View from the hill

SEPTEMBER 2015

HILLROSS

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **31 August 2015.**

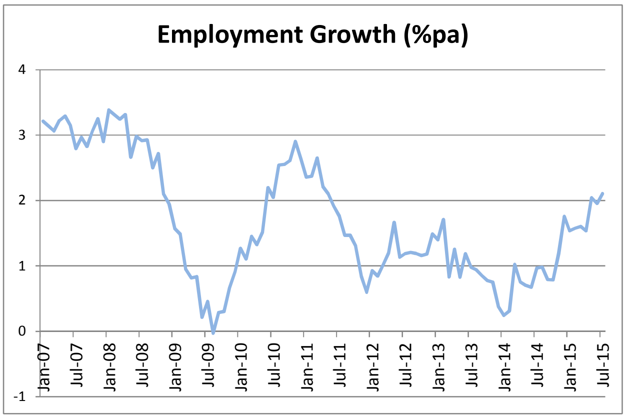
Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	-7.8	-8.8	-3.2	11.3
Smaller companies	-4.9	-10.9	-9.6	0.4
International shares (unhedged)	-3.1	0.5	27.5	26.3
International shares (hedged)	-6.7	-6.7	4.2	16.8
Emerging markets (unhedged)	-6.5	-11.2	1.4	10.9
Property – Australian listed	-4.1	-2.8	14.2	16.8
Property – global listed	-5.7	-3.1	6.0	12.4
Australian fixed interest	0.6	1.0	6.3	5.2
International fixed interest	-0.1	0.0	4.8	5.6
Australian cash	0.2	0.5	2.5	2.8

Overview & Outlook

Large losses were recorded on equity markets over August, more than reversing July's positive bounce back. Negative sentiment dominated markets, with concerns centered around a deterioration in the outlook for Chinese economic growth. Related to this concern was the decision by the Chinese central bank to devalue the Chinese currency, which created an additional source of instability for financial markets. Locally, losses on the Australian share market were magnified by further falls in commodity prices and ongoing weakness in the banking sector. The regulator's requirement for Australia's major banks to raise more capital was not well received by the market, with bank stocks sold down heavily.

Economic data did little to boost confidence over August. The release of National Accounts data for the June quarter showed a very subdued 0.2% increase in the size of the economy, resulting in the annual rate of growth falling from 2.5% to 2.0%. Flat business investment and a decline in exports were two of the major contributions to the weaker growth pattern last quarter. In contrast, household consumption and government spending continued to make a positive contribution to growth.

Labour force data once again provided mixed signals. During July, the unemployment rate jumped from 6.1% to 6.3%; however this was primarily due to a rise in the workforce participation rate from 64.8% to 65.1%. Annual employment growth remained at a healthy 2.1%.

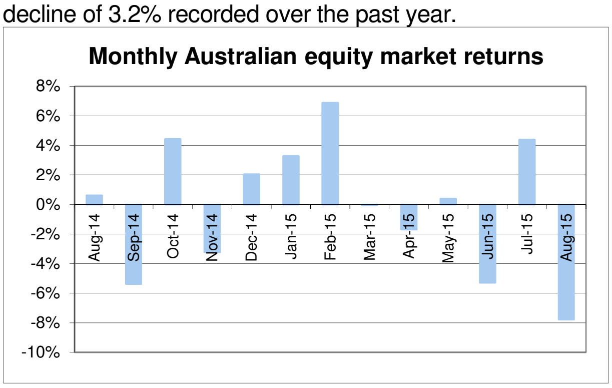


Source: Australian Bureau of Statistics 6202.

Notwithstanding the weak economic data and negative market sentiment over August, the fall in share prices appears to have the characteristics of a shorter term correction rather than the start of an extended period of weakness. Longer term "bear markets" in the past tend to have been associated with financial system dysfunction, excessive overvaluation or imminent economic recession. None of these factors appear to be in place today. In particular, the global economy remains on a modest growth path with low inflation and accommodative policy support creating an environment conducive to company profit growth.

Share markets

August was a particularly volatile month on share markets with significant falls in values recorded across all major markets. The Australian market experienced its largest monthly decline since October 2008, with the S&P ASX 200 Index falling 7.8%. The annual return on the local market has now moved into negative territory, with a decline of 3.2% recorded over the past year.

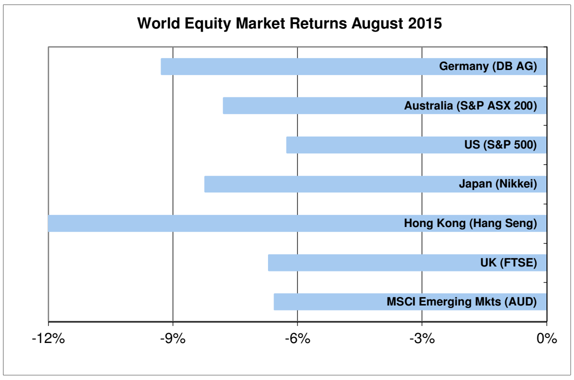


Source: S&P ASX 200 Index

Banking stocks led the market lower last month, following the confirmation that the major banks would be required to raise additional share capital. The finance sector finished the month down 9.6%. Also creating a major drag on performance was the energy sector (down 13.8%) and resource stocks (down 7.2%), as global concerns over the economic growth prospects for China sent commodity prices lower.

Non-finance industrial stocks were the best performers over August. The Utilities sector provided a safe haven, with an average decline of just 0.4%. Smaller Companies also performed better than the market average, with a fall of 4.9% recorded on the Small Ordinaries Index.

All major global markets also experienced sharp losses last month. Heavy price falls were recorded in China given firming expectations for lower economic growth. The Shanghai and Hong Kong markets both declined by 12%. Europe also performed below the global average with the German market dropping 9.3% and the British FTSE Index some 6.7% lower. Despite some favourable company earnings results, the U.S. market finished the month down 6.3%.

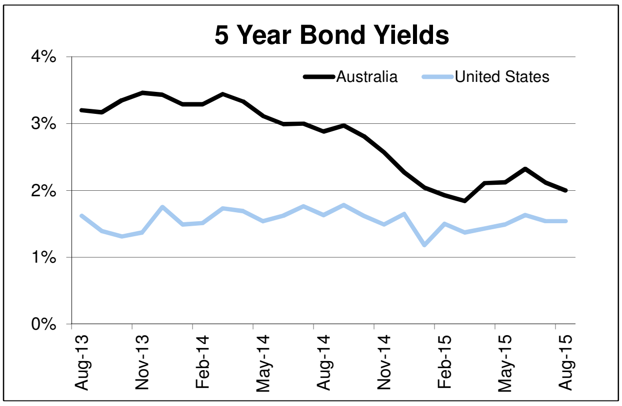


Source: Indicies as shown on chart.

Australian investors with unhedged currency positions were protected to some degree from the full impact of the decline in global share prices. With the $A declining from U.S. 72.9 cents to U.S 71.5 cents over August, there was some increase in the value of overseas domiciled currencies. This limited the average fall in the value of unhedged overseas shares to 3.1%, compared to a 6.7% decline for investments with hedged currency exposures.

Interest rates

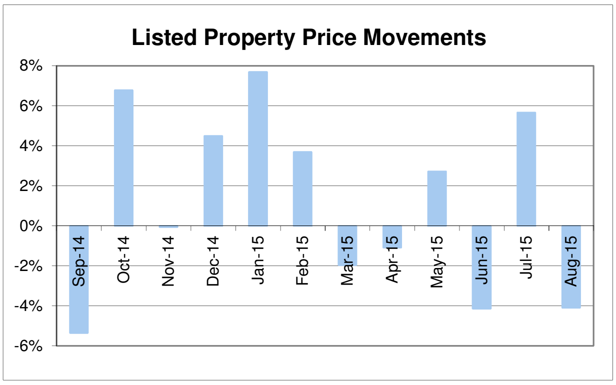
Interest rates were relatively stable over August with no change in the overnight cash rate and minimal movement in longer term yields. The Australian Government 5-year yield dropped from 2.12% to 2.00%; with the equivalent yield in the U.S. remaining unchanged at 1.54%



Source: Reserve Bank of Australia. US Federal Reserve.

Property

Listed property prices were impacted by the decline on equity markets more generally over August. The local A-REIT sector fell by 4.1% and thereby performed somewhat better than the equities asset class. Losses were larger on overseas listed property markets, with a fall of 5.7% recorded.



Source: S&P ASX 200 A-REIT Acc Index.

Unlisted (direct) property was one of the few asset classes to record a positive return last month. The Mercer Australian Unlisted Property Index posted an increase of 0.5%, to bring the annual gain to 10.5%.