

Currency – the Vicious Cycle

As indicated, the other factor impacting the Australian share market presently is the **value of the AUD**, which has been falling against the USD on the back of talk of higher US interest rates. The immediate effect of this is for US investors to sell Australian assets (shares and securities) and repatriate funds to the US. This selling pushes our share market lower and forces the AUD lower – it operates as a vicious cycle in the short term forcing both the Australian share market and AUD into oversold territory. In the medium to longer term, however, a lower AUD is beneficial for Australian companies and the economy more generally.

Financial Systems Inquiry (FSI) & Parliamentary Review

During the past quarter, David Murray released the interim report of the FSI. There has been much speculation about what has been proposed, but the truth is that David Murray has done nothing more at this point in time than lay out the potential “book ends” around key issues (including proposals to maintain the status quo).

Murray and his panel have advocated a principles-based approach to nine priority issues. Key amongst these from our perspective are the issues of superannuation efficiency, retirement incomes and regulatory architecture. There will be further rounds of hearings and submissions with the final set of recommendations due some time in November’14. For those finding it a little difficult to sleep at night, we have included a link on our Axiom Wealth website to the FSI Executive Summary.

Earlier this month we also made a submission to the Parliamentary Joint Committee on Financial services. We took the opportunity to call for a more measured approach to adviser qualifications, continuing education and professional standards. With recent scandals involving some large planning businesses (eg CBA & Macquarie Wealth), there has been a lot of knee jerk reactions on both sides of the fence which will do very little to improve the quality of financial advice provided to Australians. We have also included a link to a copy of our submission on the Axiom Wealth website.

OUTLOOK

Our view about equity markets has remained relatively consistent over the past twelve months – we remain constructive on the medium term outlook for Australian and International equities, albeit with the likelihood of some type of short term retracement, which now appears to be underway. Continued volatility in the AUD is likely to exacerbate the extent and duration of any pullback here in Australia.

The Australian market currently sits around “fair value” (as measured by the PE ratio) and the same can be said about the US market. With the prospect of lower interest rates into 2015 and improved company

earnings, we believe the current pullback is one to be bought with the prospect of a further rally into, and beyond, Christmas.

ASSET ALLOCATIONS

We are looking to position client portfolios as follows:

- **Australian Equities (Slightly Overweight):** We remain constructive on Australian stocks, particularly as we move into the latter part of 2014. If the currency remains at or below current levels and the RBA delivers a further rate cut, the next 12-18 months could be very profitable for Australian equities.
- **Global Equities (Neutral):** The US market has had a very strong recovery over the last 5 years, aided by low rates and liquidity. The US economy is further along the business cycle and may be subject to less relative growth over the medium term. Asian equity markets (particularly China) are looking quite bullish.
- **Property (Underweight):** Listed Property has clearly benefited from the flight to yield, but now appears to be in a correction phase. Higher relative gearing levels together with the prospect of rising longer term rates necessitates some caution in this market.
- **Fixed Interest (Overweight):** Listed income securities continue to be an attractive fixed interest investment, particularly when compared to term deposits. Given the level of interest rates, it is preferable to hold a little less cash and a little more in income securities as part of any defensive allocation in portfolios.
- **Cash (Neutral):** As a result of our positions in other asset classes, cash is presently around a neutral level.

Regards

Andrew & Stephen
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