HOUSE VIEW

EXECUTIVE SUMMARY

- While the recent share market correction reflected real growth and costs concerns particularly as valuations were elevated, it is important to note that across most regions the economic fundamentals while softening are still solid.
- Locally, the Reserve Bank of Australia surprised with a more upbeat outlook. GDP has been revised up.

OUR VIEW

Share markets corrected sharply lower in October weighed down by gradual US Federal Reserve (Fed) tightening, a peak forming in global growth with Chinese and European leads continuing to slow, signs that wages are lifting across most regions and fear of a further escalation in the trade war that is a headwind to growth and is lifting costs. US shares fell almost 7%, Hong Kong's Hang Seng was down almost 10% and bourses in Europe didn't fare much better with the FTSE 100 lower by -5.1%. Locally, the ASX 300 fell -6.2%.

While the correction reflected real growth and costs concerns particularly as valuations were elevated, it is important to note that across most regions the economic fundamentals while softening are still solid. The US economy continues to steam ahead as unemployment levels are at its lowest in 50 years, consumer confidence is high and GDP growth remains strong.

Also, the latest US reporting season has generally been solid versus consensus and while there are signs that US firms now see cost pressures from tariffs as a meaningful headwind to earnings growth, the magnitude of these concerns to date remain modest. Therefore, we consider the Fed will continue to gradually tighten policy.

Locally, the Reserve Bank of Australia surprised with a more upbeat outlook. GDP has been revised up and "with the economy growing above trend, a further reduction in the unemployment rate is expected to around 4¾ per cent in 2020."

However, data out of Europe wasn't as rosy with PMI data softer and political issues reflecting Italy and Brexit hovering over the region. Concerns over a slowdown in the Chinese economy remains the key growth risk though we are seeing active support by the Chinese authorities. However, we believe such initiatives would only likely soften the pace of moderation rather than lifting growth meaningfully.

In our view, the risk to share market returns from further tariff increases is greater than the upside risk to returns from no more tariff increases. However further trade escalation may also invite a stronger response from Chinese policymakers and this would likely be viewed favourably by share markets.

Pulling these strands together we remain neutral growth assets. The pace of the gradual slowdown already underway in global economic growth looks set to continue. A new concern is that costs and wages are now tracking higher, flagging that a combination of softer growth and somewhat higher inflation could unfold by 2020.

STRATEGY TILTS

Preference level	LOW	NEUTRAL	HIGH
GROWTH ASSETS	−		+
Australian shares	−		+
International shares	−		+
Emerging markets	−		+
Listed real assets[1]	−		+
DEFENSIVE ASSETS	−		+
Fixed income	−		+
Australian	−		+
International	−		+
Cash[2]	−		+
CURRENCY - AUD	−		+

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 November 2018.

STRATEGY POSITIONS

GROWTH ASSETS	
GLOBAL EQUITIES: NEUTRAL	Macro leads have softened to neutral. Following the October correction valuations across most markets except the US are now hovering around fair value, or slightly cheap for emerging market shares. By region US leads earnings while emerging markets remain weak. EU has stabilised after a soft start to the year and Japan is now also easing. The IT sector is strongly supported by earnings rather than stretched valuations, although the macro processor cycle is under pressure. We believe the 2019 global earnings per share (eps) is stretched at 11%; our expectation is 8%.
AUSTRALIAN EQUITIES: NEUTRAL	Macro leads are solid but have eased. Valuations have returned to fair value. 2019 eps growth has moderate upside to consensus of 6.6%. We continue to expect Australian equities to perform well relative to bonds and offer an attractive yield.
EMERGING MARKET EQUITIES: NEUTRAL	Macro leads are still soft and valuations are now 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. We consider rising rates will continue to be a headwind to this sector, although valuations have now shifted from expensive to around fair value.
DEFENSIVE ASSETS	
INTERNATIONAL FIXED INCOME: UNDERWEIGHT	The European Central Bank is expected to slow bond purchases from this month, which could see yields rise modestly in the euro area, and the Fed is expected to raise rates again in December. Valuations for US 10-year bonds have returned to our fair value range of (3-3.2%). We would look at closing our current underweight position at upper end of the range.
AUSTRALIAN FIXED INCOME: NEUTRAL	Australian fixed income signal remains neutral on subdued inflation and the Reserve Bank of Australia holding rates steady. Valuations are moderately expensive with fair value around 3.6%. Inflation expectations are subdued compared to the rest of the world and a key driver holding yields below US yields.
CURRENCY	
AUD (NEUTRAL)	Moderately positive signal as valuations below fair value (US77c) with bulks elevated relative to base metals. Headwind from interest rate differential to the US is partly offset by sold 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.

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 12 November 2018 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.