<u>OUTLOOK FOR FINANCIAL MARKETS as at 31/5/2018</u>

Things are a bit "all over the place" at the moment and it is difficult to be too confident about any shorter term predictions (*although when is it ever easy*)? You could easily go crazy reading all the differing opinions circulating in the financial media at present. What follows is a list of current issued affecting the world and Australia at present – some negative, some positive and some a bit of both depending on your perspective.

<u>The Potential Negative Stuff</u>

- Trump
  - Will he, won't he, settle things with Kim Jong Un
  - Verses Iran
  - Verses Russia
  - Verses China; will all the stuff about trade tariffs / protectionism eventuate or is his threat just a negotiating tactic.
  - Tax cuts have been legislated but his planned large expenditure on infrastructure projects may have stalled due to budget constraints.
- Italy's new Government or lack of one. No one party has a majority although the Protectionist / Anti Refugee / Eurosceptic leftist 5 Star Movement and the far – right League parties are trying to form some sort of coalition.

  Markets were worried that Italy (*the 3rd largest Euro State*) might try and leave the European Union so there was a big sell off in Italian Government Bonds and Shares which spilled over into other Bond and Share markets (*28th & 29th May*). The sell off got reversed to a degree (*30th May*) when the Italian President, Sergio Mattarella, refused to allow the appointment of 81 year old anti Euro politician Paolo Savona as finance minister and instead threatened to appoint former IMF official Carlo Cottarelli to form a temporary technocratic Government before new elections. Quite possibly the blow out in Bond yields (*10 year Government Bonds went from below 2% to above 3% in one day*) might have scared enough people to prevent a "Quitaly" from the EU – an exit would mean much higher interest rates and probably inflation for the Italians whose government debt is very high (*2.3 trillion Euros or close to 135% of Italy's GDP*).
- More protectionist / anti free trade biases gaining sway in some parts of the world.
- Russia / Syria – the other day I read that Sweden (*of all places*), who have always been a neutral country, are massively boosting their defence spending because they are worried about Russia (*under Putin*).
- Global Debt
  - High US Government debt, high debt in some European Countries, high Japanese Government debt (*although nearly all of this is owed to the Japanese people and their interest rates are incredibly low which makes things less problematic for them*) and high debt by state owned enterprises / regional authorities via the "shadow banking sector" in China. As I said in last quarter's Outlook, I am not so worried about this and think any consequences of it can be minimised if managed properly.
- Australian Debt
  - Australian Government debt is rising but is still quite low by international standards. Our main debt problem is household debt at record levels (*some of the highest in the world*) fuelled by residential property prices getting to unsustainable levels and people borrowing more to spend using the security of their over-valued properties. I actually think this presents a problem for future Australian economic growth prospects because an amount of <u>future</u> household expenditure has been brought forward to the "now", meaning less sales for <u>some</u> business in future.

- That leads into my next point which is I can't see much capital growth prospects for Australian residential property for quite a long while (*5 or 6 years*) unless property prices fall significantly first, which would not be good for our banking sector (*already under pressure from the Royal Commission*).
- Governments in parts of the world, including Australia, without a clear majority, find they are hamstrung in governing and unable to make the necessary policy changes they want to hopefully improve our lives.
- Australians are already hamstrung and less efficient due to far too much useless Red Tape. We need rules, but they need to be sensible and have a meaningful impact.

But Life Goes On - The Potential Positive Stuff

- Global Economic Growth is steady in most countries (*including Australia*) and a bit higher in some others.
- Globally inflation is low in most countries (*including Australia*) although some would argue that inflation is set to increase in some jurisdictions (*even though the historical figures don't show this yet*).
- Global interest rates are very low by historical standards (*close to record lows in Australia – our Reserve Bank official cash rate hasn't changed from 1.5% since 2016*). Although they have been increasing rates in the USA the Fed official cash rate is still only 1.5% to 1.75%, but a few more 0.25% increases are expected in future to try and "normalise" their interest rates to some extent coming off earlier record lows. I personally can't see US rates increasing too much more in the foreseeable future because:
  - The US Government owes too much money, and
  - If they go too much higher it would put too much upward pressure on the $US meaning they would be less Globally competitive.
- Longer life spans and aging populations. Some may see this as a negative, but who says people have to retire at 65 – the magical 65 figure was first set in 1900 (*118 years ago*). With improved health, job flexibility and less manual work than 100 years ago, people should be able to work productively for well past 65 if they choose to.
- Unemployment rates in a lot of countries (*exclude some Southern European countries*) are very low e.g. USA, UK, Japan, some parts of Asia and Europe. Australia's unemployment rate could be a bit better but isn't too bad.
- New technologies are improving efficiencies and increasing the standard of living in many places. Availability of Information, Robots, Artificial Intelligence, Cheaper On-line Goods, Biotech / Medical advances, Electric Vehicles, more efficient energy creation from the sun, wind and water etc. One negative to some of this however could be cybercrime and privacy concerns.

So, What Does This Mean To Our Approach To Investing?

No changes really.

1. Remain genuinely diversified in your investments. This is the best way, bar none, to control all the various forms of investment risk.
2. Stick to your medium to long term strategy and don't pay too much attention to short term fluctuations, but be willing to adjust your portfolio when it makes sense due to changes in all manner of things – changes to rules, changes to markets or individual investments, new attractive options becoming available, changes to people or philosophies running various investment funds and changes to your own circumstances

3. Where investment markets and individual investment's pricing are currently positioned, you need to be carefully selective in your investment choices – we are in an environment where some investable assets (*shares, property, bonds, interest paying securities / deposits etc*) are good value and some are expensive and following the average (*various indexes*) is unlikely to generate acceptable returns.

4. Choose to invest with fund managers who are active when they need to be – selling various investments when their prices get too high and buying into quality assets when their prices become attractive (*cheap*) enough, who follow sensible investment philosophies and have the resources and proven abilities to implement these philosophies effectively in practice.