

A HIGH YIELDING RESILIENT ECONOMY: THE CASE FOR AUDS - \$A STRENGTH

January 2017

**BetaShares Strong Australian Dollar Fund (hedge fund)
(ASX: AUDS)**



BetaShares

Exchange Traded Funds

www.betashares.com.au

The BetaShares Strong Australian Dollar Fund (hedge fund) (ASX: AUDS) and the BetaShares Strong U.S. Dollar Fund (hedge fund) (ASX: YANK) provide investors with cost-effective geared exposure to currencies, irrespective of whether they want to go 'long' the Australian Dollar or 'long' the U.S. Dollar. The Funds can be used by investors to profit from a view that the Australian Dollar will strengthen relative to the U.S. Dollar, or vice versa.

Recognising that investors will have opposing views on the future direction of the currency, we have prepared a separate "case for" both future Australian Dollar strength and future Australian Dollar weakness against the U.S. Dollar. Using the Funds investors are now able to back their view on the USD/AUD trade in a capital-efficient manner, no matter which direction they wish to trade.

After its commodity driven rise and fall since earlier last decade, the Australian Dollar (\$A) appears to have bottomed out since mid-2015. The \$A hit a month-end low of 70.18c at end-September 2015, but has since tended to consolidate around the mid-US75c level.

THE AUSTRALIAN DOLLAR VS. US DOLLAR: 31 JANUARY 2002 TO 31 DECEMBER 2016



Source: Bloomberg.

Having already fallen a long way in the past few years, there are two key arguments to suggest the \$A could now remain well supported and lift somewhat further looking ahead.



1. Commodity prices may have already bottomed

As seen in the chart below, there has been a sharp rebound in key Australian export commodity prices such as coal and iron-ore since early 2016, reflecting a lift in Chinese steel demand and supply rationalisation among high cost Chinese coal and iron ore producers.

BULK EXPORT COMMODITY PRICES: 2007 TO 2016

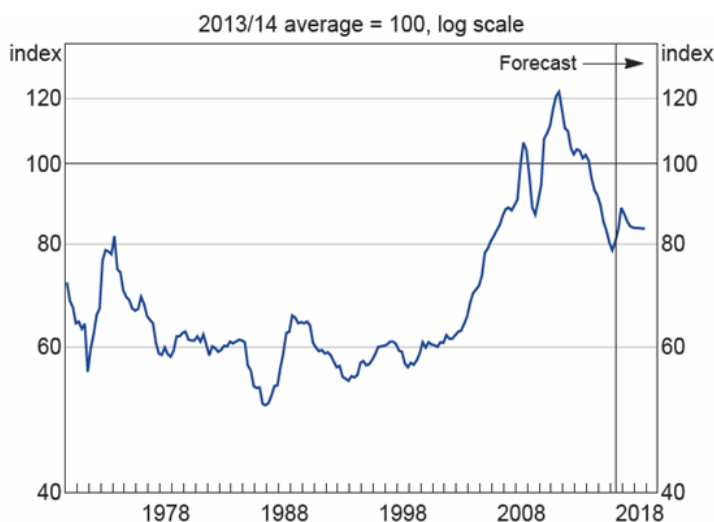


Source: Reserve Bank of Australia

More broadly, firmer commodity prices may reflect the fact that supply-demand commodity “re-balancing” is finally now underway in a typically lagged response to the decline in prices since 2011. Over the past year, moreover, it has also been apparent that Chinese officials remain ever determined to keep their economy growing at a robust pace, even if this means aggravating longer-term imbalances in terms of housing and industrial overcapacity and rising levels of debt among State-owned enterprises. Adding to the upside commodity risk is the surprise election of Donald Trump as US President, given he has ambitious plans to boost infrastructure and defence spending.

As seen in the chart below, the Reserve Bank of Australia is now forecasting that Australia’s terms of trade (i.e. price of exports on world markets relative to the price we pay for imports) has bottomed, with modest gains ahead over the coming year.

TERMS OF TRADE: 1970 TO 2018(F)



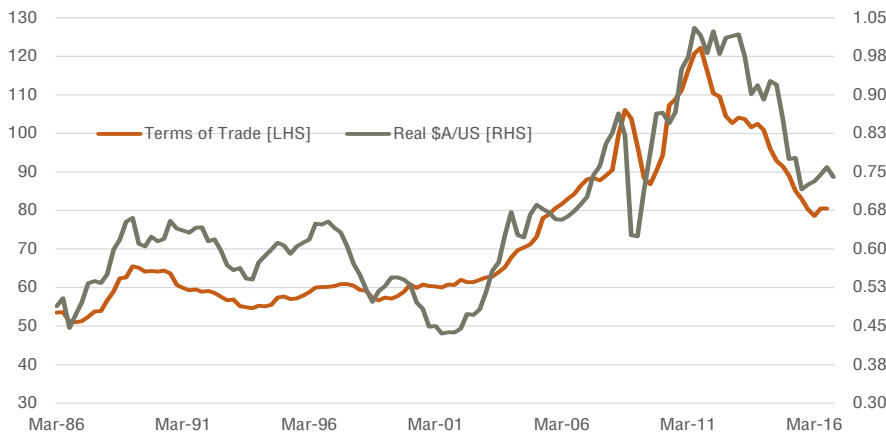
Source: OECD-FAO Database

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As seen in the chart below, a bottoming in the terms of trade would have important implications for the Australian Dollar, given their relatively close relationship over time.

REAL AUSTRALIAN DOLLAR AND THE TERMS OF TRADE: MARCH 1986 TO DECEMBER 2016*

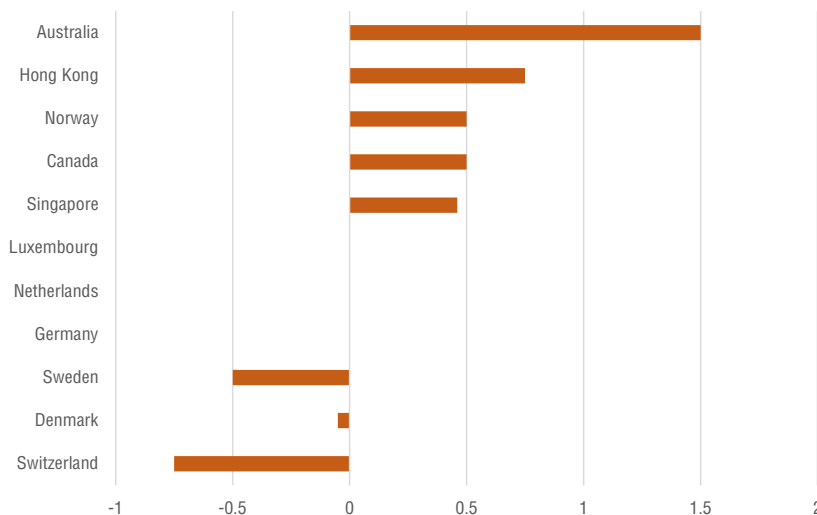


* Deflated by consumer prices. Terms of Trade to September 2016.
Source: BetaShares, Australian Bureau of Statistics, Reserve Bank of Australia

2. Australian interest rates likely to remain attractive

Also supporting the A\$ this year is the fact that local interest rates remain relatively attractive by global standards. As seen in the chart below, Australia retains the highest official interest rates among countries with a triple-A sovereign credit rating from Standard & Poor's.

OFFICIAL INTEREST RATES AMONG TRIPLE-A RATED COUNTRIES: DECEMBER 2016



Source: www.TradingEconomics.com

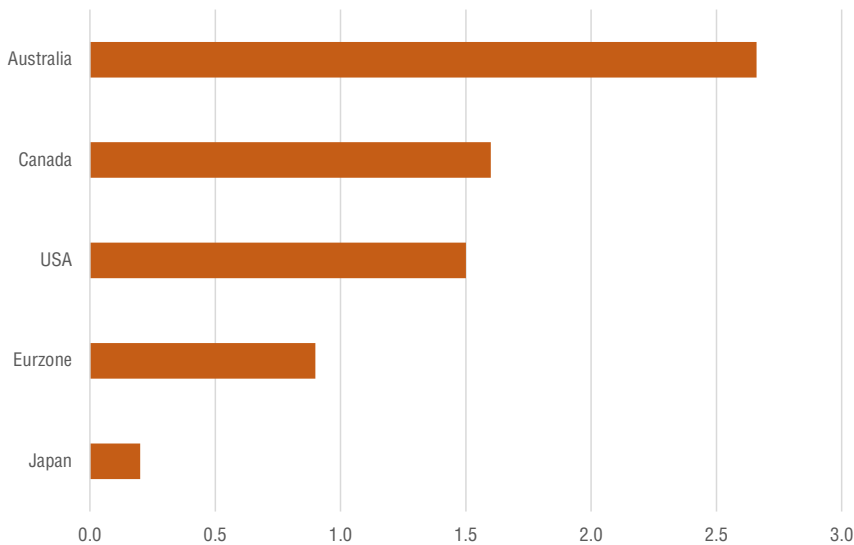
Most critically, Australian official interest rates also remain above those of the United States. Indeed, several bouts of global financial market instability in 2016 caused the United States Federal Reserve to back away from further interest rates hikes in 2016 – after only a single rate hike in December 2015. This led to some weakness in the \$US and associated strength in the \$A.



Although the Federal Reserve finally raised rates in December last year, it stated it would pursue only “gradual” increases over coming years due to low inflation. Meanwhile, other major central banks such as the Bank of England, European Central Bank and Bank of Japan appear likely to retain relatively accommodative monetary policies for some time.

Supporting Australia’s relatively high interest rate level is our relatively high level of potential economic growth, which in turn largely reflects our strong immigration program and population growth. As seen in the chart below, OECD estimates suggest potential growth in Australia is considerably higher than that of other major global peers.

ANNUALISED GROWTH IN POTENTIAL GDP (%): 2012 TO 2018 (F)



Source: OECD

With property prices across Sydney and Melbourne still growing strongly and economic growth at a pace consistent with a broadly stable unemployment rate, financial economists now feel Australian official interest rates will remain on hold through much of 2017, with the next move in rates likely up.

Conclusion - the case for \$A strength

Given tentative signs of a bottoming in export commodity prices and the fact that Australian interest rates and economic growth remain relatively high by global standards, there are reasonable grounds to believe that the worst may now be over for the \$A in this cycle.

Should commodity prices remain firm, perhaps reflecting ongoing Chinese stimulus, the \$A could well rise over the coming year. This would be supported if there is an eventual rise in local interest rates and/or if there is further hesitation by the US Federal Reserve over the need to raise interest rates further.

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The BetaShares Strong Australian Dollar Fund (hedge fund) (ASX Code: AUDS)

Investors seeking a simple way to obtain cost-effective geared exposure to the change in value of the Australian Dollar relative to the U.S. Dollar can do so through the BetaShares Strong Australian Dollar Fund (hedge fund) (ASX Code: AUDS).

The Fund's exposure to the change in value of the Australian Dollar relative to the U.S. Dollar can be expected to vary between 200% and 275% on a given day. That means a 1% increase in the value of the Australian Dollar relative to the U.S. Dollar, for example, can generally be expected to deliver a 2.0% to 2.75% increase in the value of the Fund (and vice versa) on a given day¹.

AUDS can be bought and sold like any share on the ASX and, unlike alternative investments providing geared currency exposure like CFDs, does not expose investors to margin calls.

AUDS can be used to implement a variety of investment strategies. For example:

- Profit from a view that the Australian Dollar will strengthen relative to the U.S. Dollar via an efficient use of capital (i.e. that the USD will fall in value against the AUD)
- Hedge international investments - reduce the impact of currency movements from investments denominated in U.S. Dollars
- Diversify a portfolio - currencies have historically shown low correlation to equities, fixed income and most other asset classes

Gearing magnifies gains and losses and may not be a suitable strategy for all investors. Investors in geared strategies should be willing to accept higher levels of investment volatility and potentially large moves (both up and down) in the value of their investment. Investors should seek professional advice before investing, and monitor their investment actively. The Fund does not track a published benchmark.

¹ As measured by the currency futures contracts held by the Fund. Changes in the value of the futures will not always move in line with changes in the spot Australian dollar / U.S. dollar currency exchange rates. Investors should note that the return earned on their investment over any longer period will not necessarily be equivalent to 200% to 275% of the return of the Australian Dollar relative to the U.S. Dollar over that period. As such, investors should check BetaShares' website for details of the Fund's historical performance, as well as the current gearing exposure, to ensure that the Fund continues to meet their investment objectives.

Trading Information

BetaShares Funds can be bought or sold during the trading day on the ASX, and trade like shares.

EXCHANGE	ASX
ASX CODE	AUDS
CURRENCY	AUD
TRADING	10:00-16:00 (AEST)
BLOOMBERG CODE	AUDS AU
IRESS CODE	AUDS.AXW
IRESS INAV CODE	AUDSINAV.ETF

Fund Information

DISTRIBUTIONS	Annual
MANAGEMENT FEE	1.19% p.a
EXPENSES	capped at 0.19% p.a
FUND INCEPTION	28 November 2016

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There are risks associated with an investment in the Fund, including currency exchange rate risk, gearing risk, currency futures risk and concentration risk. For more information on risks and other features of the Fund please see the Product Disclosure Statement.

An investment in any BetaShares Fund ('Fund') is subject to investment risk including possible delays in repayment and loss of income and principal invested. Neither BetaShares Capital Ltd nor BetaShares Holdings Pty Ltd guarantees the performance of any Fund or the repayment of capital or any particular rate of return. Past performance is not an indication of future performance. This information has been prepared by BetaShares Capital Ltd (ACN 139 566 868 AFS Licence 341181) ("BetaShares"), the product issuer. It is general information only and does not take into account your objectives, financial situation or needs so it may not be appropriate for you. Before making an investment decision you should consider the product disclosure statement ('PDS') and your circumstances and obtain financial advice. The PDS is available at www.betashares.com.au or by calling 1300 487 577 (within Australia) or +61 2 9290 6888 (outside Australia). Only investors who are authorised as trading participants under the Australian Securities Exchange (ASX) Operating Rules may invest through the PDS. Other investors may buy units in the Fund on the ASX through a stockbroker, financial adviser or online broker. This document does not constitute an offer of, or an invitation to purchase or subscribe for securities. This information was prepared in good faith and to the extent permitted by law BetaShares accepts no liability for any errors or omissions or loss from reliance on any of it.

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