View from the hill

APRIL 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 **31 March 2018.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	-3.8	-3.9	2.5	3.8
Smaller companies	-2.3	-2.8	15.0	10.7
International shares (unhedged)	-0.5	0.8	13.3	8.0
International shares (hedged)	-2.3	-2.3	11.0	8.5
Emerging markets (unhedged)	-0.3	3.4	24.3	8.7
Property – Australian listed	0.1	-6.2	-0.1	5.8
Property – global listed	3.0	-5.9	-0.7	2.0
Australian fixed interest	0.8	0.9	3.3	2.5
International fixed interest	0.8	-0.1	2.9	3.2
Australian cash	0.1	0.4	1.7	2.0

Overview & Outlook

Equity market volatility continued into March with most global markets ending weaker. The MSCI World ex Australia Index was down 2.3% (hedged), following February's loss of 3.7%. Australian equities were impacted by the negative sentiment with the S&P/ASX 200 down 3.8%. This brought annual returns for the respective indices to 11.0% and 2.5%.

Over March, equities generally traded sideways although the US equity market displayed some very large daily moves which caught investors as they had become used to the very low volatility that has prevailed over the last few years. However, toward month-end markets fell sharply notably in the technology sector, a sector that has lead markets over the last few years, on concerns over the potential for regulation of some of the social media companies, with Facebook receiving significant attention because of its release of data to an outside party. Adding to the sector's woes was the death of a cyclist from a driverless car which led to a sell-off of several of the technology stocks expected to benefit from the growth in this area. Into April, stocks had stabilised when President Trump in an unscripted town meeting in West Virginia announced his intention to add tariffs to another $100bn worth of Chinese imports. This was over and above the tariffs on $50bn of imports from China already announced.

In response to the first set of tariffs on steel and aluminum China has announced some carefully targeted tariffs on US imports to China in response. China's proposed tariffs are on US soybeans, aircraft, whiskey, wheat etc. and designed to impact industries that occur in areas where President Trump has significant electoral support.

As a result of the announcement US stocks saw another sharp sell-off on April 6th. Investor concerns, which had risen after the first announcement, were further heightened, that a full-blown trade war may eventuate and impact global growth as well as inflation, as the expected tariffs increased the price of imported goods of the nations involved. We detail investor concerns and the potential impact of these on the US economy below.

The first point we would make is that the announced tariffs are not in place and need to go through a 60-day comment period and if, over this time, negotiations fail then the tariffs are imposed. Both parties have announced their intention to try to preclude the imposition of the tariffs. Assuming the tariffs are put in place, what is the likely impact? AMP Capital[1] has researched this issue and they note that the impact is difficult to model reliably - Chinese and US goods flowing to each other could just be swapped for goods coming from countries not subject to tariffs, reducing the impact. But modelling by Citicorp of a 10%

[1] AMP Capital Weekly Market Update, April 6th

tariff hike by the US, China and Europe (a scenario that at this point appears unlikely given as this presumes all exports are involved and that Europe also imposes tariffs) showed a 2% hit to global GDP after one year with Australia seeing a 0.5% hit to GDP reflecting its lower trade exposure compared to many other countries. This is notable, but not catastrophic and negotiations could take months.

The initial market response to President Trump's proposed tariffs on China was an overreaction with US shares losing US$1.4 trillion in market capitalization in response to maybe less than US$50 billion in tariffs and as compared to US$800 billion in fiscal stimulus in the US this year from the tax cuts recently enacted.

In the meantime, there will be ongoing noise around the issue – with China and the US potentially announcing a further escalation in their proposed tariffs. In addition, negotiations could take months while President Trump and Republicans are facing mid-term elections in November and are thus the potential for error as a result of "talking tough" is raised. Investors are cautious, and markets could remain volatile as this issue combined with a rising rate environment and raised geopolitical risk will be difficult for equities in the next few months.

The chart below clearly shows why President Trump has a view that US trade with China is not being conducted on an equitable basis.

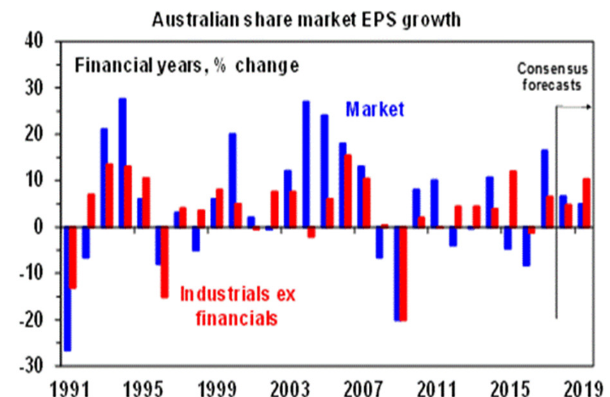
Economist.com

Source: The Economist

Share markets

The ASX 200 Accumulation Index was down over March (3.8%), led by the US equity sell-off as opposed to any specific domestic factors although the discussion around changes to dividend imputation refunds under a Labor government did impact specific high yield stocks. Financials (-6.0%) were further impacted by the Royal Commission despite trading at a deep discount to the market (~33% discount to industrials as compared to a long-term average of ~20%). A cooling house market also added to negative sentiment. At a sector level, the worst performers on a capital return basis were Telecommunications (-6.2%), Financials (-6.0%) and Materials (-5.6%). All sectors were negative over the month with the best relative performers being the rate sensitive sectors, including Real Estate (-0.3%) and Utilities (-1.2%). They were supported by the fall in long-dated bond yield as the ten-year bond fell 19 basis points and investors reduced risk and moved into safer assets.

EPS growth expectations are now around 5% for 2018-19 and this outlook, combined with a benign interest rate environment, will be supportive of the equity market. However, over the short term, domestic equities will be driven by US equity market volatility.



Interest rates

In Australia, cash rates continued at 1.5%, with rates on hold for a record 20 month consecutively. The RBA appears unconcerned about share market volatility, the risk of a trade war and higher bank funding costs. While global growth, business conditions and employment growth are strong, there are offsetting factors notably very low inflation and the RBA appears comfortable to wait for a clear change in conditions prior to raising rates.

Beyond the cash rate, 10-year bond yields were largely unchanged over the month at 2.60% in the absence of any significant new data impacting investor outlook. US bonds fell 14 basis points to end at 2.74% as there was a flight to safety driven by equity market volatility.

Property

The Australian AREIT sector fell marginally in March, down 0.1%, supported by falling bond yields and an attractive yield after the recent pullback.

In the retail sector, primary shopping centres continue to see positive trading conditions, as owners continue to introduce and reposition their dining, cafes and other food retail offers into their centre expansion plans to reduce the ongoing headwinds of increased competition from international retailer entrants and internet sales. While the downward underlying trend in retail sales growth continues, consumer confidence remains stable.

This newsletter is provided by Hillross Financial Services Limited (ABN 77 003 323 055 & AFSL No. 232705) an AMP Group Company. It is of a general nature only and any advice is not based on your objectives, financial situation or needs. Accordingly, you should consider the appropriateness of any advice to your personal circumstances before acting on the advice. Before you make any investment decision, you should read the current Product Disclosure Statement available from Hillross or your financial adviser. Although this information was obtained from sources considered to be reliable, we do not guarantee it is accurate or complete. The information in this publication is current as at 10 April 2018 and may change over time. Hillross is part of the AMP group of companies. No additional remuneration or other benefits are paid to us or our related companies or associates in relation to the advice provided on this page. If you decide to purchase or vary a financial product, your financial adviser, Hillross and other companies within the AMP Group or associates of Hillross will receive fees and other benefits, including fees calculated as a percentage of either the premium you pay or the value of your investment. Further details are available from your adviser or Hillross. Past performance is not a reliable indicator of future performance.