Bank of Melbourne | Private

Investor Sentiment Indicator

Insights into the investment intentions of wealthy Australians

Quarter 1 2016

CORE DATA

Welcome to the Quarter 1 2016 Bank of Melbourne Private Investor Sentiment Indicator

We are delighted to share with you the latest key insights from our Bank of Melbourne Private High Net Worth Investor (HNWI) Sentiment Indicator survey for Quarter (Q) 1 2016.

The HNWI Sentiment Index dropped to its lowest level in nearly three years this quarter, amid high levels of volatility and sharp price corrections experienced in global financial markets during the first six weeks of this calendar year. More specifically, the Q1 2016 HNWI Sentiment Index fell to 5.1, compared with a reading of 16.2 in Q4 2015. Similarly, the Mass Affluent Sentiment Index retreated this quarter, to -9.0 from 4.2 in the previous survey.

However, although HNWIs were markedly more downbeat this quarter, we are cognisant that members of this group are seasoned investors who tend to take a 'wait and see' approach during times of sharp market corrections. In periods of heightened volatility, HNWIs are likely to pause some of their investment decision-making until more normalised levels of volatility return. HNWIs are also acutely aware of the peaks and troughs in investment markets and have invested through multiple cycles.

In line with this thinking, the survey found that this quarter wealthy Australians largely sat on the sidelines with regards to their investment decision-making.

Underpinning this bearish outlook, close to half of respondents said they expected investment markets, the Australian economic outlook and local business conditions to be worse in the next quarter. Sentiment towards all asset classes weakened this quarter, highlighted by the decline in the HNWI Equities Sentiment Index (to -6.2 compared with 0.3 in Q4) and the HNWI Property Sentiment Index (-10.7 this quarter compared with -8.8 in Q4).

Consistent with previous quarters, cash was the most common recent investment among HNWIs, followed by Australian equities. Cash and Australian equities were also identified as the most likely next investments by HNWIs. Close to a quarter of HNWIs maintained their cash holdings as they were "waiting for a better investment option".

Against this backdrop, your Private Banker and our team of specialists can assist you to navigate the current market volatility and achieve your investment objectives. We have seen an increasing number of our HNW clients actively taking advantage of our comprehensive range of investment solutions to find alternative yield-based investment opportunities.

As always, we remain committed to providing you with market insights, expertise and opportunities that protect and grow your wealth, both now and for future generations

Research background

Bank of Melbourne Private and CoreData have partnered to undertake research to understand the sentiments, investment behaviours and service preferences of HNWIs in Australia. The research looks beyond historical data and uses a tool to map HNWI intentions.

This report does not attempt to summarise all of the data which has been collected. It examines the predictive abilities that the data provides – in particular, the way in which HNWI sentiment is able to predict investment markets in a post-global financial crisis environment.

CoreData has been researching Australia's HNWIs since 2002. The survey deployed by CoreData pays particular attention to asset class, investment type and product data to build a robust picture of the sentiments of Australia's HNWIs and how they are likely to behave quarter on quarter.

The CoreData research panel has an estimated 17,000 Australians that satisfy the requirements of HNWIs – namely, investment portfolio size of $1,000,000 or more outside both their superannuation and principal place of residence. Those with an annual household income of $250,000 or more are also classified as HNWIs. Mass Affluent respondents, by contrast, have between $50,000 and $750,000 in investable assets.

The research provides a rolling sample (2004-2016) which enables one to compare future intentions with past results. Interestingly, the research reveals that those who followed the predictions of wealthy Australians would have been better off than those who kept invested in the S&P/ASX 200 Index.

The research was conducted between 1 February and 15 February 2016.

Investor sentiment

HNWI sentiment drops to lowest level in three years

The HNWI Sentiment Index fell to 5.1 in Q1 (January-March) 2016 from 16.2 in the previous quarter. This is the lowest level since Q2 2013.

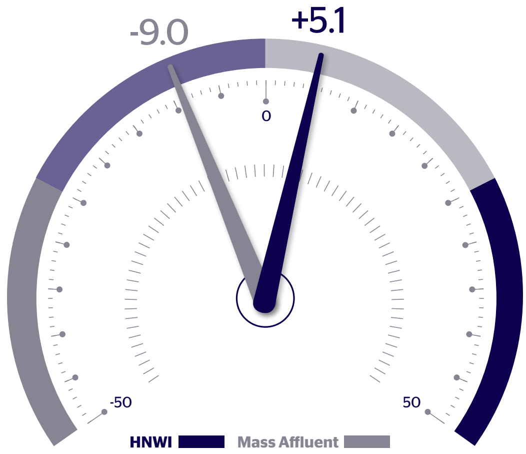
The decline in sentiment was largely driven by respondents' expectations of a worsening investment market in the next quarter as well as weaker investment intentions, lower satisfaction with existing investments, a decrease in the purchase of new investment products and less investment of new money in existing investments.

The Mass Affluent Investor Sentiment Index also receded this quarter, to -9.0 compared with 4.2 in Q4 2015.

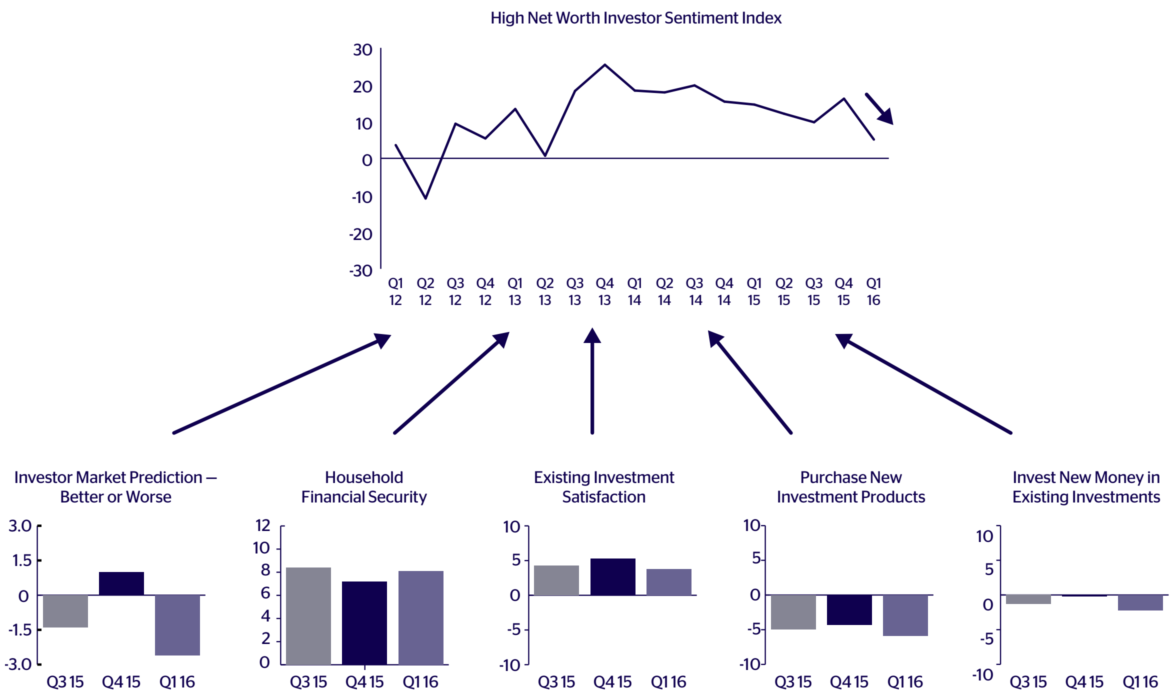
As aforementioned, the research for this survey was conducted between 1 and 15 February 2016. During this period, as well as the month of January, global financial markets experienced significant declines across all major asset classes. Thus we believe investors' two key concerns amid this heightened volatility were: how much further the market correction would play out and for how long, both of which affected their investment decision-making.

HNWI Sentiment Index: Q4 2015 versus Q1 2016

HNWI versus Mass Affluent Investor Sentiment Index: Q1 2016



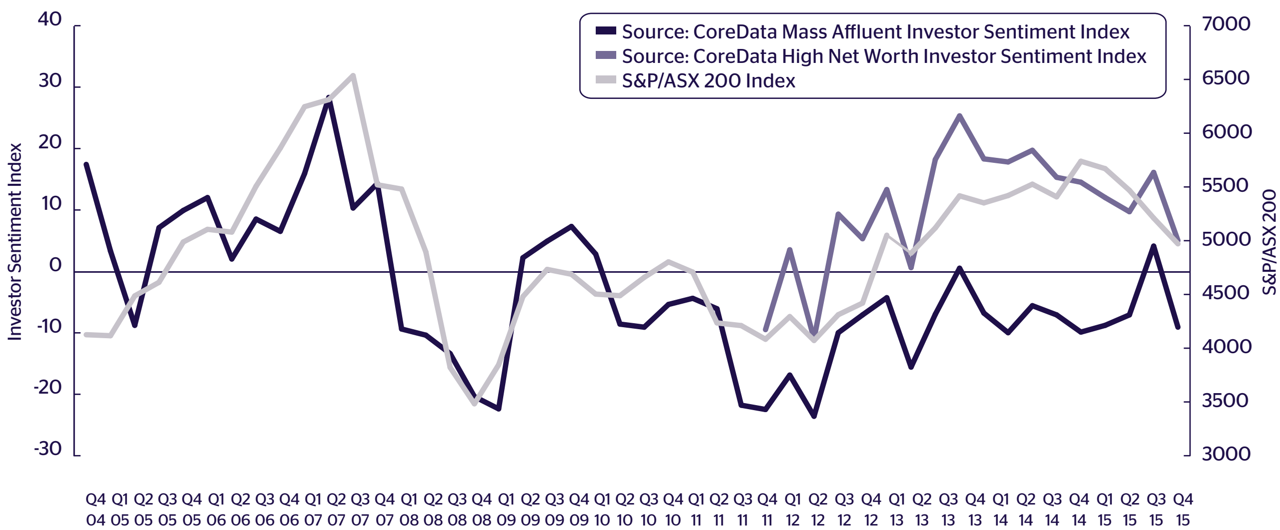
The HNWI Sentiment Index comprises five key drivers, illustrated below, namely: investor market prediction, household financial security, existing investment satisfaction, new investment product purchase intention and plans to invest new money into existing investments.



HNWI sentiment trend line

HNWI sentiment dropped significantly in Q1 2016, reversing the previous quarter's positive trajectory.

The Bank of Melbourne Private HNWI Sentiment Index continues to be an insightful predictor of the direction of Australia's investment market, in line with the S&P/ASX 200 Index. The graph below overlays the HNWI index with the S&P/ASX 200 Index performance from Q4 2011.

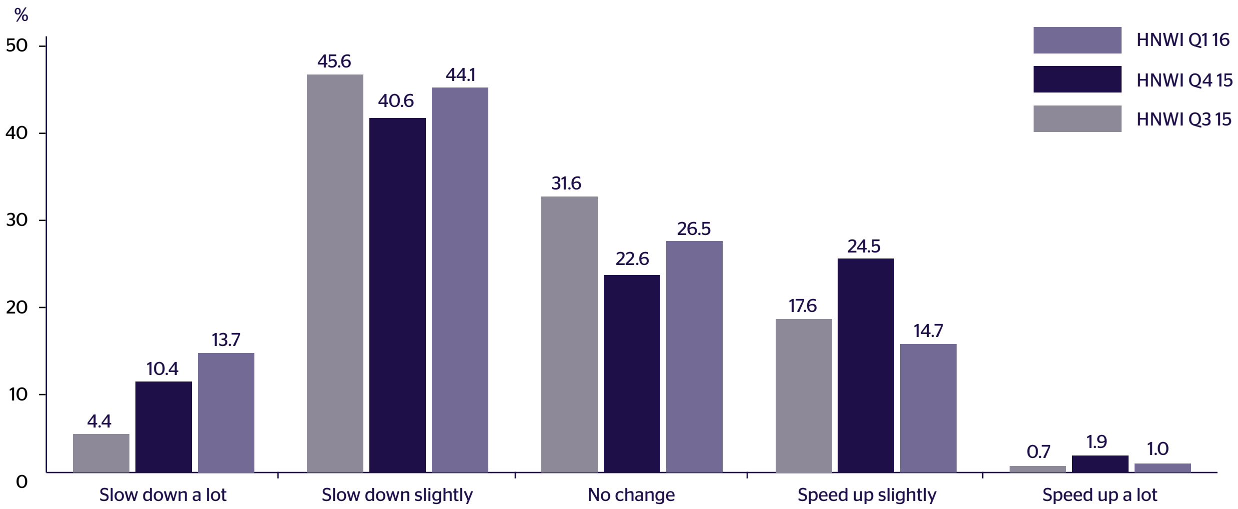


Economic and business outlook

Growth outlook uncertain

- Overall, HNWIs' growth expectations for the Australian economy waned this quarter.
- A growing proportion (57.8%) of wealthy Australians think the domestic economy will grow at a slower rate in the next three months, compared with 51.0% of respondents in the previous quarter.
- In line with this sentiment, less HNWIs think the Australian economy will grow at a faster rate in the next quarter, with just 15.7% of respondents believing so in Q1 2016, down from 26.4% in the previous survey.
- However, contrary to such pessimistic views, the Australian Bureau of Statistics' (ABS) most recent report card on the health of the domestic economy surprised on the upside.
- Australian GDP growth for Q4 2015 was a seasonally adjusted 0.6% quarter-on-quarter, exceeding market expectations of a 0.4% rise and bringing the annual growth rate to a seasonally adjusted 3.0%.
- This is the strongest yearly increase since a one-off in March 2014 and, prior to that, since 2012. Furthermore, annual GDP growth of 3.0% is a little above trend, which is judged to be 2.75%. This is a shift from recent experience, when GDP growth has been typically a little below trend..

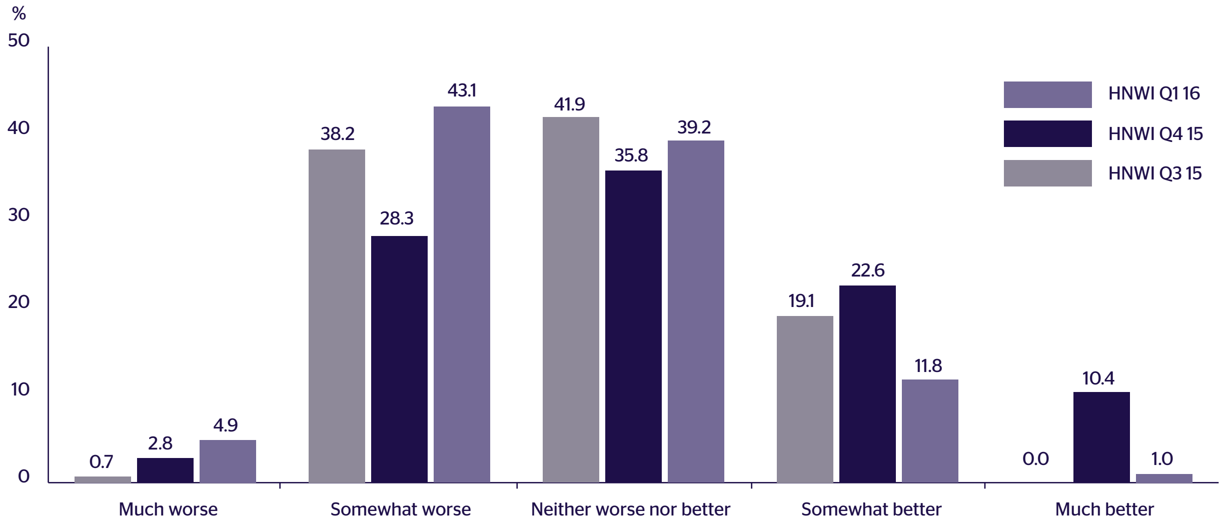
Comparing the next quarter with this past quarter, do you think the Australian economy will grow at a slower or faster rate?



Business outlook wanes

- A greater proportion (48.0%) of HNWIs now expect business conditions to be worse in the next quarter, up from 31.1% in Q4 2015.
- There has also been a fall in the proportion of wealthy Australians who expect the business outlook to improve in the next quarter – 12.8% in Q1 2016, compared with 33.0% in the previous survey.
- The federal government's recent proposals for tax changes may have spooked respondents, negatively affecting their business outlook.
- Nevertheless, recent commentary released by the Reserve Bank of Australia (Monetary Policy Decision Statement, 1 March 2016) paints a more optimistic picture for Australian business. The RBA stated, "In Australia, the available information suggests that the expansion in the non-mining parts of the economy strengthened during 2015 despite the contraction in spending in mining investment. This was reflected in improved labour market conditions. The pace of lending to businesses also picked up."

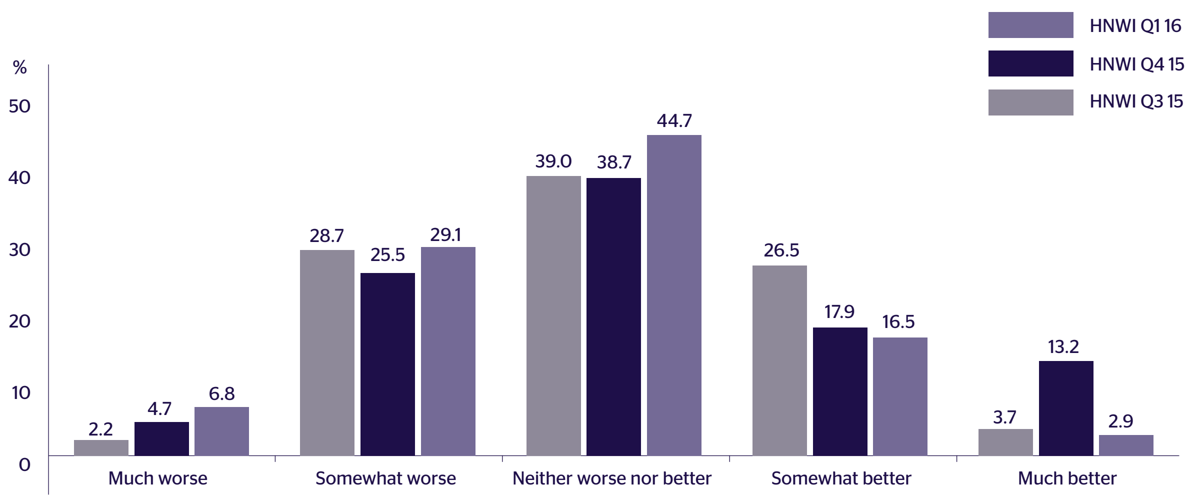
Comparing the next quarter with this past quarter, do you think business conditions in Australia will be better or worse?



Household situations not improving

- This quarter, the vast majority of HNWIs said they had not experienced an improvement in their household financial situation compared with 12 months ago.
- More than two in five (44.7%) claimed their household financial position was neither worse nor better in Q1 2016, up from 38.7% in the previous survey.
- Meanwhile, there was an increase in the number of HNWIs who felt their household financial situation was worse this quarter (35.9% of respondents) compared with the previous quarter (30.2%).
- Similarly, there was a drop in the number of wealthy Australians who maintained that their household financial situation had improved over the quarter, with only 19.4% experiencing an uplift in Q1 2016 versus 31.1% in Q4 2015.
- Wealthy Australian households saw a significant correction in their equity exposures throughout January and the first half of February (when global financial markets experienced a major correction), which in turn drove down their overall household financial situation, impacting overall sentiment.

How does the present financial situation of your household compare with what it was 12 months ago?



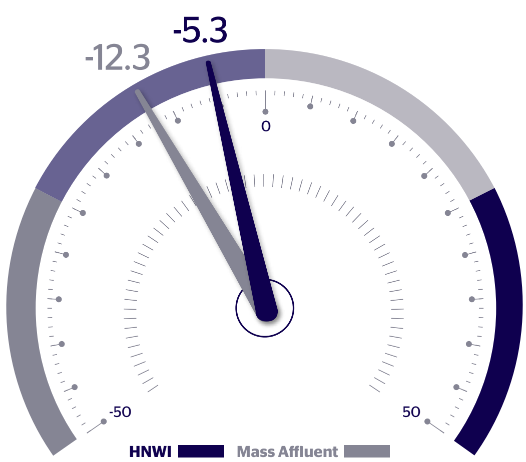
Investor intention

The Investor Intention Index is a subset of the Investor Sentiment Index and measures investors' future investment intentions. A series of questions are asked to determine each measure.

- The HNWI Intention Index fell into negative territory this quarter, declining to -5.3 from 3.8 in the previous survey.
- Similarly, the Mass Affluent Investor Intention Index also declined in Q1 2016, to -12.3 from -2.4 in Q4 2015.
- As previously mentioned, global financial markets fell into negative territory during January and the first half of February this year, when this survey was conducted, hence HNW respondents' intention to invest was adversely affected during this period.
- Our HNW clients are astute in times of sharp asset price corrections and tend to adopt a 'wait and see' approach before actively deploying further capital when they feel price gains are more probable. HNWIs also tend to try look through the short-term noise of financial markets in times of lower re-pricing and use such corrections as opportunities for their investments.

HNWI Intention Index: Q4 2015 versus Q1 2016

HNWI versus Mass Affluent Investor Intention Index: Q1 2016



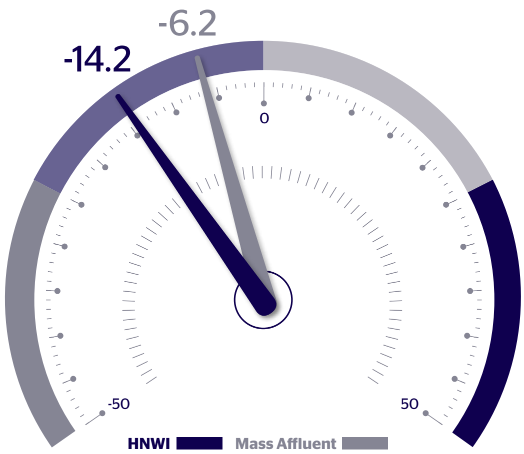
HNWI confidence in equities weakens

The Investor Equities Sentiment Index measures investor sentiment towards equities.

- HNWIs' sentiment towards equities weakened further this quarter, with the index declining to -6.2 compared with a reading of -0.3 in the previous quarter.
- The Mass Affluent Equities Sentiment Index fell more sharply in Q1 2016, dropping to -14.2 from 1.3 in Q4 2015.
- Due to the high levels of volatility and significant repricing experienced by global equity markets during the first two months of this year, it is not surprising that HNWIs' confidence in equities weakened this quarter.
- To illustrate, the benchmark Australian and US indices – the S&P/ASX 200 and S&P 500, respectively – both experienced intraday drops of between 2% and 3% during this period.

HNWI Equities Index: Q4 2015 versus Q1 2016

HNWI versus Mass Affluent Investor Equities Sentiment Index: Q1 2016

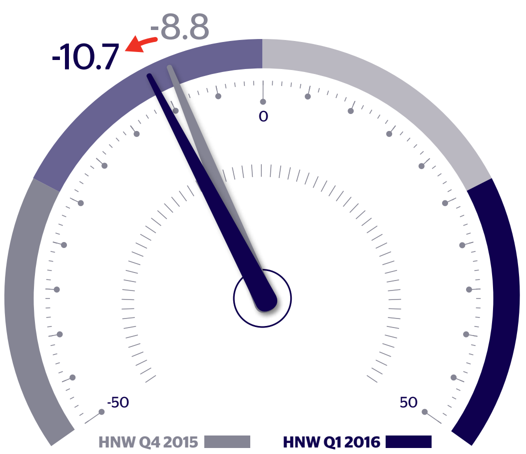


Property sentiment dips

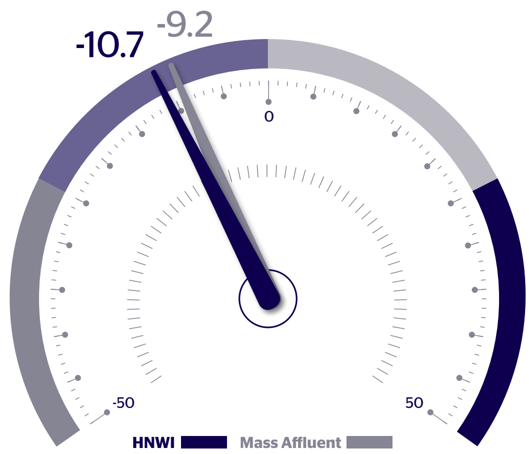
The Investor Property Sentiment Index measures investor sentiment towards both direct and indirect property investments.

- The HNWI Property Sentiment Index slipped to -10.7 this survey, from -8.8 in the previous quarter.
- Likewise, the Mass Affluent Property Sentiment Index also fell in Q1 2016, to -9.2 from -4.1 in Q4.
- We believe the dip in wealthy Australians' sentiment towards property is not materially significant and that HNWIs are well aware that recent property price gains have largely run their course.
- Furthermore, the Australian Prudential Regulation Authority's (APRA) recent regulatory measures to tighten lending restrictions in the property space have seen a dampening in demand.
- Supporting this view, the RBA said in its March Monetary Policy Decision Statement: "... [APRA's] supervisory measures are working to emphasise prudent lending standards and so to contain risks in the housing market. Credit growth to households continues at a moderate pace, albeit with a changed composition between investors and owner-occupiers. The pace of growth in dwelling prices has moderated in Melbourne and Sydney and has remained mostly subdued in other cities."

HNWI Property Sentiment Index: Q4 2015 versus Q4 2015



HNWI versus Mass Affluent Investor Property Sentiment Index: Q1 2016



Other research highlights

Most HNWIs not looking to invest, a third likely to divest

- Looking ahead, close to half (47.0%) of HNWIs think the investment market in general will be worse in the next quarter, up from 31.7% in Q4 2015. Fewer respondents (21.0%) also expect better market conditions, down from 34.6% in Q4.
- Reflecting this sentiment, compared with the previous quarter, a greater proportion of wealthy Australians said they were unlikely to reinvest (42.6% versus 32.4%) or purchase new investments (57.4% versus 45.7%) in the next quarter.
- About one-third (32.7%) of HNWIs are also likely to withdraw money from investment markets within the next three months, in line with Q4 (33.3%).

Satisfaction with existing investments falls, HNWIs most happy with property

- While close to half (48.5%) of respondents reported being happy with their current investments, this is down from 58.1% in Q4.
- Furthermore, more than twice as many HNWIs are unhappy (15.8%) with their existing investments, compared with 7.6% in the previous quarter.
- HNWIs' satisfaction with property, international equities, Australian equities and cash investments all fell this quarter.
- Despite this fall, wealthy Australians were most satisfied with residential property investments (69.4% compared with 70.4% in Q4 2015), followed by international equities (53.8% versus 82.6%), Australian equities (39.7% versus 47.0%) and cash (27.6% versus 38.8%).

Cash most common recent investment and most likely next investment

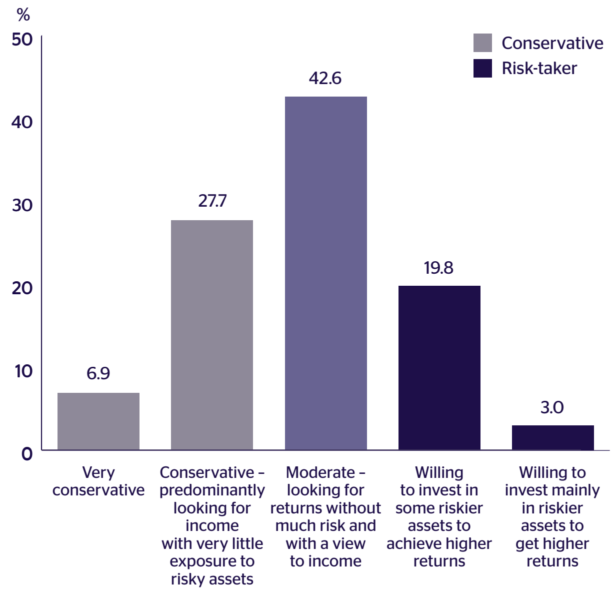
- Consistent with previous quarters, the most common recent investments among HNWIs are cash (44.6%) and Australian equities (31.7%).
- Cash and Australian equities are also the most likely next investment by HNWIs (41.6% and 27.7%, respectively).
- Although close to two in five (38.5%) of HNWIs are dissatisfied with their cash returns over the past 12 months (compared with 40.7% in Q4), the love affair with cash continues, with 62.5% of respondents intending to leave their cash investments at current levels in the coming 12 months, up from 47.3% in Q4 2015.
- However, less than one in 10 (9.4%) intend to increase the value of their cash assets, down from 22.6% in Q4.

HNWIs bearish on equities but only temporarily

- HNWIs are becoming bearish on equities – more than half (52.1%) expect Australian equities to perform worse in the next quarter, while more than two in five (41.0%) think international equities will perform worse, up from 36.2% and 19.6%, respectively, in Q4 2015.
- However, despite this bearish outlook on equities, more than a third (34.4%) of HNWIs are more likely to invest in Australian equities in the next quarter, up from 24.7% in Q4. This suggests a perception of value at current stock prices and a view that any downturn may only be temporary.
- Fewer HNWIs say they are more likely to invest in international equities this quarter: 19.1% versus 27.8% in Q4.

More HNWIs are moderate investors, not interested in high risks

- Compared with Q4, more HNWIs describe themselves as a moderate investor (42.6% compared with 35.2%) and fewer describe themselves as a conservative investor (34.6% compared with 40.0%).
- The overwhelming majority (93.1%) of HNWIs are not interested in high-risk investments, largely in line with the previous quarter (91.4%).
- Income is top of mind for wealthy Australians, with three in five (60.4%) citing this as their primary investment objective, up from 47.6% in Q4 2015.



Conclusion

High net worth investors (HNWIs) finished last calendar year with renewed optimism towards selective investment opportunities. However, the Q1 2016 HNWI Sentiment Indicator reveals a fall in sentiment, driven largely by the sharp repricing of risk assets seen in the first quarter of this year as well as concerns about equity market volatility. During this period, the volatility of all risk asset classes spiked, with heightened concerns around weaker global growth outlooks, coupled with lower inflationary forecasts as central banks' involvement in providing liquidity to financial markets enters its final stages.

This heightened volatility seen in the first six weeks of 2016 was prominent across all asset classes in all major markets, driving investors to temporarily pause some of their investment decision-making until more normalised levels of volatility are presented.

The HNWI segment is dominated by seasoned investors who have invested through multiple market cycles and across multiple asset classes. With this type of experience, HNWIs show an ability to see through short-term market dislocation periods to look for risk-reward opportunities in line with medium-term investment themes.

The timing of this quarter's HNWI Sentiment Index significantly influenced the key findings. In light of the improvement in equity markets now being seen in the latter half of the quarter, such sentiment has already begun to improve as seasoned investors reopen their investment decision-making for new opportunities, which, in many cases, have represented at more attractive entry levels.

The survey findings illustrated that HNWIs are acutely aware of both the local and global growth outlook remaining uncertain in many major economies. With three-quarters of HNWIs in this survey expecting the local economy to grow at a slower rate over the next quarter than the previous quarter, investors are expecting higher levels of market volatility to persist throughout this year.

HNWIs are therefore utilising our various wealth offerings to capitalise on investment opportunities which complement their existing exposures.

The findings of the survey highlighted that despite the bearish outlook on equities at the point in which the survey was conducted, HNW investors are more likely to invest in Australian equities over the next quarter. With the knowledge that single stock equity volatility will remain higher this year, we have seen an increasing number of HNWIs actively utilising our Private Wealth Markets institutional execution service in listed markets.

In property-related exposures, the survey showed continued HNWI satisfaction with property investments. Nevertheless, this quarter's survey findings showed that less HNWIs are adding to residential property investments compared with Q4. One possible reason for this is that HNWIs believe major asset price gains in the sector have been realised. Instead there is increasing HNWI interest in property-related investment exposures as an alternative to direct ownership. These investments with debt funding structures sit higher in the capital structure and have risk-reward parameters which can be more favourable following a period of strong price growth.

The survey this quarter also found a large percentage of HNW investors have a need for further risk reduction or to increase their investment liquidity in order to coincide with their retirement needs. The challenge for these investors becomes the lack of return now available on their cash holdings in light of the record low interest rates in Australia. The BT Private Wealth business is working actively with such investors via our Direct and Advised Wealth teams to demonstrate alternative yield-based investment opportunities where risk and reward can be more favourable than direct cash.

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