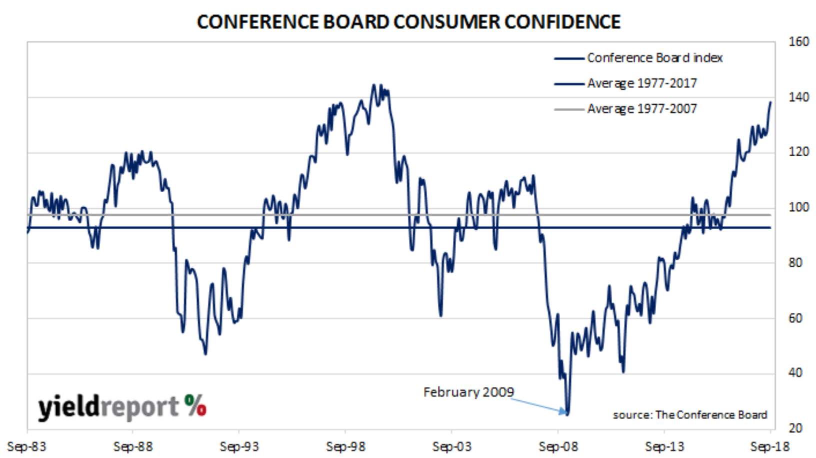
Economic Overview

Global GBP growth is expected to slow from 3.9% in 2018 to trend-like 3.6% in 2019 and 3.7% in 2020. The recent era of low interest rates and low inflation ('lower for longer') has now transitioned to a period of rising interest rates, rising wages and central bank tightening. However, there are mixed views whether the current environment can be characterised as 'late cycle', given that the US, EU and Japanese economies are not exhibiting characteristics of a typical 'late cycle' expansion. The implication is that this cycle could extend, especially if inflation continues to rise slowly. The risks for the current cycle are trade policy, US fiscal policy and central bank policies, and these factors should be monitored.

Quantitative easing is winding down fast. The measures to stimulate the global economy peaked at an annual rate of $US2 trillion in 2016. They will be negative by the end of this year. The Fed is shrinking its balance sheet by $US50 billion a month. The European Central Bank has tapered bond purchases from €80 billion to €15 billion a month, and will end its program altogether in December. This could lead to further volatility in equity markets as liquidity is withdrawn by the reversal of quantitative easing.

US unemployment rate at 3.7% and it reached near 50-year lows. Wages rose 2.8% in September, a tad below the 9-year high growth rates in the prior month.



The US Conference Board's September survey indicates US consumers are about as optimistic as they can possibly be. The reading came in at 138.4, up from August's revised reading of 134.7 and well up on September 2017's comparable figure of 120.6. It is the highest reading since October 2000 and it is not far from the highest reading recorded in the series.

Sales of previously owned US homes eased in September to the weakest pace in almost three years, a sign rising prices and mortgage costs are keeping potential buyers on the sidelines. The sixth-straight monthly drop in sales, the longest streak since 2015, underscores what is now a challenging time in the real estate market for buyers. The average mortgage rate for a 30-year fixed term has advanced nearly one percentage point this year, compared to a decline in 2017. The drag from higher mortgage rates is likely to weigh on the existing home sales data in upcoming reports over the next several months.

US home-price gains slowed in the third quarter as higher mortgage rates cut into affordability. The national median price of a previously owned single-family home was US$266,900, up 4.8% from a year earlier. In last year's third quarter, prices rose 5.3% on an annual basis.

The German government has cut its forecasts for growth this year and next in Europe’s largest economy and sees an escalation in the global trade dispute as the main risk for the future. The government slashed its 2018 and 2019 growth forecasts to 1.8%, compared with its previous predictions of 2.3% and 2.1% respectively. Due to an increasingly tight labour market, characterized by low unemployment and more than a million job vacancies, the government expects nominal wages to rise by 3.0% this year and by 3.1% in both 2019 and 2020. With inflation, predicted to rise to 1.9% this year and 2.0% in 2019, the wage hikes mean that German consumers will have more money to spend also in real terms.

Skilled workers that come to Japan will be eligible for a new type of visa that can be renewed indefinitely -- and thus essentially confers permanent residency -- as the nation races to relieve chronic labour shortages. The government will create a two-tier visa status for foreign workers next April. The new framework will be created for workers with skills requiring a certain degree of knowledge or experience. Workers who pass skills and language tests, as well as technical interns who remain in training for at least three years, will be eligible for the first level of the new status. This will let them stay in the country for five years, though they cannot be accompanied by family members. Those who exhibit greater proficiency by passing more advanced exams can qualify for the second level, letting them bring spouses and children. The government ministry envisions this status initially lasting five years, with no limit on the number of extensions.

China’s economy, which grew in the third quarter at the slowest pace in a decade, is likely to slow further in the coming months as the ongoing trade war with the United States takes its toll. Gross domestic product increased by a slower-than-expected 6.5% in the third quarter from a year earlier, down from 6.7% in the second quarter. That would be the slowest quarterly growth pace since the global financial crisis a decade ago.

China's official manufacturing Purchasing Managers' Index (PMI) for October was 50.2 and down from 50.8 in September. The official PMI reading for October was the lowest since

July 2016, with the production and new orders sub-indices also falling from a month ago. New export orders contracted for the fifth straight month.

China reduced the banks' reserve requirement ratios by 100 basis points from 15.5% for large commercial lenders and 13.5% for smaller banks on 15 Oct , matching a similar-sized move in April.

The International Monetary Fund has cut its global growth forecasts as trade tensions between the US and trading partners have started to hit economic activity worldwide. The IMF said the global economy is now expected to grow at 3.7% this year and next year — down 0.2 percentage points from an earlier forecast, according to the fund's latest World Economic Outlook report released in October. The two economies in the centre of the ongoing tariff fight — the US and China — are also expected to grow slower than initially projected. The IMF maintained that the US and China will grow by 2.9% and 6.6%, respectively, this year but said both would slow more than expected to 2.5% and 6.2%, respectively, in 2019.

Interest Rates & Currency

Federal Reserve policymakers are largely united on the need to raise borrowing costs further, minutes from their most recent policy meeting show, despite U.S. President Donald Trump's view that interest rate hikes have already gone too far. Every Fed policymaker backed the central bank's September decision to raise the target policy rate to between 2% and 2.25%, according to minutes of the Sept. 25-26 meeting. Participants in the Fed's rate-setting committee also *"generally anticipated that further gradual increases"* in short-term borrowing costs *"would most likely be consistent"* with the kind of continued economic expansion, labour market strength, and firm inflation that most of them are anticipating, the minutes showed. The broadly united front could bolster expectations the central bank will raise rates a fourth time this year in December, but the minutes also show the committee remains split on how much further to raise rates next year.

European Central Bank President Mario Draghi has confirmed wind-down of €2.5 trillion in bond buying will continue this year, despite "somewhat weaker momentum" in the eurozone economy. He also says that the ECB likely will maintain negative interest rates until the second half of next year.

The Bank of England (BOE) kept its benchmark interest rates unchanged in November, and hinted that a smooth Brexit could quicken the bank's rate-hiking cycle. The BOE rate-setters voted unanimously to hold rates at 0.75%. In August this year, the bank raised interest rates by 25 basis points — its second time since the financial crisis.

The Bank of Japan's policy committee will keep short-term interest rates at negative 0.1% and will maintain a yield close to zero as its target for the 10-year government bond. The committee also said the central bank remains a couple of years away from pushing inflation up to a 2% target.

The RBA's November meeting held the cash rate at 1.50% as widely expected. Their policy outlook remains 'near-neutral' as holding is consistent *"with sustainable growth in the economy and achieving the inflation target over time".* The RBA remains unlikely to be pre-emptive given *"further progress in reducing unemployment and having inflation return to target is expected, although… gradual"*, & this is predicated on *"low… rates… continuing to support the Australian economy"*. UBS' view is *"We still have a more dovish view than consensus, and see rates on hold until 2020 given weakening housing & low inflation continuing."*

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 investment grade corporates.

Closing Rates as at 31 October 2018					
	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	1.50%	1.50%	US Fed Funds Rate	2.20%	2.18%
90 Day Bank Bills	1.91%	1.94%	AUD/USD	70.85	72.22
180 Day Bank Bills	1.92%	1.94%	US 10 Year T-Bond	3.14%	3.07%
5 Year Govt Bonds	2.179%	2.227%	US 30 Year T-Bond	3.39%	3.21%
10 Year Govt Bonds	2.630%	2.671%	Japan 10 year yield	0.126%	0.131%

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

Australian Shares

According to Schroders, *"Three of the tailwinds for ASX investors across the past decade — policy with respect to interest rates, trade, and regulation — have turned into headwinds. While profit may be hit, it is also likely that multiples will revert to something more like normal. Policy has driven equity market returns for the past 30 years. The more leverage had to financial assets and falling rates, the better the equity performance, firstly as a consequence of policy designed to shed inflation, and latterly as a consequence of global QE. Our base case is that policy will drive the next decade's equity market returns as well, just be a much broader policy set. The unwind of QE will be a big deal. Apart from the increase in interest rates, however, government policy will be a massive deal for shareholders – in many cases, literally, the government is deciding what return is acceptable for certain industries,*

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

and this determination can change meaningfully through time." Banks, energy and healthcare are some industries that face headwinds from government policy changes.

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

Closing Rates as at 31 October 2018					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	5,913.3	6,325.5	AOX Earnings Yield	6.99%	6.53%
PE Industrials (2018)*	15.3x	16.5x	Div Yld Indust (2018)*	5.1%	4.7%
PE All Ords (2018)*	14.3x	15.3x	Div Yield All Ords (2018)*	5.1%	4.7%

*Source – UBS

Stance: Neutral

<u>International Shares</u>

According to Crestone, *"Since its all-time high on 20 September, the S&P 500 index has fallen around 9%. In October, it suffered its first 5% drawdown in 69 sessions. Since 1928, the index has suffered a 5% pullback every 71 trading days. The 11.5% pullback over 18 days was less vicious than the 12% pullback over nine days that we saw in February. Valuation risk has fallen somewhat, with the year-to-date surge in earnings per share (EPS) combined with the S&P 500 s flat year-to-date performance reducing forward P/E multiples by 14% to 14.8x. However, earnings risk remains, with rising US labour costs representing a key margin risk. Coupled with the prospect of additional tariffs and the cycling of tax -inspired boost to earnings, the outlook for 2019 is more uncertain than it has been in some time."*

Notwithstanding the recent pullback, US equities have risen based on earnings growth, PE expansion and having priced in tax cuts and better business conditions. There is risk of a greater pullback, if the trade war further escalates, earnings growth disappoint or if inflation unexpectedly rises.

Closing Rates as at 31 October 2018					
	Level	Level (Prev) [1]		Rate	Rate (Prev)
US Dow Jones	25,115.76	26,458.31	Nikkei Dow	21,920.46	24,120.04
S&P 500	2,711.74	2,913.98	Hang Seng	24,859.16	27,788.52
FTSE 100	7,128.10	7,522.05	MSCI	2,022.0	2,184.01

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

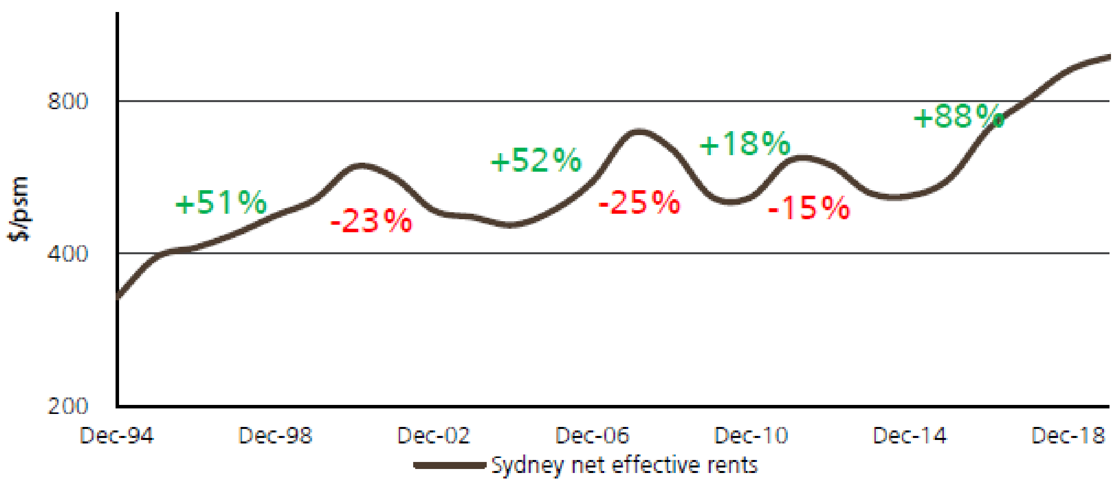
Stance: **Neutral, and to purchase international shares if currently underweight international shares**

Property

UBS' view is *"The acceleration of falls in home loans shows our credit tightening thesis is playing out, even before the next three game changers of Debt-To-Income limits, & potentially negative gearing & CGT. Loans already slumped by 17% since the peak in Aug-17, to the lowest level in 5 years. Our long-held forecast of a peak-to-trough drop of 20% increasingly looks like heading to -30%; seeing housing credit growth slow towards flat by 2020, & house prices to drop by a ~record 10%."*

UBS' view for the Australian Office REIT sector is *"Industry office rent forecasts were revised up 1-2% in the September quarter for the major markets of Sydney and Melbourne, continuing the momentum into the end of the year. (See chart below) Investors' expectations for rent growth expectations in Sydney and Melbourne have been pushed up from +10% at the start of the year to +12% as supply remains benign and withdrawals in the Sydney market increase. On cap rate compression, we believe the market expects another 25bp cap rate at the December revaluation."*

Figure 1: Sydney net effective rents



Source: UBS, CBRE

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 31 October 2018		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,382.9	1,427.4

Stance:

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

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.

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