

## 2017 – The year in review

2017 was a favourable year for investors with the global economic backdrop being highly supportive of further gains on share markets. Economic growth firmed across Europe, Japan and the United States, creating a rare synchronisation of improvement in the world's major economies. Although there was some expectation that higher growth levels combined with tightening labour markets and stimulatory policies put in place by the new U.S. administration would all generate inflationary pressure, this wasn't forthcoming. As a result, interest rates were able to be maintained at historically low levels. This environment has been near perfect for equity markets, with positive demand growth and the absence of cost pressures allowing earnings to rise; whilst flat interest rates have ensured the relative return available from share markets remains attractive – even at current very elevated valuations.

Although the performance of the Australian economy has been less impressive than that of other developed economies, it has also been able to achieve ongoing expansion concurrently with low interest rates and inflation. Boosted by continued high levels of residential housing construction and population growth, the Australian economy grew in real terms by 2.8% over the year to September. With inflation remaining below the central bank's target range at 1.8%, cash interest rates were maintained at the record low level of 1.5% over the course of 2017.

Consistent with the more subdued performance from the local economy, the Australian share market underperformed the global average increase of 20% - but still generated an impressive 12% return in 2017. Higher global commodity and energy prices made a significant contribution to this gain via a 26% jump in the price of resource stocks. These gains in the price of commodities also added support to the Australian dollar, which appreciated from U.S. 72 cents to U.S. 78 cents over the course of the year. With the exchange rate higher, investors holding global equity investments without currency hedging in place experienced lower rates of return, but still enjoyed an average gain of 13%.

Asset Class Return	2017 Return
Australian Equities	11.8%
Global Equities - Unhedged	13.4%
Global Equities - Hedged	20.0%
Australian Listed Property	6.5%
Global Listed Property	4.7%
Global Listed Infrastructure	15.4%
Australian Fixed Interest	3.6%
Global Fixed Interest	3.7%
Cash	1.7%



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Notwithstanding some lifting of shorter term cash interest rates, most notably in the United States, longer term bond yields remained relatively steady last year. Adding to the stability for fixed interest investors was the ongoing lack of any pick up in corporate loan defaults, which resulted in some improvement in the price of debt securities. As a result, returns from the fixed interest asset class were modest, but nonetheless still positive in both nominal and real (inflation adjusted) terms.

### **The year ahead**

A defining characteristic of the global economic environment in recent times has been the stability of major economic variables. With the global economic and financial system appearing to be in equilibrium, there is no obvious catalyst for this stability to break down. As such, an environment that is highly supportive of equity markets may continue for some time. Possible disrupters to this stability could include an unexpected downturn in global economic growth (potentially triggered by a softer Chinese economy) or a spike in wages and inflation pressures that sends interest rate higher than expected.

Locally, the ultimate unwinding of the residential housing boom provides an additional source of risk - both in terms of its impact on economic activity and the earnings of the all-important banking sector.

Given the elevated levels of share markets and some of the risks mentioned above, investors should take a cautious approach in the year ahead. For the time being, however, the economic backdrop remains accommodative of expanding company profit margins, which may continue to have positive ramifications for share markets.

### **Important Information**

The following indexes are used to report asset class performance: 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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