

HOUSE VIEW

EXECUTIVE SUMMARY

We are gaining confidence that a base is forming in the global industrial cycle and from there we expect a U-shaped recovery. This is supportive of growth assets but looks to be largely priced.

OUR VIEW

Share markets weakened late in 2018 on recession fears, before rebounding in the past three months, consistent with continued reasonable earnings growth in the year ahead. Recent data is increasingly supportive of this trend and we are gaining confidence that a base is forming in the global industrial cycle, suggesting the economic expansion will continue for some time yet. However, the bond market is not yet convinced given current low yields. While we expect this trend to be supportive of share markets, bond yields will likely experience moderate upward pressure over the near term as the base in activity becomes more established.

After forming a base in activity, a number of indicators support an elongated U-shaped recovery, which typically bounces around the base with a gradual shift higher rather than a V-shaped recovery that begins with a steep fall, but troughs and recovers quickly. Supporting factors for a U-shaped recovery include: inventory is still at neutral or modestly high levels; the US yield is flat while the USD is steady; moderate Chinese stimulus; and US capex lead indicators are now slowing.

Furthermore, markets are signalling a prolonged period of stagnation across Japan and the eurozone, with both the US and China growing but settling at a slower pace of trend growth. This environment would anchor yields lower for longer, although a base in growth could exert near-term upward pressure.

A U-shaped recovery could work to extend the cycle as a strong V-shaped recovery would ultimately be negative for growth assets as the US Federal Reserve (Fed) could be drawn back to a hawkish stance which would reignite

recession risks. We are currently expecting the Fed to hold rates until 2020 with inflation subdued and a U-shaped gradual recovery.

WHAT THIS MEANS FOR OUR DIVERSIFIED PORTFOLIOS

If a base in global growth does progress as we expect and a modest improvement in the earnings outlook eventuates, we would look more favourably towards growth assets.

However, at present this is largely priced with global markets around fair value and our economic scorecard is still suggesting caution towards growth assets given the current weak pace of economic growth. We consider the share market rally to remain vulnerable until clear signs develop that an upgrade earnings cycle is emerging.

The RIC strategy for growth assets remains at neutral, but our actual portfolio positioning has a preference for global over Australian shares, reflecting the relative easing in financial conditions that favours international exposures and the risks that still surround the unwinding of the house price and construction cycles.

We continue to maintain an underweight to fixed income, with this concentrated in international markets with Australia at benchmark due to the relatively attractive level of rates and subdued inflationary pressures. We remain overweight cash. Global listed property and infrastructure are relatively expensive and are susceptible to an increase in yields which may unfold if growth levels out; portfolios are running a small underweight to both types of real assets.

HOUSE VIEW

STRATEGY TILTS

Preference level	LOW	NEUTRAL	HIGH
GROWTH ASSETS	-		+
Australian shares	-		+
International shares	-		+
Emerging markets	-		+
Listed real assets ¹	-		+
Alternatives	-		+
DEFENSIVE ASSETS	-		+
Australian fixed income	-		+
International fixed income	-		+
Cash	-		+
CURRENCY - AUD	-		+

Notes:

Equities, fixed income, cash and currency are relative to benchmark.

1. Comprises of 50/50 split between GREITs and infrastructure securities.

As at April 2019.

STRATEGY POSITIONS

GROWTH ASSETS	
GLOBAL EQUITIES: NEUTRAL	Macro leads remain weak and below-trend growth. However recent data is increasingly supportive of a base is forming in the global industrial cycle, suggesting the economic expansion will continue for some time yet. Valuations across most markets are at fair value although the US is on the expensive side. Earnings momentum continues to slow across all regions and sectors although the pace is now easing. We believe consensus 2019 global earnings per share (eps) has declined from double digits to around 6% but further downside is possible. Investment sentiment has now returned to neutral. Within the neutral range global equities are modestly overweight, a counterweight to modest underweights in Australian equities and listed real assets.
AUSTRALIAN EQUITIES: NEUTRAL	Macro leads have eased and have now caught up with the global slowdown. Valuations have now largely returned to fair value. Consensus 2019 eps growth is moderate at around 3% and we see limited risk of a sharp downgrade cycle that would threaten dividends unless unemployment moves sharply higher. We continue to expect Australian equities to perform relatively well given attractive yields and the Reserve Bank of Australia (RBA), and the US Fed, holding rates steady for an extended period. However, our actual portfolio positioning has a preference for global over Australian shares as financial conditions have not eased in line with global markets due to a structural credit tightening and risks that still surround the unwinding of the house price and construction cycles.
EMERGING MARKET EQUITIES: NEUTRAL	Macro leads are still weak and despite the rally, valuations remain on the cheap side of fair value. EM will benefit from a base being formed in the global industrial cycle. A cap and possibly weaker US dollar with the Fed on hold will also assist these markets. Outflows out of the region have improved, but the outlook for the USD and China policy easing are key factors in the period ahead.
LISTED REAL ASSETS: Global REITS/Infrastructure NEUTRAL	Valuations in global listed property are now at the expensive end of fair value. With the Fed pausing rate-tightening, this sector will be supported by a cap on yields but this is likely fully reflected in rich valuations. For listed infrastructure valuations have recovered to the upper band of fair value as the market rotated to defensive sectors. Listed infrastructure valuations are not as stretched as GREITS but both are vulnerable to any increase in bond yields. Portfolios are running a small underweight to both types of real assets
DEFENSIVE ASSETS	
INTERNATIONAL FIXED INCOME: UNDERWEIGHT	The slowdown in global growth and the collapse in the oil price have supported a solid rally in fixed income. After trading around fair value, our valuation for the US 10-year bond yield has fallen with Fed tightening expectations taken out for 2019 and expectations that the Fed will now ease. While slower global growth in the period ahead, this environment should anchor yields lower for longer, although a base in growth could exert near-term upward pressure.
AUSTRALIAN FIXED INCOME: NEUTRAL	Australian fixed income has rallied strongly and signals remain neutral on subdued inflation and the RBA holding rates steady for an extended period. Valuations are moderately expensive possibly reflecting markets shifting to a rate cut. Inflation expectations are subdued compared to the rest of the world and in conjunction with an improved fiscal outlook will likely anchor yields below the US.
CURRENCY	
AUD NEUTRAL	Moderately positive signal as valuations are below fair value (US78c) with bulk commodity prices elevated. The headwind from interest rate differential to the US is partly offset by solid bulk prices. While easing global lead indicators have driven base metals e.g. copper lower (although prices have based over recent weeks), this has been offset by bulks (iron ore, coal), driven by China's supply side reform and now supply disruptions in Brazil favouring higher grade iron ore. Overall, slow global growth and the headwinds from the housing markets are headwinds to our fair value estimate of US78c.

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 3 April 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.