OUTLOOK FOR FINANCIAL MARKETS (6/3/14)

FIXED INTEREST – AUSTRALIAN & GLOBAL

Country/Region	Official Central Bank Rate for Short Term	90 Day Bills	10 Year Gov't Bonds
Australia	2.50%	2.64%	4.099%
China	6.00%		4.59%
Euro	0.25%		1.07%
German			1.606%
Japan	0.10%		0.619%
UK	0.50%		2.719%
USA	0.07%	0.2344%	2.71%

Interest rates are close to record lows in most of the so called "developed" world – the exceptions being some European Countries who are only slightly higher like Spain and Italy (*10 year bonds currently 3.44% and 3.42% respectively*) and the occasional problem country e.g. Greece 6.94%.

Although some emerging markets rates are quite low, some are higher as a result of the sell-off supposedly caused by the US Federal Reserve's "Tapering" (*reduction in monthly US Treasury Bond purchases*) announcements e.g. Brazil 12.7%, Russia 8.66%, India 8.84% and Indonesia 8.2%, which may present good investment opportunities down the track.

Globally inflation is quite low and while-ever things stay this way there aren't many reasons for rates to rise much from where they are now. That said I do believe rates will eventually start to normalize i.e. rise, sometime after 2014. If this is the case I can't see much advantage in presently being invested in those Government Bonds that are currently yielding close to record low rates – interest received will be low and if rates start to rise the value of the Bonds will fall. Better value can be had by investing in Corporate Bonds, in particular those that pay an attractive margin above the cash rate. In Australia current yields to maturity for Corporate Bonds cover a range of approximately 5% per annum to 8% per annum (*ignoring the extreme cases*). A lot of these pay a set margin over and above the Bank Bill Rate so as interest rates rise, so to does the amount of interest you are paid which removes a large part of the risk of falling bond prices due to rising interest rates which affect those (*such as Government Bonds*) whose interest paid is fixed.

SHARES

AUSTRALIAN

Some large cap companies, some mid size and a few (*but not many*) smaller companies are in my opinion fully (*but not excessively*) priced. At the moment the prices for these can be justified because interest rates are so low and many of these companies are paying decent dividends. However, future share price rises for these companies should be dependent on them growing their earnings at a respectable (*or even better*) rate – more so if interest rates rise. Some of these companies may find it difficult to grow their profits much. Then there are the rest of the listed companies (*ignoring the basket cases*) whose prices are fair to very cheap as they are yet to receive enough recognition from market forces (*buyers and sellers*) for a host of reasons, some of which aren't very logical (*at least from a longer term perspective*). In this category I see (*longer term*) some excellent opportunities in some Resource and Small Company stocks. That said, I am not prepared to suggest the share prices for these type of companies are about to take off in the near term – they might, but then again you may need to be patient for a year or two to reap the rewards. If I could tell you exactly when things were about to move I would be very rich. It would be fair to say longer term gains almost always come with some volatility i.e. downward movements as well as price rises. What does all this mean? Simply, we (*or the Fund Managers we use*) need to be selective in shares we buy and hold and disciplined in when we sell them and to not get distracted by the short term noise.

GLOBALLY

I think the comments above regarding Australia can be applied to global shares. From a sector perspective some Emerging Market shares look to be particularly good value due to the recent indiscriminate sell-off sparked by the share market's interpretation of the US Federal Reserve's announcement of some "Tapering" to their Bond Buying Program. Another issue with global shares is that of the currency movements (*the $A as at the date of writing was at $0.9012 to the $US and 69.2 on the Trade Weighted Index*). At present I believe the $A is still a little overvalued and that global share portfolios should be mostly "unhedged" – falls in the $A translate into extra gains for unhedged portfolios as we get more $A for gains made in overseas currencies.

PROPERTY

AUSTRALIA

Australian listed property trusts appear to be fair value on average at present. If interest rates rise that would presumably be a slight negative, unless they rise in response to a booming economy where employment has picked up and vacancy rates declined (*meaning property supply would be tight and rents increasing*). Selected direct property trusts / syndicates look to be good value generating income yields at 7.75% per annum plus.

GLOBAL

Global listed property currently looks (*on average*) to be OK value. The income yields on global property are mostly lower than their Australian equivalents, but then their interest rates are also lower.