informed investor

threePILLARS wealth management

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Economic update

Market and Economic overview

Australia

- The Reserve Bank of Australia lowered interest rates in June by 25 basis points to 1.25 per cent, and again in July by a further 25 basis points - moving the official cash rate to 1.00%.
- In a July speech, the Governor of the Reserve Bank suggested it would be imprudent to lower Australia's inflation target (2% to 3%/yr) and affirmed that policy makers are willing to ease policy settings further, if required.
- Australia's Composite PMI – a reasonable barometer of activity levels in the manufacturing and services sectors – deteriorated slightly in July, but remained in 'expansionary' territory.
- Unemployment was unchanged at 5.2%. While new job adverts increased markedly in June, it is too early to suggest this is indicative of a meaningful improvement in the labour market.
- The residential property market appeared to stabilise. National home prices rose 0.1% in July; only a modest gain, but significant in that it followed 20 consecutive months of declines.

United States

- At the end of July, the Federal Reserve lowered US interest rates by 0.25 percentage points.
- Consensus expectations suggest US interest rates could be lowered further in the months ahead. Markets have already factored in a 60% probability of another cut after the Federal Reserve Board's next meeting in September.
- Economic growth in the US slowed in the June quarter, to an annual pace of 2.1%. Whilst below the 3.1%/yr rate seen in the March quarter, the reading was ahead of forecasts. A marked improvement in consumer spending supported growth; rising employment and a reasonable level of wage growth appear to have contributed to buoyant discretionary expenditure.

Welcome

Welcome to our latest edition of the Informed Investor newsletter.

As always, should you have any questions or would like some further information, please get in touch and we'll be happy to help.

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Europe

- The Eurozone economy expanded just 0.2% in the June quarter, down from 0.4% growth in the first three months of the year.
- There was no growth at all over the quarter in Italy, while the pace of growth decelerated in both France and Spain.
- These releases increased the probability that the European Central Bank will announce a new phase of Quantitative Easing; most likely in September.
- Core inflation dipped back below 1%/yr in July, which is likely to be another concern for policy makers.
- In the UK, Boris Johnson won the Conservative Party leadership contest and has been sworn in as the new Prime Minister.
- Johnson has talked openly about his willingness to pursue a 'no deal' Brexit in October if terms cannot be agreed with European officials. The increased probability of this potentially destabilising event resulted in sterling weakness and a sharp move lower in UK government bond yields following his election.

New Zealand

- Business confidence deteriorated in July, to its lowest level in a year. This does not augur well for growth.
- Inflation remained below target in the June quarter, but picked up to an annual pace of 1.7%. Some suggested this might result in the Reserve Bank of New Zealand leaving monetary policy settings unchanged when it meets on 6 August.
- That said, markets continue to suggest one or two rate cuts remain likely before the end of 2019.

Asia

- Economic growth in China fell to a 30-year low of 6.2%/yr in the June quarter. The slowdown appeared primarily due to trade tensions with the US, which are reducing export demand and affecting the manufacturing sector.
- A slowdown in Chinese imports is a separate concern, indicating weakness in the domestic economy.
- Export demand has also tailed off in Japan. June data indicated exports were 6.7% lower than the corresponding period a year ago.
- Consumer confidence levels in Japan have deteriorated to their lowest levels in more than five years. With demand weak, Core inflation remained anchored at 0.7%/yr, well below the Bank of Japan's 2.0%/yr target.

Australian dollar

The release of mixed economic indicators in Australia and stronger-than-expected GDP data in the US saw the 'Aussie' dollar depreciate against the US dollar.

By the end of July, the Australian dollar had fallen back below the US$0.70 level, closing below US$0.69.

Commodities

Iron ore prices closed the month of July at around US$115 per tonne. There was a notable increase in stockpiles at Chinese ports, indicating demand could tail off in the near term.

Continued weakness in China's manufacturing activity saw a sharp decline in premium coking coal prices during the month. Oil prices weakened for much of the month and closed July around -2.0% lower. The demand outlook in a slowing global growth environment offset potential supply concerns as geopolitical tensions between the US, UK and Iran intensified. Disruptions in the Persian Gulf could affect a significant proportion of global oil supply.

The gold price climbed a further 1.1%, adding to recent strength. The nickel price rose a further 17.8%, adding to gains earlier in the year. In fact, nickel has been the best performing industrial metal in 2019, benefiting from increased demand for electric cars.

Australian equities

Australian equities followed global equity markets higher as prospects of more stimulatory monetary policies both here and in the US drove Australian shares to all-time highs during the month of July.

Sector performance was dominated by Consumer Staples, which rose an impressive 10.2%. The Health Care sector (+6.2%) also fared well, supported by Resmed (+10.7%). The sleep disorder mask and medical device manufacturer announced a 13% increase in revenue in the June quarter and set an ambitious target for its user base to jump to 250 million by 2025. Materials (+0.4%) lagged in spite of rising iron ore prices.

Australian small caps bounced back from the longer-term underperformance of their large cap counterparts. The S&P/ASX Small Ordinaries Accumulation Index rose 4.5%, driven by small gold stocks.

Listed property

Global listed property posted moderate gains for the month. The FTSE EPRA/NAREIT Developed Index returned 0.4% in USD terms and 2.2% in AUD terms.

Europe (ex UK) was the best performing market (+2.5%), while Hong Kong was the worst performer (-5.1%) amid ongoing civil unrest in the territory.

In Australia, the S&P/ASX 200 A-REIT Index returned 2.6%. Diversified A-REITs was the best performing sub-sector (+4.2%), followed by Retail A-REITs (+4.1%), which bounced back after three consecutive months of negative returns. The worst performing sub-sector was industrial A-REITs, driven by the underperformance of Goodman Group.

Global equities

Global equity markets continued to establish new highs in July. The MSCI World Index edged up only 1.2% in local currency terms, but the weaker AUD helped to bolster returns in AUD terms to 2.3%. While momentum in US markets helped, the UK bourse was the strongest performer, with the FTSE 100 Index up 2.2% in local currency terms. UK stocks were up as much as 3.6% as sterling fell to two-year lows. German stocks struggled, with the Dax falling -1.7% in euro terms.

Emerging markets have now underperformed their developed counterparts for six straight months as the MSCI Emerging Markets Index only rose 0.7% in AUD. MSCI EM Asia was the weakest regional index in AUD terms, rising only 0.3%. Both MSCI India (-5.5%) and MSCI South Korea (-3.9%) fell particularly heavily in local currency terms.

The US/China trade conflict is hitting many Asian companies hard, but there is also an escalating trade disagreement between South Korea and Japan. Indian stocks fell sharply on market unfriendly budget proposals announced earlier in July.

Global and Australian Fixed Interest

Fixed income markets remained dominated by expectations of interest rate cuts and other potential forms of monetary policy easing.

Australian 10-year government bond yields closed the month 14 bps lower, for example, at 1.19% as Reserve Bank of Australia officials indicated that borrowing costs could be lowered further. Investors are speculating that Australian interest rates could fall as low as 0.50% in this cycle, effectively pricing in two further 0.25 percentage point cuts.

Yields plunged even further into negative territory in Europe, with 10-year German bund yields closing July at a new record low of -0.44%. In the UK 10-year gilt yields declined 22 bps, to 0.61%, as markets factored in the prospect of a potentially disorderly withdrawal from the European Union.

Bond markets were little changed in the US and Japan, with 10-year yields up a single basis point in both countries in the month as a whole.

Global credit

Anticipation of interest rate cuts worldwide helped support sentiment towards global credit markets. All else being equal, lower borrowing costs make it easier for companies to service their debt repayment obligations by reducing the cost of new issuance.

Around two thirds of US companies also released their quarterly earnings during July. Collectively, earnings increased by nearly 3.0% during the period, which was well ahead of consensus expectations.

These positive factors saw spreads narrow in both the investment grade and high yield areas of the market in July, resulting in another month of positive returns from global credit portfolios.

Source: Colonial First State

Six cognitive biases that influence how we save, spend and invest money

We like to think we're rational beings. But the reality is that a lot of our daily behaviour is influenced by our subconscious.

Behavioural scientists have looked at the way human beings are wired and discovered some 'cognitive biases' that influence our everyday behaviour. So if you find yourself clicking on that Amazon special or buying lunch at the same expensive cafe near work every day, they could explain why it's so difficult to stick to your spending limits or saving plan.

Here are a few of their insights into how our minds work.

We tend to discount the future

We value immediate rewards over rewards in the distant future. This tendency to want instant gratification is hard wired from birth. Studies have shown that children find it hard to stop themselves eating a treat even when a bigger and better treat is offered for those who wait for a few minutes. And 'discounting the future' doesn't stop when you reach adulthood.
It could explain why it's hard to get too excited about saving for your retirement in your 20s. But the earlier you start planning, the more you'll be able to put away.

We tend to feel the pain of a loss more than the pleasure of a gain

You can see an extreme example of this sort of behaviour at the casino when gamblers chase their losses. This 'loss aversion' can also manifest itself in continuing to commit to a poor investment because you've already put a lot of money into it. It can help to think long term and avoid focusing on short-term fluctuations in the value of your investments.

We tend to follow the herd

Much as we like to think of ourselves as independent human beings, we tend to look to others for affirmation. Think about the rush to secure seats for the concert when you know that

everyone else is using the online booking system. It's all about FOMO. This sort of 'herd mentality' can work in a positive way. Just a generation or two ago it was socially acceptable to smoke in restaurants or to drive without a seatbelt. Now it's unthinkable.

When it comes to money, this 'herd mentality' can manifest itself after stock market downturns, when investors start panicking and selling up, even though rationally this will crystallise their losses. It can help to shut out daily market noise and focus on long-term goals.

We tend to think things are more likely to happen than they are

You can see this in the popularity of lotteries around the world. While the chances of winning are infinitesimal, the winners get a lot of publicity, which makes us think it's more likely to happen. But at least the lottery is relatively harmless. Thanks to the global mass media, this 'availability bias' often focuses on bad events like kidnapping, plane crashes or stock market downturns.

Investors who experience a market crash like the GFC over-estimate the chances of the same thing happening again, even though statistically it's unlikely. It can lead to people saving for retirement changing their investment preferences to lower risk investments, even though this may not be in their best interests as their long-term returns struggle to keep pace with inflation.

We tend to favour recent reference points when making decisions

This 'anchoring bias' can make it easy to overspend in shopping malls. When you first see a pair of shoes for $200 and then a similar pair for $150 it's easy to anchor on the first amount and perceive $150 as a great bargain. And these days it doesn't stop when you leave the mall—online shopping means plenty more opportunities for that anchor to embed itself and end up in an unwanted purchase.

To counter this, try setting your own 'base price' before you set out shopping and stick to it. You can also see anchoring in practice when investors rush in to buy stocks that have just plunged in value without looking at the underlying performance of the company. They have made the mistake of anchoring the recent high point in their mind.

We tend to be a bit lazy

We tend to stick with current plans rather than change if it's too much hassle. This is probably why so many of us stay with our utility providers rather than shopping around for a better deal. If you find yourself suffering from 'status quo bias', try making a start with one area of the household finances—say, your electricity bill—to make it more manageable, rather than trying to tackle everything at once.

Source: AMP

Five global themes that may impact your investment portfolio

When running a self-managed superannuation fund (SMSF), it's important for investors to be aware of some of the key global and economic environmental factors that may impact their investment portfolio. Here we look at five global themes that are currently playing out in world markets, and how they may potentially impact their investment portfolios.

1. Trade Wars

Trade tensions between the United States and China have shown their ability several times to cause turmoil in the investment markets.

The showdown kicked off in July 2018, when the US implemented its first China-specific tariffs. In turn, China has retaliated with its own tariffs, and threatened a range of other measures that may affect US businesses operating in China.

Things escalated in May 2019, as the US extended tariffs on a range of imported goods from China, drawing further tit-for-tat measures from Beijing.

With the solution of the trade tensions having a long way to go; nobody wants to see a full-blown trade war. The prospect makes markets nervous, and that may mean volatility for portfolios.

2. Slowing global economic growth

Global economic growth is an important driver of investment performance, but to a certain extent is hostage at present to the trade war concerns.

In March 2019, the Organisation of Economic Co-operation and Development (OECD), Australia's peer group of developed countries, said in its Interim Economic Outlook that global trade growth had slowed from 5.25 per cent in 2017 to about 4 per cent in 2018.

In April 2019, the International Monetary Fund (IMF) cut its global economic growth forecasts for 2019 and said growth could slow further due to trade tensions. The IMF lowered its growth forecast for the global economy in 2019 from 3.5 per cent, which it expected back in January, to 3.3 per cent with the ongoing trade tensions remaining a risk for the global economy.

Any further deterioration in the outlook for world economic growth could mean volatility for equities.

3. Growth in China and how it affects Australian Resources

As China's economy has grown, the world has become used to spectacular numbers: its gross domestic product (GDP, the amount of goods and services produced in the economy) grew at an average annual rate of 9.5 per cent between 1989 and 2019, with a peak of 15.4 per cent in the first quarter of 1993.

Falling Chinese economic growth rates is not good for investors, as it raises concern for global economic growth. Investors are now conditioned to expect Beijing will stimulate the economy when growth rates slip, but there are also concerns about its ability to sustain this given China's huge levels of debt.

One of the closest exposures to China that many Australian SMSFs have is through holding shares in the big miners that supply the country's voracious heavy industries including: BHP (iron ore and steelmaking coal), Rio Tinto (iron ore) and Fortescue Metals Group (iron ore). While China is a concern at the portfolio level, in terms of the sensitivity of the broader share market to perceptions of Chinese economic health, at the company level, these stocks continue to benefit from selling to China.

The big miners are also benefiting from the fact that iron ore supply from Brazil has suffered in the wake of January's tailing dam disaster. Brazilian miner Vale has stated that it could be up to three years before it resumes exporting at full capacity, and the supply disruption means that iron ore prices are likely to stay stronger than had been expected over that time.

4. The low-interest rate environment

The low-interest-rate environment that has been the investment setting for several years appears unlikely to change anytime soon. This is mainly due to central banks being reluctant to lift interest rates from long-term lows and bond yields pushed lower as investors become pessimistic about economies.

The dilemma for yield-oriented investors is that income is difficult to find in the traditional areas, meaning that higher risk has to be borne to generate higher levels of income. In Australia, listed shares have been popular for this purpose, using Australia's dividend imputation system: infrastructure investments, real-estate investment trusts (REITs) and corporate bonds have been other alternatives used.

The challenge of a global low-interest-rate environment for investors looks like it will remain for some time.

5. New and disruptive technologies

An area that has opened up for investors recently is new and disruptive technologies. These include advances in areas such as cloud computing, artificial intelligence, virtual reality as well as social and new media.

Companies that have "disrupted" established industries by doing business differently such as the likes of Amazon, Uber, Netflix and Airbnb, have created new levels of value in very short periods of time, but now find themselves vulnerable to disruption.

The digital and IT-powered revolution will continue to pose both risks and opportunities for investors: the only certainty for an investor is that technological advances cannot be ignored.

Source: BT

The impact of falling house prices

Housing is the most important asset owned by the majority of Australian households, according to the Reserve Bank of Australia (RBA).

A house not only serves as a place to live, but as a long-term investment, a measure of household wealth and a source of consumer spending. Therefore, a change in house prices can have a knock-on effect on a number of variables, such as wealth perception, consumer spending, interest rates and the overall health of the economy. Existing and potential homeowners and investors alike are keeping a close eye on the current downturn in house prices.

The impact of falling house prices

National house prices fell by 7.8 per cent over the year to March 2019. This compares to two consecutive years of growth, an increase of 2.3 per cent over the year to March 2018 and of 10.2 per cent in the year before that.

This most recent decline has had a negative impact on the 'Wealth Effect', which is the relationship between household wealth, (measured as the household's assets minus liabilities), and consumption. When house prices rise, homeowners tend to spend more and save less of their disposable income, or they may even remortgage to release equity from their homes to fund a new car or holiday. Remortgages account for about 30 per cent of the housing market in terms of value.

However, ABS figures show that household net worth decreased by 2.1 per cent in the December 2018, predominantly driven by losses on property and financial assets. Consumer spending has also suffered a corresponding

fall - car sales are down by 8.1 per cent for the year to April 2019 and although the March retail report indicated a slight increase in spending, from 3.2 per cent to 3.5 per cent, the gain was predominantly due to a rise in prices rather than an increase in sales, which were materially weaker.

Financial Health Confidence

While falling international demand and tighter lending criteria may have shaken the housing market and initiated a slowdown in economic spending, the good news is that the downturn is easing up and the rate of decline in house prices has started to slow.

"The improvement in the rate of decline is attributable to an easing in the market downturn across Sydney and Melbourne where values were previously falling much faster," says Tim Lawless, CoreLogic Head of Research.

Despite the fall in house prices, Australians actually report a four-point increase in positive financial health sentiment between January and May 2019, according to BT's Financial Health Index.

Australians remain as positive about their financial health in May 2019 as they did in March 2018, with overall responses remaining unchanged, while the index reveals a two-point increase in positivity since the June quarter last year.

Furthermore, when asked how confident they feel about being able to afford their desired lifestyle in the future, Australians also report a four-point increase in positivity between January and May, with males and females feeling equally confident.

Interestingly, those aged 54 to 75 have seen a seven-point increase in confidence. This group may feel buffered from falling house prices because on average this group has lower overall mortgage balances and more assets elsewhere. Interestingly, this group are also likely to be impacted by lower property values when downsizing but this is not necessarily playing out in sentiment for this age group.

Similarly, the GenY/Z, 18 to 35-year olds, who are potentially first-time buyers looking at a more affordable housing market, are also more positive about their financial health, with a six-point increase in positivity between January and May of this year.

Driving the improved sense of financial wellbeing over the longer term has been a fall in the concern about house prices, which has fallen from 6.1 points to 5.6 points in the March 2019 quarter, measured on a scale where 0 is 'not at all concerned' and 10 is 'extremely concerned'.

Overall, it's important to remember to take a step back and consider a long-term view when there's any price correction in the housing market. For example, according to the RBA, over the 30 years to September 2015, house prices increased by an average 7.25 per cent a year.

This could mean that short-term fluctuations are of less concern when approached with a longer investment horizon.

Source: BT

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