FUND MANAGEMENT DIARY
Meeting held on 13th March 2018

Australia in an era of low commodity prices

- The Australian economy has done well over the last decade, powered by mining and housing booms

- However, softness in the housing market and no prospect of a surge in commodities prices mean that growth is unlikely to top 2.5 per cent in 2018 or 2019

- Unsurprisingly the mining sector will be the main loser over the next decade, while services exports, construction and parts of finance are likely to do well

Mining and housing booms have been a significant driver of growth

The mining and housing booms allowed Australia to sail through the last decade while most other advanced economies have struggled. Gross domestic product grew by 2.5 per cent annually on average over 2008 to 2017. The equivalent figure was 1.4 per cent in the United States, 1.2 per cent in Germany and 1.0 per cent in the United Kingdom.

The mining boom was triggered by demand for resources by emerging economies, with China being the most significant. This led to a sharp rise in business investment in Australia, which contributed up to four percentage points of gross domestic product growth each year in 2011 and 2012. However, the mining boom ended in 2012 as the Chinese economy slowed and commodities prices fell. Business investment then went to being a drag on growth in Australia.

When the mining boom turned to bust a housing boom took over. House prices grew by 42 per cent between the start of 2013 and March 2017. This growth in household wealth boosted consumption and the prospect of rising house prices increased investment into dwellings.

But both booms are now over, with little chance of restarting

The chances of another mining boom appear to be slim. China's economic growth is expected to soften over the next few years. This will have a material impact on commodities prices. After all, the country accounts for around half of the demand for industrial metals and is the world's largest oil importer.

What's more, the Australian housing boom effectively ended when authorities capped the share of interest-only mortgages that banks could issue in March 2017.

Since then, house price inflation has slowed from over ten per cent to two per cent. With interest rates low, the unemployment rate falling and banks having kept lending standards relatively high, the chances of a United States-style 30 per cent collapse in house prices are slim. But it is plausible that they will weaken further.

Lingering concerns over the health of the financial system will prevent the authorities from easing their lending restrictions. At the same time, rises in global funding costs may prompt lenders to raise mortgage rates independently of the Reserve Bank of Australia. And over the next few years, a rising share of borrowers who currently only have to pay interest will also have to start repaying principal. Until official interest rates start to rise, it is likely that house prices will be more or less flat. This may contribute to consumption growth slowing this year and dwellings investment being a persistent drag on gross domestic product growth.

In the absence of any boom, the long-run prospects for many sectors are strong

Three big trends will influence the shape of growth over the next decade, and determine whether or not any sector can have the same impact that mining has. First, Australia stands to lose as China's commodity-heavy investment phase ends, but it stands to benefit as China's households become richer. Second, growth of Australia's own population provides a domestic opportunity. Third, policymakers will probably place more emphasis on maintaining financial stability.

The first trend means that the mining sector will become less important and, at some point, Australia's resources exports will start to decline relative to gross domestic product. The rise in real incomes in China and other parts of Asia, however, mean that Australia will increasingly sell services overseas rather than commodities. Indeed, Australia's exports for services like education and tourism have already been growing as a share of gross domestic product for some years.

Other parts of the economy should be able to compensate for a smaller mining sector. First, the demands of a growing population will support the construction sector as more homes, schools and roads will need to be built. Australia already punches above its weight in infrastructure spending. And, in 2016, it spent more as a share of gross domestic product on energy, telecommunications, water and transport projects than any major economy apart from China.

Second, the financial sector will become a bigger part of the economy over the next decade, partly as these infrastructure projects will need to be financed. But there won't be a sustained housing boom over the same period. Household debt as a share of gross disposable income has risen further and faster than in other advanced

economies, such as the United States. Australian policymakers are more likely therefore to use tighter regulation to reduce the chances of a home-grown financial crisis. This will probably constrain overall mortgage lending, although the lending activities of the less regulated shadow banking sector will probably flourish.

The Australian economy should do well without a mining or housing boom

Overall, Australia will probably cope reasonably well without a mining or housing boom. But gross domestic product growth of around 2.5 per cent and below-target inflation will probably prevent the Reserve Bank of Australia from raising interest rates until late 2019. That may mean Australian bonds continue to outperform United States bonds this year.

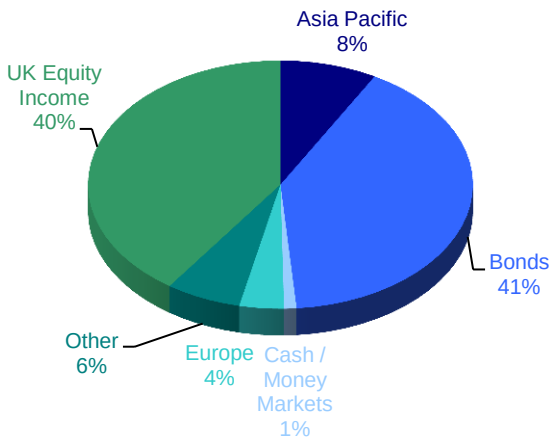
Beyond that, life after mining may be quite rosy with the greatest opportunities in services exports, construction and parts of finance. So while low commodity prices may weaken the Australian dollar this year, over the next decade it may become less of a commodity currency. That would result in it becoming less risky and less volatile.

Strategy

Within the Future Money portfolios, our exposure to Australia is through the underlying Asian funds. Funds with a focus on income tend to have a higher allocation to Australia, relative to growth orientated strategies, as a result of the higher yielding stocks found in Australia. Within the Asian allocation we invest in a blend of income and non-income focussed funds, with the view to diversify our exposure across a number of different countries.

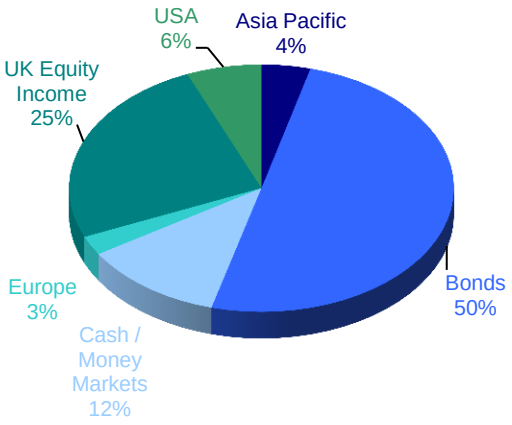
Income

The Fidelity Short Dated Corporate Bond fund has been selected to replace the M&G UK Inflation Linked Corporate Bond fund in Future Money Income. Further to comments in last week's diary, this decision has been taken largely due to the higher yield that is available on the Fidelity fund. No further changes are currently being considered.



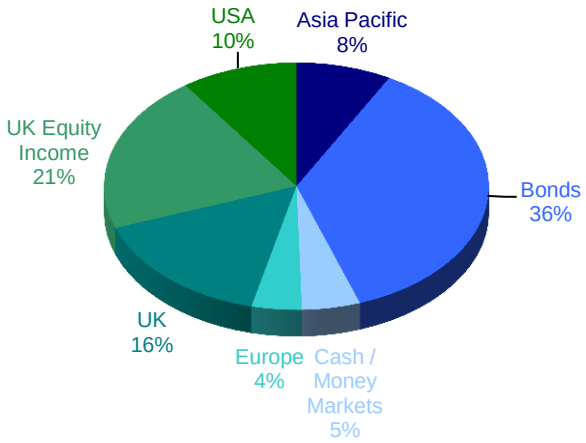
Real Value

No changes will be made to Real Value this week. The Threadneedle UK Equity Income has delivered a relatively strong performance over the past month. This is encouraging after a weaker performance earlier this year.



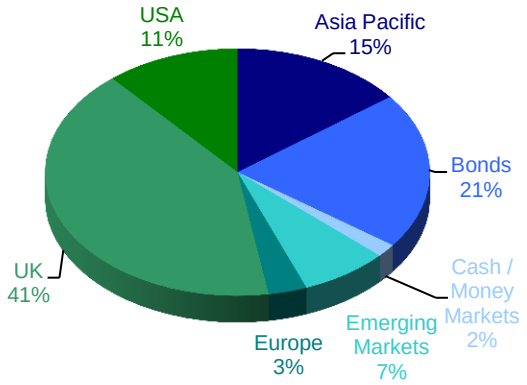
Real Growth

The Schroder Asian Income fund is performing well, delivering the portfolio's best returns of the past three months. The fund has approximately 16% invested in Australia and this is an important factor in generating the fund's yield, which currently stands at nearly 4%. The income received from this fund is paid back into the portfolio and therefore contributes to the total return of Real Growth, along with the capital gains earned through share price increases.



Dynamic Growth

The range of funds held across Dynamic Growth are performing well and no changes are being considered. The bias towards short duration strategies is working well in the bond allocation.



Important Information

Please note that the contents are based on the author's opinion and are not intended as investment advice. This information is aimed at professional advisers and should not be relied upon by any other persons.

Any research is for information only, does not constitute financial advice or necessarily reflect the views of the author and is subject to change.

It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

For any information about the Future Money funds please contact the authorised corporate director, Margetts Fund Management Ltd, on 0121 236 2380, admin@margetts.com or at 1 Sovereign Court, Graham Street, Birmingham B1 3JR. A copy of their Terms of Business which relates to investments into the funds can also be obtained using these contact details.

Issued by Future Money Ltd

Future Money Limited is authorised and regulated by the Financial Conduct Authority

Future Money Ltd

Henry Wood House · 2 Riding House Street · London · W1W 7FA

0203 4570 387

www.futuremoney.co.uk