UniSuper

July 2014

Investment market update

Australian shares were unable to keep pace with solid global share markets and actually fell in June. However this wasn't enough to temper the healthy 14% return* for the Balanced option in the 2013/14 financial year. This month we take a look back on the lack of volatility in the share market during this past year. This occurred despite a range of economic, political and market concerns. Though low volatility often precedes market downturns, it's quite possible that the current benign environment may persist for some time yet.

PERFORMANCE OF KEY MARKETS

	% CHANGE				
	MONTH	FYTD	1 YEAR	3 YEARS P.A.	5 YEARS P.A.
Australian Shares (ASX 300)	-1.4	17.3	17.3	9.9	11.0
US Shares (S&P 500) in US Dollars	2.1	24.6	24.6	16.6	18.8
US Shares (S&P 500) in Australian Dollars	0.7	20.8	20.8	21.6	15.2
Asian Shares (MSCI Asia)	1.8	11.8	11.8	2.0	7.4
Australian Dollar (AUD/USD)	1.4	3.1	3.1	-4.1	3.1
Australian Fixed Interest (UBSA Composite)	0.8	6.1	6.1	7.0	6.9
Cash (UBSA Bank Bill)	0.2	2.7	2.7	3.6	3.9
Balanced option*	**0.4**	**14.0**	**14.0**	**10.3**	**9.9**

Returns are for periods to 31 June 2014.

* Past performance is not an indication of future performance. Returns relate to our Accumulation (not Pension) investment options and are published after fund taxes and investment expenses, other than account-based fees.

See performance information on all options

Balanced option up 14% in 2013/14

June was a good month for global share markets. Despite the uncertainty associated with escalating sectarian violence in Iraq, developed economy shares rose 1.6% and emerging markets rose by 2.2%. The tendency towards easier monetary policy continued globally with central banks in both China and Europe making policy more accommodative.

Unfortunately for Australian investors, local shares were unable to keep pace and actually fell by 1.7%. Weaker consumer confidence following the Federal Government's May Budget and unseasonably warm weather drove a number of profit warnings from retailers. Additionally, the money needed to fund a surge in corporate transactions and public offerings also weighed on liquidity. Nevertheless, Australian shares recorded a strong 18% return for the financial year.

The above table only shows returns for the Balanced option as it is the default option for our members. UniSuper offers a range of investment options and the strength in markets has underpinned strong performances across the board. As many as 10 investment (Accumulation) options have recoded returns of at least 15% over 2013/14. Topping the table is the Global Environmental Opportunities option with 20.4%.#

Dramatic headlines, but calm markets

As seen in the attention-grabbing headlines above, there has been no shortage of global developments vying for investors' attention over the past year. Reported issues included the tightening of credit in China and concerns over the 'shadow banking' sector there (unregulated activities), the tapering of U.S. stimulus, geopolitical tensions in Europe, currency depreciation in emerging markets, conflict in the Middle East, regional strains about the South China Sea, and the progress of economic stimulus in Japan.

The market is a pricing mechanism that discounts for risk as new information comes to hand. Given this backdrop, one might expect markets to have been roiled by uncertainty and large price swings over the year. However, the data tells a different story.

Despite the sensational headlines, price movements have been relatively restrained. For example, the percentage range of the S&P/ASX 300 Index from low to high over the year was limited to 17%. It means that Australian shares have traded within a tighter price range this financial year than any other in the past decade (see following table).

AUSTRALIAN SHARES - S&P/ASX300 INDEX

FINANCIAL YEAR	RANGE (% from high to low)
2004 / 2005	24
2005 / 2006	27
2006 / 2007	30
2007 / 2008	34
2008 / 2009	65
2009 / 2010	35
2010 / 2011	19
2011 / 2012	23
2012 / 2013	27
2013 / 2014	17

Source: S&P/ASX 300 Index data from Bloomberg

So why haven't the news headlines created more volatility? It is because market volatility is a function of not only news that surprises, but also the market's ability to cope with such surprises.

Markets are most vulnerable to bad news when they are overvalued and over-leveraged, and we do not see evidence of either in the current environment.

While the sharemarket is certainly not cheap, valuations do not look overly stretched either. A popular valuation metric involves the comparison of share prices (p) to company earnings (e). Currently the ASX 300 is trading on a P / E multiple of approximately 15 compared to a historical average of approximately 14.

Similarly, while there are pockets of over-leverage, they are mainly confined to the public sector. Corporate balance sheets are generally in very robust shape after companies moved to reduce their leverage in the aftermath of the financial crisis. Not only are corporate sector debt levels relatively low, debt servicing levels are low across the board due to the ultra-accommodative monetary policies pursued by central banks. This means in many countries, interest payments relative to gross incomes are the lowest they have been for decades.

The extraordinary stimulus efforts of central banks also provides a support mechanism for risky assets, as yields on defensive assets such as cash and bonds are rendered relatively unattractive. This again exerts a calming influence on markets as investors use market corrections as a buying opportunity, rather than seeing such corrections as harbingers of more bad news in the pipeline.

The good news is that periods of low volatility generally provide a positive backdrop for the share market, while they last. The bad news is that the great market crashes have tended to be immediately preceded by such periods of low volatility. Unfortunately, as shown in the following chart, the history of volatility does not reveal any discernible patterns to guide our decision making. While crashes have followed periods of ultra-low volatility, there is no telling how long such periods could last.

As it is so often the case with investing, historical data can be (and is) used to support an optimistic or pessimistic case about the immediate future. Only time will tell who is right.

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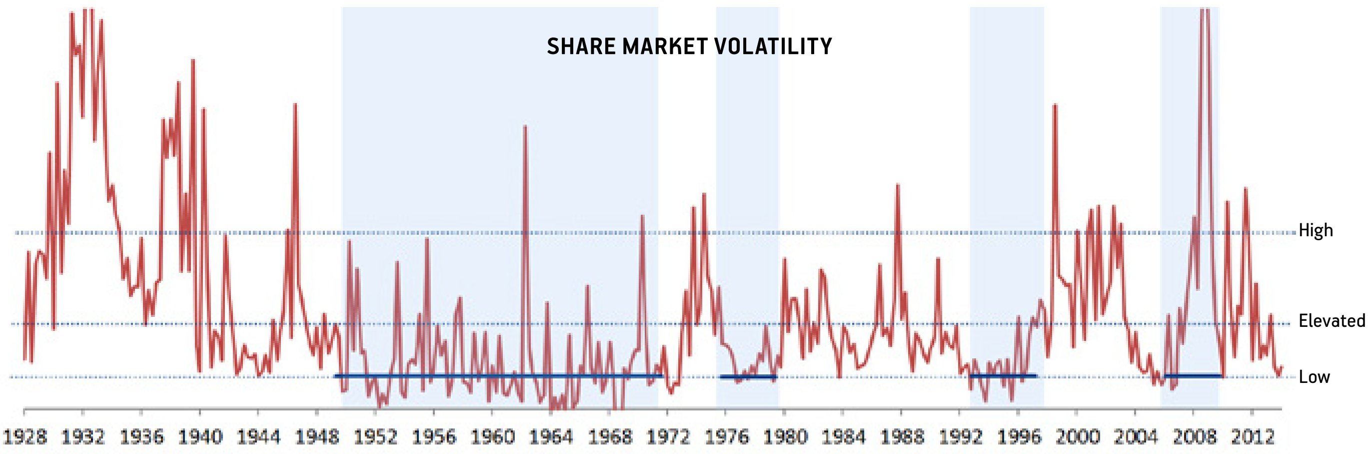

Source: S&P500 Index 30 day historical volatility from Bloomberg.

Exit Westfield Retail Trust/Enter Scentre

Last month's market update focused on the public battle UniSuper was having with Westfield in relation to the Scentre proposal. The vote took place on 20 June 2014. Westfield's resolutions were passed—which was contrary to our position. WRT ceased to exist on 25 June 2014, and UniSuper is now a substantial shareholder in Scentre Group.

Despite some commentary and expectations, UniSuper is not an automatic seller of Scentre. We manage various portfolios with a range of risk return profiles. Given attractive valuations and taking into account other considerations such as portfolio liquidity, we are always likely to be in the market for quality assets.

While we lost the WRT battle, we would not do anything differently if we had the time again. As it turned out, with only a very small (1.1%) swing, the resolutions would have been defeated. In our opinion this could have resulted in a renegotiating of price, in our members' favour. Additionally, there was a matter of principle at stake. We see it as our fiduciary duty to vote our rights as we believe best serves the interest of our members and we will continue to act on this basis in the future.

On that note, we sincerely thank the many members who contacted us with their words of support and encouragement over the past couple of months.

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