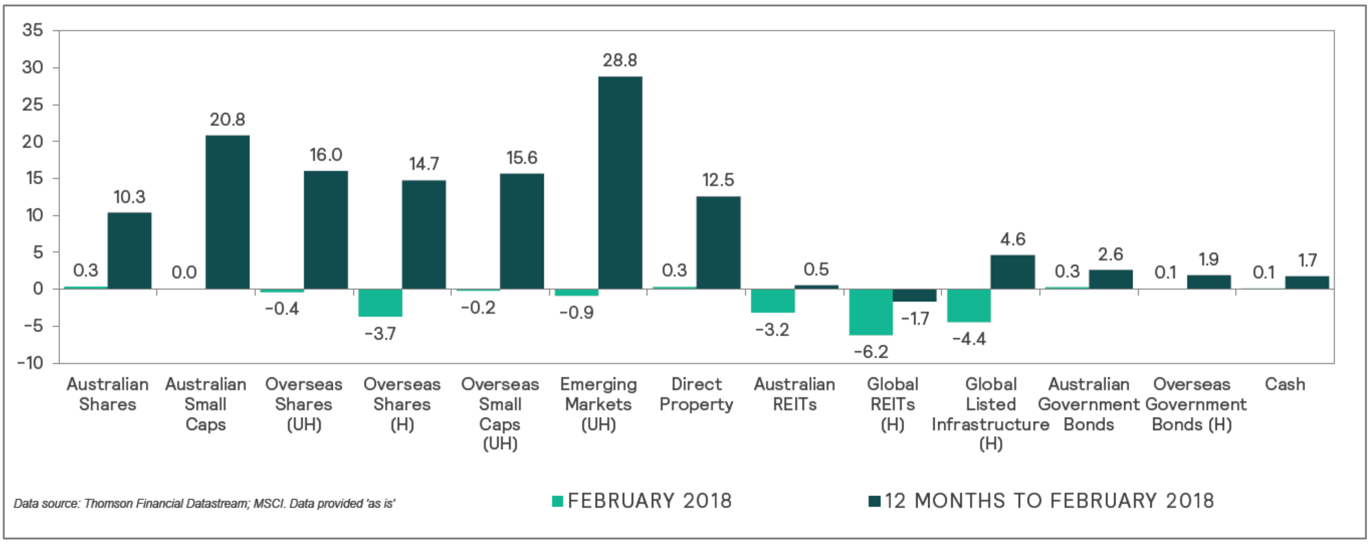
Quarterly commentary and outlook March 2018^

Asset class returns (%)



The positive investor sentiment observed in growth markets over the past year came to a halt in February 2018 as rapid sell-offs were observed in the US market early in the month. Speculation places the cause of the sell-off on multiple flashpoints. US inflation and labour costs returned higher rates than expected, and when reinforced with the Trump tax package, point to positive growth in the short to medium term for the US economy. This trend combined to support the notion for multiple rate hikes in the US ahead for the US Federal Reserve (Fed). Preparation for this end to the low interest rate environment and the ensuing rise in bond yields, coupled with lower than expected earnings reports released in early February, appear to be have ignited the sell-off. In response, the Volatility (VIX) index shot up 116% over a day and the S&P 500 decreased 10.2% over nine days, retracing to November 2017 levels.

Over the month of February, the S&P 500 decreased 3.7%, the Dow Jones Industrial Average decreased 4.0% and the ASDAQ decreased 1.9%.

Emerging markets also contracted over February, with the MSCI Emerging Markets Index falling 0.9% over the month, following seven months of consecutive positive rises. Performance was influenced by the global trend following the US sell-off, as well as a strengthening USD and lower commodity prices. China also contributed to the shift in performance as confidence waned following lower than expected official manufacturing results as well the announcement from the Chinese Communist Party to begin the process of abolishing term limits for its Presidential position, currently held by Xi Jinping. The SSE Composite (China) fell 6.4% over the month of February following these developments.

European markets were similarly affected by the activity in the US, while the environment remains dominated by political uncertainty. In Germany, Angela Merkel conceded to a coalition agreement with the Social Democratic Party (SPD) to retain power, giving up influential roles in the process to form the coalition. Brexit negotiations are also beginning to heat up as trade and transition discussions begin between European leaders and British parliament.

Focus is also turned to the upcoming Italian election, with no clear frontrunner, and the possibility of far right candidate Five Star Movement as a strong contender. Within this environment, the FTSE 100 (United Kingdom (UK)) decreased 3.4%, the DAX 30 (Germany) decreased by 5.7% and the CAC 40 (France) decreased by 2.9% over the month of February.

Despite shaky conditions globally, Australian equities managed to outperform their hedged international counterparts, with the S&P/ASX 300 index returning 0.3% over February. A relatively successful reporting season over February was a contributor to this.

Significant developments

- The Reserve Bank of Australia (RBA) decided to leave the cash rate unchanged again in its early March meeting at 1.50%, the cash rate has remained at this level since August 2016. RBA Governor, Philip Lowe, noted that economic growth in the global economy has picked up over the past year, with above- trend growth experienced in most major economies. Asian economies continue to grow, aided by international trade, highlighting China's key role in the region, while Chinese authorities place more emphasis on sustainable growth. Oil and commodities prices have experienced a rise alongside the global economic growth, although a decline is expected for Australia's terms of trade, despite this growth. Market volatility has also increased from the low levels over 2017. Wage growth and core inflation remains low in most countries, although tighter labour markets and higher commodities prices are expected to support increasing inflation.

In Australia, the RBA has forecast the economy to grow at a quicker pace in 2018 than in 2017.

Improvements in non-mining sectors and an influx of infrastructure projects support this outlook. On the other hand, low wage growth and rising household debt remain a concern, restraining household consumption. To combat the threat of rising household debt, the Australian Prudential and Regulatory Authority (APRA) has introduced new supervisory measures, and credit standards have been tightened to reduce the risk profile of borrowers. House price fluctuations have settled down in the past six months.

Wage growth is expected to remain low for some time, but could improve with stronger conditions in the labour market. Australian employment growth has been strong over 2017. Underlying inflation is currently low, and expected to remain low as long as slow wage growth continues. With the gradual improvements in the economy and a view that low interest rates will continue to support the Australian economy, the RBA believed it was appropriate to leave the rate unchanged.

- Australian seasonally adjusted employment increased 16,000 in January, above expectations for a 15,000 rise while December figures were revised up to 33,500. The unemployment rate increased to 5.5%
- for January, in line with expectations. The participation rate decreased to 65.6%, in line with expectations. Part time jobs increased by 65,900 while full time jobs decreased by 49,800.
- Australian building approvals increased 17.1% month-on-month (MoM) to be up 12.0% for the year to January, compared to previous levels of -20.6% (revised) and -5.0% (revised) for respective periods ending December.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 60.8 in February, above consensus for 58.7, and above the 59.1 recorded in January. Of the 18 manufacturing industries, Printing & Related Support Activities, Primary Metals and Machinery were the top contributors while Apparel, Leather & Allied Products and Furniture & Related Products reported a contraction in growth during February.
- The ISM Non-Manufacturing Index recorded 59.5 in February, above consensus for 59, but below the 59.9 for January. The top performers were Educational Services, Transportation & Warehousing and Utilities with Arts, Entertainment & Recreation, and Accommodation & Food Services being the only industries to report contractions during January.
- US Non-Farm Payrolls increased by 313,000 in February, above the previous 239,000 increase (revised) for January. The unemployment rate was unchanged at 4.1% in February.
- US gross domestic product (GDP) for Q4 2017 was 2.5% quarter-on-quarter (QoQ) annualised, in line with expectations, and below the 3.2% growth recorded in Q3 2017.
- The Caixin Manufacturing purchasing managers' index (PMI) in China increased to
- 51.6 in February, above expectations for 51.3. The indicator continues to show positive improvements in China's manufacturing industry, with the latest reading representing a six month high.
- European Core consumer price index (CPI) estimate remained at 1.0% over the year to February, in line with expectations. The unemployment rate decreased to 8.6% in
- January, while MoM CPI decreased by 0.9% in January, following 0.4% increase in December.
- The Eurozone composite PMI decreased to
- 57.1 in February, below expectations for 57.5, but maintained an expansionary signal for the fifty-sixth month in a row.
- Eurozone seasonally adjusted GDP increased 2.7% year-on-year, and 0.6% QoQ for Q4 2017, the same levels growth as those recorded for Q3 2017.

Australian equities

The Australian equity market outperformed its hedged international developed counterpart index over the month, as the S&P/ASX 300 Index increased 0.3%. The S&P/ASX mid 50 Index was the strongest relative performer, increasing 0.9%, while the S&P/ASX Small Ordinaries was the weakest, remaining flat over the month.

The best performing sectors were Healthcare (+7.0%) and Consumer Staples (+2.1%). The weakest performing sectors were Telecom services (-6.2%) and Energy (-3.8%). The largest positive contributors to the return of the index were CSL, NAB and A2 Milk, with absolute returns of 11.5%, 4.2% and 47.5% respectively. In contrast, the most significant detractors from performance were Telstra, Woodside Petroleum and Wesfarmers with absolute returns of -8.2%, -10.4% and -5.3% respectively.

Global equities

The broad MSCI World ex Australia (NR) Index was down 3.7% in hedged terms and 0.4% in unhedged terms over the month, as the Australian dollar (AUD) depreciated against the major currencies. The strongest performing sectors were IT (+3.7%) and Consumer Discretionary (+0.3%), while Energy (-5.6%) and Consumer Staples (-3.3%) were the worst performers. In AUD terms, the Global Small Cap sector was down 0.2% while Emerging Markets decreased by 0.9%.

Over February, the NASDAQ decreased 1.9%, the S&P 500 Composite Index decreased by 3.7% and the Dow Jones Industrial Average decreased by 4.0%, all in USD terms. In local currency terms, major European equity markets experienced negative returns as the FTSE 100 (United Kingdom (UK)) decreased 3.4%, the DAX 30 (Germany) decreased by 5.7% and the CAC 40 (France) decreased by 2.9%. In Asia, the Japanese TOPIX (-3.7%), Hang Seng (-6.0%), SSE Composite (-6.4%) and Indian S&P BSE 500 (-4.4%) all decreased over February.

Real assets

The Real Assets sector was broadly negative over February. The FTSE Global Core Infrastructure index fell 4.4% while Global REITs also fell 6.2% over the month (both in AUD hedged terms).

Domestic REITs posted a decrease of 3.2% over February, while Australian Direct Property (NAV) returned 0.3%.

Fixed interest

Global bond markets were mixed over February. The Barclays Capital Global Aggregate Bond Index fell 0.2% while the Citigroup World Government Bond (ex-Australia) Index increased 0.1% over the month. Ten-year bond yields increased in the US (+16bps to 2.87%) and the UK (+1bps to 1.51%), but decreased in Germany (-1bps to 0.63%) and Japan (-4bps to 0.05%). Two-year bond yields also saw mixed movement over the month as US yields rose (+11bps to 2.25%) along with the UK (+11bps to 0.78%) while yields in Germany (-4bps to -0.61%) and Japan (-2bps to -0.16%) decreased.

Returns for existing domestic bond holders were modest over February, as 10-year yields remained flat (2.81%) while five-year (-2bps to 2.38%) and two-year (-3bps to 2.01%) yields decreased. Of the Bloomberg Ausbond indices, the Credit Index produced the highest relative return, increasing 0.4% over the month, while the Australian Composite Bond Index return was 0.3% over the month.

Currency markets

The AUD depreciated against the major currencies over February, ultimately finishing with a decreased Trade Weighted Index of 63.6 on 28 February 2018. The AUD depreciated against the USD (-3.8%), the Pound Sterling (-1.6%), the Euro (-1.9%) and the Yen (-5.0%). On a trade-weighted basis, the local currency decreased 3.0% over the month.

Commodities

Iron Ore increased 10.3% over February, finishing the month at $80.5 per metric tonne. The S&P GSCI Commodity Total Return Index increased 0.4% over the month. Gold prices finished the month at US$1,319.34 per ounce, decreasing 1.7% over the period, while the oil price decreased 4.3% to $65.7 per barrel over February.

Select market indicators

	RETURN (%)				RETURN (% PA)			RISK (% PA)	
	1 mth	3 mths	Fin yr	1 yr	3 yrs	5 yrs	10 yrs	5 yrs	10 yrs
AUSTRALIAN EQUITIES									
S&P/ASX 300	0.3	1.8	8.5	10.3	5.2	7.9	5.3	11.1	13.8
S&P/ASX 50 ACCUM	0.3	1.4	6.8	7.5	3.5	7.2	5.7	11.3	13.3
S&P/ASX MID 50 ACCUM	0.9	3.5	12.0	21.1	13.7	14.1	5.6	11.7	16.3
S&P/ASX 100	0.4	1.7	7.5	9.2	4.7	8.0	5.7	11.2	13.5
S&P/ASX 200	0.4	1.7	8.3	10.1	5.1	8.0	5.4	11.2	13.7
S&P/ASX SMALL ORDS	0.0	2.7	18.1	20.8	10.8	6.2	1.1	13.3	18.9
S&P/ASX ALL ORDINARIES	0.2	1.9	9.1	10.8	5.7	8.1	5.2	10.9	13.9
GLOBAL EQUITIES – IN LOCAL CURRENCY									
MSCI WORLD EX AUSTRALIA (NR, LC)	-3.6	1.2	9.6	13.7	7.9	11.9	6.8	9.3	14.3
S&P 500 COMPOSITE	-3.7	3.0	13.5	17.1	11.1	14.7	9.7	9.8	15.0
TOKYO SE	-3.7	-1.2	10.8	17.6	7.3	14.9	5.1	15.5	19.0
FTSE ALL SHARE	-3.3	-0.6	1.7	4.4	5.9	7.3	6.6	9.6	13.8
GLOBAL EQUITIES – IN AUSTRALIAN DOLLARS									
MSCI WORLD EX AUSTRALIA (NR)	-0.4	-0.4	9.9	16.0	8.5	17.2	8.1	10.6	11.4
MSCI WORLD EX AUSTRALIA HEDGED (NR)	-3.7	1.1	10.1	14.7	9.3	13.8	8.7	9.4	14.6
S&P 500 COMPOSITE	0.1	0.3	11.7	15.5	11.3	21.2	11.8	11.2	12.2
TOKYO SE	2.4	1.0	14.8	21.7	11.6	17.9	6.8	12.2	13.4
FTSE ALL SHARE	-2.6	-1.4	6.2	14.0	2.1	11.1	4.7	13.0	13.0
MSCI EMERGING MARKETS (NR)	-0.9	4.3	17.9	28.8	9.1	10.9	4.5	9.6	13.1
MSCI SMALL CAPS (TR)	-0.2	-1.6	9.6	15.6	10.2	18.4	10.9	11.1	12.9
REAL ASSETS									
S&P/ASX 300 PROPERTY	-3.2	-6.2	3.0	0.5	5.0	10.2	3.3	12.4	17.9
MERCER UNLISTED PROPERTY (GAV) (TO JAN 2018)	0.4	3.7	N/A	13.5	12.9	11.6	7.4	2.2	3.5
FTSE EPRA/NAREIT GLOBAL INDEX HEDGED	-6.2	-6.3	-2.6	-1.7	2.3	7.8	5.8	11.4	19.6
FTSE GLOBAL CORE INFRASTR 50/50 HDG TR	-4.4	-7.2	-1.7	4.6	6.2	11.0	10.3	8.7	8.5

AUSTRALIAN BONDS AND CASH										
BLOOMBERG AUSBOND COMPOSITE BOND		0.3	-0.5	1.4	2.9	2.4	4.1	6.1	2.6	3.0
BLOOMBERG AUSBOND TREASURY		0.3	-0.9	1.0	2.6	2.0	3.7	5.6	3.2	3.8
BLOOMBERG AUSBOND SEMI-GOVERNMENT		0.3	-0.3	1.5	2.6	2.6	4.4	6.5	2.6	3.2
BLOOMBERG AUSBOND CREDIT		0.4	0.2	2.6	4.3	3.5	4.8	6.7	1.7	2.1
BLOOMBERG AUSBOND INFLATION		0.0	-1.0	1.6	3.1	0.9	3.5	5.5	4.5	5.6
BLOOMBERG AUSBOND BANK BILL		0.1	0.4	1.1	1.7	2.0	2.3	3.5	0.1	0.5
GLOBAL FIXED INTEREST										
CITIGROUP WGB HEDGED (EX AUSTRALIA)		0.1	-0.5	0.9	1.9	3.0	4.8	6.5	3.0	3.1
BARCLAYS CAPITAL GLOBAL AGGREGATE HDG		-0.2	-0.7	0.9	2.1	3.2	4.6	6.8	N/A	N/A
INFLATION										
CPI (PERIODS TO DEC 2017)		N/A	0.6	N/A	1.9	1.7	1.9	2.3	N/A	N/A
CURRENCY										
EXCHANGE RATE (EQUIVALENT TO 1 AUD)		**(AUD RISES + / AUD FALLS –)**								
USD	0.779	-3.8	+2.6	+1.6	+1.4	-0.1	-5.3	-1.8	N/A	N/A
JPY	83.520	-5.0	-1.7	-3.1	-3.5	-3.5	-2.5	-1.7	N/A	N/A
GBP	0.561	-1.6	-0.5	-5.2	-9.4	+3.6	-3.7	+1.6	N/A	N/A
EUR	0.637	-1.9	-0.3	-5.3	-12.2	-2.8	-4.0	+0.2	N/A	N/A
TWI	63.600	-3.0	+0.0	-2.9	-4.6	-0.3	-3.9	-1.2	N/A	N/A

^ Mercer Market Insights Australia, March 2018.

Returns are based on actual investment options, and are net of all investment fees, administration fees and taxes. Past performance should not be relied upon as an indication of future returns.

Smartsave Personal Choice and Smart Pensions are part of the Smartsave Member's Choice Superannuation Master Plan ABN 43 905 581 638 (Fund). Diversa Trustees Limited ABN 49 006421 638, AFSL 235153. RSE Licence L0000635 (Trustee) is the Trustee of the Fund and the product issuer. The information in this document has been prepared by Diversa Superannuation Services Pty Ltd ABN 77 107 165 962, AFSL 273321 as the Fund Administrator. It is intended to provide you with general information only and does not take into account your personal objectives, financial situation or needs. Before making any financial decisions it is important that you read the current product disclosure statement (PDS) relevant to your membership and consider your particular circumstances and whether the particular financial product is right for you. The current PDS for each product is available on smartsavesuper.com.au. You should consult a financial adviser if you require personal advice.