

An update from our Chief Investment Officer

As we approach the end of an eventful year in investment markets, I'm pleased to share our reflections on the year with TelstraSuper's ongoing advice clients.

Investors are likely to look back on 2018 as the year when volatility returned to investment markets, after being absent for several years. The year started off very strongly - with the United States (US) share market surging in January by more than 5.5% for the month. Investor optimism was stoked by tax cuts in the US, combined with strong economic growth and low unemployment.

We then saw two negative months in share markets in February and March as investors became concerned about the potential for inflation, interest rate rises, as well as the emerging threat of a trade war between the US and China.

However despite weaker investment sentiment, the actual economic data following the first quarter was surprisingly strong. The world's economy continued to grow strongly, unemployment fell in almost all countries, inflation remained benign, and companies reported robust profits. This strong economic data led to a surge in investor confidence between April and September which translated into strong investment gains in most asset classes. In fact, global share markets were up by almost 13% in Australian dollar terms for the first nine months of the year. The gains were led by large US technology stocks such as Apple, Facebook and Amazon.

These gains occurred despite the US Federal Reserve increasing interest rates three times during the nine month period. As US interest rates rose, the US dollar strengthened and this placed pressure on emerging countries with debt obligations denominated in the US currency. As a result of this, investments in emerging market assets substantially underperformed their developed market counterparts.

In the months of October and November, investor sentiment took a sharp turn for the worse and we saw a significant sell-off in share markets once again. The catalyst again appears to have been concerns about rising US interest rates, rising input costs (especially from tightening labour markets) and the escalating trade conflict between the US and China. The same large technology stocks that led the market higher for most of the year, took the lead in taking the market lower in October and November - largely reversing all of the gains for the year.

However, the volatility we've seen in share markets during 2018 is not unusual. Share investments offer much higher potential returns than assets such as cash and fixed interest, but are also subject to greater volatility. And as already noted, the market falls have followed some extraordinarily strong returns in recent years.

Pulling all of this together, I'm pleased to report that when we look across the first 11 months of the year, all of TelstraSuper's diversified investment options have delivered positive returns. These returns are lower than they were in 2017, but our members have still achieved growth in their superannuation balances. For our latest investment returns, please see the TelstraSuper website.

Looking forward, TelstraSuper believes that the key ingredients for strong economic growth remain in place – such as low unemployment, low interest rates, moderate inflation and strong corporate profitability. These factors should provide support against an escalation of the negative sentiment seen in October/November, although we expect that markets will continue to be volatile and skittish.

The main risks to returns are likely to come from two sources: higher inflation as the economic cycle matures and full employment puts pressure on wage rises, and geopolitical/trade risks. Although

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inflation remains moderate relative to history and is generally towards the lower end of central bank targets, it does appear to be increasing – this may well prompt more aggressive interest rate tightening, especially in the US.

The key geopolitical risk that we are watching is the trade tensions between the US and China. An escalation in the size and extent of tariffs would be very negative for global growth and investor sentiment, and would hit emerging markets particularly hard. On the other hand, a resolution of the tensions is likely to result in a sharp recovery in emerging markets.

Against this backdrop, TelstraSuper maintains a high level of diversity in our investment portfolios, with a moderately cautious bias. In most of our investment options our current equity targets are generally about 1 to 2% below their long term levels and we have been selectively reducing our property exposure, particularly in the retail sector. We remain overweight in cash and underweight in fixed interest.

Our investments draw their returns from many different types of assets, in many different countries, and are managed by multiple investment teams. We aim for our portfolios to be resilient in a variety of investment environments, and to maximise long-term returns for the risk profiles chosen by our members.

It's a privilege to be entrusted with the management of your superannuation and retirement savings. As always we will continue to manage your investments in a prudent and proactive manner - remaining vigilant to identify both risks and opportunities as they emerge.