FOX Wealth Management

Quarterly Market Review

March 2018

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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OVERVIEW

Volatility Returns

The global markets finished mixed for the quarter after a bout of volatility hit the share markets, following a series of non-market related events. One of the triggers was the announcement by US President Trump regarding tariffs and restrictions on imported goods manufactured in China. China responded with a round of tariffs targeting US exports to China.

This quickly spread to talk of trade wars between the two economies and consequently led to investor concern about what was the likely future impact on related trade flows and company profits.

Much of the attention was focussed on:

- President Trump and the import tariffs;
- China's response with their import tariffs;
- The US Federal Reserve Banks (Fed) continued tightening of domestic monetary policy; and
- The Syria conflicts.

Share market volatility was the main driver following the uncertainty surrounding the tariff measures. Most investors had anticipated the Fed monetary policy moves and associated drift higher of interest rates.

Monetary Policy

The new Fed Chairman, Jerome Powell raised the target for the US federal funds rate to 1.5%-1.75% and reiterated plans for two more increases this year at the recent 20th-21st March 2018 FOMC meeting.

The Bank of Japan and the European Central Banks maintained their Quantitative Easing (QE) programme keeping interest rates low.

Growth and Inflation

The GDP data revealed that growth in the advanced economies continues 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%.

The latest charts for GDP and inflation data reveal:

Chart 1

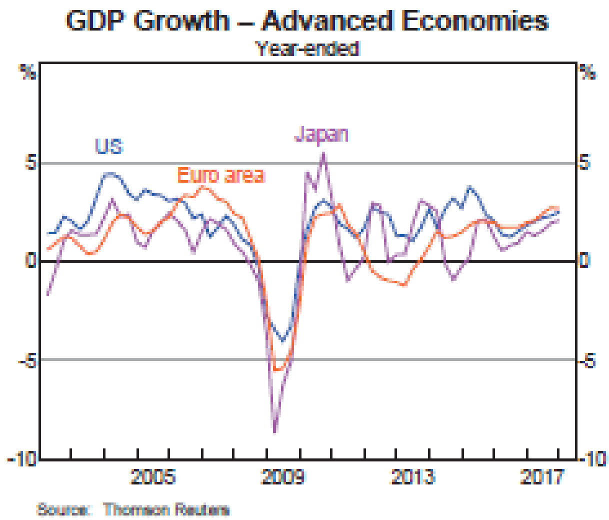
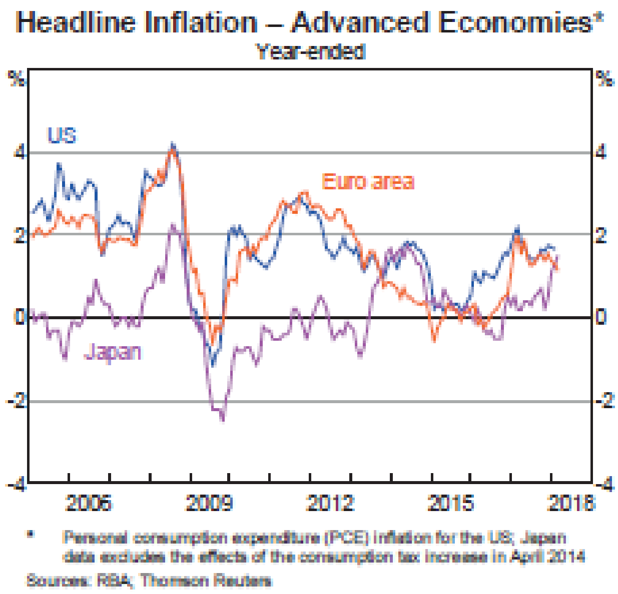


Chart 2

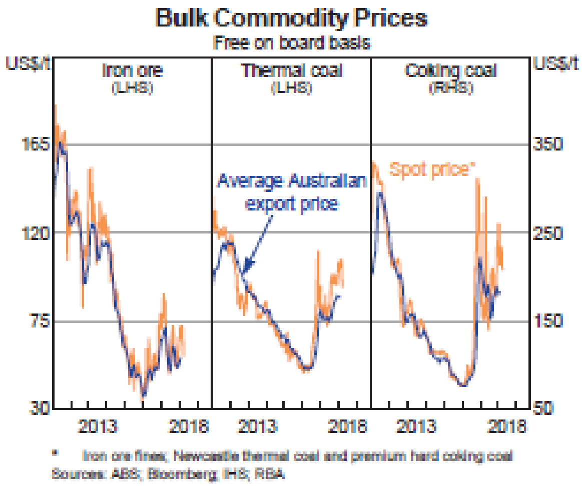


WHAT HAPPENED IN THE MARKETS

The global markets finished mixed following the announcements. The share markets responded negatively to the developments around tariffs with expectations that the escalating tensions are likely to hurt company profits longer term.

Commodity markets were mixed over the quarter with the Oil price closing at US $64.94 which was a gain of 7.48% since December 2017 close of US$60.42 a barrel.

Chart 3



Iron Ore however traded lower from US$71.28 a dry metric ton to close at US$69.70 in March 2018. This was a loss of some 2.22% over the quarter.

Regionally, the economic data revealed the following:

- **United States of America**: The US economy in GDP terms to expanded by an annualized 2.9% in the fourth quarter of 2017. The unemployment rate was unchanged at 4.1%% in December 2017 quarter. Inflation edged higher to 2.4% in March 2018.
- **China**'s GDP growth rate eased to 1.4% in March 2018. The annual growth rate year-on-year was unchanged for December at 6.8 % with the unemployment rate steady at 3.9%.
- **Europe area** GDP annualised growth rate was stable at 2.7% in December 2017. Europe's unemployment rate improved to 8.5% for February 2018. Core inflation settled at 1.0% in March 2018 up slightly from 0.9% in previous quarter of 2017; and
- **Australia's** latest GDP data for December 2017 quarter revealed an annual growth rate of 2.4% which was down from the previous 2.8%. Unemployment rose slightly to 5.6% or 734,100 persons in February 2018. The Core Inflation rate finished at 1.9% in December 2017.

ASSET CLASS REVIEW

Growth assets were hit hard by the spike in volatility over the quarter. Investor confidence was dented somewhat by the trade war noise but retain a positive outlook overall for 2018.

Defensive assets also recorded positive results over the quarter as bonds benefitted from the share market volatility. The attention of bond holders is still focussed on the US QT (quantitative tightening) strategy of the Fed.

Table 1

ASSET CLASS	RETURNS		
GROWTH	**3 Months**	**6 Months**	**12 Months**
Global Shares	0.93%	6.91%	13.94%
Australian Shares	-3.86%	3.48%	2.53%
Global Property	-5.23%	-1.99%	1.44%
Australian Property	-6.40%	1.00%	-0.77%
Global Infrastructure	-5.80%	-4.08%	1.44%
ASSET CLASS	**RETURNS**		
DEFENSIVE	**3 Months**	**6 Months**	**12 Months**
Global Fixed Interest	0.63%	1.47%	3.19%
Australian Fixed Interest	0.86%	2.31%	3.27%
Australian Cash	0.43%	0.85%	1.73%

Source Data: Lonsec as at 31st March 2018

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

GLOBAL SHARE MARKETS

Global share markets were mixed as investors struggled to understand the US trade announcements. Australia suffered from the US/China trade war implications, especially the touted tariffs for our major commodity exports, steel and iron ore. The Financial sector was also hit by the revelations coming from the Royal Commission into Australian Banks over the financial planning fees charged to client's.

Chart 4

Source Data: Lonsec as at 31st March 2018

European share markets ended flat and the developed countries and remained mildly positive. The job market has begun to stabilize but remains very soft with unemployment stubbornly holding high levels.

Asia benefitted from the prospect of a trade war between the US and China which may open the door to opportunities. Japan fared better despite the implied restrictions and potential trade implications.

Emerging markets continue to attract capital flows as they appear to have not been unduly influenced by the volatility of the developed markets for now.

As China is looking a little uncomfortable with the proposed US tariffs which are more about the theft of intellectual property rights than trade at this point however, President Trump is making a point and sending a clear message about addressing the problem. China's trade surplus with the US was $15.4 billion in March 2018.

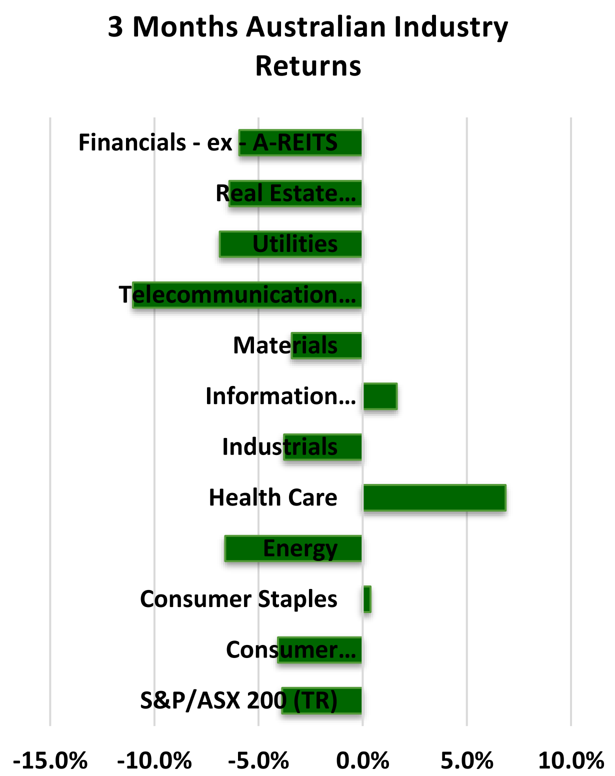
In Japan, the unemployment rate rose slightly to 2.5% after hitting 2.4% in January 2018. The stock market is performing well responding to the Bank of Japan stimulus and the economy is growing with annualised GDP growth rate of 2.0% reported in December 2017.

DOMESTIC SHARE MARKETS

The Australian share market (S&P ASX200) posted sharp falls of 3.86% over the quarter suffering primarily from the volatility of global markets.

Nearly all sectors experienced falls with Healthcare, Consumer Staples and IT the only positive results.

Chart 5



Source data – Lonsec as at 31st March 2018

For the rest of 2018 share analysts are still quietly confident of an improving economy and growing company profits with predictions for the S&P/ASX200 of 6,330 by year end. With the S&P/ASX200 price closing at 5,759 for March 2018, this would put growth estimates for the year ahead at an optimistic 9.91%. Caution is advised as revisions are always on the cards given the changed market conditions.

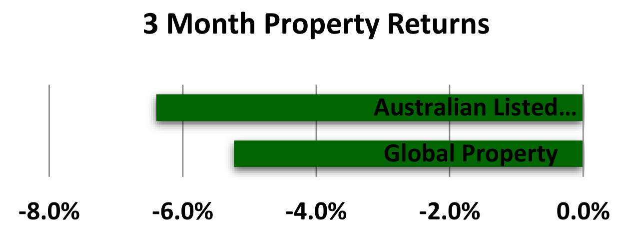
In terms of dividends, analysts expect defensive stocks to deliver around the 4.0 % p.a. which if fully franked at 100% (company tax at 30%) would deliver a yield of

5.71% grossed up. So: growth 9.91% + income 5.71% = 15.62% total return. 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 sharp falls as the expectations for rising interest rates ramped up post the Fed move. The trade war threat also weighed heavily on the sector given China has already pulled back on investment outside the country.

Chart 6



Source Data: Lonsec as at 31st March 2018

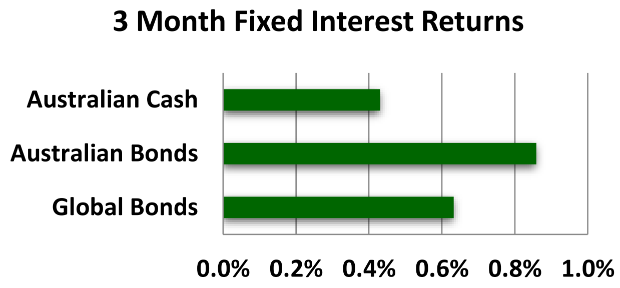
As mentioned previously, most property funds have moderate gearing levels (circa 30% to 40%) with many opting for CPI indexed leases to help counter any future interest rate rises with additional revenue.

DEBT MARKETS

Global debt markets achieved small positive returns over the quarter as bonds benefitted marginally from the share market volatility. For Australian bonds, price gains plus the income received from bond coupons resulted in returns of 0.86% over the quarter.

In the US, the Board of Governors of the Federal Reserve System voted to increase the federal funds target rate to 1.5% to 1.75% at their meeting on March 20-21, 2018. The Committee said it "expects that economic conditions will evolve in a manner that will warrant further gradual increases in the federal funds rate". **Source: FOMC Statement 21st March 2018.**

Chart 7



Source Data: Lonsec as at 31st March 2018

The US 10-year Government bonds closed at 2.74% for the quarter down 13.97% from the previous quarter close of 2.41%. The Australian Government 10-year bonds finished December at 2.58% down in yield from 2.64% in December 2017.

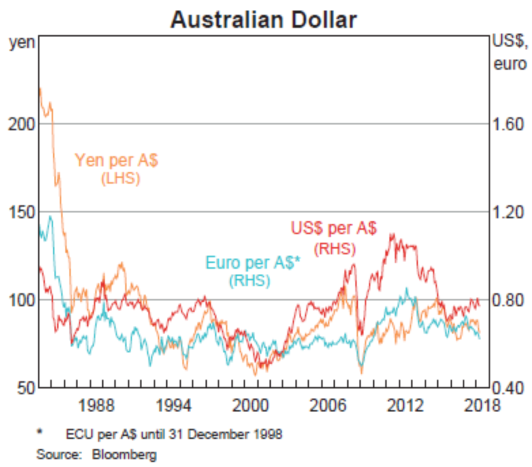
The Reserve Bank of Australia retained its monetary policy stance leaving the target cash rate unchanged at 1.5% at the recent March 2018 board meeting.

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

CURRENCY

The AUD finished the quarter lower at AUD/USD 0.7665 compared to 0.7800 a fall of 1.73% 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 has been impacted by the recent market volatility and the shift higher in US interest rates resulting in a 0.16% interest rate differential in favour of the US.

WHERE TO FROM HERE

With volatility returning to the Global scene after a year of relative calm, investors are wary. The trade war threats are real and will disrupt company profits in certain sectors however, growth momentum is also real and will continue despite all the noise. Other countries not involved in the conflict remain on track and will continue to grow.

For **Australian share investors**, the US tariffs and restrictions for our key export markets have weighed heavily on the corporate earnings expectations although the US administrators seem to have weakened their original stance to cater for countries that have a trade surplus with them.

In 2017, the US trade position with Australia was a net US$14B in their favour. They had a trade deficit with China of approximately $395B in 2017.

Other background factors keeping the lid on shares is the Royal Commission into the Banking sector which is not looking as rosy as we were led to believe. The Banks remain profitable, but the investor sentiment has been weakened by the revelations regarding the trustworthiness of their internal management and fee issues surrounding their Financial Planning businesses which make painful reading.

The big Banks run vertically integrated businesses that channel a significant number of product sales internally. This may not necessarily be in the clients' best interest.

For **Australian fixed interest investors**, the bond markets remain cautious watching the inflation numbers as they are released. The bigger threat is global interest rates and credit spreads widening. We expect bond yields will increase mildly over the quarter ahead.

KEY MESSAGE

The "X" factor for this year looks like being President Trump and his next move on the economic front. The Fed appears to have US Monetary Policy firmly in hand and will continue to tighten liquidity in response to the growth and employment conditions.

Other factors relating to Facebook data privacy, Syria and the influence of Artificial Intelligence on our society, are developing themes that will remain on our "watch" list for 2018.

For Australia, the economy is tracking along however it is currently dominated by developments in our key export markets coupled with the domestic housing market which appears to be reaching a mature stage.

These factors may curb retail spending and dampen consumer sentiment, so it remains a waiting game.

Looking further ahead, we expect that over the medium term, shares will experience earnings growth and the markets will slowly resume their upward bias despite the most recent events.

The key factors on our radar include:

- The impact of the trade tariffs and restrictions between the US and China;
- Central banks in Japan and Europe will maintain their QE monetary policy stance and keep interest rates low in their respective regions fostering growth; and
- Watch the Emerging Markets to see their responses to the trade developments and look for any detrimental impact on the expected growth in their economies because of the trade restrictions.

Overall

Equity markets will need time to assess just what the trade restrictions mean in terms of company profits and what sectors specifically will be impacted.

For Debt markets, interest rates globally continue to shift higher fuelled by inflationary expectations. Bond investors are watching the economic releases to gauge the demand and credit response.

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.

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