OUTLOOK FOR FINANCIAL MARKETS as at 3/6/2015

I have been to quite a few conferences and investment forums of late. I have also listened to teleconferences, webinars on investment market outlooks and as usual read different people's opinions on where things are positioned on a daily basis. Many of these views from the supposed experts are somewhat contradictory:

- There are those that think that Australia's economic outlook and the global outlook is quite reasonable (*no-one thinks things are about to boom*) and there are those who believe that global growth will be very low (*negative in some cases*) causing investment returns to be low for some years to come.
- Some think that interest rates across the globe will remain at historical lows for a long time and some think the US and UK will start raising rates soon.
- Some think the US and UK will continue to improve and that Europe is starting to turn the corner to better performance whilst others disagree with this view.
- Some think the outlook for China, India, Indonesia and even Japan looks pretty good while some others have the opposite view.
- Share prices are cheap relative to where interest rates are now, but a bit expensive relative to historical norms (*e.g. price earnings ratios are above historical averages*).

All of these opposing views makes choosing the right investments fairly confusing, so here is what I think:

- First of all no one can predict the short term movements in markets consistently so don't bother trying. Instead look for investment options that should produce decent to very good results over the medium term (*2 to 5 years*) that can be purchased for a good price – nothing is worth buying if you pay too much for it.
- As a by-product of the previous point be very selective in which investments you choose and make sure you spread your investments across as many <u>different</u> options as you can from those you like the look of – you won't get them all right. Back Fund Managers who are good stock pickers of shares, good at selecting the right properties to buy or the right type of fixed interest securities to buy, hold or sell at various points in time. Don't just buy a cross section of everything that is available, weighted towards bigger companies and Government Bonds (*I am very anti just following indexes – the average of the underlying securities which by definition includes all the rubbish together with the good)*.
- Expect investment markets to be volatile at times in the short term and fall in value from time to time before improving. If things fall in value don't panic and sell as this only crystalises losses unnecessarily. If the truth be known, more often than not, falls in prices provide opportunities and are a much better time to be buying – not selling.
- If the US Fed raises interest rates at some stage in the next 12 months I don't think it will be by much because:
  a) Economic growth in the US whilst positive is hardly booming.
  b) They have no real inflationary pressures at this stage – inflation is low, there is still some excess capacity and it wasn't that long ago that they seemed to be worried about deflation.
  c) Even if they did have some inflation (*provided it wasn't excessive*), while you won't get them to admit it, they would actually be happy because this would be one way of reducing the large amount of Government debt in the US i.e. debt does not increase in line with inflation since the amount owed is fixed, but other things such as taxes collected do.
  d) Most countries in the world are happy to see their currencies devalue so that their exporters and import replacement industries are more competitive. If the US increases their interest rates it will place even more upward pressure on the $US and I'm sure they don't want that – there are already some signs that the recently stronger $US is hurting them.

- The European Central Bank and its Japanese equivalent are currently undertaking large scale Quantitative Easing (*another form of money printing*) and have exceptionally low interest rates (*below 1% and in a a few cases actually negative e.g.. you have to pay the Swiss Government to lend money to them*). This is unequivocally a big positive for share prices.
- Greece is in the news again, but whatever happens other than maybe some short term knee jerk reactions by financial markets to decisions made, I can't see any medium to long term effects.
- China may well be growing more slowly now (*1% to 7% instead of 10% plus*) but this is on an economy double the size of what it was less than 10 years ago. This is actually a plus because if they continued to grow at 10% plus it would create all sorts of structural problems. The Chinese are actually targeting the lower growth rate as part of sound economic management and the fact is most countries would love a growth rate of 6% - actually they would probably panic with growth this high and make decisions to try and slow things down. Whilst China's restructuring is not so good for the Australian Iron Ore and Coal producers and businesses that rely on them, globally it presents a multitude of opportunities.
- In fact, due to clear election mandates, significant structural reforms are taking place in some other large countries (*Japan, India and Indonesia*) which can only benefit world trade, growth and present opportunities for some businesses.
- I can't see how interest rates can go much lower than where they are now.

  <u>10 year Government Bonds</u>

Australia	2.89%
US	2.12%
Germany	0.89%
Japan	0.41%
Swiss	0.07%

  Short term anything is possible (*maybe rates could fall a tiny bit*). That said, I don't think rates are going to rise much over the short to medium term (*the next couple of years*) either. This I would suggest will make it difficult to make much gain from fixed interest investments moving forward. This is contrary to what has happened over the last 25 years as interest rates have fallen from very high levels (*can any of you remember home loan rates at 18% in 1989*) to where they are now.

  So some of what has worked in the past for fixed interest investing won't work in the next few years at least – following fixed interest indexes heavily laden with developed country Government Bonds. Successful fixed interest investing moving forward will need to be very active and focused on security selections.
- Over the last 3 months Australian share prices have fallen 3% to 4% on average whilst Global Shares have risen 2% to 3%. That said shares, both Australian and Global, look to me to have reasonable prospects over the next few years (*allowing for a possible volatile ride as mentioned above*). However I believe that there is a fairly large dispersion in how shares are priced at present – some appear expensive and others cheap (*with everything in between*). I believe there are better opportunities to be found in medium to small size companies.
- I think there are at present some good investment options available in the "alternates" space:

  Managed Futures Funds
  Event Driven Funds
  Long / Short Funds
  Infrastructure
  Private equity