Economic Overview

A slowing, but still growing world economy and patient central bankers are supportive of growth assets. A reduction in geopolitical risk has also served to boost market sentiment. The rally in growth assets in the first four months of this year was a snapback from fears in late 2018 of an imminent economic slowdown and hawkish US Fed rhetoric. Since then the US Fed has made a dovish pivot and markets have rallied. However, the path forward from here for markets has various risks that can bring the market lower. These risks include the path of global growth and geopolitical risks.

The global economy has to be strong to avoid fears about a recession, but at the same time weak enough for central bankers to keep policies on hold. A decline in growth expectations is likely to lead to a market sell-off as recession fears grow. Similarly, a more hawkish Fed in resuming its tightening policy due to stronger US growth or increases in inflation, is likely to lead a similar market sell-off. Any geopolitical shock, such as rising US-China trade tensions, could also hit market sentiment.

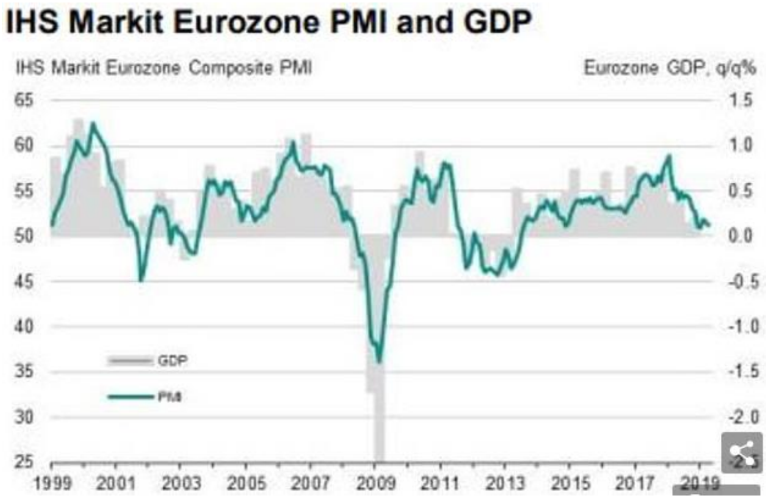
US GDP grew at a 3.2% annualised rate in the first quarter of 2019, exceeding expectations and continuing one of the longest economic expansions in American history. The threat of a continuing trade war with China prompted American businesses to stockpile inventories at an accelerated rate, which boded well for GDP growth but also means that those goods and materials will have to be drawn down in the coming quarters resulting in an offsetting reduction in GDP in the coming quarters.

Nonfarm payrolls in the US increased by 263,000 in April 2019, following a downwardly revised 189,000 rise in March and easily beating market expectations of 185,000. Notable job gains occurred in professional and business services, construction, health care, and social assistance. The US unemployment rate fell to 3.6% in April 2019 from 3.8% in the previous month. It was the lowest jobless rate since December 1969, as the number of unemployed persons went down by 387,000 to 5.8 million. Labour markets remained tight across the United States as businesses struggled to find skilled workers and wages grew modestly. Businesses in most districts reported shortages of skilled workers, mainly in manufacturing and construction, but also in technical and professional roles. Companies have responded to the tight labour market by boosting bonuses and benefits packages, along with raising wages moderately. Employment increases were most highly concentrated in highly-skilled jobs.

US consumer spending posted the biggest gain since 2009. The Commerce Department said consumer spending, which accounts for more than two-thirds of US economic activity, surged 0.9% in April as households stepped up purchases of motor vehicles and spent more on healthcare.

US manufacturing activity slowed to a 2-1/2-year low in April amid a sharp drop in new orders while construction spending unexpectedly fell in March, suggesting economic growth was moderating after surging in the first quarter. The Institute for Supply Management (ISM) said its index of national factory activity fell to 52.8 in April, the lowest reading since October 2016, from 55.3 in March. A reading above 50 indicates expansion in the manufacturing sector, which accounts for about 12% of the US economy.

The eurozone is suffering its worst spell of growth since 2014, with both the service and manufacturing sectors stagnating. Export order levels have fallen sharply, demand from potential customers remains sluggish and the outlook among businesses within the eurozone is the gloomiest since late 2014. The IHS Markit eurozone purchasing managers' index fell from 51.6 in March to 51.3 in April.



German annual inflation accelerated to 2.1% in April from 1.4% in March, exceeding the European Central Bank's target for the first time since November. The inflation figure may be higher due to Easter falling later this year and higher fuel prices. The May inflation figure may fall below 2%, but this would be dependent on fuel prices.

After years of work and millions of pounds spent in preparation for the UK's withdrawal from the European Union, the delay of Brexit to October and seemingly endless questions about the outcome are casting a cloud over bankers' outlooks and taking the shine off the rise in shares this year. The sentiment was underlined when HSBC Holdings Plc's Chief Financial Officer Ewen Stevenson warned that the uncertainty is plaguing consumer and business confidence. *"We continue to be cautious on the UK, probably more than anywhere else given the array of Brexit outcomes that could drive some pretty different economic outcomes,"* Stevenson said in a phone interview.

Japanese manufacturers' business confidence slipped to a 2-1/2-year low in April, underlining growing concerns the economy could slip into a recession in the face of slowing external demand. The Reuters Tankan sentiment index for manufacturers stood at eight in April, down two points from March, weighed down by manufacturers. The index posted a sixth straight month of falls and hit the lowest reading since September 2016.

China's economy grew 6.4% over a year before in the three months ending in March. That matched the previous quarter for the weakest growth since 2009. China stepped up government spending last year and told banks to lend more after economic activity weakened. Beijing's decision to reverse course temporarily on a campaign to rein in rising debt is starting to yield results.

China's official Purchasing Managers' Index (PMI) came in at 50.1 for the month of April. In May, China's central bank said it will cut reserve requirement ratios (RRRs) to release about 280 billion yuan (US$41 billion) for some small and medium-sized banks, in a targeted move to help companies struggling amid an economic slowdown. The cut in the amount of cash that banks must hold as reserves would result in the RRR to be the smallest since January 2018, when the People's Bank of China (PBOC) started its latest round of policy easing to support the world's second-largest economy. The central bank said it will cut the RRR for about 1,000 rural commercial banks operating in counties to 8%, equal to the RRR for smaller rural credit cooperatives. The move will help lower funding costs for small and micro firms, the PBOC said. The PBOC has already delivered five RRR cuts since early 2018, lowering the ratio to 13.5% for big banks and 11.5% for small-to medium-sized lenders. The central bank pumped out 3.35 trillion yuan in net liquidity through the five reserve cuts.

The global economy is slowing more quickly than expected as trade barriers and falling confidence among consumers and businesses hurt growth, the Organisation for Economic Co-operation and Development (OECD) has warned. In new forecasts, the OECD sliced expected growth for this year by 0.2 percentage points to 3.3%. Saying there were a series of risks materialising, it warned the global economy had slowed to a two-year low in late 2018, which was continuing into the new year. The downgrades are all from the OECD's last forecasts that were issued in November. The OECD said the long period of very low interest rates since the Global Financial Crisis meant financial vulnerabilities across the global economy were growing. *"One risk is that a sharper-than-expected slowdown in global growth will substantially enhance the challenges of servicing elevated debt burdens, even if interest rates remain lower for longer than previously expected,"* it said.

<u>Interest Rates & Currency</u>

The US Federal Reserve in May held interest rates steady and signaled little appetite to adjust them any time soon, taking heart in continued job gains and economic growth and the likelihood that weak inflation will edge higher. The chief concern flagged in the policy statement was the currently "muted" level of inflation, which continues to fall short of the Fed's 2% target. The statement suggested a recent decline in inflation may be more persistent than expected, and was no longer to be blamed simply on falling energy prices. The most recent data showed a measure of underlying inflation running at 1.6%.

The Federal Reserve may need to buy more government bonds than it did before the 2008 financial crisis and conduct other money-market operations to implement its current approach to managing US interest rates, a top central bank official said. After the global financial crisis, the Fed bulked up its holdings by buying Treasuries using bank reserves it created. In March, Fed officials decided to stop letting those reserves and its bond holdings decline. To keep control of rates, officials will eventually have to start buying bonds again and building up bank reserves. This is likely to keep interest rates lower.

Bank of England (BoE) Governor Mark Carney said investors were underestimating how much interest rates could rise, even as the British central bank kept borrowing costs on hold due to Brexit uncertainty. Sounding more hawkish than the US Federal Reserve and the European Central Bank, Carney warned investors they were being too relaxed about BoE plans to carry on easing Britain off its financial-crisis levels of near-zero borrowing costs. *"There are insufficient hikes in the current market curve to be consistent with our remit,"* he told reporters, referring to interest rate expectations embedded in financial market prices.

The BoE raised its forecast for growth in the world's fifth-largest economy to 1.5%, up from the decade-low 1.2% it predicted in February, thanks largely to better prospects for the global economy. During the first quarter of 2019 the British economy probably grew by a relatively strong 0.5% due to businesses building up stocks ahead of Brexit. But growth was likely to slow to 0.2% in the current quarter. The new Brexit deadline of Oct. 31, seven months later than originally planned, has removed the immediate risk of a no-deal exit from the EU which hung over the BoE at its last meeting in March, but extends a period of economic uncertainty.

The RBA's May meeting held the cash rate at 1.50%, against consensus for a 0.25% reduction with market pricing in a 50% chance of a rate cut. The RBA's concluding policy outlook shifted further in the dovish direction, saying *"there was still spare capacity in the economy and that a further improvement in the labour market was likely to be needed for inflation to be consistent with the target"* and they *"will be paying close attention to developments in the labour market at its upcoming meetings".* UBS's view is *"We expect a 25bp cut in both July & August to 1.00%, but if the labour market remains surprisingly resilient, the risk is now a later move."*

The RBA cash rate is expected to be reduced in the coming months. Our preference remains for investment grade corporate bonds, and to incorporate government bonds in portfolios for duration exposure.

Closing Rates as at 30 April 2019					
	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	1.50%	1.50%	US Fed Funds Rate	2.44%	2.41%
90 Day Bank Bills	1.56%	1.77%	AUD/USD	70.39	71.21
180 Day Bank Bills	1.62%	1.83%	US 10 Year T-Bond	2.51%	2.44%
5 Year Govt Bonds	1.389%	1.479%	US 30 Year T-Bond	2.94%	2.84%
10 Year Govt Bonds	1.799%	1.809%	Japan 10 year yield	-0.035%	-0.077%

Stance: **Corporate - Positive but selective**
Government - Neutral

Australian Shares

According to Crestone, *"Bond-sensitive names (e.g. Transurban, Sydney Airports, Macquarie Atlas, Telstra, AGL) have all benefited greatly from bond yields falling to their lowest levels ever. A dovish Fed and expectations that the RBA may cut interest rates have fueled a strong rally in yield stocks, with Transurban trading at record highs and Telstra trading at its highest levels since August. The significant moves in bond proxies has left certain stocks very vulnerable to a normalisation of bond yields. Over the course of the month, the Australian public will shift its attention to the federal election, to be held on 18 May. A potential change in government will likely have ramifications for consumer spending and housing. Additionally, the prospect of a re-invigorated union movement could have widespread cost implications for sectors such as retailing and construction."*

The franked dividend yield above the term deposit rate continues to provide support for equity valuations. With the low and potentially falling 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 30 April 2019					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	6,418.4	6,261.7	AOX Earnings Yield	6.25%	6.41%
PE Industrials (2019)*	17.7x	16.8x	Div Yld Indust (2019)*	4.6%	4.8%
PE All Ords (2019)*	16.0x	15.6x	Div Yield All Ords (2019)*	5.2%	5.2%

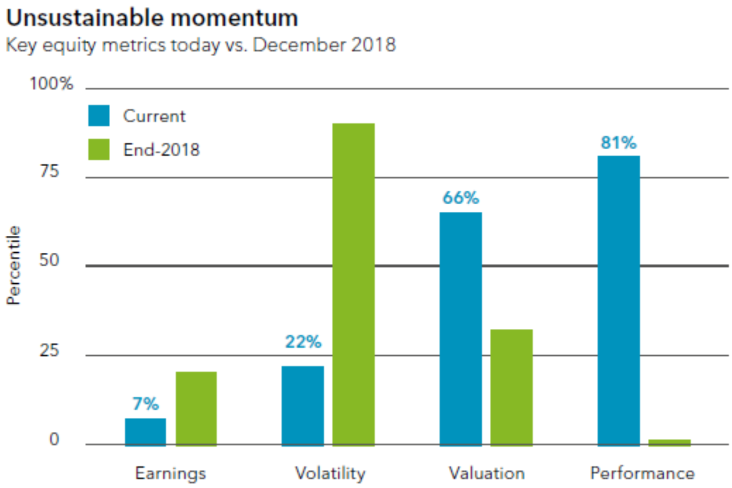
*Source – UBS

Stance: Neutral. To review direct banking share exposure.

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

International Shares

BlackRock's view is *"Equity markets face crosscurrents entering the second quarter. An ongoing global economic expansion and supportive monetary policy are positives. Yet equity fundamentals and valuations face bigger hurdles than at the start of 2019. Global stock valuations opened the year at very attractive levels after 2018 delivered the third-worst year of multiple contraction in three decades. A strong first-quarter rerating suggests there may be limited scope for further multiple expansion in the near term. What about earnings? Downgrades are outnumbering upgrades. This is reflected in the MSCI ACWI's three-month earnings revision ratio hitting its lowest level in three years. Earnings comparisons overall look tougher this year after a strong 2018, and weaker trade activity could challenge global companies. We could see pressure on historically high corporate profit margins. We see the combination of weaker earnings revisions, higher prices and low volatility, shown in the Unsustainable momentum chart, as unlikely to hold. Ten years after the start of the equity bull market, investors are taking risk chips off the table amid growth, policy and earnings uncertainty. These risks are real —yet we retain our preference for equities. The nuance: Investors might consider rebalancing, locking in profits in some of the strongest performers year-to-date."*



The figures shown relate to past performance and are not a reliable indicator of current or future results. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from Thomson Reuters, MSCI and CBOE, March 2019. Notes: The bars show the percentile rank of each measure from 2009. "Earnings" reflect the earnings revision ratio, the three-month average of the number of earnings upgrades over downgrades. "Valuation" represents the 12-month forward price-to-earnings ratio. "Performance" is the three-month trailing change in the MSCI ACWI. "Volatility" is measured by the VIX index. Index returns do not reflect any management fees, transaction costs or expenses.

There is risk of a greater pullback, if the trade war further escalates, earnings growth disappoint or if inflation unexpectedly rises.

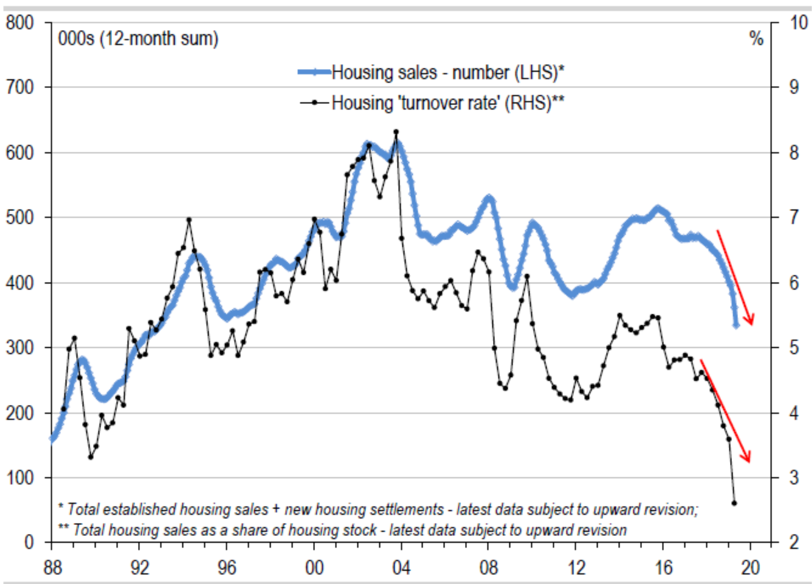
Closing Rates as at 30 April 2019					
	Level	Level (Prev) [1]		Rate	Rate (Prev)
US Dow Jones	26,592.91	25,928.68	Nikkei Dow	22,258.73	21,509.03
S&P 500	2,945.83	2,834.40	Hang Seng	29,892.81	29,541.87
FTSE 100	7,418.22	7,729.19	MSCI	2,178.7	2,107.7

Stance: Neutral

Property

In Sydney, house values dropped 0.8% in April to be down by 11.8% over the past 12 months while in Melbourne they fell by 0.7% last month to be down 12.6% over the past year. Since their peak in September 2017, Sydney dwelling values (both houses and units) have fallen by 14.5%. Melbourne property values have fallen by 10.9% since their peak. The number of home sales have now fallen by 20% over the past year to its lowest level since early 1996. The rate of property turnover had fallen to less than 3%, a development that was a bad sign for renovations and consumption.

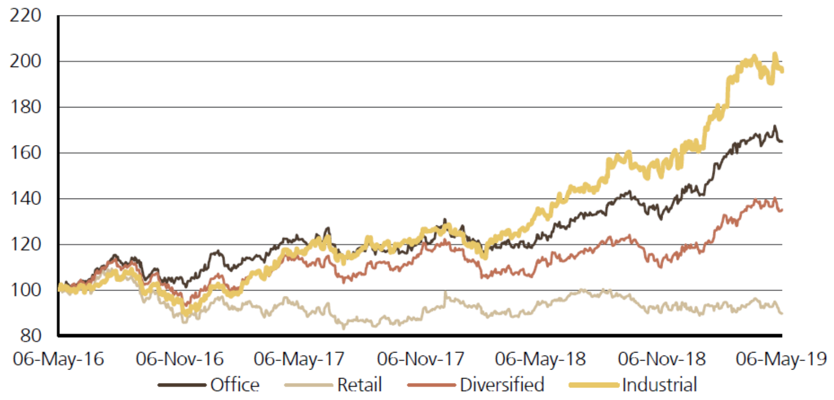
Figure 11: The number of housing sales collapsed by ~20% y/y, to around the lowest level in ~23 years



Source: CoreLogic, RBA, UBS

According to UBS, *"The market is implying cap rate expansion of c100-150bp in the large shopping centres or c.15-20% asset price declines. In office, c.20-40bp cap rate compression is anticipated and the expectations for residential is that activity stabilises post the Federal election and rate cuts."*

REIT total return by sector



Source: FactSet

The REIT sector may benefit from the expectation that interest rates may fall. Earnings per share growth will be key in determining whether distributions can grow.

Closing Rates as at 30 April 2019		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,526.9	1,567.0

Stance:

Commercial/Listed: **Neutral, positive long WALE REITs, negative retail REITS & property index, which has 34% in retail REITS**

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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