October 2018

By Brad Potter,
Head of Australian Equities

nikko am
Nikko Asset Management

FROM THE AUSTRALIAN EQUITIES DESK

Market Commentary

The S&P/ASX 200 Accumulation Index returned -1.8% during the month.

The Australian equities market weakened in September, underperforming global markets. In major global developed markets, Japan led returns with the Nikkei 225 up 5.5%. The UK FTSE 100 returned 1.0% followed by the US S&P 500 and the Euro Stoxx 50 which returned 0.4% and 0.2% respectively. During the month, the Reserve Bank of Australia (RBA) maintained the cash rate at 1.50%. The RBA continues to maintain its view on the economy with global growth continuing and global inflation remaining low.

Domestic economic data releases were mixed in September. GDP growth in the June quarter was ahead of expectations, recording growth of 0.9%. The annual rate was up 3.4%, the fastest annual expansion rate since Q3 2012. Employment rose by 44,000 positions in August (mostly in full-time positions). Meanwhile the unemployment rate remained steady at 5.3%. The NAB Survey of Business Conditions rose to +15 in August, however business confidence fell 3 points to +4, the lowest level since 2016. Retail sales disappointed, with a flat result for July.

In stock specific news BHP Billiton shares rose 7.2% following its announcement that it purchased a 6.1% stake in LSE-listed SolGold, which owns the highly prospective Cascabel copper/gold project in Ecuador. At the end of the month headlines were dominated by the release of the Royal Commission's Interim Report with the banking sector bearing the brunt of the Commissioner's criticism.

Sector returns were mostly negative in September. The best performing sectors were Energy (4.3%), Materials (4.2%) and Telecommunications (2.7%). Information Technology (-0.9%), Real Estate (-2.1%), Financials ex Real Estate (-2.2%), Industrials (-2.2%), Consumer Staples (-2.7%), Utilities (-3.3%) and Consumer Discretionary (-4.2%) were all negative. The Healthcare (-7.7%) sector was the worst performing sector during the month.

The Energy and Materials sectors outperformed the market benefitting from a rally in commodity prices and also from an easing in the negative sentiment surrounding global trade concerns. Key drivers in the Energy sector were Woodside Petroleum (4.6%) and Santos (7.1%). Materials sector heavyweight BHP Billiton (7.2%) rallied on a combination of commodity price increases including oil and the likelihood of a large capital return later in the year post closure of the US oil asset sale. Rio Tinto (8.3%) saw strong performance following its announcement of details as to how it will return approximately USD 3.2 billion of post-tax coal disposal proceeds to shareholders.

The Financial sector was dominated by the release of the Royal Commission's Interim Report into the Finance Industry at the end of the month. The Commonwealth Bank (0.2%), ANZ (-4.5%) and Westpac (-2.1%) all increased their home loan rates, citing increased funding costs. NAB (-2.0%) went against the grain and kept their rates unchanged in an attempt to gain market share. Insurance stocks suffered following the conclusion of round 6 of the Royal Commission which focused on the insurance industry.

The Consumer Staples sector underperformed the market in September. Aristocrat Leisure (-10.0%) was a key laggard following some market participants downgrading earnings, based on higher expected research and development expenses.

The Healthcare sector was the worst performer in September. CSL (-11.5%) was the key detractor, winding back last month's gains. Furthermore the announcement of a Royal Commission into aged care also negatively impacted the sector.

Outlook

Global growth continues to show positive signs, confirming the debt deflation cycle is rolling over to a more traditional industrial cycle. Global PMI data has retracted slightly, but continues to support the first synchronised global growth cycle seen in many years and this is being reflected in strong earnings growth. However, geopolitical risks will continue to weigh on the market. The Trump initiated trade dispute is ongoing as the US continues to introduce new trade tariffs.

In China, the 19th Party Congress charted a course that involves less pollution, less reliance on property construction and further increases in the services sectors that should result in a more balanced economy. The expectation is that over the next five years, fixed asset investment will slow and GDP growth will move from around 6.5% to circa 5% as China's economy becomes consumption driven.

During the latest reporting season, high growth, high PE names were squeezed higher, often on poor results and outlooks. It seems the market is becoming lost in its desire to chase growth, with little or no attention to the price they are

paying. The divergence between value and growth stocks has been widening over the past five years and has certainly picked up over the past 12 months. This reporting season has seen this divergence take a further incredible step up with the top PE quintile stocks expanding their 1 year forward PE by a further 10%, despite earnings in fact falling by 2-3% on average.

We maintain our view that a retracement of this bubble-like trend must be a high probability given the extreme levels we are seeing. We believe that the rotation towards cyclicals and value, albeit stalled, still has some way to go and should be driven by rising global inflation, and therefore earnings growth in the more economically-sensitive sectors.

Important Information

This document is prepared by Nikko Asset Management Co., Ltd. and/or its affiliates (**Nikko AM**) and is for distribution only under such circumstances as may be permitted by applicable laws. This document does not constitute investment advice or a personal recommendation and it does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient.

This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments or participate in any trading strategy. Moreover, the information in this material will not affect Nikko AM's investment strategy in any way. The information and opinions in this document have been derived from or reached from sources believed in good faith to be reliable but have not been independently verified. Nikko AM makes no guarantee, representation or warranty, express or implied, and accepts no responsibility or liability for the accuracy or completeness of this document. No reliance should be placed on any assumptions, forecasts, projections, estimates or prospects contained within this document. This document should not be regarded by recipients as a substitute for the exercise of their own judgment. Opinions stated in this document may change without notice.

In any investment, past performance is neither an indication nor guarantee of future performance and a loss of capital may occur. Estimates of future performance are based on assumptions that may not be realised. Investors should be able to withstand the loss of any principal investment. The mention of individual stocks, sectors, regions or countries within this document does not imply a recommendation to buy or sell.

Nikko AM accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this document, provided that nothing herein excludes or restricts any liability of Nikko AM under applicable regulatory rules or requirements.

All information contained in this document is solely for the attention and use of the intended recipients. Any use beyond that intended by Nikko AM is strictly prohibited.

Japan: The information contained in this document pertaining specifically to the investment products is not directed at persons in Japan nor is it intended for distribution to persons in Japan. Registration Number: Director of the Kanto Local Finance Bureau (Financial Instruments firms) No. 368 Member Associations: The Investment Trusts Association, Japan/Japan Investment Advisers Association/Japan Securities Dealers Association.

United Kingdom and rest of Europe: This document constitutes a financial promotion for the purposes of the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules).

This document is communicated by Nikko Asset Management Europe Ltd, which is authorised and regulated in the United Kingdom by the FCA (122084). It is directed only at (a) investment professionals falling within article 19 of the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005, (as amended) (the Order) (b) certain high net worth entities within the meaning of article 49 of the Order and (c) persons to whom this document may otherwise lawfully be communicated (all such persons being referred to as relevant persons) and is only available to such persons and any investment activity to which it relates will only be engaged in with such persons.

United States: This document is for information purposes only and is not intended to be an offer, or a solicitation of an offer, to buy or sell any investments. This document should not be regarded as investment advice. This document may not be duplicated, quoted, discussed or otherwise shared without prior consent. Any offering or distribution of a Fund in the United States may only be conducted via a licensed and registered broker-dealer or a duly qualified entity. Nikko Asset Management Americas, Inc. is a United States Registered Investment Adviser.

Singapore: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. Nikko Asset Management Asia Limited is a regulated entity in Singapore.

Hong Kong: This document is for information only with no consideration given to the specific investment objective, financial situation and particular needs of any specific person. You should seek advice from a financial adviser before making any investment. In the event that you choose not to do so, you should consider whether the investment selected is suitable for you. The contents of this document have not been reviewed by the Securities and Futures Commission or any regulatory authority in Hong Kong. Nikko Asset Management Hong Kong Limited is a licensed corporation in Hong Kong.

Australia: Nikko AM Limited ABN 99 003 376 252 (**Nikko AM Australia**) is responsible for the distribution of this information in Australia. **Nikko AM Australia** holds Australian Financial Services Licence No. 237563 and is part of the Nikko AM Group. This material and any offer to provide financial services are for information purposes only. This material does not take into account the objectives, financial situation or needs of any individual and is not intended to constitute personal advice, nor can it be relied upon as such. This material is intended for, and can only be provided and made available to, persons who are regarded as Wholesale Clients for the purposes of section 761G of the Corporations Act 2001 (Cth) and must not be made available or passed on to persons who are regarded as Retail Clients for the purposes of this Act. If you are in any doubt about any of the contents, you should obtain independent professional advice.

New Zealand: Nikko Asset Management New Zealand Limited (Company No. 606057, FSP22562) is the licensed Investment Manager of Nikko AM NZ Investment Scheme, Nikko AM NZ Wholesale Investment Scheme and the Nikko AM KiwiSaver Scheme.

This material is for the use of researchers, financial advisers and wholesale investors (in accordance with Schedule 1, Clause 3 of the Financial Markets Conduct Act 2013 in New Zealand). This material has been prepared without taking into account a potential investor's objectives, financial situation or needs and is not intended to constitute personal financial advice, and must not be relied on as such. Recipients of this material, who are not wholesale investors, or the named client, or their duly appointed agent, should consult an

Authorised Financial Adviser and the relevant Product Disclosure Statement or Fund Fact Sheet (available on our website www.nikkoam.co.nz).

Kingdom of Bahrain: The document has not been approved by the Central Bank of Bahrain which takes no responsibility for its contents. No offer to the public to purchase the Strategy will be made in the Kingdom of Bahrain and this document is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Kuwait: This document is not for general circulation to the public in Kuwait. The Strategy has not been licensed for offering in Kuwait by the Kuwaiti Capital Markets Authority or any other relevant Kuwaiti government agency. The offering of the Strategy in Kuwait on the basis a private placement or public offering is, therefore, restricted in accordance with Decree Law No. 7 of 2010 and the bylaws thereto (as amended). No private or public offering of the Strategy is being made in Kuwait, and no agreement relating to the sale of the Strategy will be concluded in Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Strategy in Kuwait.

Kingdom of Saudi Arabia: This document is communicated by Nikko Asset Management Europe Ltd (Nikko AME), which is authorised and regulated by the Financial Services and Markets Act 2000 (as amended) (FSMA) and the rules of the Financial Conduct Authority (the FCA) in the United Kingdom (the FCA Rules). This document should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko AME.

This document does not constitute investment advice or a personal recommendation and does not consider in any way the suitability or appropriateness of the subject matter for the individual circumstances of any recipient. In providing a person with this document, Nikko AME is not treating that person as a client for the purposes of the FCA Rules other than those relating to financial promotion and that person will not therefore benefit from any protections that would be available to such clients.

Nikko AME and its associates and/or its or their officers, directors or employees may have or have had positions or material interests, may at any time make purchases and/or sales as principal or agent, may provide or have provided corporate finance services to issuers or may provide or have provided significant advice or investment services in any investments referred to in this document or in related investments. Relevant confidential information, if any, known within any company in the Nikko AM group or Sumitomo Mitsui Trust Bank group and not available to Nikko AME because of regulations or internal procedure is not reflected in this document. The investments mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors.

Oman: The information contained in this document nether constitutes a public offer of securities in the Sultanate of Oman as contemplated by the Commercial companies law of Oman (Royal decree 4/74) or the Capital Markets Law of Oman (Royal Decree80/98, nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in the Sultanate of Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market law (issued by Decision No. 1/2009). This document is not intended to lead to the conclusion of any contract of whatsoever nature within the territory of the Sultanate of Oman.

Qatar (excluding QFC): The Strategies are only being offered to a limited number of investors who are willing and able to conduct an independent investigation of the risks involved in an investment in such Strategies. The document does not constitute an offer to the public and should not be reproduced, redistributed, or sent directly or indirectly to any other party or published in full or in part for any purpose whatsoever without a prior written permission from Nikko Asset Management Europe Ltd (Nikko AME). No transaction will be concluded in your jurisdiction and any inquiries regarding the Strategies should be made to Nikko AME.

United Arab Emirates (excluding DIFC): This document and the information contained herein, do not constitute, and is not intended to constitute, a public offer of securities in the United Arab Emirates and accordingly should not be construed as such. The Strategy is only being offered to a limited number of investors in the UAE who are (a) willing and able to conduct an independent investigation of the risks involved in an investment in such Strategy, and (b) upon their specific request.

The Strategy has not been approved by or licensed or registered with the UAE Central Bank, the Securities and Commodities Authority or any other relevant licensing authorities or governmental agencies in the UAE. This document is for the use of the named addressee only and should not be given or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration
thereof).

No transaction will be concluded in the UAE and any inquiries regarding the Strategy should be made to Nikko Asset Management Europe Ltd.