Market Overview and Outlook

Economic Overview

Politics remain a key focus for markets, but the latest developments in Europe are positive. In France, the first round of the presidential election ruled out the least market-friendly outcome, and although eurosceptic Marine Le Pen is in the run-off as expected, polls suggest reformist Macron should win. The snap election called in Britain for June is a material positive game-changer for Brexit negotiations. Beyond politics, focus has been on fading conviction in so-called Trump trades – higher inflation expectations and interest rates and buoyant risk assets – following speed bumps on the US domestic agenda and increased geopolitical tension. But with global macro momentum solid – though off recent highs – and global growth expected to pick-up next year and approach 4% in 2018, do not dismiss inflation risks, especially in the US. Indeed the macro backdrop comforts the view that we are past peak central bank easing. The Fed will likely raise rates twice more this year and announce the start of the unwinding of its balance sheet. The ECB is on track to announce a taper of its quantitative easing programme later this year.

The US economy expanded at the slowest pace in three years as weak auto sales and lower home-heating bills dragged down consumer spending, offsetting a pickup in investment led by housing and oil drilling. GDP rose at a 0.7% annualised rate after advancing 2.1% in the prior quarter. Consumer spending, the biggest part of the economy, rose 0.3%, the worst performance since 2009. The GDP slowdown owes partly to transitory forces such as warm weather and volatility in inventories, which supports forecasts for a rebound as high confidence among companies and consumers and a solid job market underpin growth. Even so, the weakness at car dealers could weigh on expansion, and further gains in business investment could depend on the extent of policy support such as tax cuts.

The Institute for Supply Management (ISM) said its index of US factory activity dropped to a four-month low of 54.8 in April from a reading of 57.2 in March. A reading above 50 indicates an expansion in manufacturing, which accounts for about 12% of the US economy. The ISM index had risen since last November, scaling a 2-1/2-year high in February, amid optimism over President Trump's pro-business policy proposals. It has declined in the last two months and some economists say the retreat probably reflects caution among business as they await implementation of the proposals.

Euro zone inflation rose by more than expected to the European Central Bank's target and core inflation increased to its highest level in more than three years. Inflation in the 19 countries sharing the euro was 1.9% year-on-year in April, up from 1.5% in March and just short of the four-year high of 2.0% recorded in February. The ECB has a medium-term target for inflation at close to but just below 2%. Core inflation, which excludes volatile prices of energy and unprocessed food and which the European Central Bank monitors closely, also rose to 1.2% year-on-year in April from 0.8% in March. The core level was at its highest level since September 2013. The estimated figures for April could increase pressure on the ECB to wind down its monetary stimulus.

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Stricter budget constraints in many member countries have caused the eurozone's combined public deficit drop to levels last seen in 2008. The dip was caused mainly by decreasing government spending. The level of government borrowing across the 19-member eurozone has fallen to the lowest level since before the most acute phase of the global financial crisis. The eurozone's deficit was equivalent to 1.4% of its combined GDP in the final quarter of 2016, down from 1.6% in the previous year. The fourth-quarter rate is the lowest since the first three months of 2008.

HSBC said some of its largest clients have already asked for their business to be routed through the bank's offices in mainland Europe rather than via the UK office and they are not waiting to see what Brexit deal the UK hammers out with the continent's trading bloc. Executives at multinational companies are said to be making plans to ensure they can continue to trade irrespective of the outcome. Global banks have started arranging for some British-based operations to move to new or expanded offices inside the EU. Privately, many executives at the world's biggest firms say they are now assuming the result will be a "hard Brexit" -- the loss of their right to sell services freely around the region from the UK. Some companies are also evaluating whether to "flip" their regional head offices to European cities from Britain. This would require them to reclassify the UK branch as a country office that would become a subsidiary of the continental headquarters. This may result in some small-scale job moves and lost taxation for the UK government, as firms start reporting the purchase and distribution of services elsewhere.

Japanese retail sales rose 2.1% on year in March on solid demand for cars and some consumer electronics as well as higher fuel costs, marking the fifth straight rise after from +0.2% in February. The government left its assessment unchanged from the previous month, saying retail sales are "showing signs of a pickup." March exports +12.0% on year, the fourth straight rise after +11.3% in February, led by higher shipments of auto parts, optical equipment and steel on a gradual pickup in global demand. Imports +15.8% on year, the third straight rise after +1.2% in February as crude oil and fuel prices continued to post year-on-year gains.

China's official Purchasing Managers' Index fell to 51.2 in April from the previous month's 51.8, which was the strongest reading since April 2012. China's economy grew a faster-than-expected 6.9% in the first quarter, boosted by higher government infrastructure spending and a property boom. But growth is expected to cool as authorities step up efforts to cool the property sector while the central bank and banking regulator have taken steps to contain financial risks. Chinese leaders have pledged to shift the emphasis to addressing financial risks and asset bubbles.

Global growth is set to reach 3.5% this year and 3.6% in 2018, the International Monetary Fund said. The Fund has raised its growth forecasts slightly from estimates released last October as macro economic conditions eased for commodity exporters and investment levels grew in advanced economies. However, the IMF warned that risks to global growth remain to the downside with structural issues holding back economic development.

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***"With persistent structural problems—such as low productivity growth and high income inequality—pressures for inward-looking policies are increasing in advanced economies. These threaten global economic integration and the cooperative global economic order that has served the world economy, especially emerging market and developing economies, well,"* the IMF said.**

Interest Rates & Currency

Federal Reserve Chair Janet Yellen said the US central bank's task has shifted from a post-crisis exercise of healing the economy to one aimed at holding on to progress made. "*Before, we had to press down on the gas pedal trying to give the economy all of the oomph that we possibly could,"* Yellen said. The Fed is now trying to *"give it some gas, but not so much that we're pushing down hard on the accelerator."* Yellen and her colleagues are aiming to ease back significantly this year on the level of support the central bank is providing the US economy as they close in on their goals of full employment and 2% inflation. Policy makers have penciled in two additional rate hikes this year, on top of one executed in March. Minutes of their March meeting showed that most Fed officials also expect to begin shrinking the bank's US$4.5 trillion balance sheet later this year, gradually reversing emergency bond purchases made during the recession and recovery. *"The appropriate stance of policy now is closer to, let me call it neutral,"* Yellen said.

The European Central Bank left its interest rates and policy stance unchanged as expected in April, keeping its unprecedented stimulus in place as inflation is still below its target, even if growth is finally accelerating. Fighting negligible inflation for years, the ECB has kept its deposit rate in negative territory since 2014 and plans to buy 60 billion euros worth of bonds each month at least until December. The ECB repeated its standard guidance that it expects its key interest rate to remain at present or lower levels for an extended period of time and well past the horizon of its asset purchases. The ECB kept its rate on bank overnight deposits, which is currently its primary interest rate tool, at -0.40%. The main refinancing rate, which determines the cost of credit in the economy, was unchanged at 0.00% while the rate on the marginal lending facility - or emergency overnight borrowing rate for banks - remains at 0.25%.

The Bank of Japan kept its stimulus policies unchanged while lowering its inflation forecast, underscoring that any exit from its unprecedented monetary easing remains far away. While global demand is supporting exports and contributing to modest economic growth, four years of extraordinary monetary stimulus is generating only the smallest of increases in prices. Governor Haruhiko Kuroda said that the accommodative policy and asset purchases will continue for some time because inflation is "quite sluggish."

At its May board meeting, the RBA held the cash rate unchanged at 1.5% as widely expected. UBS' view is that RBA will be on hold until at least 2H18. *"While the RBA remain focussed on household leverage, we continue to expect them to use macroprudential tightening, rather* *than the 'blunt stick' of rate hikes. Indeed, their expected increase of underlying inflation is only "gradual", signalling little near-term urgency (in contrast to prior cycles) to back away from a record low cash rate. This combined with the RBA needing some time to assess the impact of only very recent macroprudential policy tightening, means that we continue to see the RBA on hold until 2H-2018."*

No change in the RBA cash rate is expected in the near term. Our preference remains for both short dated fixed-rate and floating-rate securities of high investment grade corporates.

Closing Rates as at 30 April 2017					
	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	1.50%	1.50%	US Fed Funds Rate	0.9100%	0.9100%
90 Day Bank Bills	1.77%	1.82%	AUD/USD	74.75	76.44
180 Day Bank Bills	1.73%	1.78%	US 10 Year T-Bond	2.29%	2.40%
5 Year Govt Bonds	2.129%	2.235%	US 30 Year T-Bond	2.97%	3.02%
10 Year Govt Bonds	2.583%	2.683%	Japan 10 year yield	0.014%	0.073%

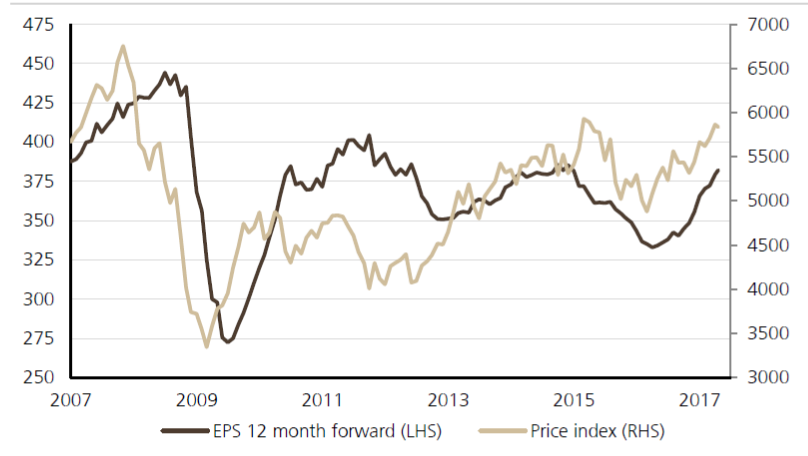
Stance: **Corporate - Positive variable rate and investment grade**
Government - Underweight

Australian Shares

According to UBS, *"Australia's current market P/E multiple of 15.3x (1-year forward) is moderately above average but not out of line with the current global multiple. The Australian market is still trading at a moderate discount to its long run price to book level. However, the market ex resources P/E is now around its (post-tech bubble) highs. As is the case globally, while P/Es are on the high side the market still could be argued to be cheap versus what are still very low competing interest rates. 6-12 month upside is likely limited from here as a central case but global conditions for equities will likely stay reasonably supportive. With a c5% dividend yield and bond yields and cash rates still looking unattractive, equities still look like a superior option in our view. We see a degree of downside skew to our market return scenarios (high valuations, domestic tail risks) but the global macro revival appears supportive for equities as a central case, so valuations may well stay elevated for some time."*

[1] Previous rate or level represents the rate or level as at the end of the previous month.

Figure 11: Market Performance versus EPS



Source: Factset

Market earnings momentum has accelerated significantly over the past year. We expect the pick up to moderate over the coming year.

The franked dividend yield above the term deposit rate continues to provide support for equity valuations. With the low cash rate, we believe there should be continued support for equity valuations and gross yields from equities.

Closing Rates as at 30 April 2017

	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	5,947.6	5,903.8	AOX Earnings Yield	6.58%	6.71%
PE Industrials (2017)*	17.2x	17.0x	Div Yld Indust (2017)*	4.4%	4.5%
PE All Ords (2017)*	15.2x	14.9x	Div Yield All Ords (2017)*	4.5%	4.5%

*Source – UBS

Stance: Neutral, and Trim if Overweight

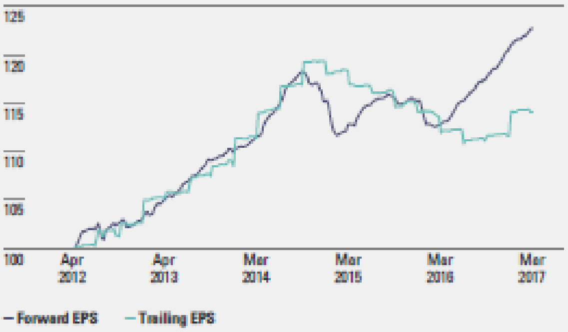
<u>International Shares</u>

State Street's view is *"The US market has seen extraordinary growth in earnings expectations compared with actual earnings. Where actual earnings have only just ticked up in the last quarter from two years of consistent decline, the forecasts of earnings have risen almost 10% from* the lows

[1] Previous rate or level represents the rate or level as at the end of the previous month.

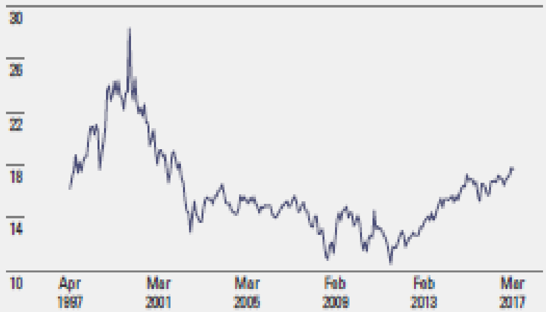
of early 2016. Not only are analysts optimistic about company earnings via their forecasts, but the market is pricing those future earnings optimistically, with the market trading on a multiple of estimated earnings as high as we've seen since 2001."

Figure 1: Index of Forward and Trailing Earnings Per Share, S&P 500 Index, as at 31 March 2017



Source: Bloomberg Finance L.P.

Figure 2: Price to Forward Earnings, S&P/500 Index, as at 31 March 2017



Source: Bloomberg Finance L.P.

US equities have priced in tax cuts and better business conditions, with share prices rising. The risk of a pullback is rising, especially if the tax cuts or additional infrastructure spending do not eventuate as initially proposed.

Closing Rates as at 30 April 2017					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
US Dow Jones	20,940.51	20,663.22	Nikkei Dow	19,196.74	18,909.26
S&P 500	2,384.20	2,362.72	Hang Seng	24,615.13	24,111.59
FTSE 100	7,203.94	7,322.92	MSCI	1,878.3	1,853.7

Stance: Neutral, and Trim if Overweight

[1] Previous rate or level represents the rate or level as at the end of the previous month.

Property

CoreLogic said Sydney units fell 1.2% in value in April while houses gained just 0.2%. Apartment values in Melbourne fell 0.9% while houses gained 0.6%. The declines – reinforced by a fall in unit prices in every capital city except Canberra and Hobart – were not yet enough, however, to conclude that the market was on its way down, CoreLogic said. Sydney and Melbourne's rental yields remain the lowest in Australia at a gross yield of 2.7% for houses and 4% for units.

In the first quarter of 2017, the A-REIT index returned -0.21%, driven by negative sentiment toward retail landlords given the threat posed by online retailers. That negativity originated in the US retail sector, where more vulnerable US mall owners are under concerted attack by hedge funds. However, in April, the A-REIT index had a positive return, with the most obvious driver being the retreat on bond yields. From a high of 2.98% in early March, the yield on 10-year Australian government bonds has dropped to 2.58%. With geopolitical uncertainty, defensives such as bonds and A-REITs have benefited with the fall in the bond yield. Looking forward, with world growth remaining robust, bond yields are expected to rise and this would negatively impact the A-REIT index.

The REIT sector has been impacted by rising long term bond yields. Earnings per share growth will be key in determining whether distributions can grow.

Closing Rates as at 30 April 2017		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,415.6	1,379.6

Stance:	**Commercial/Listed:**	**Neutral**
	Residential:	**Neutral, with a negative bias**

[1] Previous rate or level represents the rate or level as at the end of the previous month.

IMPORTANT INFORMATION

Note that this is general advice that does not take into account the current financial circumstances or financial needs of any individual which should be considered when making investment decisions and in consultation with an appropriately qualified adviser.

NEWELL PALMER SECURITIES PTY LTD

Address:	**Suite 101, 270 Pacific Highway CROWS NEST NSW 2065**
Mail:	**PO Box 1680 CROWS NEST NSW 1585**
Phone:	**(2) 9906 8066**
Fax:	**(61 2) 9906 8080**
Website:	***www.newellpalmer.com.au***
Email:	***info@newellpalmer.com.au***

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