

## IMFG Investment Insights

### End of Financial Year 2016 – ‘Taking a Broader Perspective’



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## Summary – The year in review

The last 12 months has been challenging across investment markets. There have been a number of global events to create reason for the financial news to go from the business section to the front page of the news, including:

- The Shanghai Stock Market crash of June 2015;
- Heightened concerns in January 2016 of a Chinese economic 'hard landing';
- Housing affordability;
- Britain voting to leave the European Union;
- A long Australian Federal Election campaign and close result.

And looking forward additional uncertainty reigns in relation to the outcome of the US Presidential Election, whether the European Union trading bloc further untangles, the Chinese transition of its economy and the impact of broader geopolitical issues on real lives across the globe.

We understand that even the hardest of investors may be concerned about recent volatility in investment markets. We note that uncertainty is not new, nor can it be ignored. On balance, history shows that uncertain times have been, generally, a good signal for the long term investor.

Capital markets owe you a return in proportion to the level of risk you are comfortable taking. And what really matters is remaining on track in meeting your most important life goals.

The IMFG End of Financial Year review draws on research and insights from a variety of sources to provide:

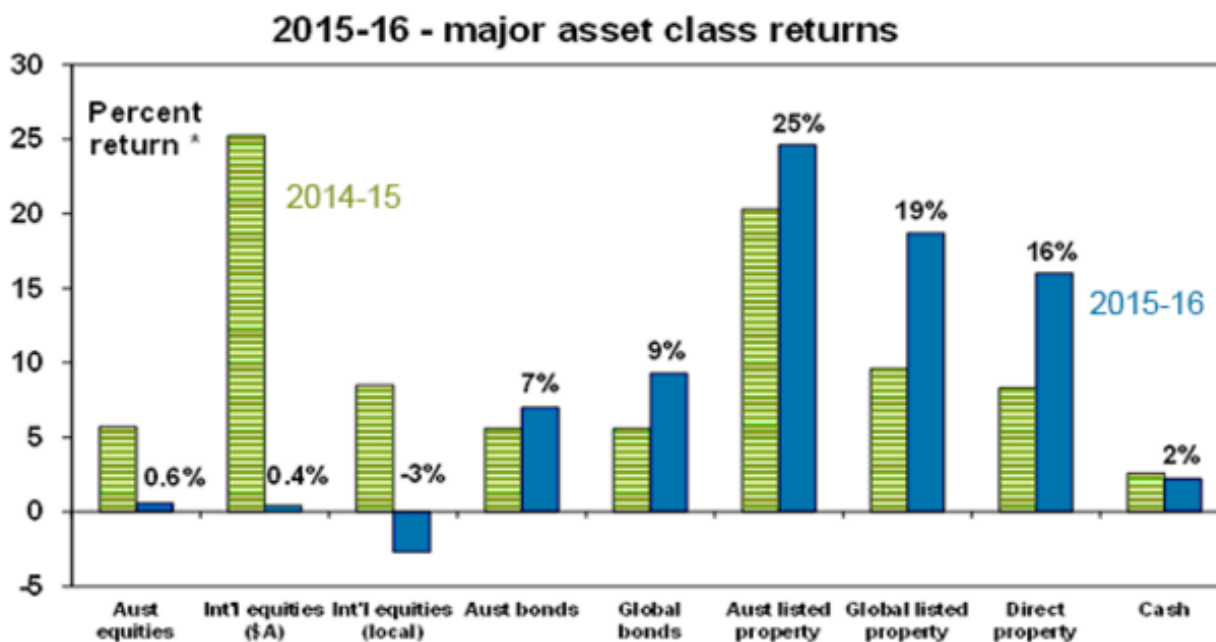
1. an **update** on the financial news shaping market dynamics;
2. a considered view of what markets are expected to deliver in the **future**, and;
3. a focus on the factors you control along your **journey**.

*"The only certainty is uncertainty" Pliny the Elder*

*"The most important thing about an investment philosophy is that you have one you can stick with." David Booth*

## What did markets deliver?

The below graph outlines what each major market has delivered for the 12 months to 30 June 2016 (in blue), compared with the previous 12 months (in lime green). In the pages following, we do a 'deeper dive' to provide more insights on the sources of return over the last year and a framework for the future.



\* pre fees and taxes.

Source: Thomson Reuters, AMP Capital

### Key insights:

- In the low return environment there were 'winners and losers'. Last financial year's winners (international shares) were different to this financial year's winners (listed property and global bonds).
- Performance in Australian shares was anaemic and below long term expectations, although dividend income remains stable and relatively high compared with other sources of investment income.
- Global shares fell by 3% after more than 3 years of double digit returns. The range of returns across geographic markets was wide. For example, the German stock exchange *fell* 11.6%, whereas the US S&P500 index *rose* 7.58%.
- Fixed interest bonds achieved a relatively high return.
- Listed property provided higher returns than long term expectations.
- Interest rates continued their downward trend.
- A diversified portfolio delivered an improved outcome when compared with picking last year's winner, with a smoother ride.

### *Market volatility – friend or foe?*

Market volatility is hardly a new phenomenon. The below graph shows the changing value of the 200 largest Australian listed companies over the last 7.5 years. Over this time the market has continued to rise despite enduring five periods when the market fell more than 10% in value (refer to the shaded areas of the below graph).

**ASX200: Higher volatility has been a harsh reality of the post-GFC era.**



Source: Morgans, IRESS

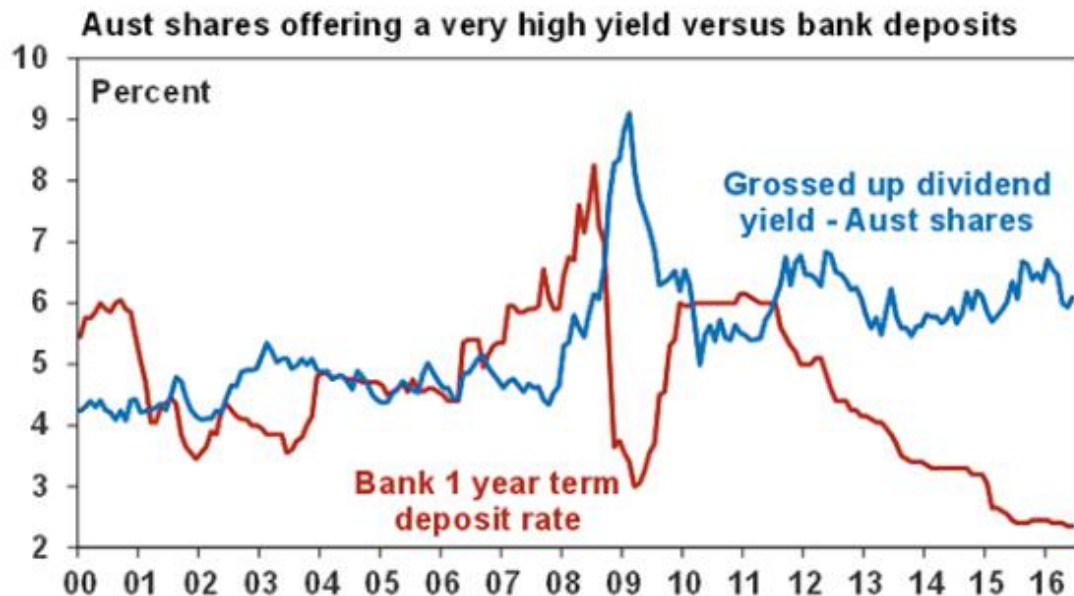
While it may be tempting to simply respond to the sense of financial pain that these price falls cause, it is worth remembering that it is precisely these price falls that open the best wealth creating opportunities.

### *Share market returns – a deeper dive*

A closer look at the factors that have driven market returns reveals a high level of divergence between the areas that have outperformed and underperformed:

- In Australia, it has been the smaller companies that have outperformed over the last year. The ASX smaller company index achieved a *positive* investment return of 14.40% for the 12 months to 30 June 2016 whereas the ASX300 Index, which consists of the largest 300 businesses, only appreciated 0.87%. In the years' prior it was the larger Australian businesses that outperformed their smaller counterparts.
- Interestingly, the value of the Australian banking and financial sector *fell* by 14.8% - as measured by the S&P/ASX200 Financials ex-A-REIT Index in light of concerns that bank dividends may not grow as they have in the past. Furthermore, the value of the mining sector *fell* in value by 8.1% - as measured by the S&P/ASX200 Materials Index.
- In other words, an investor that has *not* diversified away from holding just the Australian banks and big miners – an all too common portfolio for many self-directed SMSF investors – has underperformed significantly.
- Developed markets (North America, Western Europe et al) have continued to outperform developing markets (China, India et al). This experience has continued over the last three years. Will this revert in the future? If so, when?

- Share markets are valued at near or slightly above long term averages in most of the major stock markets, including Australia. However, as outlined in the below graph, we note the income return one can receive from the Australian share market is significantly more than the income you can earn from a bank term deposit.



Source: RBA, AMP Capital

We believe in having realistic expectations about the returns that are available in this low return environment and the importance of managing risk.

History teaches us that it's important to be clear about your objectives and focus on how you manage risk. If something looks too good to be true, chances are it is. Diversification remains a useful tool to minimise the financial impact a capital loss in a portfolio may have on your future lifestyle.

## Financial year performance across asset classes

### WORLD INDICES WRAP UP

<b>FIXED INTEREST</b>	<b>QTR</b>	<b>1 Year</b>
Bloomberg AusBond Bank Bill Index	0.56%	2.24%
Bloomberg AusBond Composite 0+ Yr Index	2.87%	7.02%
Barclays Global Aggregate Bond Index (hedged to AUD)	2.87%	9.34%

<b>AUSTRALIAN EQUITIES</b>	<b>QTR</b>	<b>1 Year</b>
S&P/ASX 300 Index (Total Return)	3.98%	0.87%
S&P/ASX Small Ordinaries Index (Total Return)	5.85%	14.40%
S&P Australia BMI Value Index (AUD, gross div.)	3.47%	-1.92%
S&P Australia BMI Growth Index (gross div.)	4.35%	3.27%

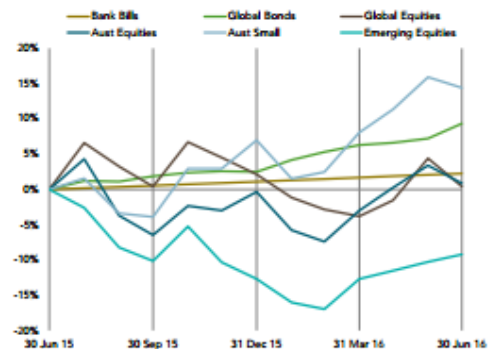
<b>GLOBAL EQUITIES</b>	<b>QTR</b>	<b>1 Year</b>
MSCI World ex Australia Index (AUD, net div.)	4.37%	0.40%
MSCI World ex Australia Index (hedged to AUD, net div.)	1.69%	-1.42%
Hedging Premium	-2.68%	-1.83%
MSCI World ex Australia Small Cap Index (AUD, net div.)	4.96%	-0.94%
MSCI World ex Australia Value Index (AUD, net div.)	4.80%	-0.34%
MSCI Emerging Markets Index (net div., AUD)	3.99%	-9.22%

<b>REAL ESTATE</b>	<b>QTR</b>	<b>1 Year</b>
S&P/ASX 300 A-REIT Index (Total Return)	9.23%	24.59%
S&P Developed REIT Index (AUD, net div.)	8.13%	21.00%

<b>WORLD MARKETS</b>	<b>QTR</b>	<b>1 Year</b>
S&P 500 Index	5.31%	7.58%
MSCI UK Index (net div.)	2.03%	-9.11%
MSCI Europe ex UK Index (net div.)	-0.84%	-7.72%
Japan Nikkei 225 Average Index (price-only)	4.11%	-5.63%
Shanghai Stock Exchange Composite Index	-2.42%	-33.86%

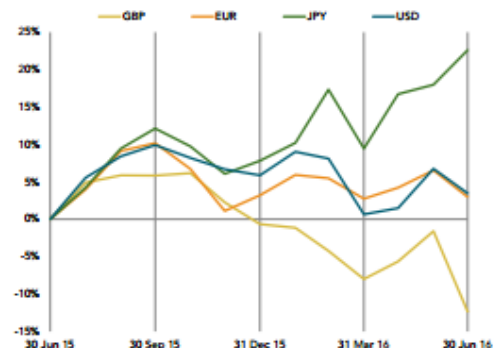
<b>CURRENCIES (RELATIVE TO AUD)</b>	<b>QTR</b>	<b>1 Year</b>
British Pound	-4.73%	-12.35%
Euro	0.24%	2.98%
Japanese Yen	12.02%	22.61%
United States Dollar	2.78%	3.45%

### MARKET RETURNS



Source: Bank Bills – Bloomberg AusBond Bank Bill Index, Global Bonds – Barclays Global Aggregate Bond Index (hedged to AUD), Global Equities – MSCI World ex Australia Index (net div., AUD), Aust Equities – S&P/ASX 300 Index (Total Return), Aust Small – S&P/ASX Small Ordinaries Index (Total Return), Emerging Equities – MSCI Emerging Markets Index (net div., AUD).

### CURRENCY RETURNS (Relative to Aud)



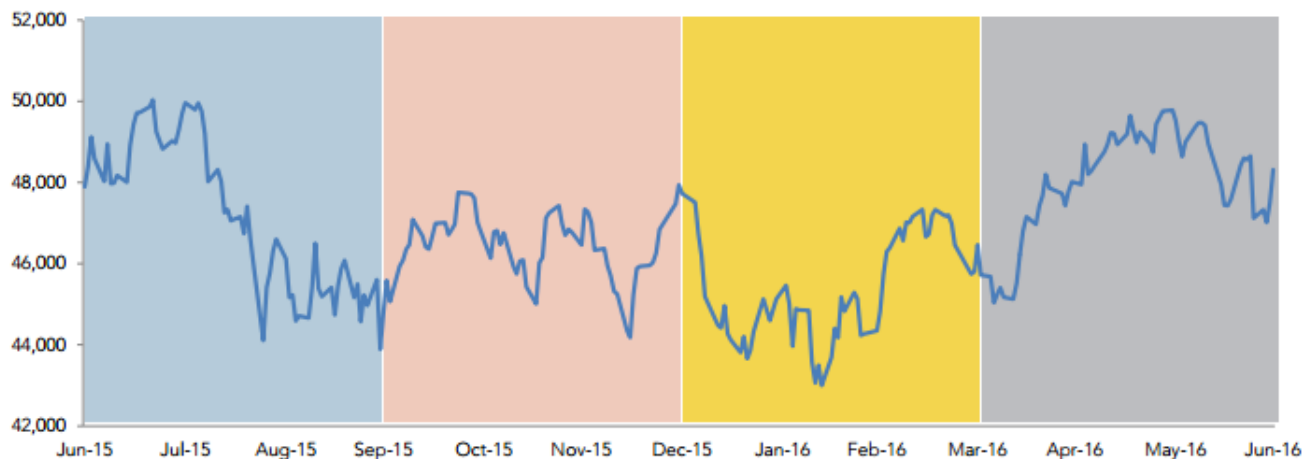
Performance is shown in AUD. Bloomberg indices copyright Bloomberg 2016. Barclays indices copyright Barclays 2016. The S&P data are provided by Standard & Poor's Index Services Group. MSCI data copyright MSCI 2016, all rights reserved. Individual country stock exchange indices provided by Datastream. Currency data provided by WM/Reuters. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Hedging premium – MSCI World ex Australia Index (net div., hedged to AUD) minus MSCI World ex Australia Index (net div., AUD).



## The year in news

The chart below highlights some of the year's major news events in the context of the broad Australian market performance. These headlines are not offered to explain market returns but to show that investors should view daily events from a longer-term perspective and avoid making investment decisions based solely on the news.

**TIMELINE OF NEWS EVENTS, FINANCIAL YEAR 2015–16**  
**S&P/ASX 300 Index (Total Return)**



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### HEADLINES: SEPT QTR, 2015

- July 5: EU Reaches Deal on Third Greek Bailout
- July 9: IMF Cuts World Growth Outlook
- July 20: UN Security Council Backs Iran Nuclear Deal
- Aug 10: China Devalues Yuan
- Aug 24: China Share Market 'Black Monday' Crash
- Sept 8: World Bank Warns Federal Reserve Against Raising Rates
- Sept 15: Turnbull Defeats Abbott in Liberal Leadership Spill
- Sept 18: VW Admits Cheating US Emissions Tests

### HEADLINES: DEC QTR, 2015

- Oct 5: Trade Pacific Partnership Deal Reached
- Oct 19: Trudeau Topples Harper in Canadian Election
- Nov 9: G20 Agrees on 'Too-Big-to-Fail' Bank Rules
- Nov 13: ISIS Terror Attacks in Paris Kill 130
- Dec 1: IMF Gives China's Yuan Reserve Currency Status
- Dec 12: Global Climate Pack Agreed in Paris
- Dec 14: Australian Budget Deficit Blows Out
- Dec 17: Federal Reserve Raises Rates

### HEADLINES: MARCH QTR, 2016

- Jan 9: Global Markets Rattled by China Slowdown
- Jan 29: Bank of Japan Cuts Rates Below Zero
- Feb 1: WHO Declares Zika Virus a Global Emergency
- Feb 11: Crude Oil Prices Hit 12-Year low
- Feb 29: Euro Zone Slides Back into Deflation
- March 10: ECB Cuts Key Interest Rate to Zero
- March 16: Deutsche Boerse to Acquire LSE
- March 26: Terrorist Attack on Brussels Airport

### HEADLINES: JUNE QTR, 2016

- April 13: Global Attack on Panama Tax Haven
- May 3: RBA Cuts Rates as Budget Tackles Super
- May 7: Trump Secures Republican Nomination
- May 8: Turnbull Calls July 2 Election
- June 1: OECD Warns Global Economy in Low Growth Trap
- June 8: Hilary Clinton Secures Democratic Nomination
- June 12: Gunman Kills 49 in Orlando Nightclub
- June 24: Brexit Vote Shocks Markets

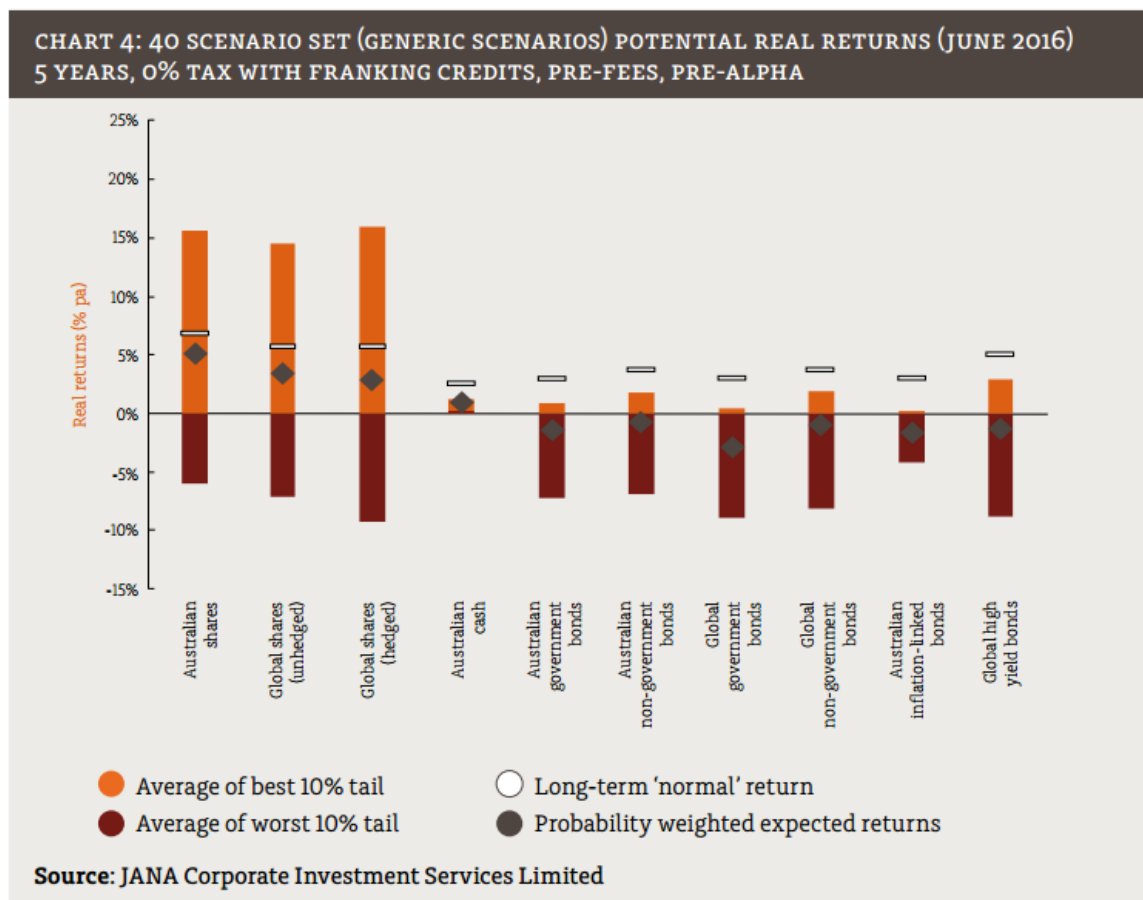
## A look ahead

The future is uncertain. Of course, the future is *always* uncertain. And we see little reason for the rules of investing to have changed. Investment markets are dynamic with many moving parts. While it may not always feel like it, and they certainly aren't perfect, markets respond to change reasonably well. CEO's have a number of levers to pull in responding to an expected low growth environment. Investors demand it.

“History does not repeat itself, but it rhymes” *Mark Twain (attributed)*

The investment consulting research firm, JANA, conduct extensive scenario modelling to forecast what they view as the potential real returns one can expect over the next 5 years, taking into account 40 different scenarios that could play out in the future across the global village.

The below graph shows the range of returns JANA expects across the various asset classes for the next 5 years. Interestingly, the range of returns and return they expect to be generated from the share market is, despite the current concerns for the future, within the 'normal' ranges that one can expect (refer to the three bars on the left hand side of the below graph). That said, JANA's expected return for Australian shares for the next 5 years – represented by the black diamond on the left hand bar – is slightly under the long term 'normal' return, indicated by the white bar.





What is particularly noteworthy is the right hand side of the above graph. That is, JANA's modelling indicates that the likely range of returns on offer from the more conservative asset classes like government bonds, other types of fixed interest securities and cash is likely to be low, if not significantly negative. Put another way, the price for perceived 'safety' is relatively high.

We are wary that investments normally seen as very defensive, such as some government bonds, may not be as defensive given how low yields are.

Any model or forecast for the future, by definition, can not be "correct". And our clients do not pay us to speculate with their hard earned capital. We remain confident and committed to diversifying one's investment portfolio and capturing the returns on offer with patience and discipline.

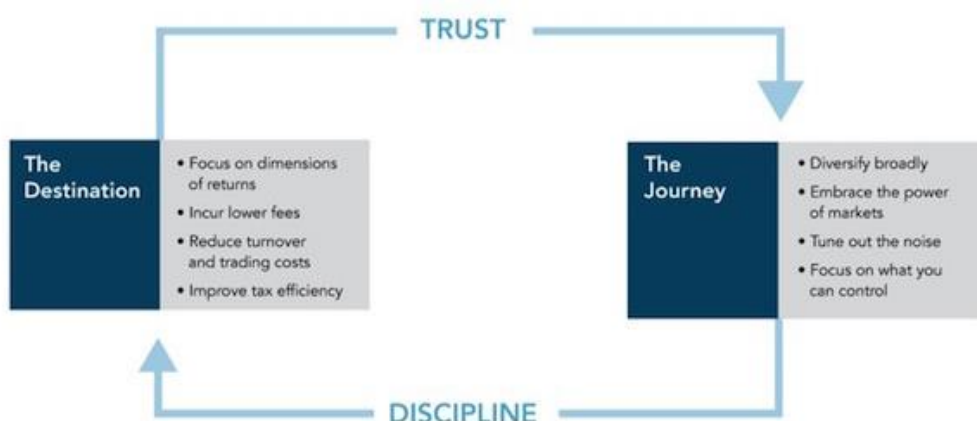
## The Journey – focus on what you can control

What does a successful investment experience entail? To many, it means arriving at a preferred destination by achieving a superior financial goal – or at least increasing the probability of reaching the goal.

However, the *journey* to the destination is also an important element of the overall experience. One definition of experience is “the act or process of directly perceiving events or reality.”<sup>1</sup> Think about this in the context of a long trip, which may involve detours, delays and other unexpected events that can raise your stress level and force decisions.

The same principle applies to an investment journey that can last decades. A successful investment *experience* is a function of how you perceive your financial affairs and market events. An important interaction also occurs between perceptions during the journey, a willingness to continue down a suitable road, and the final destination itself.

### Mapping a Successful Investment Experience



### The Journey

You can rest in the knowledge that your financial plan is focusing on elements you *can* control—for example, savings, retirement date, personal spending, asset allocation, reducing fees and taxes, and applying discipline. Everything else is not worth worrying too much about. The perspective of the Rudolf Abel character in the Academy Award-nominated film *Bridge of Spies* is worth reflection. He responds to repeated questions from James Donovan about not worrying in the face of adverse circumstances by countering, “Would it help?”

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<sup>i</sup> Source: Merriam-Webster.com.