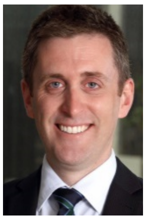

Clint Abraham

Portfolio Specialist,
Ibbotson Associates, Australia

(Un)Happy New Year

Equities have begun 2016 with many major global indices recording their worst start to a calendar year on record. Indeed, the benchmark for global equities, the MSCI World ex Australia ($A Hedged) Index, fell by more than 6% for the week (to 08 January 2015). Australia's S&P/ASX 200 fared little better and is now at its lowest level since mid-2013, as market volatility climbs to heights not seen since August 2015 and, prior to that, in the European financial crisis of 2011-2012.

Why did it happen?

There are a number of factors contributing to the events of the last week:

1) **The Chinese economy is weakening** - this is not necessarily new news. Indeed, concerns over the Chinese economy were at the heart of the market volatility in August 2015. So what's different now?
    a. **The Chinese economy continues to deteriorate** and is slowing more than was previously expected. Recent economic data regarding manufacturing, services and inflation, for instance, has been disappointing. As such, the official target for GDP growth of 6.5% looks increasingly optimistic.
    b. **Devaluation of the Yuan.** Since the Chinese government loosened the peg to the U.S. dollar, we have seen the ongoing devaluation in the Yuan, which has accelerated in recent weeks. Whilst devaluing their currency makes their exports more attractive, the risk is that the Yuan devaluation happens so quickly that it destabilises the economy or spurs further market volatility.
    c. **The Chinese Stock-market.** The rapid rise in the Chinese stock market in recent years was one underpinned by cheap money. As this unwinds, in combination with the aforementioned factors, significant volatility has gripped the Chinese market. In recognition of this, the authorities introduced a "circuit breaker" mechanism but rather than restore order to the market in times of stress, the new initiatives actually intensified selling and have since been removed.
2) **Oil price.** After falling ~45% over the 2015 calendar year, the major oil indices have fallen a further 10% in 2016 as collapsing Chinese demand meets rising oil inventories and surging supply. This position has been exacerbated by OPEC's December decision to remove any production targets, effectively giving member nations the authority to produce (and sell) as much oil as they want. Further weighing on the oil price, is its negative correlation to the U.S. dollar, which continues to strengthen.
3) As if the above is not enough, **geopolitical developments** in the Middle-East, Europe and the Korean peninsula are further contributing to the negative sentiment.

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Ibbotson's View - Stay the course

Recent market movements have understandably caused some concerns amongst clients. Indeed, as it stands, it remains extremely difficult to forecast the near term direction of markets and to predict when the current volatility may subside.

Whilst we are mindful of current events, we encourage clients to look past the short term noise and emotion and focus on the longer term objectives, which the Portfolios remain well positioned to achieve. The reason for this is that periods of heightened volatility are not uncommon but, by their nature, have the potential to cause the investor to lose sight of the bigger picture, often to the detriment of their investment outcomes.

Ibbotson are long-term valuation driven investors. This approach provides the flexibility to be invested in assets (e.g. shares, bonds, cash and property) only if it makes sense to do so. If the reward isn't worth the risk, we will avoid that asset class. This means that our portfolio positioning might, at times, be quite different to many others in the market.

With this in mind, we have become increasingly concerned in recent years by the expensive valuations of a number of key asset classes (most notably, United States equities). As such, our Portfolios have been reasonably defensively positioned, highlighted by the relatively high levels of cash. This is a position that served us well not only with regard to this current period of volatility but also in relation to the repeated bouts of volatility that plagued markets in 2015 (due to such issues as Greece, China and the outlook for U.S. interest rates).

It is our view, that the Portfolios remain well positioned to weather further market volatility, should it occur. However, with market sell-offs of this nature, invariably comes opportunity. As such, should more attractive valuation opportunities emerge, most likely in select developed and emerging market equities, high yield credit (fixed income) and currency (either directly or by adjusting the levels of hedging across portfolios) then we stand ready to deploy cash into these more compelling investment opportunities.

For further information on investment management products and services, please contact our Distribution Team on +61 2 9276 4550 or email AUDistribution@ibbotson.com

ibbotson
a Morningstar company

Level 36, Australia Square
264 George Street
Sydney NSW 2000

Locked Bag 25
Royal Exchange
Sydney NSW 1225

Tel: +61 2 9276 4550
Fax: +61 2 9276 4545
AUDistribution@ibbotson.com

www.ibbotson.com.au