Investor Insight 76 – June 2019

On Saturday 18th May, the Coalition was returned by the Australian people as the Federal Government and Scott Morrison as the Prime Minister.

We took a partisan approach towards the Federal Opposition's tax policies, especially through *The Australian* over the last twelve months, which we would not normally do. We make no apology for this as we believe the tax platform that the Federal opposition was running on would have been clearly detrimental for our clients.

The Coalition won government and nothing else needs to be said on the matter.

Returning to investment markets, equity market performance has been very strong during 1H 2019 across the world, supported by the better than expected earnings seasons in Australia, the United States and Europe, however this must be balanced against the low expectations that were set in the final quarter of 2018.

The US is the largest, deepest and most important equity market. Sentiment that flows from this market affects the rest of the world and the bounce we have experienced in the first half of 2019 has rubbed off globally.

The "noise" around markets has accelerated. A "melt-up" is evident as momentum and a fear of missing out has taken hold. Complacency towards risk is growing and fundamentals are often ignored.

Capital Economics in London recently pointed out that the rebound in equities is justified based on the strength in corporate profits, especially in the US, but noting that this profit rebound has not been as pronounced in markets such as Europe.

If earnings were to come under pressure, then equities will likewise come under pressure. Capital Economics are concerned about the earnings outlook in the second half of this year and are re-iterating their S&P 500 call of 2,300 - about 19 per cent below current levels.

While trade wars are a concern, Capital Economics believes that most of the slump in world trade over the last 6-9 months is due to broader weakness in the global economy and this must eventually feed through to earnings. Any pick up in US GDP growth from here will rely more on an increase in productivity – which looks unlikely right now but could happen – rather than a more dovish stance from the Federal Reserve.

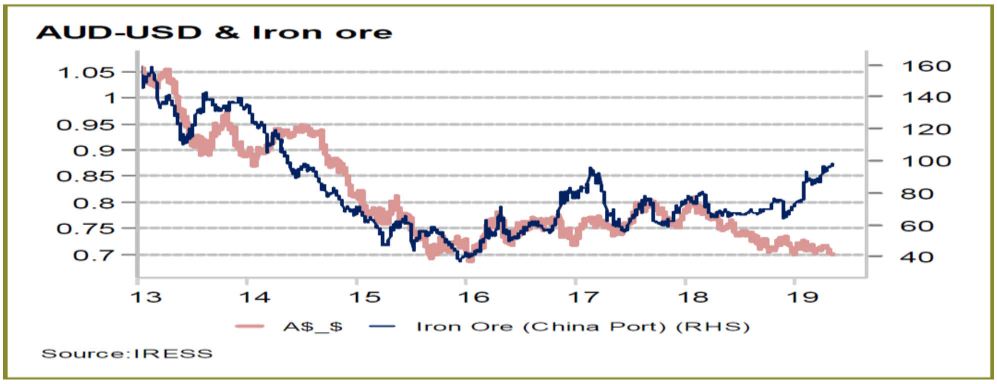
One of the anomalies now is the Australian Dollar. During May we saw AUD weakness in anticipation of the RBA cash rate being cut from 1.5 per cent.

Investor Insight 76 – June 2019, continued

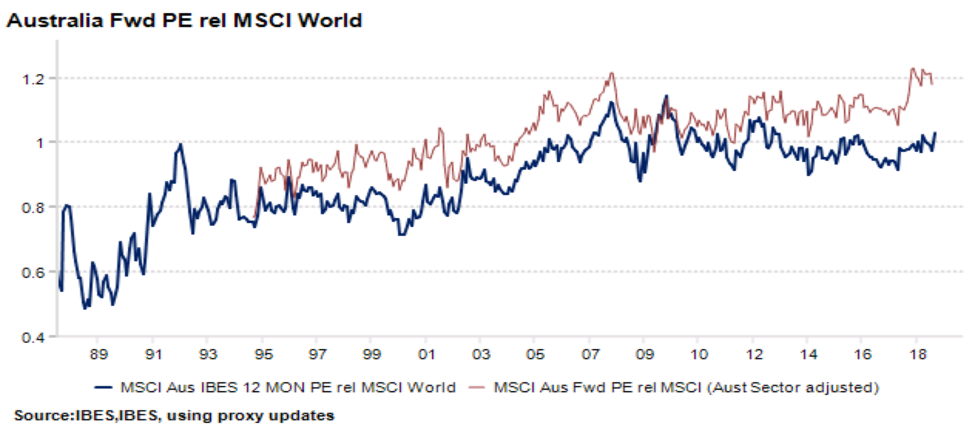
Many economists were forecasting a cut during May, which didn't eventuate. With inflation remaining stubbornly low and the unemployment rate ticking up 0.1 per cent to 5.2 per cent, this cut in the official cash rate is now expected in early June and Reserve Bank Governor Lowe all but confirmed this in a speech in Brisbane on May 21. The Australian dollar has weakened in anticipation.

This is despite the Iron Ore price having strengthened substantially since the beginning of this calendar year.

The chart below from *Heuristic Investment Services* illustrates the historically close relationship between the AUD and the Iron Ore Price. This relationship has broken down for now because of domestic interest rate expectations but something is likely to give eventually, and this gap will narrow once again.



The second chart from *Heuristic Investment Services* takes the ASX sector weights and applies these to the MSCI All Country World Index (ACWI), which suggests a premium of around 15 per cent for the Australian market over the MSCI ACWI. Whilst Australia has traditionally traded at a premium over the past 25 years (as you can clearly see from the chart) this premium has recently widened from its norm of approx. 10 per cent to 15 per cent today.



Investor Insight 76 – June 2019, continued

At a recent presentation, fund manager SGHiscock pointed out that some sectors in Australia have performed well, highlighting that one reason for outperformance - and therefore the premium they are trading at compared to these same sectors globally - is due to the low weighting these sectors have in our indices versus global indices. As an example, the IT sector is 3 per cent of the Australian index against 26 per cent of the US. It shows twelve-month performance of 31 per cent to the end of April 2019 against IT in the MSCI ACWI of 22 per cent.

Likewise, SGHiscock makes the point that the Australian market is trading at a premium across every segment of the market against its 20-year averages. However, the extremities are in the ASX100-150 segment which is trading at 19.1 times earnings, a 34 per cent premium. At the same time, the ASX200-300 segment is trading at 15.7 times earnings, a 26 per cent premium.

A final salient point: we are now in the tenth year of economic recovery in what is the longest upswing in economic growth since the Second World War. Cycles will always exist. The current rally in equities may have further to run. If we are in the Optimism stage of the cycle as we believe we are, we could even see further "melt ups" in equity markets and therefore good gains ahead of us.

What we do also know though is that we are in the fifth set of the match. We don't know if we are in the tie beak or the second or third game of the set. We will be continuing to fade the rallies during this calendar year.

Hamilton Wealth Management is a Fee for Service, Wealth Management business and as such our advice is built around the conviction to our process and philosophy and our strong belief in diversification.

We would be happy to discuss this further with you, please don't hesitate to contact us.

Will Hamilton	Ian Gillies	John Green
CEO and Managing Partner	COO and Founding Partner	Partner
P +61 3 9275 8808	P +61 3 9275 8809	P +61 3 9275 8803