OUTLOOK FOR FINANCIAL MARKETS as at 11/3/2015

In preparation for writing this outlook I have gone cross-eyed reading the very wide spread of supposed expert opinions on where things are headed:

- Some are predicting deflation whilst others are predicting inflation;
- Some predicting interest rates staying lower for longer and even falling further whilst others are suggesting interest rate rises;
- Some are predicting substantial falls in global *(including Australian)* share prices whilst others are suggesting the exact opposite;
- Some say Australian property prices are in a boom bubble which will burst and prices fall, whilst others suggest prices will continue rising, albeit at a subdued rate;
- A lot of commentary refers to lower oil prices as though they are here to stay without considering the possibility they could rise again, and do so very quickly;
- I regularly read about currency wars where nearly every country on earth would prefer their currency to be lower to improve the competitiveness of their export and import replacement industries, thereby boosting their countries economic growth. The US FED has used "quantitative easing" *(QE or money printing)* and setting very low interest rates to achieve this in recent years, but the $US is now rising strongly as they have stopped QE and started contemplating interest rate rises, whilst at the same time Europe and Japan have introduced very large QE programs combined with very low *(negative in some cases)* interest rates which are lower than US rates. At the same time as this is happening the $A continues to drift lower, although mostly just against the $US.

I also recently attended a couple of full day conferences *(Portfolio Construction Forum Markets Summit Feb2015 and Franklin Templeton Asia Pacific Investment Forum March 2015)* where I had the opportunity to listen to *(& speak to some)* world renowned experts in the fields of economics and financial markets. In some respects their opinions differed as much as the articles I referred to above, but one thing that most *(but not all)* agreed was that Global Shares offered better value than Australian Shares. Having said that I suspect they were probably confirming their remarks to larger Australian companies *(the banks, Telstra, BHP, Wesfarmers and the like)* because not many of them would have had a reason to analyse smaller Australian companies that aren't major parts of the main share market indexes.

Where do I see the Australian and Global economies headed?

I don't see any significant deflation, in fact I think inflation may become more of a problem but this will be a few years down the track at this stage. I think interest rates will remain low for a few more years *(a few small rises in some countries coming off record lows, if they happen, still won't change the fact that interest rates are very low)*. Some comments from the US FED suggest they are contemplating starting to raise interest rates around mid 2015, but I think they just want everyone to "think that" and won't actually start until 2016 or later because:

1. The $US is above where they would like it and raising rates would only push it higher and act as a headwind to economic growth;
2. Inflation is still low and below their target so they don't need to increase rates to control inflation – lower oil prices, cheaper imports, still under utilisation of capacity, still not full employment *(although much improved on where it was)*. Their last inflation reading was barely above zero;
3. While interest rates remain low it is easier for the US Government to service its large debt;
4. While you won't get them to admit it, they would like some moderate inflation *(say 3%)* as this would help in reducing real Government debt i.e. the nominal $ amount of debt stays fixed while the overall value of their economy and therefore tax receipts increases due to inflation.

As far as Australia is concerned I think our interest rates will remain low for a few more years. The $A is still a bit higher than we would prefer, we have low inflation, low growth, unemployment up from where it was and likely to get a little worse before it improves, leading to not much real wage inflation pressure.

So where do I see investment markets?

There are plenty of opportunities and there are no doubt some threats (*although these are sometimes hard to predict e.g. a massive earthquake on the West Coast of America, Russia declares war on the Ukraine, ISIS bombs Gatwick Airport*). I expect the share markets to be volatile in 2015 with gains overall but with some periods of price falls. However whilst ever interest rates remain so low returns from shares and property are more attractive than fixed interest, so expect to see more and more of the still very large cash holdings by investors worldwide finding their way into shares and property.

More specifically European and Japanese shares look to be better value than US shares at current prices, even after allowing for the fact that the US economy is doing considerably better than Japan's or Europe's at the moment. Some emerging market countries are attractively priced. In Australia there are more opportunities for gains in the small cap sector (*need to be selective though*) as a lot of the larger companies are fully priced. Agriculture has potential (*particularly with new free trade agreements*), some resource companies look cheap but there needs to be a catalyst to turn things around and it is hard to see this happening in the short term for commodities like iron ore and coal, but energy (*oil & gas) could turn very quickly and some other minerals (less well covered by the financial media*) have some interesting dynamics at play.

I like the outlook for some other investment alternatives:

- Some direct (*non-residential*) property
- Direct infrastructure investment where you can access it
- Some Private Equity Opportunities e.g. Partners Group Global Value Fund
- Some Hedge Funds including some managed futures such as Winton Global Alpha and some Long / Short strategies such as Bennelong Kardinia Absolute Return Fund.

Having said all of this because we can't predict the future completely I still believe the best approach is to remain genuinely diversified in your investment portfolios.