HOUSE VIEW

EXECUTIVE SUMMARY

Firmer signs that the industrial cycle has based led us to reduce our recession risk for 2020. As a result, we have increased our developed market and emerging market equities exposures, funding them by reducing listed real assets and cash.

OUR VIEW

October ended on a positive note with shares largely outperforming traditional safe haven assets. This relative calmness reflects the ease in US-China trade relations, signs that the global industrial cycle is basing, and the US Federal Reserve cutting rates again over the month by another 0.25%. However, we believe this is the last of the cuts for 2019 as central banks monitor the impact of rate cuts to date.

In fact, central bank policy support already appears to have had some positive effect. The economic data flow from the troubled industrial sector seems to have bottomed and with businesses advanced in cutting back on excess inventories, there is some prospect for a weak recovery into 2020. Company earnings have also been coming in better than expected.

Likewise, rate cuts have supported the household and services sector, which remains firm. US jobless claims, a good contemporaneous indicator of the US economy, while no longer falling, are showing no signs of a sharp rise. The recession risk that had built through 2019 now looks to be easing.

While our Investment Cycle Clock remains firmly in late cycle territory, supportive financial conditions suggest that policy easing should gain traction and likely extend the investment cycle for some time yet. However, risks still remain from uncertainty around the US-China trade conflict, even though a partial deal was reached.

Overall our score cards and recession risk indicators have modestly improved, signalling a neutral position to growth assets. Valuations are around fair value overall for global shares, with Europe and Japan relatively attractive versus the US range. Australian shares are close to the top of our fair value range.

Riskier assets (the Australian dollar, emerging market and value equities) are around the bottom of fair value and would gain traction if the nascent recovery were to strengthen. In contrast, rate sensitive and defensive assets such as real assets are more expensive and could come under downward pressure.

While the industrial cycle looks to be basing, the growth outlook remains modest. Our key leads suggest little earnings growth for global share markets in the year ahead implying downgrades will likely continue across most markets and sectors, although the risk of a large drop in earnings has receded.

Investor sentiment has deteriorated along with the fall in business confidence. From a contrarian perspective, this is a short-term positive for markets.

WHAT THIS MEANS FOR OUR DIVERSIFIED PORTFOLIOS

With some signs of stabilisation in the economic cycle, better earnings outcomes, a reduction in tail risks and soft investor sentiment, we have taken growth assets back to benchmark from a small underweight. This increase has been concentrated in both developed market and emerging market equities. These are funded by reducing our listed real assets exposures and cash.

With expectations of (at best) a modest recovery in growth, bond yields are likely to remain low for an extended period, and as such Australian and international bonds are kept at benchmark. Similarly, while the Australian dollar has strengthened, likely reflecting the early stages of the industrial recovery, we have maintained our benchmark position.

STRATEGY TILTS

	SAA	TAA	Over/ Under weight
Growth assets	70%	70%	0%
Australian equities	26%	25.25%	-0.75%
Developed market equities	28%	29.35%	+1.35%
Emerging market equities	4%	4%	0%
Listed Real Assets[1]	6%	5.4%	-0.6%
Alternative Growth	6%	6%	0%
Defensive assets	30%	30%	0%
International fixed income	8%	8%	0%
Australian fixed income	12%	12%	0%
Cash	10%	10%	0%
Foreign currency hedge ratio[2]	30%	30%	0%

SAA – strategic asset allocation
TAA – tactical asset allocation

STRATEGY POSITIONS SUMMARY

GROWTH ASSETS: 0.0% at benchmark	Due to signs that the global industrial cycle is basing, we have increased our developed market and emerging market equities exposures. These are funded by reducing our listed real assets exposures and cash.
Developed market equities: +1.35% overweight	Macro lead indicators point to below-trend growth in the global industrial cycle. However, signs are building that the global industrial cycle is basing. This development has been supported by rate cuts and progress on a US-China trade deal. Valuations are around fair value overall for global shares, with Europe and Japan relatively attractive versus the US range. Technical and sentiment are stretched for rate sensitive sectors, but overall supportive for equities.
Australian equities: -0.75% underweight	Australian macro lead indicators have softened. Valuations are beginning to look stretched and are now close to the top of our fair value range as the market has factored in policy support from tax cuts, lower rates and some easing in lending restrictions. Earnings indicators were beginning to stabilise but have softened again. Resources are benefiting from rising commodity prices due to supply constraints, particularly in iron ore although prices have fallen sharply recently, and a lower Australian dollar (AUD).
Emerging market equities: 0.0% at benchmark	Macro lead indicators for the region and the earnings-per-share (EPS) growth are still weak, although signs of a base in the global industrial cycle are supportive. Valuations remain generally more attractive than developed markets. However, more sustained outperformance will depend upon the US dollar (USD) weakening. To this end, the US Fed's decision to cut rates assists, but broad USD weakness would depend on regions outside the US doing more heavy lifting on global growth.

Listed real assets[1]: -0.6% underweight	Valuations in global listed property are now expensive. This asset class generally does well in periods of uncertainty while bonds yields are low. If the growth outlook deteriorates further and the major central banks continue easing policy then the asset class should perform well. However, signs that growth could improve is a headwind relative to cheaper asset classes. Listed infrastructure valuations are also above our fair value estimates. Investors have rotated into defensive sectors, but this has now become a crowded trade.
Alternative growth: 0% at benchmark	Alternative growth assets are held at benchmark. This asset class adds to diversification and it typically has less volatility than listed real assets. It should provide protection if volatility in risk assets increases in the months ahead.
DEFENSIVE ASSETS **0.0% at benchmark**	Defensive assets have continued to be supported by subdued inflation and the slide in global growth that have led to the US Fed to cut rates, and the ECB to relaunch quantitative easing. Australian inflation is undershooting RBA forecasts and this is putting downward pressure on Australian yields and lifting expectations of further rate cuts. However, signs that growth is stabilising has seen yields rise over recent weeks. Nevertheless, with expectations of (at best) a modest recovery in growth, bond yields are likely to remain low for an extended period, and as such we have kept Australian and international bonds at benchmark.
International fixed income: 0.0% at benchmark	The slowdown in global growth and subdued inflation have supported a solid rally in fixed income. Signs that growth is likely levelling out have been a headwind with yields rising as further central bank easing has been scaled back. Technical and sentiment factors are also stretched and some repositioning is likely. Nevertheless, we expect subdued inflation and modest growth to continue supporting yields at low levels.
Australian fixed income: 0.0% at benchmark	Australian fixed income has rallied strongly and signals remain neutral on subdued inflation and expectations that the RBA would ease further in the new year. Inflation expectations are subdued compared to the rest of the world, and in conjunction with an improved fiscal outlook, should anchor yields below the US. However, in line with global yields, the improved growth outlook has lifted local bond yields.
Cash: 0.0% at benchmark	We are neutral between cash and fixed income at present. With early signs of a basing in the industrial cycle, the positive data flow for fixed income markets has reversed in the past month. Nevertheless, subdued inflation and below-trend economic growth continue to provide a supportive environment for bond markets.
FOREIGN CURRENCY HEDGE RATIO[2] 0.0% at benchmark	The headwind from interest rate differential to the US is partly offset by rising bulk prices. While easing global lead indicators have driven base metal prices lower, China's supply side reform and supply disruptions in Brazil mean that iron ore has good support at relatively high prices. We need firmer signs to emerge that the current base moves to a recovery to change from a neutral position.

Notes:
1. Comprises of 50/50 split between GREITs and infrastructure securities.
2. Percentage of developed market and emerging market equities hedged from foreign currency into Australian dollars.

Representative diversified portfolio with 70/30 growth/defensive assets.
As at November 2019.

Disclaimer: This information is issued by the Australia and New Zealand Banking Group Limited (ABN 11 005 357 522, AFSL 234 527). The information is current as at 8 November 2019 and is subject to change. The information is general in nature and does not take into account your personal objectives, needs and financial circumstances. You should consider the appropriateness of the information, having regard to your personal objectives, needs and financial circumstances and read the relevant disclosure documents before acting on this information. This information is not to be construed as personal advice, and should not be relied upon as a substitute for professional advice. Although all the information in this document is obtained in good faith from sources believed to be reliable, no representation or warranty, express or implied is made as to its accuracy or completeness. Past performance is not indicative of future performance. The value of investments may rise or fall and the repayment of subscribed capital is not guaranteed.