OUTLOOK FOR FINANCIAL MARKETS as at 8/3/2019

As financial markets are ultimately affected over the medium to long term by what happens in the real world, as opposed to short term fluctuations which are rarely predictable, I thought I might start this outlook by outlining what various economic and political indicators seem to be suggesting at present.

USA

The Pros – Economic (*GDP*) growth at healthy levels; low unemployment; wage levels increasing moderately; inflation about where they want it; interest rates still low by historical standards despite the Federal Reserve Bank (*until now*) regularly increasing rates over the last couple of years – from close to zero to 2.5%; company profits mostly healthy; increased spending on infrastructure.

The Cons – Very high Government debt and still growing (*due to previous tax cuts and increased spending on infrastructure*); this is occurring at the same time as the Federal Reserve is looking to shrink their balance sheet (*Quantitative Tightening*) which might put some upward pressure on longer term interest rates; increased tariffs on imports and possible trade war with some other countries and in particular, subject to the outcome of the ongoing trade negotiations currently taking place, with China.

EUROPE

Very low interest rates (*still negative in some countries)*; economic growth positive but quite low; inflation low; unemployment not as bad as it was some years ago but still high in some countries; Brexit – will they, won't they; political problems in many European countries; still high levels of Government debt in some countries. Overall the outlook for Europe seems to be fairly muted.

JAPAN

Similar to Europe with very low interest rates, low but positive GDP growth, low inflation, but with a few differences – they don't have Europe's political problems; unemployment is low; Government debt is very high but the vast majority of it is owed to their own people which makes it less of a problem.

CHINA

Economic growth is lower than it was a few years ago (*around 10% to 12%*) but is still healthy at around 6% per annum of a much bigger number, which would be considered high growth for any developed economy. Some people are concerned about this decrease (*unreasonably in my opinion*), but China's growth rate was always expected to decline as part of their intentional process of transitioning away from a manufacturing and export led economy to a more stable domestically focussed and service-oriented economy. Sure, China has its problems (*such as excessive debt in the shadow banking sector*), but there are a lot of opportunities for business in China.

OTHER EMERGING MARKETS

The outlook for some of the Countries classified as emerging markets looks very good with economic performance and governance improving at a very healthy rate. There are however some basket cases in this category e.g. Venezuela.

AUSTRALIA

- Real *(inflation adjusted*) GDP Growth which is lower than our long term average at — 2.3% per annum
- Inflation (CPI), under control at — 1.8% per annum
- Unemployment, a bit higher than we would like (4% would be better) — 5%
- Reserve Bank's official interest rate (*unchanged since mid 2016 & a historical low*) — 1.5% per annum
- Currently we have a balance of trade surplus (*exports are worth more than imports*) but due to interest payable on the net amount borrowed from overseas we have a Current Account Deficit equivalent to about 1.6% of GDP which is less than it has been and therefore not too bad (*less vulnerability to foreign lenders*).

<u>OUTLOOK FOR FINANCIAL MARKETS (*Cont'd*) as at 5/3/2019</u>

These numbers reflect economic activity for Australia which, whilst not too bad, is at a lower level than we would like in an ideal world. The biggest potential problem for Australia (*apart from something happening overseas beyond our control*) is the record level of household debt probably brought about (*until the last 18 months*) by ever increasing residential property prices, causing people to borrow more for property purchases and / or using the equity in their properties to borrow more to spend on all sorts of things. Now that residential property prices have started falling (*by over 10% to date*) people are becoming concerned and are using surplus income to pay off their borrowing more quickly and therefore spending less on goods and services. The bottom line is that some Australian businesses might find their normal level of sales under pressure leading to lower profits and potentially less need for employees meaning less money in circulation to buy goods and services. At the moment things seem mostly under control but if residential property prices keep falling much more we could be in for an interesting time.

<u>INVESTMENT STRATEGY</u>

Taking the above into account nothing much has changed really. Remain genuinely well diversified with your investments and be selective in those investments you choose. And where managed investment funds are used, the managers should apply these same principles. Expect some more volatility over the next year or so (ups and *downs*) but remain patient and stick to your medium to longer term strategy. Don't get put off by temporary dislocations.