Investor wealth
STRATEGIC WEALTH MANAGEMENT

Season's Greetings

The team at Investor Wealth wish you a Merry Christmas, and a safe and Happy New Year.

Investor Wealth proudly supports a number of charities throughout the year which include the Salvation Army, World Vision, Solar Buddy for Children, and the National Breast Cancer and Prostate Cancer Foundations.

Our office will close at 1pm Friday 21st December 2018 and re-open Monday 7th January 2019.

Christmas 2018 Newsletter

Welcome to the Christmas edition of the Investor Wealth newsletter. We witnessed reasonable global economic and profit growth in 2018 with continued low interest rates however it has been a rough year for investors with worries about the Fed, trade wars and global growth causing volatility. Please refer to the article below which has an overview of 2018 and a look at what to expect next year. The Investor Wealth team wishes you all a wonderful and safe Christmas period, and look forward to the New Year ahead.

Dr Shane Oliver:
2018 – a lot weaker than expected

After the relatively low volatility and solid returns of 2017, the past year has seen almost the complete opposite with high volatility and poor returns. It started strongly in January but started to get messy from February. At a big picture level things were fine: global growth looks to have held solid at around 3.7%, inflation rose in the US but only to target and it remained low elsewhere, the Fed raised interest rates but rates generally remain low and profits rose solidly. But it was the risks below the surface that came together to give a rough ride. There were five big negatives:

- **Fear of the Fed.** The Fed provided no real surprises and nor did US inflation, but investors became increasingly nervous that Fed hikes would crush US growth and profits.
- **US dollar strength.** While the US dollar did not rise above its 2016 high it caused problems in the emerging world where US dollar denominated debt is high.
- **President Trump's trade war.** This was always a high risk for 2018 and once it got underway it weighed on share markets. While the initial focus seemed to be the US versus everyone it morphed into fears of a new Cold War with China adding to fears about growth and profits.
- **China slowdown.** This was as expected to around 6.5% as a result of credit tightening but fears that it will combine with the trade war and get worse added to global growth angst.
- **Global de-synchronisation.** US growth was strong, but it slowed in Europe, Japan, China and the emerging world.

Australia saw growth around trend and made it through 27 years without a recession, as infrastructure spending, improving business investment and strong exports helped support growth and this in turn drove strong employment growth, a fall in unemployment and the Federal budget closer to a surplus. Against this though credit conditions tightened significantly with the Royal Commission adding to regulatory pressure on the banks, house prices fell, wages growth edged up but remained weak and inflation remained below target, all of which saw the RBA leave rates on hold. Overall this drove a volatile and messy investment environment.

Investment returns for major asset classes

Total return %, pre fees and tax	2017 actual	2018* actual	2019 forecast
Global shares (in Aust dollars)	13.4	6.0	11.5
Global shares (in local currency)	18.7	0.6	9.0
Asian shares (in local currency)	36.3	-10.8	10.0
Emerging mkt shares (local currency)	30.6	-7.8	10.0
Australian shares	11.8	-2.7	8.0
Global bonds (hedged into $A)	3.7	0.2	0.5
Australian bonds	3.7	3.0	2.0
Global listed property securities	8.2	2.7	7.0
Aust listed property trusts	5.7	1.2	7.0
Unlisted non-res property, estimate	11.0	10.0	7.0
Unlisted infrastructure, estimate	13.0	10.0	9.0
Aust residential property, estimate	5.0	-4.5	-6.0
Cash	1.8	1.8	1.7
Avg balanced super fund, ex fees & tax	**10.5**	**0.5**	**6.5**

* Yr to date to Nov. Source: Thomson Reuters, Morningstar, REIA, AMP Capital

- Global shares saw weak returns in local currency terms with significant corrections around February and October. But this masked positive returns from US shares but weakness elsewhere. Global share returns were boosted on and unhedged basis because the $A fell.

- Asian and emerging market shares paid the price for being star performers in 2017 with losses thanks to a rising $US causing debt servicing fears, the US trade war posing a threat to growth and political problems in some countries.
- Australian shares were hit by worries about the banks, consumer spending in the face of falling house prices and weakness in yield-sensitive telcos and utilities offsetting okay profit growth and low interest rates.
- Government bonds yet again had mediocre returns reflecting low yields and capital losses from rising yields in the US as the Fed hiked. Australian bonds outperformed.
- Australian house prices fell led by Sydney and Melbourne.
- Cash and bank term deposit returns were poor reflecting record low RBA interest rates.
- Reflecting US dollar strength, the $A fell not helped by a falling interest rate differential and lower commodity prices.

2019 – better, but volatility to remain high

In a big picture sense, the global economy looks to be going through a mini slowdown like we saw around 2011-12 and 2015-16. This is most evident in business conditions indicators that have slowed but remain okay. The key global themes for the year ahead are likely to be:

- **Global growth to stabilise and then resynchronise.** Global growth is likely to average around 3.5% which is down from 2018 but this is likely to mask slower growth in the first half of the year ahead of some improvement in the second half as China provides a bit more policy stimulus, the Fed pauses in raising interest rates, and trade war fears settle down (hopefully).
- **Global inflation to remain low.** With growth dipping back to around or just below trend in the short term and commodity prices down inflation is likely to remain low.
- **Monetary policy to remain relatively easy.** The Fed is likely to have a pause on rate hikes during the first half and maybe hike only twice in 2019 as it gets into the zone that it regards a neutral. Rate hikes from other central banks are a long way away. In fact, further monetary easing is likely in China and the European Central Bank may provide more cheap funding to its banks.
- **Geopolitical risk will remain high causing bouts of volatility.** The main focus is likely to remain on the US/China relationship and trade will likely be the big one. While Trump is likely to want to find a solution on the trade front before tariffs impact the US economy significantly.

In Australia, strength in infrastructure spending, business investment and export values will help keep the economy growing but it's likely to be constrained to around 2.5-3% by the housing downturn and a negative wealth effect on consumer spending from falling house prices. This in turn will keep wages growth slow and inflation below target for longer. Against this backdrop the RBA is expected to cut the official cash rate to 1% with two cuts in the second half of 2019.

Implications for investors

With uncertainty likely to remain high around US interest rates, trade and growth, volatility is likely to remain high in 2019 but ultimately reasonable global growth & still easy global monetary policy should drive stronger overall returns than in 2018:

- Global shares could still make new lows early in 2019 (much as occurred in 2016) and volatility is likely to remain high but valuations are now improved and reasonable growth and profits should see a recovery through 2019.
- Emerging markets are likely to outperform if the $US is more constrained as we expect.
- Australian shares are likely to do okay but with returns constrained to around 8% with moderate earnings growth. Expect the ASX 200 to reach around 6000 by end 2019.
- Low yields are likely to see low returns from bonds.
- Unlisted commercial property and infrastructure are likely to benefit from the search for yield but it's slowing.
- National capital city house prices are expected to fall another 5% led again by 10% or so price falls in Sydney and Melbourne as tighter credit, rising supply, reduced foreign demand and potential tax changes under a Labor Government impact.
- Cash and bank deposits likely to provide poor returns.
- The $A is likely to see more downside into the high $US0.60s, as the gap between the RBA's cash rate and the Fed Funds rate goes further into negative.

What to watch in 2019?

After the turmoil of 2018, the outlook for 2019 comes with greater than normal uncertainty. The main things to keep an eye on in 2019 are as follows:

- US inflation and the Fed – our base case is that US inflation stabilises around 2% enabling the Fed to pause/go slower, but if it accelerates then it will mean more aggressive tightening, a sharp rebound in bond yields and a much stronger $US which would be bad for emerging markets.
- The US trade war – while it may now be on hold thanks to negotiations with China, Europe and Japan these could go wrong and see it flare up again. US/China tensions generally pose a significant risk for markets.
- Chinese growth – a continued slowing in China would be a major concern for global growth and commodity prices.
- The property price downturn in Australia – how deep it gets and whether non-mining investment, infrastructure spending and export earnings are able to offset the drag from housing construction and consumer spending.

Source: Dr Shane Oliver, AMP Capital