Investment market update

The new financial year has got off to an interesting start with August losses eroding some of July's gains. The Australian share market tends to get buffeted in August as a large number of Australian corporates report their financial year results. While the share market's short-term performance is generally disconnected from the broader economy, the underlying operating performance of individual companies is linked to the economies in which they operate. In this update we take a look at five features of Australia's economy through the lens of Australian corporates.

Performance of key markets

	% CHANGE				
	MONTH	FYTD	1 YEAR	3 YEARS P.A.	5 YEARS P.A.
Australian shares (S&P/ASX 300)	-1.6	4.7	9.7	6.6	9.5
Global shares (MSCI All Country World Local Currency)	0.7	4.8	6.8	9.0	11.1
Australian dollar (AUD/USD)	-1.1	0.9	6.0	-5.5	-6.8
Australian fixed interest (Bloomberg Composite)	0.4	1.2	6.2	6.5	6.2
Cash (Bloomberg Bank Bill)	0.2	0.3	2.2	2.5	3.0
Balanced option*	**-0.6**	**2.8**	**9.1**	**9.9**	**10.9**

Returns are for periods to 31 August 2016. 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 for all options

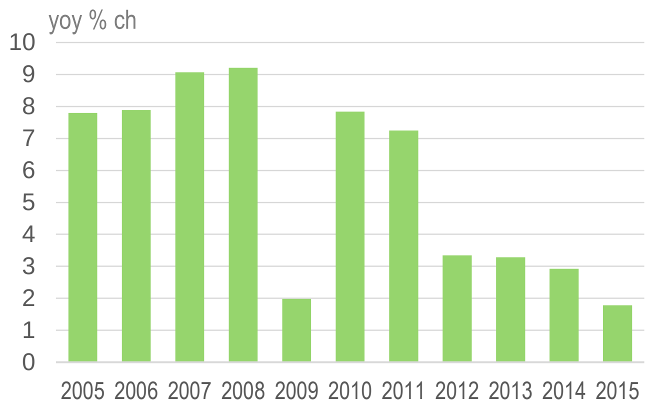
The economy through the lens of Australian Corporates

We're in a low growth environment

Although we've avoided a recession, Australia's economy could at best be described as 'lacklustre'. Nominal GDP growth has averaged just 2.6% over the past four years, considerably below the 7% average for the preceding 10 years. In this environment, it isn't surprising that Australia's listed companies have had difficulty achieving growth in earnings and dividends. In aggregate, corporate profits were down 8% over the year, which included a whopping 47% fall in the mining sector. Excluding mining companies, overall profits fell 1%.

Given their reach into all sectors, the performance of our major banks is directly impacted by the economy's overall health. The Commonwealth Bank (CBA), is seen as a 'bell-weather' company, and its results certainly reflected lacklustre economic conditions. On a positive note, CBA's

Australian nominal GDP growth



Growth in:
Revenues +5%
Profit +2%
Dividends 0%

Source: Company Reports
Past returns may not repeat.

balance sheet currently remains strong with high levels of capital, and only marginal deterioration in loan quality. However, the loan book and overall profits are growing slowly.

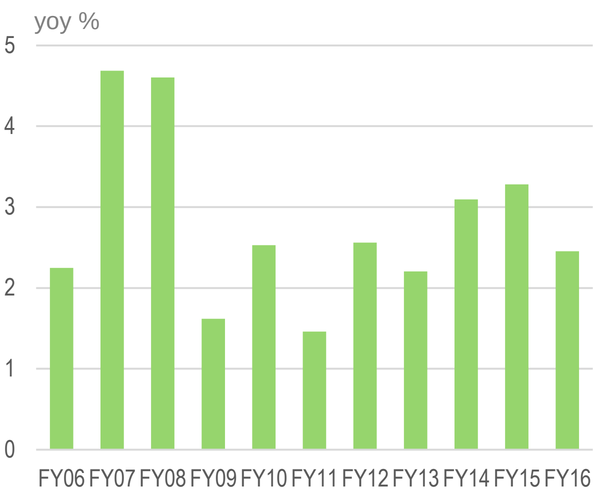
Of particular note is that, after six years of steadily increasing dividends, CBA held its annual dividend unchanged from the prior financial year.

The consumer still has a pulse ...

The retail environment has faced its fair share of headwinds over the past decade: a more cautious consumer, volatile asset prices and the rise of internet shopping. Nevertheless, Australian households continue to spend, with retail sales volumes averaging about 2.8% growth over the past four years. This is modest relative to the strength observed before the GFC, but is still a solid outcome and a decent recovery from GFC lows.

While this environment has challenged the business models of some poorer performers, retailers who have remained relevant to consumers' needs have continued to perform well. JB Hi-Fi was one company which stood out during reporting season, posting +12% profit growth. While JB Hi-Fi has benefitted from a consolidating industry, it's a very well-managed company with a history of surprising on the upside.

Australian retail sales volumes



JB HI-FI

Growth in:
Sales +8%
Profit +12%
Dividend +11%

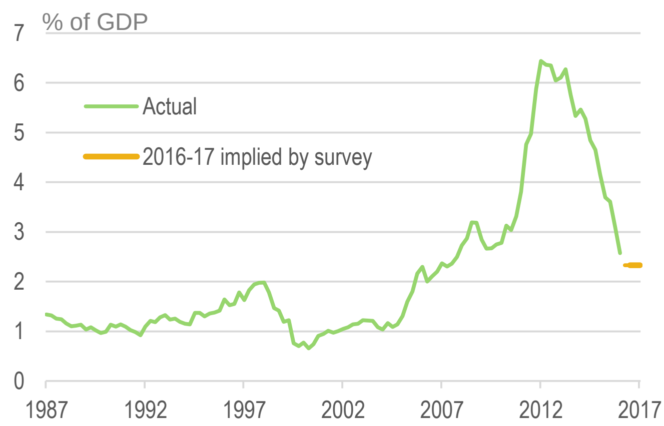
Source: Company Reports
Past returns may not repeat.

... But the mining boom is definitely over

The most significant headwind to Australia's economy over the past four years has been the mining sector. Mining company earnings, government tax revenue and national income have all suffered as the global prices of Australia's largest exports have plummeted from record highs. Activity has also softened as mining companies have responded to falling prices by cutting back on investment for future growth.

As Australia's largest mining company, the results from BHP reflect these trends, reporting a USD 6.4 billion loss for FY16 and cutting capital expenditure for the third consecutive year. However, with commodity prices finding support and the decline in investment levelling off, there is some hope that the worst is behind us.

Mining investment as a percentage of GDP



bhpbilliton

Growth in:
Sales -31%
Profit -434%
Dividend -76%

Source: Company Reports (in USD)
Past returns may not repeat.

A lower Australian dollar is supporting export volumes

While the profits of our mining companies have been smashed by falling commodity prices, export volumes have actually increased. In fact, a falling currency has provided a tailwind for all of our export industries, with volumes having averaged more than 6% growth over the past four years. An obvious beneficiary has been the tourism sector as Australia becomes a relatively cheaper holiday alternative for foreigners.

The benefits to the tourism industry were seen this reporting season through Sydney Airport which showed continued solid growth. Other obvious beneficiaries are hospitality-linked businesses and airlines. Qantas, a much maligned company not that long ago, reported a surge in profit of +85%, and was able to pay its first dividend since 2009.

Australian short-term tourism arrivals

Sydney Airport

Sales +11%
Profit +10%
Dividend +20%

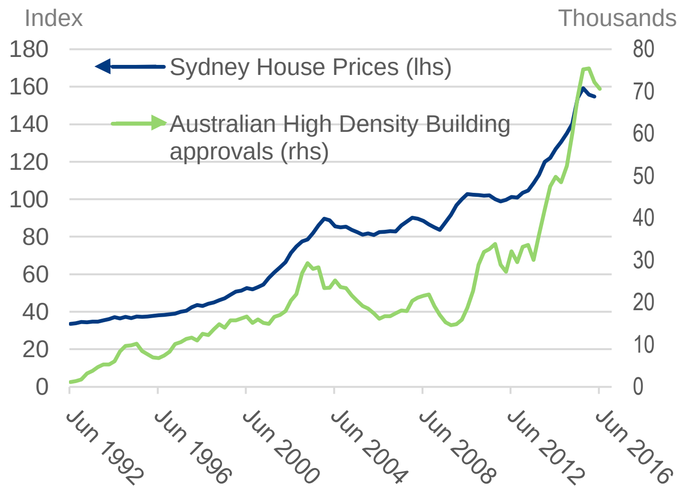
Source: Company Reports (6 month period)
Past returns may not repeat.

And housing is the hottest sector in town

Though tourism has been strong, it's the housing sector that has been the standout performer in recent years. While the media focuses on the price of housing, its construction activity that matters for listed companies such as Lend Lease. Approvals for new high density apartments have been at record highs, which has been a boon for property developers. Underpinning a 13% rise in Lend Lease's profits was a 64% growth in profit from their Australian construction business.

Of course this 'hockey-stick' growth profile can't continue indefinitely, particularly when it's driven by historically low rates and ever-increasing indebtedness of Australian households. If business investment does not pick up, economic growth will remain anaemic, and this will ultimately impact company earnings.

House prices and building approvals



lendlease

Growth in:
Sales +14%
Profit +13%
Dividend +11%

Source: Company Reports
Past returns may not repeat.