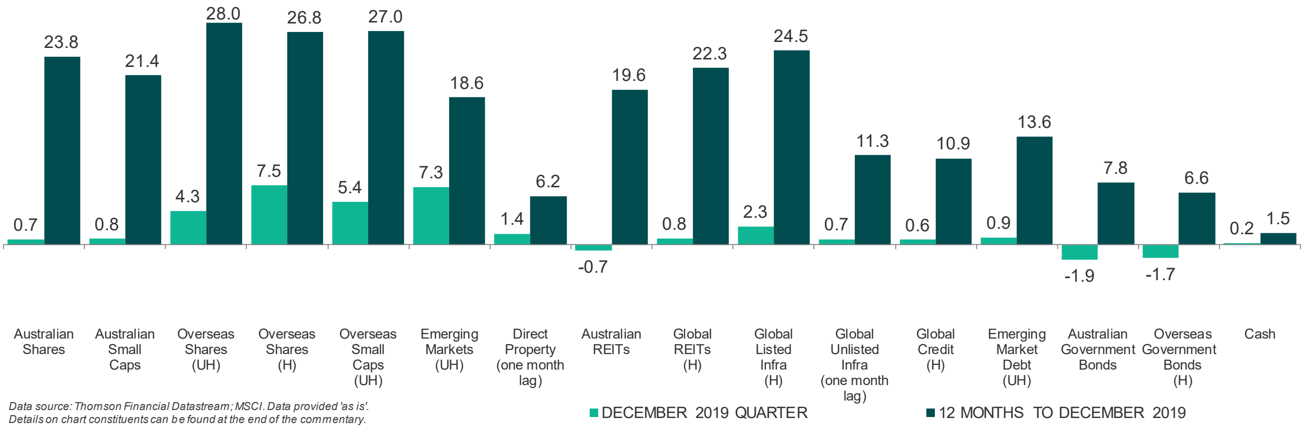
Q4 2019

MARKET AND ECONOMIC CONDITIONS

SELECTED MARKET INDICATORS COMMENTARY

ASSET CLASS RETURNS (%) AS AT DECEMBER QUARTER 2019



Data source: Thomson Financial Datastream; MSCI. Data provided 'as is'. Details on chart constituents can be found at the end of the commentary.

Global share markets ended a remarkable 2019 rally on a strong note with major stock indexes reaching fresh all-time highs. Investors favoured riskier assets following declining trade tensions and easing geopolitical headwinds. Hedged Overseas Developed Shares was the best performing asset class gaining 7.5% over the quarter, marginally outperforming Emerging Markets shares (UH).

Within bonds, investor's search for yield and higher risk appetites favoured riskier bonds over sovereign bonds. Over the quarter, the Bloomberg Barclays High Yield Index gained 2.6% and credit spreads narrowed by 37bps, which remains below the long-term median level. The yield curve steepened as US 3-month yields fell 33bps, whilst US 10-year and US 30-year yields rose by 25bps and 27bps respectively on the back of a 25bps rate cut by the US Fed in October.

Negative yielding debt reached a record high in October to a point where nearly 30% of the investment grade market had a negative yield, by quarter end the level of negative-yielding bonds fell to 20% as trade tensions eased and there was a slightly improved economic outlook.

Some geopolitical risks faded after the US and China reached a preliminary trade agreement. Also, Brexit uncertainties fell after Prime Minister Boris Johnson's Conservative Party obtained a solid majority in Parliament. The UK parliament has passed a withdrawal agreement and will start the exit process at the end of January 2020. Markets looked past the political turmoil in the US, where a deeply divided House of Representatives passed two articles of impeachment against President Trump.

However, macroeconomic stress related to tighter financial conditions in Argentina, geopolitical tensions in Iran, and social unrest in Hong Kong, Venezuela, Libya, and Yemen still persist.

Gold and commodities soared towards the end of the quarter, driven by concerns of a US-Iran conflict, global low interest rates and quantitative easing. Gold gained 18.9% over 2019 and oil finished 2019 at $66.31 per barrel, its largest annual gain since 2016. Global central banks have paused easing efforts to evaluate the effects of prior rate cuts, although the European Central Bank (ECB) and Bank of Japan (BOJ) continue to ease.

Over the quarter, global share sectors Information Technology and Healthcare were up 9.4% and 9.1% respectively. Quality stocks outperformed over Q4 and 2019, and small-cap growth stocks narrowly outperformed large-cap growth stocks.

The Australian share market underperformed its hedged international counterpart, as the S&P/ASX300 returned 0.7% over the quarter. The S&P/ASX Mid 50 was the greatest contributor to the S&P/ASX 300 return, returning 2.3% over Q4. Healthcare (+13.6%) and Energy (+6.1%) were the strongest sectors, whilst the weakest performing sectors were Financials (-6.3%) and Consumer Staples (-2.5%), driven by negative stock returns of the Australian Big 4 banks.

SIGNIFICANT DEVELOPMENTS

- The Reserve Bank of Australia (RBA) decided to leave the cash rate unchanged for two consecutive months in November and December at 0.75%. Please note, the RBA did not hold a meeting in January. RBA Governor, Philip Lowe, noted that the outlook for the global economy remains reasonable, however risks are tilted to the downside due to trade disputes and a slowdown in international trade, as businesses scale back future spending plans as a result of increased uncertainty. Interest rates around the world are very low and a number of central banks around the world have eased monetary policy in response to the subdued inflationary environment. Employment growth has continued strongly, despite the unemployment rate recently remaining steady at 5.3% over recent months. The unemployment rate is expected to remain at this level for some time, before dropping just under 5.0% in 2021. Inflation pressures remain subdued and this is likely to continue for some time. The RBA estimates both headline and underlying inflation to be close to 2.0% in 2020 and 2021. There are further signs of a turnaround in house prices in Sydney and Melbourne, despite the growth in housing credit remaining low. The easy monetary policy this year has lowered the exchange rate, supporting activity across a range of industries. The Board has noted that it is reasonable to expect an extended period of low interest rates in order to reach full employment and achieve the inflation target in Australia.
- Australian seasonally adjusted employment decreased by 24,800 (revised) in October, below expectations for a 15,000 rise while in November, employment increased by 39,900, above expectations for a 15,000 rise. The unemployment rate decreased from the previous quarter's 5.3% to 5.2% in November. The participation rate has decreased from the previous quarter to 66.0%. Part time jobs decreased by 14,300 (revised) and full time jobs decreased by 10,500 (revised) in October and in November part time jobs increased by 35,700 and full time jobs also increased by 4,200.
- Australian house prices increased by 2.4% in the third quarter of 2019, taking it -3.7% lower from a year earlier, above expectations for -1.5% quarter-on-quarter (QoQ) and -4.6% year-on-year (YoY). Building approvals increased 11.8% month-on-month (MoM) and were down -3.8% for the year to November, compared to expectations for 2.0% and -11.7% respectively.
- US Non-Farm Payrolls increased by 145,000 in December, below the previous 256,000 increase (revised) for November and below the previous 152,000 increase (revised) for October. The unemployment rate remained at 3.5% over October, November and December.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 47.2 in December, below consensus for 49.0, and below the 48.1 recorded in November. Of the 18 manufacturing industries, Food, Beverage & Tobacco Products; Miscellaneous Manufacturing were the top contributors, Chemical Products, Plastics and Rubber Products and Machinery were the largest detractors over the month. The ISM Non-Manufacturing Index recorded 55.0 in December, above consensus for 54.5 and below the 53.9 recorded in November.

Of the 18 non-manufacturing industries, the top performers in December were Retail Trade, Arts, Entertainment & Recreation Agriculture and Management of Companies & Support Services while Educational Services, Real Estate, Rental & Leasing were the industries which reported a decrease over the month.

- US gross domestic product (GDP) third estimate for Q3 2019 is 2.1% quarter on quarter (QoQ) annualised, in line with expectations and above the 2.0% recorded as a third estimate for Q2 2019.
- US headline consumer price index (CPI) steadily decreased from 0.4% MoM in October to 0.2% MoM in December, whilst the CPI increased from 1.8% YoY in October to 2.3% YoY in December.
- The Caixin Manufacturing PMI in China recorded 51.5 for December, below expectations for 51.6.
- Chinese GDP increased 6.0% YoY for Q3 2019, below expectations for 6.1%. Seasonally adjusted GDP increased 1.5% QoQ for Q3 2019, in line with expectations.
- A preliminary estimate of the European Core Consumer Price Index (CPI) recorded 1.3% over the year to December, in line with expectations. The unemployment rate decreased to 4.8% over the final quarter of 2019.
- The Eurozone composite PMI increased to 50.9 in December, above expectations for 50.6.
- The Eurozone's final estimate recorded for seasonally adjusted GDP over Q3 2019 was 1.2% for year-on-year (YoY) and 0.2% QoQ.

AUSTRALIAN EQUITIES

Australian shares were positive over Q4 2019 as the S&P/ASX 300 Index returned 0.7% for the period. There were positive movements across all the market cap spectrum, with the best performer being the S&P/ASX mid 50; returning 2.3% for the quarter while the worst performer was the S&P/ASX 50; returning 0.4%. The best performing sectors were Healthcare (+13.6%) and Energy (+6.1%), while the weakest performing sectors Financials (-6.3%) and Consumer Staples (-2.5%). The largest positive contributors to the return of the index were CSL, BHP and Fortescue with absolute returns of 18.3%, 7.4% and 22.9% respectively. On the other hand, the most significant detractors from performance were Westpac, NAB and ANZ with absolute returns of -16.8%, -15.6% and -12.3% respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) increased 7.5% in hedged terms and increased 4.3% in unhedged terms over the quarter, as the AUD appreciated against most major currencies over the period. The strongest performing sectors were IT (+9.4%) and Healthcare (+9.1%), while Real Estate (-2.9%) and Utilities (-2.1%) were the worst performers. In AUD terms, the Global Small Cap sector increased 5.4%, whilst Emerging Markets (NR) returned 7.3%.

Over the December quarter, the NASDAQ increased 12.2%, the S&P 500 Composite Index increased 9.1% and the Dow Jones Industrial Average increased 6.7%, all in USD terms. European markets also experienced positive returns, with the FTSE 100 United Kingdom (UK) increasing 2.7%, the DAX 30 (Germany) increasing 6.6% and the CAC 40 (France) increasing 5.5% over the period. Equity returns were also positive across Asia as the Indian BSE 500 increased 5.8%, the Hang Seng increased 8.4% and the SSE Composite (China) also increased 5.0% and the Japanese TOPIX increased 8.6%.

REAL ASSETS

Global and Domestic property experienced mixed results over the December quarter. Unhedged domestic Real Estate Investment Trusts (REITs) were down -0.7% and hedged Global REITs increased 0.8%. The unlisted property sector (NAV) rose 1.4% over the quarter (on a one-month lagged basis). Meanwhile, Global Core Listed Infrastructure 50/50 index increased 2.3% for the quarter in hedged terms.

FIXED INTEREST

Global Sovereign Bonds produced mixed returns over the December quarter for hedged Australian investors. Ten-year bond yields increased in the US (+25bps to 1.92%), UK (+42bps to 0.83%), Germany (+38bps to -0.19%), and in Japan (+21bps to -0.02%). Two-year bond yields decreased in the US (-8bps to 1.58%) and increased in Japan (+20bps to -0.13%), Germany (+14bps to -0.61%) and the UK (+17bps to 0.54%). In terms of Global Bond indices, the Barclays Capital Global Aggregate Bond Index decreased -0.8% and the FTSE World Government Bond (ex-Australia) Index also decreased -1.7% over the December quarter, on a fully hedged basis.

Domestically, Australian 10-year bond yields increased by 37bps to 1.37%, five-year bond yields increased by 27bps to 1.04% and two-year bond yields increased 20bps to 0.93%. Bloomberg Ausbond indices were broadly negative over the quarter, with Bloomberg Ausbond Bank Bill being the only positive return at 0.2%. Whilst the weakest being the Bloomberg Ausbond Treasury returning -1.9%.

CURRENCY MARKETS

The AUD appreciated against most major currencies, over the December quarter, finishing at US$0.703 with a Trade Weighted Index of 60.30. It depreciated against the Pound Sterling (-2.7%), but appreciated against the USD (+4.2%), the Japanese Yen (+4.7%) and the Euro (+1.3%). On a trade-weighted basis, the local currency appreciated +1.9% over the quarter.

COMMODITIES

The S&P GSCI Commodity Total Return Index increased by 3.9% over the quarter. Gold prices finished the quarter at US$1,520.5per ounce for a 3.2% increase over the period. While the oil price decreased by 8.9% to US$66.31 per barrel and Iron Ore prices also decreased by 1.1% to US$92.0 per metric tonne over the December quarter.

CHART CONSTITUENTS

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

ASSET CLASS	BENCHMARK	DATA TYPE
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Unlisted Infrastructure (one month lag)	Mercer Global Unlisted Infrastructure Fund	Gross Return
Global Credit (H)	Bloomberg Barclays Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

CONTACT: Mercer >IS<

Tel: +1800 512 947

Email: merceris@mercer.com

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