Synopsis of the Macro Background

Global growth: Global growth expectations continue to be pared back, which together with the strong commodity supply pipeline continues to undermine commodity prices. The latest *IMF World Economic Outlook* projects growth for 2015 at 3.1 percent, 0.3 percentage point lower than in 2014 and the slowest rate of global growth since 2009 (see chart below). In aggregate Advanced Economies continue to improve modestly whilst Emerging Economies have continued to slow, weighed down by the structural slowing in China, weaker commodity prices and a stronger US Dollar. In the **US** GDP growth for 3Q released overnight was weaker at 1.5% annualised, but after a 3.9% increase in 2Q. Further, the composition of growth was favourable with Private Consumption growth of 3.2% annualised and Inventories reduced. In **China**, growth continues to slow, inconveniently (for Australia) concentrated in the industrial and construction sectors. Significant overcapacity issues take time to resolve and will likely continue to bear down upon aggregate commodity demand. The outlook for steel demand looks particularly poor, as Chinese exports surge. Weakness in China is spilling across to **Asian** trading partners and **Emerging Markets**.

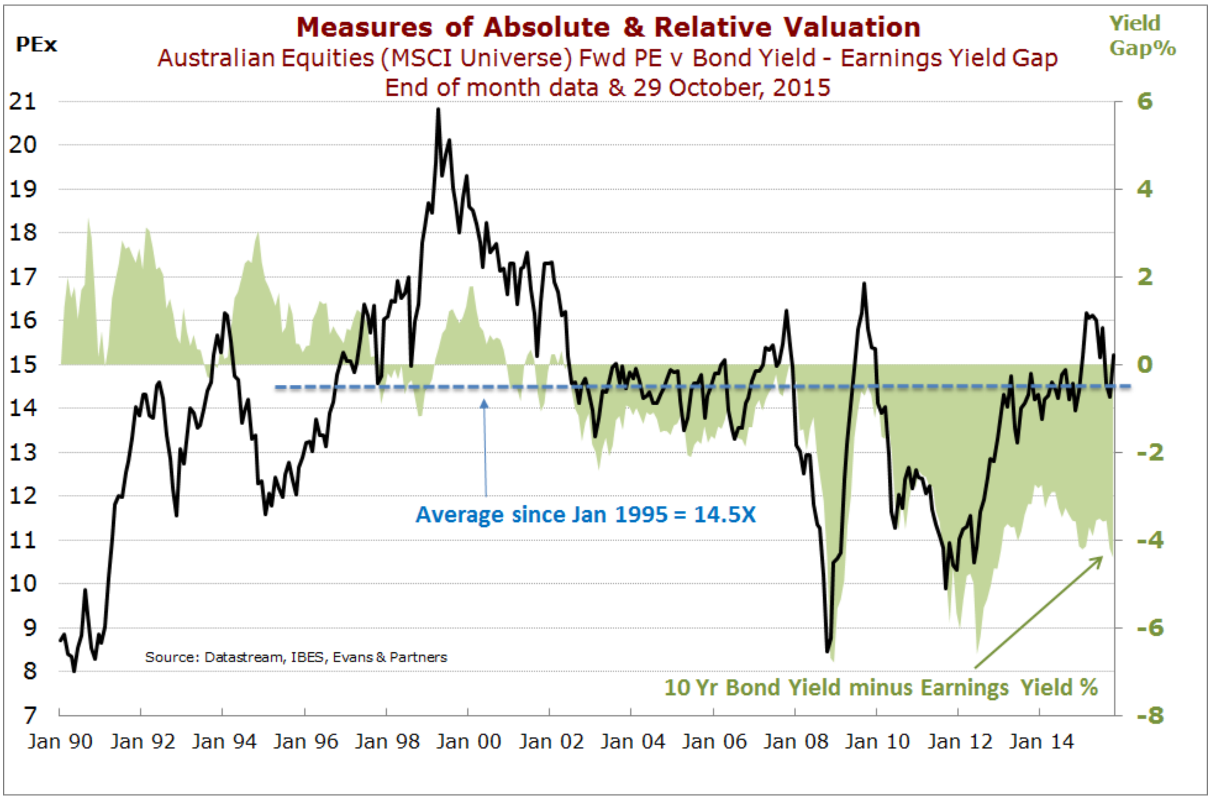
Global monetary policy: Despite the weaker growth in US Non-farm Payrolls over the last two months there was a more hawkish tone to the US FOMC Statement. We are increasingly confident tightening will commence at the December meeting but that the subsequent pace of tightening will be very modest, and that the Fed will stress it is "data dependent." Elsewhere, monetary policy and interest rates continue to ease. China has just reduced interest rates for the sixth time since last November and the ECB has clearly hinted that further easing is likely at their December meeting.

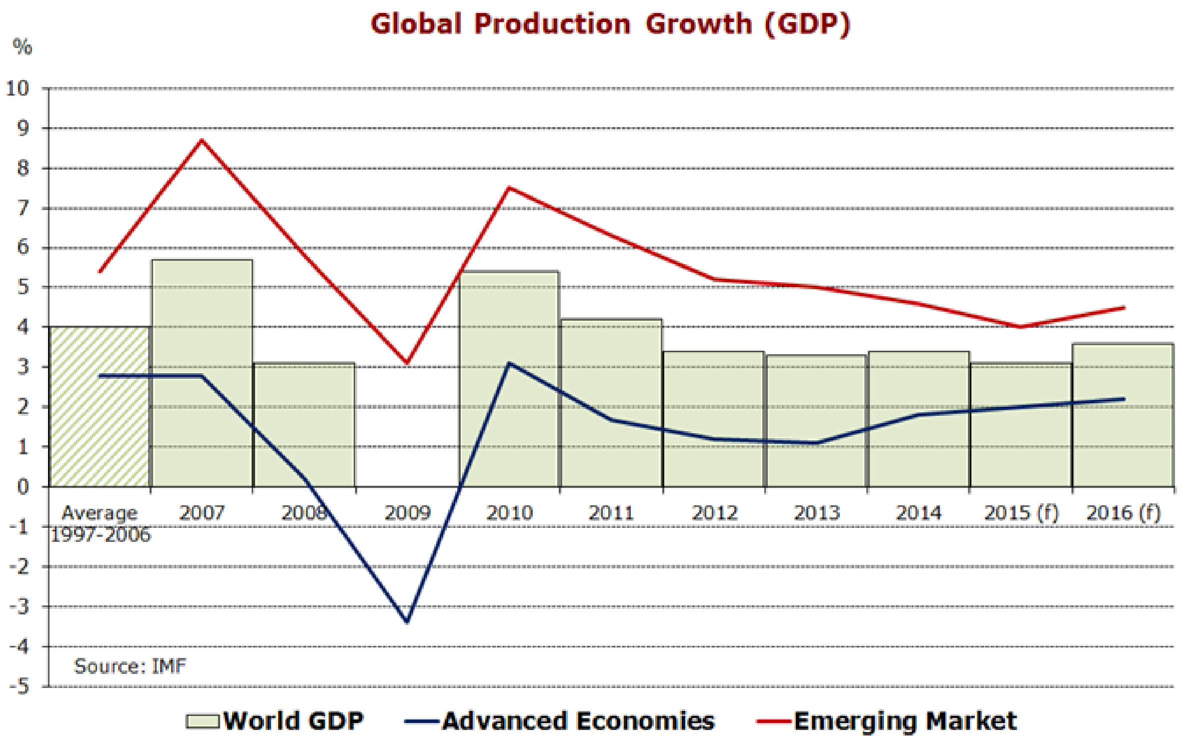
Global equity markets: Remains our preferred asset class, supported by ultra-low interest rates, continuing growth and a structurally more attractive investment universe than domestic equities.

Domestic growth: Weak income growth, the unwinding of the mining investment boom and the terms of trade decline continue to constrain growth. Low interest rates support solid Final Demand growth in NSW and Victoria. Building approvals are now slowing, but are still above previous cyclical peaks in trend terms.

Domestic monetary policy: The lower than expected September Q CPI, together with the out of cycle mortgage rate increases have heightened expectations of a further reduction in the RBA Official Cash Rate. We do not expect any change at the Cup Day meeting; it is likely to be too soon for the RBA to assess the impact of recent out of cycle rate increases by the banks. A February RBA rate cut is a possibility if the international growth outlook continues to deteriorate and the impact of the out of cycle mortgage interest rate increases is substantial.

Domestic equity markets: Downgrades continued in October, primarily driven by the Metals & Mining and Energy sectors (especially in the out years as commodity expectations adjust). Earnings prospects remain best in the Industrials ex-Banks, REIT's and Utilities; this remains our preferred part of the market. We maintain our underweight to Resources. S&P/ASX200 FY 2016 EPS growth is expected to be negative as resource EPS declines offset mixed positive sectoral industrial EPS growth. The estimated 12 month forward PE based on consensus expectations as at 29 October is 15.2X; compared with the average since January 1995 of 14.5X. (See chart below).





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