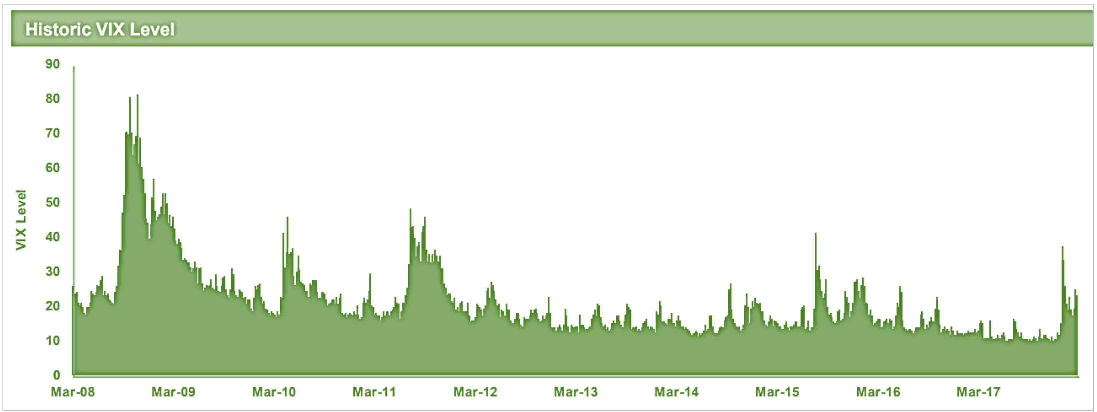
MARKET SUMMARY

Quarterly Report
April 2018

MARKET OVERVIEW

Market Volatility- Volatility Index



The VIX measures the implied volatility of the S&P 500 index over the next 30 days. The higher the index, the higher the expected volatility.

Cash

Whilst the Reserve Bank of Australia (RBA) has elected to leave our cash rate unchanged at 1.5%, interest rates internationally have seen some upward movement – in particular, the US Federal Reserve (Fed) raised the rate from 1.5 to 1.75 percent at its March 2018 meeting, in line with market expectations. The Fed also raised its growth forecasts for 2018 and 2019 and pointed to an extra three (3) rate rises in 2018.

Fixed Interest

The bond market behaved like a fast car in February as yields accelerated very quickly, causing the largest one-day sell-off in US equities since 2011. Rising bond yields are not new. The US 10-year yield steadily rose fifty-nine (59) basis points between June 2017 and January 2018. But it was February's aggressive move that unnerved investors. In the near term, the pace of the move, rather than the magnitude, will influence equity markets.

When yields have been low and rising, the economy has typically been in recovery with inflation slowly building and the outlook for earnings improving. At that point in the cycle, monetary policy is accommodative, supporting equities. Once yields rise above 5%, however, equities start to lose their shine. That's when the economy would historically start to heat up and corporate borrowing costs can become punitive, with monetary policy tightened to the point where it brings about an economic slowdown.

Bond yields should continue to rise through 2018 but at a gentler pace, remaining some way below the level that would suggest investors rotate away from equities and into bond markets. There is no magic bond yield number that signals when equity returns will be impacted – the 5% yield threshold we discussed above is only a rough guide and arguments could be made for why it should be lower. Other factors beyond the yield on bonds, matter more for equities.

The US bond market returned (-)1.5% in the quarter when compared to the Bloomberg Barclays US aggregate Index. The short-term debt concerns regarding trade policy and tightening monetary policy factored the low return.

Global fixed income markets experienced strong performance in the first quarter with strength driven by Japan, Europe and emerging markets.

Australian Equities

We entered the New Year with a positive outlook for investors. However, things did not last for long. Shares fell in February due to the worries in US inflation, only to rebound and then to fall again with markets falling back to or below their February lows.

Market volatility reflects the ongoing worries about the US Federal bank raising interest rates and higher bond yields, concerns about President Trump's tariff hikes, with the fear of a global trade war with China, rising short-term bank funding costs in US and privacy issues in relation to technology stocks (Facebook, etc). These factors all contributed to see our share market to close at 5868.90 points as at 29 March 2018.

We are expecting slow growth positions in Australia and below are some of contributing factors:

- The level of housing construction and building approvals;
- The outlook for consumer spending is constrained and uncertain;
- Diminished mining investments;
- Low inflation and wages growth;
- Domestic political issues and economic reforms.

International Equities

For the first time in three years, the S&P 500 posted a negative return of (-) 0.8% for the quarter, Eurozone shares has fallen by 10%, Chinese shares fell by 12% whilst Japanese shares were down by 15%.

A fair question might be, '*should we be worried about the Fed?"* As an investor, yes we should be but not yet. As highlighted by our economists, the risk to US inflation has moved to the upside as spare capacity continues to be used up and the lower US$ adds to import prices. We continue to see the Fed raising another three (3) times this year and this will cause periodic scares in financial markets. Within the recent sell-off in the International market, positive contributors were Technology (+3.5%) and Consumer Discretion (+3.1%).

Property

Australian Residential and Commercial Property have again produced mixed results.

Returns from the AREIT sector are mixed with the benchmark S&P AREIT Index with a return of a (-)6.40% compared with the 5 year return of 10.61%. Global Property was generally in negative territory with returns from the GREIT sector marginally better at (-)5.87%.

Market Outlook

Upon reflection, 2017 recorded the sixth consecutive year of positive real returns from all major asset classes for Australian investors – including both Australian and International equities. It was the first time in history that everything has gone up for six straight years for Australian investors.

But as recent market weakness has shown, momentum does not always travel gently or slowly rollover, it can violently reverse, wiping out a large portion of previously accumulated gains.

The breathless headlines about the Dow Jones falling the largest number of points in one day ever and about $61 billion being wiped from markets needs to be seen in perspective. Whilst the fall in the Dow Jones on 5 February 2018 of 1,176 points was indeed the largest single day fall in percentage terms this represented '*only'* 4.6%.

In part the February fall should be seen in the context that the Dow Jones rallied 32.9% last year and a further 7.6% in January.

The weakness in shares reflects ongoing worries about the US Fed raising interest rates and higher bond yields – and worries that President Trump's tariff hikes will result in a global trade war – depressing economic growth.

Clearly sharp market falls are stressful for investors as no one likes to see the value of their portfolio decline. However, periodic sharp setbacks are normal and healthy.

Selling shares or switching to a more conservative investment strategy after a major fall – simply just locks in a loss.

The best way to guard against selling on the basis of emotion is to adopt a well thought out, long-term investment strategy and stick to it. Notwithstanding that this can be difficult in periods of market turmoil, when the flow of negative news can reach fever pitch.

As interest rates begin to normalise (as has already been seen in the US) it is likely that investors might well benefit from more active and value investing.

We welcome your queries and/or concerns regarding your portfolio, contact either Donald Hands or Lasadi Felsinger on (03) 8419 9800 or by email info@wilsonpateras.com.au.

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Index Descriptions
Standard & Poor's: CBOE: Baird Analysis
Reserve Bank Of Australia

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