assessment of the current cycle is that a US recession is unlikely until at least 2020”.

This relatively positive view about US equities is consistent with longitudinal analysis of US interest rate rises (previously reported) which concluded that equities continue to outperform other asset classes until at least after the 4th interest rate hike in any cycle (so far we’ve seen one rate rise from the Federal Reserve).

On the point of valuations, Schroder’s recently crunched some numbers looking at the relationship between interest rates and the Australian Market’s price earnings ratios (PEs). We hear a lot at the moment that the market is “over-valued” because PE ratios are above historic averages. As we’ve pointed out in the past, however, investment returns are relative and whilst the average ASX PE since inception is around 14-15 times, it is also true that as interest rates fall, the average PE rises. Notably, the average PE when bond yields have been around 5% is 12 times. When yields have fallen to circa 3%, the PE has averaged 15.5 times. Bond yields in Australia are currently at 2% and the (trailing) PE is around 16 times. So following any short term pull-back, we believe that there is scope for developed markets to move higher into the latter part of the year.

ASSET ALLOCATIONS

We are looking to position client portfolios as follows:

- **Australian Equities (Slightly Underweight):** Whilst we remain constructive on Australian stocks in the medium term, particularly as we move into the latter part of the year, we do anticipate a short-term pull-back.
- **Global Equities (Slightly Underweight):** The US market is looking vulnerable. Uncertainty around rates and a looming Presidential election will keep a lid on equities over the next couple of months.
- **Property (Underweight):** Listed Property has clearly benefited from the flight to yield (and reductions to interest rates), but these macro gains are now fully baked-in. In the very short term the sector might be buoyed by further M&A activity, but this will then likely signal a period of under-performance.
- **Fixed Interest (Slightly Overweight):** Given the level of interest rates, it is preferable to hold less in cash and a little more in fixed interest instruments (such as income securities).
- **Cash (Neutral):** As a result of our positions in other asset classes, our net cash position is neutral

Regards

Andrew & Stephen
30 August 2016