FRONTIER ADVISORS

Monthly Markets

August 2015

After months of market chatter that the US Federal Reserve will raise their interest rate for the first time in almost a decade ("rates lift off") in September, the market no longer appears to be so sure after the selloff in global financial markets in recent weeks. At the time of writing, the market is expecting around a 30% chance of the US Federal Reserve raising interest rate at its September meeting, down from around 50% in early August.

There are two things to consider with the US rate hike – the "when" and the "path". In terms of when, the US Federal Reserve may raise rates in September, October or even next year as it balances the relatively robust US data to issues overseas. In terms of the path, the US Federal Reserve may raise interest rate once in September to get the first rate hike over with and leave it there for some time.

Regardless of the "when" and the "path", Frontier believes the key consideration will still need to be why the US Federal Reserve is raising rates. That is, are they raising rates because of growth or inflation? If it is because of growth, then it is likely to be positive for most asset classes. Conversely, if it is because of inflation, then it is likely to be negative for most asset classes.

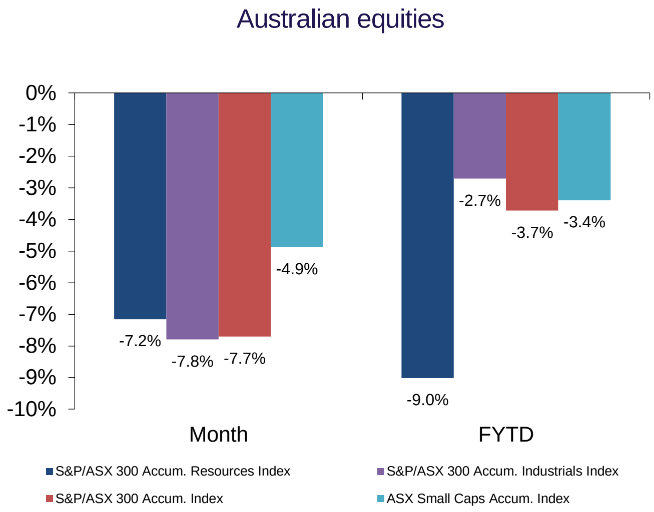
Looking at the latest data, US real GDP is robust at 2.7% p.a., unemployment rate is now at 5.1% and inflation remains benign. It appears likely at present that if the US Federal Reserve raises interest rates in September, it will be because they view growth to be robust enough.

On Europe, although Greece has moved into the background after receiving its third bailout programme, it is worth noting that they will be holding their election on 20th September and this could lead to renewed uncertainty and tension in the Eurozone.

Elsewhere in Europe, the ECB announced no change to its official interest rates but did increase the issue share limit of its quantitative easing (QE) programme from 25% to 33%. In essence, this provides the ECB more flexibility in implementing its QE programme. In its statement, ECB President Mario Draghi also announced that they were willing to adjust the "size, composition and duration" of its QE programme and go beyond the current programme deadline of September 2016 if necessary in light of the recent market gyrations. All in all, this continues to support the view that authorities will err on the side of accommodative monetary policy for longer to ensure a sustainable recovery.

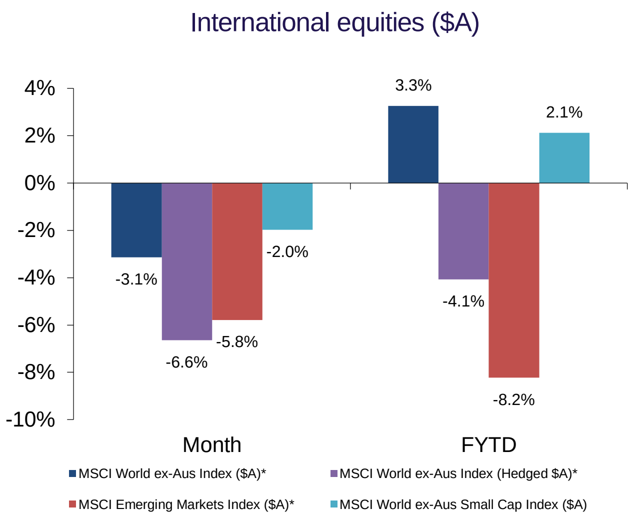
China has been one of the sources for recent market volatility due to concerns on its growth. Our view is that it is almost inevitable that Chinese growth will slow over time as the size of its economy grows and as it transitions from higher growth drivers (i.e. export and infrastructure) to a lower growth driver in consumption. We note that Chinese authorities have many levers at their disposal to manage their economy however a key risk is the opaqueness in its setting of policies which can create market volatility. One example of this was the recent surprise intervention of its currency, the Renminbi that was discussed in last months' update.

As widely expected, the RBA left the cash rate unchanged at 2% at its September meeting. In its statement, it retained its new wording on the Australian dollar that it "is adjusting to the significant declines in key commodity prices" and no longer suggesting that further depreciation is likely nor necessary. On the economy, the RBA maintained its view that it is growing albeit at a rate below its long term average. And with inflation being contained, the RBA believes their monetary policy will need to remain accommodative.



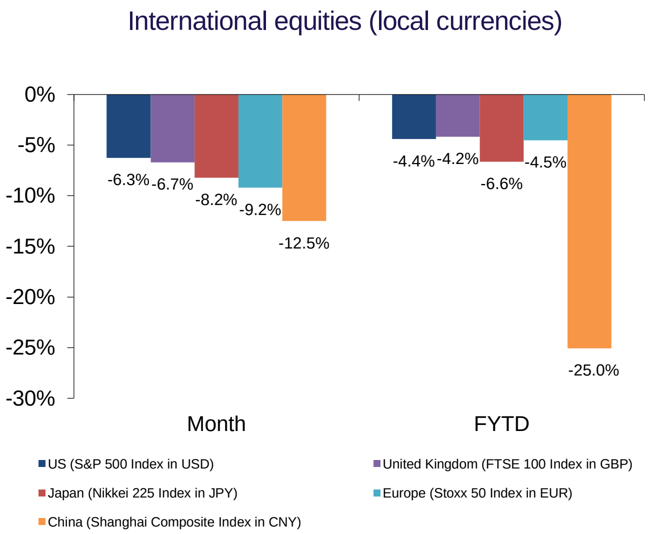
Australian equities had a very poor month in August largely driven by growth concerns on emerging market economies, in particular China and the renewed fall in oil prices.

By sector, Energy (-13.8%) was the worst performer with Utilities (-0.4%) being the least affected by the selloff over the month.



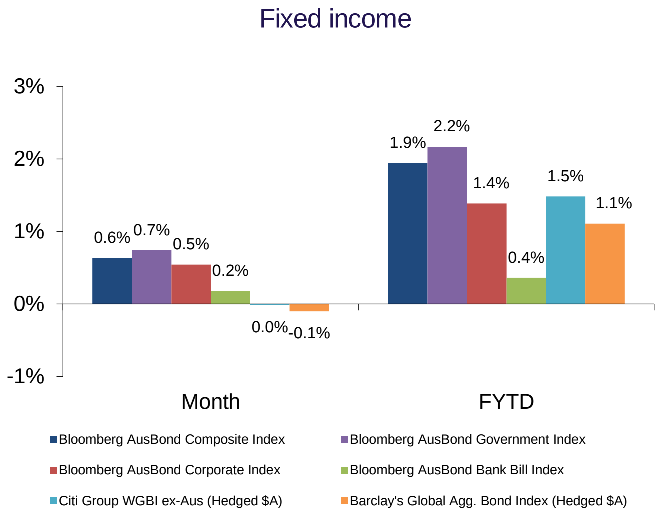
The volatility in global financial markets led to both developed and emerging market equities posting a negative performance for August.

Unhedged developed market equities outperformed its hedged counterpart as a result of the fall in the Australian dollar during the month.

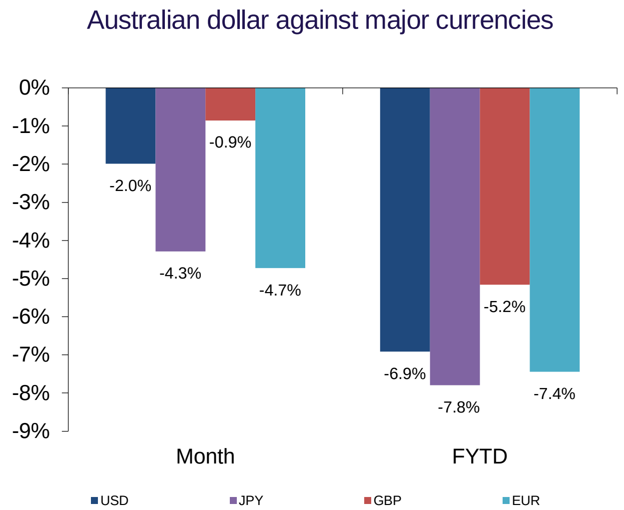


The fear was widespread with most local equity markets having a negative month.

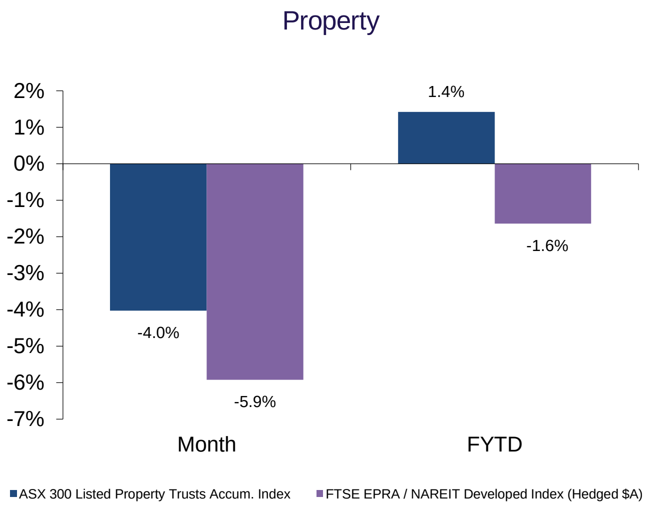
The correction in the Chinese equities market continued in August as Chinese authorities scaled back measures to prop up the market.



Fixed interest returns were largely flat across markets as bonds yields were relatively unchanged in August.



As a “risk asset”, the Australian dollar weakened against other major foreign currencies in August due to global concerns around Chinese growth and the renewed fall in oil prices.



Both Australian and global listed property trusts did not escape the widespread selloff and posted negative returns for August.

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31-August-2015	Index value	Month	3 months	FYTD	1 year
Australian equities					
S&P/ASX 300 Accum. Index	46,116	-7.7%	-8.8%	-3.7%	-3.2%
S&P/ASX 300 Accum. Industrials Index	95,536	-7.8%	-7.1%	-2.7%	2.8%
S&P/ASX 300 Accum. Resources Index	16,241	-7.2%	-17.3%	-9.0%	-27.4%
ASX Small Caps Accum. Index	5,170	-4.9%	-10.9%	-3.4%	-9.6%
International equities					
MSCI World ex-Aus Index ($A)*	7,050	-3.1%	0.5%	3.3%	27.5%
MSCI World ex-Aus Index (Hedged $A)*	1,202	-6.6%	-6.7%	-4.1%	4.2%
MSCI Emerging Markets Index ($A)*	494	-5.8%	-11.0%	-8.2%	1.7%
MSCI World ex-Aus Small Cap Index ($A)	451	-2.0%	0.8%	2.1%	26.9%
US (S&P 500 Index in USD)	1,972	-6.3%	-6.4%	-4.4%	-1.6%
United Kingdom (FTSE 100 Index in GBP)	6,248	-6.7%	-10.5%	-4.2%	-8.4%
Japan (Nikkei 225 Index in JPY)	18,890	-8.2%	-8.1%	-6.6%	22.5%
Europe (Stoxx 50 Index in EUR)	3,270	-9.2%	-8.4%	-4.5%	3.1%
China (Shanghai Composite Index in CNY)	3,206	-12.5%	-30.5%	-25.0%	44.6%
AUD versus …					
USD	0.71	-2.0%	-6.7%	-6.9%	-23.5%
JPY	86.60	-4.3%	-8.8%	-7.8%	-10.8%
GBP	0.46	-0.9%	-7.3%	-5.2%	-17.8%
EUR	0.64	-4.7%	-9.2%	-7.4%	-10.4%
Property					
ASX 300 Listed Property Trusts Accum. Index	36,881	-4.0%	-2.6%	1.4%	14.2%
FTSE EPRA / NAREIT Dev. Index (Hedged $A)*	2,119	-4.5%	-4.6%	-0.2%	5.4%
Australian Fixed Interest					
Bloomberg AusBond Composite Index	8,561	0.6%	1.0%	1.9%	6.3%
Bloomberg AusBond Government Index	8,930	0.7%	1.0%	2.2%	6.6%
Bloomberg AusBond Corporate Index	8,681	0.5%	0.8%	1.4%	5.7%
Bloomberg AusBond Bank Bill Index	8,304	0.2%	0.5%	0.4%	2.5%
Global Fixed Interest					
Citi Group WGBI ex-Aus (Hedged $A)	-	0.0%	0.3%	1.5%	5.5%
Barclay's Global Agg. Bond Index (Hedged $A)	-	-0.1%	0.0%	1.1%	4.8%
Oil and Commodities					
Crude Oil ($/bbl)	49	4.4%	-18.4%	-17.3%	-48.7%
Copper Spot ($/tonne)	5,147	-1.4%	-14.3%	-10.6%	-26.6%
Gold Spot ($/ounce)	1,133	3.4%	-5.0%	-3.5%	-12.4%

Fixed income (yields) as at …	**31-Aug-15**	**31-Jul-15**	**31-May-15**	**30-Jun-15**	**31-Aug-14**
Australia Bank Bill	2.13	2.14	2.13	2.13	2.63
Australia 10 Year Government Bond	2.66	2.76	2.73	3.01	3.29
US 10 Year Government Bond	2.22	2.18	2.12	2.35	2.34
UK 10 Year Government Bond	1.96	1.88	1.81	2.02	2.37
Germany 10 Year Government Bond	0.80	0.64	0.49	0.76	0.89
Japan 10 Year Government Bond	0.38	0.42	0.39	0.47	0.50

* Net dividends reinvested