ten of the worlds top twenty sovereign wealth funds (which are amongst the largest investors in the world) derive their capital from countries heavily dependent on oil and gas revenue. The concern is that these sovereign funds may be forced to liquidate significant equity positions to help keep their respective governments afloat.

The thing to note about oil (unlike other commodities such as iron ore) is that supply is already beginning to adjust to the lower prices. Most of the additional oil production capacity in recent years has been added in the US (largely by way of shale oil reserves) and recent statistics from that part of the world indicate that the number of productive oil rigs fell by almost 20% in the two months to December'14. This would indicate that oil prices are likely to rise as we move further into 2015.

OUTLOOK

In looking ahead we see a number of factors that will act to support favourable returns for Australian equities:

- Lower interest rates
- Reduced energy costs (particularly oil)
- Strength in the Australian housing market
- Lower AUD
- Continuing growth in US economy
- Inflation low globally

So whilst the tailwinds look very positive for equities (particularly here in Australia), after such a run-up in prices over the past couple of months, we would expect the market to take some type of breather. This will likely take the form of a leg-down that is not expected to be significant, with 5,680 points being a solid technical support level for the ASX 200.

Technically there is potential for a larger correction in 2nd quarter 2015.

Whilst the tailwinds are potentially significant, at some point, the fundamentals will need to improve to justify materially higher equity values. Forecast company earnings growth for 2015 has fallen from around 6% just prior to the start of the 2014 year, to sit almost flat following the completion of the recent profit reporting season (albeit resource stocks have disproportionately dragged this forecast lower). Whilst falling market interest rates might warrant a more lenient view on fair value PEs, the macro tailwinds above will need to translate into higher company earnings at some point during the next 6-12 months to warrant still higher share prices. We saw this happen in the US and we feel reasonably confident that a similar flow-through to earnings will eventuate her in Australia.

Even after a potential correction in the 2nd quarter, we think that the tailwinds here in Australia have the potential to push the ASX 200 well above 6,000 points by the end of 2105.

ASSET ALLOCATIONS

We are looking to position client portfolios as follows:

- **Australian Equities (Slightly Overweight):** We remain constructive on Australian stocks, particularly in the second half of 2015 and beyond. We expect one more interest rate cut from the RBA before June which, combined with lower oil prices and a softer currency, could see an extended period of outperformance by Australian equities.
- **Global Equities (Neutral):** The US market has enjoyed above average returns for some time and whilst we are still generally positive on the market, the rising USD together with the prospect of rising interest rates (in the medium term) could act as a handbrake to returns. Asian equity markets (particularly China) are looking quite bullish.
- **Property (Underweight):** Listed Property has clearly benefited from the flight to yield (and more recent reductions to interest rates). Most REITs are now not able to fund current distributions from free cashflow so it would appear that a correction is not too far away.
- **Fixed Interest (Overweight):** Given the level of interest rates, it is preferable to hold a little less cash and a little more in fixed interest instruments (such as income securities) as part of any defensive allocation in portfolios.
- **Cash (Slightly Underweight):** As a result of our positions in other asset classes, cash is presently a little underweight.

Regards

Andrew & Stephen
12 March 2015