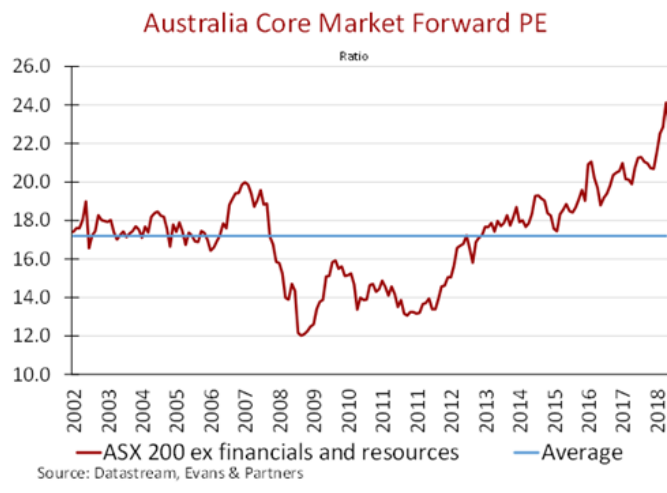


Market Valuation Update – October 2018

The Australian market went back through the long term fair value estimate of 5,720 this morning. This took the forward PE back to 14.2x – equal to its long term fair value.



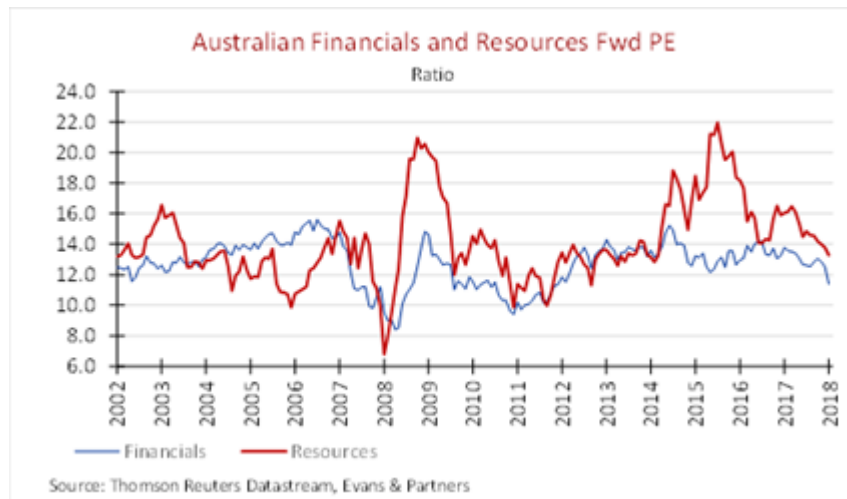
However please note the dispersion at the sector level. Industrials have become cheaper but are still well above LT averages. Need to remain very selective.



Resources and financials is where the value is. In the case of the major banks this may be for good reason but there are a bunch on non-bank financials (insurance, REITs, asset managers) that are also very cheap however earnings outlook does have some headwinds.

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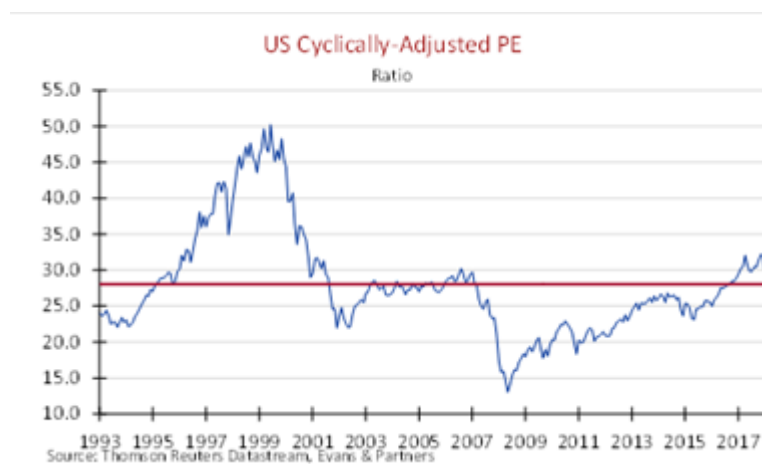
Helping you make the right financial decisions for both now & the future



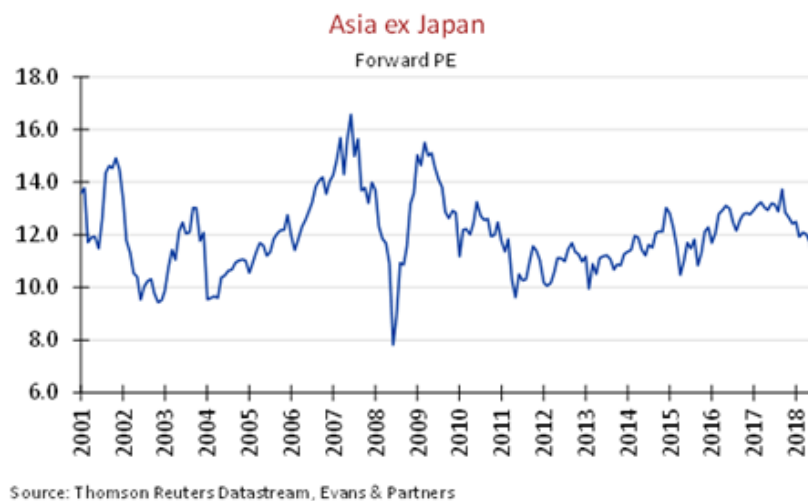
The US market is now also below its long term average on a one-year forward PE. The LT average in the US is around 16x and the market is now at 15.5x.



The complication for the US is that the current level of earnings is elevated by tax cuts and the very strong economy. Using cyclically adjusted earnings (the Shiller PE) the market is still around 5% above long term averages.



The markets that are really cheap are in Asia. The forward PE for MSCI Asia ex Japan could easily fall below 10x today – which is close to a record low excluding the GFC.



In Summary

Overall we are seeing this market weakness as an opportunity to buy, particularly now that the Australian market is back at fair value. We still see macro fundamentals as favourable: the economic backdrop is as strong as it has been in a decade and the corporate sector is healthy; central banks can reduce their pace of tightening, given core inflation rates remain low; and Chinese authorities have scope to provide stimulus.

We would note that the volatility could continue for a little longer given that there are a large number of events on the immediate horizon including:

- The US reporting season will continue for the next month and recent results have been more mixed
- Geopolitical risk will also step up a notch in November when the Iranian oil embargo comes into force.
- US political risk will also be higher in the lead up to the US mid-term elections on 6 November.
- The China/US trade war could get worse, before it gets better. The current timeline is that the US will move to an across-the-board tariff of 25% on all imports from China in January.
- European political risk will be higher in coming months particularly due to Italian budget negotiations and Brexit.

