

# June Quarter 2018 Review

## NEWSLETTER



### Investor sentiment remains cautious

Following the spike in volatility in the March quarter, a cautious mood prevailed over financial markets last quarter. In summary, the June quarter produced the following:

- Positive returns from global equities, with material outperformance from Australian equities.
- Global investors seeking “safety” by holding U.S. dollars, with an outflow from emerging economies.
- Strong support for the \$US resulted in a decline in the \$A against the \$US.

Following the small correction on equity markets early in 2018, investors remained cautious throughout the June quarter. The threat of escalating trade protection between the United States and China was a continuing source of concern for investors, with the widening of the scope of new tariffs threatening to slow trade volumes and general economic growth.

Emerging markets experienced the worst of the trade related concerns, with a retreat in support of these markets leading to falling currency and equity valuations. The MSCI Emerging Markets Index declined by 3.5% over the June quarter (with an additional 1% loss recorded once currency effects are taken into account). These losses were most concentrated in Latin America, where share prices dropped 8.1%. After holding up reasonably well early in the quarter, China experienced a sell-off of 5.2% in the month June, to finish the quarter 3.5% lower.

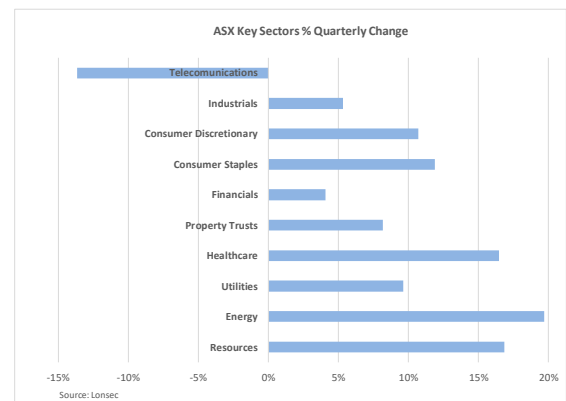
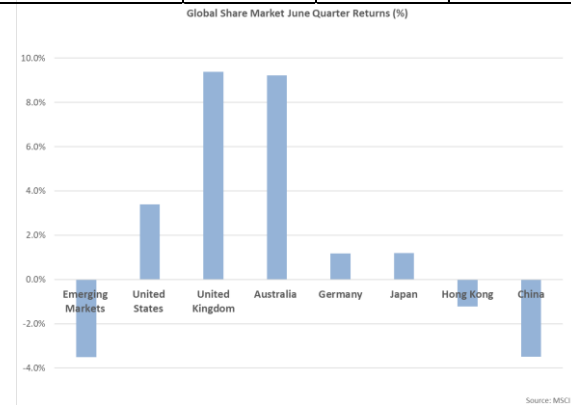
The United States was the beneficiary of the flow of funds out of emerging markets, with the \$US escalating against most currencies. Higher U.S. government bond yields may have added to this support for \$US, with the 10-year U.S. Treasury bond yield finishing the quarter 0.11% higher at 2.85%. The “safe haven” status of the U.S. is likely to have bolstered the performance of its share market, which finished the quarter 3.4% higher. The performance of other key developed markets was more subdued, with both Japan and Germany posting quarterly increases of just 1.2%.

Overall, currency movements had a positive impact on returns for Australian investors holding unhedged global equities last quarter. Against the \$US, the \$A finished the quarter at U.S. 73.9 cents - down from U.S. 76.7 cents at the end of March. However, this fall was driven by an escalating \$US, with the \$A moving higher against other key currencies. The \$A appreciated 2.0% relative to the Euro and gained 3.5% against the British Pound and 0.3% against the Japanese Yen.

Possibly also benefitting from the flow of funds out of emerging markets, the Australian share market was generally well supported over the June quarter. Partially reversing the trend of underperformance of recent years, the S&P ASX 200 Index jumped 8.5% during the quarter to be 13.0% higher on an annual basis.

The local share market was led higher by resource and energy stocks. An ongoing escalation in global oil prices was one source of support for these sectors, with the WTI Crude Oil price rising from \$US 70 to \$US 74 over the quarter. However, with other commodities not following this lead, the rise in the price of Australian resource stocks over the quarter can be considered a little surprising given the cautious mood generally prevailing globally. Over the quarter, resource stocks rallied 16.9%, with energy stocks up 19.7%. It was also a positive quarter for some of the more defensive sectors. Healthcare continued to outperform with a gain of 16.5%; whilst the consumer staples sector moved 11.9% higher. The more interest rate

Asset Class	Return	Jun-18	3 Months	Annual
Australian Equities		3.3%	8.5%	13.0%
Global Equities - Unhedged		2.3%	5.5%	15.4%
Global Equities - Hedged		0.3%	3.6%	11.5%
Australian Listed Property		2.3%	9.8%	13.2%
Global Listed Property		3.1%	8.5%	5.2%
Global Listed Infrastructure		2.5%	5.5%	2.9%
Australian Fixed Interest		0.5%	0.8%	3.1%
Global Fixed Interest		0.2%	0.2%	1.9%
Cash		0.2%	0.5%	1.8%



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sensitive sectors recovered some of their lost ground from the previous quarter, with listed property trusts rising 8.2% and utilities gaining 9.6%. Within the listed property sector, shareholder approval was granted for the acquisition of Westfield Corporation by French based Unibail-Rodamco. This, combined with the takeover bid for the Investa Office Trust by US property giant and private equity company Blackstone, is likely to have added support for the property sector last month. As has been the case over recent quarters, the financial and telecommunications sectors underperformed the wider market. An unfavourable market response to Telstra's restructuring plans contributed to a 13.7% decline in telecommunications stocks last quarter. Banking stocks did show some support towards the end of the quarter, however the 4.1% gain in the financial sector was well below the overall market increase. In addition to the likelihood that tighter lending standards will constrain loan growth, the banking sector is currently faced with the additional challenge of higher funding costs on overseas borrowings, which is placing pressure on interest margins.

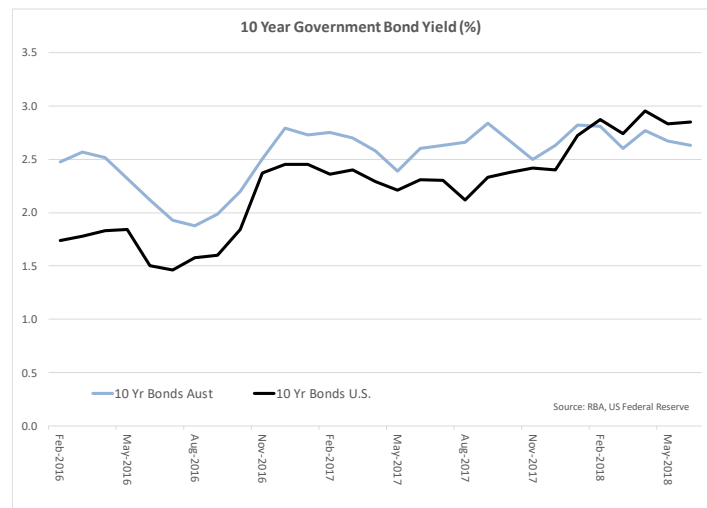
Notwithstanding the strength of the Australian share market over the June quarter, there appears general consensus that growth momentum in the Australian economy is insufficient to warrant any change in monetary policy over the short to medium term. As a result, longer term bond yields have remained relatively flat. In the June quarter, the Australian 10-year government bond yield finished virtually unchanged at 2.63% and is now 0.22% below its U.S. counterpart.

### Outlook and Portfolio Positioning

The more cautious mood being displayed on global financial markets is warranted given the threats posed by escalating trade protection and the high valuations prevailing on some share

markets. However, underpinning these valuations is ongoing strong economic growth across the globe. The potential for this growth to boost company earnings further and support share prices remains. In addition, recent slowing in the upward trajectory of bond yields has reduced some of the concerns of a bond led "valuation squeeze" that generated the spike in volatility in the March quarter.

With interest rates remaining near historic lows, and the outlook for company earnings still reasonable, exposure to equity markets remains the most likely source of wealth accumulation over the medium to longer term. We continue to maintain close to benchmark exposures to equities in our portfolios but seek to diversify this risk across geographies and company type. In addition, we are maintaining our preference for holding global assets on an unhedged currency basis, as our expectation is that any unexpected downturn in equity markets is likely to be accompanied by a decline in the \$A, thereby cushioning the impact of any share price decline.



### Important Information

The following indexes are used to report asset class performance and calculate the benchmark returns for this model portfolio: ASX S&P 200 Index, MSCI World Index ex Australia net AUD TR (composite of 50% hedged and 50% unhedged), FTSE EPRA/NAREIT Developed REITs Index Net TRI AUD Hedged, Bloomberg AusBond Composite 0 Yr Index, Barclays Global Aggregate (\$A Hedged), Bloomberg AusBond Bank Bill Index, S&P ASX 300 A-REIT (Sector) TR Index AUD, S&P Global Infrastructure NR Index (AUD Hedged).

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