THE COMMODITY BOOM MAY BE OVER:

THE CASE FOR YANK - $A WEAKNESS

January 2017

BetaShares Strong US Dollar Fund (hedge fund) (ASX: YANK)

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.

Although the Australian Dollar ($A) has been in a broad downtrend against the U.S. Dollar ($US) since the peak in commodity prices in mid-2011, it has displayed some resilience over 2016. Indeed, from a month-end low of US 70.18c at end-September 2015, the $A has since tended to consolidate around the mid-US75c level.

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

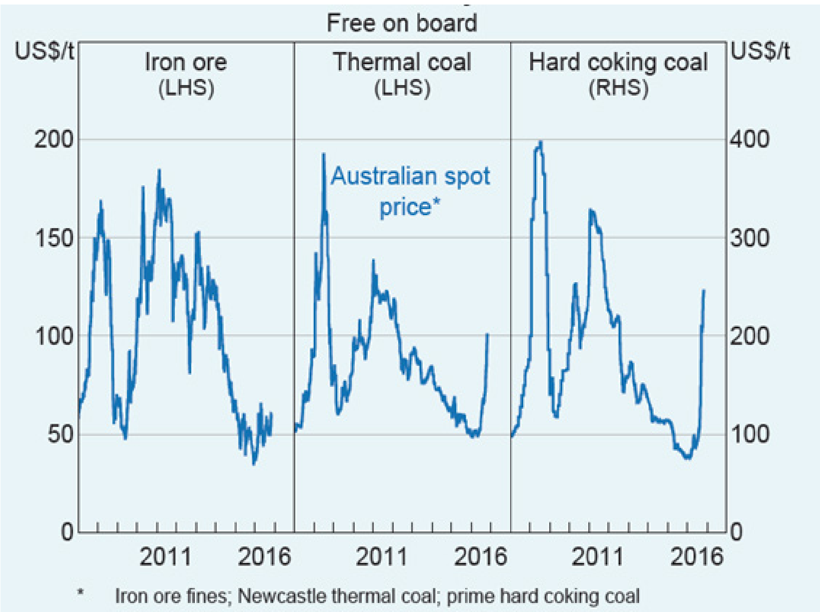
Source: Bloomberg.

Despite this rise, however, there are several reasons to believe the broader downtrend in the $A is not yet over and that the $A has further to fall.

1. Recent commodity price gains are unlikely to be sustained

As seen in the following chart, a major reason for the rebound in the $A in the second half of 2016 has been the sharp rebound in key Australian export commodity prices such as coal and iron-ore. In turn, this has reflected a policy-driven boost in Chinese steel demand and supply rationalisation among high cost Chinese coal and iron ore producers.

BULK EXPORT COMMODITY PRICES: 2007 TO 2016



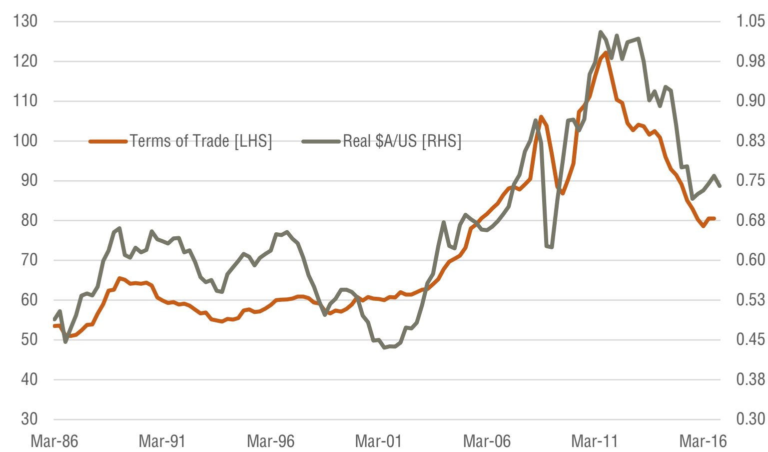
Source: Reserve Bank of Australia

That said, the longer-run outlook for commodity prices still appears subdued. For starters, it appears inevitable that China's demand for industrial raw materials will slow further. Although Chinese authorities have responded to slowing private investment and a loss of export competitiveness by increased public spending on infrastructure projects and easing restrictions on residential development, this has come at the expense of exacerbating excess capacity and debt levels among many State-owned enterprises. China's current policies are also fuelling speculative activity in the housing sector, and international resentment about the "dumping" of cheap Chinese steel exports on world markets.

It's also the case that major commodity producers based in countries such as Australia and Brazil are set to expand supply further. Strong commodity prices will also encourage higher-cost Chinese producers to re-enter the market. In short, supply-demand factors are likely to increasingly weigh against further commodity price gains.

As seen in the chart below, while Australia's terms of trade (its price of exports relative to imports on world markets) have broadly stabilised in recent quarters, it remains well above long-run average levels. What's more, allowing for inflation differentials between Australia and the US over time, the $A "real" exchange rate has broadly tracked the terms of trade over time. Accordingly, if the terms of trade do fall back toward longer-run average levels, it would be consistent with an $A at considerably lower levels than at present.

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

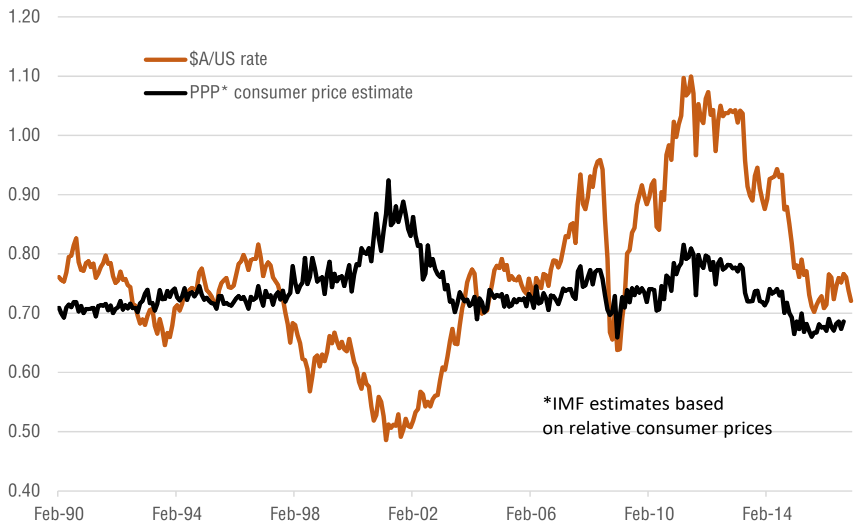


Source: Reserve Bank of Australia, Australian Bureau of Statistics. *Deflated by trends in relative core consumer prices in Australia and the US, re-based to Sep-2016 prices. Terms of Trade to September 2016.

2. The $A is still above purchasing power "fair-value"

At around the mid-$US70c level, the $A also remains above broad estimates of purchasing power parity fair-value[1]. According to International Monetary Fund estimates, for example, fair-value for the $A on a PPP basis as at end-September was around $US68c. As seen in the chart below, the $A tends to move in cycles around PPP fair-value, suggesting a period of undervaluation on a PPP-basis may be ahead after several years of commodity-price driven overvaluation.

THE $A/US BILATERAL RATE VS. PURCHASING POWER PARITY "FAIR-VALUE" ESTIMATES: FEBRUARY 1991 TO DECEMBER 2016*

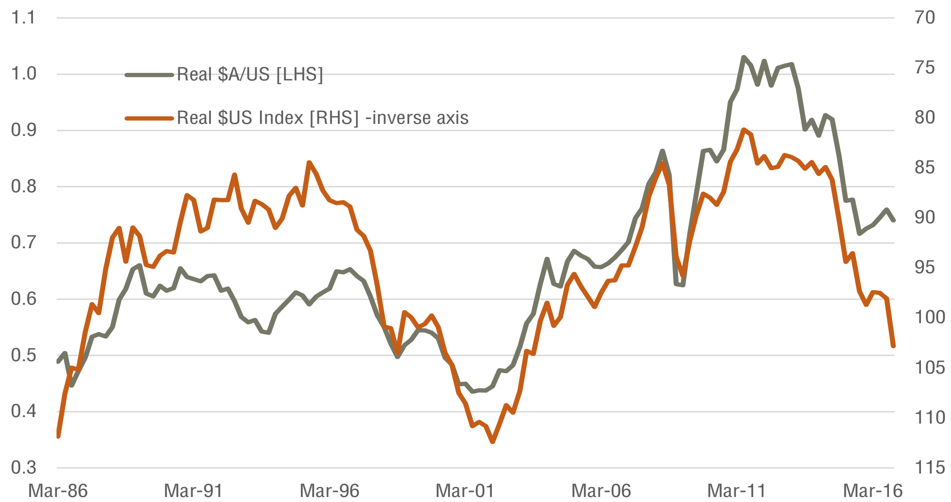


Source: Bloomberg. PPP estimates to end-September 2016.

3. The $US should rise further

The direction of the $US also has an important influence on the A$. As seen in the chart below, the $A's performance against the $US has tended to be inverse to that of the $US Index over time i.e. when the $US is rising, the $A is generally falling against it. Despite this broad correlation, the $A tended to strengthen during 2016 even though the $US rose. Should the $US rise further – as seems likely given the prospect of higher US official interest rates and continued relative strength in the US economy – it should eventually add to downside pressure on the $A.

REAL $A AND THE REAL $US EXCHANGE RATE INDEX: MARCH 1986 TO DECEMBER 2016



Source: RBA, US Federal Reserve

[1] Purchasing power parity fair-value exchange rate estimates reflect the relative cost differences between countries. In short, the PP fair-value exchange rate is that which would equalise the cost of buying a comparable basket of goods and services in two different countries.

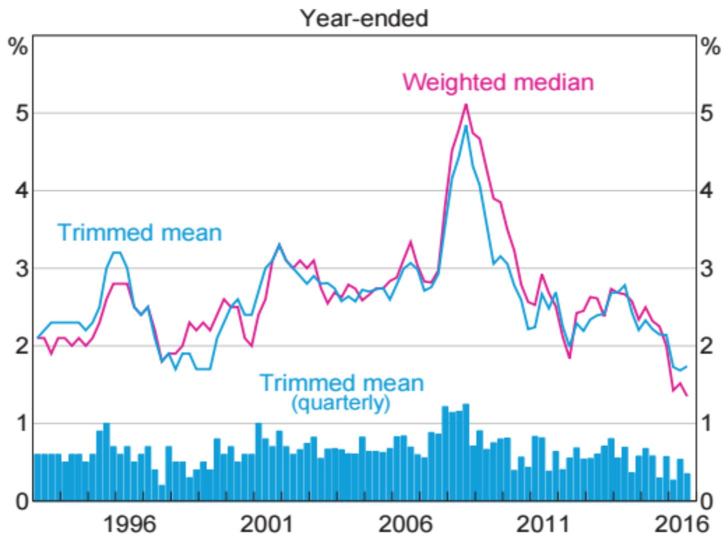
Indeed, the election of Donald Trump to the US Presidency arguably adds to the upside risks to the $US, given the prospect of significant fiscal stimulus through tax cuts and increased spending on defence and infrastructure – which only adds to the case for further Fed tightening in 2017.

4. The bias on local interest rates remains to the downside

The Reserve Bank of Australia cut interest rates twice in 2016 reflecting a lower than expected trajectory for underlying inflation. In particular, the RBA's preferred measures of underlying inflation dropped to annual rates of around 1.5% during 2016, compared to earlier estimates that inflation would hold at around 2%.

Heading into 2017, the RBA is counting on annual underlying inflation rising back toward 2% by mid-year, which could prove difficult given the recent strength in the $A, and continued very low rates of wage growth. If, over coming months, it appears that inflation will remain stuck at below the RBA's 2 to 3% target band, the RBA will be under increasing pressure to cut interest rates further. That will be especially the case if rising supply and deteriorating affordability leads to a softening in recent robust house price growth in Sydney and Melbourne.

UNDERLYING INFLATION MEASURES: MARCH 1993 TO SEPTEMBER 2016



* Excludes interest charges prior to the September quarter 1998; adjusted for the tax changes of 1999–2000

Source: RBA, Australian Bureau of Statistics

Conclusion – the case for $A weaknesses

Although the Australian dollar has already fallen some way since the peak in commodity prices in mid-2011, there are arguments to suggest further downside seems likely. For starters, it's far from clear the downtrend in commodity prices is already over, especially as they still remain well-above long-run average levels. On a purchasing-power parity basis, moreover, the $A still seems overvalued. With rising US interest rates on the cards and lingering downside risks to local interest rates in 2017, a narrowing short-term interest rate differential would also work against the Australian dollar.

BETASHARES

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BetaShares
Exchange Traded Funds
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The BetaShares Strong U.S. Dollar Fund (hedge fund) (ASX Code: YANK)

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

The Fund's exposure to the change in value of the U.S. Dollar relative to the Australian Dollar can be expected to vary between 200% and 275% on a given day. That means a 1% increase in the value of the U.S. Dollar relative to the Australian 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 day[2].

YANK 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.

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

- Profit from a view that the U.S. Dollar will strengthen relative to the Australian Dollar via an efficient use of capital (i.e. that the $A will fall in value against the $US)
- Hedge against $US currency risk - can be used by individuals or businesses that are exposed to movements in the $A/$US exchange rates
- 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.

[2] 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 U.S. Dollar relative to the Australian 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	YANK
CURRENCY	AUD
TRADING	10:00-16:00 (AEST)
BLOOMBERG CODE	YANK AU
IRESS CODE	YANK.AXW
IRESS INAV CODE	YANKINAV.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.