# View from the hill

MAY 2017

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 2017.**

| Asset class (% change) | 1 month | 3 months | 1 year | 3 years (%pa) |
|---|---|---|---|---|
| Australian shares | 1.0 | 6.7 | 17.8 | 7.3 |
| Smaller companies | -0.3 | 3.8 | 10.0 | 6.8 |
| International shares (unhedged) | 3.6 | 7.0 | 16.9 | 13.7 |
| International shares (hedged) | 1.3 | 5.5 | 19.2 | 10.5 |
| Emerging markets (unhedged) | 4.2 | 9.6 | 21.6 | 9.3 |
| Property – Australian listed | 2.6 | 7.6 | 6.1 | 15.6 |
| Property – global listed | 0.6 | 2.0 | 4.4 | 9.7 |
| Australian fixed interest | 0.8 | 1.4 | 2.6 | 4.9 |
| International fixed interest | 0.7 | 1.7 | 2.6 | 5.5 |
| Australian cash | 0.2 | 0.4 | 1.9 | 2.3 |

## Overview & Outlook

Several political tensions characterized April, including Eurozone elections, tensions between the US and North Korea and simmering conflict in the Middle East. However, markets looked through these threats and were largely unaffected by them. The lack of political momentum in terms of the Trump business agenda, contributed to concerns that equity markets may pullback, as the so-called Trump trade faded, however markets were again resilient. Notably, bond yields fell as concerns regarding impending inflation pressures, driven by the potential for increased US infrastructure spending, also declined.

Markets have taken their lead from the buoyancy in global economic growth, which is looking healthier than at any time since the GFC. The growth improvement has resulted from easy monetary policy globally via very low interest rates and the reduction in budget constraints as the need for deficit reduction has fallen. In addition, memories of the GFC, and fears of another crisis are receding, as the crisis was around 10 years ago and so the negative impact on confidence is receding. The improved outlook will support earnings growth and equity markets however it may also lead to higher bond yields beyond their current decline.

Several factors are pointing to stronger global growth. Business condition indicators have moved to their highest level since the post-GFC recovery and the recovery is widespread, not just in the US. Surprisingly, Europe has recorded the strongest recovery. A second indicator is the OECD's leading economic indicators (effectively an indicator that turns positive early in a growth recovery) has also turned up sharply.

Other indicators include unemployment, which in most economies has started turning down and Asian economies' export growth, which is a good indicator of the health of the global economy, has accelerated. These indicators give a strong indication that the improved outlook for global economic growth could run for some time.


AMP Capital

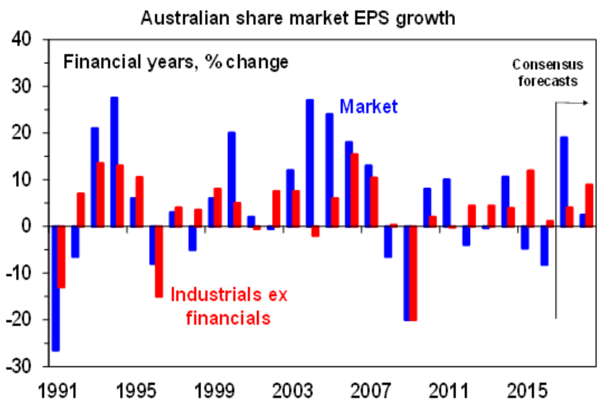
In addition, most signs of peak in activity are still very benign. Spare capacity remains in labor markets, manufacturing is still below capacity and wage growth and inflation remain low.

In Australia, the improved economic growth will have a positive impact most directly through higher resource prices and export demand and then through higher domestic growth, albeit with a time lag. Some of the higher earnings growth that can be expected from the improved economic outlook has already been reflected in the equity market which delivered a return of 14% in the last six months.

The investment implications will differ for each asset class but, broadly speaking, we would expect improved earnings growth to support equity markets and commodity prices although the impact here will be reduced by increasing supply. The end to declining interest rates globally however, may dampen some of the buoyancy. The Fed is already hiking and reversing its quantitative easing while China is also gradually hiking. Japan and Europe will most likely follow suit but with a significant lag. Improving growth will see bond yields most likely resume their upward path, albeit gradually, and this will weigh on their returns as well as the returns of global REITs and infrastructure equities.

## Share markets

Australian equities were up again in April, with the S&P/ASX 200 Accumulation Index 1.0% higher. Most sectors recorded positive returns but notably Resources had a negative month as did Telco's. The resource sector was impacted by drops in the oil price toward month-end as well as sharp declines in the iron ore price. This decline has raised some concerns around the delayed impact of the monetary tightening in China on economic growth in that country. Telco's fell as Telstra was impacted by the granting of a 4 G license to TPG which will allow it to compete directly with Telstra in several markets.




Source: UBS, AMP Capital

The chart above demonstrates the expected improvement in company earnings over the next 2 years. While there is significant support from the rebound in resource earnings, the Industrials (red bars) is now moving to a higher growth profile. The recent weakness in the $A, to around $US0.74c, will also contribute to earnings growth, if sustained.

Global markets rose in April, with the MSCI World ex-Australia up 3.6% on an unhedged basis. The US market was again weaker than other global markets, up 0.9% for the S&P500. As global confidence has improved the risk-on trade has returned with Asian (4.2%), Emerging markets (4.2%) and global small company (4.1%) indices all recording strong gains.

## Interest rates

Bond yields, both locally and globally, declined over April as investors became less concerned that an uptick in inflation was imminent despite higher global growth. In Australia, cash rates were held at 1.5% at the RBA's May 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 and higher national income against low underlying inflation, a still strong $A and high levels of under-employment. The April RBA Board minutes noted that the "developments in the labor and housing markets warranted careful monitoring over coming months".


Source: RBA

The US Fed continued to manage rate expectations, reiterating in its policy statement that further increases are conditional on improved growth and continued low inflation. We expect two hikes this year with the first at the Fed's meeting in June. In addition to the expected rate hikes the Fed is also moving to start reducing its balance sheet toward year-end. This will be done by not re-investing the proceeds of bonds as they mature, as has been the case until now. The current stockpile of bonds are those that were bought to hold down medium- and long-term interest rates immediately after the GFC. This roll-off will take several years and will have the same effect as raising rates as it will place upward pressure on yields.

## Property

The Australian listed real estate market posted a positive return during April (2.6%), outperforming the wider Australian equity market. The most significant market news was the long-expected announcement by Amazon that it is developing a retail offering in Australia. This development is likely to further impact falling sales at retail malls and will exert downward pressure on rental levels, over the longer term.