VISSF
An education industry super fund
GROW WITH US

Market Update

March 2016

Share markets weaker

It was a difficult start to the year for global share markets with sentiment souring amid some less-than-encouraging developments in China, further oil price weakness and escalating geopolitical tensions. In China, the devaluation of the Yuan, some disappointing manufacturing data and growing regulatory uncertainty combined to drive stocks sharply lower in the early part of the period as investors worried about another emerging markets crisis. Meanwhile, oil prices sank to levels not seen in over a decade as supply continued to outpace demand, tensions between Saudi Arabia and Iran escalated and North Korea carried out a surprise nuclear test. Sentiment was also impacted early by some softer US economic data, doubts about central banks' ability to successfully support global growth and uncertainty over the health of the global financial sector. Importantly, stocks were able to recoup much of these early losses toward the end of the period as valuations began to look a little more attractive than they did at the start of the year, oil prices staged a strong rebound and US Federal Reserve (Fed) chair Janet Yellen reiterated that any future rate hikes will be gradual.

The Australian share market was also weaker; stocks falling early for much the same reasons as their global counterparts. However, the local market was also hampered by sharp falls across the 'Big Four' banks, which account for almost 30% of the S&P/ASX 300 Index. Banks were sold off amid uncertainty over the health of the global financial sector and concerns that rising funding costs and bad debts will hurt profitability. Some encouraging domestic growth data and strong rebounds in both iron ore and oil prices through the second half of the period did help to limit the market's decline.

Market Update

RBA leaves rates on hold

The Reserve Bank of Australia (RBA) left the official cash rate unchanged at a historically low 2.00% throughout the period, despite a deterioration in the global growth outlook, heightened market volatility and a stronger Australian dollar. In making its decision, the central bank concluded that *"there were reasonable prospects for continued growth in the economy, with inflation close to target"* and that *"the current setting of monetary policy remained appropriate." Further, the RBA noted that "over the period ahead, new information should allow the Board to judge whether the improvement in labour market conditions is continuing and whether the recent financial turbulence portends weaker global and domestic demand."* Russell Investments believe interest rates will remain on hold until at least midway through this year; pending of course any significant deterioration in key domestic economic data or major external market shock.

Australian dollar stronger

The Australian dollar (AUD) continued to strengthen in the first quarter, though much of the local unit's gains came in March amid some better-than-expected domestic growth data, a less aggressive Fed and strong rebounds in both iron ore and oil prices. The AUD rose 8.3% against the British pound, 4.8% against the US dollar (USD) and 1.2% against the Euro. It fell 2.3% against the Japanese yen while the broader Australian Trade-Weighted Index1 closed the period up 2.7%.

Domestic growth beats forecasts

The Australian economy expanded by more than expected in the final quarter of 2015 with gross domestic product rising 0.6% for the three months ended 31 December. The market had anticipated growth of 0.4%. Household spending was the main driver of growth over the quarter while exports, government spending and dwelling investment also made modest contributions. In contrast, mining investment continued to act as a significant headwind. On an annual basis, the economy grew 3.0%; up from the 2.5% growth recorded in the 12 months ended 30 September.

Looking ahead

Russell Investments' view on global equities has shifted downward since the beginning of the year. The favoured scenario was for mid-to-low single-digit returns and a gradual rise in long-term interest rates. Whilst this remains the case, Russell believes low single-digit returns now look more likely.

This shift in thinking comes as the outlook for corporate profits weakens, global trade and manufacturing softens and the risks around emerging markets increase, albeit slightly. In short, they believe the cyclical backdrop for equities is becoming less supportive.

Global divergence will remain a key theme this year and is likely to drive further market volatility. On the one hand, the European Central Bank and the Bank of Japan are expanding quantitative easing and moving interest rates further into negative territory. On the other hand, the Fed is facing inflationary pressures from an unemployment rate that recently dipped below 5%, as well as the fading deflationary impacts of falling commodity prices and a rising USD. The weakness in the rest of the world is acting as a headwind for the US economy, but domestic inflation pressures mean that the Fed is likely to still raise interest rates a couple of times this year. The net result is that periods of market stability are likely to be punctuated by episodes of Fed tightening speculation and fears of a global slowdown.

Europe remains the preferred exposure while Russell has become more cautious on the US and emerging markets. In Asia-Pacific, they expect patchy economic growth will result in only modest performance across the region.

Fixed income returns will likely be constrained by the upward pressure on bond yields from Fed rate hikes while credit market returns will be kept in check by concerns over company profitability and default rates.

[1] The trade-weighted index for the AUD is an indicator of movements in the average value of the AUD against the currencies of our trading partners.

* All information contained in this update is sourced from Russell Investment Management Limited (ABN 068 338 974) and is considered to be reliable however is not guaranteed. This update is issued by the Trustee of The Victorian Independent Schools Superannuation Fund (ABN 37 024 873 660, RSE Registration number R1000436, MySuper Authorisation 37024873660599) VIS Nominees Pty Ltd (ABN 11 006 586 367 AFS Licence number 235097, RSE Licence number L0000321). The information provided in this update is general information only and does not take into account your personal financial situation or needs. You should consider obtaining advice that is tailored to suit your personal circumstances.