OUTLOOK

As we indicated last quarter, the US share market has continued to factor in most of the upside of Trump's intended economic policies. The reality of what he will actually be able to deliver (or not as the case maybe) is beginning to sink in and markets are ripe for a pull back.

Moreover, the removal of liquidity by the Federal Reserve is likely to cause volatility in markets. Interest rate increases are now an accepted part of the US land scape and the market is comfortable with the approach being taken by the Fed in this regard. However, The Fed has now flagged that at some point soon it will commence reducing the size of its balance sheet (ie allowing treasury bonds to mature without replenishment) and this will curb the liquidity that has supported the growth in equity prices. In the same way that the initial speculation about Fed interest rate rises created uncertainty and drove markets lower (2015/16), we can see a situation where debate about "quantitative tightening" will fuel investor uncertainty and drive markets down.

Here in Australia, the market has been trading in a tight range for some time (broadly between 5,600 and 5,800). Profit reporting season was (in aggregate) uninspiring, particularly when the earnings growth and dividend payments of the miners are backed out of the equation. The economic backdrop is tepid and, as noted above, the RBA needs to be very careful about how it manages interest rate policy over the next 6-12 months as the economy waits for non-mining business investment and consumer spending to kick in.

Turning to technical factors, the second half of the calendar year is traditionally softer than the first. As noted last quarter, the "7th year" charts, when overlaid with the market history associated with the first year of a presidential cycle, also point to a pull-back in coming months.

Hence, we see equity markets easing back over the next few months, lead by falls in the Dow Jones (US). It is conceivable that the Dow will give back around 50% of the "Trump gains", which translates into a fall of around 8% (for the technically minded, a Fibonacci retracement (61.8%) would see the market drop by just over 10%). Here in Australia, the ASX 200 is also likely to soften, with initial resistance sitting around 5,500 and key support at 5,200 (just on 8% below current levels). The low in markets should be in place by early November, before a seasonal upswing into Xmas and the new 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, we are anticipating a short-term pull-back.
- **Global Equities (Slightly Underweight):** The US market is looking vulnerable and uncertainty about "Quantitative Tightening" may spook markets.
- **Property (Underweight):** Listed Property has clearly benefited from the flight to yield (and reductions to interest rates), but these macro tailwinds have now fully abated. REITs were off over 9% last quarter.
- **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 (Slightly Overweight):** As a result of our positions in other asset classes, our net cash position is slightly overweight.

Regards

Andrew & Stephen
28 August 2017