View from the hill

JANUARY 2020

HILLROSS

Market update

The table below provides details of the movement in average investment returns from various asset classes for the period up to **31 December 2019.**

Asset class (% change)	1 month	3 months	1 year	3 years (%pa)
Australian shares	-2.2	0.7	23.4	10.3
Smaller companies	-0.3	0.8	21.4	10.0
International shares (unhedged)	-0.9	4.3	28.0	13.8
International shares (hedged)	2.4	7.7	27.4	11.8
Emerging markets (unhedged)	3.4	7.3	18.6	12.7
Property - Australian listed	-4.2	-0.7	19.6	9.5
Property - global listed	-0.1	0.8	22.3	9.0
Australian fixed interest	-1.6	-1.3	7.3	5.1
International fixed interest	-0.3	-0.8	7.2	4.1
Australian cash	0.1	0.2	1.5	1.7

Past performance is not a reliable indicator of future performance. The Global Listed property reference index changed to FTSE EPRA/NAREIT Developed Rental NR Index (AUD Hedged) as of August 2019

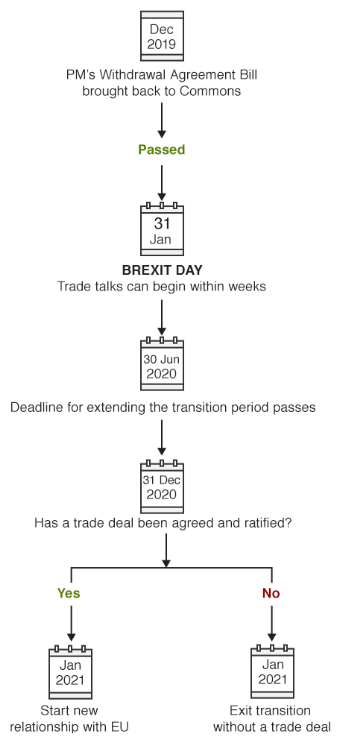
Overview & Outlook

Global investor sentiment was bullish towards the end of December, which is not only consistent with the Santa Claus rally (which refers to the strong market returns that are observed during the December holiday season) but may also reflect investor optimism about stronger global economic conditions into 2020.

The two largest economies in the world, China and the US, have finally agreed on the terms of the Phase One trade deal. However, it should be noted that the deal is still in the process of being translated into legal terms and is expected to be signed at the White House on January 15. The US President Donald Trump has taken plenty of credit for the negotiations and the deal, possibly as a result of the need to gain political traction after he was formally impeached on December 18 for abuse of power and obstruction of Congress.

Boris Johnson's Conservative Party achieved a landslide majority win in the December 12 UK general election. Since the election, the UK Parliament has voted in favour of the EU (Withdrawal Agreement) Bill. According to the Bill, the UK would exit the EU on 31 January 2020 and a transition period with free trade will begin during which the EU and UK are expected to negotiate trade deals for after the transition period. Furthermore, the government is prohibited from extending the transition period beyond 31 December 2020, meaning that the free trade deal between the UK and EU could still end in a hard exit if no agreement is reached by the end of the year.

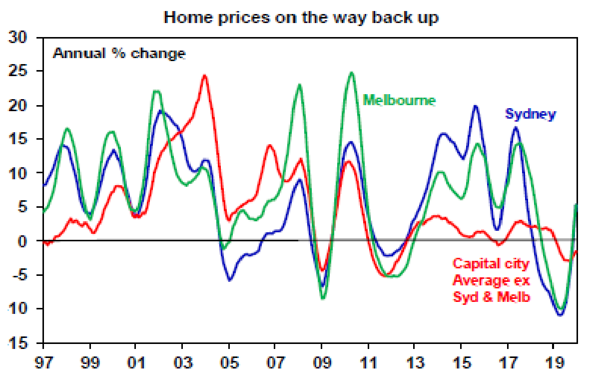
Conservatives win majority



Source: BBC

Just when many believed that geopolitical risks were beginning to settle somewhat, the US carried out a drone strike in Iraq on 3rd January, killing Iranian Major General Soleimani. This initially heightened tensions between the two nations as Iran retaliated by launching over a dozen missiles at two Iraqi bases that held US troops, none of which were present at the time. Since the strike Trump has declared that the US will not further escalate the issue through military action.

CoreLogic data displayed that domestic house prices continued to strengthen in December, especially in Sydney and Melbourne. Since the housing price fall in 2017, Sydney and Melbourne house prices have recovered 57% and 79% of their losses, respectively. House prices are expected to continue growing strongly in the first half of 2020 with anticipated assistance from further RBA cash rate cuts down to 0.25%, whereas the growth is expected to slow during the second half of the year due to stricter lending. A continued increase in house prices may result in the wealth effect by which consumers increase spending as homeowners believe they have greater wealth, potentially boosting the economy.



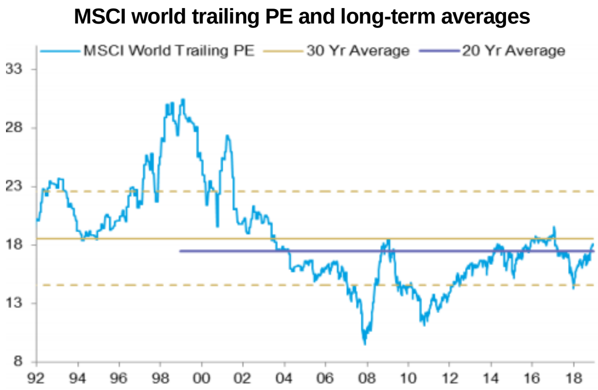
Source: CoreLogic, AMP Capital

Share markets

Stock markets experienced positive returns in December as many ongoing geopolitical risks displayed signs of settling and as global economic data improved slightly, suggesting that monetary easing seen throughout 2019 gained momentum. On the other hand, the Australian market lagged its global counterpart and recorded negative returns.

International stock returns were in line with the Santa Claus Rally, gaining 2.4% in December on a currency hedged basis. Key contributors included global small cap stocks, which returned +2.6% on a currency hedged basis as well as US equities (+3.0%). Global emerging market stocks (+3.4%) benefitted from monetary easing by major central banks and progress in US-China trade talks encouraged investors to consider riskier assets.

Some investors argue that global stocks are expensive when considering their fundamentals. However, this is not necessarily true when looking at their PE ratio, apart from in certain markets such as Australia and the US. Although the MSCI World 12-month forward PE ratio is trading somewhat higher than the long-term average, it may be more appropriate to use 12-month trailing earnings as the confidence level surrounding the 12-month forward consensus earnings is low. As displayed in the graph below, this results in a PE multiple that is below the 30-year average PE ratio of 18.5x.



Source: MSWM Research, Bloomberg. As at 19 Dec 2019

The Australian equities market was down 2.2% in December as most sectors experienced losses. After a slump early in the month due to uncertainties around the US-China Phase One deal, the ASX200 progressively recovered throughout the month before ending with a sharp decline on the last trading day of the year. The materials sector led the domestic market, gaining 1.5% as it benefitted from the increases in the prices of oil, copper, raw materials as well as gold as the US and China progressed towards a Phase One trade agreement throughout the month. Consumer staples (-8.1%) and telecommunication services (-7.8%), were the two worst performing sectors in the domestic market, with investors exiting these bond proxies and trade tensions eased.

Interest Rates

The Australian fixed interest market was down 1.6% in December as the Australian 10-year bond yield increased by 33 basis points to 1.37%, which may be a correction from the all-time low of 0.85% experienced in August. This increase as well as the gain in the US and UK 10-year bond yields (which were up 5 and 13 basis points, respectively) also reflect the improved investor sentiment and optimism regarding stronger global economic conditions in the year ahead.

Property

December was a weak month for the property market as A-REITs fell by 4.2% and G-REITs returning -0.1% on a currency hedged basis. These negative returns were driven by higher bond yields and investors reticence to investing in defensive areas of the market.