View from the hill

MAY 2018

HILLROSS

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **30 April 2018.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	3.9	0.3	5.5	5.7
Smaller companies	2.8	0.4	18.5	11.1
International shares (unhedged)	2.8	1.8	12.4	9.2
International shares (hedged)	2.0	-4.0	11.8	8.8
Emerging markets (unhedged)	1.2	0.0	20.6	7.6
Property – Australian listed	4.3	1.1	1.6	7.6
Property – global listed	2.3	-1.2	1.0	3.9
Australian fixed interest	-0.4	0.8	2.2	2.7
International fixed interest	-0.4	0.2	1.7	3.2
Australian cash	0.2	0.4	1.8	2.0

Overview & Outlook

Equity markets were reasonably quiet over April as investors became more sanguine about geopolitical issues with most global markets trending higher. The MSCI World ex Australia Index was up 2.0% (hedged), following a loss in March of 2.3%. Australian equities were significantly stronger with the S&P/ASX 200 up 3.9%. This brought annual returns for the respective indices to 11.8% and 5.5%.

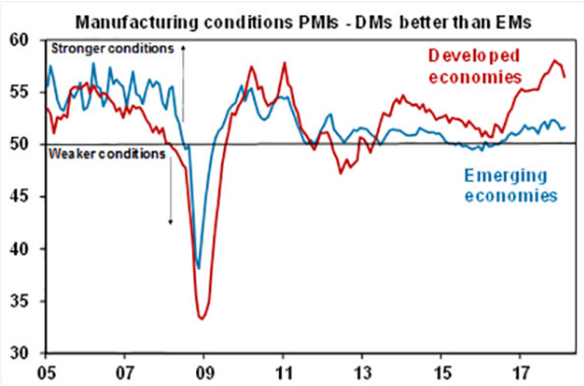
While several of the political issues from March continued into April, market responses to the news flow were muted. Investor attention in the US was focused on the company reporting season currently under way. To date, earnings have been very buoyant supported by strong economic growth, low unemployment and the recent tax cuts. Technology stocks staged a recovery after last month's sell-off driven by solid earnings growth, notably by Amazon, while concerns around regulation have ameliorated, at least in the short-term. Solid earnings were supported by the Tax Cuts and Jobs Act introduced last year but investors have grown concerned about whether this is as good as it gets for earnings. As a result, solid earnings weren't necessarily reflected in equity price moves over the month with the S&P 500 recording +0.3% as investors grew concerned over the impact of inflation, costs, and wage pressures going forward. The United States and China are engaged in talks to settle the trade and tariff issues however at the time of writing no announcements as to any outcomes had been made.

More recently there have been some signals that global business deteriorated since the buoyant growth conditions at the end of 2017 and into the early part of this year, notably in the Euro area. This has led some investors to question the duration of the current upswing.

The concern has arisen because of the downturn in what is known as manufacturing PMI's[1] These indices are forward-looking measures of economic conditions and growth and therefore a guide to the outlook for the sector under consideration. The recent downturn in PMI's was more marked in developed countries as compared to emerging markets. At this point, these concerns are not valid, and we discuss this issue below.

First, it is important to note that the indicators are falling from the very high levels that occurred earlier this year and from levels that were not sustainable. Current levels still indicate sound expectations going forward. Notable was the weakness in the European PMI's and this can be attributed, at least in part to the strength of the Euro, which knocked down export growth, as well as abnormally cold weather. Both these factors have ameliorated recently.

[1] Purchasing Manager Indices.



Source: Bloomberg, AMP Capital

Also, important to note is that global trade volumes, usually a sensitive indicator of economic conditions, are still strong and business investment is rising. This still has some way to go to catch up from low levels of investment that prevailed after the GFC. In addition, current global growth forecasts from the IMF remain buoyant at 3.9% for each of 2018 and 2019. Consumer spending remains buoyant, supported by strong employment markets, notably in the US, where unemployment has fallen to 3.9% and wage growth is showing some improvement. The strength in commodity prices also reflects solid global demand for raw materials. Finally, the tax cuts and increased government spending will also add to global growth.

In summary, it appears too early to expect a global slowdown or recession at this point. However rising interest rates as well as the worsening debt picture in the US are of concern into 2019/20. Currently the overall environment of sound economic growth, low rates and earnings growth remains a favorable background for growth assets.

Share markets

The ASX 200 Accumulation Index rose over April (3.9%), led by very strong increases in the Energy and Materials sectors, up 7.4% and 10.8%, as commodities and oil prices continued to increase and trade news emanating out of China and the US turned increasingly positive. Financials, not unexpectedly, were the weakest performers, as the fallout from the Royal Commission into banks widened, with the introduction of tougher regulations around lending criteria looking close to certain for banks. This, combined with weak residential property prices, led to banks underperforming the market in April and shorts from traders on the sector increasing.

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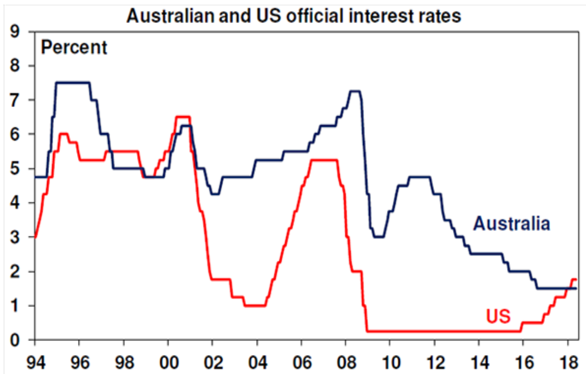
Interest rates

In Australia, cash rates continued at 1.5% with rates on hold for a record 21 months consecutively. The RBA appears unconcerned about share market volatility, the risk of a trade war and higher bank funding costs. Notable over the month was the decline in the $A against the $US which is not only positive for domestic exporters, but the strength of the currency was a factor against interest rate increases. In addition, tighter bank lending conditions have seen Sydney house prices declining marginally. Any generalised decline in house prices will also act as a factor against any decision to increase the cash rates. Global growth, business conditions and employment growth remain strong, however there are offsetting factors, notably low inflation, and the RBA appears comfortable to wait for a clear change in conditions prior to raising rates.

Headline and core inflation continue to track at the bottom of the RBA's 2-3% target. Specifically, core CPI inflation for the March quarter was +0.5% q/q and a little higher in year-ended terms at +2.0% y/y. Utilities and tobacco have substantially boosted headline inflation, whilst retail inflation remains subdued, but showing some signs of increasing.

Beyond the cash rate, 10-year bond yields rose 17 basis points over the month to 2.77% in the absence of any significant new data impacting investor outlook other than a rally in US bond yields. US bonds rose 21 basis points to end at 2.95% but off recent highs.

Recent moves in bond yields have seen US interest rates above those of Australia for the first time since the early 2000's. One outcome of this is likely downward pressure on the $A as investors move offshore to invest in the higher interest rates offshore.



Source: Bloomberg, AMP Capital

Property

The Australian AREIT sector rose sharply in April, up 4.3%, supported by a decline in long bond yields and solid rental conditions. The recent decline had also led to the sector offering attractive yields. There was supportive news for the retail sector, which has declined on the back of a range of concerns, when Scentre Group released its first quarter earnings update. Total sales growth was slightly stronger in the first quarter, growing by 1.1%, driven by stronger than expected sales growth from the major retailers.