<u>OUTLOOK FOR FINANCIAL MARKETS as at 5/12/2017 *(Updated 6/2/18)*</u>

I thought I would include in this quarter's outlook some facts and figures on the Australian economy and then conclude what it all means:

- <u>Unemployment</u>: Our unemployment rate currently sits at 5.4% which, whilst not at recession levels, is a little high (the last 10 years have been between 4.0% to 6.3%). True unemployment is probably a bit higher again because there are a higher proportion of people with part time or casual jobs who would like to work more hours – sometimes referred to as Underemployment.
- <u>Inflation</u> for the last 12 months as measured by the Consumer Price Index (*CPI*) sits at 1.9% which is below Reserve Bank's target of 2% to 3%. It doesn't get much lower than this.

  The reasons why inflation is low in Australia and globally are many:

  - Even though the US, UK, Europe and Japan have undertaken massive money printing in the trillions (*Quantitative Easing*) this hasn't caused inflation as you might think because the velocity this extra money circulates at is much lower than normal.
  - Globalisation, New Technologies and Online Sales all result in more competition.
  - Globally economic growth has been substantially lower than previous cycles.
  - Demographics / Aging Populations in the developed world. Older people tend to spend less and perversely they have less money to spend because older people on average tend to invest more of their money into fixed interest investments / bank deposits.
  - Higher debt levels needing to be repaid means there is less money to spend by consumers.
  - Confidence is not yet fully restored after the GFC, so businesses on average are less inclined to spend money on increasing capacity or new ventures and there is still some surplus capacity stemming from the GFC. Consumers are more cautious with their spending.
  - People's expectations have been reset to expect lower inflation.
- <u>Real *(inflation adjusted)* GDP growth</u> was 2-3% for the last 12 months (*to 31/12/17*) which is below the longer-term average of around 3.5%. GDP is short for "Gross Domestic Product" which is the most commonly used measure for the total value of goods and services produced by the Australian economy.
- <u>Australia's Current Account Deficit</u> as per Australian Bureau of Statistics 5/12/17 Media Release (*refer to attached article*) is $9.1 billion, made up of a balance of trade surplus (*more exports than imports*) of $3 billion offset by a negative net primary income of $12 billion, i.e. more interest and dividends paid to overseas than received from overseas. This is mainly because Australia owes $990 billion more than is owed to us from overseas countries. This hinders our economy's capacity to grow at a faster rate.
- <u>Household debt in Australia</u> is close to record highs, yet growth in consumer spending is meant to be weak. This is because a disproportionate amount of household borrowing has been used to finance ever increasing residential property prices, which surely can't keep increasing at recent rates. Some commentators are expecting residential property prices to fall. I don't know if this will happen, but my hope is that residential property prices go sideways for quite a few years so the relevant fundamentals like household income and rents relative to property prices can catch up to where property prices are and restore balance to more normal levels.
- <u>Official Interest rates in Australia</u> are still at record lows. The Reserve Bank cut its official cash rate to 1.5% in August 2016, it has remained there ever since and doesn't look like changing any time soon. Other relevant interest rates are 90 day bank bills at 1.76% per annum, Government Bonds at 2.23% for 3 years and 2.93% for 10 years (*up about 0.5% from its low point in line with what is happening in interest rates globally – small rises*). Who wants to lend the Australian Government money for 10 years locked in at 2.56% per annum?

OUTLOOK FOR FINANCIAL MARKETS (Cont'd) as at 5/12/2017 *(Updated 6/2/18)*

- Currency: $1 Australian buys $0.7931 US *(in July 2014 it was above $0.94 US and January 2016 it was below $0.69 US)*. The Australian Trade Weighted Currency Index is currently 64.5 *(September 2014 it was 72.5 and September 2015 it was 59.2)*. Where is the Australian dollar headed? I'm not sure but longer term I suspect it will fall versus the $US.
- Australian share prices as measured by the S & P / ASX 200 are currently 5,820.20. The index was 6,121.39 two trading days ago but has fallen by 4.9% in line with what has happened on Wall Street. A sell off on the US stock market has apparently been triggered by worries about the impact of a tightening job market on the prospects for inflation and as a consequence rises in interest rates which the Fed has already foreshadowed and everyone already expects? I'm not sure why that should be a negative for Australia, but history would show that when the US shares drop Australia follows, even if there is no logical reason for a fall. The Australian index was above 6,000 in April 2015 and above 6,800 in October 2007 over 10 years ago. That said a large portion of this index is taken up by a handful of stocks, i.e. CBA, Westpac, ANZ, NAB, BHP, RIO, Woolworths, Wesfarmers, Telstra and CSL make up 42% of the index, which can distort how things are really performing. I think from a broader perspective *(considering the other 2,200+ listed companies)* that prices are everything from cheap to expensive and the medium to long term outlook for a carefully selected portfolio of Australian shares is still decent.

So, based on the above, Australia is not going backwards, it's just that it's going forward very slowly. That said the above figures are averages or totals including everything, and I firmly believe there are plenty of good opportunities to invest in quality assets across most sectors (*shares, property etc.*) provided the people choosing the investments pick mostly good ones and avoid most poor ones. This is a function of having the right people (*highly skilled, trained with experience*) implementing sound philosophies / approaches to investing and backed by extensive relevant resources.

Looking at financial markets globally in some senses is similar to Australia in so far as there are good investment opportunities and yet others to be avoided. The key is to be selective in the investments you (*or your manager*) choose to back.