EXECUTIVE SUMMARY

- Following the strong start to global equities in 2018 markets have given back gains. While the correction has been meaningful, valuations continue to look expensive particularly in the US.
- Solid global economic growth flags that central banks will likely continue to wind back the extreme policy support especially as inflation pressures are now rising.

OUR VIEW

The environment is becoming increasingly challenging for markets:

- Following the strong start to global equities in 2018 markets have given back gains. While the correction has been meaningful, valuations continue to look expensive particularly in the US even though US tax cuts have boosted earnings. The recent correction however, has seen some of the complacency fall and sentiment indicators of an overbought market ease.
- Solid global economic growth flags that central banks will likely continue to wind back the extreme policy support particularly as inflation pressures are now rising. A major change in market sentiment over recent weeks has been an acceptance that the US Federal Reserve (Fed) will raise rates possibly four times in 2018. Meanwhile the European Central Bank has said it would halve the rate of bond purchases this year.
- Other concerns that are weighing on markets are that the US fiscal deficit has widened sharply despite the economy being fully employed and growing well above potential, and policy measures like steel and aluminium tariffs will likely add to cost pressures.

Investment strategy recap
Our investment strategy continues to be anchored by our view that growth will remain above trend and will be fairly synchronised, with most major developed economies continuing to perform well.

However, there are signs emerging that we could be approaching the end of the current investment cycle. An example of such warning signs is the wider US fiscal deficit and tariffs, which will likely add to inflation pressures. The signals are not yet strong enough and we consider the current cycle has more to run.

The RIC retained its neutral position to growth assets with a constrained overweight bias to growth assets.

STRATEGY TILTS

Asset class	Position relative to Benchmark/Outlook[1]
GROWTH ASSETS	**Neutral**
Australian equities	Neutral
International equities	Neutral
- **United States**	Neutral
- **Europe**	Neutral
- **Japan**	Neutral
- **Emerging markets**	Neutral
Listed real assets[2]	Neutral
DEFENSIVE ASSETS	**Neutral**
Fixed income	Underweight
- **Australian**	Neutral
- **New Zealand**	Neutral
- **International**	Underweight
Cash[3]	Overweight
CURRENCY	
AUD/USD	Neutral
NZD/USD	Neutral
USD TWI	Neutral

Notes:

1. Equities, Fixed income and Cash are relative to Benchmark. Currencies are relative to an absolute return outlook (short term).

2. Comprises of 50/50 split between GREITs and infrastructure securities.

3. Cash is the balancing asset class. Cash is a residual to Portfolio Manager's overall implementation of other asset class strategies. It continues to form part of the overall defensive asset allocation, with PMs having flexibility in terms of how to implement the stated defensive asset strategy across fixed income and cash. In the RIC model cash overweight to facilitate an underweight position we hold in international bonds and to manage overall fund duration.

As at March 2018.

STRATEGY POSITIONS

GROWTH ASSETS	
GLOBAL EQUITIES: NEUTRAL	We expect global equities to perform relatively well, with good economic and earnings momentum. Global financial conditions are supportive and central banks are expected to tighten monetary policy very gradually. While this suggests we should hold an overweight position in this asset class, we have opted for a more cautious stance. There is also some risk that data flows are below lofty expectations in coming months which will see earnings revisions momentum weaken and leave global share markets looking more expensive. The gradual rise in interest rates also tempers our enthusiasm.
AUSTRALIAN & NEW ZEALAND EQUITIES: NEUTRAL **Note:** IMS portfolios do not include New Zealand equities.	New Zealand & Australian equities are expected to continue to perform well relative to bonds and offer an attractive yield. Australian equities look slightly more attractive than their New Zealand counterparts as improving global growth could further support the highly cyclical resource sector which makes up a substantial part of this market. The New Zealand market is more comparable with the industrial sector of the Australian market and both are expected to deliver reasonable earnings and dividend growth this year. Valuations could be considered to be on the expensive side in this sector and this may limit the upside in both markets, especially with improved opportunities for growth in offshore markets. The New Zealand market has the added headwind of transitioning to the new government's policies affecting immigration, wages, housing and the environment.
EMERGING MARKET EQUITIES: NEUTRAL	Emerging markets have run hard and while we remain constructive we remain concerned that slower growth in the Chinese industrial sector in conjunction with gradual Fed tightening will become a headwind in 2018. This asset class has delivered strong returns as earnings bounce from the 2015 trough. Analysts continue to revise forward estimates higher on the back of robust global growth, strong pricing power and improvement in manufacturing and trade activity. Valuations across the market are no longer cheap but moderately expensive on an absolute basis but this is still attractive relative to developed market equities.
LISTED REAL ASSETS: NEUTRAL	In contrast to broader equity markets, real estate markets and infrastructure have underperformed on the back of rising interest rates. Valuations are becoming more fairly valued. Earnings remain consistent and fundamentals are still very supportive for the sector with low vacancy rates supporting property and economic growth infrastructure. Higher interest rates are a hurdle but, if as we expect, the growth backdrop remains firm and central banks reduce policy accommodation gradually, this sector can deliver stable cashflow and returns to portfolios. Furthermore, real assets are expected to perform well in a higher inflation environment.
DEFENSIVE ASSETS	
INTERNATIONAL FIXED INCOME: UNDERWEIGHT	The US Federal Reserve has reiterated its commitment to gradually reduce the size of its balance sheet and to raise interest rates. The ECB won't be buying as many bonds but remains committed to accommodative monetary support and is some way from raising interest rates. This has resulted in a modest lift in growth and inflation expectations in bond markets and bond yields are continuing to rise to levels more consistent with where they should be in this part of the cycle. As bond yields rise, the return on bond investments will be low. In this benign economic environment high grade corporate bonds can provide better returns relative to government bonds. High yield spreads are too narrow in our view given the equity-like risk inherent in this market.
AUSTRALIAN and NZ FIXED INCOME: NEUTRAL	Local bond markets are largely going to be influenced by rising interest rates offshore where we expect to see a gradual removal of monetary policy accommodation. In light of this we would expect low returns from this asset class over the coming years. The higher yield available on high grade credits can provide a better return, however spreads are very narrow and do not compensate investors for the additional risk relative to government bonds. We have a preference for short-dated cash-like exposures.
CURRENCY	
AUD (NEUTRAL) **NZD** (UNDERWEIGHT)	The Australian dollar is currently around fair value, supported by recent commodity price strength. Weak wages growth is likely to see the RBA lag the Fed in 2018 but domestic rate hikes into the second half of the year are possible as the economy benefits from an upswing in non-mining capex. The New Zealand dollar has appreciated on the back of US dollar weakness and is currently above fair value against the US dollar. Over the medium term, we expect the US dollar to strengthen as the Fed raises interest rates and the RBNZ remains on hold. This will eliminate the higher interest rates paid on New Zealand dollar denominated debt relative to the US. In addition, a spike in risk aversion should see a fall in the NZ dollar providing an offset to the equity risk in portfolios.

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