Fund Manager Commentary

December Quarter 2017

BT Investment Management

→ Contents

Australian Shares

BT Wholesale Core Australian Share Fund

Market review

Performance for the domestic equity market was strong over the final quarter of 2017. The S&P/ASX 300 Accumulation Index advanced by 7.7% over the quarter, where most of the hard lifting was done by **Resources (+15.6%)** as commodity prices continue to rise, supporting the miners and the oil companies. **Industrials (+6.1%)** enjoyed a lower, albeit positive return.

In terms of sector performance, all the 11 GICS sectors finished the quarter with positive returns, with **Materials (+13.0%)** leading the group. The diversified miner duo, **BHP (BHP, +14.7%)** and **Rio Tinto (RIO, +13.9%)** both finished the quarter meaningfully higher, assisted by rising iron ore and copper prices on the back on the continuous local production curbs imposed by China. Also contributing to sector performance was steel manufacturer, **Bluescope (BSL)** which added a hefty 40.1% over the quarter. BSL sold off in August when management reported underwhelming FY17 results, alongside a weak guidance for the current half yearly earnings. This guidance was upgraded in December as a result of higher steel prices and domestic volumes. The company will also benefit from the latest US tax reform as a partial US dollar earner. Conversely, notable detractors within Materials over the quarter include lower-grade iron ore producer, **Fortescue (FMG, -5.1%),** and explosives manufacturer, **Orica (ORI, -7.0%)**. As the discount between high-grade and low-grade iron ore continued to widen due to increased demand for quality ores from Chinese buyers, FMG's share price weakened. For Orica, the disappointing FY17 result released in November saw the share price retreat over the period but recouped some of the losses in December. Outside of Materials, performance from **Energy (+18.3%)** was also strong over the quarter. The oil price rose over the quarter and touched a two-year high during December as strong global demand as well as production disruptions in Libya and the North Sea supported the commodity price. As such, major oil companies, including **Origin Energy (ORG, +25.9%)**, **Woodside Petroleum (WPL, +13.7%)** and **Santos (STO, +35.6%)** all recorded meaningful gains. For STO, the revelation of Harbour Energy's offer to acquire the company back in August also lifted investor sentiment. Other sectors that posted a double-digit gain over the quarter include **Consumer Staples (+10.6%)**, **Consumer Discretionary (+10.3%)** and **Information Technology (+16.7%)**.

On the other side of the spectrum, performance from index heavyweight, **Financials (+3.7%),** was less impressive. The confirmation of a Royal Commission into the banks weighed on the Big Four, with two of the four finishing the quarter in the red (ANZ, -0.3%; NAB, -3.1%); whilst gains from the other two were also somewhat muted (WBC, +1.1%; CBA, +6.8%). NAB incurred some selling after unveiling the additional spending of $1.5 billion for the restructure plan over the next three years. Also finishing below the index's return was **Real Estate (+6.5%).** Outperformance of **Westfield (WFD, +21%)** which was largely attributed to news of a cash and scrip acquisition offer from European commercial property giant Unibail-Rodamco, was somewhat offset by the 8.8% loss from **Lendlease (LLC)**. Management downgraded the outlook for its Australian construction business for FY18 due to issues with some engineering projects, which weighed on LLC's share price.

Finally on macro developments, the US Federal Reserve implemented its previously foreshadowed December interest rate hike. More broadly, investor sentiment was supported by the passing of much-anticipated US tax reform. Strong US data like ISM Manufacturing, retail sales and GDP growth also supported risk appetite. Economic releases in Europe were also solid and dovish messaging from the European Central Bank (ECB) was perceived positively.

Meanwhile, Xi Jinping consolidated his power at China's 19th Communist Party assembly and emphasised the objective of quality over quantity for future growth. Data released during the period revealed the Asian giant grew at a healthy 6.8% over the year. Reasonable leading indicators and import figures were also encouraging. Elsewhere, pockets of geopolitical risks like Catalonia's push for independence from Spain, Merkel's coalition losing its majority and North Korean missile tests had little impact on markets.

Portfolio performance

The BT Wholesale Core Australian Share Fund returned 7.64% (post-fee, pre-tax) over the December 2017 quarter, underperforming its benchmark by 0.10%.

Contributors

Overweight Metcash

Metcash (MTS, +13.5%) reported its first-half results early in the month, which saw EPS over the period increase by 14.8% compared to the prior corresponding period, as the benefits of its latest Home Timber & Hardware acquisition from Woolworths started to flow through. The Food & Grocery business also performed better than expected on the back of continuous cost reduction benefits from its Working Smarter program, in spite of the negative ex-tobacco sales growth over the prior period. Metcash remains one of our highest conviction stocks. From its half-yearly results, cash flow was evidently strong, whilst the release of inventory from the hardware acquisition demonstrates improved business efficiency. Debts were also brought down meaningfully, reflecting a business with much lower risks when compared to just a few years ago. The fact that the stock is still trading at 13-14x means that the market is yet to fully appreciate the quality of Metcash. With Aldi now approaching the end of its store rollout in WA and SA, and the weak WA economy stabilising, MTS's negative ex-tobacco sales growth is expected to improve from here. That said, we are cognisant that the supermarket industry remains highly competitive.

Overweight Santos

Oil and gas company, **Santos (STO, +35.6%)** held its strategy day in November to update guidance for FY17 and FY18. Their forecast free cash flow breakeven price now sits at US$32/bbl, with an ongoing target of $US 35-40/bbl. We believe the company has done well in reducing costs within its east coast operations and management is also seeing Santos become an onshore provider with structurally lower costs in comparison to peers. We also think the company's FY18 guidance is somewhat conservative, with good projects like the PNG LNG and the Darwin LNG backfill on hand. While the stock has run hard recently on the back of a rising global oil price, we still believe there is large enough upside potential from Santos for us to uphold our conviction, given the quality of its asset portfolio. The recent talk of a potential takeover by Harbour Energy – even if it does not eventuate – is a good reminder of the intrinsic value of those assets.

Underweight National Australia Bank

National Australia Bank (NAB, -3.1%) held its second-half trading update over the month, which saw FY17 cash earnings come in a touch below consensus, while the dividend was kept flat at 99 cents (a 79% payout ratio). Overshadowing the results was the unveiling of $1.5 billion in new spending on a restructure plan over the next three years. This will translate into a large restructuring provision for FY18 and will see the payout ratio increase towards 90% alongside a stable dividend. As such, investors sold off the stock following the trading update. The confirmation of a Royal Commission into the banking sector also kept a lid on the sector's performance. NAB is the largest underweight amongst the 'Big Four' in our portfolio, while ANZ remains our preferred exposure.

Detractors

Overweight Qantas Airways

National airliner **Qantas Airways (QAN)** started the quarter with gains in October, however the stock gave back its recent gains later in the quarter and finished the period 13.6% lower. Whilst there was nothing new surfacing in regard to Qantas' business, the rising oil price over the December quarter clearly weighed on investor sentiment. Additionally, the removal of Qantas from the MSCI Australia Index (as it nears its 49% limit of foreign ownership) as well as the end of the company's share buy-back program also exerted pressure on the share price. That said, QAN remains one of our highest conviction positions due to its strong business fundamentals and appealing stock valuation. We remain mindful that if oil prices remain elevated for a sustained period, it can begin to feed through to increased costs and remove some of the expected upside from here. However, we are not currently at that point and QAN's hedging immunises it against a significant surge in fuel costs in the near term.

Overweight ANZ Banking Group

The banking sector retreated in November on growing expectations that the Federal Government would be forced to capitulate to pressure for a Royal Commission into financial services. This eventuated in

December with an announcement made by the Turnbull Government. Many people are seeing this as the “least-worst” outcome for the banks, given that a Commission defined by the Coalition is likely to be more benign than one drawn up by a Labor leadership and that it should be manageable as a result. This does seem a reasonable view at this point, however we are mindful that the last Royal Commission into the sector to investigate the collapse of HIH insurance also began with a relatively tight mandate, which later broadened and ultimately published recommendations for the banks. It will be important to keep track of the Commission’s direction in case it does begin to delve into some unexpected areas. We are neural on the ‘Big Four’ in aggregate, with ANZ remaining our most preferred exposure and NAB the least.

Overweight Amcor

Performance of packaging company, **Amcor (AMC, +1.4%)** was somewhat anaemic over the December quarter. Rumours from the previous quarter around Amcor’s potential takeover of its global peer, Bemis, failed to spark any further media coverage after management responded vaguely without much clarity, stating that Amcor regularly assesses a range of strategic options. As previously communicated, AMC remains a key position of our portfolio, while we closely monitor any further developments on the M&A front.

Strategy & Outlook

The portfolio’s strong performance in December capped a strong 2017 in terms of both absolute and relative returns. Several of the more non-consensus positions such as Metcash, Santos and JB Hi-Fi drove December’s outperformance, while the exposure to resources – primarily via BHP – also made a strong contribution. Qantas and Nine Entertainment detracted, but both remain key drivers of the portfolio’s outperformance over the year.

Looking into 2018, there are several key issues which we believe should remain at the forefront of investor focus. The first is liquidity, which is no longer providing a tailwind to markets as central banks around the world tighten policy and start to shrink balance sheets. At this point the pace of tightening remains moderate and should allow the market to retain the prevailing valuation rating, however we remain mindful of the risk of over-tightening and keep a watchful eye on this space. We also maintain a close eye on bond yields, given the sensitivity which a large swathe of the Australian market has to changes here. At this point we expect small increases, but not a ‘bond bust’. We are underweight bond sensitives as a result, but not heavily so, and have taken advantage of individual opportunities in this sector.

China remains crucial to equity market fundamentals and sentiment and more specifically, for the health of Australia’s resource sector. The economic outlook remains stable at this point, with GDP growth expected to continue on its multi-year path of moderate deceleration. The Government remains focused on corporate profitability to help address the country’s debt problem and relieve stress on the financial system. The supply-side discipline this entails should continue to support commodity producers.

The most recent Australian reporting season saw a modest tick-up in business capital expenditure which, in combination with population growth and a bulging pipeline of infrastructure projects, should continue to support modest economic growth. This benign environment should continue to underpin corporate earnings.

Perhaps the most significant market factor is the scale and pace of disruption facing a broad swathe of local industries. Whether it is driven by new technology, global competition, or greater political or regulatory intervention, the challenges to incumbent business models and industry structures provides both threats and opportunities for investors. The ability to differentiate between companies within an industry, in terms of their ability to respond to disruption, has been a key driver of our outperformance over the last few years.

Australian Shares

BT Wholesale Smaller Companies Fund

Market review

The S&P/ASX Small Ordinaries Accumulation Index finished the December quarter with a gain of 13.7%, extending its outperformance over the S&P/ASX 100 Accumulation Index comfortably by another 6.6% from the previous quarter. Similar to its large cap counterpart, a majority of the performance came from the **Resources (+25.4%)** sector. Surging commodity prices, including oil, iron ore and copper over the period, created a tailwind for miners and energy companies. The electric vehicle thematics also benefited lithium miners significantly. Gains within **Industrials (+10.6%)** were strong, albeit significantly lower than the Resources sector.

Sector performance was upbeat across the board, with a number of sectors recording double-digit returns that beat the headline Index. These include **Materials (+22.4%), Consumer Staples (+20.4%), Information Technology (+21.8%)** and **Energy (+23.2%).** As mentioned above, the Materials sector was lifted by a number of lithium miners, including **Mineral Resources (MIN, +30.0%)**, **Pilbara Minerals (PLS, +75.6%)** and **Orocobre (ORE, +55.9%)**. The demand for lithium-ion batteries from the flourishing EV industry, mainly in the EU and China appears to be genuine, at least for the short-term and is underpinning support for these companies. Outside the lithium players, gold miner, **St Barbara (SBM, +45.2%),** also received strong buying support from investors. The company has been consistent in meeting if not exceeding its production guidance, and has been benefiting from the record high gold price since 2015. Its balance sheet has also improved dramatically over the past three years, as management turned the business from net debt to net cash. It wasn't all cheering within Materials though, with both **MACA (MLD, -21.3%)** and **Fletcher Building (FBU, -6.5%)** retreating over the quarter. The former, a mining services and civil construction company, flagged negative impacts on earnings from underperforming contracts in the MACA Interquip and Victorian Civil & Infrastructure divisions; whereas the latter, a New Zealand building material producer, downgraded the earnings guidance on its Building and Interiors (B+I) business for the fourth time in October.

Consumer Staples' strong performance came from the China-retail linked players, in particular **A2 Milk (A2M, +20.6%), Blackmores (BKL, +43.4%)** and **Bellamy's (BAL, +38.9%)** all of which maintained their momentum through the December quarter. The fact that there were no major changes coming out of the 19th National Congress in China means that foreign policy of the economic behemoth would probably remain stable, at least in the near team, and was clearly beneficial to these companies with a close tie to booming consumer demand from the country. Outside of these companies, rural services provider, **Elders (ELD, +72.6%),** also saw its share price soar over the quarter. The company reported satisfactory FY17 results in November and resumed dividend payments, including release of a special dividend. The news was well received by investors. Last but not least, the information technology sector was lifted partially by **Aconex (ACX, +92.2%)** over the quarter. The company received an acquisition offer from US IT giant, Oracle, which valued the company at $1.6 billion. The offer represented a circa 47% premium to the company's previous close, and was unanimously recommended by ACX's Board.

Finally on macro developments, the Federal Reserve completed its December hike, which had been well-broadcast leading up to the meeting. More broadly, investor sentiment was supported by the passing of much-anticipated US tax reform. Strong US data like ISM Manufacturing, retail sales and GDP growth also helped support risk appetite. Economic releases were also solid in Europe and dovish messaging from the European Central Bank (ECB) was perceived positively. Meanwhile, Xi Jinping consolidated his power at the 19th Communist Party assembly and emphasised quality over quantity for future growth. Data released during the period revealed the Asian giant grew at a healthy 6.8% over the year. Reasonable leading indicators and import figures were also encouraging. Elsewhere, pockets of geopolitical risks like Catalonia's push for independence from Spain, Merkel's coalition losing its majority and North Korean missile tests had little impact on markets.

Portfolio performance

The BT Wholesale Smaller Companies Fund returned 10.24% (post-fee, pre-tax) over the December 2017 quarter, underperforming the S&P/ASX Small Ordinaries Accumulation Index by 3.45%.

Contributors

Overweight Pilbara Minerals

Pilbara Minerals (PLS, +75.6%) owns and operates the Pilgangoora lithium project, which is due to begin mining within weeks and shipping spodumene lithium ore in in Q2 2018. Its recent surge accelerated in November on news that the company was in negotiations with South Korean companies about the development of a processing plant to help service their demand for electric vehicle batteries. If these talks come to fruition, it will diversify PLS's customer base away from its current offtake agreements with two Chinese buyers.

Underweight Retail Food Group

Retail Food Group (RFG, -42.3%) owns a range of international food and beverage chains including Donut King and Gloria Jean's Coffees. The stock plunged in December following a profit warning, as management guided to $22 million net profit after tax, versus the $33.5 million in delivered in the same period last year.

Detractors

Overweight G8 Education

G8 Education's (GEM, -16.7%) price fell in December after management warned that underlying earnings are likely to come in at $160 million, versus the mid-$170 million that it had guided to in August. While the new management team has implemented a number of initiatives which should deliver improved earnings in the medium term, the short term earnings have been impacted by lower than expected centre occupancy. While this doesn't necessarily detract from the favourable thematic, it does push out the timeframe of realising the benefits of the changes. We continue to monitor industry demand / supply dynamics and how GEM is positioned.

Underweight Aconex (ACX)

Aconex (ACX, +92.2%) makes specialised software for construction project management. The share price surged in December following a bid by global IT company, Oracle, which was at a 47% premium to its last close price. It is a stock that we have held in the past, however we sold down earlier in the year following a series of earnings downgrades and on concerns that management were having issues in digesting recent acquisitions. Nevertheless, the stock has been a good contributor to the Fund's performance over three years.

Strategy & Outlook

The Fund made good gains in the quarter, helped by strong gains from lithium miner, Pilbara Minerals, as well as by strong performance from Mantra Group on the back of a takeover bid from Accor. However, the Fund lagged the Index, partly due to weakness in Ozforex and G8 Education. Our avoidance of Aconex, with surged almost 50% on a takeover bid from Oracle, also dragged on relative performance. Overall, the Fund has posted strong absolute gains for 2017, albeit slightly lagging the Index.

Looking into 2018, we believe stock selection remains a crucial factor in small cap investing. The tide of liquidity which has supported the sector as a whole over previous years is no longer a supportive factor. Central banks around the world are generally tightening policy setting via higher rates, reduced quantitative easing, shrinking balance sheets, or some combination of these. While the pace is slow and, at this point, does not appear to present an imminent threat to the market's valuation rating, it does pose a risk to those mid-cap stocks which have been pushed to high valuation ratings. In the absence of liquidity support, even a slight disappointment in earnings can see a stock plummet, as we have seen several times in the past year as previous market darlings across a range of sectors have found themselves under pressure. As a result, it is just as important to avoid these traps as it is identifying the winners in the small cap space.

The small cap sector continues to see self-help by companies as a key driver of growth and value, with corporate actions such as acquisitions and divestments providing some of the largest share price reactions in recent times. That said, there are pockets of organic growth available in small caps which cannot be accessed at the larger end of the market cap spectrum, in areas such as tourism, specialised technology, renewable energy, and stocks with exposure to the uptick in mining capital expenditure.

At the same time, large segments of the universe are facing – or are perceived to be facing – significant industrial disruption in the form of new technologies, competition, or policy and regulation. This is particularly so in the retail space, where the arrival of Amazon’s expanded offering on Australian shores will see increased scrutiny over the ability of incumbent bricks-and-mortar franchises to deal with the challenge. This disruption is leading to significant mispricing of stocks in some instances, where investors are unable or unwilling to differentiate between the ability of two companies in the same sector to respond to the environment. This, in turn, is leading to some of the most attractive opportunities in the small cap sector for those who are able to distinguish between companies which will be able to successfully navigate the challenges – and those which will not.

International Shares

BT Concentrated Global Share Fund

Market review

Global equity markets closed the year with strong returns for the December quarter, with the MSCI World ex Australia Total Return (A$) Index returning 5.8%. Market sentiment continued to favour the major share markets, aided by strong earnings from the US, a moderating of geopolitical news on the North Korea front, and the prospect of a major overhaul of US tax policy which came to fruition in December. Key commodity prices moved along an upward trajectory, with crude oil (West Texas Intermediate) trading above the US$60/bbl mark, iron ore rising above US$75/mt and copper rallying to well above US$3/lb on supportive demand from China. The red metal has risen by over 30% for the year, while crude oil has risen to its highest level since June 2015. Bullish conditions in capital markets have pushed the MSCI World ex Australia (A$) Index to its sixth consecutive year of strong positive returns.

The US equity market enjoyed a strong quarter, buoyed by continuing strong economic momentum and policy developments. The Trump agenda for tax cuts reached completion following passage of the US

Tax Reform Bill through both houses of Congress to be signed into law. The policy will see the corporate tax rate fall to 21% from its current 35%, together with measures to improve interest on debt and spending deductions for companies. This spurred a rotation away from the technology sector towards financials. Although, major technology heavyweights – Microsoft, Intel and Alphabet – reported earnings that were above consensus estimates and acted to support sentiment across the market. The US Federal Reserve also followed through with its well-flagged intention to raise interest rates, with the policy setting board passing a unanimous decision to raise the Fed Funds Rate by 25 basis points. The S&P500 delivered a 6.6% total return while the Nasdaq was up 6.3%.

Returns from major European equity markets were mixed for the December quarter, with returns from the German DAX (+0.7%) and the French CAC (-0.3%) highlighting the muted sentiment across the region. Falling bond yields and benign inflation indications led to a risk-off environment, while positive signals on the Eurozone economy such as unemployment falling to 8.8% - the lowest level in nine years – together with generally strong private sector, manufacturing and consumer sentiment surveys, failed to placate markets. Companies within the base metals and consumer sectors were among the best performers, while utility stocks were generally weak.

The UK market delivered strong gains, aided by the broad representation of resource companies that enjoyed strengthening commodity prices. The FTSE Index rose by 4.7% for the quarter, while the Bank of England decided unanimously to maintain interest rates at 0.5%, but confirmed it expects ‘further modest increases’ as the economy moves towards the 2% inflation target. The country’s latest quarterly GDP growth came in at 0.6%, slightly ahead of expectations.

Asian markets benefitted from the positive developments offshore and strong conditions domestically to deliver gains for the quarter. Japan (+11.8%) and Hong Kong (+8.6%) led the region’s gains, with investors indicating support for Japan’s ruling coalition’s return to power. The consolidation of Xi Jinping’s power at China’s 19th Communist Party assembly similarly supported the Hong Kong and Chinese stock markets. Meanwhile, data released during the period revealed that China grew at a healthy 6.8% over the year, which added to support for the market.

The Australian dollar finished the quarter little changed against the US dollar and British pound, but was 1.9% weaker against the euro. The local currency was a direct beneficiary of stronger commodity prices and stabilising demand from China, thereby rising during December in spite of the hike in US interest rates.

Portfolio performance

The BT Concentrated Global Share Fund returned 6.29% (post fee, pre-tax) over the December 2017 quarter, outperforming its benchmark by 0.47%.

The team travelled to Hong Kong, Macau, Singapore, Japan and the US this quarter, meeting with companies across a broad cross section of industries. The general feedback from corporates remains similar to the prior quarter, in that the demand outlook remains robust. US tax reform had not been legislated at the time of our meetings although it was an issue that was raised in many meetings. Now that the tax reform Bill has been passed by the US Senate it appears a degree of uncertainty for corporates has been removed.

Our company meetings in Japan were a catalyst for the Fund to initiate a new position in Concordia Financial Group. Concordia is Japan's largest regional bank, with the largest market share (three times that of their closest competitor) in the Kanagawa Prefecture, which is home to corporates including Nissan, Isuzu, Fujitsu, Canon, Toshiba and Takeda, as well as having the number two market share in the Tokyo metropolitan region. In 2016, Concordia merged with the Bank of Yokohama and Higashi-Nippon Bank. Synergy targets have since been exceeded, with management focused on extracting further benefits from the merger over the medium term, with system integration expected to be complete by 2019. While the structural headwinds of an aging population in Japan are well recognised by the market, we do not believe that current valuations adequately reflect the benefits to come from management's current strategy to strengthen non-interest income, improve cost controls and expand business scope which in our view, will ultimately lead to an improvement in return on equity. The company's share price currently trades below its price to book and on a 2018 price-earnings ratio of 12x. We believe the 'self help' initiatives will be the catalyst over time to drive a re-rating of the share price and in the meantime, investors are receiving a 4% yield (dividend and buyback). Although not factored into our forecasts, if the Bank of Japan were to increase interest rate targets as many economists have forecast, Concordia would be a beneficiary.

For the second consecutive quarter, our semi-conductor holdings outperformed, with an average return of 12.5%. Management at some of the investor briefings over the quarter appeared keen to send a message to investors that the current double-digit growth rates for semi-conductor demand in sectors such as automotive and industrial are not sustainable over the longer term. However, they all acknowledged that given structural tailwinds such as the investment in autonomous vehicles, electric vehicles and factory automation, these sectors would likely enjoy at least a mid single-digit growth rate over the longer term. Our holding in Intel was up 21.7% this quarter, and we were reminded by the management of semi-conductor company, Broadcom (AVGO), who are in the midst of a hostile takeover offer for Qualcomm (QCOM US) that "scale matters". The deal, if consummated, would result in the creation of the third largest semi-conductor company, behind Intel and Samsung.

One of our concerns for the US semi-conductor companies' longer term has been the ambition of the Chinese to build a local semi-conductor industry. However, our meetings with Chinese semi-conductor companies in Asia this quarter somewhat eased our concerns. Despite the Chinese State subsidising losses for the industry, it is evident that the R&D lead held by large US semi-conductor companies, whilst not unassailable, is unlikely to be overtaken in the medium term. We remain comfortable that the >60% gross margins that Intel currently enjoy are sustainable. We also believe that the quest for "scale" amongst industry participants will continue.

Global healthcare company, Merck & Co (MRK US) declined by 12% this quarter. The company's underperformance is related to an announcement at the end of October that the company was withdrawing its European filing for key lung cancer drug, Keytruda, until such time that data from the KEYNOTE-189 trial becomes available. The trial was delayed to include "overall survival" data, which from a marketing and distribution perspective is important, however implies a delay of results from first half of 2018 to early 2019. Whilst Keytruda is FDA approved and available in Europe, it can only be used as a monotherapy on certain types of lung cancers. Combining Keytruda with chemotherapy treatments would allow for much wider use. In the third quarter, Merck reported strong year over year growth in the sale of Keytruda in the US and also upgraded full year 2017 guidance. The subsequent share price declines appear to reflect concerns about the longer term growth of the company. Whilst we cannot predict the outcome of the trials, it is worth noting that Keytruda is already supported by clinical data and over 400 ongoing clinical trials. While the share price reaction to the Keytruda news was disappointing, we think pursuing better quality clinical data makes strategic sense. Merck has a highly diversified portfolio, a good track record of returning capital to shareholders, and a management team who are focused on R&D spend that yields commercial results. We viewed the weakness in the share price this quarter as an opportunity to add to our position.

We sold our holding in 21st Century Fox (FOX) this month following Walt Disney Company's (DIS) US$52.4 billion takeover offer to acquire most of their assets, including Fox's film and TV studio, FX Networks, National Geographic, Fox Sports Region Networks, Star India and Fox's interests in Hulu, Sky, Tata Sky and Endemol Shine. Fox will spin out its remaining assets including the Fox Broadcast Networks and TV stations Fox News and FS1 to shareholders, with each FOX shareholder also receiving .2745 shares of DIS for the remaining assets.

Regular readers would know that our initial investment in US media companies was predicated on a view that valuations were compelling and that the headwinds facing the sector (cord-cutting) would be the catalyst for sector consolidation. We saw this play out with our holding in Time Warner which we sold following a bid by AT&T to acquire the company in October 2016. The proceeds of that sale were used to increase our weighting elsewhere in the sector in companies we believe have premium assets that are difficult to replicate. Since this time we have seen another of our holdings, Discovery Communications, agree to acquire rival Scripps Networks Interactive. The announcement by DIS and FOX further reinforces our view that share prices are not reflecting the pricing power and synergies that sector consolidation will bring to the acquirer. The Disney/Fox deal faces numerous regulatory hurdles and as we believe the bid fully values the business, our preference was to redeploy funds elsewhere in the sector, namely Discovery Communications.

Strategy & Outlook

As we reflect back over the year, our view on portfolio management has not changed despite a number of geopolitical events that most (including ourselves) did not predict. We remain of the view that the next five years will be very different from the previous five years. In the previous five years, investors had benefited from compelling valuations post the GFC, global quantitative easing, falling interest rates and a falling Australian dollar. Those tailwinds are becoming headwinds, and as such the environment is best suited in our view to owning a select portfolio of companies than having indiscriminate broader market exposure. In 2017 central banks globally were on the record with the prospect for the future unwinding of quantitative easing and the raising of interest rates. We expect more progress to be made in 2018. We remind ourselves of the importance of owing companies that have dominant positions in their respective industries, and also have the balance sheets to withstand various economic conditions. We remain confident that despite the macro risks, our portfolio of companies is well positioned to prosper and reward shareholders.

International Shares

BT Wholesale Core Global Share Fund, managed by AQR

Market review

Global equity markets closed the year with strong returns for the December quarter, with the MSCI World ex Australia Total Return (A$) Index returning 5.8%. Market sentiment continued to favour the major share markets, aided by strong earnings from the US, a moderating of geopolitical news on the North Korea front, and the prospect of a major overhaul of US tax policy which came to fruition in December. Key commodity prices moved along an upward trajectory, with crude oil (West Texas Intermediate) trading above the US$60/bbl mark, iron ore rising above US$75/mt and copper rallying to well above US$3/lb on supportive demand from China. The red metal has risen by over 30% for the year, while crude oil has risen to its highest level since June 2015. Bullish conditions in capital markets have pushed the MSCI World ex Australia (A$) Index to its sixth consecutive year of strong positive returns.

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The Australian dollar finished the quarter little changed against the US dollar and British pound, but was 1.9% weaker against the euro. The local currency was a direct beneficiary of stronger commodity prices and stabilising demand from China, thereby rising during December in spite of the hike in US interest rates.

Portfolio performance

The BT Wholesale Core Global Share Fund returned 5.73% (post-fee, pre-tax) over the December 2017 quarter, underperforming its benchmark by 0.08%.

The Fund outperformed its benchmark over the fourth quarter of 2017. Outperformance was driven by strong results in North America, offset by underperformance in developed Asia and to a lesser extent Europe, versus regional benchmarks.

Thematically, the outperformance in North America was assisted by positive results to the majority of signal themes, most notably business quality though relative valuation, investor sentiment and momentum themes also performed well over the quarter. The only source of weakness was momentum for industry selection within the US market. In developed Asia the underperformance was driven by positioning within Japan, where relative valuation measures, for both stock and industry selection, along with quality measures performed poorly over the quarter. In Europe, the underperformance was due to weakness in relative valuation measures for stock selection, offset most notably by strong results to investor sentiment signals.

From a stock/industry attribution perspective active industry tilts detracted but losses were outweighed by the outperformance of active stock positioning within industry groups over the quarter. At a sector level, the overweight to Health Care was the most notable detractor, with the underweight to Telecommunications the most notable positive contributor. Stock selection within industry groups was the source of outperformance over the quarter, most notably within the Materials and Industrials sectors.

At a stock level, the strongest positive contributors came from overweight positions in Covestro AG, a German chemical company specializing in polymers and plastics; WalMart Stores Inc., an American multinational retailer; and Freeport McMoRan, Inc., a US headquartered copper mining company. Largest detractors from active returns were overweight positions in Edison International, a US electricity utility; Group PSA, a French multinational auto manufacturer with brands including Peugeot, Citroen and Opel; and Vestas Wind Systems A/S, a Danish manufacturer & distributor of wind turbines.

Strategy & Outlook

Entering January, the largest sector tilts are overweights in Industrials and Materials and underweights in Consumer Staples and Energy. Relative to long-term allocations, we remain mildly tilted towards higher quality companies with positive momentum and away from cheaper industry peers in the US and Europe and Japan.

Australian Fixed Income

BT Wholesale Fixed Interest Fund

Market review

The Australian bond market performed reasonably well during the final quarter of 2017. A flattening of the curve was a prominent feature over the period, which was in sympathy with its global peers. Australian 10 year yields fell 19bp to 2.65%, while at the shorter end 90 day BBSW and 3 year yields rose 9bp and 2bp to 1.80% and 2.14% respectively. Rhetoric from the RBA during the period suggested little need to change policy in the nearer term. Statements from Governor Lowe highlighted several areas of strength in the local economy like business conditions and employment growth. At the same time, persistently subdued inflation, particularly wage inflation as well as soft consumption remained a feature in his communication. These points were echoed in data throughout the quarter. The NAB Business Conditions survey hit its highest level on record, before retreating slightly in December. Strong job growth helped bring the unemployment rate down 0.2% to 5.4% and was encouragingly skewed to full-time positions. Third quarter inflation data revealed a weaker-than-expected 0.4% increase in the trimmed mean measure. Wages were also softer-than-anticipated with a 0.5% rise over the quarter. GDP for the September quarter was more constructive with a 0.6% gain, which brought year-on-year growth to 2.8%.

Portfolio performance

The BT Wholesale Fixed Interest Fund returned 0.97% over the December 2017 quarter (post-fees, pre-tax), underperforming its benchmark by 0.47%.

During the quarter, the performance of the alpha overlay detracted. The Yield Curve, Macro, and FX strategies were the main detractors while the Relative Value, Duration and Cross-Sector strategies added to performance. The Government bond component underperformed its benchmark with Yield Curve and Cross-Market strategies detracting to performance. The Credit component outperformed its benchmark as well. Positive performance came from an overweight in infrastructure, utilities sector paper.

Strategy & Outlook

The key economic release in January will be the 4th quarter inflation data. Inflation data has continued to disappoint recently and has provided little near term impetus for the Reserve Bank to tighten monetary policy. There are positive signs for the Australian economy however. The labour market over the past year has seen 380,000 jobs created, the bulk of which are in full time employment. The unemployment rate would be lower than its current 5.4% but for the pick-up in the participation rate. That wage inflation remains subdued indicates that some slack does remain in the labour market and is also weighing on household consumption expenditure. Higher household debt levels are also weighing on consumption. Business conditions, despite the fall in the NAB business survey last month, are well above average levels and global economic conditions are supportive for the Australian economy. We expect no change from the Reserve Bank until at least mid-2018 - the inflation data will however be the key determinant for monetary policy expectations going forward.

International Fixed Income

BT Wholesale Global Fixed Interest Fund

Market review

Global yield curves witnessed a pronounced flattening during the final quarter of 2017. US 2 year yields rose a sizeable 40bp to 1.89%, while 10 year yields added a more modest 8bp to 2.41%. The front-end increase was shaped in part by the Federal Reserve's December hike, which had been well-broadcast leading up to the meeting. Investor sentiment more broadly was supported by the passing of much-anticipated US tax reform. Strong US data like ISM manufacturing, retail sales and GDP growth also helped support risk appetite. Economic releases were also solid in Europe and dovish messaging from the ECB was perceived positively. Meanwhile, in Asia Xi Jinping consolidated his power at the 19th Communist party assembly and emphasised quality over quantity for future growth. Data released during the period revealed the Asian giant grew at a healthy 6.8% over the year. Reasonable leading indicators and import figures were also encouraging. Elsewhere, pockets of geopolitical risks like Catalonia's push for independence, Merkel's coalition losing its majority and North Korean missile tests had little impact on markets.

Portfolio performance

The BT Wholesale Global Fixed Interest Fund returned 0.38% over the December 2017 quarter (post-fees, pre-tax), underperforming its benchmark by 0.47%.

Over the period, the Yield Curve, Duration, Cross-Market, FX and Macro strategies detracted from performance, while the Relative Value strategy added value. The Yield Curve strategy was the largest detractor as a flattening of the EUR, JPY, US and NZ curves hurt our steepening positions at various times throughout the quarter. The Duration strategy experienced a small loss. Gains early in the period on a long NZ front-end position were erased as yields rose in December on stronger economic data. Along the Australian curve, gains on outright positions in the front-end were offset later in the quarter by losses in the 3-year maturity. The Cross-Market strategy also had small losses, predominantly from a BTP versus Bunds position which was later closed and subsequently all cross-market trades were taken off. In the FX strategy there were a large number of trades. Losses in October were tied to a short EUR versus SEK position and long SGD versus a DM basket. In contrast, November was a positive month on the back of a short AUD versus EUR and JPY trade, as well as long SGD versus USD. These gains were more than offset by long USD versus TWD and CNH trades, which were hurt by a weaker USD. The Macro Strategy's losses were largely related to a buy CDX EM protection position as spreads tightened in December. Finally, the Relative Value strategy posted small consistent gains throughout the quarter on a US 2y invoice spread position.

Strategy & Outlook

The global economic recovery appears to be continuing with leading indicators in developed economies remaining in an uptrend. This is also reflected in the China Caixin PMI, where external demand is the main source of strength. We expect the global momentum to continue in the near future. On the back of these signs, central banks are more confident to end their unconventional monetary policy measures. However, the conundrum of a flatter Phillips Curve remains unsolved. Unemployment rates are near pre-GFC levels in many countries, while inflation persists at low levels. The extent of consumer optimism during the year end sales will be revealed soon in upcoming retail sales data. Uncertainties in the year ahead include US tax reform, China reform agenda and geopolitical conflicts in Asia and the Middle East.

Credit

BT Wholesale Enhanced Credit Fund

Market review

Credit spreads continued to contract during the December quarter as risk appetite remained healthy and investors looked past several pockets of geopolitical concerns. Among the more significant developments supporting sentiment was progress on US tax reform, which passed both chambers of Congress by year end. On the US monetary policy front, expectations that normalisation would be very gradual also aided risk assets and credit demand. Similarly, the ECB's emphasis on a need to remain accommodative given persistently soft inflation was taken as a positive.

From a supply standpoint two themes were particularly evident over the year; a growth in issuance versus prior years and a rise in the capital raised by infrastructure and utilities names, particularly in the 7 and 10 year maturities. In the December quarter, this included NSW utility providers, Ausgrid and Endeavour Energy. In general the additional issuance was well-absorbed, reflected by a prevalent trend lower in physical spreads during 2017. This continued (albeit to a smaller extent) in December.

The Australian iTraxx index (Series 28 contract) traded in a 14bp range finishing the quarter 14bps tighter to +58bps. Physical credit spreads were on average 5bps tighter. The best performing sectors were resources, utilities, infrastructure and industrials rallying 12, 8, 7 and 7bps respectively, while supranationals underperformed, widening 1bp. Semi-government bonds performed well narrowing 3bps to government bonds over the quarter.

Portfolio performance

The BT Wholesale Enhanced Credit Fund returned 1.31% over the December 2017 quarter (post-fees, pre-tax), outperforming the benchmark by 0.02%.

Positive performance came from an overweight in infrastructure, utilities sector paper. The positive performance was partly offset by Supranationals and offshore European financials performing strongly whilst the fund held short to index positions.

Activity over the quarter included acquiring utility, infrastructure and bank bonds

Strategy & Outlook

Our macro credit view remains neutral. While there remains the potential for event risk and associated volatility in the near term, it has diminished since early 2017. We acknowledge the recent progress on US tax reform, but note question marks remain over its potential impact and further fiscal policy changes remain absent. This in turn could impair a continued improvement for the US outlook. While on the monetary policy front, the Federal Reserve delivered three rate hikes in 2017 and their projections suggest another three over 2018 in addition to continued balance sheet normalisation.

While European growth has picked up, there remain pockets of regional event risk like the Catalonia secession struggle and the surprise dissolution of Merkel's coalition, which could cause further EU problems. We also note the ECB's tapering announcement in Q4 2017 was taken positively by markets, however there is doubt over whether sufficient supply will exist to meet required purchases of 30bn euros a month.

There is also growing uncertainty over the impact of Chinese economic reforms in 2018. While these are likely to stimulate certain areas of the economy, like tech, they may have a more negative effect on construction and infrastructure. At the same time, an emphasis on the quality of growth should be more sustainable and beneficial over the longer term.

Accordingly while the near term market tone is positive, we remain cautious with many unknowns in 2018. Domestically we see soft growth persisting and an improvement largely dependent on commodity price stability and housing. As such we continue to recommend a defensive approach with any overweights in operationally resilient sectors such as utilities and infrastructure that provide a higher yield to index returns.

BT Wholesale Managed Cash and BT Wholesale Enhanced Cash Funds

Market review

The Australian bond market performed reasonably well during the final quarter of 2017. A flattening of the curve was a prominent feature over the period, which was in sympathy with its global peers. Market expectations for an eventual RBA hike were brought forward towards the end of the year to December 2018 from early 2019. Rhetoric from the Board suggested little need to change policy in the nearer term. Statements from Governor Lowe highlighted several areas of improvement in the local economy. This included strength in business conditions and employment growth. At the same time, persistently subdued inflation, particularly wage inflation as well as soft consumption remained a feature in his communication.

These points were echoed in data throughout the quarter. The NAB Business Conditions survey hit its highest level on record, before retreating slightly in December. Strong job growth helped bring the unemployment rate down 0.2% to 5.4% and was encouragingly skewed to full-time positions. Third quarter inflation data revealed a weaker-than-expected 0.4% increase in the trimmed mean measure. Wages were also softer-than-anticipated with a 0.5% rise over the quarter. GDP for the September quarter was more constructive with a 0.6% gain, which brought year-on-year growth to 2.8%.

Looking abroad, the Federal Reserve delivered a 25bp hike in December, which had been well-telegraphed ahead of the meeting. Similarly, the announcement that Powell would take the reins as next Fed Chair had been anticipated in advance and was met with little market reaction. A more positive effect on investor sentiment stemmed from progress on the much-anticipated US tax reform, which was passed by both chambers of Congress by year end. Strong US data also helped support risk appetite with the ISM Manufacturing gauge hitting a 13 year high in October, strong retail sales growth, solid 3.2% GDP growth and a fall in the unemployment rate to 4.1%.

Solid data was also prevalent in Europe as leading indicators including manufacturing PMIs, retail sales and consumer confidence continued to firm. Lagging measures of the economy, like GDP growth also strengthened. Inflation however remained soft and was cited by the ECB as reason to retain accommodative policy rates for an extended period of time. While it also revealed its plans for asset purchase reductions, President Draghi maintained an overall dovish message and emphasised a need for flexibility. This overshadowed pockets of geopolitical risk including Catalonia’s push for independence and Merkel’s ruling coalition disaggregating. Outside of the region, North Korean missile tests prompted little reaction from markets.

In Asia, Xi Jinping consolidated power at the 19th Communist party assembly and espoused a greater need to focus on the quality rather than quantity of growth. Data over the period reflected a healthy 6.8% year-on-year rate of growth, which was in line with expectations. Leading indicators over the period were also relatively robust and strong import data was particularly encouraging. Meanwhile, in neighbouring Japan, Abe’s re-election as Prime Minister signalled policy continuation. One of the large upside surprises for the economy was a strong 2.5% GDP growth rate.

Finally turning to market movements, Australian 10 year yields fell 19bp to 2.65%, while at the shorter end 90 day BBSW and 3 year yields rose 9bp and 2bp to 1.80% and 2.14% respectively. The flattening of the US curve was more pronounced with 2 year yields rising a sizeable 40bp to 1.89%, while 10 year yields added a more modest 8bp to 2.41%. This in turn saw the AU-US 10 year yield differential narrow to the lowest level since the early 2000s. Despite this fall, the AUD/USD finished only 0.40% lower, with some support offered by a substantial 14.8% rally in the price of iron ore.

Portfolio performance

Managed Cash

The BT Wholesale Managed Cash Fund returned 0.44% over the December 2017 quarter (post-fee, pre-tax), outperforming its benchmark by 0.02%.

With a higher running yield than the index remains well positioned to outperform. Themes and credit exposure remain consistent with prior quarters, with excess spread from A-1 rated issuers likely to be the main driver of outperformance. The Fund ended the quarter with a weighted average maturity of 61 days (maximum limit of 70 days). Yields further out the curve continue to offer better relative value and the weighted average maturity has consistently been longer than benchmark due to this. With longer dated yields offering better value and with Reserve Bank monetary policy tightening a distant prospect we will remain longer than benchmark. The Fund is well positioned to continue to outperform its benchmark.

Enhanced Cash

The BT Wholesale Enhanced Cash Fund returned 0.74% over the December 2017 quarter (post-fee, pre-tax), outperforming its benchmark by 0.33%.

The portfolio had a strong quarter of performance, considerably outperforming the benchmark. Positive performance came from financials, industrials, infrastructure, RMBS and utility sectors. Activity during the quarter included investing in domestic bank, industrial and utilities sectors whilst reducing exposure to the resources sector. As at the end of the quarter, the portfolio had a credit spread of 69bps over bank bills, interest rate duration of 0.13 years and credit spread duration of 2.18 years.

Strategy & Outlook

The key economic release in January will be the 4th quarter inflation data. Inflation data has continued to disappoint recently and has provided little near term impetus for the Reserve Bank to tighten monetary policy. There are positive signs for the Australian economy however. The labour market over the past year has seen 380,000 jobs created, the bulk of which are in full time employment. The unemployment rate would be lower than its current 5.4% but for the pickup in the participation rate. That wage inflation remains subdued indicates that some slack does remain in the labour market and is also weighing on household consumption expenditure. Higher household debt levels are also weighing on consumption. Business conditions, despite the fall in the NAB business survey last month, are well above average levels and global economic conditions are supportive for the Australian economy. We expect no change from the Reserve Bank until at least mid-2018 - the inflation data will however be the key determinant for monetary policy expectations going forward.

Australian Property

BT Wholesale Property Securities Fund

Market review

The AREIT sector generated a total return of 7.9% for the December 2017 quarter, outperforming the broader market which was up 7.6%. In 2017 AREITs provided a total return of 5.7%, underperforming the broader market by 6.1%. Global REITs were up 11.4% in 2017, with Singaporean REITs the strongest performers up 43% (in USD terms) and Japan the worst performers, down 1.6%.

The best performing AREIT over the quarter was Westfield Group (+21%) as Unibail entered into an agreement to buy the Group with a combination of cash and scrip. The combined vehicle will own 104 assets, have a gross market value of €61.1B and market cap of €31B – to trade on the Dutch, French and Australian stock markets. Other strong performers were Charter Hall Group (+15%) driven by strong increases in asset values and funds under management and Propertylink Group (+11.4%) with two potential M&A acquirers building stakes. Underperformers over the quarter all raised equity capital during the period, Iron Mountain Inc (-0.6%), Centuria Metropolitan REIT (+0.9%) and Charter Hall Long WALE REIT (+0.4%).

Global equity markets continue to perform well with the S&P500 up by +3.6% for the quarter and up 19.4% for the year. The Federal Reserve lifted rates over the quarter and three times over the year, with the Fed Fund rate now at 1.25-1.5%, which saw the US Bond rate tick up 13bp to close at 2.63%. The US unemployment rate was steady at 4.1%, a 17 year low and inflation continues to be benign +1.7% for the year. The Reserve Bank left the cash rate unchanged at 1.5% over the quarter, and year. The unemployment rate was steady at 5.4%, a four and a half year low. The 10 year bond yield was down 20bp over the quarter closed at 2.63% and the Australian dollar was flat against the US dollar, to close at 78c.

It was a busy quarter for shopping centre transactions with a 50% stake in Indooroopilly Shopping Centre sold on a 4.25% cap rate to AMP. The sale price was very strong and provided solid market evidence of where the direct property market is pricing quality regional shopping centre assets. Also during the quarter Vicinity Centres and GIC entered into an arrangement to exchange assets, with VCX selling a 49% stake in Chatswood Chase (on a 4.75% cap rate) in return for a 50% interest in the QVB, The Galleries and The Strand Arcade (all in Sydney CBD) on a blended cap rate of 5.1%.

The quarter also saw significant global mall REIT M&A with the above mentioned Unibail offer for Westfield and also the UK's Hammerson's offer for Intu properties, both significant mall owners. The UK merger, recommended by both Boards, will catapult the combined group to become the UK's largest listed company. The mall REIT M&A has been precipitated by depressed share prices and lacklustre trading conditions. It could be described as a meeting of minds/skill sets or a joining of armies against the challenges of e-commerce.

Portfolio performance

The BT Wholesale Property Securities Fund returned 7.94% over the December 2017 quarter (post-fee, pre-tax), outperforming its benchmark by 0.15%.

The portfolio outperformed the benchmark over the December quarter. Overweight positions in Westfield Group, Lifestyle Communities and Charter Hall Group and underweights in Goodman Group and Vicinity Centres assisted performance. Overweights in Arena REIT, Iron Mountain Inc, Charter Hall Long WALE, Mirvac Group and Vital Healthcare Property Trust detracted from performance.

Strategy & outlook

The sector is now priced on an FY18 dividend yield of 4.8%, a PE ratio of 17.4 times and a 23% premium to NTA, above its long-term average of 15%. Cap rates will likely compress further in the next reporting period (on the back of recent transaction evidence), but asset valuation uplift thereafter will depend on income growth and tenancy retention. Balance sheets are stable with sector gearing at 28%.

International Property

BT Wholesale Global Property Securities Fund, managed by AEW

Market Review (In USD)

The global property securities market (on an ex-Australia basis), as measured by the FTSE EPRA/NAREIT Developed Index, returned 3.6% for the quarter. Europe (up 7.7%) was the strongest performing region, followed by Asia Pacific (up 5.1%), and North America (up 1.8%). Results in Europe were positive across the region: Austria (up 14.3%) was the strongest performer, followed by France (up 11.6%) and Germany (up 11.0%). In Asia Pacific, results were similarly positive across the region: Singapore (up 9.5%) posted the largest gain, followed by Hong Kong (up 6.7%), New Zealand (up 5.3%), and Japan (up 2.6%). Within North America, the US and Canada returned 1.6% and 5.9%, respectively.

Portfolio performance

The BT Wholesale Global Property Securities Fund returned 3.29% over the December 2017 quarter (post-fee, pre-tax) underperforming its benchmark by 0.13%.

North America

For the quarter ended December 31, 2017, the North America portfolio returned 1.49% before fees and taxes, lagging the FTSE EPRA/NAREIT North America Index by 33 basis points. Underperformance relative to the benchmark was driven by negative stock selection results, which were partially offset by positive sector allocation results. In terms of stock selection, results were weakest in the diversified, hotel and triple net lease sectors and were strongest in the regional mall, office and industrial sectors. Regarding sector allocation, positive results were largely attributable to the portfolio's overweight to the outperforming regional mall sector and an underweight to the underperforming health care sector. Among the portfolio's holdings, top individual contributors to relative performance included overweight positions in outperforming Taubman Centers (TCO), CubeSmart (CUBE) and Simon Property Group (SPG). Detractors most notably included overweight positions in underperforming Gramercy Property Trust (GPT) and Welltower (HCN) and a lack of exposure to outperforming GGP, Inc. (GGP).

Europe

For the quarter ended December 31, 2017, the European portfolio returned 8.79% before fees and taxes, exceeding the FTSE EPRA/NAREIT Developed Europe Index by 109 basis points. Outperformance relative to the benchmark was attributable to both positive stock selection and positive country allocation results. In terms of stock selection, results were strongest in the United Kingdom, France, and Netherlands and were weakest in Sweden, Germany, and Austria. Regarding country allocation, positive results were largely driven by the portfolio's underweight to the underperforming Switzerland as well as a lack of exposure to the underperforming Belgium. Conversely, the portfolio's small cash position was a detractor to relative performance in light of the regional benchmark's positive absolute performance for the quarter. Among the portfolio's holdings, top positive contributors to relative performance included overweight positions in outperforming Vonovia SE (Germany), Gecina SA (France) and Unite Group PLC (United Kingdom). Detractors most notably included overweight positions in underperforming Wihlborgs Fastigheter AB (Sweden) and Merlin Properties Socimi SA (Spain) and an underweight position in outperforming Buwog AG (Austria).

Asia

For the quarter ended December 31, 2017, the Asia portfolio returned 5.07% before fees and taxes, roughly equaling the return of the regional EPRA benchmark. Performance relative to the benchmark was attributable to positive stock selection in Japan and Singapore, where were partially offset by negative results in Hong Kong. Country allocation results were largely neutral, while the portfolio's small cash position was a detractor to relative performance in light of the regional benchmark's positive absolute performance for the quarter. Among the portfolio's holdings, top contributors to relative performance included an overweight position in outperforming Hulic Co. Ltd. (Japan), lack of exposure to underperforming Swire Properties (Hong Kong) and an underweight position in underperforming CapitaLand Ltd. (Singapore). Detractors most notably included overweight positions in underperforming HongKong Land Holdings (Hong Kong) and Nomura Real Estate Master Fund (Japan) and a lack of exposure to outperforming CapitaLand Commercial Trust (Singapore).

Strategy & Outlook

North America

At the end of the fourth quarter, REITs were most attractive relative to corporate bonds on a yield spread basis. REIT dividends have steadily increased and REIT dividend yields climbed 12 basis points to 4.15% during the fourth quarter, only 2 basis points below the Moody's BAA corporate bond yield. This is much tighter than the usual spread of 122 basis points and the most attractive REITs have looked relative to bonds since the GFC. REITs were attractive relative to private real estate given that the sector was trading at an average 2% discount to net asset value. REITs are most expensive versus other equities on a long-term multiple basis. Overall, AEW's US Relative Value Index was 0.45 standard deviations below fair value at the end of the quarter, the most attractive combined REIT valuation we've seen since the GFC.

Europe

At quarter-end, the outlook for the Continental European REITs was favorable. The positive economic environment should lead to more demand for office space and, as new developments are limited, some markets have already posted attractive rental growth. Rents for the better quality shopping centers showed a slight positive development as retail sales were strong due to rising employment and increasing consumer confidence. Although interest rates are expected to move up, the gap between property and bond yields were sufficiently large at year-end to make property an attractive investment. At quarter-end, the Continental European REITs traded around net asset value with a cash flow yield of 5.3% and a dividend yield of 3.8%. The outlook for the REITs in the United Kingdom has improved as the Brexit negotiations showed willingness from both sides for a smooth transitionary period. However, uncertainty regarding UK rights to sell financial products from London to Continental Europe will continue to weigh on the London office market. At quarter-end, part of the potential pain had been priced in as the UK REITs were trading at a discount of around 9% to net asset value with a cash flow yield of 4.5% and a dividend yield of 3.6%. Overall, at year-end, European REITs traded at a 2% discount to net asset values, offered a cash flow yield of 5.1% and a dividend yield of 3.7%.

Asia

As we enter 2018, we believe Asia Pacific property stocks remain attractively valued with an average dividend yield of 4.5% and annual earnings growth between 3-6%. The large number of property transactions in the fourth quarter highlighted the gap between transactional cap rates and the listed companies' appraisal cap rates. These transactions should support further net asset value growth. At the fundamental level, new supply is manageable, and most sectors should see rental growth although the retail sector faces headwinds. The portfolio continues to seek the best relative value in the sub-property markets where we expect to see improving property fundamentals, with potential earnings, dividend, and net asset value upside.

Active Balanced

BT Wholesale Active Balanced Fund

Market review

Performance for the domestic equity market was strong over the final quarter of 2017. The S&P/ASX 300 Accumulation Index advanced by 7.7% over the quarter, where most of the hard lifting was done by **Resources (+15.6%)** as commodity prices continue to rise, supporting the miners and the oil companies. **Industrials (+6.1%)** enjoyed a lower, albeit positive return.

In terms of sector performance, all the 11 GICS sectors finished the quarter with positive returns, with **Materials (+13.0%)** leading the group, assisted by rising iron ore and copper prices on the back on the continuous local production curbs imposed by China. Conversely, notable detractors within Materials over the quarter include lower-grade iron ore producer, **Fortescue (FMG, -5.1%),** and explosives manufacturer, **Orica (ORI, -7.0%)**. As the discount between high-grade and low-grade iron ore continued to widen due to increased demand for quality ores from Chinese buyers, FMG's share price weakened. For Orica, the disappointing FY17 result released in November saw the share price retreat over the period but recouped some of the losses in December. Outside of Materials, performance from **Energy (+18.3%)** was also strong over the quarter. The oil price rose over the quarter and touched a two-year high during December as strong global demand as well as production disruptions in Libya and the North Sea supported the commodity price. As such, major oil companies, including **Origin Energy (ORG, +25.9%)**, **Woodside Petroleum (WPL, +13.7%)** and **Santos (STO, +35.6%)** all recorded meaningful gains. Other sectors that posted a double-digit gain over the quarter include **Consumer Staples (+10.6%)**, **Consumer Discretionary (+10.3%)** and **Information Technology (+16.7%)**.

On the other side of the spectrum, performance from index heavyweight, **Financials (+3.7%),** was less impressive. The confirmation of a Royal Commission into the banks weighed on the Big Four, with two of the four finishing the quarter in the red (ANZ, -0.3%; NAB, -3.1%); whilst gains from the other two were also somewhat muted (WBC, +1.1%; CBA, +6.8%). Also finishing below the index's return was **Real Estate (+6.5%).**

Global equity markets closed the year with strong returns for the December quarter, with the MSCI World ex Australia Total Return (A$) Index returning 5.8%. Market sentiment continued to favour the major share markets, aided by strong earnings from the US, a moderating of geopolitical news on the North Korea front, and the prospect of a major overhaul of US tax policy which came to fruition in December. Key commodity prices moved along an upward trajectory, with crude oil (West Texas Intermediate) trading above the US$60/bbl mark, iron ore rising above US$75/mt and copper rallying to well above US$3/lb on supportive demand from China. The red metal has risen by over 30% for the year, while crude oil has risen to its highest level since June 2015. Bullish conditions in capital markets have pushed the MSCI World ex Australia (A$) Index to its sixth consecutive year of strong positive returns.

The US equity market enjoyed a strong quarter, buoyed by continuing strong economic momentum and policy developments. The Trump agenda for tax cuts reached completion following passage of the US Tax Reform Bill through both houses of Congress to be signed into law. The policy will see the corporate tax rate fall to 21% from its current 35%, together with measures to improve interest on debt and spending deductions for companies. This spurred a rotation away from the technology sector towards financials. Although, major technology heavyweights – Microsoft, Intel and Alphabet – reported earnings that were above consensus estimates and acted to support sentiment across the market. The US Federal Reserve also followed through with its well-flagged intention to raise interest rates, with the policy setting board passing a unanimous decision to raise the Fed Funds Rate by 25 basis points. The S&P500 delivered a 6.6% total return while the Nasdaq was up 6.3%.

Returns from major European equity markets were mixed for the December quarter, with returns from the German DAX (+0.7%) and the French CAC (-0.3%) highlighting the muted sentiment across the region. Falling bond yields and benign inflation indications led to a risk-off environment, while positive signals on the Eurozone economy such as unemployment falling to 8.8%   the lowest level in nine years – together with generally strong private sector, manufacturing and consumer sentiment surveys, failed to placate markets. Companies within the base metals and consumer sectors were among the best performers, while utility stocks were generally weak.

The UK market delivered strong gains, aided by the broad representation of resource companies that enjoyed strengthening commodity prices. The FTSE Index rose by 4.7% for the quarter, while the Bank of England decided unanimously to maintain interest rates at 0.5%, but confirmed it expects 'further modest increases' as the economy moves towards the 2% inflation target. The country's latest quarterly GDP growth came in at 0.6%, slightly ahead of expectations.

Asian markets benefitted from the positive developments offshore and strong conditions domestically to deliver gains for the quarter. Japan (+11.8%) and Hong Kong (+8.6%) led the region's gains, with investors indicating support for Japan's ruling coalition's return to power. The consolidation of Xi Jinping's power at China's 19th Communist Party assembly similarly supported the Hong Kong and Chinese stock markets. Meanwhile, data released during the period revealed that China grew at a healthy 6.8% over the year, which added to support for the market.

The Australian dollar finished the quarter little changed against the US dollar and British pound, but was 1.9% weaker against the euro. The local currency was a direct beneficiary of stronger commodity prices and stabilising demand from China, thereby rising during December in spite of the hike in US interest rates.

Within the fixed interest sector, Global yield curves witnessed a pronounced flattening during the final quarter of 2017. US 2 year yields rose a sizeable 40bp to 1.89%, while 10 year yields added a more modest 8bp to 2.41%. The front-end increase was shaped in part by the Federal Reserve's December hike, which had been well-broadcast leading up to the meeting. Investor sentiment more broadly was supported by the passing of much-anticipated US tax reform. Strong US data like ISM manufacturing, retail sales and GDP growth also helped support risk appetite. Economic releases were also solid in Europe and dovish messaging from the ECB was perceived positively.

The Australian bond market performed reasonably well during the final quarter of 2017. A flattening of the curve was a prominent feature over the period, which was in sympathy with its global peers. Australian 10 year yields fell 19bp to 2.65%, while at the shorter end 90 day BBSW and 3 year yields rose 9bp and 2bp to 1.80% and 2.14% respectively. Rhetoric from the RBA during the period suggested little need to change policy in the nearer term. Statements from Governor Lowe highlighted several areas of strength in the local economy like business conditions and employment growth. At the same time, persistently subdued inflation, particularly wage inflation as well as soft consumption remained a feature in his communication. These points were echoed in data throughout the quarter.

Portfolio performance

The BT Wholesale Active Balanced Fund returned 5.38% (post-fee, pre-tax) for the December quarter, outperforming its benchmark by 0.48%.

The Fund's performance for December quarter was materially driven by the strong performance of growth assets, while exposure to fixed interest assets made smaller but positive contributions. Exposure to alternatives also contributed to returns.

Tactical asset allocation contributions were driven by the Fund's overweight exposure to domestic and international equities and an underweight to Australian fixed income. However, the short position in global bonds detracted from performance.

The key factors influencing our active management returns were our material exposure to Australian and global equity strategies. Within the Australian equity strategy, stock selection outcomes were the primary driver of active returns, particularly through overweight positions in Metcash and Santos. Contributions were also sourced from holding no exposure to National Australia Bank, although the manager's preferred banking exposure in ANZ Banking Group detracted from relative performance.

All of our developed market global equity managers delivered outperformance over the quarter, which more than offset a minor detraction from active returns by our emerging markets manager. Stock selection and industry exposure outcomes for both our core and concentrated managers added value.

Our Alternatives strategy delivered a positive return for the quarter, with a significant contribution from the core component. The Alternatives strategy delivered a total return (before fees) of 2.18% vs a cash return of 0.42%. Within the underlying strategies, contributions were sourced from the managed futures, market neutral, asset allocation, risk parity and equity income strategies, while our global macro and Australian fixed interest components detracted from returns. Within the equity-based strategies, gains were sourced from both the directionally long equity exposure and the stock selection component, which benefitted from strong returns to momentum and quality themes. Within the Global Macro strategy, detractions resulted from the Developed Bond strategy, where both Value and Carry themes detracted, along with Emerging Currencies, where losses were attributable to Momentum & Carry themes.

Our tactical positioning within alternatives made a further contribution to returns. A long position in copper together with long equity market exposure and tactical positioning in gold and crude oil produced a material contribution to returns, as did the Fund's short volatility position These positions more than offset a small detraction from long positions in Australian and German bonds.

Strategy & Outlook

Looking into 2018, there are several key issues which we believe should remain at the forefront of investor focus. The first is liquidity, which is no longer providing a tailwind to markets as central banks around the world tighten policy and start to shrink balance sheets. At this point the pace of tightening remains moderate and should allow the market to retain the prevailing valuation rating, however we remain mindful of the risk of over-tightening and keep a watchful eye on this space. We also maintain a close eye on bond yields, given the sensitivity which a large swathe of the Australian market has to changes here.

China remains crucial to equity market fundamentals and sentiment. The economic outlook remains stable at this point, with GDP growth expected to continue on its multi-year path of moderate deceleration. The Government remains focused on corporate profitability to help address the country's debt problem and relieve stress on the financial system.

Performance as at 31 December 2017

(%)	1 Month	3 Months	6 Months	FYTD	1 year (pa)	2 Years (pa)	3 Years (pa)	5 Years (pa)	Since Incp. (pa)
Australian Shares - All Cap									
BT Wholesale Core Australian Share Fund								APIR - RFA0818AU	
Total Return (post-fee, pre-tax)	2.34	7.64	9.56	9.56	15.04	10.29	8.89	1127	10.09
Total Return (pre-fee, pre-tax)	2.40	7.87	10.01	10.01	15.96	1116	9.75	12.15	1110
Benchmark	186	7.74	8.60	8.60	1194	1186	8.76	10.15	10.05
BT Wholesale Imputation Fund								APIR - RFA0103AU	
Total Return (post-fee, pre-tax)	173	6.22	7.47	7.47	1152	9.00	6.91	9.16	9.61
Total Return (pre-fee, pre-tax)	181	6.46	7.96	7.96	12.53	9.98	7.87	10.15	10.63
Benchmark	186	7.74	8.60	8.60	1194	1186	8.76	10.15	8.82
BT Wholesale Focus Australian Share Fund								APIR - RFA0059AU	
Total Return (post-fee, pre-tax)	2.30	7.78	9.39	9.39	16.36	12.09	10.69	13.21	9.45
Total Return (pre-fee, pre-tax)	2.41	7.99	9.93	9.93	18.03	13.02	1189	14.29	10.56
Benchmark	186	7.74	8.60	8.60	1194	1186	8.76	10.15	7.64
BT Wholesale Ethical Share Fund								APIR - RFA0025AU	
Total Return (post-fee, pre-tax)	2.40	7.73	9.61	9.61	14.88	10.38	9.10	1134	8.73
Total Return (pre-fee, pre-tax)	2.49	7.99	10.13	10.13	15.98	1142	10.14	12.40	9.79
Benchmark	186	7.74	8.60	8.60	1194	1186	8.76	10.15	8.19
Australian Shares - Mid Cap									
BT Wholesale MidCap Fund								APIR - BTA0313AU	
Total Return (post-fee, pre-tax)	3.27	12.20	16.07	16.07	24.79	18.27	16.82	16.59	1110
Total Return (pre-fee, pre-tax)	3.48	12.36	16.78	16.78	26.12	19.20	18.11	18.29	13.35
Benchmark	2.79	12.60	13.74	13.74	22.33	19.37	16.22	14.25	6.20
Australian Shares - Small Cap									
BT Wholesale Smaller Companies Fund								APIR - RFA0819AU	
Total Return (post-fee, pre-tax)	2.41	10.24	16.11	16.11	17.01	10.00	14.90	12.31	13.39
Total Return (pre-fee, pre-tax)	2.51	10.59	16.85	16.85	18.46	1137	16.33	13.72	14.68
Benchmark	3.20	13.69	18.70	18.70	20.02	16.55	14.38	7.39	7.96
Australian Shares - Micro Cap									
BT Wholesale MicroCap Opportunities Fund								APIR - RFA0061AU	
Total Return (post-fee, pre-tax)	5.91	10.87	18.75	18.75	23.85	18.80	23.05	20.94	19.32
Total Return (pre-fee, pre-tax)	6.01	10.59	19.50	19.50	26.26	20.76	26.67	25.97	24.71
Benchmark	3.20	13.69	18.70	18.70	20.02	16.55	14.38	7.39	3.36
International Shares									
BT Wholesale Core Global Share Fund								APIR - RFA0821AU	
Total Return (post-fee, pre-tax)	-151	5.73	9.12	9.12	14.06	9.42	10.48	18.30	5.86
Total Return (pre-fee, pre-tax)	-144	5.99	9.65	9.65	15.14	10.45	1153	19.44	7.02
Benchmark	-171	5.81	8.49	8.49	13.38	10.61	1101	18.42	7.30
BT Global Emerging Markets Opportunities Fund - Wholesale								APIR - BTA0419AU	
Total Return (post-fee, pre-tax)	-0.26	7.17	12.39	12.39	29.39	16.27	10.93	12.55	12.52
Total Return (pre-fee, pre-tax)	-0.15	7.53	13.14	13.14	3115	17.88	12.46	14.29	14.77
Benchmark	0.54	7.78	13.68	13.68	27.09	19.16	10.76	10.43	1187
BT Concentrated Global Share Fund								APIR - BTA0503AU	
Total Return (post-fee, pre-tax)	-0.52	6.29	9.39	9.39	15.70	N/A	N/A	N/A	17.26
Total Return (pre-fee, pre-tax)	-0.41	6.62	10.08	10.08	17.15	N/A	N/A	N/A	18.73
Benchmark	-171	5.81	8.49	8.49	13.38	N/A	N/A	N/A	15.12
Property									
BT Wholesale Property Securities Fund								APIR - BTA0061AU	
Total Return (post-fee, pre-tax)	0.42	7.94	9.50	9.50	6.70	9.81	10.93	12.82	7.65
Total Return (pre-fee, pre-tax)	0.48	8.11	9.86	9.86	7.40	10.53	1165	13.55	8.46
Benchmark	0.12	7.79	9.88	9.88	6.44	9.76	1128	13.38	7.51
BT Wholesale Global Property Securities Fund								APIR - RFA0051AU	
Total Return (post-fee, pre-tax)	125	3.29	4.81	4.81	8.52	6.60	5.66	9.72	9.47
Total Return (pre-fee, pre-tax)	133	3.54	5.30	5.30	9.53	7.58	6.64	10.74	10.47
Benchmark	109	3.42	4.47	4.47	8.47	7.02	5.96	10.08	9.19
Fixed Interest									
BT Wholesale Fixed Interest Fund								APIR - RFA0813AU	
Total Return (post-fee, pre-tax)	-0.78	0.97	0.93	0.93	3.08	2.24	2.02	3.62	6.44
Total Return (pre-fee, pre-tax)	-0.74	110	119	119	3.59	2.76	2.53	4.13	6.99
Benchmark	-0.52	144	137	137	3.66	3.29	3.05	4.15	6.67
BT Wholesale Global Fixed Interest Fund								APIR - RFA0032AU	
Total Return (post-fee, pre-tax)	-0.10	0.38	0.93	0.93	190	3.02	2.51	4.04	6.12
Total Return (pre-fee, pre-tax)	-0.06	0.52	119	119	2.44	3.57	3.06	4.59	6.70
Benchmark	0.13	0.85	150	150	2.86	3.89	3.80	4.88	7.05
BT Wholesale Enhanced Credit Fund								APIR - RFA0100AU	
Total Return (post-fee, pre-tax)	-0.30	131	190	190	4.50	3.91	3.51	4.52	5.79
Total Return (pre-fee, pre-tax)	-0.26	142	2.13	2.13	4.97	4.38	3.97	5.00	6.32
Benchmark	-0.23	129	184	184	4.45	3.92	3.57	4.49	5.90
Cash & Income									
BT Wholesale Enhanced Cash Fund								APIR - WFS0377AU	
Total Return (post-fee, pre-tax)	0.26	0.74	158	158	3.21	2.94	2.72	3.05	4.98
Total Return (pre-fee, pre-tax)	0.29	0.80	171	171	3.47	3.20	2.98	3.31	5.32
Benchmark	0.14	0.42	0.86	0.86	175	191	2.05	2.34	4.92
BT Wholesale Managed Cash Fund								APIR - WFS0245AU	
Total Return (post-fee, pre-tax)	0.15	0.44	0.89	0.89	179	195	2.06	2.33	6.50
Total Return (pre-fee, pre-tax)	0.17	0.50	100	100	2.01	2.17	2.28	2.55	6.80
Benchmark	0.14	0.42	0.86	0.86	175	191	2.05	2.34	6.57
BT Wholesale Monthly Income Plus Fund								APIR - BTA0318AU	
Total Return (post-fee, pre-tax)	0.37	2.87	3.80	3.80	6.50	4.81	4.18	5.11	5.68
Total Return (pre-fee, pre-tax)	0.43	3.04	4.14	4.14	7.20	5.49	4.86	5.80	6.34
Benchmark	0.13	0.38	0.76	0.76	151	163	180	2.14	2.98
Diversified									
BT Wholesale Active Balanced Fund								APIR - RFA0815AU	
Total Return (post-fee, pre-tax)	0.79	5.38	7.62	7.62	12.05	8.02	7.30	9.98	7.77
Total Return (pre-fee, pre-tax)	0.88	5.64	8.15	8.15	13.11	9.04	8.31	1102	8.84
Benchmark	0.39	4.90	6.25	6.25	9.35	8.92	7.58	9.35	7.55

All returns calculated by BT Investment Management (Fund Services) Limited, ABN 13 161 249 332, AFSL 431426 (BTIM). No part of this Fund Manager Commentary (Commentary) is to be circulated without this page attached.

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