View from the hill

DECEMBER 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 **30 November 2018.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	-2.2	-9.3	-1.0	7.7
Smaller companies	-0.4	-10.3	-1.6	10.4
International shares (unhedged)	-1.8	-6.6	4.2	8.2
International shares (hedged)	1.2	-5.0	1.9	9.3
Emerging markets (unhedged)	1.1	-6.4	-5.5	9.1
Property - Australian listed	-0.3	-4.9	1.6	8.4
Property - global listed	3.2	-1.6	3.7	5.5
Australian fixed interest	0.2	0.3	2.5	3.3
International fixed interest	0.5	-0.2	0.5	3.0
Australian cash	0.2	0.5	1.9	1.9

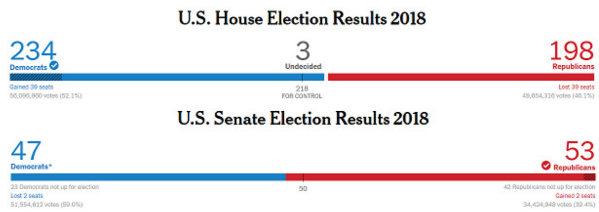
Overview & Outlook

As we move toward the festive season respite for investors may be coming given developments on trade with China, as discussed below, combining with some clarification from US Federal Reserve Chair Jerome Powell where he indicated that rates are "just below the broad range of estimates of the level that would be neutral for the economy."

Markets have continued to see volatility largely driven by investor fatigue from a long bull market and significant headwinds in the face of slowing economic growth in Europe, the US and China combining Trump's trade wars and the shift from quantitative easing to quantitative tightening and rising interest rates.

All year investors have been concerned about the escalating protectionism in US-China trade. The end of November G20 Summit may have been a pivotal point with China and the US agreeing not to increase or add tariffs for 90 days to allow further negotiations on a range of trade related issues such as IP protection, forced technology transfer and agriculture. According to Chinese sources there was discussion around working toward eliminating tariffs which would be a positive for trade. While the issues may be resolved if they are not, then the proposed tariff increases will likely go ahead. This would mean that tariffs on $200 billion of Chinese goods would increase from 10 to 25 percent and potentially put tariffs on the remaining $267 billion worth of goods from China that are not yet subject to tariffs.

The US mid-term elections were much less surprising than the elections that swept Donald Trump into the White House. The Republicans lost their majority in the House, as was widely expected, losing 39 seats to finishing with 198 seats to 234 seats. Due to the number and location of senators up for re-election, the Republicans were able to increase their margin in the Senate 53 seats to 47 seats. The impacts of this are yet to be seen but one would expect much more pressure on Trump from the House now with a Democrat majority.



Source: New York Times 3/12/2018

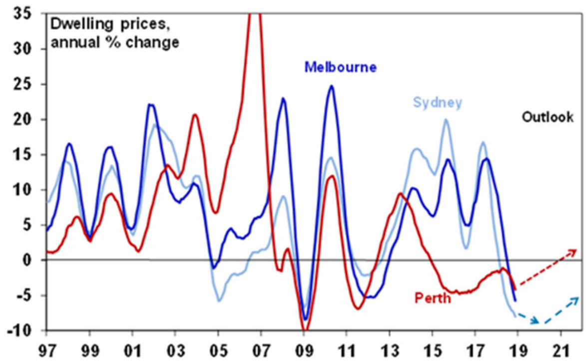
Another area of concern for markets is the UK's exit from the European Union (Brexit). In recent developments Britain's Prime Minister Theresa May and the EU have agreed on a deal for the UK's smooth exit in March. But British politicians are threatening to derail it, and the Prime Minister is battling to persuade them to support her agreement when Parliament votes later this month.

If the deal is rejected and the UK exits with no deal the Bank of England has said that in a worst-case scenario Britain's economy could slump more than it did after the 2008 global financial crisis. It predicted with tariffs and other trade barriers, and no transition period to help businesses adapt — inflation would rise to almost 7%, unemployment would soar to 7.5% from 4.1%, the pound would fall to near parity with the dollar and house prices would fall 30%. While the worst case is unlikely it clearly would impact financial markets if things went this way.

Share markets

In the last week of November US shares had their strongest week since December 2011. Which highlights when markets are falling strong rebounds can occur. Australian shares (-2.2%) continued to see the weakness that really took hold in October. The weakest returns were recorded in Energy (-10.3%), Resources (-6.5%) and Consumer Discretionary (-5.1%). Some positive returns were eked out in Financials (1.4%) and Info Tech (1.0%).

On top of the global issues and weakening macro factors the Australian residential property market is weighing on investor sentiment. With weak clearance rates, uncertainty around credit tightening, potential changes in negative gearing rules and immigration into Melbourne and Sydney being restricted by government further weakness in these markets is likely. This is having a negative wealth effect and may be a driver of the weaker retail sales being seen in Australia and is acting as another drag on Australian shares.



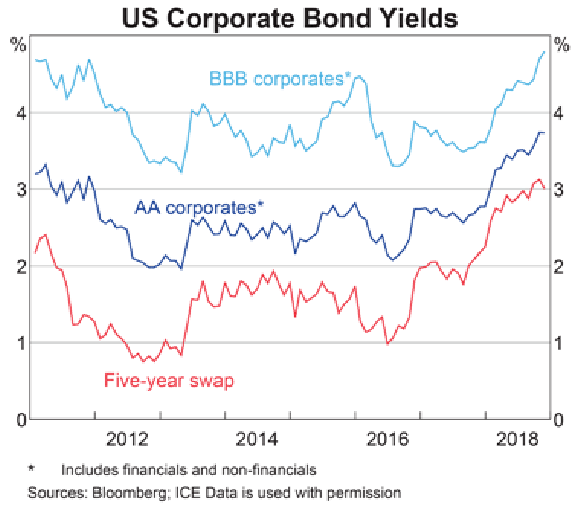
Source: CoreLogic, AMP Capital

Global shares (1.2%) were able generate positive returns despite continued concerns around US China trade tensions, weakening macro-economic indicators and tightening monetary policy. Emerging markets (1.1%) unhedged saw some strength after recent weakness. Emerging Market equities (3.2%) in local currency terms was one of the best performers in November, this was supported by the indication by the US Fed that future rate rises may be less than previously anticipated. A rise in the Australian dollar resulted in global shares falling (-1.8%) in Australian dollar terms where the currency risk wasn't hedged.

Interest rates

Fixed interest markets saw yields decline across the board as the asset class benefitted from flight to safety buying driven by the volatility of equity markets. In addition, benign inflation data and increasing evidence of a slowing in global growth supported bond prices. Comments by the Fed that US cash rates may have peaked also pushed yields lower. The bellwether US ten-year bond yield fell 15 bps to 2.99% while the Australian ten-year bond yields fell 4 bps to 2.59%

Spreads in corporate bonds have risen, particularly in high yield which given how low they had become was one of the areas of concern within fixed interest markets. We continue to favour quality but acknowledge that rising rates and unwinding of quantitative easing is a headwind to traditional fixed interest markets including developed market investment grade sovereign bonds and corporate credit. Lower duration (sensitivity to interest rate movements) as opposed to no duration is also preferable in case of equity market falls being accompanied with investors moving into sovereign bonds as a safe haven as has usually occurred in the last twenty plus years.



Source: RBA

Property

Listed property in Australia was down (-0.3%) and not immune to Australian equity market weakness although better than the broader Australian share market. Globally real estate investment trusts performed well gaining (3.2%).

The underlying market is seeing strength in Office particularly Sydney and Melbourne where prices through to September, according to the most recent release of IPD Direct Property Index data, rose 17.1% and 14.4% respectively. The industrial sector also has performed well gaining 11.6%. Retail remains the weakest sector with weak retail sales growth impacting on the underlying property value growth rates.

Due to the upcoming holiday season next month's report will be published in the week starting 15th January 2019