

EXECUTIVE SUMMARY

- Strengthening economic prospects have overshadowed an increasingly volatile political landscape to propel equity markets higher during the first quarter.
- Corporate earnings growth momentum is accelerating, providing some support for relatively full valuations, including Australia.
- In a low growth world, long term, secular growth opportunities are attractive investments. We see Food, Technology and the Emerging Asian Middle Class as three such propositions.
- Key risks are rising inflation in the US, disruptive technology outcomes and a sustained slowdown in China.
- As the ASX200 index approaches the 6,000 level, the high since the GFC, we anticipate a period of consolidation, before a stronger finish into year end.

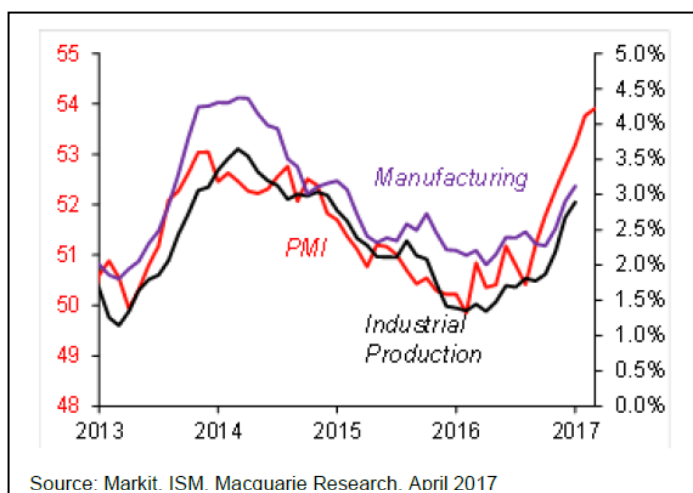
Trump Rally Fades

The Trump rally that fuelled markets during the latter part of 2016 lost momentum during the first quarter of 2017 and in several cases, trends seen in late 2016 reversed. The \$US weakened, interest rates drifted towards the lower end of recent trading ranges and interest rate sensitive and more defensive equities outperformed. Failure to get the Obamacare reform package through the political process, called into question the new administration's ability to deliver policy objectives.

From a low of 5,586 on the 7th of February, the ASX200 rose 5.7% to 5,905 by March end, generating a return 3.5% for the quarter. The rally was driven by Consumer stocks including Food, Healthcare, Financials, Utilities and REITS some that were sold down during the latter part of 2016. Materials, Technology, Resources and Gold underperformed. Seasonally the months November through to April have historically been the strongest, and that has held true again this year.

Regardless of the uncertain political landscape in much of the developed world, the global economic outlook has continued to improve during Q1 2017. Key leading indicators such as PMI's (Purchasing Managers Indices) have been strong (though latest readings suggest a levelling out), business and consumer confidence levels are high and GDP has been strengthening in most major economies including China. This has supported a recovery in corporate earnings across most markets, partially alleviating elevated valuations.

The chart below from Macquarie highlights a strong recovery in the global economy through the second half of 2016 into 2017.



In a low growth world, identification of long term, secular growth opportunities capable of providing, sustainable income represent attractive investment alternatives. We have identified three such areas: Food, Technology and the Emerging Asian Middle Class.

Food

We recently attended the Food Forum conference in Melbourne (sponsored by the Australian). Many of Australia's leading industry participants presented including food producers, retailers and industry experts. Some of the key takeaways included:

- Australia's food exports have been growing rapidly, and this trend is expected to continue. In CY15 total agriculture exports were \$46.5Bn, 14% of total exports. Of this beef is the largest at 20% and meat in total was 28%. Vegetables were just 4%. The general expectation from the conference was that food exports could double over the next decade.
- There is a fundamental shift in consumer behaviour. The proportion of the shopping budget allocated to "fresh" food is increasing. Supermarkets are allocating space more to chilled / cool areas (with higher energy costs). Food content is more relevant to consumers than brands.
- Technology is playing an increasingly important role in improving the efficiency of the industry. From the use of IOT (internet of things) in managing livestock in remote areas to seed genetics, pasture and cropping management. Greater use of controlled environment for growing horticulture products are leading to productivity gains.
- China and Asia generally will be an important part of the development of Australia's growth over the next decade. This will not be without its challenges as we have recently seen with Ballamys and Blackmores. However for companies such as A2 and Treasury Wines who get it right, it can be very rewarding.

In summary, we continue to like the growth opportunities in the food sector. Companies that we have invested in on your behalf or have under observation include Bega (which rose more than 50% last quarter), Costa Group, A2 Milk, Tassal, Webster, Capilano Honey and Blackmores.

Technology: Opportunities & Threats

UBS recently held a technology conference where a diverse range of companies presented. Some key points to emerge from the conference included:

- The accelerating pace of change in the technology sector generally. Computing power, data usage and storage, internet usage, cloud usage and interconnectedness are key trends.
- Some of the outcomes from use of Artificial Intelligence are assisting advancement in healthcare and biotech, autonomous vehicles and renewable energy.
- Rapid advancement in sensor technology linked to mobile devices is likely to be transformational in medical science, transportation, energy usage in business and households.
- 3D printing appears near commercial reality and is also likely to be transformational.

Also with rapid change comes disruption. One situation we have been focused on is the anticipated arrival of Amazon in Australia. It is clear from a glance at the retail landscape in the US, that Amazon has been a major disruptor to the sector in a short period of time. Where will Amazon focus on in Australia? What sectors are most likely to be impacted? Is Amazon capable of producing another wave of deflation via lower retail prices and reduced margins? Which local retailers are best positioned to deal with Amazon competition? While Amazon's intentions remain unclear, it is safe to assume that they will certainly increase competition and pressure margins in the retail sector.

Our key technology exposures have been primarily through a combination of a global technology exchange traded fund, select international stocks such as China internet company Tencent (listed in Hong Kong), China ecommerce giant Alibaba (US listed), Zillow (US listed) and some locally listed small cap stocks such as Aconex. We continue to look for suitable ways to take advantage of opportunities in the technology area.

Emerging Asian Middle class: The opportunities

Although somewhat difficult to define, it is clear that Asia's middle class is growing rapidly in major population countries such as China, India and Indonesia. Australia is geographically and strategically well positioned to benefit from this growth. Whereas historically our economic relationship has primarily been based on providing commodity exports to the region, we see the future as being far more services oriented.

Recent history suggests this transition is well underway. One of the largest service exports is education. According to government statistics, there were 376,449 international students in Australia in January 2017, up 16% on the previous year. While obviously impacting directly the education sector, it has indirectly supported housing, consumption spending and tourism.

Another sector benefiting materially from the Asian Middle class is tourism. In the latest International Visitor Survey, visitors to Australia in the 12 months to September 2016 spent \$38.8bn, up 11.5% on the previous corresponding period. Of this total, China contributed \$9bn. Chinese tourists visiting Australia has more than doubled over the last five years and exceeded 1m for the first time in 2016.

Looking ahead, we see opportunities in other areas. Australia's high quality healthcare sector is likely to find opportunities in Asia. Ramsay, CSL, Cochlear and Resmed are already involved in some shape or form. Food and agriculture is another opportunity discussed

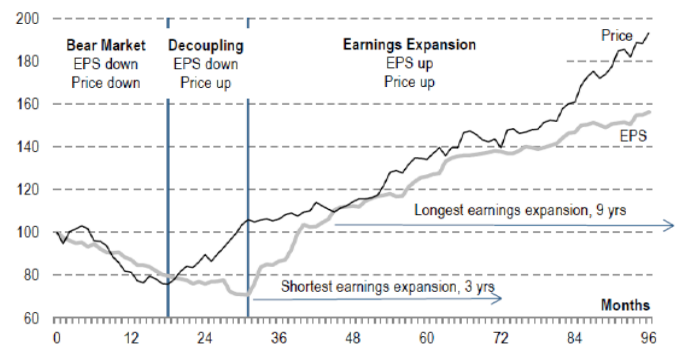
in part above, but also including land remediation, water, agriculture technology and farm management. Fonterra and Nufarm are actively engaged in Chinese agriculture.

Market Prospects

Despite this market cycle proving to be one of the longest in history- we are now into the 8th year- sentiment remains cautious rather than euphoric which is more typical of advanced market cycles. Valuations are elevated though being supported by stronger earnings momentum. Interest rates are increasing in the US, long term interest rates have risen off long term lows, though appear to have stabilised within defined trading ranges.

Inflation is the major risk we see. While this is trending up, it is advancing in a very orderly manner. Higher commodity prices are providing some inflation, however wage growth remains subdued. Technology appears likely to deliver strong productivity gains in the future, while potentially delivering deflation via the likes of Amazon.

Credit Suisse have recently highlighted the fact that corporate earnings upgrade cycles tend to be multi-year affairs, and our sense is that this one still has duration.



Source: Company Data, Thomson Reuters Datastream, Credit Suisse

In a world that has become less predictable and, potentially less stable, our investment strategy remains anchored around a limited number of investment themes such as those discussed above. Others include a positive view on Infrastructure (both operators as well as construction), Aged Care, Energy, oligopoly service providers such as banks and energy producers. We also continue to find attractive opportunities in the Small Cap space.

As the market approaches its post GFC high of 6,000 and conscious of the seasonally weak period normally from May to October, we may increase cash levels somewhat in April and May to take advantage of better opportunities in the second half.

With earnings growth momentum having further to run, it is our expectation that the ASX200 will close above 6,000 by year end.

We look forward to catching up with you soon to discuss your portfolio and any change of circumstances or issues that we might be able to help you with.

Ian Wenham
Director

Richard Nicholas
Director

Andrew Martin
Director

Contact details

Level 11, 56 Pitt Street, Sydney NSW 2000

GPO BOX 2058 Sydney NSW 2001

Phone: (+61 2) 8274 5800 Fax: (+61 2) 8274 5899

Email: info@peakinvest.com.au www.peakinvest.com.au