HILLROSS

Market Correction Comments

A comment on Equity Market Volatility

US equity markets were down 2.1%[1] overnight and are down 7.8% month-to-date. While there was no specific factor that has caused the recent declines investor concerns around some of the ongoing issues appear to have increased. Specifically, and perhaps most important, is that the background concern around the potential for and timing of a US recession appear to have been brought forward. There are some tentative signs that some of the more economically sensitive sectors of the economy, e.g., housing construction, are slowing down in response to higher interest rates. In addition, a survey of American home builders showed sentiment continuing to fall. Concerns were also heightened by surveys that supported the outlook for a softening in market activity, including a survey of sentiment among manufacturers in New York state which fell sharply. This is a private survey and is quite narrow when compared the US government surveys of economic activity however given current sentiment any negative data has a heightened impact.

Other issues that have become more front of mind are Brexit as well as the poor communication of the tariff and trade issues between the US and China.

Selling was widespread and across a number of sectors notably technology, the healthcare industry, and small companies. Despite some of the selling being industry or company specific the general view was that the economy was slowing. The healthcare sector saw significant declines driven by elimination of Obamacare (the US private health insurance program) which impacted the insurers and hospitals. There was already some negative sentiment toward the sector after Johnson and Johnson announced that it had known for some time that one of its products contained asbestos. This announcement saw the share price fall 12.7% over two days. In the technology sector, Amazon was down 4%, Microsoft 2.9% and Alphabet (Google) 2%.

In this environment of uncertain outlook for growth and corporate profits the US Federal Reserve will be having its last meeting for the year. There is an expectation that it will raise interest rates by 25 bps however recent market declines may see it leave rates at current levels of 2.25%. While a rate hike is priced in, an increase in the current weak sentiment may see equities move lower.

The Australian market has been slightly more resilient recently as valuations are more reasonable and the outlook for profit growth appears more stable, unlike the US equity market. The issue of the refunding of franking credits to non-taxpayers will also be an overhang for the market. However, given that offshore investors own around one-third of the Australian equity market the negative market will be reflected here, at least in the short-term.

Looking forward, markets are likely to remain volatile as investors examine data and form a view on a slowdown or recession in the US. The holiday season will also see trading volumes fall away and may lead to exaggerated moves in shares prices in response to news.

[1] S&P500

The current economic environment remains supportive with reasonable economic growth, low interest rates and a lower oil price. The sound yield support of ~4.5% plus franking credits will give the Australian market support while fixed interest markets remain sound at this point and therefore it is premature to change asset allocation. International equities are likely to be volatile for some time however this investment provides exposure to industries and technologies not available on the domestic market and which are likely to see long-term growth. We continue to believe investors are best served with well diversified portfolios and staying the course.

AMP Research

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