
- However, the RBA is sat on its hands at the past 2 meetings, citing a desire to monitor the impact of earlier action but also presumably because of the surge in house prices. The chart above shows that house prices have indeed been moving up in all States since 2013 but Sydney has been particularly strong, up around 30% over this period. But to some extent, Sydney is catching up after a 5-year period of no growth.
- **We believe, rising house prices will not stand in the way of a further cut** and the RBA has noted the role of other regulatory organisations in managing housing risks.
- Our RBA indicator shows a modest easing bias.
- Labour market data and consumer and business confidence data does not stand in the way of another move.
- **Overall financial conditions not easy enough at present, i.e. the AUD is still too high.**

Australia Monetary Conditions(with mortg rates) & Business confidence



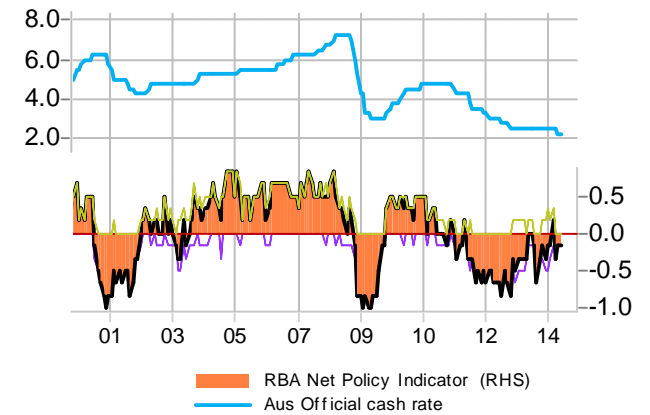
Source:NAB,RBA, using proxy updates

Australia Business & Consumer confidence & Policy easing



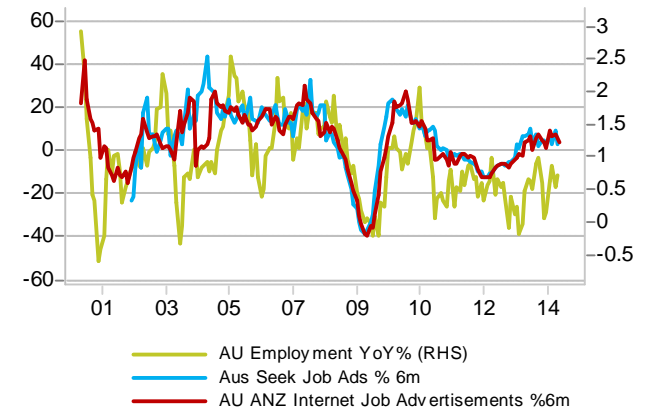
Source: NAB, WBC, RBA

RBA Watch... Easing indicators (Watch Group)



using proxy updates

Labour Market Indicators



Source:Seek, ABS, HIS

Market performance : Equities

MSCI World ex-Aust (USD)



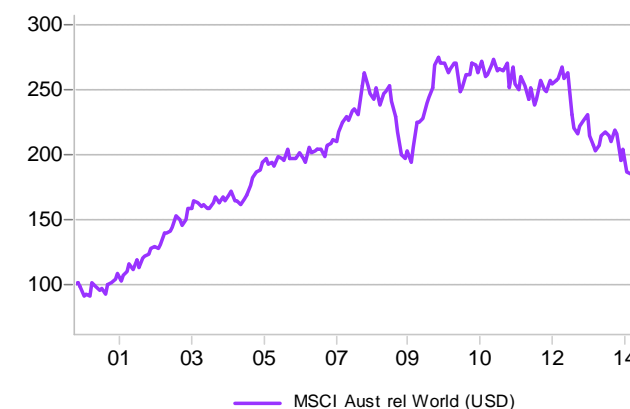
Source: IRESS, using proxy updates 8/04/2015

S&P/ASX 200



Source: IRESS, using proxy updates 8/04/2015

AUSTRALIA relative to WORLD EQUITIES



Source: MSCI, using proxy updates 8/04/2015

EQUITY MARKETS MIXED

- Equity markets lost ground in March with weakness in the US equity market offsetting the ongoing positive performance in Europe. USD strength undermined returns in USD terms. The MSCI World Index ex Aust (USD) fell 1.5% in March, reducing the year to date return to 2.3% and the financial year to date return to 1.4%. In AUD terms the gain was around 0.5% while for the year to date the estimated return in AUD terms was 9.9%, reflecting the 6.9% decline in the AUD.
- Europe ex-UK has driven returns in global equities, up 2.5% in March and 14.8% for the year to date according to MSCI data. Germany, Portugal and Italy have all advanced 20-22% so far in 2015. The MSCI Japan index rose 1.2% in March and 9.5% in the first quarter of 2015 while the MSCI US index has managed to add only 0.9%.
- The regional rotation reflects divergent growth patterns and the associated divergence in monetary policy and exchange rates. Europe has been supported by the ECB's QE program, the 15% drop in the EUR and the general easing in financial conditions. Signs of improvement in the region's economy have helped. On the other hand, the US is dealing with the prospect of higher rates and a strong currency. US valuations and profit margins are also considered to be stretched.

Equities	MTD %	3mth%	FYTD%
S&P/ASX 200(price)	-0.63	8.88	9.19
S&P 500 Index	-1.74	0.44	5.49
Nikkei 225 Index	2.18	10.06	26.68
FTSE 100 Index	-2.50	3.15	0.43
Nasdaq Composite	-1.26	3.48	11.18
CAC 40 Index	1.66	17.81	13.81
DAX Index	4.95	22.03	21.69
Milan MB 30 Index	3.67	21.80	8.81
Spain IBEX 35 Index	3.07	12.08	5.47
Hang Seng Index	0.31	5.49	7.37
Straits Times Index	1.30	2.43	5.88
BOMBAY SE SENSEX	-4.32	1.67	10.01
SHANGHAI ALL ORD INDEX	13.22	15.87	82.97
BOVESPA General Index	-0.84	2.29	-3.80
Korean Kospi Index	2.78	6.55	1.94
NZX 50 INDEX GROSS	-0.76	4.77	13.47
Mexico IPC INDEX	-1.27	1.12	2.08
Turkey large-mid cap TR(local FX)	-3.29	-5.79	1.78
MSCI World ex Aust USD	-1.77	1.82	0.23

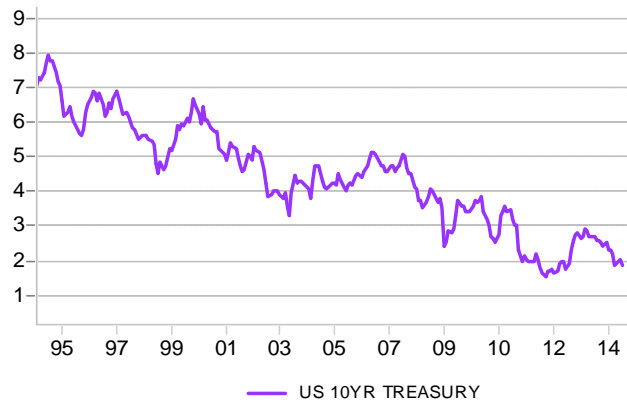
EMERGING MARKETS relative to WORLD EQUITIES



Source: MSCI, using proxy updates 8/04/2015

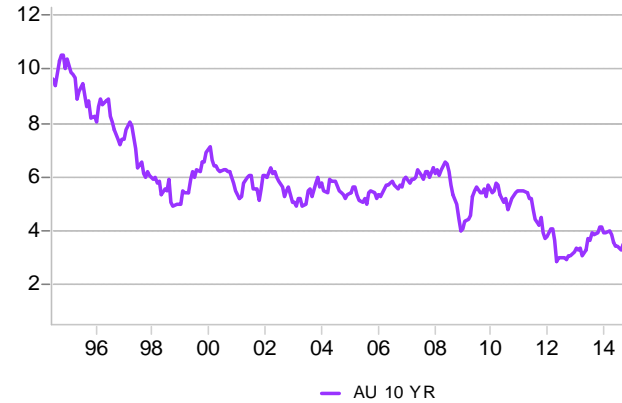
Market performance : Bonds

US 10 year yield



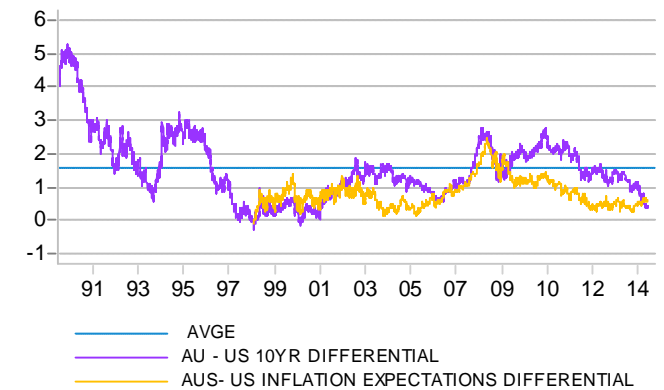
Source: IRESS, using proxy updates 8/04/2015

Australian 10yr



Source: IRESS, using proxy updates 8/04/2015

AU-US 10yr spread & Inflation differentials

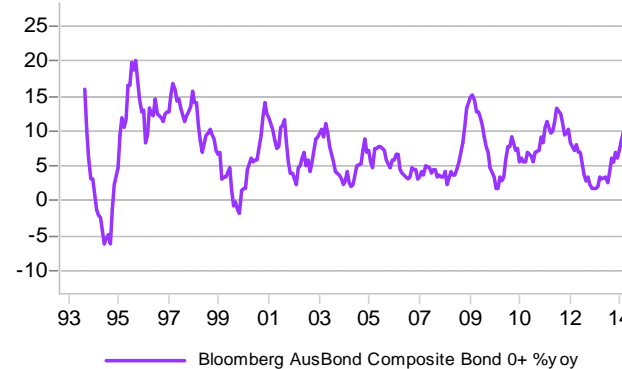


Source: RBA, ABS, IRESS, using proxy updates 8/04/2015

BOND YIELDS LOWER

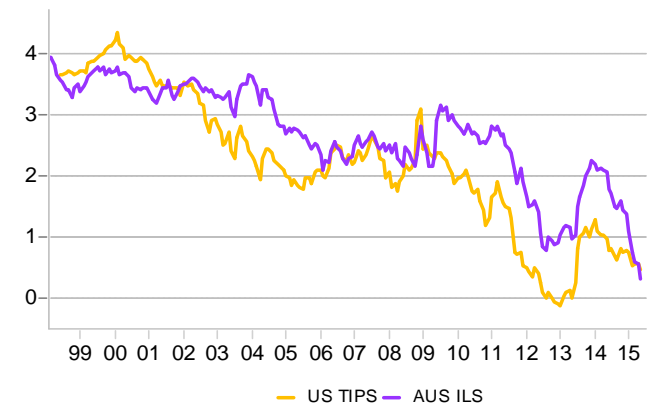
- US bond yields ended the month at 1.92% after hitting a high of 2.25% in early March following the stronger than expected February US payrolls report. However, a slightly more dovish March FOMC meeting which included a lower estimate for full employment and a lowering of Fed funds projections by FOMC members saw markets also reduce and delay rate hike expectations. The FOMC now estimates full employment to be 5-5.2%, down from 5.2-5.5%. The FOMC members lowered the median Fed funds projection to 0.625% for end -2015 (from 1.125%), 1.9% for end-2016 (from 2.5%) and 3.1% for end-2017 (from 3.6%).
- The ECB's QE program is also depressing bond yields globally.
- Australian bond yields declined from 2.42% to 2.32%. After cutting rates to 2.25% in early February, the RBA has kept rates on hold citing a desire to monitor both the impact of the earlier move and upcoming data. Stronger property prices may also be a factor behind the "on hold" decision. The RBA stated that it is working with other regulators in relation to housing risks. The RBA maintains a bias to ease.

Bloomberg AusBond Composite Bond Index Returns



Source: IRESS, using proxy updates 8/04/2015

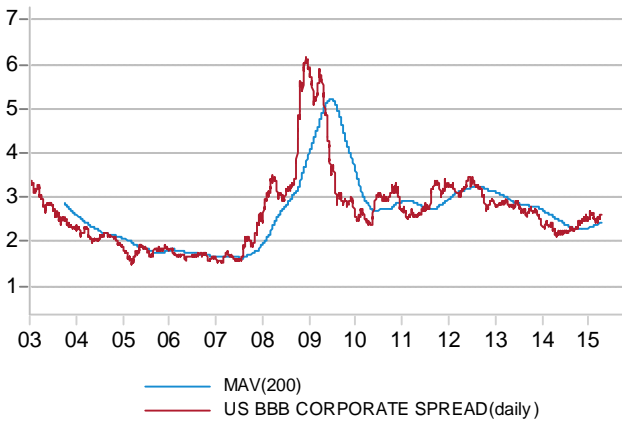
Indexed Bond yields



Source: RBA, US Fed, using proxy updates 8/04/2015

Credit

US BBB Corporate Spreads

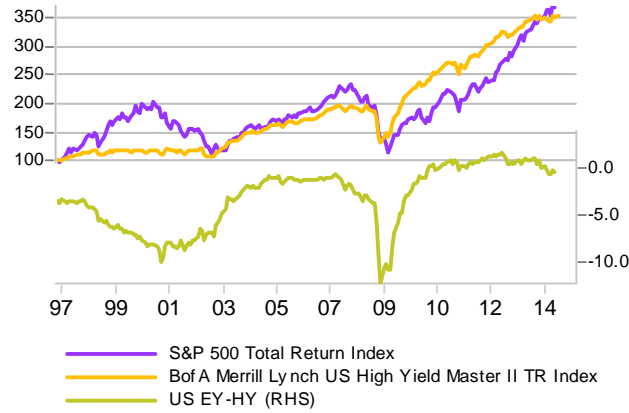


Source: Moody's, IRESS, using proxy updates 8/04/2015

CREDIT STABILISES

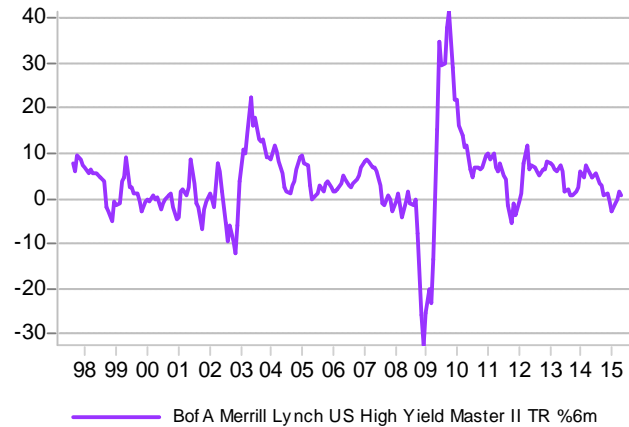
- High yield spreads widened almost 40 basis points in March to 482 basis points while US BBB spreads widened 10 basis points.
- Default rates are still very low despite the recent pick-up in energy sector-related defaults and are consistent with tight spreads.
- Relative to equity market yields, the high yield sector is now the most attractive since 2009-10.

High Yield v Equities



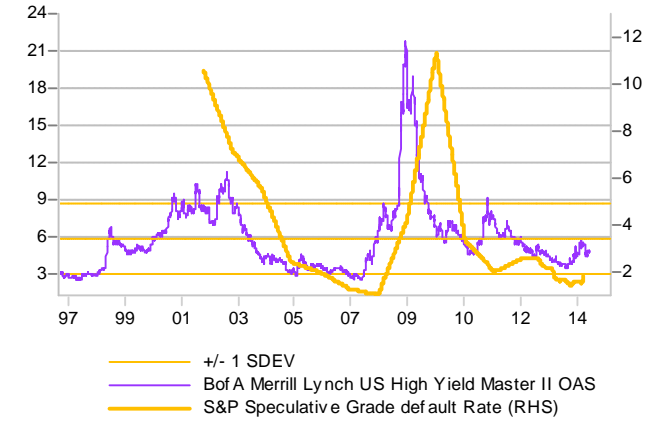
Source: US Fed, IRESS

US High Yield Returns



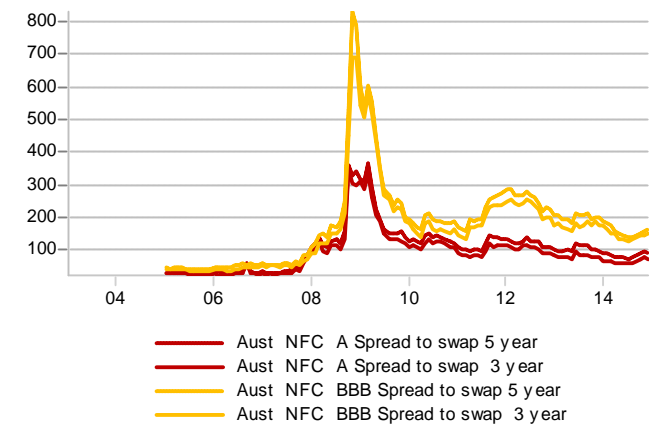
Source: St Louis Fed, BoA, using proxy updates 8/04/2015

US High Yield spreads & Default rates



Source: St Louis Fed, BoA, S&P

Australian Credit Spreads



Source: RBA, Bloomberg, using proxy updates 8/04/2015

Valuations : Equities

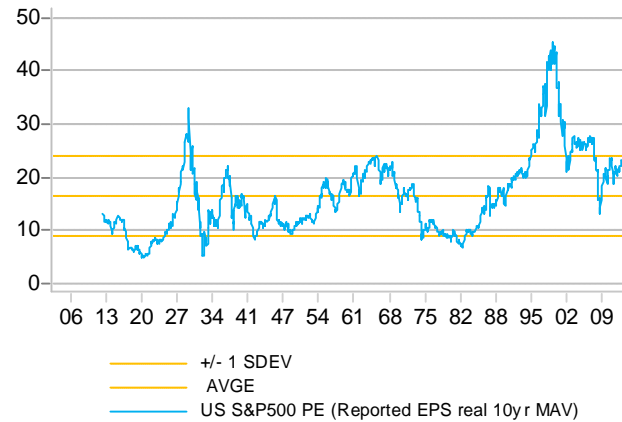
Equity Markets	Dear	Fair	Cheap	
Aus Equities	▼			LT trailing Trend real EPS(1950 on)
US Equities PE	▼			trailing Trend real EPS (1910 on)
World PE		▼		slightly cheap on Fwd PE from '87
US Equities (fwd)		▼		fwd PE from '87
Aus Equities(fwd)	▼	▼		fwd PE from '87
Ausr ERP			▼	top down 1960 on
US ERP			▼	1955 on
Aust PE rel	▼	▼		fwd PE from '87
Emerging Markets PE		▼		fwd PE from '87
EMkts PE rel			▼	slightly cheap

Sources: IBES, IBES, R Shiller, Latest values & 3M ago

VALUATIONS STRETCHED BUT EQUITY RISK PREMIUM NEUTRAL/SLIGHTLY POSITIVE

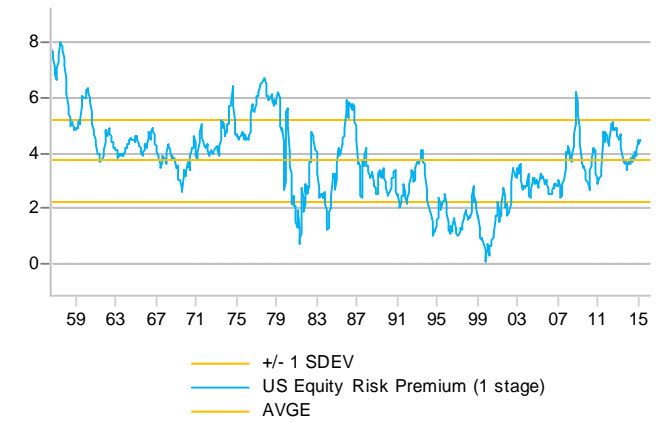
- The long term cyclically adjusted P/E for the US is 26.7 times, more than 1 sdev above average. For Australia using long term trend EPS, the Australian market PE rose to 19 times (trend EPS \$3087) compared with the 13.3 average. Using a Shiller method for calculating PE's (and therefore a higher EPS base from the past 10 years i.e. \$373), the market is now on 15.8 times (i.e. above the average of 14.5).
- Using trend nominal GDP growth as the EPS growth rate and current dividend and bond yields, the US Equity risk premium is now at 4.5%, well above the long term average of 3.7%. The Australian Equity risk premium using trend nominal GDP as the EPS proxy, current dividend and bond yields is 6.8% compared with the long term average of 5.1%.
- At 16.9 times forward EPS global equities are trading above the 25-year average of 16 times. **At 16.5 times the Australian market is now expensive against the 25-year average of 13.7.**

US PE (real reported 10yr mav EPS)



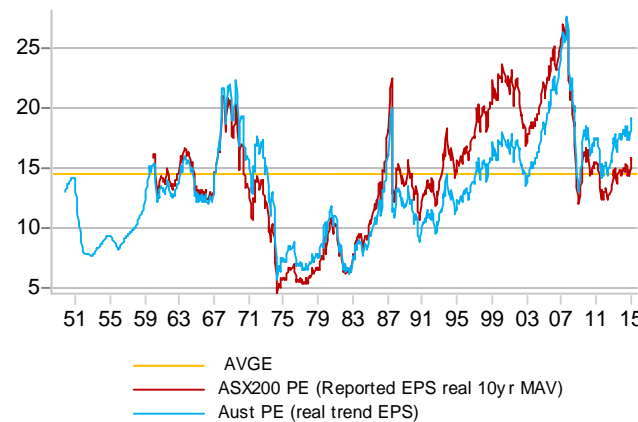
Source: IBES, Shiller, using proxy updates 8/04/2015

US Equity Risk Premium



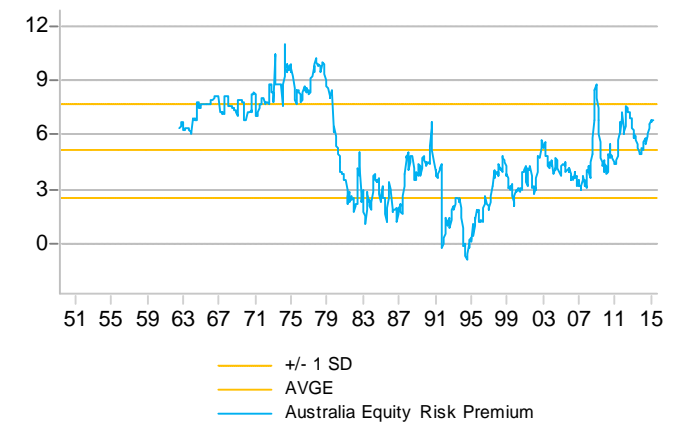
Source: IBES, BEA, Fed, using proxy updates 8/04/2015

Aust PE (real trend EPS)



Source: IBES, RBA, ABS, using proxy updates 8/04/2015

Aust Equity Risk Premium



Source: IBES, RBA, using proxy updates 8/04/2015

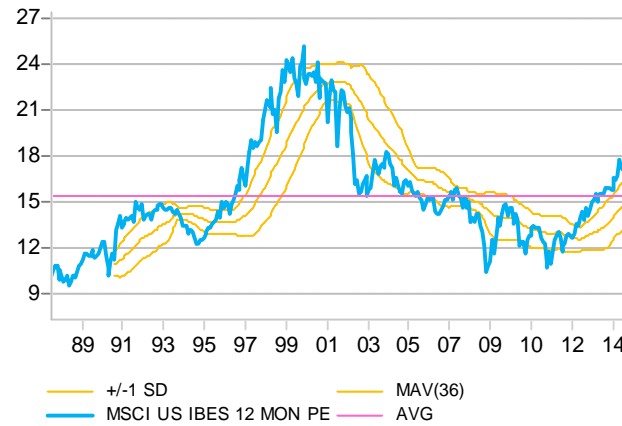
Valuations: Forward PE's

World Forward PE



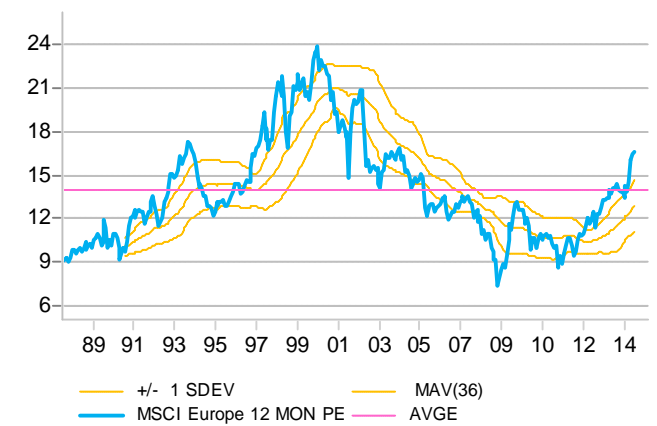
Source: IBES, using proxy updates 8/04/2015

MSCI US Forward PE



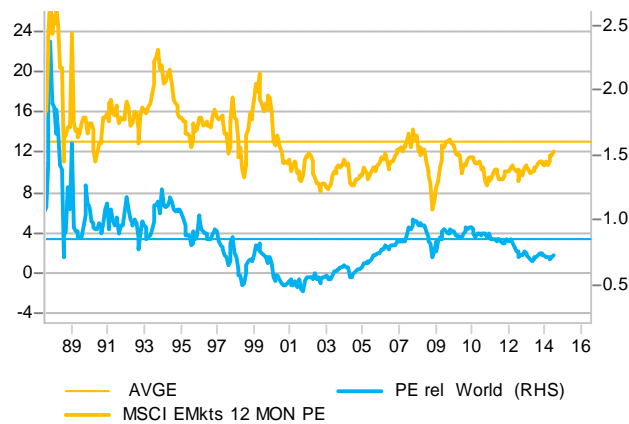
Source: IBES, using proxy updates 8/04/2015

MSCI Europe Forward PE



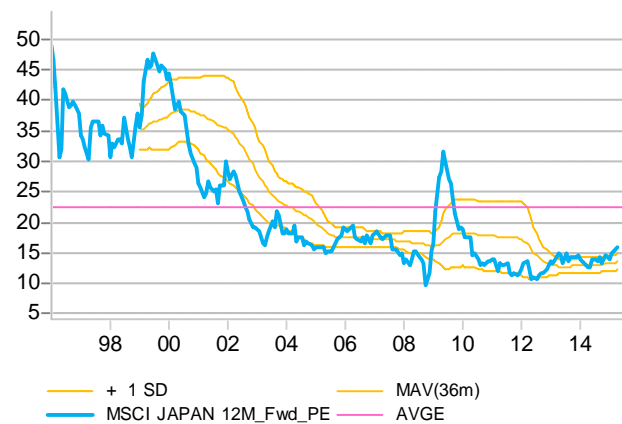
Source: IBES, using proxy updates 8/04/2015

Emerging Mkts Fwd PE



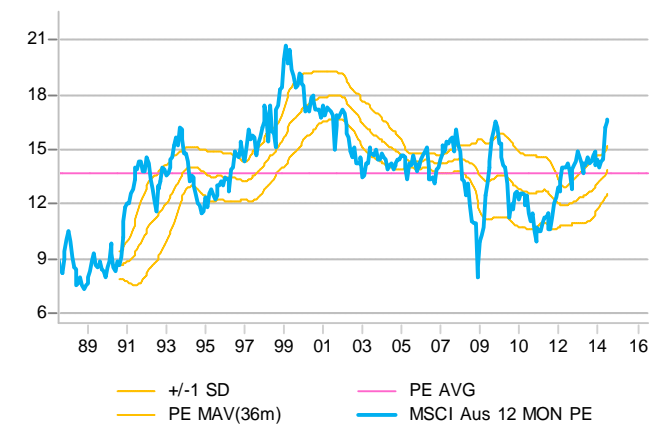
Source: IBES, using proxy updates 8/04/2015

MSCI JAPAN Forward PE



using proxy updates 8/04/2015

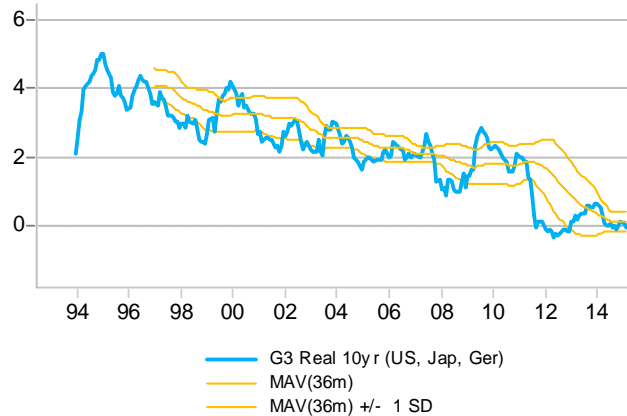
Australian Forward PE



Source: IBES, using proxy updates 8/04/2015

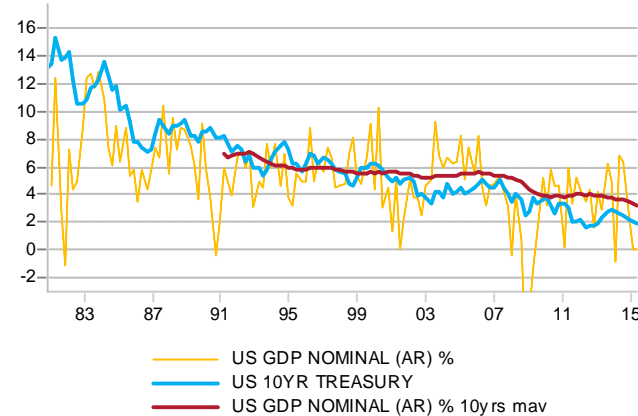
Valuations: Bonds

G3 Real 10 year yield



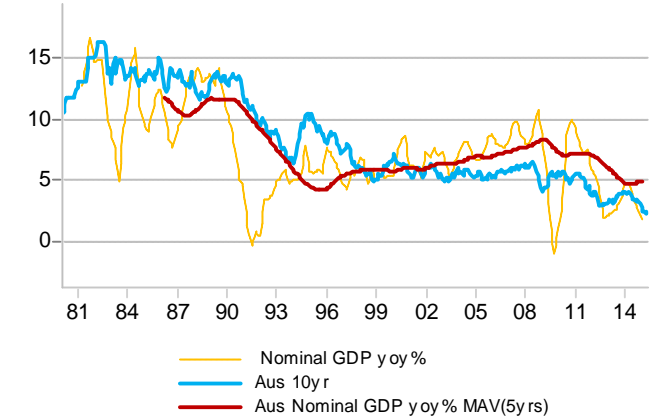
Source: US Fed, IRESS, HIS est., using proxy updates 8/04/2015

US 10YR & US NOMINAL GDP



Source: BEA, US Fed, using proxy updates 8/04/2015

Australian 10 year & Nominal GDP

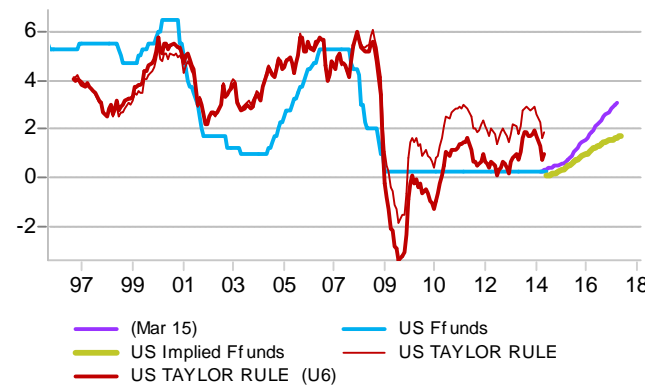


Source: ABS, RBA, IRESS, using proxy updates 8/04/2015

VALUATIONS STRETCHED...OR ARE THEY???

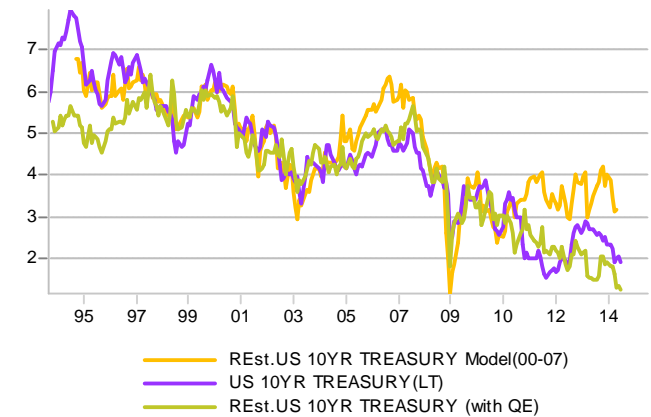
- However, US bonds are in line with the bond model incorporating the Fed balance sheet (1.5%) but expensive against the longer term model (3%).
- Although trend nominal GDP growth in Australia is around 5%, more recent experience is closer to 3%, which would make bonds around fair value. Recent US nominal GDP growth is closer to 4%, also suggesting bonds are not overly expensive.
- **A simple Taylor rule for the Fed funds rate (using the long run average equilibrium real rate of 2%) suggests Fed funds of just below 2% (using the current unemployment rate or under 1% (using the underemployment rate). Markets imply reaching these levels over a three year period while the FOMC expects higher rates.**

Us Fed Funds Projection & Taylor rule



Source: St Louis Fed, CME, FED

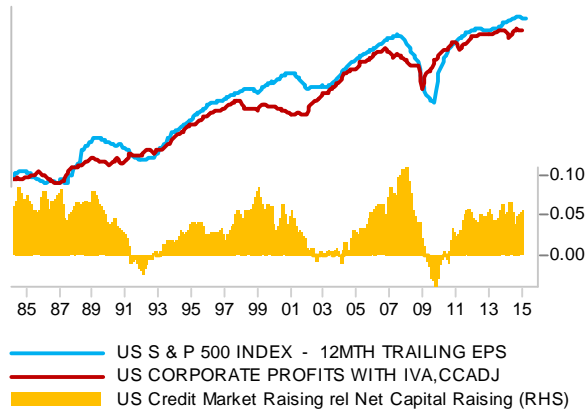
US 10YR TREASURY Model



Source: IRESS, HIS est., using proxy updates

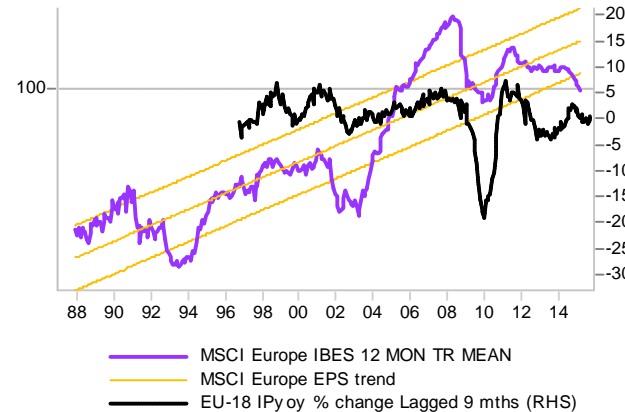
Earnings ... Global

US S&P EPS GROWTH & US PROFITS BEFORE TAX & CREDIT MARKETS RAISING v EQUITY



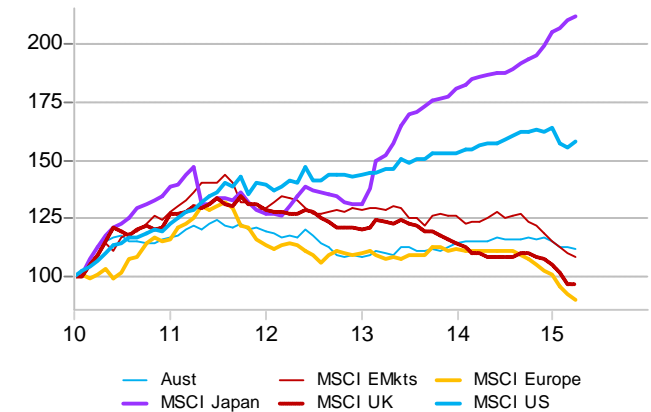
Source: US Fed, BEA

MSCI Europe EPS v trend



Source: IBES

Global EPS

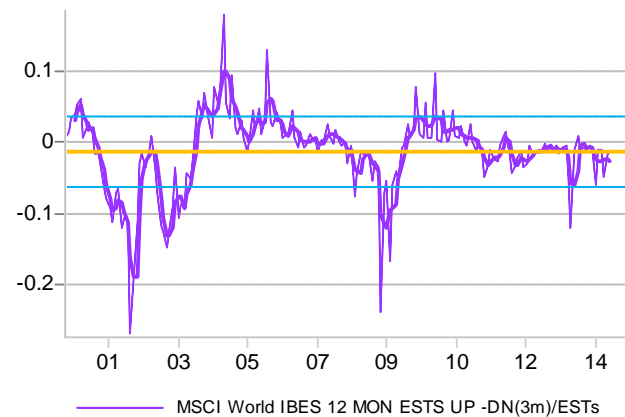


Source: IBES

GLOBAL EPS & SALES WEAK

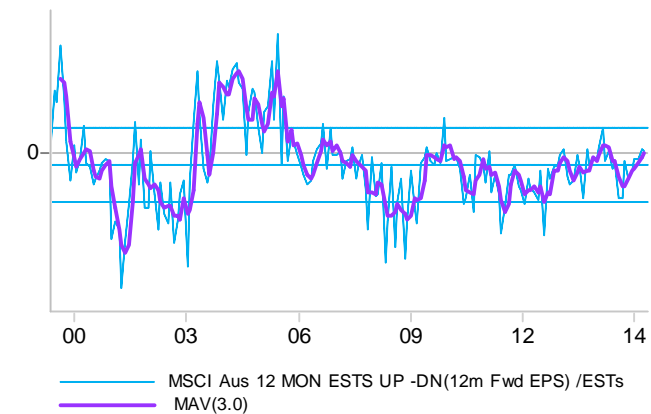
- Earnings have been weak globally, reflecting poor sales growth and, in the case of the US, declining energy prices and a strong USD. Last month however we saw some stabilisation in US EPS numbers while global EPS revisions appear to have stabilised.
- For Europe, the turnaround in activity data is likely to produce a turnaround in EPS estimates.
- The weaker yen and low wages costs have supported rising Japanese EPS.
- Meanwhile, in the US, the NIPA profits series has been flatting over the past 12 months yet EPS, although slowing, has “outperformed” due to increased buy-backs/gearing.

World Earnings Revisions



Source: IBES

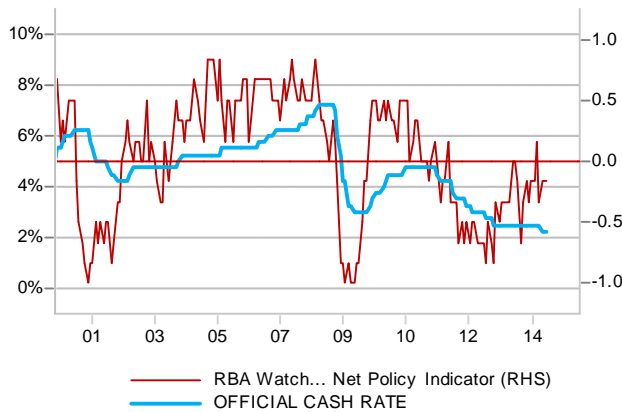
Australia Earnings Revisions



Source: IBES

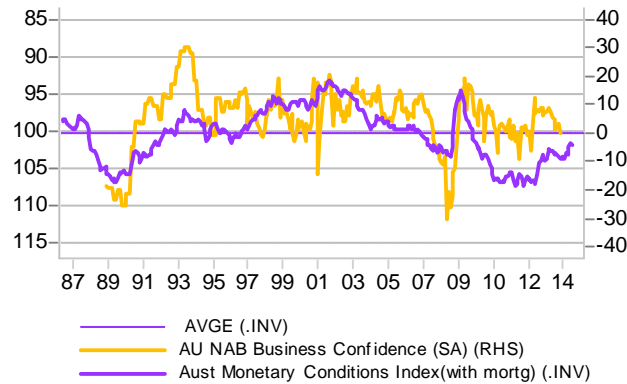
Policy & Liquidity

RBA Policy Indicator & Cash rates



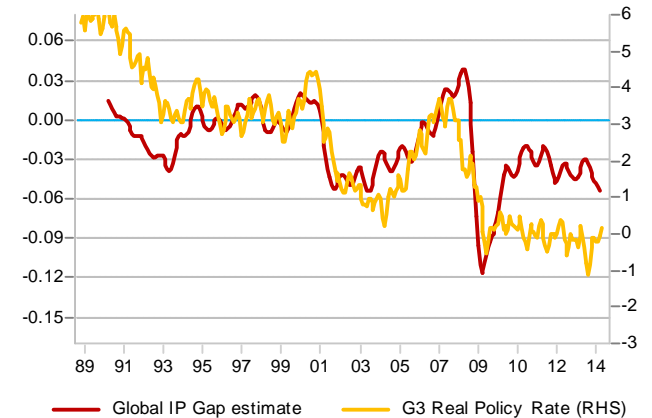
Source: RBA, IRESS, ABS, NAB, using proxy updates

Australia Monetary Conditions(with mortg rates) & Business confidence



Source: NAB, RBA, using proxy updates

Global IP Output Gap & G3 Real Cash

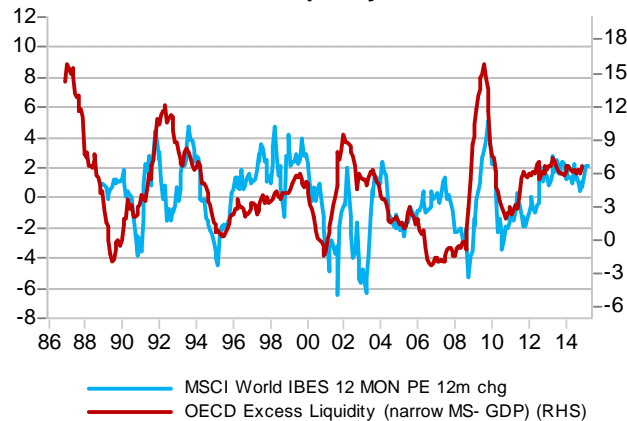


Source: OECD, HIS est.

MONETARY CONDITIONS NOT YET EASY ENOUGH IN AUSTRALIA, CENTRAL BANK BALANCE SHEET EXPANSION GLOBALLY TO ADD EXCESS LIQUIDITY

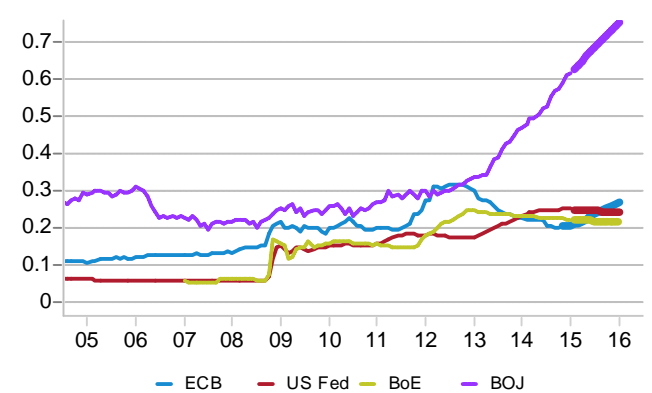
- Our RBA policy indicator shows a modest easing bias. With the AUD declining, the monetary conditions index for Australia has eased, although not enough as yet (particularly given the weak terms of trade impact)
- Globally, monetary conditions and real interest rates are easier than suggested by global capuse/output gap measures. However, with the recent slowdown in growth, the global IP output gap is widening.
- **Global excess liquidity remains around 6% and continues around these levels in 2015 as the BOJ and the ECB expand their balance sheets by 25-30%. This would be consistent with modest PE expansion.**

Global PE's & Excess liquidity



Source: IBES, OECD

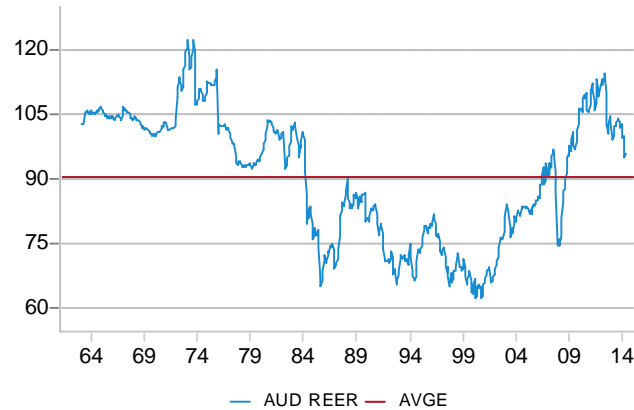
Central Bank Balance Sheets % of GDP



Source: US Fed, ECB, BOJ, BoE

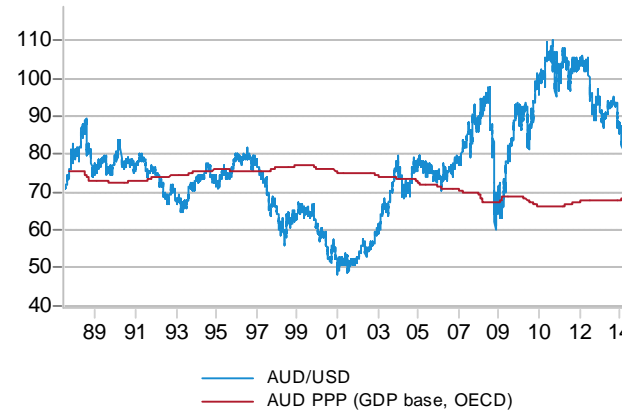
Currency

AUD REER



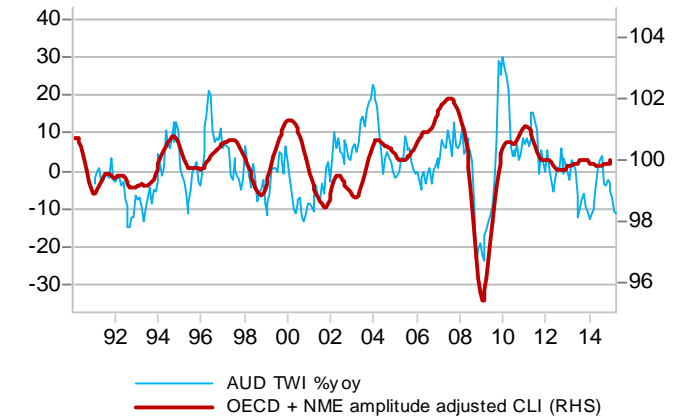
Source: BIS, using proxy updates

AUD PPP & AUD-USD



Source: OECD, IRESS, using proxy updates

AUD & Global Growth

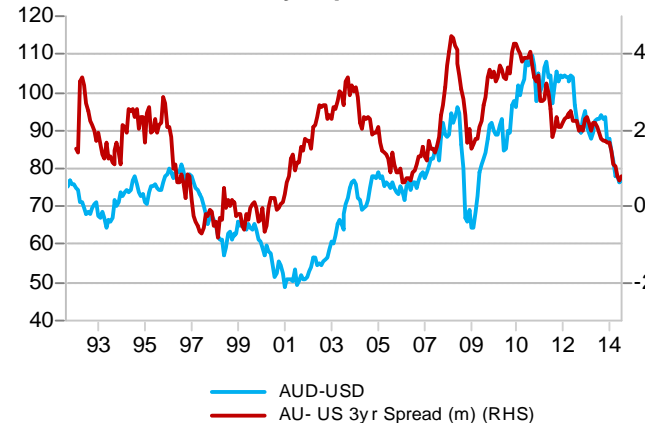


Source: IRESS, OECD, HIS, using proxy updates 8/04/2015

AUD ABOVE FAIR VALUE, MACRO DRIVERS NEGATIVE

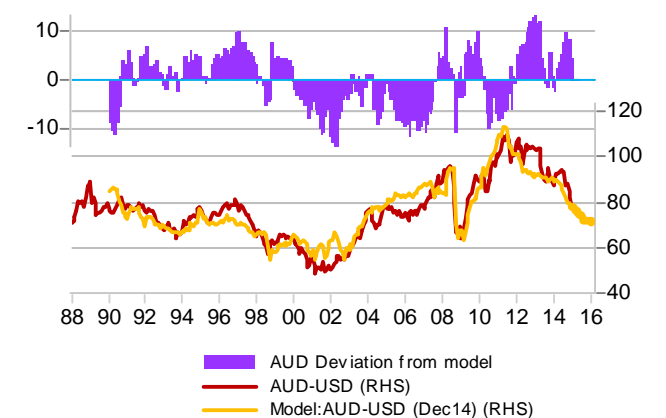
- The AUD still appears overvalued relative to fundamentals (around 2-3 cents now and 5-6 cents on projections for the terms of trade (down a further 6%) and rate differentials (down to 120 bp from 200)). The AUD is now only 8% above long term averages for REER and 15% on a PPP basis.
- The macro drivers are mostly negative. Although the OECD plus major non-member economy leading indicator was modestly higher in January, other more recent data has eased back. EM remains subdued and iron ore prices remain under downward pressure. Interest rate differentials are also narrowing and could narrow further. In absolute terms bond yields are still attractive.
- The upside risk is that US growth subsides and the USD weakens.

AUD-USD & AU- US 3yr Spread



Source: IRESS, RBA, using proxy updates 8/04/2015

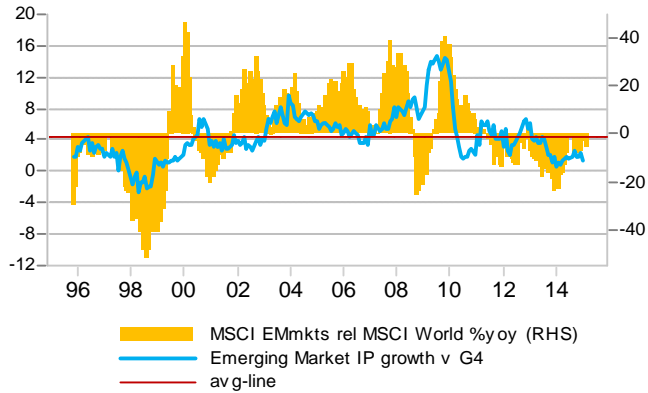
AUD Deviation from model



Source: ABS, RBA, FED, IRESS, CBOE

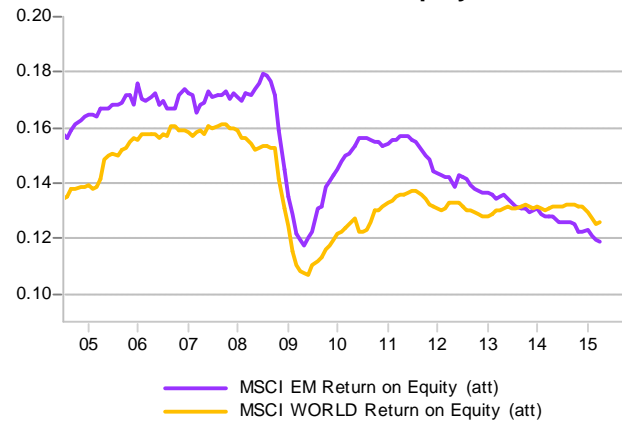
Emerging Markets

Emerging Market Output v OECD & relative performance



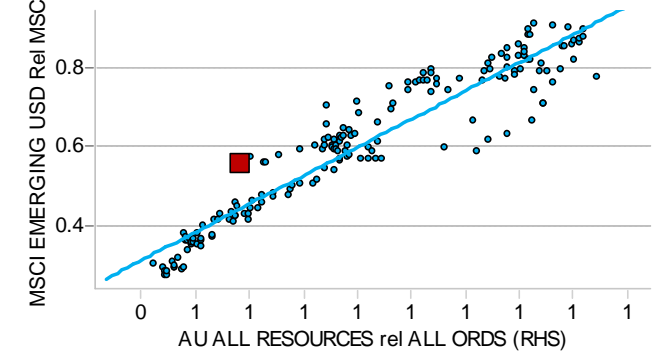
Source: OECD, MSCI, using proxy updates 8/04/2015

MSCI EM & WORLD Return on Equity



Source: IBES

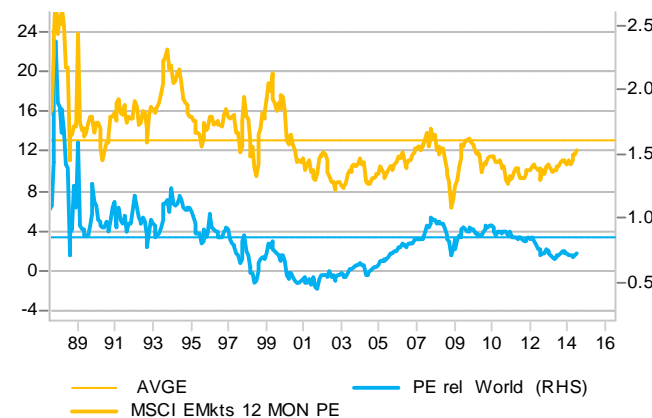
MSCI EMERGING USD (Rel MSCI) & RESOURCES rel ALL ORDS



$$MSCI EMERGING USD Rel MSCI = 0.72 * AU ALL RESOURCES rel ALL ORDS (RHS) + 0.03 (R^2 = .90)$$

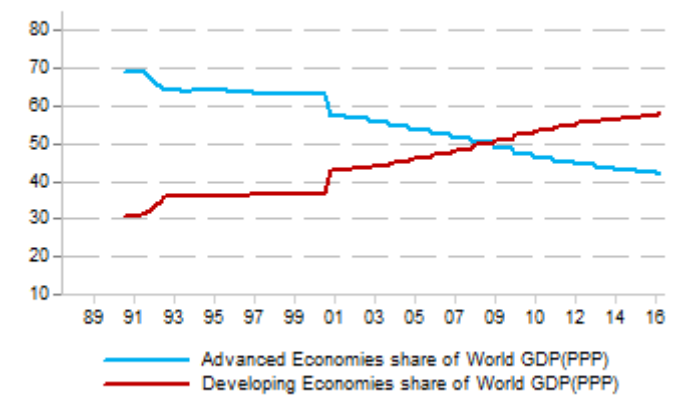
VALUATIONS FINE BUT DECLINING ROE, DECLINING COMMODITY PRICES, SLOWER GROWTH

Emerging Mkts Fwd PE



Source: IBES, using proxy updates 8/04/2015

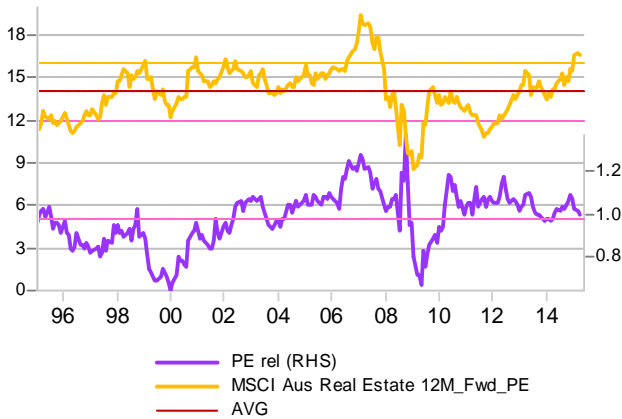
Advanced & Emerging Economies % Share of GDP (PPP)



Source: IMF

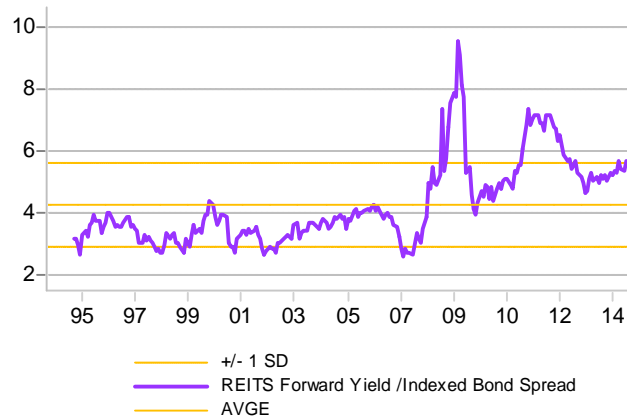
REITs

MSCI Aust Real Estate Forward PE



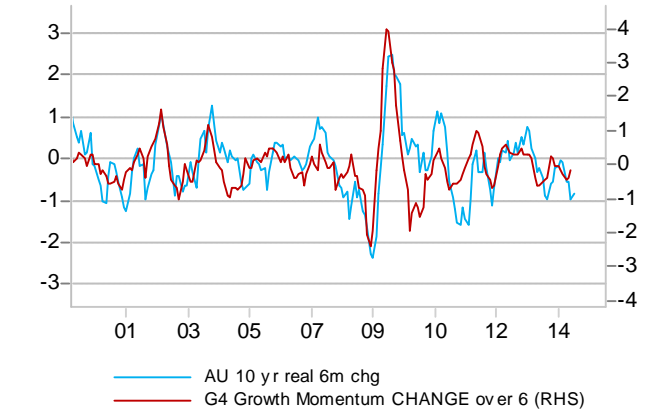
Source: IBES, using proxy updates 8/04/2015

REITS Forward Yield less 10yr Real



Source: IBES, IRESS, using proxy updates 8/04/2015

AU 10YR REAL & G4 Growth Momentum

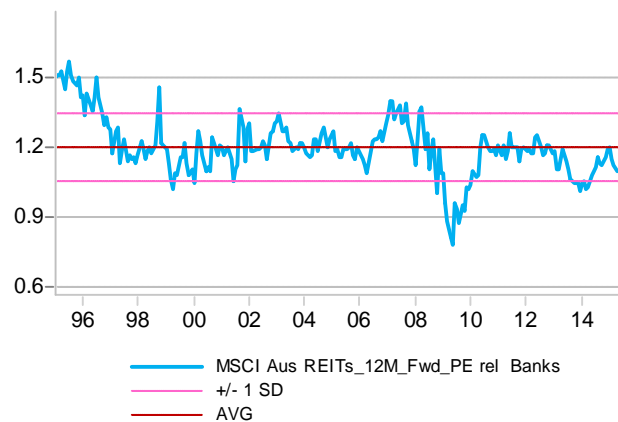


Source: ISM, IFO, IRESS, using proxy updates

RELATIVE TO EQUITY MARKET VALUATIONS CORRECTING, STILL POSTIVE V BONDS

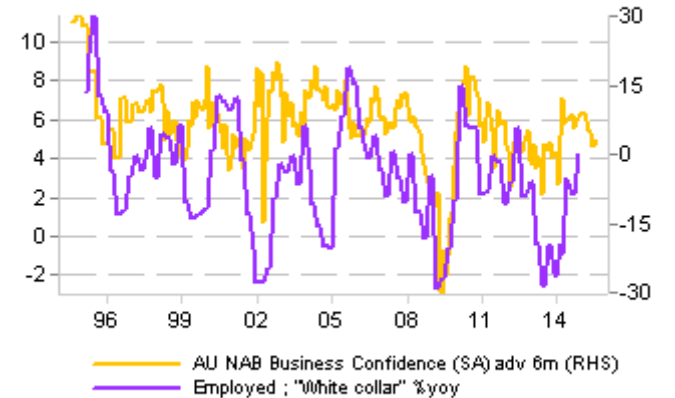
- REITs appear expensive and are vulnerable to higher bond yields. Relative to the equity market, REITs have corrected some of the overvaluation.
- Along with telco's and utilities, REITs have had the highest (negative) correlation with bond yields and to global growth momentum. A pick up in momentum would be negative.

LPT's Forward PE rel Banks



Source: IBES, using proxy updates 8/04/2015

**"White collar" Employment
& NAB Business Confidence**



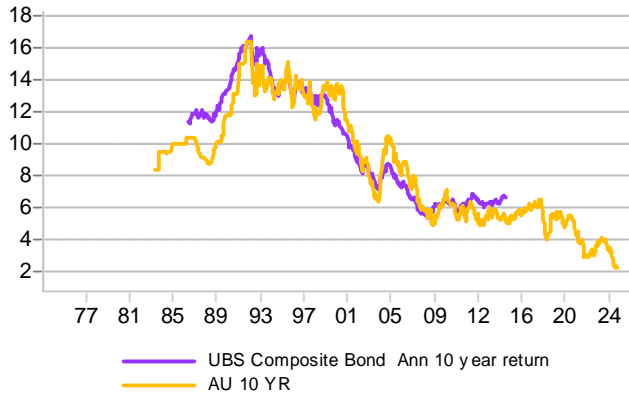
Source: ABS, NAB

Appendix 1: Asset class returns

Asset Classes March 31 2015									
ASSET CLASSES	Month % chge	3 Month % chge	6 month % chge	FYTD%	YTD %	1 year % chge	3yr return pa	5yr Return pa	10yr return pa
Bloomberg AusBond Bank Bill Index	0.21	0.67	1.36	2.04	0.67	2.72	3.02	3.76	4.80
Bloomberg AusBond Composite 0+ yr Index	0.76	2.67	6.73	7.77	2.67	11.13	7.11	7.63	6.80
ASX 200 Accumulation	-0.06	10.33	13.76	13.08	10.33	14.13	15.82	8.59	8.33
S&P/ASX 200 - Property Trusts (TR)m	-2.08	9.37	21.96	23.26	9.37	34.70	22.75	14.54	3.24
MSCI WORLDEX AUST-NI(USD)	-1.54	2.29	3.47	1.43	2.29	6.42	12.42	10.20	6.34
MSCI WORLD ex Aust NI (AUD est)	0.50	9.90	18.62	25.16	9.90	28.55	24.64	14.29	6.46
UBS Warburg Global Property Investors Index (dom r)	0.53	6.46	19.35	17.42	6.46	26.01	16.84	15.16	8.25
UBS Global Property Investors Index(hedged AUD)	0.62	7.09	20.57	18.80	7.09	27.84	18.10	16.52	8.33
Sub Asset classes	Month % chge	3 Month % chge	6 month % chge	FYTD%	YTD %	1 year % chge	3yr return pa	5yr Return pa	10yr return pa
S&P 500 Total Return Index	-1.58	0.95	5.93	7.12	0.95	12.73	16.11	14.47	8.01
ASX Small Ords Accum (Ex 100)	-1.94	7.30	3.13	4.67	7.30	2.30	-1.72	-0.30	2.72
MSCI Small Cap Index (USD, net)	0.20	4.45	7.28	0.17	4.45	3.50	13.42	12.05	8.13
MSCI Emerging Markets (USD)	-1.59	1.91	-3.06	-7.25	1.91	-2.02	-2.19	-0.72	5.91
UBS Infrastructure Acc Index	4.14	9.77	19.29	20.21	9.77	24.05	22.08	19.29	8.63
Bloomberg AusBond Infl Govt 0+ yr Index (d)	0.42	4.69	9.68	11.30	4.69	16.24	7.58	9.22	7.26
CRB Spot	-1.41	-5.20	-12.34	-16.40	-5.20	-15.94	-5.21	-0.76	3.36
AUD-USD (m)	-2.03	-6.93	-12.77	-18.96	-6.93	-17.21	-9.80	-3.58	-0.11
AUD TWI(m)	-1.25	-4.81	-8.13	-12.08	-4.81	-10.85	-6.28	-2.46	-0.08
US 10yr Total return Index Est(mth)	-0.37	2.00	5.50	6.80	2.00	8.62	2.57	5.39	5.35
BofA Merrill Lynch US High Yield Master II TR Index	-0.48	2.54	1.45	-0.50	2.54	2.05	7.47	8.40	8.04
Bloomberg AusBond Corporate Bond Index (d)	0.41	2.24	4.78	6.12	2.24	8.39	7.61	7.67	6.97
Credit	MOM Chge	3mth chg	6mth change	FYTD chg	YTD chg	YOY chge			
AU 10YR SWAP SPREAD INDEX	0.07	-0.03	0.06	-0.03	-0.03	0.02			
Au Housing Loan - 90 d Bill Spread	0.06	0.15	0.06	0.10	0.15	0.06			
US AAA CORPORATE SPREAD	-0.05	0.07	0.04	-0.02	0.07	'.			
US BBB CORPORATE SPREAD	0.10	0.08	0.25	0.39	0.08	0.30			
BofA Merrill Lynch US High Yield Master II OAS	-0.02	-0.41	0.61	1.21	-0.41	0.87			
GERMAN - US 10yr Spread	-0.06	-0.14	-0.18	-0.49	-0.14	-0.62			
France - German 10 yr Bond spread	0.04	'.	-0.08	-0.09	'.	-0.20			
Italy - German 10 yr Bond spread	-0.15	-0.31	-0.39	-0.45	-0.31	-0.71			

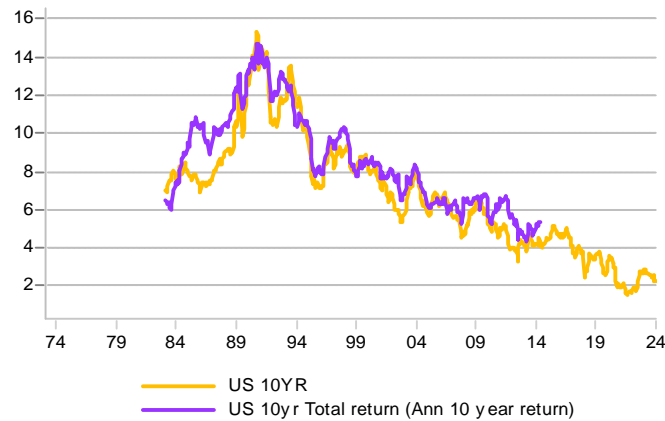
Appendix 2: Long term returns

Aust 10 yr bond yield & Bloomberg AusBond Comp Bond(Ann 10 yr return)



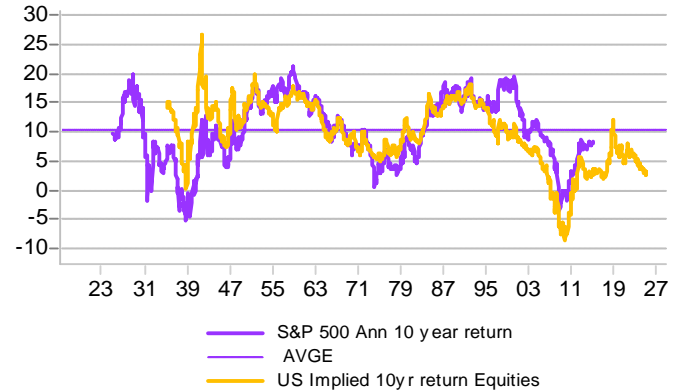
Source: IRESS, using proxy updates 8/04/2015

US 10 yr bond yield & US 10yr return (Ann 10 year re



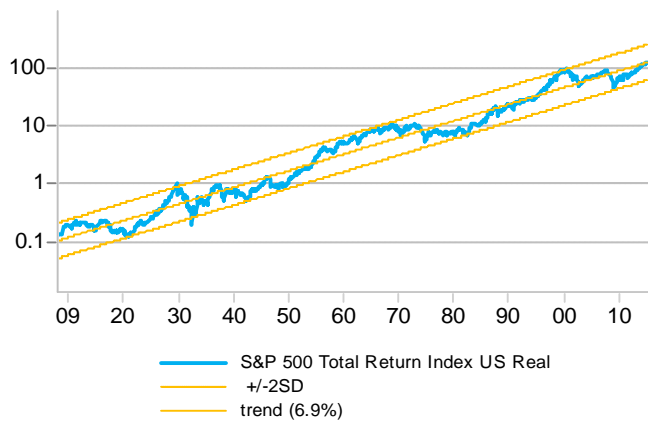
Source: US Fed, using proxy updates 8/04/2015

S&P 500 (Ann 10 year return & US Implied 10yr return Equities



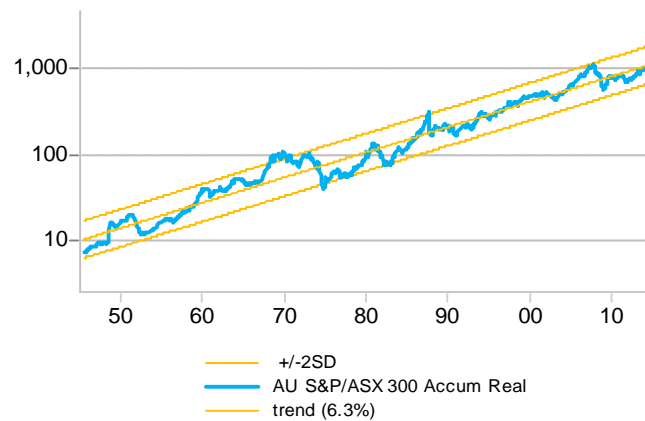
Source: IRESS, S&P, US Bureau of Labour Statistics, using proxy updates

S&P 500 Total Return Index Real



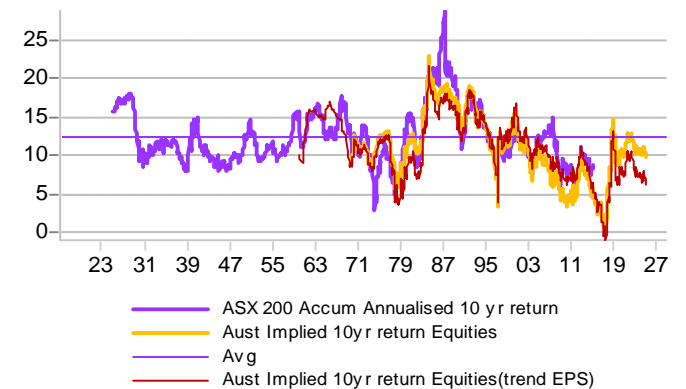
Source: S&P, R Shiller, IRESS, BLS, using proxy updates 8/04/2015

Australia Total Return Index Real



Source: IRESS, ABS, using proxy updates 8/04/2015

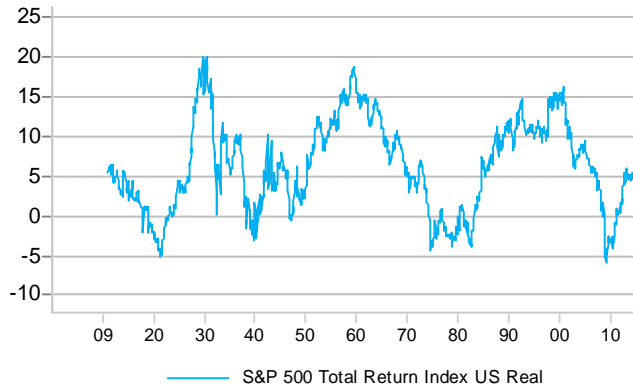
ASX200 (Ann 10 year return & Aus Implied 10yr return Equities



Source: IRESS, RBA, IRESS, ABS, using proxy updates 8/04/2015

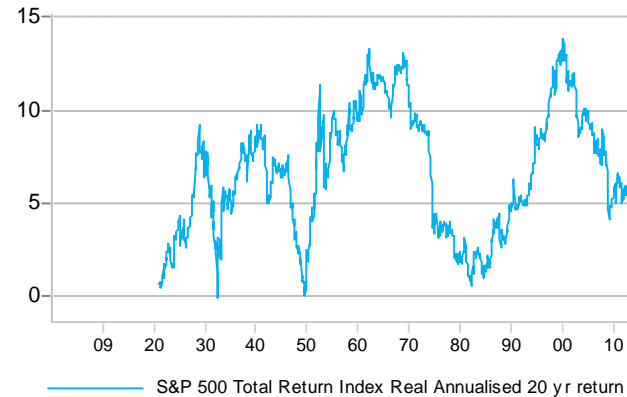
Appendix 2: Long term returns...cont

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



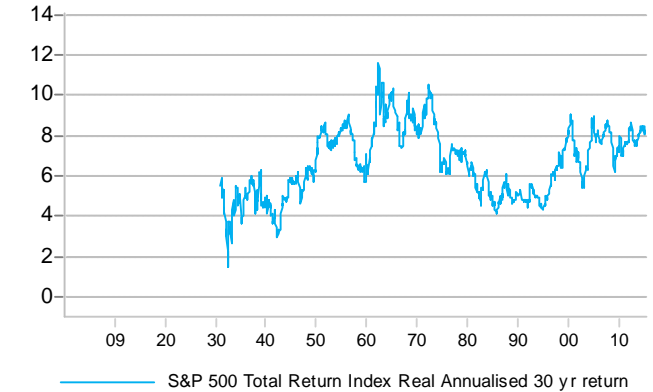
Source: BLS, S&P, , using proxy updates 8/04/2015

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



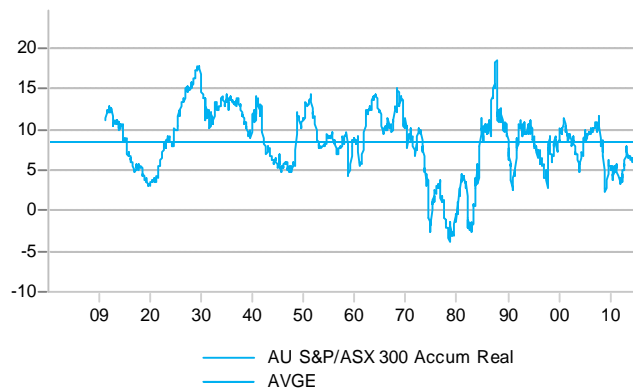
Source: BLS, S&P, using proxy updates 8/04/2015

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



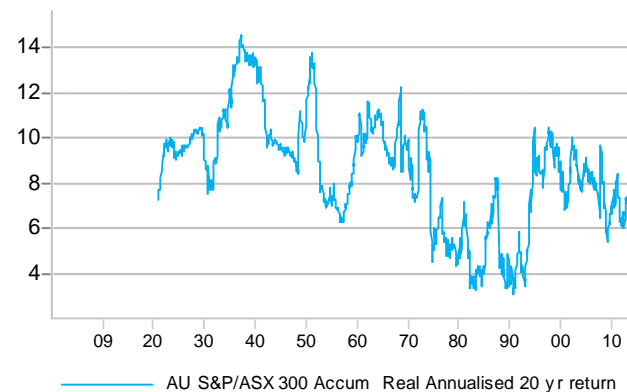
Source: BLS, S&P, , using proxy updates 8/04/2015

**Aust Total Real Return Index
(Annualised 10 year return)**



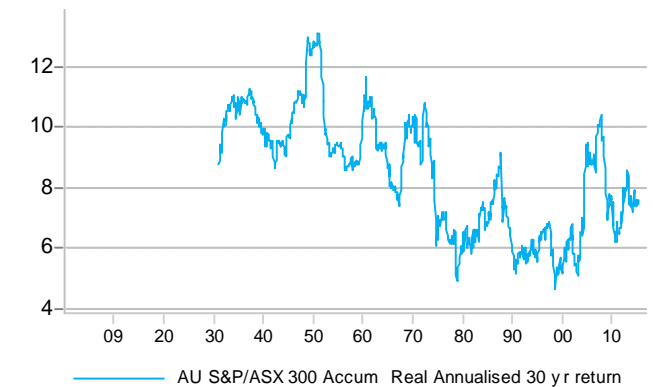
Source: ABS, RBA, IRESS, using proxy updates 8/04/2015

**Aust Total Real Return Index
(Annualised 20 year return)**



Source: ABS, RBA, IRESS, using proxy updates 8/04/2015

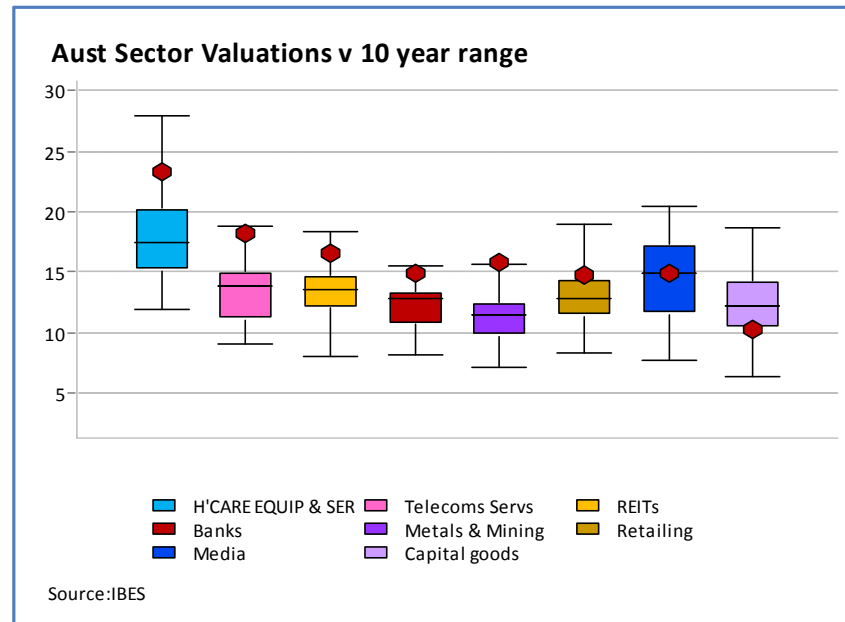
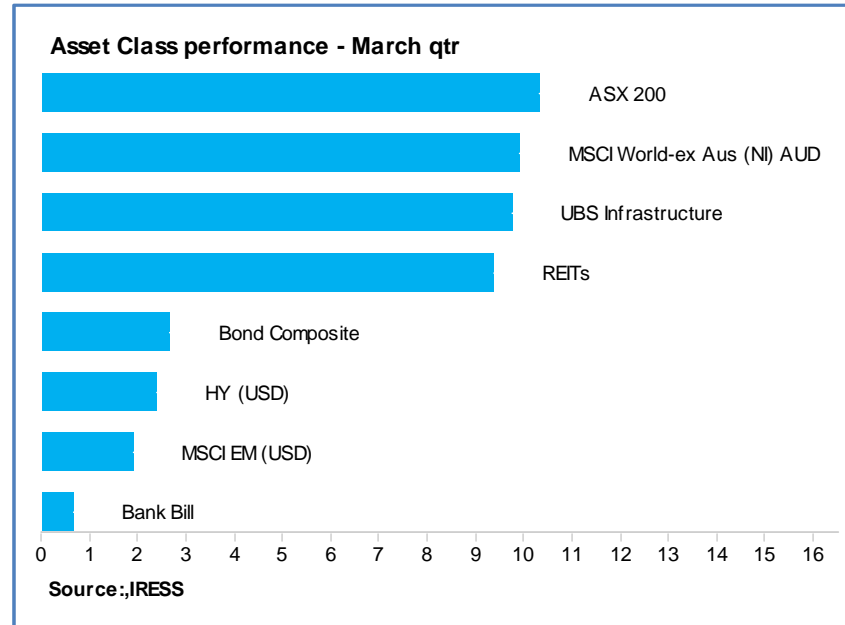
**Aust Total Real Return Index
(Annualised 30 year return)**



Source: ABS, RBA, IRESS, using proxy updates 8/04/2015

Appendix 3: Asset class performance & Sector valuations

- Chart 1. Australian equities outperformed in the 1st quarter. Developed equities in AUD terms, infrastructure, REITs were also strong performers.
- Chart 2. This chart looks at the current PE of key Australian equity sectors (red dot) relative to the range of valuations (excluding outliers) over the past 10 years. The defensive, higher yielding sectors tend to be towards the top of their range and relatively high in absolute terms while the cyclical sectors tend to be within their 10-year range. Miners PE is currently high reflecting lower EPS at present.



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