FOX Wealth Management

Quarterly Market Review

December 2017

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

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

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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

The Markets Bounce Back

The global markets finished the quarter with a flourish buoyed by the attraction of US President Trump's positive steps regarding the reduction of US company tax rates towards 21% from 35%. This will result in a significant shift in focus for local companies and will hopefully encourage sustainable growth in the economy.

Much of the attention was focussed on:

- President Trump and the promised corporate tax breaks;
- The US Federal Reserve Banks (Fed) tightening of domestic monetary policy; and
- The "Bitcoin Bubble" and the blockchain distributive technology which has the potential to be quite disruptive on future technological trends.

Investors continued to look at the markets through rose coloured glasses and overall, remained optimistic about the global recovery. Share market volatility remains subdued which is also encouraging investors to trust the recovery resulting in share trading continuing to push stock prices to record highs.

Monetary Policy

The Fed chair, Janet Yellen expects a more expansionary fiscal policy, notably via the 2017 tax cuts, to add more stimulus to the economy in the short run. It remains to be seen whether the Fed will decide to raise rates more quickly to offset fiscal stimulus to prevent higher inflation (still sub 2%) with the economy running close to full employment. Interest rates are still expected to head north (rising) however in line with the growth in the economy.

The Bank of Japan and the European Central Banks maintained their Quantitative Easing (QE) programme keeping interest rates low. Both Central Banks remain committed to stimulating growth in their respective economies.

Growth and Inflation

The GDP data revealed that growth in the advanced economies is starting to respond to the Central Bank efforts as demand has improved in the developed markets. Economists and Government officials are still looking for GDP growth of between 2% and 3%, a tad above what we are experiencing now however the direction is encouraging.

The latest charts for GDP and inflation data reveal:

Chart 1

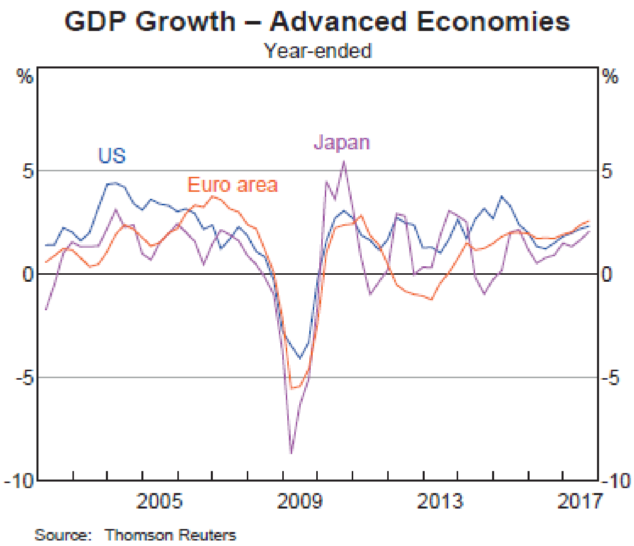
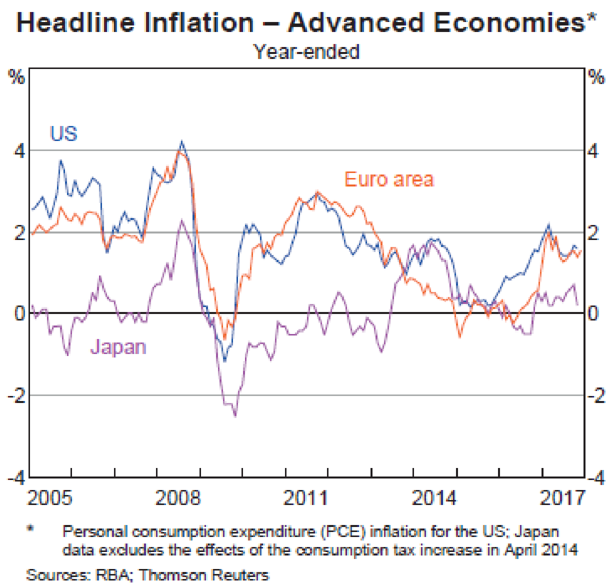


Chart 2

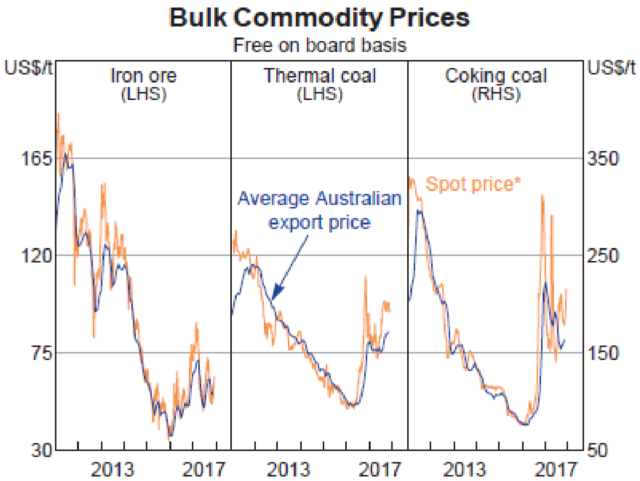


WHAT HAPPENED IN THE MARKETS

The global markets finished on a solid note for the quarter with expectations that the price momentum will most likely continue in the short to medium term.

Commodity markets continued to recover from the previous quarter with the Oil price closing at US $60.42 which was a gain of 16.93% since September 2017 close of US$51.67 a barrel.

Chart 3



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

Iron Ore traded mildly higher from US$69.77 a dry metric ton to close at US$71.28 in December 2017. This was a gain of some 2.16% over the quarter.

Given the sharp jump in oil, Energy based company share prices banked impressive gains of 17.48% for the quarter in the Australian market.

Regionally, the economic data revealed the following:

- **United States of America**: The US economy in GDP terms to expanded by an annualized 3.2% in the fourth quarter of 2017. The unemployment rate fell to 4.1%% in December 2017 down from 4.2% in the previous quarter.
- **China**'s GDP growth rate was unchanged coming in at 1.7 %. The annual growth rate year-on-year was slightly lower for September at 6.8 % with the unemployment rate steady at 3.95%.
- **Europe area** a similar story in Europe with the GDP annualised growth rate stabilising at 2.6% in September 2017. Europe's unemployment rate improved to 8.7% for November 2017 which is encouraging. Core inflation settled at 0.9% in December 2017 unchanged from November 2017; and
- **Australia's** latest GDP data for September 2017 revealed an annual growth rate of 2.8% which was a strong jump up from the previous 1.8%. Unemployment settled at 5.4% or 707,720 persons in November 2017. The Core Inflation rate finished at 1.8% in September 2017.

ASSET CLASS REVIEW

Growth assets were impressive posting solid returns over the quarter. Investor confidence continues to improve in the US and Europe. The Santa Claus rally was kind to investors this year.

Defensive assets also recorded positive results over the quarter as bonds rallied. The attention of bond holders is still focussed on the unwinding of the US QE (quantitative easing) strategy and the now ongoing QT (quantitative tightening) strategy by the Fed.

Table 1

ASSET CLASS	RETURNS		
GROWTH	**3 Months**	**6 Months**	**12 Months**
Global Shares	5.93%	8.75%	14.02%
Australian Shares	7.63%	8.36%	11.78%
Global Property	3.42%	4.47%	8.47%
Australian Property	7.90%	9.76%	5.72%
Global Infrastructure	1.82%	3.55%	15.40%
ASSET CLASS	**RETURNS**		
DEFENSIVE	**3 Months**	**6 Months**	**12 Months**
Global Fixed Interest	0.83%	1.54%	2.79%
Australian Fixed Interest	1.44%	1.37%	3.65%
Australian Cash	0.42%	0.85%	1.74%

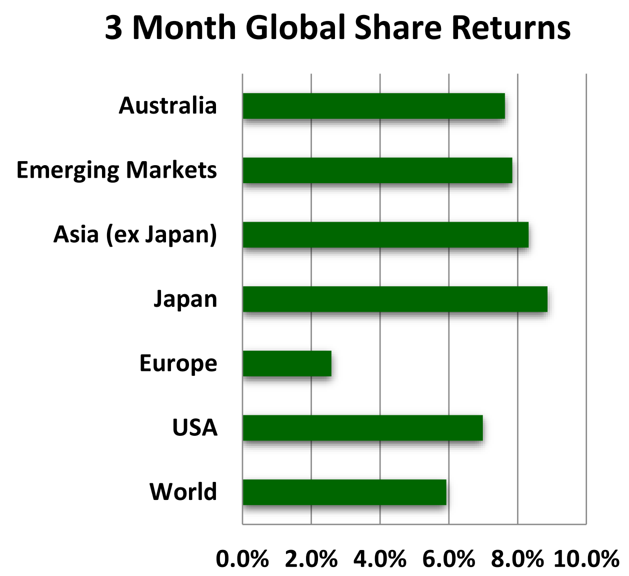
Source Data: Lonsec as at 31st December 2017

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

GLOBAL SHARE MARKETS

Global share markets continued their strong advance as investor confidence returned to markets.

Chart 4



Source Data: Lonsec as at 31st December 2017

European share markets lagged the developed countries and remain in consolidation mode. The job market has begun to stabilize but remains very soft with unemployment stubbornly holding high levels.

Asia is benefitting from a resurging China on the back of a pick-up in commodity prices. Labour cost advantages are obvious with average unskilled salaries p.a. in places like Vietnam around US$150 and US$80 in Bangladesh. China is still competitive at US$300-US$350, depending on the internal location.

Emerging markets are benefitting from a perception that the developed markets have diminishing investment opportunities as quality companies become expensive. Capital flows are now finding their way to under priced emerging companies.

As China's has expected hard landing is looking more like a soft landing as the economy starts to build momentum again. The massive "One Belt One Road" (OBOR) infrastructure initiative is working. Manufacturing competition is heating up in the region with its neighbours challenging for investment.

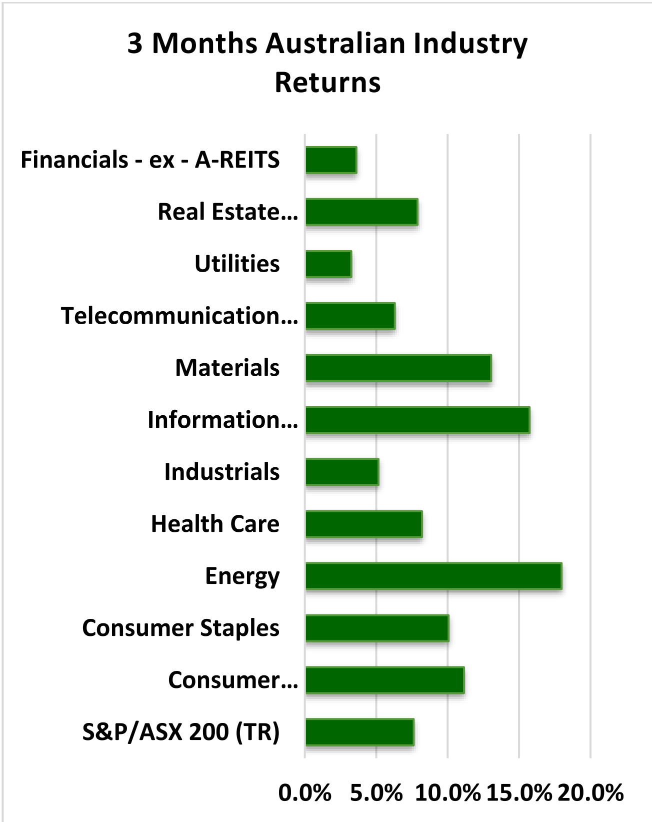
In Japan, the unemployment rate hit a 24year low of 2.7% which is starting to hurt the expansion of the economy. The stock market is performing well responding to the Bank of Japan stimulus and the economy is now growing with annualised GDP growth of 2.5% reported in September 2017.

DOMESTIC SHARE MARKETS

The Australian share market (S&P ASX200) posted strong gains of 7.63% over the quarter benefitting from the recovering commodity markets.

All sectors experienced gains with Energy, Telecommunication and Materials sectors being the big winners.

Chart 5



Source data – Lonsec as at 31st December 2017

Investors enjoyed a "Happy Christmas" as growth expectations carried over into continued support for all sectors of the market.

As mentioned, commodity prices have attracted investment back into the resource and energy companies with the Energy sector up 17.98%, and Material Sector up 13.04% over the quarter. Information Technology up 15.72% buoyed by takeover activity and bitcoin uphoria.

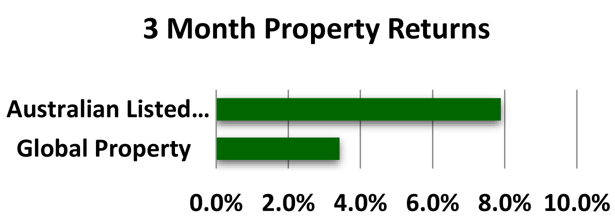
For 2018 share analysts see the Australian market doing much of the same as 2017 with predictions for the S&P/ASX200 to head towards 6,330. With the S&P/ASX200 price closing at 6,088 for December 2017, this would put growth estimates for the year ahead at a conservative 4%.

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. So: growth 4.00% + income 5.71% = 9.71% total return. Remember this is a projection, **past returns are no guarantee of future returns**.

DOMESTIC & GLOBAL PROPERTY

Globally, the property sector posted solid returns as the expectations for rising interest rates eased to a more gradual increase rather than any sharp jump. The sector is still attracting investors given the yields and the prospect of capital gains if inflation emerges and drives valuations higher.

Chart 6



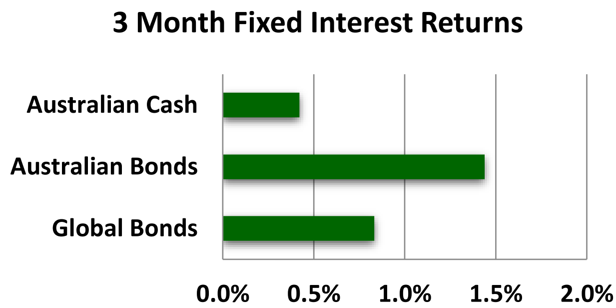
Source Data: Lonsec as at 31st December 2017

The sector remains concerned about the potential for rising interest rates and the flow-on effects that unhedged borrowings may have on valuations. As mentioned previously, most funds have moderate gearing levels with many opting for CPI indexed leases to help counter any future interest rate rises.

DEBT MARKETS

Global debt markets achieved a small positive outcome over the quarter as bonds marked time. For Australian bonds, price gains plus the income received from bond coupons resulted in returns of 1.44% over the quarter.

Chart 7



Source Data: Lonsec as at 31st December 2017

In the US, the Board of Governors of the Federal Reserve System voted to maintain the federal funds rate in a target range of 1.25% to 1.5% at their meeting on December 13, 2017. The Fed also voted to continue with the balance sheet normalisation programme which will effectively reduce the liquidity of the short-term money market by not reinvesting all the maturing debt built up over the GFC period. This action will be gradual and did not concern the debt markets as it was in the main, expected.

The US 10-year Government bonds closed at 2.41% for the quarter up 0.10% from the previous quarter. The Australian Government 10-year bonds finished December at 2.64% down in yield from 2.84% in September 2017. This is a fall of 0.20%. The interest differential between the 10-year US bonds and A$ bonds was 0.23% a fall of 0.31% over the quarter.

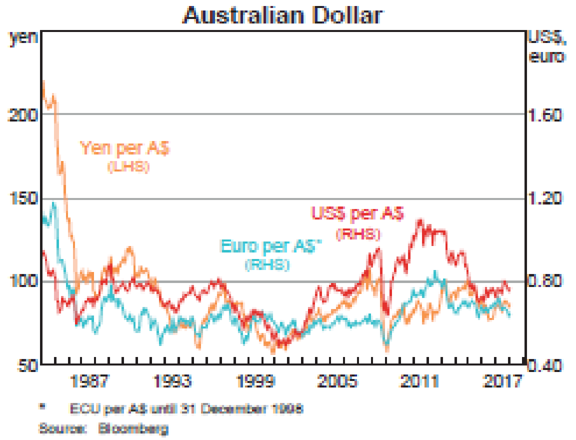
The Reserve Bank of Australia retained its monetary policy stance leaving the target cash rate unchanged at 1.5% at the recent December 2017 board meeting.

Most domestic economists are expecting little to no change in the official cash rate in the medium term.

CURRENCY

The AUD finished the quarter lower at AUD/USD 0.7800 compared to 0.7839 a fall of 0.50% over the quarter. Currency forecasters see the AUD/USD range between 0.6500 and 0.8500 cents in the medium term.

Chart 8



The Australian dollar is remains well supported by strengthening export activity off the back of improving commodity prices.

WHERE TO FROM HERE

Globally the world economies appear to be on the road to recovery with investor confidence gaining momentum. While share valuations are stretched the market keeps on heading higher which is as stated last report, still good but bad. Good that investors remain confident of the earnings being achieved by companies will continue to grow but bad if you want to get into the market, such as the US, given that it is trading at or near record highs.

For **Australian share investors**, the retail sales trend in the December quarter appears not to have suffered any significant changes to consumer behaviour despite the hype surrounding the emergence of online retailers, such as Amazon. Time will tell so we will be watching the next retail sales data with interest to see what impact the results may have on future company earnings and/or RBA monetary policy direction.

For **Australian fixed interest investors**, the bond markets are nervious as inflation may lead to rising interest rates which over time, will impact their capital position. There are debt securities available that are market linked to either the CPI or the Bank Bill Swap rate which will protect investors capital to a degree but they still have credit default risk attached to the underlying bond issuer. We expect bond rates will trade sideways over the quarter ahead.

KEY MESSAGE

The start of the year is always hard to fathom as thin trading conditions in January tend not to always reflect the underlying fundamentals however, the markets have resumed on a positive note, so we expect this trend to continue over the next quarter.

Looking further ahead, we expect that over the medium term, shares will continue to experience earnings growth momentum and the markets will resume their upward bias.

The key factors on our radar include:

- The impact on global companies' revenue and strategic direction they may have in mind post the changes to the corporate tax rates in the US;
- Watch for Central banks in Japan and Europe to maintain their QE monetary policy stance and keep interest rates low in their respective regions; and
- Sector and/or regional rotation as investors change direction in search for the next big opportunity. Emerging Markets are expected to come under the microscope as the developed markets become expensive.

Overall

we see a sound background for equities across the large mid and small cap sectors however, a more challenging one for bonds. There are undercurrents for gradual rises in interest rates globally fuelled by inflationary expectations.

Technological change and the impact on the prices of manufactured goods is keeping the inflation genie in the bottle at this time, but this year may be the one where the bottle is washed up onto the beach.

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.

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Note: The data used in this review was sourced from LONSEC, http://www.lonsec.com.au accessed on the 16th January 2018.

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

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