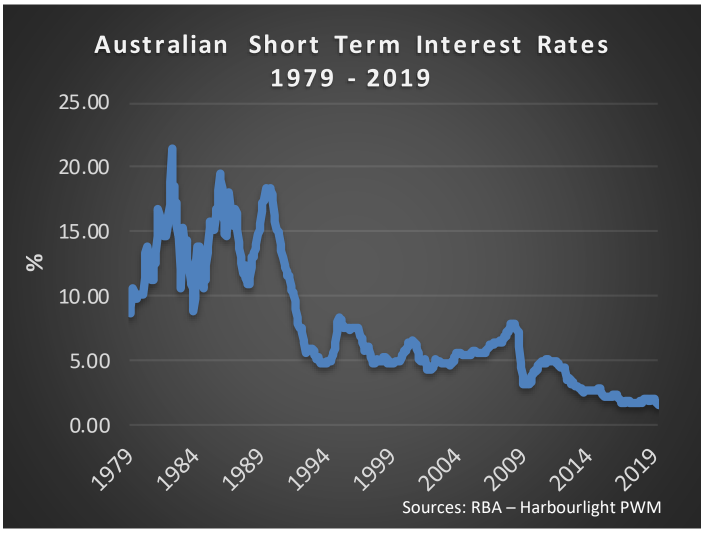
A brief review of investment markets and broader factors affecting clients. **June 2019**

Macro-Economic and Asset Class

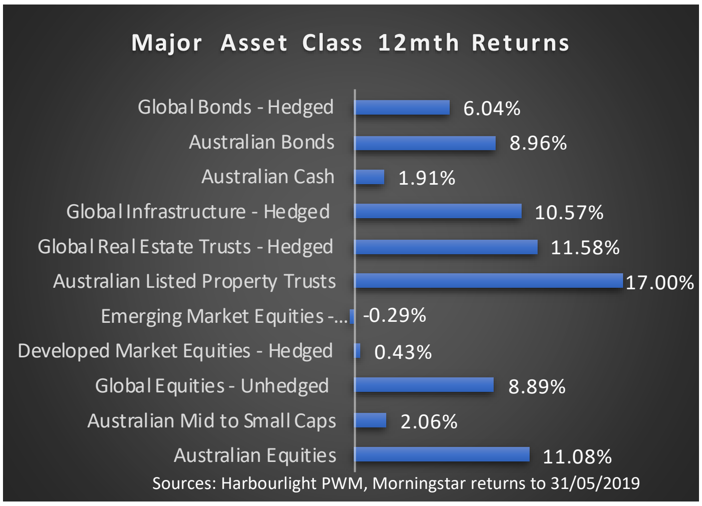
We've seen some good investment returns over the last 12mths, though falling interest rates are making it harder for investors to reach their target investment returns. In conjunction with this, most other assets are rising in value, looking more expensive and reducing their expected return moving forward. 2019 marks 12 years from our last major financial crisis. While it was a particularly large one and no one can predict when the cycle will turn or if regional cycles will be synchronised, one thing we know as a fact is that we are 12 years closer to the next major crisis. We believe it's an important time for investors to make sure their portfolios are prepared as possible for either a few more years of growth or a potential bear market.

As we go into Australian financial year end, many investment markets have provided strong returns. Signs of slowing global growth have interest rates falling and central banks once again talking about more accommodative monetary policy.

Australian interest rates are now at a record low (see chart) and adjusted for inflation, look to have little - if not negative real returns. Though Australian investors still remain in better stead than other parts of the world such as Germany, where longer term interest rates have become negative for the second time in five years.



Looking at returns for varying asset classes over the last 12 months, increasing risks have delivered particularly good results for high grade bonds which have returned 6 to 9 percent. A very high return for this type of product.



Growth assets such as shares and property have also broadly risen, driven by investors searching for returns and not reflecting the rising risk shown in bond markets.

With the exception of Emerging Market equities which are being hindered by the Sino-US trade war and Australian small cap shares, most growth assets are increasing in value at the same time. In normal conditions, these types of assets tend to be negatively correlated. Whilst assets going the same way at the same time has been more common since central banks started injecting money into global economies, from some aspects of finance theory this is not very logical.

This 12 months hasn't provided a smooth ride either, globally we've had an escalation and re-escalation of a trade war, as well as various other issues including increased talk of a US recession, which saw returns drop meaningfully through the end of 2018 before recovering.

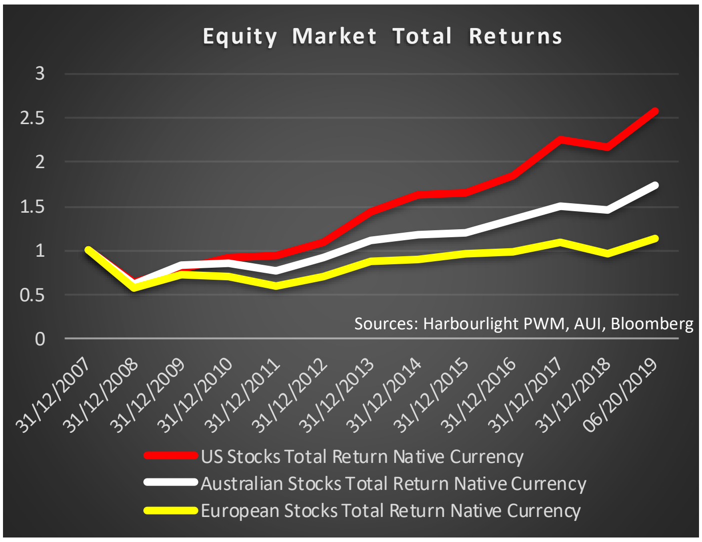
Locally we believe getting through the last Australian election meaningfully reduced the risk in Australian assets and provided a stable government. Something which is becoming rarer in developed markets economies.

We expect loosening regulation towards lending and political stability to reduce the rate of decline in the local residential property market though any form of sharp recovery remains a lower chance.

Interestingly Australian listed property was the best performing major asset class whilst residential housing fell sharply.

Our views for the remainder of 2019

Whilst it's been 12 years from the peak preceding the last financial crisis, it's important to remember that we've seen many large headlines that haven't negatively affected the long term returns of major asset classes over the last decade and that regional cycles aren't always in tune.



Looking at the returns of major stock markets from before the last crisis, we can observe some reasonably different outcomes. $100,000 invest in US shares would be worth $257,000 today or if invested in European shares would be worth $112,000.

Locally, the media is writing of the ASX 200 reapproaching its October 2007 high, yet strong dividends have helped $100,000 be worth $175,000 even without share price growth.

For investors trying to navigate their way through all this it's not easy. Whilst investing through the cycle is a good strategy. It's not wise to ignore valuations when managing your portfolio.

Many mainstream investment funds have been increasing their exposure to equities and other growth assets thus significantly increasing the risk in investment portfolios. We believe this behaviour is converse to the way investors should behave, essentially reducing growth assets as they become more expensive and increase as they cheapen and offer higher returns.

We are also seeing investors stretching for higher yielding assets, we also don't believe it is the time for investing in deposit products with a higher chance of not repaying their principal.

When valuations push higher, there is logic in accepting slightly lower returns to guard against larger drops in capital value, should something go wrong. Diversity remains the key to reducing the risk in portfolios especially when approaching the later part of an investment cycle.

We continue to support slightly more conservative yet well invested portfolios positioned to benefit from the themes currently shaping our world. Whilst risks and valuations are elevating, we still believe shares in quality businesses in developed and emerging nations add value. Post the stellar return in listed property we believe it's wise to consider forms of direct, unlisted and global property. We are growing more cautious of infrastructure assets though smaller allocations serve a purpose and from currency perspective we continue to support a half-hedged approach to international assets.

Other Regulative Matters

- Passing through the last Australian election, the risk of increases to the rate of capital gains tax, family trust tax, reductions to negative gearing benefits and reductions to the benefits of franking credits have passed for now.
- Talk of primary residence capital gains tax exclusions for expatriates who sell their homes whilst offshore have quietened somewhat.
- Income tax bands will remain the same this financial year, however the Coalition government has proposed some further reductions which are yet to be passed to law.
- The maximum level of Superannuation contributions remains at $25,000 for concessional and $100,000 non-concessional contributions.
- The transfer balance cap applying to commencing retirement income streams remains at $1.6m.
- Incentives continue to be provided for those who have had less time to contribute to super, with the largest being a $300,000 non-concessional allowance for those aged over 65 who are downsizing their home if held for over 10 years.
- Superannuation guarantee contributions remain at 9.5% with a scheduled increase to 10% in 2021

Please feel free to contact us if you wish to discuss any of these matters.

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