GSS Index Managed Models – Annual Asset Allocation Review & Re-weight January 2019

Adviser Use Only

The strategic asset allocation ('SAA') is reviewed yearly by the model consultant and this was recently completed in January 2019. As a result, the models were re-balanced to reflect the updated strategic asset allocation.

Capital Market Assumptions Update

The process commences with a review of the 'capital market assumptions' ('CMA') that under-pin the asset allocation framework. The CMA include an updated view on the global economy including GDP, inflation and interest rates. This is used to generate a 'risk and return' outlook for each asset class including correlations and to determine appropriate long-term asset class weights. The SAA weights use a 7 – 10 year' timeframe which is aligned to the average economic cycle.

In general, there were no major changes to the CMA and long-term outlooks for the major asset classes have not changed significantly.

In equities, despite weaknesses in prices in the last quarter of 2018 the forecast remains largely intact as the outlook for fundamentals such as GDP growth, interest rates and corporate earnings have not changed significantly. Expected returns to equities rose slightly based on 2018 Q4 volatility and weakening price levels while earnings growth and yields expectation remains un-changed.

The CMA's incorporate a view that the global economy is late cycle which is the driver of the re-weight between international and Australian equities.

In the fixed income, the expected returns from both bonds and credit remains largely unchanged. The higher yielding segments of the asset class such as lower grade credit is viewed more positively but we note remains under-weight compared to long term asset class weights. The outlook for government bonds has improved compared to the forecast in the previous year which has been essentially driven by tightening US rates.

In currency, the AUD/USD hedging costs is expected to remain elevated and perhaps even increase a bit further in 2019. This is due to rising US interest rates whilst Australian rates have remained unchanged over 2018.

SAA Changes

Based on the CMA's, the following summarises the changes to the SAA.

- Removal of the allocation to Australian real estate investment trusts ('AREITS') based on valuation but we note the models will still be exposed to AREIT's through broader Australian equities;
- The allocations to international equities have been reduced due to a view that the global economy is late economic cycle and caution on US equities based on trade frictions, political dynamics, and general uncertainty over the future path of US fundamentals;

- The allocation to Australian equities was increased based on the reduced allocation to international equities and removal of Australian listed property. The AREIT allocation was minimal and varied between 2% and 4.5%;
- The international fixed interest allocation has been reduced based on the view that the US Federal Reserve monetary policy stance is expected to be neutral in addition to the increased costs of currency hedging offshore investments;
- The Australian fixed interest allocation has been increased due to the view on international fixed interest described above; and
- No change to the cash allocation and remains unchanged at 2% across all models.

Below is the updated SAA for the GSS Index Models. The models were rebalanced to reflect the new SAA in January 2019.

Asset class	GSS Conservative Index Model	GSS Balanced Index Model	GSS Growth Index Model	GSS High Growth Index Model	GSS Total Growth Index Model
Australian equities	17	28	39	47.5	54.5
International equities	14.5	23	31.5	37.5	43.5
Australian property	0	0	0	0	0
Australian fixed interest	27	19	11	5	0
International fixed interest	39.5	28	16.5	8	0
Cash	2	2	2	2	2
TOTAL	100	100	100	100	100