

connect

Autumn 2019

Economic update

What happened to the share market in 2018?

Globally, Share markets were down during the December 2018 quarter with the Australian share market falling 8.4% and the global share market index dropping 11.1%. Market volatility spiked – to the highest levels last seen in 2016 when the share market was dealing with a sharp decline in commodity prices.

"The stock market is the only market where things go on sale and all the customers run out of the store..."

Cullen Roche – US economical commentator

Why did the share market drop?

Market sentiment can be fragile. What was once good news can become bad news and vice versa and, once the selling begins, it can acquire a life of its own.

There were three main reasons for the selloff.

1. US interest rate rises

The US is the world's biggest share market. Some people say, "When the US sneezes, the world catches a cold". Last year the US raising interest rates had major flow-on effects.

As US interest rates rise:

- holding US dollars in a bank account offers a competitive return compared to other financial product including savings accounts, bonds and shares
- other assets re-price lower as a result of people switching to cash and away from longer-term investments
- it is more expensive to borrow money. More expensive borrowing equals less borrowing which translates to less spending and fewer investments. People fear that this will result in slower growth or even a recession.

What does the future hold?

US interest rates may continue to rise in 2019 but probably not at the same pace as during 2018. Inflation will likely remain under control or even lower and this should limit the upward movement of interest rates in the medium term.

If US rates continue to rise in the short term, there will likely be negative implications for the Australian dollar unless the Chinese economy grows at a faster rate as higher commodity prices tend to push the Australian dollar upwards. This could result in further market fluctuations as seen in early 2018 and during the December 2018 quarter.

2. The US and China trade war

Tension between the US and China over 'unfair' trade policies turned into a saga of trading tariffs (meaning, over taxes placed on imports by each other), on billions of dollars-worth of goods.

The tariffs looked like they were beginning to cause an economic slowdown in China. It was unclear whether the US would continue to increase tariffs which further added to investor uncertainty.

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What does the future hold?

There's been a tariff ceasefire between the US and China and they are holding talks with a view to reaching a new trade agreement. Markets are optimistic, perhaps overly so, and this situation may cause some investor uncertainty this year.

3. Peak business profits

Investors were worried that business profits, particularly in the US, had peaked and were headed lower as the economy slowed.

Technology is the biggest sector in the US market and lower growth expectations were triggered by Apple suppliers reporting lower sales which implied the iPhone was not selling as well as expected.

What does the future hold?

Lower profit growth is likely in 2019 particularly as US companies are not expected to get a boost from an extra tax cut, which they did in 2018.

However, profits are still expected to grow. This could result in a positive year ahead, particularly if concerns on trade and interest rates get resolved.

Source: IOOF



Bullet-proofing your equity income portfolio

It's obvious, if you're a retiree you need income. With cash and fixed interest offering low yields, equities are a good place to look for income. On the surface, it may seem easy creating an income portfolio from shares – just select stocks from a list of high dividend yielders. However, setting up an income portfolio is harder than you think.

A high yield equity portfolio for retirees will certainly deliver higher income, however, it may put their other objective of capital preservation at risk. If risk is ignored, capital losses may outweigh the income delivered. For example, owning Telstra in 2015 delivered a 6% fully franked yield over the next twelve months, but investors lost 50% of their capital over the next three years. Who cares about the income when capital is destroyed.

So here is the challenge: how does one create a high yield portfolio while preserving capital in the most volatile asset class? We know for a fact that delivering income is easy but capital preservation is hard (think about how an equity portfolio fared during the recent market correction in the last quarter of 2018). Hence, retirees who want a more holistic retirement solution should have their income portfolios mitigate risk first and only then think about yield.

Invest in low risk stocks

There are several investment styles which may deliver good returns at certain times, but they may not be for the faint hearted. For example, chasing the latest

momentum stocks (eg Afterpay) where expensive stocks become even more expensive. Or bottom fishing for deep value companies (eg Myer) where investors get lured into seemingly cheap companies with structurally challenged earnings. Both investment styles are very different, but they have something in common – they have a wide range of possible outcomes.

A low risk investment style requires investing in quality companies with a margin of safety. To deliver the desired lower risk outcomes it's critical to have a strong valuation framework. For example, high quality companies can be poor investments if their valuations are very high, and lower quality companies can be good investments if their valuations are extremely cheap. The art is understanding the balance between a company's quality and the margin of safety required to make the investment.

A low risk investment style may not shoot the lights out in a raging bull market, but it will preserve capital better in down markets.

Source: Vertium Asset Management (Copia Investment partner)

Three ways a financial adviser can help you plan for retirement

When it comes to creating the retirement lifestyle you dream of, a little support goes a long way.

Retirement may be one of the most significant life changes you will go through, and there's a lot to think about financially when you decide to leave the workforce and no longer receive a regular income. Managing finances in retirement can also be quite complicated, so it's not surprising that six out of ten Australian seniors turn to financial advisers for advice and information about how to structure their retirement finances.¹

But do you really need professional advice to help you plan for your retirement?

A financial adviser can make all the difference when it comes to getting the most out of your super savings and reducing potential risks as you enter a new phase of your life. Here are three ways an adviser can help you achieve the retirement you deserve.



1. Making sure your retirement savings will last the distance

One of the risks in retirement is that of outliving your savings. An adviser will help you calculate the amount of super you'll likely need for your retirement – based on your short, medium and long-term goals – and they'll tailor a personalised strategy for growing your nest egg while you're still working. That way, you'll be able to retire when and how you choose, with peace of mind that your savings will last the distance. What's more, an adviser can make sure you know about any Centrelink entitlements and they can consider your changing medical and health needs as you move through the different phases of retirement, so you can set aside enough to afford quality care.



2. Structuring your retirement portfolio

Depending on your circumstances and retirement goals, you may want to create a retirement portfolio that consists of several types of investments that will all provide you with different benefits in retirement. For example, a Challenger lifetime annuity to provide secure guaranteed income payments, an account-based pension to continue building your wealth, and a term deposit or cash account to provide easy access to your money. An adviser can help you navigate the different options available and structure your retirement portfolio to reduce potential risks from market volatility while also ensuring that you'll get the most out of your investments.



3. Downsizing the family home

You may be planning a sea or tree change during retirement, looking to move closer to your grandchildren, or just want to simplify your life. An adviser can assist you by determining the financial implications of keeping or selling the family home. They can also help you make informed decisions about what to do with the proceeds of the sale – ensuring this money works hard for you in retirement.

Seek help from an expert

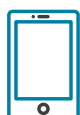
Everyone's plans for retirement are unique. That's why it's worth getting the right financial advice before you retire, so you can relax and enjoy your golden years knowing your future is taken care of.

Speak to your financial adviser to discuss your retirement plan.

Seven technology disruptions happening now

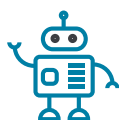
Australia looks to be in the later stages of the business cycle, and is not alone here among its developed economy peers. In an environment of potentially slowing growth, we propose that a way forward is to invest in companies which are 'share-takers' – companies that can gain market share from technology-enabled advances in their business model, and in changes in consumer behaviour.

Here are seven fronts where technology is enabling disruption and creating opportunities;



Connectivity/mobile devices

The developed market is spending more time online, and much of the emerging market is gaining access to the internet for the first time.



Artificial intelligence

Advancement in the healthcare sector alone – robot-assisted surgery, virtual nursing assistants, and dosage error reduction.



E-commerce

Low penetration categories are on the verge of moving online; including food, consumables, auto and auto parts, furniture, appliances and luxury goods.



Digital music

The industry is shifting to a subscription model – looking to capture value.



Online advertising

Spend is still catching up with traditional media advertising and has room for continued long-term growth.



Video games

Expanding markets and margins through more downloadable content, increasing mobile phone graphics processing power and eSports momentum.



Genomics

The cost of sequencing a human genome has declined – from the A \$3+ billion human genome project, to under A \$1,500 in 2017.¹

Source: Invesco

¹ www.genome.gov/sequencingcostsdata/

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