View from the hill

APRIL 2017

Market update

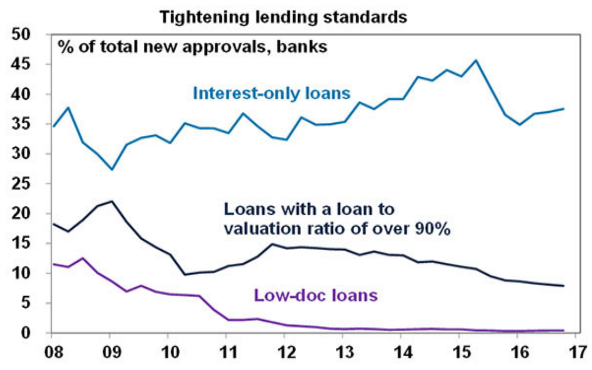
The table below provides details of the movement in average investment returns from various asset classes for the period up to **31 March 2017.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	3.3	4.8	20.5	7.5
Smaller companies	2.7	1.5	13.7	6.4
International shares (unhedged)	1.8	0.9	15.6	12.8
International shares (hedged)	1.0	5.7	18.8	10.3
Emerging markets (unhedged)	3.3	5.8	18.2	8.0
Property – Australian listed	0.7	-0.1	6.3	16.8
Property – global listed	-1.8	0.5	2.6	10.8
Australian fixed interest	0.4	1.2	2.1	5.0
International fixed interest	0.0	0.7	2.2	5.6
Australian cash	0.2	0.4	1.9	2.3

Overview & Outlook

The Trump administration's tax reduction and infrastructure policies continued to have a positive influence on equity markets, following a broadly well-received address to Congress in late February. However, towards the end of March, the withdrawal of the Affordable Care Act repeal bill focused the market on the reality that electoral promises and intentions do not necessarily or easily translate into legislation. In the US, Congress largely determines budget outcomes however despite its majority the Republicans cannot be considered as a single voting block and there will most likely be significant compromises before policy is settled. However, the Trump Administration's push to implement lower taxes and trade reforms may see the failure to repeal or amend the Act as likely to be only a short-term issue.

The failure of the Obamacare reforms has seen the focus move to tax reform while negotiations around a passable health care bill appear to be continuing so some form of legislation on this issue may yet be passed. Talk of another government shutdown is also likely to start and increase through April as a new resolution funding spending will need to be passed by month-end. Ongoing in-fighting in Congress means that a shutdown is possible but as the 2013 experience showed, it's not in either parties interest to allow this situation to eventuate. It is likely that a deal will be worked out ahead of a shutdown.



AMP Capital

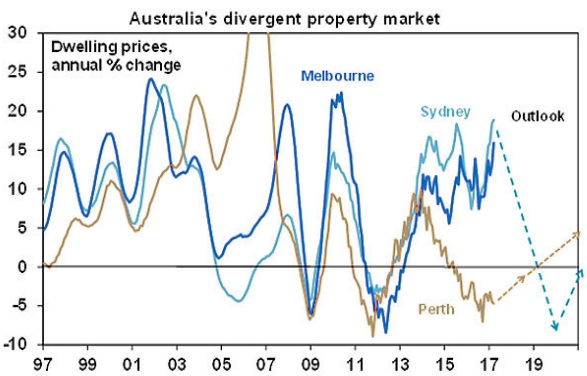
In Australia the buoyancy in the Sydney and Melbourne housing markets has seen the Australian Prudential Regulation Authority's long awaited additional macro prudential tightening add to the likelihood that these property markets will start too slow. The main change was an expectation that lenders limit interest-only loans to 30% of new mortgage lending (from 40% at present) and strict limits on loan-to-value ratios above 80% for interest-only loans. There is also an expectation that lending to investors remains "comfortably below" the 10% growth limit, that serviceability measures remain "appropriate" and that lending to high risk categories is "constrained".

Notable was that the investor lending growth limit remains at 10% rather than being reduced to a more reasonable 5-7%. Limiting interest -only lending may have the same effect as cutting lending growth because around 60% or more of investor loans are interest only, and the regulator is likely to be monitoring impacts closely. The latest moves are in addition to the bank mortgage rate hikes over the last two weeks, and likely to boost affordability in the May budget (including a cut to the capital gains tax discount). The surge in unit supply and all these factors are likely to result in a slowdown in property price gains in Sydney and Melbourne this year, ahead of a potential 5-10% price fall starting next year at some point.

Within the debate on house prices is the issue of levels of household debt and there appears to be a view that household debt is now so high that any hike in interest rates will cause significant defaults. These could impact the banking system with knock-on impacts on the economy. While household debt has increased since the GFC, interest payments as a share of household disposable income are at their lowest since 2003. Mortgage rates would need to rise by nearly 2% to get the interest servicing ratio back to its most recent 2011 high, which slowed the economy but did not cause any significant issues. Notably most mortgage holders are ahead on their debt payments.

Share markets

Australian equities were up strongly in March, with the S&P/ASX 200 Accumulation Index closing 3.3% higher. The big four banks were significant contributors to performance, as they benefitted from the strong residential property market and positive sentiment that has prevailed across global share markets since the US elections in November last year. Banks have benefitted from increased rates on investor and interest-only loans which flow through to increased earnings. Concerns have however, been raised by some analysts around the potential for a property downturn, which would increase bad debts as well as the ability of some corporates to service loans.



Source: AMP Capital

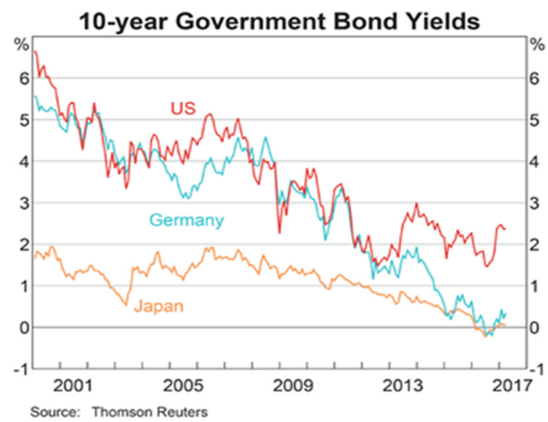
Other significant sector moves over the month were in Utilities (6.3%) and Healthcare (5.6%) while weaker performers were Materials (0.2%) and Telco's (0.3%). The better performing sectors were responding to share news while Materials were flat as the recent run in commodity prices levelled off, notably iron ore, and Telco's struggled on poor investment sentiment to Telstra.

Global markets, rose again in April, with the MSCI World ex Australia Net Index closing 1.8% higher on an unhedged basis. The US market however, while still positive, was weaker than other global markets, as investors have begun to scrutinise the maturing 'Trump-trade' rally, and are looking at the increasingly stretched market valuations against the likelihood of the Trump administration getting its much-discussed pro-business legislation through Congress. European markets were firm on improved economic data and the Dutch election results indicating strong support for pro-Europe parties.

Interest rates

Bond yields, both locally and globally, were largely flat over March as investors receiving little new information that would drive yields. Cash rates in Australia were maintained at 1.5% at the RBA's April meeting. Current rate settings are likely to remain in place until the second-half of next year as the Bank continues to balance a very buoyant housing market in Sydney and Melbourne with low underlying inflation, a strong $A and high levels of underemployment.

The US Federal Reserve raised interest rates by 25 basis points for the second time in three months to 0.75%. However, the Fed continued to manage expectations, reiterating in its policy statement that further increases are conditional on improved growth and low levels of inflation. The Fed dot plot, which shows the Fed officials expectations of rates going forward, indicates expectations of 3 more rate hikes this year and the same number of hikes again next year. Market expectations continue to be below this outlook indicating some potential for market turbulence should investors adjust their interest rate expectations upward.



Source: RBA

Property

In an uneventful month for listed property sector was up slightly with the S&P/ASX300 A-REIT total return index returning 0.7% - valuations were supported by flat bond yields and the commercial market supported ongoing rental growth, particularly in the Sydney office market.