FOX Wealth Management

Quarterly Market Review

December 2018

This review looks at the global investment markets and reports on some of the underlying asset class performance and influences.

Published: 24th January 2019

CONTENTS

OVERVIEW	3
WHAT HAPPENED IN THE MARKETS	4
ASSET CLASS REVIEW	5
GLOBAL SHARE MARKETS	5
DOMESTIC SHARE MARKETS	6
DOMESTIC & GLOBAL PROPERTY	6
DEBT MARKETS	6
CURRENCY	7
WHERE TO FROM HERE	7
KEY MESSAGE	8
DISCLAIMER	9
CONTACT DETAILS	9

Please Note: Past performance is not a reliable indicator of future performance.

Warnings and Disclosure: The contents of this review are general advice and do not relate to the acquisition or possible acquisition of classes of assets or financial product(s). Before making any investment decisions the reader should obtain and consider more information, including the Investment Statement or Product Disclosure Statement for each product and, where relevant:

The reader must consider whether it is personally appropriate considering his or her financial circumstances or should seek further advice on its appropriateness. This is not to be taken as personal advice and does not constitute a recommendation to purchase, hold, redeem or sell any product(s), and the reader should seek independent financial advice before investing in any product.

OVERVIEW

Share Market Corrections Dominate Activity

The global markets tumbled in the last quarter of 2018 as investors experienced a volatile period driven by doubt over the future direction of economic and business trends. The sharp sell-off was mainly fuelled by the global growth expectations as the US trade tariffs started to bite and early signs of China slowing worried investors. The Federal Reserve (Fed) continued to tighten monetary policy, which added uncertainty to the US future growth prospects.

Cyclically October and November can be problematic as the market digest's company and economic data ahead of the festive break however this year, December ended up experiencing a month of reflection and uncertainty as many forecasters changed their view and started talking of recession possibilities. This seemed to spook the market.

While the duration of such market corrections is never certain, without clear evidence that a problem exists, the underlying signals are still supportive of global growth but maybe not at the same level as we had seen in the first half of 2018.

Debt markets rallied with investors running for cover chasing the higher yielding securities which is a typical tactical move given the share market volatility.

Big picture uncertainty is mostly centred around:

- The late cycle environment and talk of the end of the bull market for US equities;
- Corporate profitability following the US trade tariffs;
- China's economy and signs of slowdown; and
- Global growth expectations given the political events and continued market price volatility.

Share market volatility proved to be the main driver of the investor nervousness along with the falling asset prices. **It is never easy when markets correct but it is part of the investment cycle.**

Monetary Policy

The Fed Chairman, Jerome Powell raised the target range for the **US federal funds to 2.25%-2.50%** at the recent 18th – 19th December 2018 FOMC meeting and lowered forecasts for interest rate hikes in 2019 amid recent volatility in financial markets and early signs of slowing global growth

The Bank of Japan maintained their Quantitative Easing (QE) programme the BOJ maintained its short-term interest rate target at minus 0.1% and a pledge to guide 10-year government bond yields around zero percent.

The European Central Bank maintained the refinancing interest rates at positive 0.25% for margin loans and negative 0.40% deposit facility however, the Governing Council confirmed that the ECB will cease the net asset purchases as at the end of December 2018 citing risks are broadly balanced.

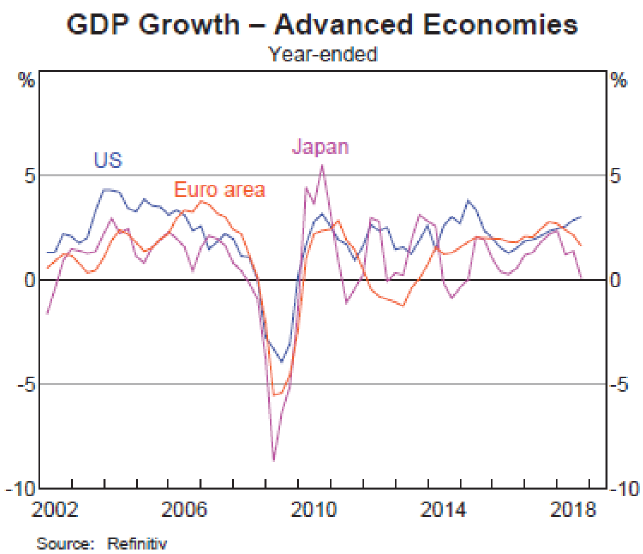
Growth and Inflation

The GDP data revealed that growth in the US was up slightly however, the Euro area, China and Japan eased over the quarter.

Globally, economists and Government officials are still looking for **GDP growth of between 2% and 3%** for the next fiscal year.

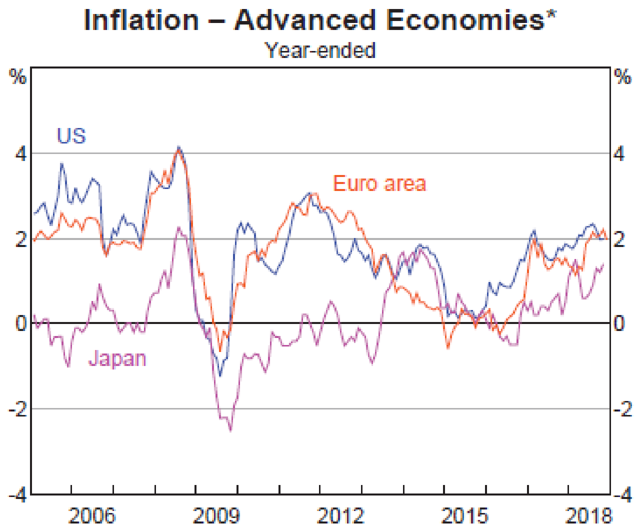
The latest charts for GDP and inflation data reveal:

Chart 1



Inflation slowed in the US over the quarter along with the other regions. **Global inflation is still expected to be 2.8%** in 2019 which reflects increased tariffs, as well as, a higher profile for oil prices next year. Gauging the effects of tariffs on inflation requires a view on currency moves and the degree of pass-through to final prices which can be difficult to accurately project.

Chart 2



* Personal consumption expenditure (PCE) inflation for the US; Japan data excludes the effects of the consumption tax increase in April 2014
Sources: RBA; Refinitiv

Investment Climate

Investors have been spooked by the emerging talk of a global slowdown and potentially, recession on the horizon. The sharpness of the correction in equities over December 2018 has added fuel to this discussion.

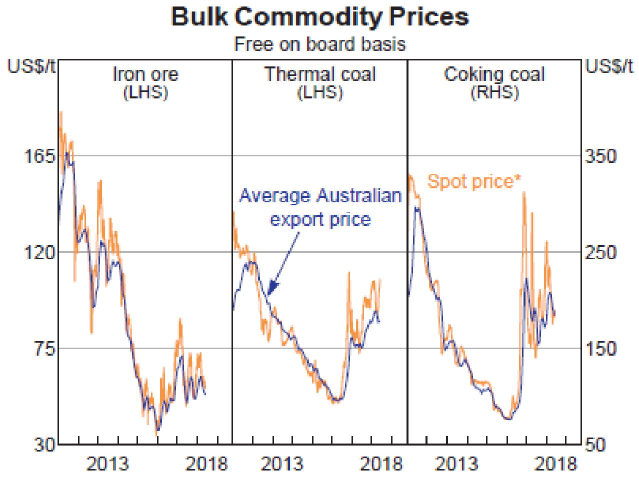
WHAT HAPPENED IN THE MARKETS

The global **share markets finished sharply lower over the December quarter** as investor optimism waned following recession talk. Much will depend on how this pattern unfolds during the next quarter.

Debt markets benefited as the US yield curve shifted lower in response to the volatility in the equity markets. We expect this trend to be short lived.

Commodity markets were pressured over the quarter with the WTI Oil price closing at US $45.41 a barrel which was a fall of 38.01% since September 2018 close of US$73.25 a barrel.

Chart 3



* Iron ore fines; Newcastle thermal coal and premium hard coking coal
Sources: ABS; Bloomberg; IHS; RBA

Iron Ore tracked sideways from US$68.44 a dry metric ton to close at US$69.15 in December 2018. This was a gain of some 1.04% over the quarter.

Economic Data:

Regionally, the economic data revealed the following:

- **United States of America**: The US economy in GDP terms, expanded by an annualized 3.0% in the third quarter of 2018, up slightly from the 2.9% in the second quarter of 2018. The unemployment rate rose to 3.9% in December 2018 up from 3.7% in September 2018. **Inflation shifted lower to 2.2% in December 2018** from the previous 2.7%.
- **China**'s GDP growth rate slowed to 1.6% in October 2018. The annual GDP growth rate year-on-year was lower at 6.4 % from 6.7% with the unemployment rate steady at 3.80% in the fourth quarter, down from 3.82%.
- **Europe area** GDP annualised growth rate was a little lower at 1.6% for the third quarter of 2018. Europe's unemployment rate improved to 7.9% for November 2018. Core inflation settled at 1.0% in December 2018; and
- **Australia's** latest GDP data for the second quarter of 2018 revealed an annual growth rate of 2.8% which was down from the previous 3.1% in September 2018. Unemployment fell to 5.1% in

December 2018. The CPI Inflation rate finished flat at 1.9% in the third quarter of 2018.

ASSET CLASS REVIEW

Growth asset prices fell sharply in every sector over the quarter. Investor confidence was weak as the concerns about the impact of the trade war on global growth weighed on the return expectations. We expect this uncertainty to carry over into the next quarter but overall a growth trend to continue although at a slower pace.

Defensive assets achieved positive results over the quarter as bonds were deemed to be a safe-haven given the share market volatility. The main concern for bond holders remains the US QT (quantitative tightening) strategy of the Fed and the impact on liquidity and capital prices globally. We expect this rally to be temporary.

Table 1

ASSET CLASS	RETURNS	RETURNS	RETURNS
GROWTH	3 Months	6 Months	12 Months
Global Shares	-11.00%	-4.34%	2.08%
Australian Shares	-8.24%	-6.83%	-2.83%
Global Property	-6.03%	-5.84%	-4.37%
Australian Property	-1.91%	-0.08%	2.91%
Global Infrastructure	-3.95%	-5.21%	-5.81%
ASSET CLASS	RETURNS	RETURNS	RETURNS
DEFENSIVE	3 Months	6 Months	12 Months
Global Fixed Interest	2.30%	1.70%	2.50%
Australian Fixed Interest	2.23%	2.79%	4.52%
Australian Cash	0.47%	0.99%	1.92%

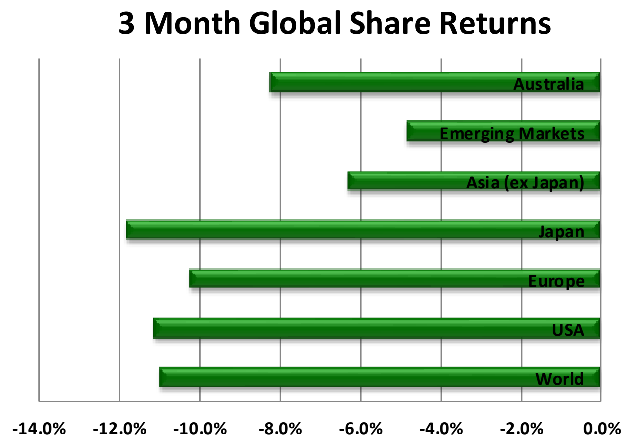
Source Data: Lonsec as at 31st December 2018

Note: The above performance returns reflect total returns in Australian Dollars (prices plus dividends assumed reinvested).

GLOBAL SHARE MARKETS

Global share markets suffered sharp falls over the December quarter 2018 led by investor sentiment. The short-term impact of the US/China trade flows remains the unknown background factor.

Chart 4



Source Data: Lonsec as at 31st December 2018

United States share market faltered from their recent run and retreated some (-11.12%) over the quarter but still returned a (+6.22%) over the last 12 months.

European share markets fell sharply (-10.25%) over the December 2018 quarter. The ECB made changes to their monetary policy, despite softer economic growth. The ECB indicated it will cease asset purchases (QE) in December 2018.

Asia retreated (-6.29%) following the global rout in shares. The impact of any trade war between the US, Canada, Mexico and China still weighs on the region.

Emerging markets delivered a (-4.83%) being slightly protected by the continued sell-off with analysts viewing the sector as heavily oversold.

China is still confident of hitting its economic growth target of around 6.5% this year despite views that it faces a bumpy period as the trade row with the United States plays out. We will watch the economic data for any impact.

In Japan, the stock market retreated (-11.82%). The economy has stalled with annual GDP growth rate close to zero reported in the third quarter of 2018 along with au unemployment rate edging up to 2.5% in November 2018

DOMESTIC SHARE MARKETS

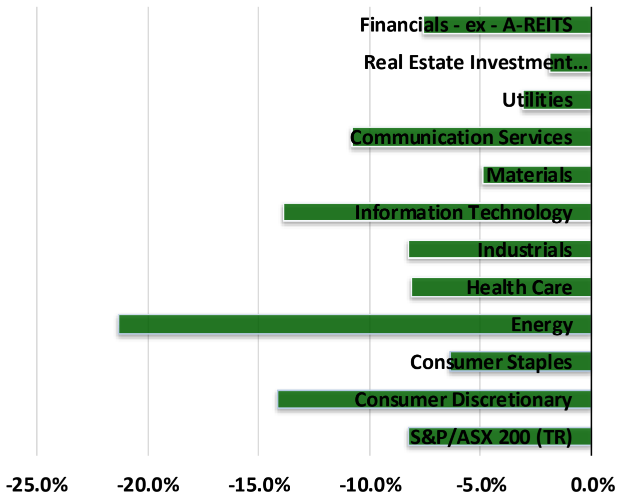
The Australian share market (S&P ASX200) posted a loss of (-8.24%) over the December 2018 quarter.

The underlying sector performance reflected the broad-based sell-off with all sectors impacted.

The oil price fall by 38% took a heavy toll on energy stocks with the sector falling some (-21.31%).

Chart 5

3 Months Australian Industry Returns



Source Data: Lonsec as at 31st December 2018

For the beginning of 2019 share analysts remain confident of an improving economy and growing company profits however, projections for the S&P/ASX200 have been trimmed. With the S&P/ASX200 index price closing at 5,656.40 for December 2018, growth estimates for the year ahead have been downscaled to 6% plus dividends of 4% so looking for total returns of approximately 10.0%. This would mean a price target of 5,995 which looks achievable.

In terms of dividends, analysts expect defensive stocks to deliver around the 4.0 % p.a. which if fully franked at 100% (company tax at 30%) would deliver a yield of 5.71% grossed up.

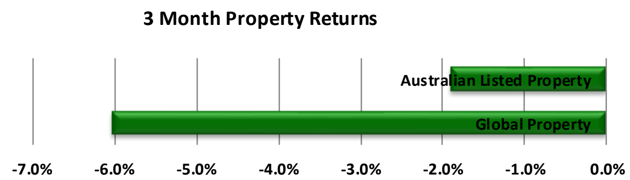
Remember this is a projection and subject to revision, **past returns are no guarantee of future returns**.

DOMESTIC & GLOBAL PROPERTY

Globally, the property sector experienced losses of (-6.03%) as the share market volatility and sentiment dragged the sector lower. Expectations for rising interest rates and falling asset prices continue to weigh heavily on the sector.

Listed property in Australia was less impacted and ended lower at (-1.91%) over the quarter.

Chart 6



Source Data: Lonsec as at 31st December 2018

As mentioned previously, most property funds have moderate gearing levels (circa 30% to 40%) with many opting for CPI indexed leases to help counter any future interest rate rises with additional revenue.

Many lock in their interest rate exposure which limits the impact of rising interest rates on cash flows.

DEBT MARKETS

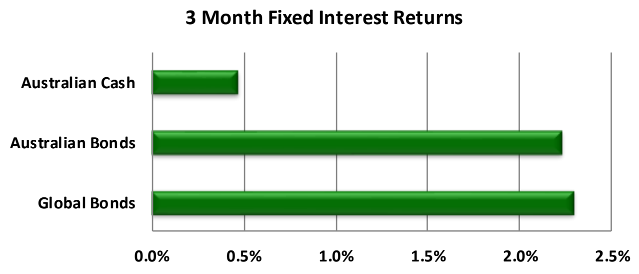
Bonds rallied over the quarter as investors preferred the relative safety of debt markets with lower levels of volatility. For the moment, longer term trends for rising interest rates have taken a back seat as the equity market volatility stole the limelight.

In the US, the Board of Governors of the Federal Reserve System voted to increase the federal funds target rate to 2.25% to 2.50% at their meeting on 19th - 20th December 2018.

Their insights suggest that there could be fewer rate hikes next year than originally anticipated. Most members of the Federal Open Market Committee (FOMC) predict that there will be two rate hikes in 2019 rather than the three projected in September.

Source: FOMC Statement 20th December2018.

Chart 7



Source Data: Lonsec as at 31st December 2018

The US 10-year Government bonds closed at 2.83% for the quarter down in yield (0.23%) from the previous quarter close of 3.06%. The Australian Government 10-year bonds finished firmer in December 2018 at 2.32% down in yield from 2.68% in September 2018.

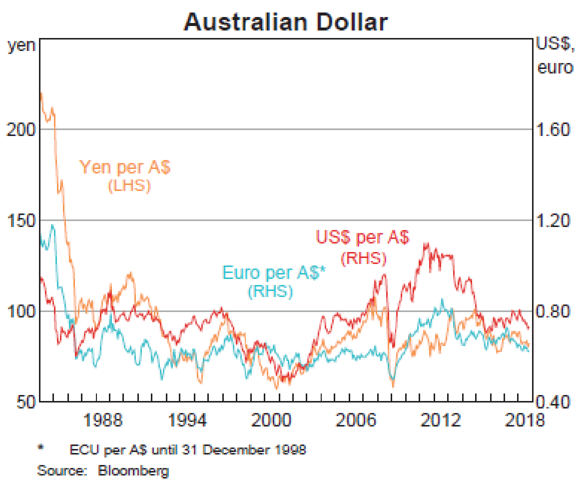
The Reserve Bank of Australia retained its monetary policy stance leaving the target cash rate unchanged at 1.5% at the recent 4th December 2018 board meeting.

Most domestic economists are expecting **little to no change** in the official Australian cash rate in the medium term however, the market is thinking that by mid-2019 inflation and growth may bring about a policy change.

CURRENCY

The AUD finished the December 2018 quarter lower at AUD/USD 0.7068 compared to 0.7222 in September 2018, a fall of 2.27%.

Chart 8



The interest rate differential blew out to 51 basis points (0.51%) in the AUD/USD 10year bonds in favour of the US.

Currency forecasters see the AUD/USD range between 0.6500 and 0.8500 cents in the medium term.

WHERE TO FROM HERE

The US trade war impact on global growth remains top-of-mind for investors. Any disruption to the US supply chain may cause problems for importers who rely on China exports.

On the flip side, US exporters of agricultural products, such as Soybeans, have already been impacted with China sourcing the commodities elsewhere due to trade tariffs.

For **Australian share investors**, we watch the markets for clues as to the impact of the US tariffs and restrictions for our key export markets.

We expect the market volatility to remain a part of the market process for the immediate future however, we expect economic growth to continue, although at a slower pace, and company earnings to support a mild increase in share prices over the year ahead despite periods of uncertainty.

For **Australian Bond investors**, the fixed rate bond markets are likely to reverse the recent gains which will enhance the **potential for capital losses**, particularly the long-dated issues.

The inflation numbers in Australia remain largely subdued around 2% and now that the residential property market is retreating, there is little momentum to excite consumers.

Inflation should track sideways under this scenario.

The bigger picture threat is rising global interest rates and credit spreads widening. Despite the recent rally, we expect Australian bond yields will increase mildly over the year ahead but official cash rates to remain on hold at 1.5%.

KEY MESSAGE

The global political landscape is littered with "hot spots" including:

- The US with the latest government shutdown over the funding costs to "build the wall" along with the ongoing arm wrestling with China over the US trade imbalances;
- The UK and BREXIT - repercussions across Europe for this on again off again drama;
- Europe (European Central Bank) has issues with growth and inflation concerns along with Italy's ongoing the debt refinancing saga;
- Japan – stuck in the mud with economy stubbornly tracking sideways despite the ongoing support from the Bank of Japan;
- China slowdown post the trade war implementations; and
- Asia caught up with the contagion of Emerging Market sell off in both debt and equity markets.

Growth expectations will weigh heavily on markets over the next quarter. The focus for investors will be on company earnings.

Strategic Asset Allocation (SAA)

Globally we expect to see more volatility across all asset classes. While this is not the time to radically change SAA exposures in terms of risk and return, there is the potential to **tactically allocate surplus cash towards Emerging Markets** as the sector looks cheap and has potentially been oversold.

For Australia, we look for the following as sources of guidance for our investment and asset allocation strategies:

- Await the latest economic data to see what impact the trade wars are having on our export sector;
- Analyse the company reporting season coming up to get any indication of revenue changes across industries given the slowing domestic housing sector;
- Watch the Banks for early signs of mortgage default rates increasing or out of cycle interest rate rises;
- Check the inflation data to see if there is any pressure building for a change in monetary policy settings (up or down).

House View - Australia

We expect that for 2019:

- **Quality shares will continue to offer reasonable sources of capital growth and the S&P ASX200 index dividend yield to remain above cash;**
- **Bonds offer good sources of yield, but fixed interest rates and longer duration maturities have an element of capital risk; and**
- **Listed Property still has good yields available, but valuation risk needs to be considered;**

Asset price volatility is here to stay as global markets recalibrate after such a long period of Central Bank intervention.

We anticipate this volatility however are also confident that a diversified asset allocation will mitigate a lot of the return risk.

DISCLAIMER

The information contained in this review is General Advice, not Personal Advice and does not take into account the investment objectives, financial situation or needs of any person. Past performance is not necessarily an indication of future performance. Future results are impossible to predict.

This review includes opinions, estimates and other forward-looking statements which are, by their very nature, subject to various risks and uncertainties. Actual events or results may differ materially, positively or negatively, from those reflected or contemplated in such forward-looking statements. Forward-looking statements constitute our judgment as at the date of preparation of this review and are subject to change without notice.

Please seek personal financial and tax and/or legal advice prior to acting on this information. The material contained in this review is based on information received in good faith from sources within the market, and on our understanding of legislation and Government press releases at the date of publication, which are believed to be reliable and accurate.

Opinions constitute our judgement at the time of issue and are subject to change. Neither, the Licensee or any of Cornwall Holdings (NSW) Pty Ltd or FOX Wealth Management, nor their employees or directors give any warranty of accuracy, nor accept any responsibility for errors or omissions in this review.
Note: The data used in this review was sourced from LONSEC, http://www.lonsec.com.au accessed on the21st January 2019.

Benchmark	Country/Asset Class
MSCI World ex Australia TR Index AUD	Global Shares
MSCI Europe TR Index AUD	European Shares
S&P 500 TR Index AUD	United States Shares
MSCI Japan TR Index AUD	Japan Shares
S&P/ASX 200 TR Index AUD	Australian Shares
S&P/ASX Small Ordinaries TR Index AUD	Australian Small Companies
FTSE EPRA/NAREIT Developed ex Australia NR Index (AUD Hedged)	Global Property
S&P/ASX 200 A-REIT TR Index AUD	Australian Listed Property
S&P Global Infrastructure TR Index (AUD Hedged)	Global Infrastructure
Citi World Government Bond Index (AUD Hedged)	Global Bonds
Bloomberg AusBond Composite 0 Year Index AUD	Australian Bonds
Bloomberg AusBond Bank Bill Index AUD	Australian Cash
MSCI Emerging Markets TR Index AUD	Emerging Markets
Reserve Bank of Australia	Currency

CONTACT DETAILS

Member
Association of Financial Advisers

Graham Fox,

Dip Fin Services, Dip Fin Planning

PRINCIPAL CONSULTANT/INVESTMENT ADVISER

FOX Wealth Management

Mobile: 0410 882 860

Office Phone: 02 4365 2554

E-mail: graham@foxwealth.com.au

Website: www.foxwealth.com.au

Postal & Office: Suite 17c, Karalta Plaza, 8-12 Karalta Road, Erina NSW 2250

Licensee

Cornwall Holdings (NSW) Pty Ltd trading as FOX Wealth Management and Graham Fox are Authorised Representatives (No. 426084 & 404026) of:

HNW PLANNING

HNW Planning Pty. Ltd

ABN 42 083 745 055

AFS Licence No. 225216

Suite 17c, Karalta Plaza

8-12 Karalta Road, Erina NSW 2250

PO Box 3305, Erina NSW 2250

www.hnwplanning.com.au