FM FINANCIAL

June 2019 Investment News

Phone: 1300 763 544 | Email: info@fmfinancial.com.au | Web: www.fmfinancial.com.au

Share markets remain strong despite unresolved trade dispute

The rally in equities and bonds that commenced in January continued into the June quarter, due in part to a change in the outlook for interest rates. Highlights for the quarter included:

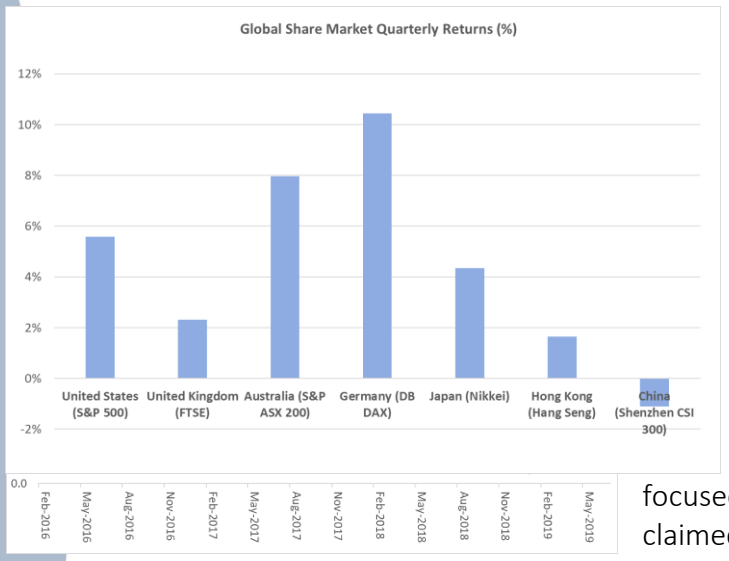
- Major asset classes finished the financial year with solid returns
- Global bond yields headed lower
- Coalition achieves surprise election victory
- Reserve Bank of Australia lowers interest rates

International Equities

Asset Class Return	3 Months	Annual
Australian Equities	8.0%	11.5%
Global Equities - Unhedged	5.2%	12.0%
Global Equities - Hedged	3.4%	6.2%
Australian Listed Property	4.3%	19.9%
Global Listed Property	-0.5%	8.2%
Global Listed Infrastructure	4.5%	10.1%
Australian Fixed Interest	3.1%	9.6%
Global Fixed Interest	2.7%	7.2%
Cash	0.4%	2.0%

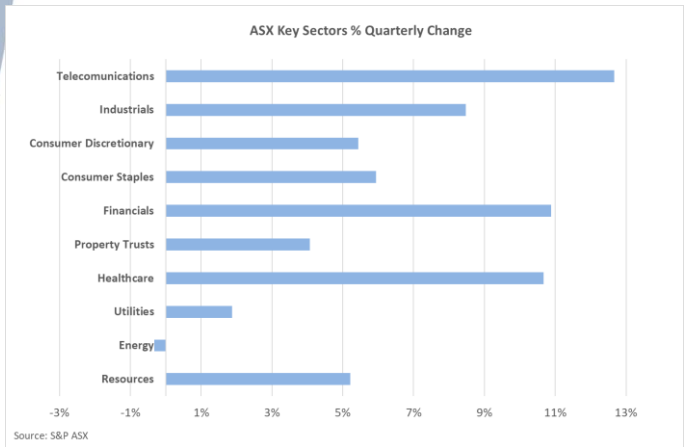
Over the past 12 months, several central banks around the globe have reversed their guidance as to the direction of interest rates. In the latter half of 2018, the firm outlook was for interest rates to head higher and this partially accounted for the poor performance of financial markets towards the end of that year. But this changed with the "pivot" by the U.S. Federal Reserve leaving rates on 'hold' in the first calendar quarter, which has been followed in the June quarter by firming expectations of interest rate reductions. Equity and bond markets have reacted positively to the lower interest rate outlook, with rallies that commenced in January continuing through to the end of the 2019 financial year. Of the first 6 months this year, only May has produced a negative return on global share markets.

The change in the outlook for global interest rates is associated with the threat of a slowing global economy. Whilst not the only issue, escalation of trade tariffs between the U.S. and China is impacting global growth sentiment. Having increased tariffs on Chinese and Indian goods, the U.S. threatened action against Mexico and Europe. Reports of positive dialogue between Chinese and U.S. authorities following the G20 meeting at the end of June, saw some respite in concerns on the trade front and this contributed to the ongoing strength of global share markets.



The US market (S&P 500), having fallen nearly 5% in May, rallied 5.7% in June given increased optimism around a trade dispute resolution and more solid guidance from the Federal Reserve pointing to lower interest rates. The U.S. market finished up 5.6% for the quarter. In contrast, the Chinese (Shenzhen CSI 300) finished the quarter down 1.1%, having fallen 7.7% in May and rallying 5.2% in June. In Europe, attention remained focused on the U.K. and Brexit. Having claimed another Prime Minister, the challenge is now to find a replacement with Boris Johnson the current front runner. But sentiment as to the outcome from the departure from the EU is hampering performance with the U.K. market rising just 2.3% for the quarter. This compares to the strong performance of the German DAX index, which had been lagging its peers over recent times, but rose 10.4% over the quarter.

Australian Equities



On the local market, the major event for the quarter was the surprise re-election of the Coalition government in May, which contributed to the Australian market outperforming the global average with a gain of 8.0%. The lack of any change in government removed the threat of changes to capital gains tax, franking credits and negative gearing. Additionally, banking stocks were buoyed by the lack of the introduction of another bank levy and some relaxation in home lending regulatory criteria. This, in conjunction with a cut in official interest rates, saw financial stocks rise (+10.9%) for the quarter. Lower rates supported higher dividend paying stocks, with returns in Property Trusts (+4.1%), and Telecoms (+12.7%) strengthening. In the latter case, the regulator's dismissal of the merger of TPG and Vodafone and the announced bid for Vocus by AGL certainly stirred interest in the sector. In contrast, the energy sector went against the general trend (down 0.3%), in part due to concern any global economic slowdown would dampen energy demand.

Fixed Interest & Currencies

Global bond markets enjoyed a broad-based rally in the June quarter due to US and European central bankers providing guidance on the outlook for lower rates. Even Japanese authorities, with 10-year yields at negative 0.2%, indicated they were prepared to provide monetary stimulus if required. US 10-year Government bond yields ended the quarter at 2.0%. Australian bond yields followed the global trend with 10-year yields finishing at 1.32%, having hit an all time low of 1.28% only a few days earlier. Despite the 0.25% rate cut in official cash interest rates in June (followed by a further 0.25% reduction in early July), the Australian dollar held

relatively firm. The widening spread between US and Australian 10-year bond rates (as shown in the accompanying chart) would normally see the Australian dollar weaken further. However, the high level of commodity prices, particularly gold and iron ore, has helped support the currency. Having drifted down slightly to U.S. 69.2 cents at the end of May, the currency finished the quarter only marginally lower at U.S. 70.1 cents.

Outlook and Portfolio Positioning

The June quarter demonstrated that equity markets were more guided by movements in interest rates than the lack of any resolution to the escalation in tariffs between the U.S. and China. However, this may not always be the case and we anticipate the second half of 2019 may be characterised by increased equity market volatility should there continue to be a lack of any agreement on trade between world's two largest economies. Conversely, should an acceptable compromise be reached, there is scope for the recent rally on global share markets to continue. With low interest rates and low inflation seemingly entrenched, global share market valuations are not excessive, despite the strength of markets over recent months.

For investors, the shorter term outlook for share markets remains highly unpredictable, given the dependence on trade negotiations for direction. In such an environment, remaining focussed on longer term strategies becomes even more important than normal.

The recent decline in Australian interest rates has pushed expected returns from low risk defensive investments below normal levels of inflation. As such, the environment has become more challenging for investors, as exposure to investment risk becomes necessary to provide any scope for returns to exceed inflation. Ensuring this risk is diversified remains the key component of our investment strategies. With the outlook for the local economy remaining relatively soft, holding material levels of exposure to global investments is a core component of this diversification.