The View From The Outer

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EVANS & PARTNERS

Market Outlook

ASX200 Index Target March 2018 = 5750 – 5900

Synopsis: As of 27 February, the ASX200 at 5724, has risen 1.8% on a month to date. The rally this month has been US led, with the S&P500 up 4.0% month to date, the US corporate profit reporting season well received and continuing optimism of a more pro-growth US policy agenda. Despite a continuing strong rise in the spot iron ore price in February, the Resource sector pared recent stellar gains, falling 2.9% month to date. Once published, the 12 month Accumulation Index returns to end February will inevitably be inordinately strong, but will also significantly reflect the extent of undue pessimism re global growth and the commodity outlook that prevailed in early 2016 before the Chinese stimulus program gained traction. This however, is now very well discounted in the market.

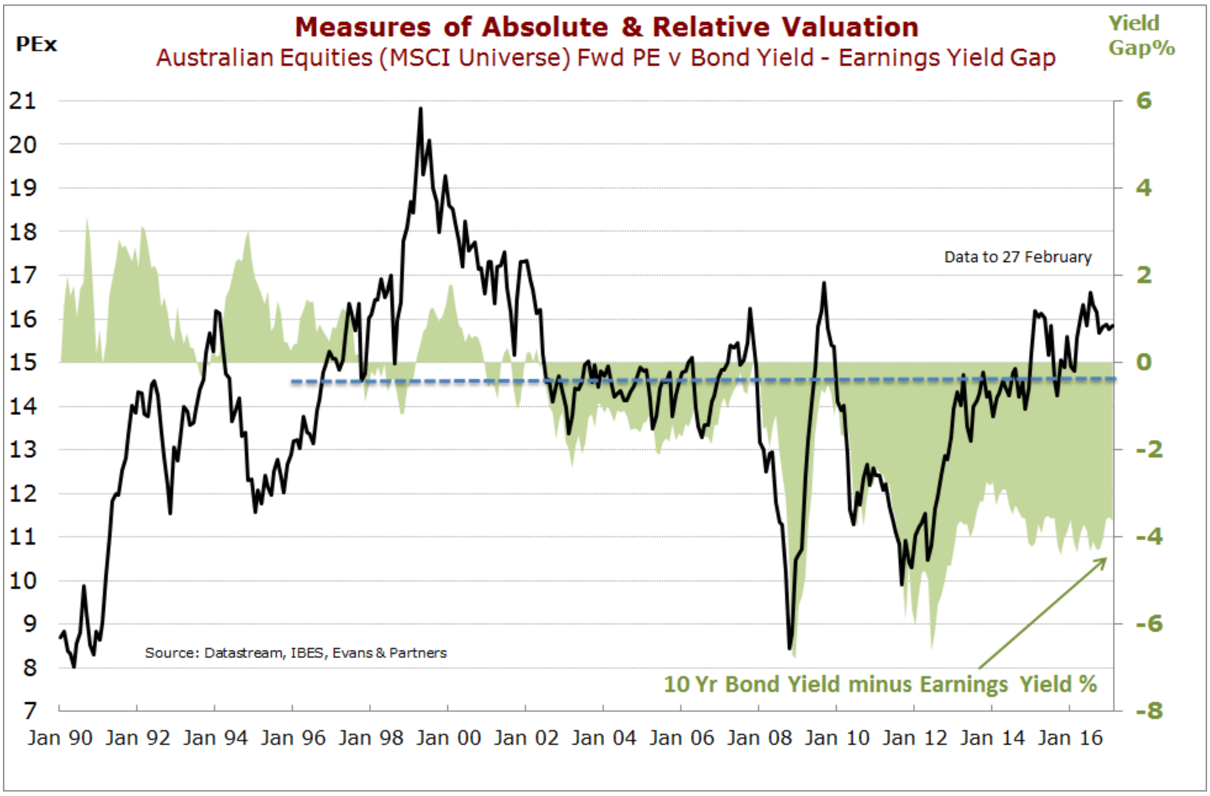
Our 12 month index price target implies little aggregate upside in the overall index, but assumes a meaningful pull-back in the Resource sector and a year of respectable total returns from the Industrials. Given US policy uncertainties and heightened geo-political risks, volatility risk may be higher than normal this year. Inevitably, our market forecast reflects contemporary interpretations of a range of both positive and negative influences. We briefly note the following:

Positives

- Record low short term interest rates in Australia remain an ongoing positive. We assume the RBA holds official cash rates at 1.5% until at least end 2017 despite rising US rates. Fed tightening expectations (and the USD) have increased post Donald Trump's election as the US economy continues to approach full employment. Together with weaker commodity prices, we therefore expect the AUD/USD weaken over 2017 (a net positive for the Industrial sector).
- Given monetary policy's diminished efficacy in stimulating growth, the axis globally is tilting towards fiscal policy as a policy tool. Commodity prices have remained higher than expected which is reflecting in a recovery in the terms of trade and should be supporting an improved domestic nominal growth environment and a less deflationary environment globally.
- While resource led, Australian EPS growth expectations have improved for FY17 and FY18.

Negatives

- The February reporting season has again underscored that the structural challenges confronting a significant proportion of Australia's largest listed companies remain substantial and an impediment to strong profit growth.
- China's fiscal and credit stimulus certainly supported demand in 2016, but the coking coal price spike (now unwinding) was supply driven, while the outlook for additional low cost iron ore supply in 2017 remains daunting. Longer term risks remain from the rapid escalation of Chinese debt to maintain current growth rates.
- If implemented, Donald Trump's proposed tax reductions / fiscal stimulus implies stronger US economic growth from late 2017/ early 2018. The risk of a sell-off at the long end of the US bond market, however, challenges valuation multiples.
- Equity markets initially responded favourably to the pro-growth and pro-business components of the Trump manifesto, but substantial uncertainties remain. The harder the market rallies, the greater the near term risks, noting that US equity market volatility (as measured by the US VIX Index is unusually low. While not our base case scenario, potential risks remain over the Trump Administration approach to trade policy.



RESEARCH RECOMMENDATION DEFINITIONS

Positive	Stock is expected to outperform the S&P/ASX 200 over the coming 24 months
Neutral	Stock expected to perform in line with the S&P/ASX 200 over the coming 24 months
Negative	Stock is expected to underperform the S&P/ASX 200 over the coming 24 months
Speculative Buy	Stock has limited history from which to derive a fundamental investment view or its prospects are highly dependent on event risk, *eg.* Successful exploration, scientific breakthrough, high commodity prices, regulatory change, etc.
Suspended	Stock is temporarily suspended due to compliance with applicable regulatory and/or Evans & Partners policies in circumstances where Evans & Partners is acting in an advisory capacity.
Not Rated	Stock is not included in our investment research universe.

Research Criteria Definitions

Recommendations are primarily determined with reference to how a stock ranks relative to the S&P/ASX 200 on the following criteria:

Valuation	Composite of rolling 12 month prospective multiples and discounted cash flow (DCF), or DCF for resource stocks.
Earnings Outlook	Forecast 2 year EPS growth.
Earnings Momentum	Percentage change in the current consensus EPS estimate for the stock (rolling 1 year forward basis) over the consensus EPS estimate for the stock 3 months ago.
Shareholder Returns	Composite of forecast ROE (rolling 1 year forward basis) and the percentage change in ROE over 2 years.
Debt Servicing Capacity	Rolling 12 month EBIT Interest Cover ratio.
Cyclical Risk	Qualitative assessment of the 2 year outlook for a stock/industry's profit cycle.
Industry Quality	Qualitative assessment of an industry's growth/returns potential and company specific management capability
Financial Transparency	If we don't understand it, we won't recommend it.

For stocks where Evans & Partners does not generate its own forecasts, Bloomberg consensus data is used. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate.

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