McGregor Asset Consulting

Economic and Market Commentary
May 2015

Global growth markets continue to benefit from the ongoing flood of quantitative easing being undertaken by Europe's ECB, Japan and China. The record low interest rate environment across the developed world has led investors to seek out yield opportunities. The search for yield has been a dominant driver for investors seeking above cash returns and have been turning to equities and listed REITs where yields have been higher than fixed interest coupons. While share market returns have been strong over the past year with the global unhedged index up 26.7%, concern is increasing that the US recovery is maturing and that investors need to be more selective as markets reach record highs.

Stock picking and active management is likely to become more important for the remainder of the year. Confidence is still high with US corporate management and merger and acquisition activity likely to be a key driver of returns over the coming year. Opportunities appear to be more attractive in Europe where companies balance sheets are improving as well as a weak Euro v $US which increases Europe's competiveness. Japan's large quantitative easing program is also providing opportunities for equities as well as Asia including India and China's equity markets have responded from a low base.

Investors continue to watch closely for guidance and direction from the US Federal Reserve as to when interest rates are likely to be increased. Recent commentary from the Federal Reserve indicates that they are in no hurry to start increasing rates as they need to see more improvement in the US job market and higher inflation before it raises rates. Also, the stronger US$ is starting to slow US exports. The Fed has kept interest rates extremely low for six years, which has helped drive stock and bond prices higher by making borrowing cheap. Markets have reacted positively to this approach and have generated strong returns over the past year. The markets are now anticipating that the first rate increases are likely to be in the second half of 2015 or early 2016.

The current low interest rate and quantitative easing environment has been the catalyst for supporting growth assets and remains in place. Europe's ECB has followed both the US and Japan in implementing a very large quantitative easing programme (€60 billion per month) which commenced during March and is planned to run until September 2016 with the aim to counter the risk of deflation and stimulate growth back into the Eurozone. This stimulus is aimed at both lowering the borrowing costs across the Eurozone as well as stimulating the economy. Global growth in the developed world is forecast to remain low for the rest of the decade at around 2.2% a year. Borrowing costs also are likely to remain low over the same period.

Easy monetary conditions and uneven global growth continue to set the course for 2015. Growth assets should continue to be the focus for investors with global shares, infrastructure and listed property providing opportunities. Markets have been digesting the large drop in the oil price where the price declined over 50% since June 2014 to US$45 per barrel and has now rebounded to US$57 per barrel. Also, from Australia's perspective commodity prices led by iron ore have declined over 50% from $130 per tonne to $57 per tonne. This is having a significant negative effect on Australia's national income and has contributed to the increase in the Federal budget deficit announced in the recent budget.

Currencies are also playing an increasing role in the outcome of the global recovery and we are now seeing a structurally stronger US $ v Euro, Yuan, Yen and Australian $. The euro has dropped to a 12 year low versus US$. The A$ has succumbed to the lower oil and commodity prices, dropping to the 77 US cent level and is unlikely to rebound until commodities prices start to increase, which may not occur for a prolonged period of time. The fall in the $A should further help the economy avoid recession as mining investment slows. It also provides a boost to corporate earnings as each 10% fall in the $A adds around 3% to earnings.

The US economy continues to provide optimism for markets as it has generally been performing well with unemployment steadily declining and now at 5.5%, which is providing the catalyst for a return to higher interest rates. As a result, US equities markets now require underlying earnings to grow in order to support the equities valuations. Also, business confidence is providing a boost and the housing market recovery is still intact. Access to cheap funds and access to affordable energy is also supporting the improved sentiment in the US.

China and Indian equities markets are continuing to perform strongly. China's Shanghai Composite index is likely to be further supported as it opens to foreign trading, which is seen as a significant advancement. Also, the Chinese property market has slowed during the past quarter and this may well be supportive for the equities market as funds are moved from property to equities. While China has under gone a slowing over the past months, the leadership has responded by lowering interest rates and providing additional liquidity to spur growth by offering low interest rate loans to the small business and housing sectors. The Chinese leadership continues to step up the reform process as the country transforms from the export and investment phase to a consumption phase. This consumption phase is likely to generate marginally lower growth over the coming years as the transition to a broader based economy takes effect with less impact than the investment phase has had over the past five years.

While Asian equities markets are performing well fears are still high with many of the emerging markets such as Russia, Turkey, South Africa and Brazil underperforming as well as dealing with geo political uncertainties, social unrest and currency problems. Falling commodities prices are also negatively impacting Brazil, Russia and South Africa.

The Japanese equities market continues to be driven by the large stimulus as they continue to embark on an ambitious reflation strategy. The Japanese equities market has responded strongly. Abe is now seeking to undertake more difficult reforms to re-energise Japan's economy. The aim is to continue to drive down the currency and boost export earnings, which is starting to occur although it will undergo periods of volatility.

Returns for bonds, both global and domestic remain low and unappealing. With the easing of monetary conditions bond markets have rallied strongly with US 10 year rates trading around 2.1% and Australian 10 year bonds at 2.8%. The RBA cash rate was cut by 0.25% to 2.00% at the beginning of May in an attempt to stimulate a modest growth environment. This should continue to provide support to the housing market. Term deposits are also losing appeal with one year rates around 2.75%. With lower returns from bonds investors are seeking higher yields from riskier assets, such as property, infrastructure and equities. Quality large cap companies that pay reliable dividends have benefitted the most.

In Australia, the focus is now on consumer and business confidence which has been boosted by the recent budget initiatives in providing incentives, especially for the small business sector. While unemployment has increased to over 6% the Federal government’s initiatives should now provide the support to underpin the economy and offset the slowing resources sector. Current GDP growth forecast for 2015 is 2.5% and is below the long term growth of 3.5%.

Returns from fixed interest are harder to achieve as cash rates are well below long term levels and opportunities are now difficult to find. Commercial and retail property valuations are offering better value and long term investors are being attracted to the market. Listed REITs are attracting investors seeking yield.

- **International shares: [Overweight]** Sentiment in global equities markets is positive providing opportunities for international shares to outperform in the coming year. An overweight unhedged position is appropriate for the sector. A weakening A$ should provide opportunities.

- **Australian shares: [Neutral] Australian Small Caps: [Neutral]** Increased pressure on the economy and particularly the mining sector is limiting opportunities. Investors need to be selective in this environment. Large cap stocks are preferred over small cap stocks.

- **Australian Listed Property: [Neutral] Global Listed Property: [Neutral]** Quality listed property securities delivering solid yields are likely to benefit from the focus on yield and suggest a neutral weighting to this sector. Quality direct property is also offering value although investors need to be selective in this sector.

- **Infrastructure: [Neutral]** Listed infrastructure securities provides opportunities in this environment as they provide both yield and defensive attributes. Governments globally are focussing on building infrastructure assets which should provide opportunities for the sector.

- **Fixed Interest: [Underweight]** With interest rates at historically low levels both globally and in Australia, opportunities for fixed interest are likely to be limited over the coming months. An underweight for the sector is appropriate. Corporate bonds should provide the best opportunities.

- **Cash: [Underweight]** The risk return profile of Cash and Term Deposits is less attractive.

Risks

- A major risk ahead for the global economy is the mismanagement of the QE stimulus programs currently in place and its repercussions on bond markets and rising interest rates.
- The European Union continues to face significant challenges in dealing with the Greek government over debt levels and are likely to test the resolve of the ECB over coming months and Greece's future as a member of the Eurozone.
- The conflict with the Islamic State in Iraq and Syria has been elevated with a coalition of the West and is likely to contribute to global uncertainty. An escalation of the unrest may have negative implications for the countries involved as defence spending is impacted and global relationships may well be tested.
- Political unrest in Ukraine and Russia needs to be managed carefully in order to avoid a major conflict. If conflicts escalate, markets are likely to be effected, especially energy supplies into Europe.
- A number of the emerging market countries and parts of Asia need to manage their currency and economies closely in order to prevent a currency crisis.
- The Chinese leadership need to implement their economic reforms without stalling the economy which would have major flow on effects, especially for Australia. We are now starting to see defaults on loans in China where the government previously chose to bail them out, which may lead to a contagion effect.
- The risk of sovereign debt defaults continues to remain with large deficits being run by many countries. Investors need to be selective. Servicing debt is likely to be an issue when interest rates rise.

Global Opportunities

- The Asian region continues to generate satisfactory GDP growth and should continue to be a major driver of world growth. India is likely to be a significant contributor and provide market opportunities.
- A key factor for continued Asian growth is the increasing demand by China's consumers as they develop greater wealth and require ever increasing volumes of commodities and agricultural products, which should underpin Australian resources and agricultural sectors over the longer term. The China Free Trade Agreement with Australia should under pin trade. We are witnessing greater interest by China in our agricultural sector. Also, tourism is benefiting from the lower A$ and greater interest in Australia as a destination.
- With the signing of a Free Trade Agreement with Japan this should provide increased opportunities for Australia.

Fixed Interest, Property and Infrastructure

- Opportunities for higher returns from traditional fixed interest are limited. The market has largely factored in the lower rates.
- The listed property trust and infrastructure sectors are in good shape to participate in an improving investment cycle and low borrowing rates provide increased opportunities.

Monthly Share Market Performance over the last Twelve Months

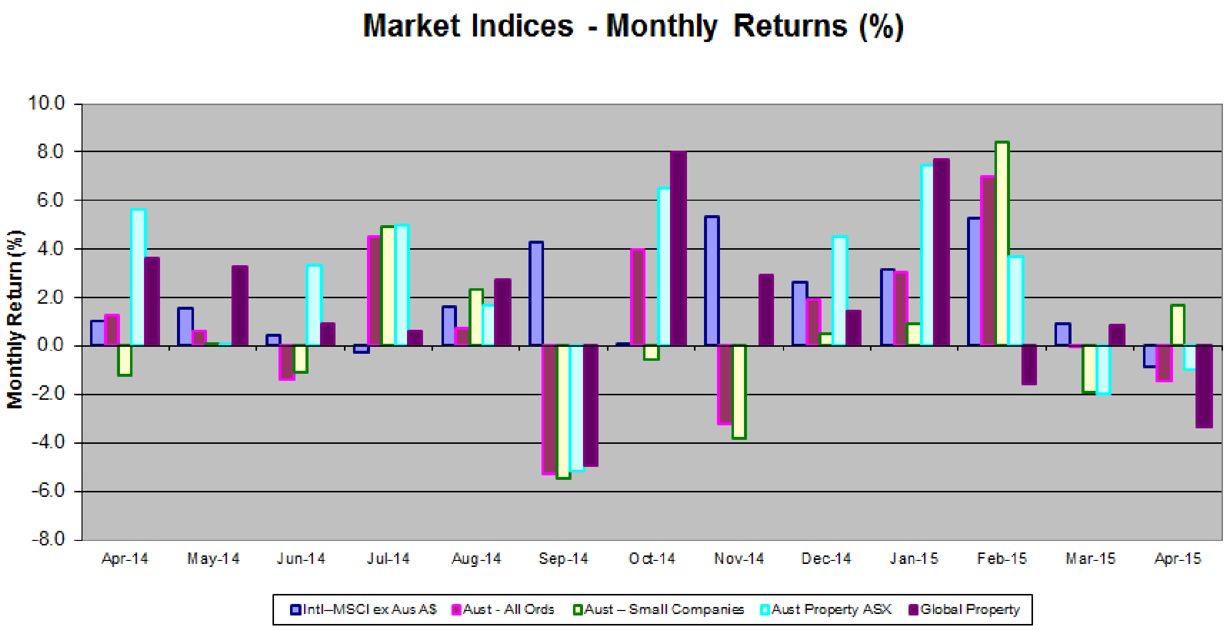
Market Indices	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15	Apr-15
Intl–MSCI ex Aus UH A$	1.54	0.44	-0.25	1.63	4.30	0.05	5.32	2.63	3.18	5.27	0.89	-0.84
Aust - All Ordinaries	0.61	-1.41	4.49	0.72	-5.26	3.96	-3.20	1.93	3.03	7.00	-0.03	-1.47
Aust – Small Company	0.08	-1.11	4.91	2.34	-5.47	-0.54	-3.81	0.47	0.91	8.43	-1.94	1.66
Aust Property REITs	0.05	3.33	4.96	1.68	-5.14	6.53	0.00	4.49	7.44	3.69	-1.96	-0.99
Global Property REITs	3.30	0.89	0.62	2.75	-4.91	7.97	2.89	1.46	7.71	-1.54	0.84	-3.33

Annual Share Market Performance

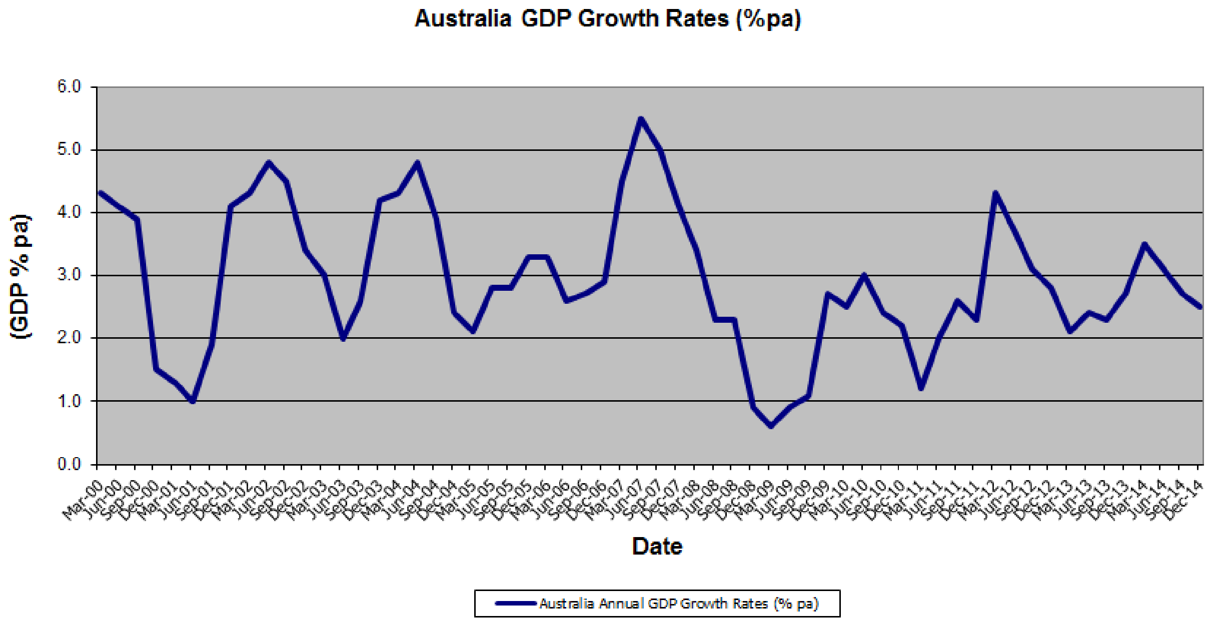
Markets Index	1 Year to 30 Jun 13 %	1 Year to 30 Sep 13 %	1 Year to 31 Dec 13 %	1 Year to 31 Mar 14 %	1 Year to 30 Jun 14 %	1 Year to 30 Sep 14 %	1 Year to 31 Dec 14 %	1 Year to 31 Mar 15 %	1 Year to 30 Apr 15 %
Intl–MSCI ex Aus UH A$	33.10	34.02	48.03	34.73	20.41	20.37	15.01	29.12	26.73
Aust - All Ordinaries	20.67	23.55	19.66	13.19	17.64	5.89	5.02	13.25	10.16
Aust – Small Company	-5.32	1.42	-0.76	-1.46	13.11	-0.07	-3.81	2.30	5.31
Aust Property REITs	23.98	16.39	7.27	4.96	11.08	12.28	26.79	34.39	25.97
Global Property REITs	15.46	11.46	5.84	4.18	15.77	13.92	28.41	27.99	19.39

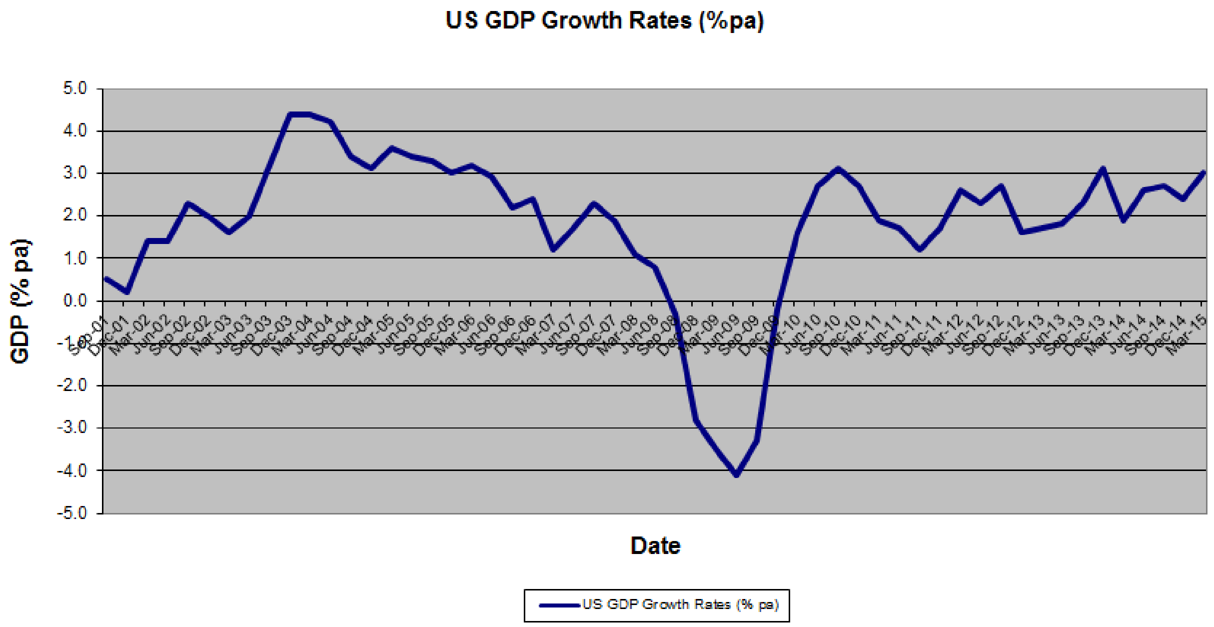
Best Performing Asset Sectors for twelve months ended 30 April 2015

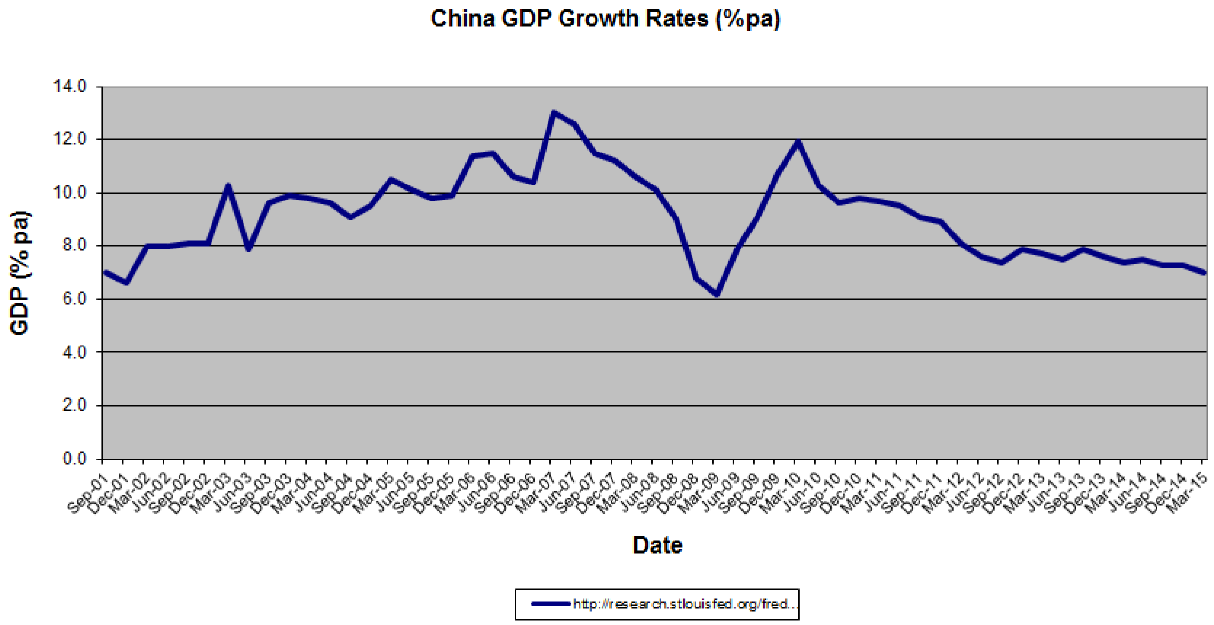
Sector	Market Index	Return
International Equities Unhedged	MSCI World Ex Aust Accum Index A$	26.73
Aust Listed Property	S&P/ASX Property Trusts Accum Index	25.97
Global Listed Property	UBS Global Real Estate Inv Ex Aust Idx Hedge $A	19.39
International Equities Hedged	MSCI World Accum Index Hedged A$	17.43
Australian Shares	S&P/ASX All Ords Accum Index	10.16
International Fixed Interest Hedged	JP Morgan Gov Bond Accum Index Hedged $A	9.68
Australian Fixed Interest	UBS Warburg Composite 0 + Years	8.91
Australian Smaller Companies	S&P/ASX Small Ordinaries Accum Index	5.31
Cash	Australian 90 Day Bank Accepted Bill	2.67

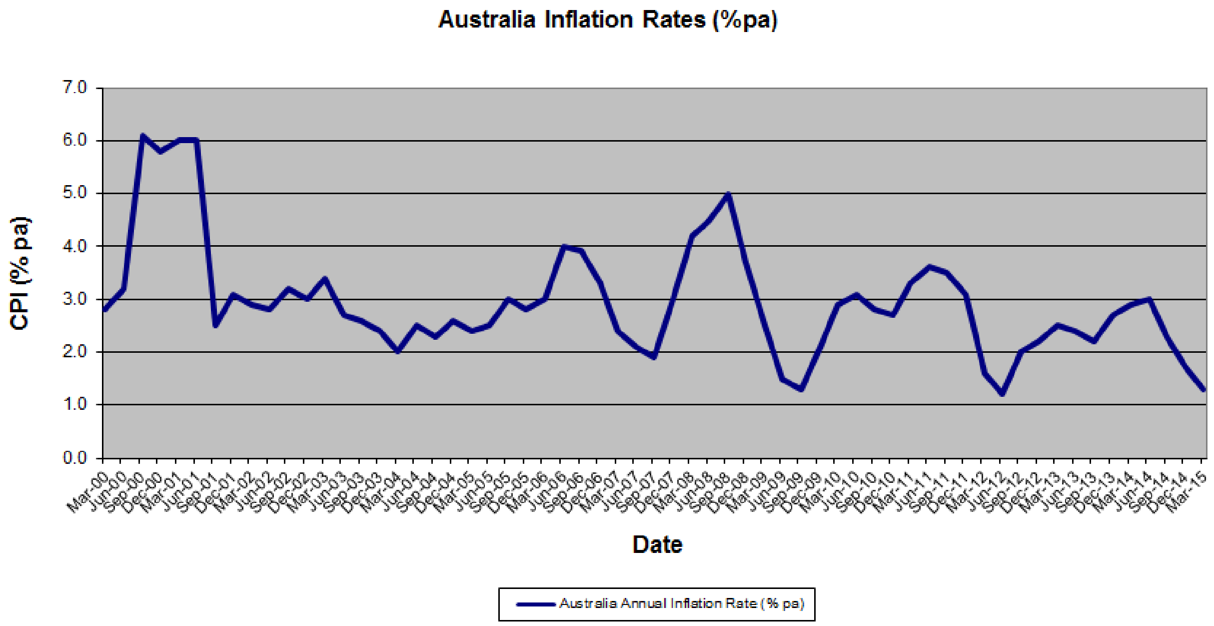


Major Economic Indicators

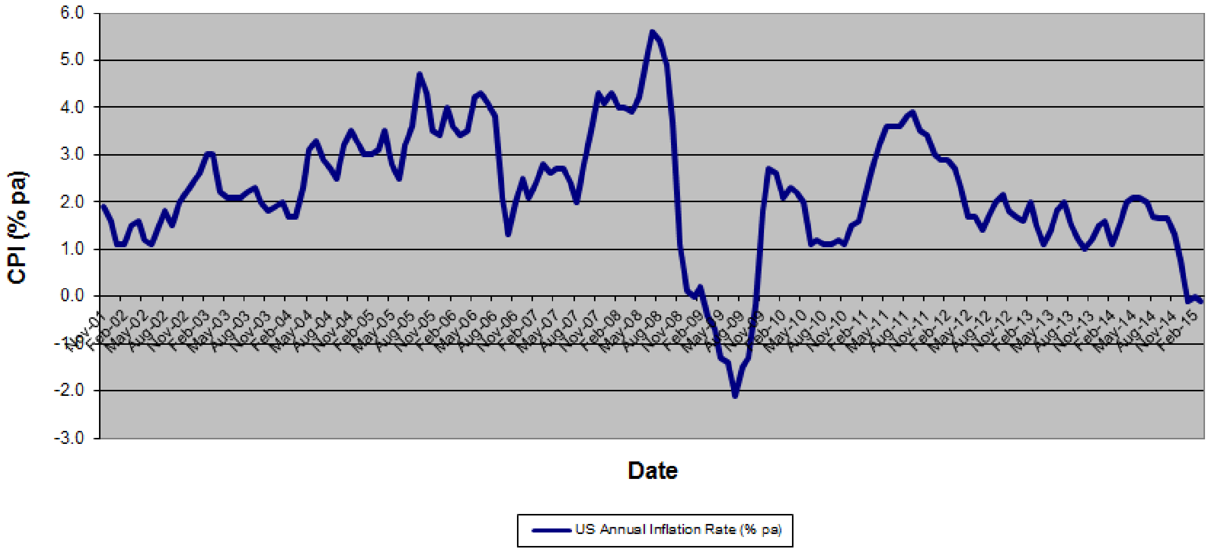




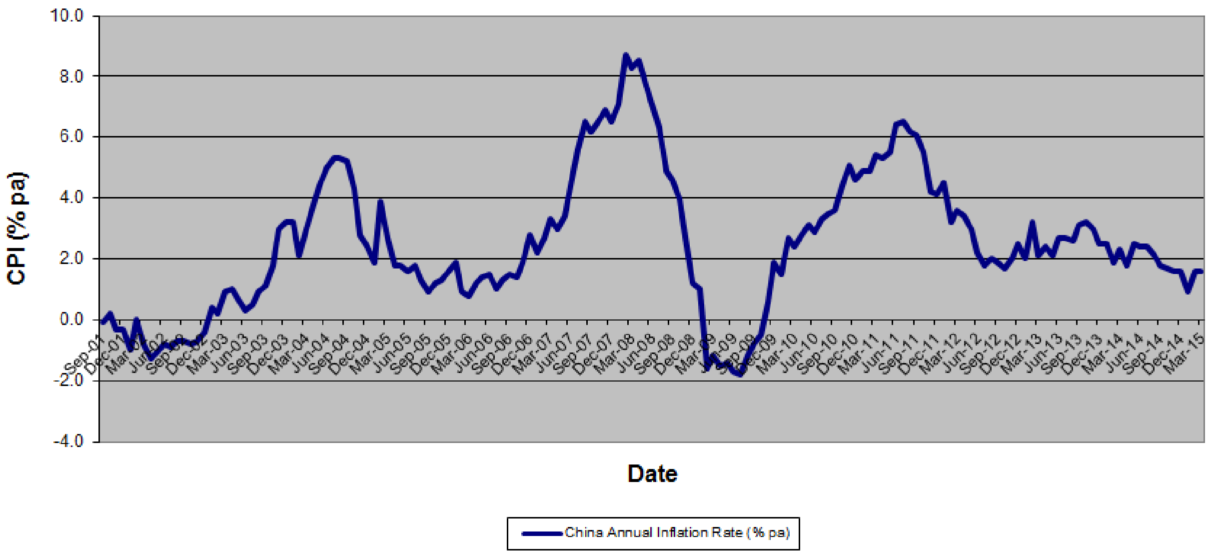

China GDP Growth Rates (%pa)
GDP (% pa)
Date
http://research.stlouisfed.org/fred..

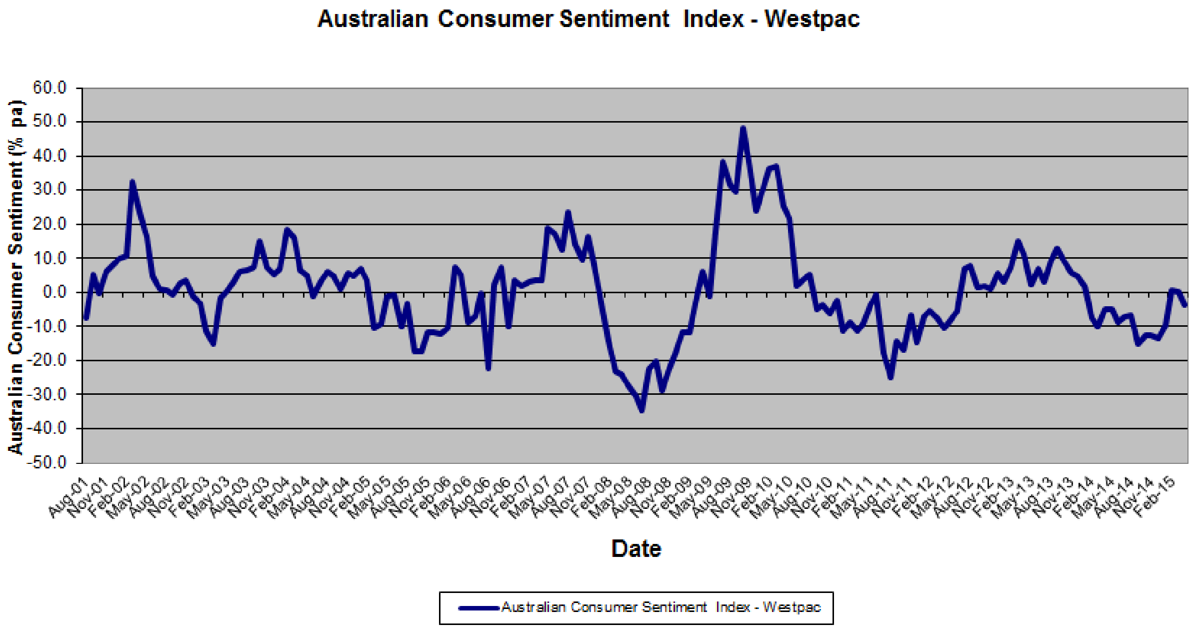

Australia Inflation Rates (%pa)
CPI (% pa)
Date
Australia Annual Inflation Rate (% pa)

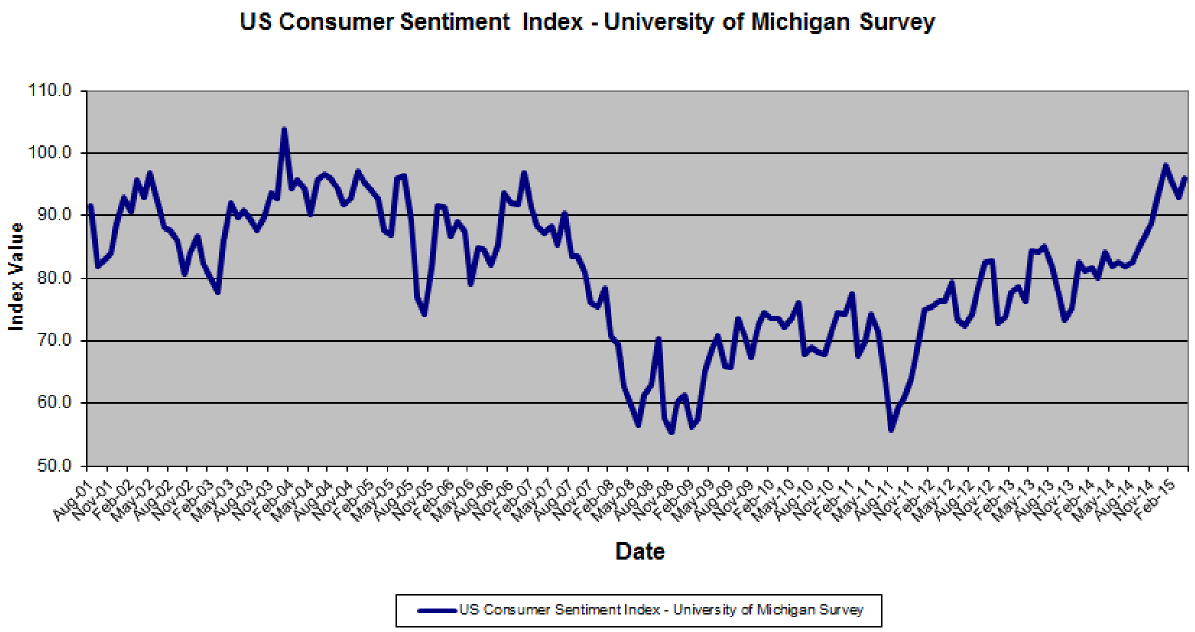
US Inflation Rates (%pa)



China Inflation Rates (%pa)

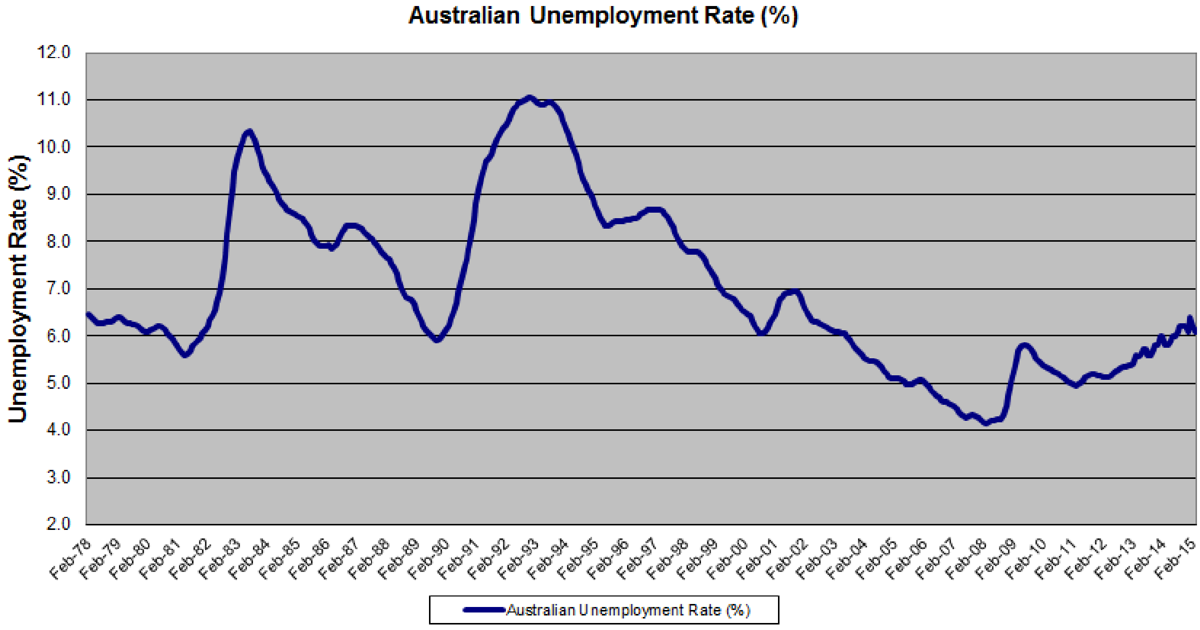


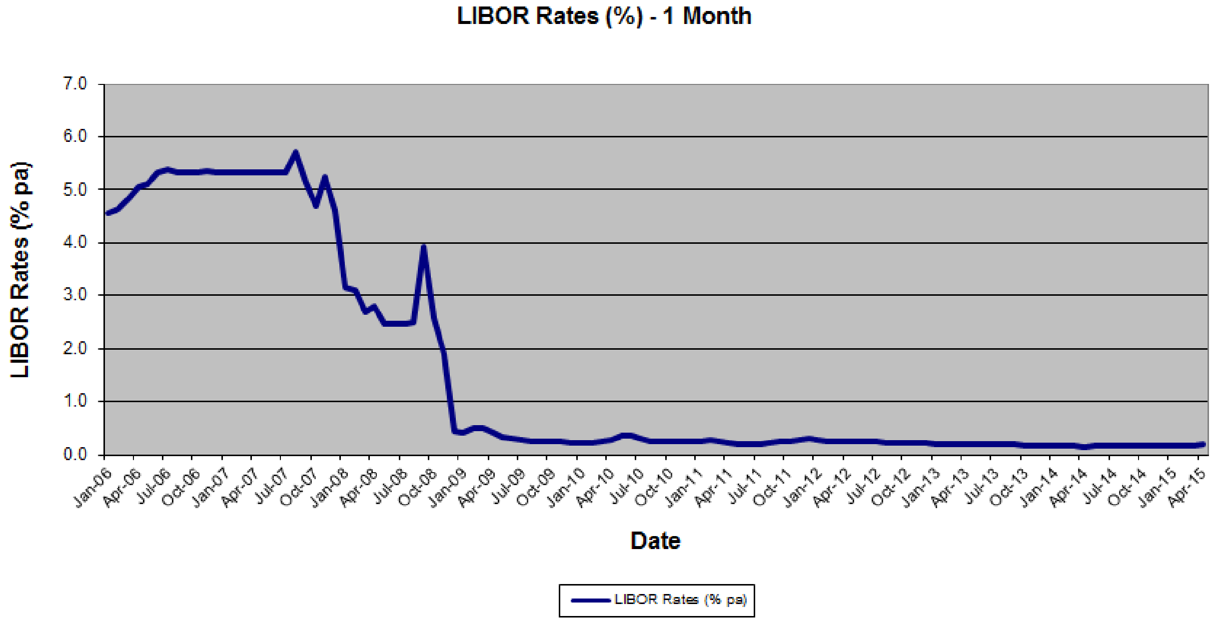

Australian Consumer Sentiment Index - Westpac
Australian Consumer Sentiment (% pa)
Date
Australian Consumer Sentiment Index - Westpac

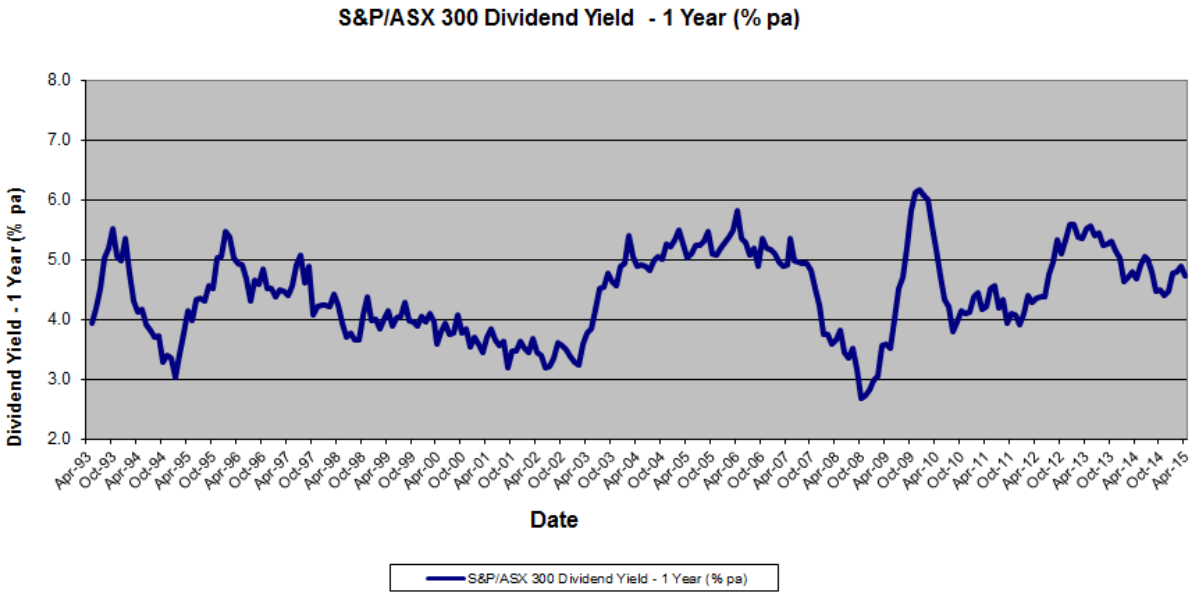

US Consumer Sentiment Index - University of Michigan Survey
Index Value
Date
US Consumer Sentiment Index - University of Michigan Survey

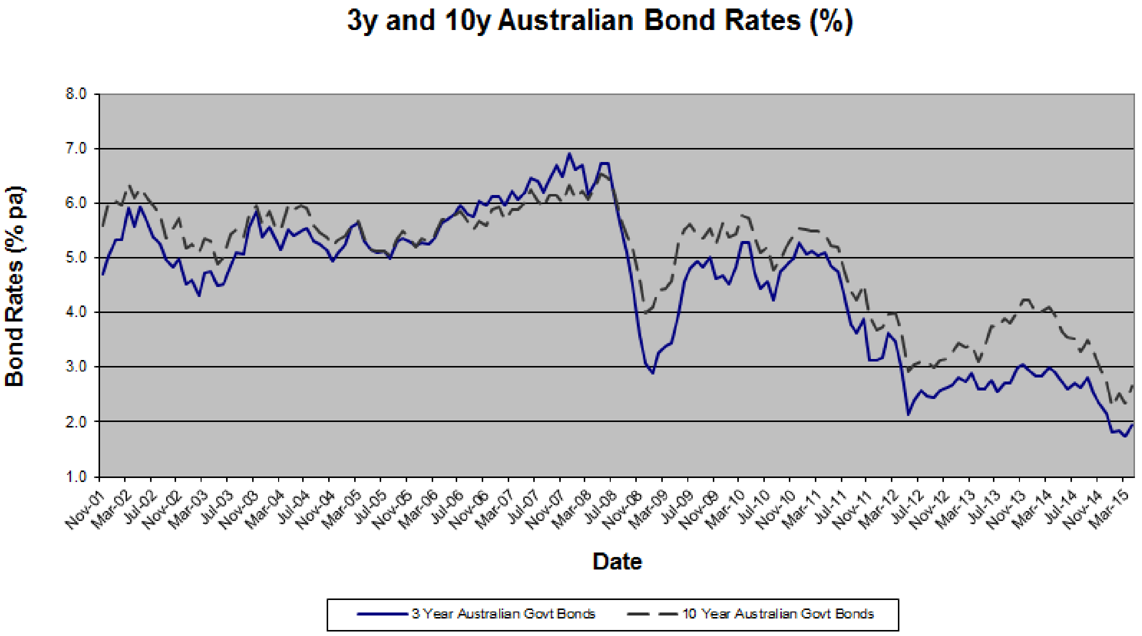

China Retail Sales Value (%pa)
Retail Sales (% pa)
Date
China Retail Sales Value (% pa)

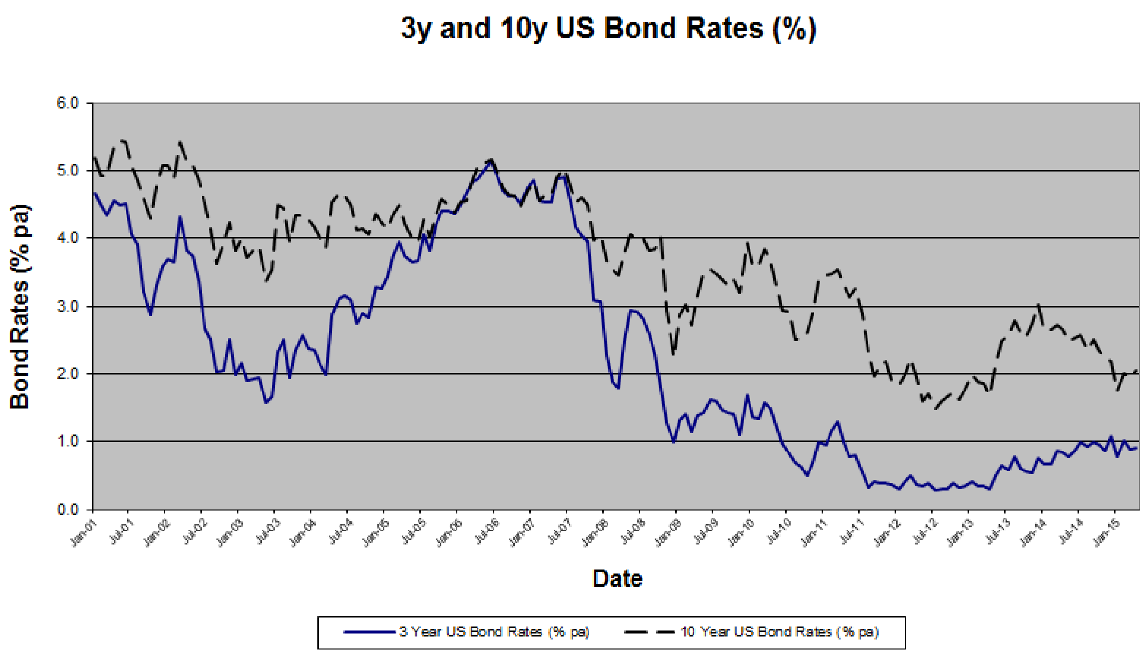

US Unemployment Rate (%)
Unemployment Rate (%)
Date
US Unemployment Rate (%)

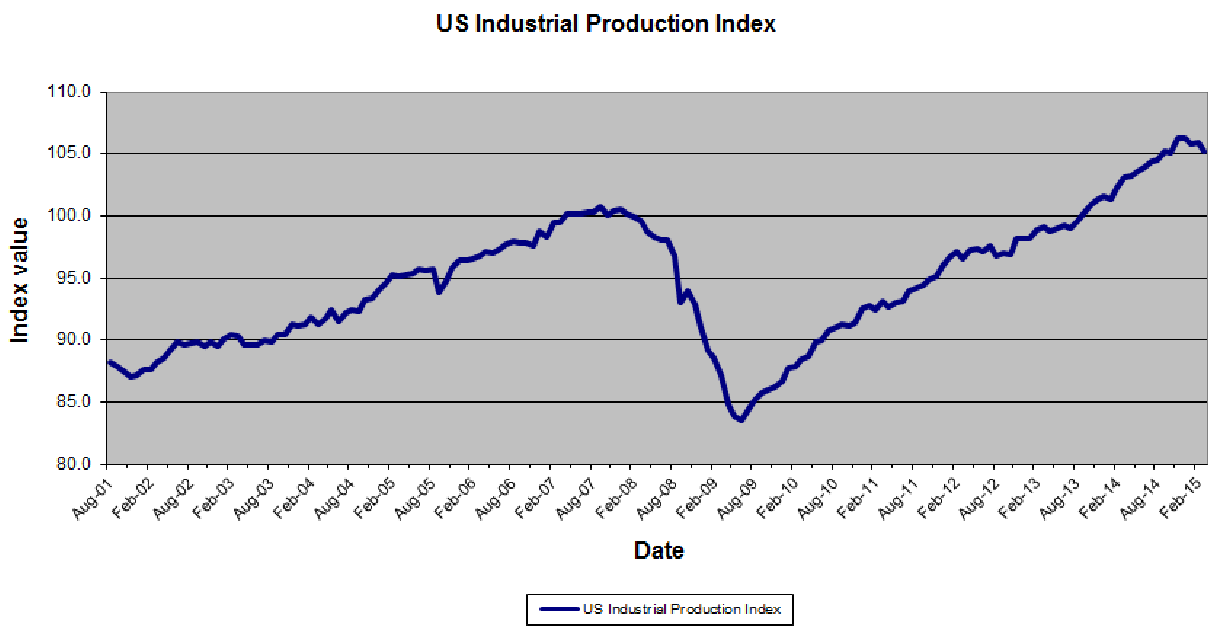

Australian Unemployment Rate (%)
Unemployment Rate (%)
12.0
11.0
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
Feb-78
Feb-79
Feb-80
Feb-81
Feb-82
Feb-83
Feb-84
Feb-85
Feb-86
Feb-87
Feb-88
Feb-89
Feb-90
Feb-91
Feb-92
Feb-93
Feb-94
Feb-95
Feb-96
Feb-97
Feb-98
Feb-99
Feb-00
Feb-01
Feb-02
Feb-03
Feb-04
Feb-05
Feb-06
Feb-07
Feb-08
Feb-09
Feb-10
Feb-11
Feb-12
Feb-13
Feb-14
Feb-15
Australian Unemployment Rate (%)

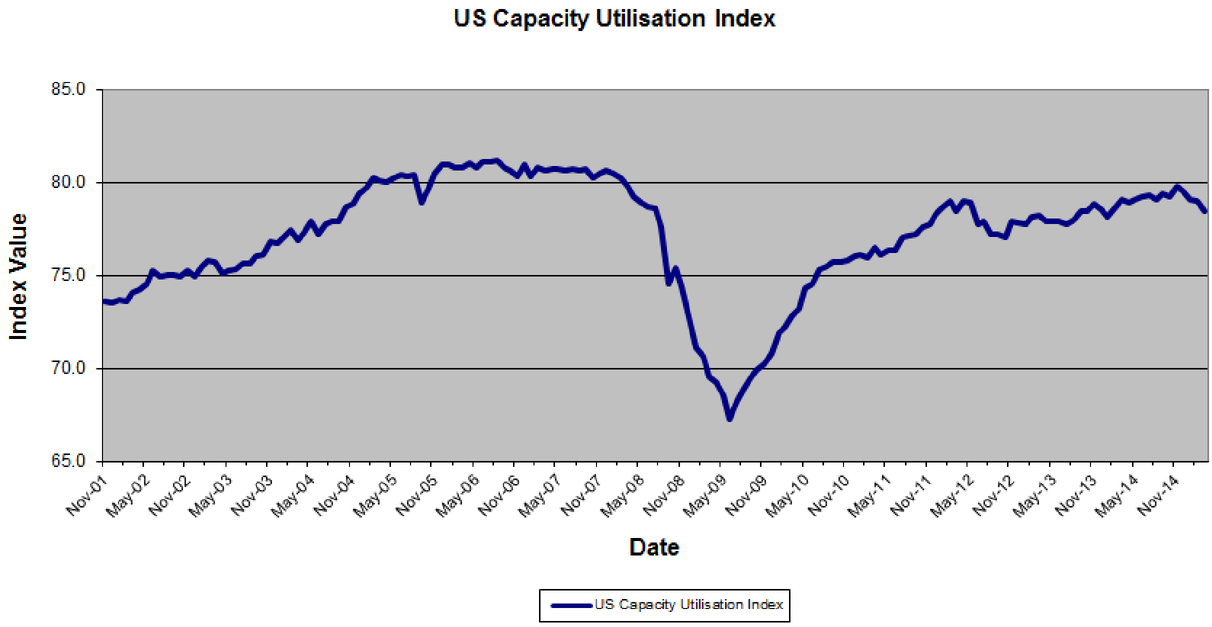

LIBOR Rates (%) - 1 Month
LIBOR Rates (% pa)
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
Jan-06
Apr-06
Jul-06
Oct-06
Jan-07
Apr-07
Jul-07
Oct-07
Jan-08
Apr-08
Jul-08
Oct-08
Jan-09
Apr-09
Jul-09
Oct-09
Jan-10
Apr-10
Jul-10
Oct-10
Jan-11
Apr-11
Jul-11
Oct-11
Jan-12
Apr-12
Jul-12
Oct-12
Jan-13
Apr-13
Jul-13
Oct-13
Jan-14
Apr-14
Jul-14
Oct-14
Jan-15
Apr-15
Date
LIBOR Rates (% pa)


S&P/ASX 300 Dividend Yield - 1 Year (% pa)
Dividend Yield - 1 Year (% pa)
Date
S&P/ASX 300 Dividend Yield - 1 Year (% pa)


3y and 10y Australian Bond Rates (%)
Bond Rates (% pa)
Date
3 Year Australian Govt Bonds
10 Year Australian Govt Bonds


3y and 10y US Bond Rates (%)
Bond Rates (% pa)
Date
3 Year US Bond Rates (% pa)
10 Year US Bond Rates (% pa)


US Industrial Production Index
Index value
Date
US Industrial Production Index


US Capacity Utilisation Index
Index Value
85.0
80.0
75.0
70.0
65.0
Nov-01
May-02
Nov-02
May-03
Nov-03
May-04
Nov-04
May-05
Nov-05
May-06
Nov-06
May-07
Nov-07
May-08
Nov-08
May-09
Nov-09
May-10
Nov-10
May-11
Nov-11
May-12
Nov-12
May-13
Nov-13
May-14
Nov-14
Date
US Capacity Utilisation Index


China Purchasing Managers Index (PMI)
Index Value
65.0
60.0
55.0
50.0
45.0
40.0
35.0
Feb-05
May-05
Aug-05
Nov-05
Feb-06
May-06
Aug-06
Nov-06
Feb-07
May-07
Aug-07
Nov-07
Feb-08
May-08
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May-11
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Nov-11
Feb-12
May-12
Aug-12
Nov-12
Feb-13
May-13
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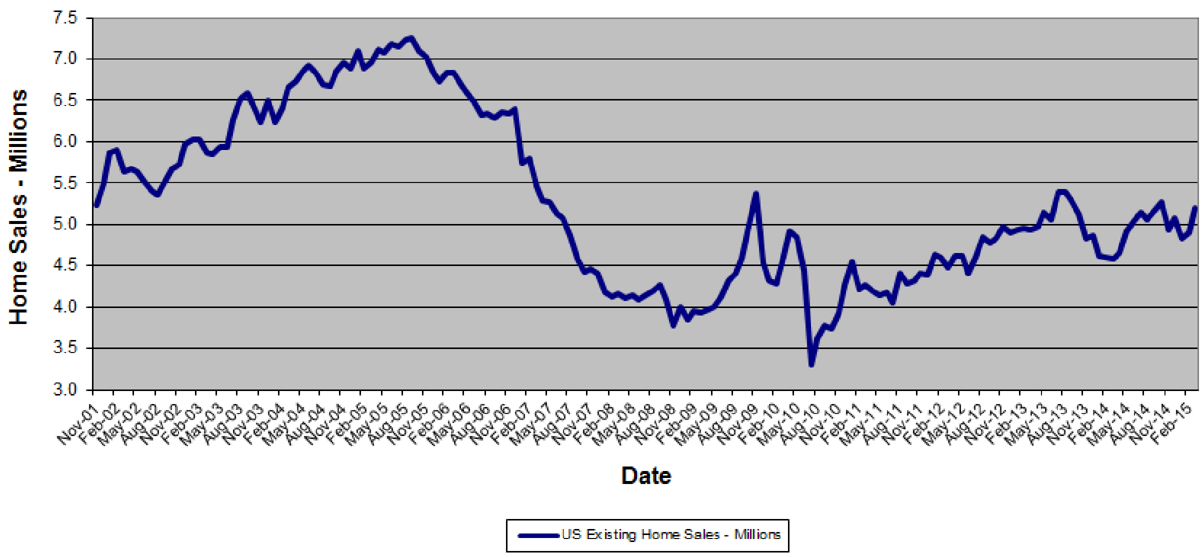
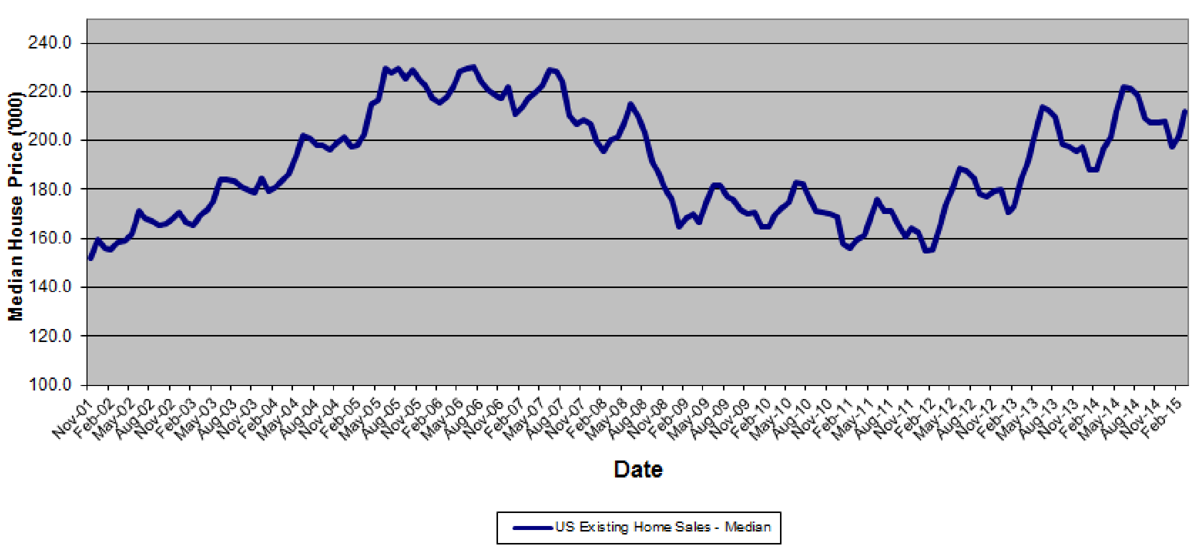
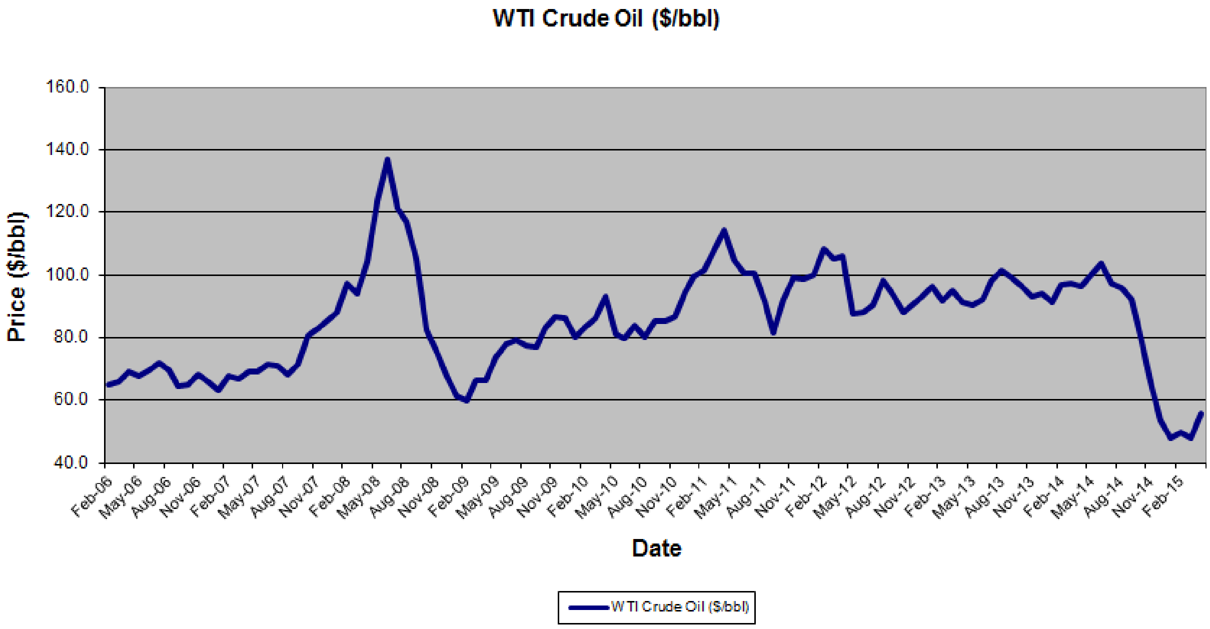
Nov-13
Feb-14
May-14
Aug-14
Nov-14
Feb-15
Date
China PMI Index

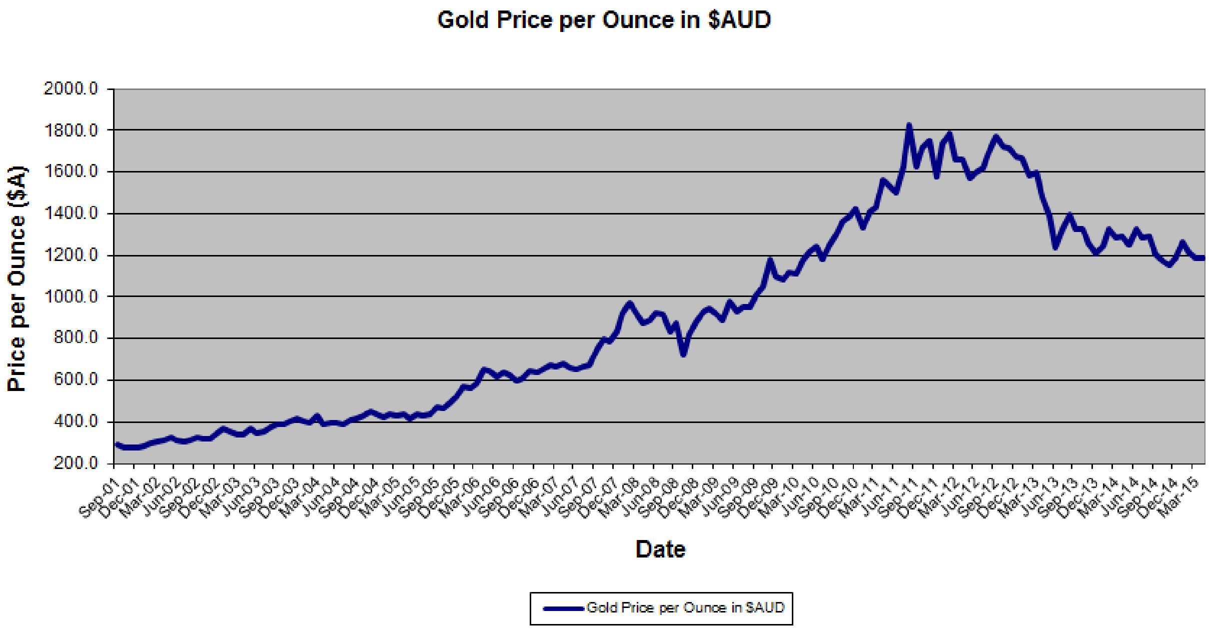
US Existing Home Sales - Millions

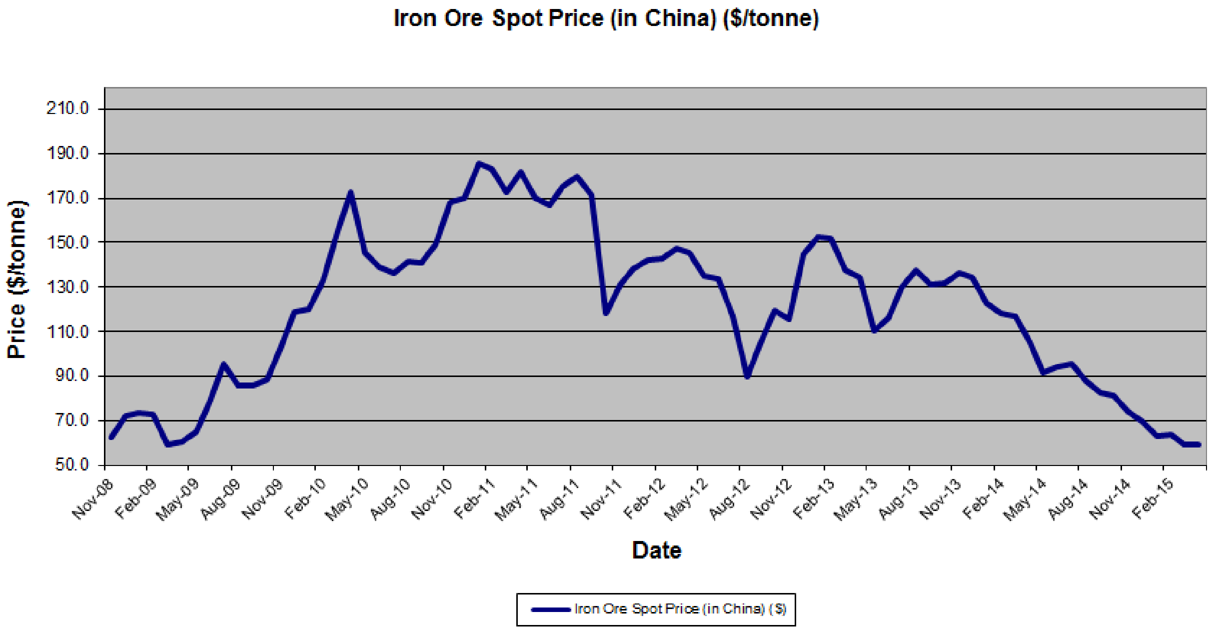


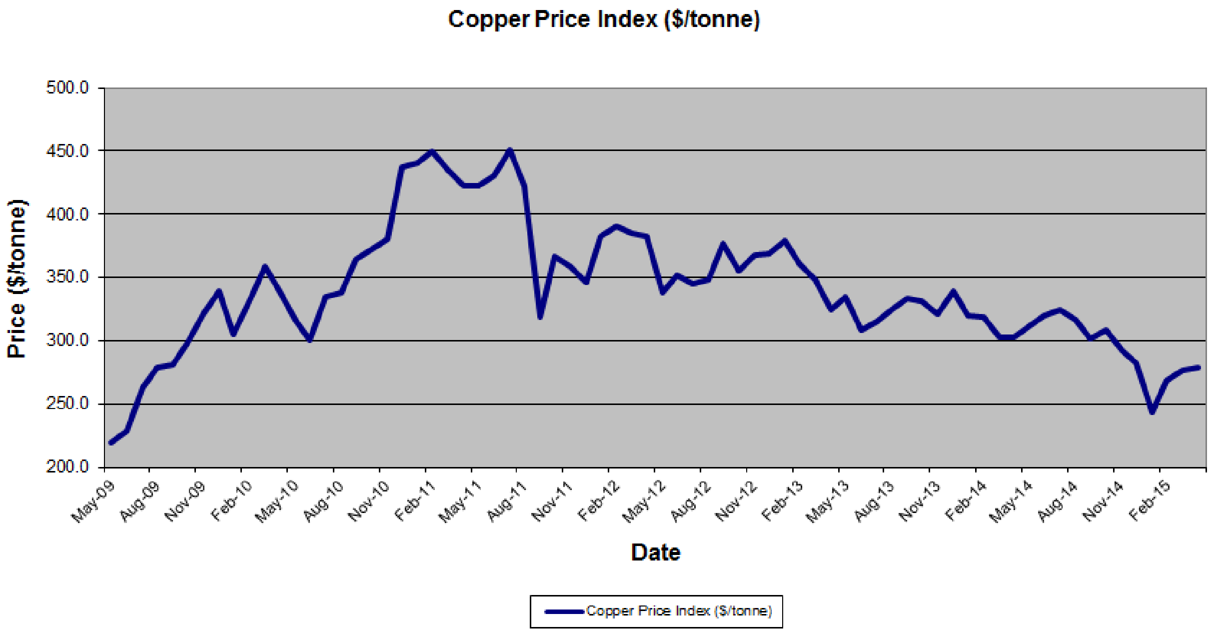
US Existing Home Sales - Median

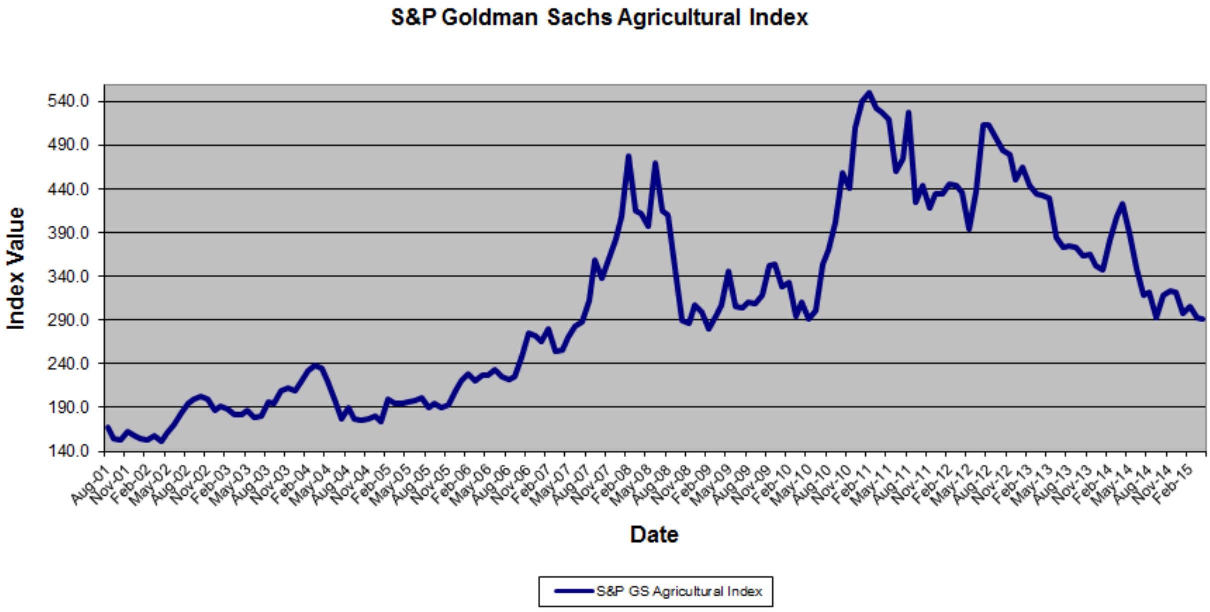


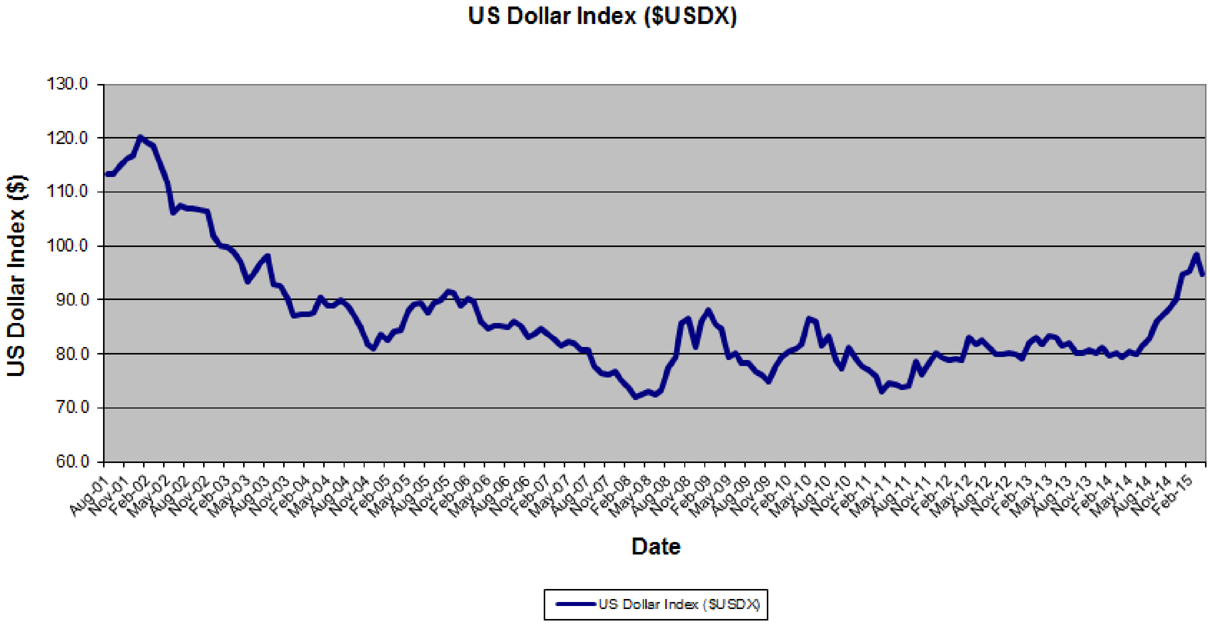

WTI Crude Oil ($/bbl)
Price ($/bbl)
160.0
140.0
120.0
100.0
80.0
60.0
40.0
Feb-06 May-06 Aug-06 Nov-06 Feb-07 May-07 Aug-07 Nov-07 Feb-08 May-08 Aug-08 Nov-08 Feb-09 May-09 Aug-09 Nov-09 Feb-10 May-10 Aug-10 Nov-10 Feb-11 May-11 Aug-11 Nov-11 Feb-12 May-12 Aug-12 Nov-12 Feb-13 May-13 Aug-13 Nov-13 Feb-14 May-14 Aug-14 Nov-14 Feb-15
Date
WTI Crude Oil ($/bbl)


Gold Price per Ounce in $AUD
Price per Ounce ($A)
2000.0
1800.0
1600.0
1400.0
1200.0
1000.0
800.0
600.0
400.0
200.0
Date
Gold Price per Ounce in $AUD


Iron Ore Spot Price (in China) ($/tonne)
Price ($/tonne)
210.0
190.0
170.0
150.0
130.0
110.0
90.0
70.0
50.0
Nov-08
Feb-09
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
May-12
Aug-12
Nov-12
Feb-13
May-13
Aug-13
Nov-13
Feb-14
May-14
Aug-14
Nov-14
Feb-15
Date
Iron Ore Spot Price (in China) ($)


Copper Price Index ($/tonne)
Price ($/tonne)
500.0
450.0
400.0
350.0
300.0
250.0
200.0
May-09
Aug-09
Nov-09
Feb-10
May-10
Aug-10
Nov-10
Feb-11
May-11
Aug-11
Nov-11
Feb-12
May-12
Aug-12
Nov-12
Feb-13
May-13
Aug-13
Nov-13
Feb-14
May-14
Aug-14
Nov-14
Feb-15
Date
Copper Price Index ($/tonne)





The DXY is a weighted index of some of the major trading partners of the United States. The components of the DXY Index are (by weighting): Euro (57.6%), Japanese Yen (13.6%), Great Britain- Pounds Sterling (11.9%), Canadian Dollar (9.1%), Swedish Krona (4.2%), and Swiss Franc (3.6%).