

Market & Economic Update

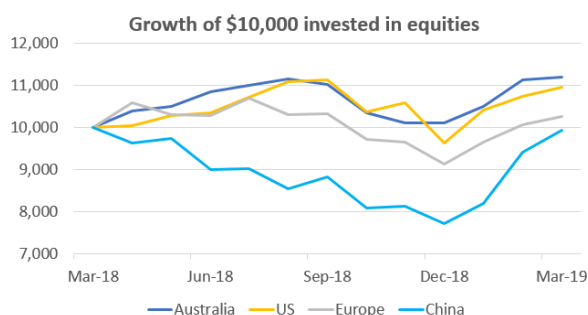
March 2019 Quarter

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Share markets rebound

After a horror end to 2018 global share markets rebounded sharply through the first quarter of 2019. The local Australian market rallied 11.7% in the 6 weeks from its low point on 20 December¹ providing a timely reminder of the difficulty in trying to time markets and the potential for investors to miss out on big gains if they do not stay the course and remain invested in markets.

All regional share markets enjoyed strong gains through the first quarter of 2019, reversing the sharp falls of late last year. China was the standout performer rocketing up 28.6% (in local currency) for the quarter². The strong gains did not however appear to be supported by improving macroeconomic fundamentals as many of the concerns weighing on markets in the second half of 2018 remain.



Source: Lonsec

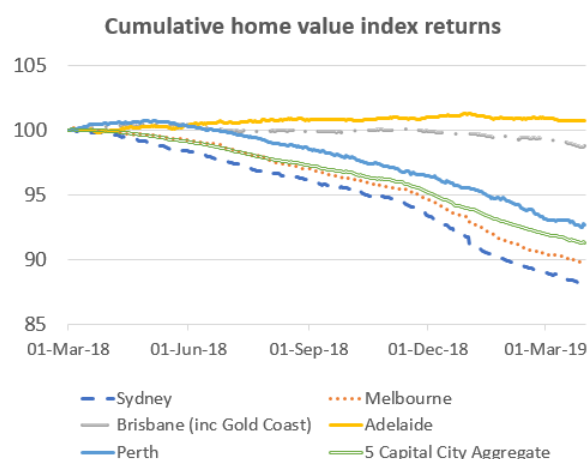
The US China trade dispute continues to be unresolved and manufacturing data released through the quarter points to a continued slowdown in economic growth across Europe, China and the US. The ongoing saga of the UK's decision to leave the European Union and the inability of the government to reach a Brexit deal remains another major threat to the global economy.

¹ S&P/ASX 200 TR Index AUD

² Shanghai Shenzhen CSI 300 PR Index RMB

House price falls extend

The fall in Sydney and Melbourne house and unit prices experienced in the second half of 2018 gained pace through the summer. Prices began to slide in states which were previously holding up (Brisbane including Gold Coast fell 1.00% over the 3 months to 31 March 2019³) and by the end of the March quarter Hobart and Canberra were the only Australian capital cities to avoid a fall in dwelling prices.



Source: CoreLogic

As detailed in last quarter's update, the risk to the Australian economy of falling house prices occurs through the **wealth effect**. Consumers typically spend less when they perceive that their wealth has fallen (for example as a result of a decline in the value of their property) even if they have not experienced an actual fall in income or cash flow. Research by the Reserve Bank of Australia (RBA) has demonstrated that spending on new cars and home furnishings are two of the first areas to be impacted by the wealth effect⁴. Recent data suggests that the wealth effect is starting to play

³ CoreLogic RP Data Daily Home Value Index Brisbane (including Gold Coast)

⁴ Australian Financial Review, 6 March 2019

out. New car sales have slumped recently, hitting their lowest level in seven years in February.⁵

The federal Labor party has committed to make changes to the rules relating to negative gearing and capital gains tax concessions for property investors, if they are elected at the Federal election in May. This may lead to further headwinds for the cooling residential property market.

Interest rate hikes halted amid fears of global slowdown

Representatives of the RBA have expressed a far more dovish tone (likely to lower rather than raise interest rates) at public speaking engagements and in the minutes of the RBA board meetings in recent months. The RBA identified Australian house price weakness as one of the major threats facing the economy late last year and several economists changed their forecasts and began pencilling in interest rate cuts rather than hikes through 2019 and 2020.

What began as whispers from a few outlier economists late last year has become the consensus call over the quarter with the bond market now pricing 0.40% of interest rate cuts in Australia by the end of 2019.⁶

Central banks around the world appear to be co-ordinated in their views on this matter. It now seems that the sugar hit of easy money and ultra-low interest rates which has fuelled asset prices over the past decade may be extended as central banks have called a halt on their moves to increase interest rates to more “normal” levels

amid fears of stalling economic growth and derailing financial markets.

After a sustained period of increasing interest rates up from the emergency low settings implemented in the wake of the Global Financial Crisis a decade ago, the US Federal Reserve did an abrupt about face in early March and signalled an end to the current rate rising cycle. Central banks in Europe and New Zealand have recently made statements echoing this sentiment.

Outlook & portfolios

We expect the rollercoaster ride experienced by financial markets over the past 6 months is likely to continue. Despite the dramatic bounce back in share markets since the new year we don't believe that the fundamentals have improved and there are a significant number of economic and geopolitical risks facing markets.

Despite the headwinds facing equity markets, we do not recommend allocating capital away from growth assets and into cash. It is extremely difficult to time the market and taking this type of action may cost portfolios dearly in the event of markets continuing to rise.

More than ever the quality of investment managers is of crucial importance and we recommend including an allocation to strategies with a specific focus on downside protection and capital preservation in portfolios to reduce drawdowns and provide a smoother ride for clients.

⁵ Federal Chamber of Automotive Industries & Australian Financial Review, 6 March 2019.

⁶ Janus Henderson, 12 March 2019

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