FOX Wealth Management

Quarterly Market Review

June 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

Political tensions & trade wars elevate Market Risk

The global markets finished strongly for the June quarter despite the political noise surrounding the US trade wars and other conflicts. Markets seem to have shrugged off the potential disruptions to company earnings for the moment and were mostly focussed on rising interest rates and inflation expectations.

Big picture concerns were mostly:

- 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
- Global inflation and interest rate trends.

Share market volatility was moderate despite the background noise. Most US investors believe that the tariff issue and the expected trade impact will be mitigated to a degree by the introduction of US corporate tax cuts.

Monetary Policy

The new Fed Chairman, Jerome Powell raised the target for the US federal funds rate to 1.75%-2.00% and reiterated plans for more increases this year at the recent 13th June 2018 FOMC meeting.

The Bank of Japan and the European Central Bank maintained their Quantitative Easing (QE) programme for the moment, 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. The Bank of Japan is still expecting inflation to return to 2% during the 2019 fiscal year.

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

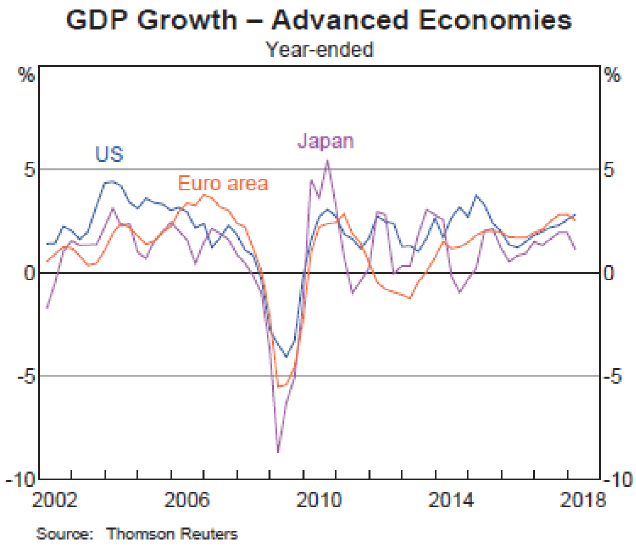
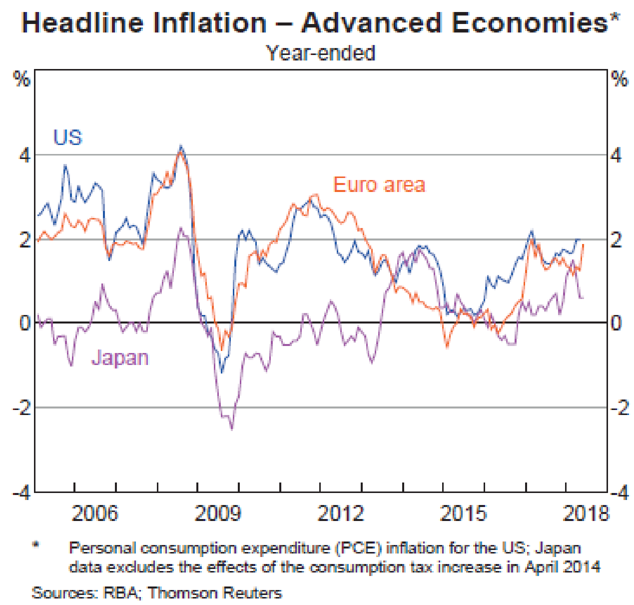


Chart 2



Investment Climate

Investors are concerned about economic growth, wage growth, the current price of assets and inflationery trends.

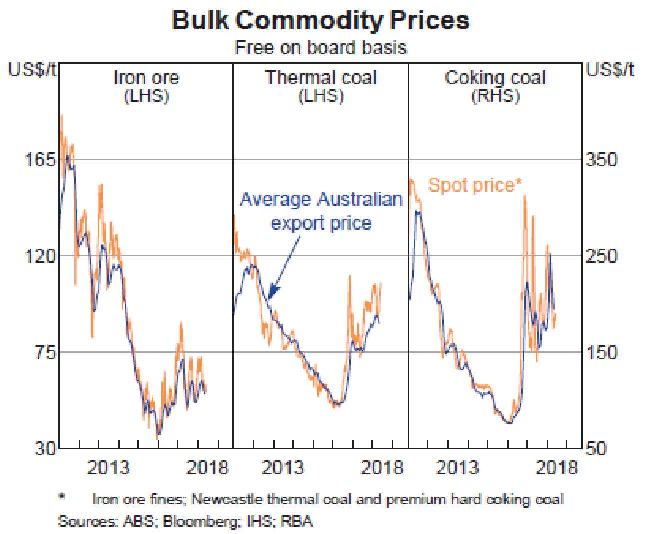
These factors have **elevated the probability of a market correction** at some stage however, the momentum of the current economic activity will take time to dissipate.

WHAT HAPPENED IN THE MARKETS

The global markets finished strongly as investor optimism continued to show support for a growing global economy. The share markets seemingly brushed aside the developments around tariffs with expectations that the tensions are unlikely to hurt company profits longer term.

Commodity markets were mixed: Energy related markets enjoyed a strong bounce over the quarter with the Oil price closing at US $74.15 which was a gain of 14.18% since March 2018 close of US$64.73 a barrel.

Chart 3



Iron Ore however traded lower from US$69.70 a dry metric ton to close at US$64.80 in June 2018. This was a loss of some 7.03% over the quarter.

Economic Data:

Regionally, the economic data revealed the following:

- **United States of America**: The US economy in GDP terms to expanded by an annualized 2.0% in the first quarter of 2018, down slightly from the 2.9% in December 2017. The unemployment rate improved slightly to 4.0%% in June 2018 down from 4.1% in March 2018. Inflation edged higher to 2.9% in June 2018.
- **China**'s GDP growth rate reached 1.8% in June 2018. The annual GDP growth rate year-on-year was a little lower at 6.7 % with the unemployment rate improving to 3.89%.
- **Europe area** GDP annualised growth rate was a little lower at 2.5% for the first quarter of 2018. Europe's unemployment rate improved to 8.4% for May 2018. Core inflation settled slightly lower at 1.0% in June 2018; and
- **Australia's** latest GDP data for May 2018 quarter revealed an annual growth rate of 3.1% which was up strongly from the previous 2.4% in March 2018. Unemployment fell to to 5.4% in May 2018, or 714,600 persons. The Core Inflation rate finished unchanged at 1.9% in the first quarter of 2018.

ASSET CLASS REVIEW

Growth assets rallied hard over the quarter. Investor confidence was back as the concerns about the impact of the trade war eased. Investors retain a positive outlook overall for the rest of 2018.

Defensive assets also recorded positive results over the quarter as bonds were able to hold their own as interest coupons flowed through. The main concern for bond holders is the US QT (quantitative tightening) strategy of the Fed and the impact globally.

Table 1

ASSET CLASS	RETURNS		
GROWTH	3 Months	6 Months	12 Months
Global Shares	5.73%	6.71%	16.05%
Australian Shares	8.48%	4.29%	13.01%
Global Property	7.16%	1.56%	6.10%
Australian Property	10.04%	3.00%	13.05%
Global Infrastructure	5.49%	-0.63%	2.89%
ASSET CLASS	RETURNS		
DEFENSIVE	3 Months	6 Months	12 Months
Global Fixed Interest	0.16%	0.79%	2.35%
Australian Fixed Interest	0.82%	1.69%	3.08%
Australian Cash	0.48%	0.91%	1.77%

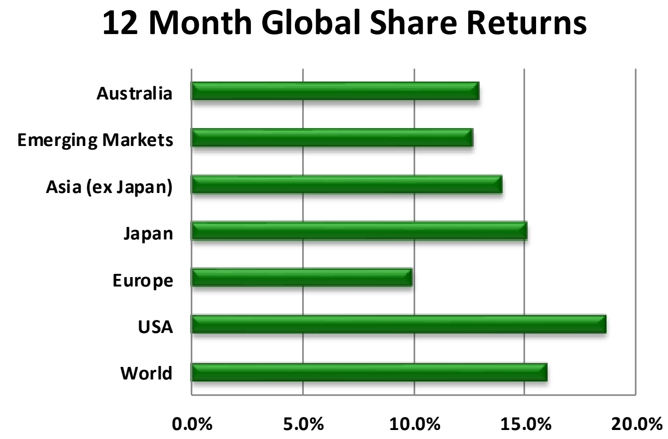
Source Data: Lonsec as at 30th June 2018

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

GLOBAL SHARE MARKETS

Global share markets rebounded strongly over the June quarter 2018 to finish the fiscal year with mostly double-digit returns.

Chart 4



Source Data: Lonsec as at 30th June 2018

European share markets ended higher over the June 2018 quarter. While the ECB did not make changes to their monetary policy, ECB President Mario Draghi stated that the moderation observed in the pace of economic growth in the euro zone warranted caution. The ECB indicated it will continue to buy EUR30 billion each month to support their recovery.

Asia benefitted from the prospect of a trade war between the US and China. It is too early to observe any meaningful opportunities however investors are positive to the region's growth prospects. Japan fared better despite the implied restrictions and potential trade implications for them as well.

Emerging markets continue to attract capital flows although they had felt the brunt of the negative response to the trade concerns over the quarter retreating some 4.34%.

China is still confident of hitting its economic growth target of around 6.5% this year despite views that it faces a bumpy second half as a trade row with the United States intensifies according to the state planning agency.

In Japan, the unemployment rate strengthened slightly to 2.2% in May 2018. The stock market is performing well returning over 15%this fiscal year, as it continues to respond to the Bank of Japan stimulus. The economy is growing with annual GDP growth rate of 1.1% reported in March 2018.

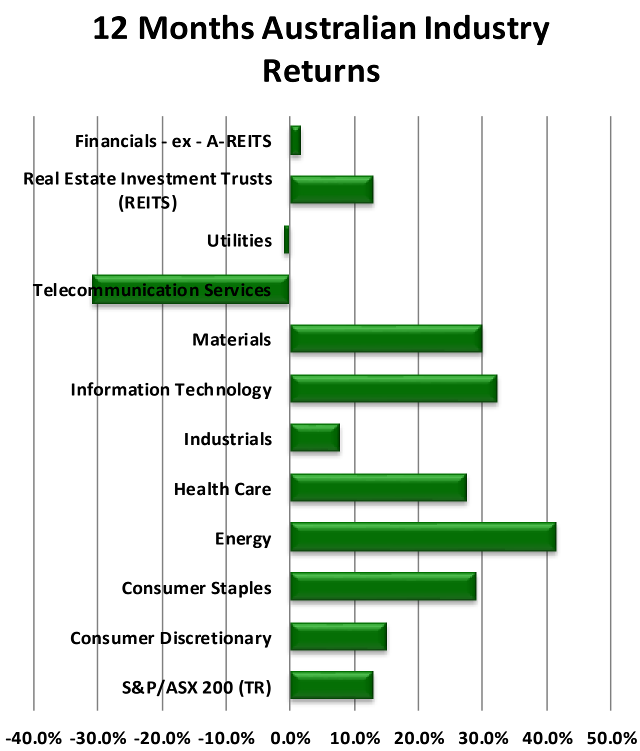
DOMESTIC SHARE MARKETS

Australia rebounded from the cautious overhang post the US/China trade war implications, especially buoyed by increases in the major commodity exports, steel and iron ore.

The Technology sector was impacted by the NBN rollout and mobile price wars between new market entrants falling 30.9% over the year. This was offset to a degree by gains in the Energy sector of some 41.56%.

The Australian share market (S&P ASX200) posted a strong rally over the June quarter ending up 3.27% and posting a gain of 13.01% over the fiscal year.

Chart 5



Source data – Lonsec as at 30th June 2018

For the rest of 2018 share analysts remain quietly confident of an improving economy and growing company profits with predictions for the S&P/ASX200 of reaching 6,780 (high 31st October 2007) by year end. With the S&P/ASX200 price closing at 6,194 for June 2018, this would put growth estimates for the second half of the year at 9.4%. This looks too ambitious and no doubt will be revised if the market falters.

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.

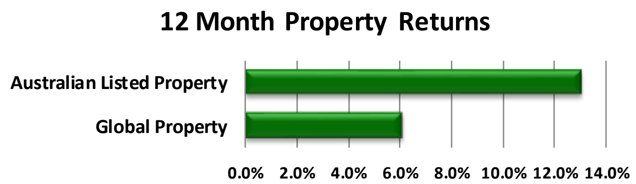
Remember this is a projection and subject to revision, **past returns are no guarantee of future returns**.

DOMESTIC & GLOBAL PROPERTY

Globally, the property sector experienced small gains (mostly dividend related) as the expectations for rising interest rates continue to weigh heavily on the sector.

Listed property in Australia bucked the trend and posted a strong 10.04% return in the June 2018 quarter and 13.05% over the fiscal year.

Chart 6



Source Data: Lonsec as at 30th June 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.

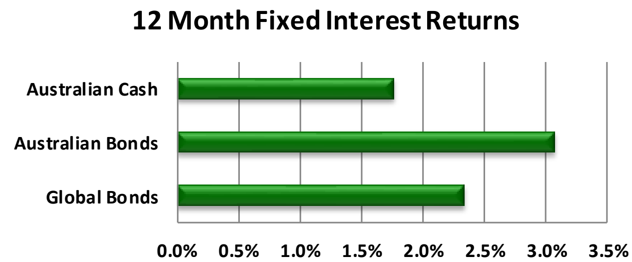
DEBT MARKETS

Mirroring the low interest rate environment, Global debt markets achieved small positive returns over the year as bonds marked time. The fixed and variable coupons helped returns remain in the black however, capital gains were limited due to the impact of rising interest rates.

In the US, the Board of Governors of the Federal Reserve System voted to increase the federal funds target rate to 1.75% to 2.0% at their meeting on 13th June 2018. The Committee commented "In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective".

Source: FOMC Statement 13th June 2018.

Chart 7



Source Data: Lonsec as at 30th June 2018

The US 10-year Government bonds closed at 2.86% for the quarter up in yield from the previous quarter close of 2.74%. The Australian Government 10-year bonds finished higher in June 2018 at 2.66% up in yield from 2.60% in March 2018.

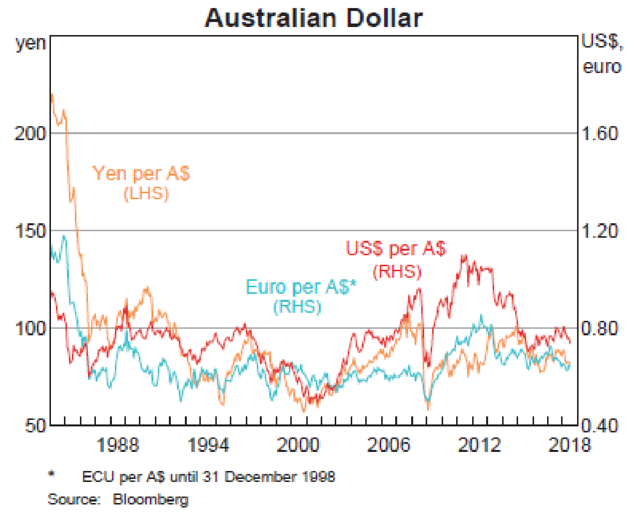
The Reserve Bank of Australia retained its monetary policy stance leaving the target cash rate unchanged at 1.5% at the recent June 2018 board meeting.

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 a policy change.

CURRENCY

The AUD finished the June 2018 quarter lower at AUD/USD 0.7391 compared to 0.7692 at the start of the fiscal year, a fall of 3.91%. 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 shift higher in US interest rates resulting in a stronger US dollar on the back of a 0.20% interest rate differential in favour of the US.

WHERE TO FROM HERE

The trade war emanating from the US appears to have been largely discounted in the short term as markets wait for the real fall out (in terms of earnings) post the tariffs coming in to practice.

While the trade war threats are real and will disrupt company profits in certain sectors, many of the US companies gain their revenue from all parts of the world and it will be difficult to gauge the overall impact until some time has passed.

In 2017, the US trade position with Australia was a net US$14.43B in their favour. The US had a net trade deficit with China of approximately US$395B in 2017.

Other countries not involved in the conflict remain relatively unaffected at this point and are expected to continue to grow.

For **Australian share investors**, the US tariffs and restrictions for our key export markets have dampened expectations for corporate earnings however, resource companies continue to ramp up supply of raw materials such as iron ore and coal.

We expect company earnings and profits to remain within guidance and support a mild increase in share prices over the year ahead.

For **Australian Bond investors**, the fixed rate bond markets remain the "hot spot" for **potential capital losses**, particularly the long-dated issues. The inflation numbers in Australia remain largely subdued and now that the residential property market is retreating, there is little to push the cost of goods higher in the short term hence, inflation will track sideways.

The bigger picture threat is global interest rates and credit spreads widening. We expect Australian bond yields will increase mildly over the year ahead but official cash rates to remain on hold.

KEY MESSAGE

President Trump and his unusual management style will keep investors on their toes, but the US economy appears to have a full head of steam up and this will be hard to stem in the short to medium term. The Fed has US Monetary Policy firmly in hand and as stated, will continue to tighten liquidity in response to the growth and employment conditions.

For Australia, the economy is tracking along and now that the tariff issue appears to be manageable, we expect the export markets will remain firm. We will be watching the cooling down of the domestic housing market to see where the problems arise. This slowdown 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 continue their upward bias** despite the most recent events.

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 July 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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