HOUSE VIEW

EXECUTIVE SUMMARY

- There are signs that the US economy is now also slowing with the growth gap to the rest of the world narrowing and the US Federal Reserve (Fed) possibly pausing its rate hikes in 2019.
- On the Australian outlook, RIC members agreed that while there is pressure from falling house prices, there have been few signs of stress, and for the housing situation to become a more significant headwind, global credit would need to significantly tighten.

OUR VIEW

The December RIC discussion centred on the steady loss of global economic momentum and the ensuing earnings downgrade across most regions and sectors. There were mixed views among participants as to whether growth was already consolidating or whether momentum would bounce around as in the 1990s for an extended period with margins consolidating rather than collapsing.

The group also discussed the Australian outlook and agreed that while there is pressure from falling house prices, to date there have been few signs of stress, and for the housing situation to become a more significant headwind, global credit would need to significantly tighten.

The RIC council also identified that since the group last met in October, there have been signs that the US economy is now also slowing with the growth gap to the rest of the world narrowing and the US Federal Reserve (Fed) possibly pausing in 2019. The recent decline in the oil price is also a major development. The oil collapse has eased inflationary pressures into the slowdown and provided some scope for the Fed to pause its rate hikes.

These developments have eased upward pressure on the US dollar (USD) with many participants expressing the view that the USD was now likely peaking.

Meanwhile, the US yield curve has continued to flatten and our investment cycle clock continues to lift, flagging caution.

The members agreed that while both upside risks to inflation from tight labour markets (although lower oil prices now offer some offset) and downside risks from slower Chinese growth have lifted, they remain moderate.

As a result, the group acknowledges the possibility that a recession and a large equity sell-off remain a possibility next year. However, while this risk has increased the group considers it remains relatively moderate.

The RIC also note that equity valuations have improved back to fair value across most markets. However until clear signs emerge that the growth slide consolidates, the group continues to favour a neutral position to growth assets with a preference for rate sensitive, lower volatility growth assets.

For now, the RIC maintains our current benchmark position to growth assets, Australian fixed income and the Australian dollar. The RIC also decided to maintain our current underweight to international fixed income.

ANZ PRIVATE

STRATEGY TILTS

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

1. Comprises of 50/50 split between GREITs and infrastructure securities.
2. Cash is the balancing asset class.

As at December 2018.

STRATEGY POSITIONS

GROWTH ASSETS	
GLOBAL EQUITIES: NEUTRAL	Macro leads have softened to neutral with US leads now also slowing. Following the recent correction, valuations across most markets except the US are now hovering around fair value, or slightly cheap for emerging market shares. Earnings momentum is now slowing across all regions and sectors. We believe consensus 2019 global earnings per share (eps) is stretched at 9%; our expectation is around 6%.
AUSTRALIAN EQUITIES: NEUTRAL	Macro leads have eased but remain better supported than our global leads. Valuations have returned to fair value. Consensus 2019 eps growth is moderate at around 6% and we see limited risk of a sharp downgrade cycle. We continue to expect Australian equities to perform well given attractive yields.
EMERGING MARKET EQUITIES: NEUTRAL	Macro leads are still soft and valuations are now on the cheap side of fair value. Outflows out of the region have improved however the outlook for the US dollar and China policy easing are key factors in the period ahead.
LISTED REAL ASSETS: Global REITS/Infrastructure NEUTRAL	Valuations in global listed property have come down due to the recent correction. Listed infrastructure after initially performing poorly has recovered solidly as markets have turned somewhat more defensive. This sector has gained support due to interest rate expectations coming down although valuations are no longer attractive.
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, valuations for US 10-year bonds have returned to the expensive side of fair value at a 2.9% yield.
AUSTRALIAN FIXED INCOME: NEUTRAL	Australian fixed income signal remains neutral on subdued inflation and the Reserve Bank of Australia holding rates steady for an extended period. Valuations are moderately expensive with fair value around 3.6%. Inflation expectations are subdued compared to the rest of the world and in conjunction with an improved fiscal outlook are key drivers holding yields below US yields.
CURRENCY	
AUD (NEUTRAL)	Moderately positive signal as valuations are below fair value (US77c) with bulks elevated relative to base metals. 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, this has been offset by bulks (iron ore, coal), driven by China's supply side reform which favours higher grade iron ore. Overall, slow global growth is a headwind to our fair value estimate of 0.77c.