OUTLOOK FOR FINANCIAL MARKETS as at 4/9/2015

SHARES

Since April / May share prices have been falling (*particularly in August*) and in fact are still down (*except for the odd exception, notably the USA*) on where they were on 31/10/2007 (*when the Global Financial Crisis (GFC) was starting to gain traction*):

As at 4/9/15	Since 27/4/15	Since 31/10/07
Developed markets (*excluding Australia*)	-10.8%	+3.0%
Emerging markets	-19.5%	-20.1%
Australia	-16.1%	-24.7%

Note these figures are averages only, do not include dividends, are measured from the absolute high points and as most people didn't invest exactly on the 31/10/07, our clients share components of their investment portfolios have produced solid above average gains from those share based investments held for at least a year.

Whilst I can't predict whether or not these prices will fall further over the shorter term, what I can say with certainty is that shares on average are better value now than they were earlier in the year. Moving forward medium to long term, I believe that buying shares now (*or keeping those you already have*) in companies with good future prospects will provide you with attractive returns, albeit that there will be fluctuations along the way.

As always, I believe intelligent stock picking will produce better long term results than simply following the market indices by buying a cross section of everything (*e.g. All Ordinaries, S & P 500 etc.)*. Whilst there will no doubt be some very good performers in most sectors within the various subcategories, I think the biggest upside will be found in:

1. Quality Smaller companies;
2. Some Emerging Market countries;
3. Eventually, although it is tricky to know when, resource stocks – minerals and energy – those that are well capitalized, with long life assets and low production costs. Share prices in these sectors have been in free fall over the last few years and when commodity prices start to recover as they invariably will those that are left standing will do very well. Because of the boom in resource demand (*mostly emanating from China*) in the first decade of this century, commodity prices rose steeply and as a consequence a lot more production (*supply*) was added resulting in an oversupply, but more recently demand has flat lined (*possibly declined in some cases*) so commodity prices have fallen substantially. Mining and energy companies are now cancelling proposed new projects, moth balling some existing production facilities, aggressively cutting costs and some companies have gone out of business. The likely outcome of this trend will be a reduction to supply and eventually commodity prices will start rising again.

PROPERTY

I think the outlook for quality Australian commercial property (*Office, Retail, Industrial & Tourism*) is quite reasonable at this point in time. Average rental yields for these types of properties are in the region of 7% or more and are set to keep pace with inflation (*or better*) which should result in some steady valuation increases as well. With regard to residential property I think valuations are expensive, particularly in Sydney and Melbourne, and whilst I am not suggesting a property price crash, as I don't foresee Australian interest rates increasing any time soon, I can't see how further price rises can be justified in the near term.

As far as the Australian listed version of the above property (*listed on the ASX*) is concerned, valuations are reasonable – their prices are on average trading at a premium to the underlying value of their assets. A premium of 5% to 10% can be justified due to the extra liquidity they provide (*ability to be sold on the stock market at short notice if funds are required)*. The income yields from Australian listed property as a consequence are around 1% p.a. less than their direct property equivalents. Global direct and listed property is in my opinion slightly less attractive than their Australian counterparts because income yields on property located in Developed countries (*USA, UK, Japan & Europe*) tend to be less. That's not to say there aren't some good opportunities in global property, but the yields are noticeably lower in most cases.

FIXED INTEREST

Nothing much has changed with regard to interest rates in 2015. They are still very low and look like staying that way for a while yet:

	Central Bank Cash Rates	10 year Gov't Bonds
Australia	2.0%	2.69%
USA	0 – 0.25%	2.15%
Germany	0.05%	0.68%
Switzerland	-1.25%	-0.19%
UK	0.5%	1.80%
Japan	0 - 0.10%	0.34%

I would steer clear of anything associated with longer term versions of these type of investments. If interest rates rise, the value of your longer term bonds can fall substantially. Conversely if interest rates fall longer term bonds will rise in value, but it is hard to envisage any meaningful falls to rates from where they are now. If interest rates stay where they are, you only have to look above to see that you are being paid very little. In my view, better fixed interest returns can be obtained by carefully selecting from available Corporate Bonds, Hybrid Fixed Interest securities and some Emerging Market Government Bonds.