Market & Economic Update

June 2019 Quarter

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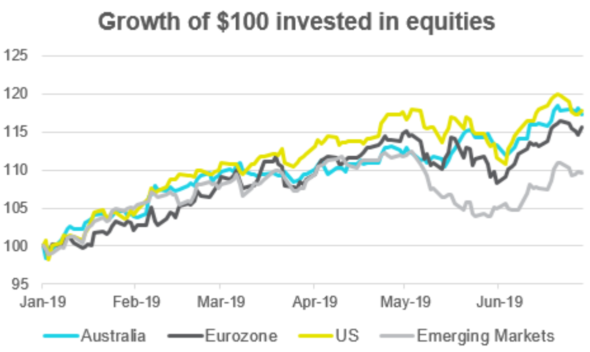
Shares continue to rise

Global share markets continued their strong run through the second quarter of 2019. By 30 June many major developed equity markets rocketed up over 15% in AUD terms since the start of the year - making gains in half a year which would typically be expected over a 2-year period. The local market led the way in the June quarter, rising 7.0% [1] over the 3-month period including a strong rally in May after the surprise federal election victory of the Liberal National Coalition.



Source: Refinitiv

The strong gains being enjoyed by global share markets, do not however appear to be supported by improving macroeconomic fundamentals. Many of the issues we have previously highlighted, which we would expect to weigh on stock markets, have intensified, rather than dissipated, through the first half of 2019.

Politics at play

Geopolitical drama intensified through the quarter with a number of developments increasing the risks to global economic growth.

The US China trade dispute continues to be unresolved following a meeting between the nations' leaders at the G20 Summit held in Japan in June. Following the G20 Summit in Northern Asia, US President Trump made a historic visit to North Korea following an invitation he made via Twitter to Leader Kim Jong-un for a meeting. The meeting, however, appeared to be more a spectacle staged for social and traditional media than a meaningful diplomatic negotiation.

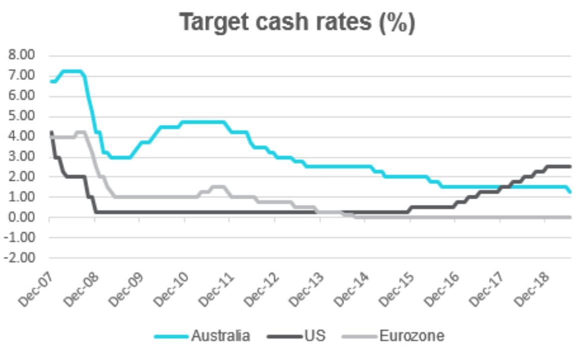
Meanwhile, tensions flared between the US and Iran with the US calling off a military strike on Iran and instead imposing further economic sanctions on the oil rich nation.

The ongoing saga of the UK's decision to leave the European Union continues with the mechanics of a Brexit and the future leader of the United Kingdom still unclear.

Amid this heightened geopolitical tension, economic indicators released through the quarter point to a continued slowdown in economic growth across Europe, China and the US.

Australian cash rates cut

The Reserve Bank of Australia met the market's expectations by cutting the target Australian cash rate to a record low 1.25% in June. Economists and market commentators widely expect this cut to be the first in a series with most expecting the official cash rate to be below 1% by the end of 2019 [2].



Source: Refinitiv

[1] S&P/ASX 200 TR Index AUD

[2] Australian Financial Review quarterly economists' survey, 1 July 2019.

Only two of the Big 4 Australian banks, Commonwealth Bank of Australia and National Australia Bank, passed the rate cut through to borrowers in full. Sceptics would argue it is no coincidence given these banks bore the brunt of the negative fallout from last year's Royal Commission and are now trying to improve their image with the government and consumers.

While rate cuts will provide some much needed relief to the cost of living for those with a mortgage, the flipside is that rate cuts are not positive for many Australians. Net savers who do not have a mortgage (including many self-funded retirees) have seen interest rates on their savings reduced as banks (not surprisingly) were quick to cut deposit rates following the RBA's move. This will force many retirees to make tough decisions around their spending and investment behaviour.

Central banks around the world appear to be co-ordinated in their dovish (more likely to reduce than increase) view towards interest rates. More than a decade on from the Global Financial Crisis, many central bankers have signalled their intent to hold interest rates, or even reduce them, in the face of economic uncertainty and low inflation expectations.

Outlook & portfolios

Share markets have had a phenomenal run through the first half of the year with major developed markets all gaining over 15% (in AUD terms) and a number of stock market indices flirting with all-time highs. Worryingly, the underlying economic fundamentals do not appear to be supportive of such lofty share market valuations with many major economies facing stubbornly low wage and productivity growth and an uncertain outlook for corporate earnings. Inflation, as measured by the price change of consumable goods and services, has been below the levels targeted by central banks in order to support robust economic growth. However, as central banks continue to provide very easy money there is an increasing threat of inflation lurking not through consumption goods and services, but rather in the form of growing asset bubbles in the residential and commercial property sectors and global share markets which continue to make new highs.

We expect there to be continued volatility in markets with the growing geopolitical risks and challenging economic growth outlook providing headwinds to future returns. Despite the less positive outlook for share markets, we don't recommend allocating away from growth assets and into cash as it is extremely difficult to time the market accurately. Instead of attempting to make tactical changes to asset allocations, we recommend including an allocation to strategies with a specific focus on downside protection and capital preservation in portfolios. This allocation will reduce the severity of drawdowns and provide a smoother ride over the long term. Now, more than ever, it is crucial to invest in high quality investments managed by experienced and well-resourced managers.

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