Economic Overview

2019 has been unpredictable for investors, with weaker economic growth and ongoing geopolitical tensions resulting in heightened volatility for investment markets. Looking ahead to 2020, the themes of weaker economic growth and geopolitical tensions are expected to continue. Trade friction and broader economic and policy uncertainty is expected to reduce economic growth and continue to generate volatility in markets.

US consumer confidence fell for a fourth straight month in November amid worries about current business conditions and employment prospects, but remained at levels sufficient to support a steady pace of consumer spending. The Conference Board said its consumer confidence index slipped to a reading of 125.5 in November from an upwardly revised 126.1 in October. The index was previously reported at 125.9 in September.

US home prices increased modestly in September from a year ago, as roughly seven years of rising home values have hurt affordability. The S&P CoreLogic Case-Shiller 20-city home price index rose 2.1% in September from a year ago, up from a 2% annual gain in August. Prices have steadily outpaced wage growth for several years and the market is now constrained by buyers’ capacity to pay.

The US manufacturing purchasing managers index from the Institute for Supply Management (ISM) came in at 48.1 in November, compared with a 48.3 reading in October. This is the fourth straight month of slowdown.

Activity in the US service sector, which makes up lion's share of the world's largest economy, slowed unexpectedly in November. The soft reading in the ISM index followed a surprise drop in private sector hiring in November, as well as further slowing in the ISM manufacturing index, underscoring the weakening US economy. The dominant service sector remains in far better health than the trade-war-battered manufacturing sector, which has been in contraction for four straight months. ISM said its non-manufacturing index slid 0.8 point to 53.9, which was below forecasts and lower than the average for the prior 12 months.

The European Commission cut its growth forecast for the 19 countries that share the euro from 1.2% to 1.1% for 2019, and from 1.4% to 1.2% in 2020 and 2021. The Commission forecast the euro zone’s aggregate budget deficit would rise from an historic low of 0.5% of GDP in 2018 to 0.8% this year, 0.9% in 2020 and 1.0% in 2021, unless policies change.

Japan’s exports fell 9.2% in October from the year before, the biggest drop in three years as the US-China trade war and tensions with South Korea bit into demand. The tariff war between the US and China has taken a toll across Asia, hurting manufacturers and supply chains. Exports to the US dipped 11% from a year earlier in the third straight month of declines, with weaker shipments of cars, auto parts and machinery. Imports from the US fell 17% year-on-year. Shipments to China, Japan’s biggest export market, dropped 10%. Twoway trade with South Korea in October sank 41%, with both exports and imports falling as relations between the neighbours and US allies languish at their worst level in decades amid antagonisms over longstanding historical issues and disputes over high-tech exports.

The purchasing managers' index for China's manufacturing sector firmed up to 50.2 in November from 49.3 in October. A reading above 50 indicates expansion, while a reading below reflects contraction. November's figure re-entered the expansion zone, ending month-on-month contraction reported in the previous six months in a row.

The global economy is growing at the slowest pace since the financial crisis as governments leave it to central banks to revive investment, the OECD said in an update of its forecasts. The world economy is projected to grow by a decade-low 2.9% this year and next, the OECD said in its Economic Outlook, trimming its 2020 forecast from an estimate of 3.0% in September. A concern is that governments are failing to get to grips with global challenges such as climate change, the digitalisation of their economies and the crumbling of the multilateral order that emerged after the fall of Communism. It would be a policy mistake to consider these shifts as temporary factors that can be addressed with monetary or fiscal policy; they are structural, OECD said.

Interest Rates & Currency

Monetary policy is "well positioned" to support the strong labour market, which is just now starting to benefit workers on the margins, Federal Reserve Chair Jerome Powell said. Powell said he has heard stories of employers and schools collaborating to train and hire people with various levels of education and workers with disabilities. *"The benefits of the long expansion are only now reaching many communities, and there is plenty of room to build on the impressive gains achieved so far,"* Powell said.

Powell said adjustments to employment data suggested the labour market may not have been as strong last year as previously thought, a shift that supported the case for lower rates. In September, the Bureau of Labor Statistics revised down its estimates for job creation. The agency said the economy added 170,000 jobs a month in the 12 months through March 2019, half a million fewer jobs than previously estimated. *"While this news did not dramatically alter our outlook, it pointed to an economy with somewhat less momentum than we had thought,"* Powell said.

Federal Reserve officials were more upbeat about the economy in late October than they had been only six weeks earlier, according to minutes of their policy discussion released in November. Officials *"generally viewed the economic outlook as positive,"* the minutes said. *"Uncertainties associated with trade tensions as well as geopolitical risks had eased somewhat, although they remained elevated,"* the summary said. Officials talked about a "resilient" economy in the face of headwinds. At their October meeting, the Fed voted 8 to 2 to trim rates by a quarter-point. It was the third straight meeting with a cut, bringing the benchmark fed funds rate to a range of 1.5%-1.75%. As expected, there was widespread support among Fed officials for moving to the sidelines to give officials time to assess the impact of the easing.

The RBA's December meeting held the cash rate at 0.75%, as widely expected (after last cutting 25bps in October). Crucially, they retained an explicit easing bias, and concluded *"The Board is prepared to ease monetary policy further if needed to support sustainable growth in the economy, full employment and the achievement of the inflation target over time".* UBS comments are *"UBS remain more dovish than consensus, still seeing a 25bp rate cut at the RBA's next board meeting in Feb-20 as likely, & then another 25bps cut to 0.25% by mid-20; albeit the latter remains conditional on more global central bank easing & no material fiscal stimulus in the government's Mid-Year Economic and Fiscal Outlook (MYEFO)."*

The RBA cash rate is expected to be reduced further 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 November 2019					
	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	0.75%	0.75%	US Fed Funds Rate	1.55%	1.82%
90 Day Bank Bills	0.885%	0.93%	AUD/USD	67.77	69.26
180 Day Bank Bills	0.88%	0.96%	US 10 Year T-Bond	1.81%	1.78%
5 Year Govt Bonds	0.738%	0.846%	US 30 Year T-Bond	2.24%	2.26%
10 Year Govt Bonds	1.097%	1.138%	Japan 10 year yield	-0.045%	-0.138%

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

Australian Shares

According to JPMorgan, *"The rising prices on the ASX 200 and decline in earnings expectations in the coming year means that the forward price-to-earnings ratio is now over 17x. Valuations on equities have not been this high since 2002."*

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

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

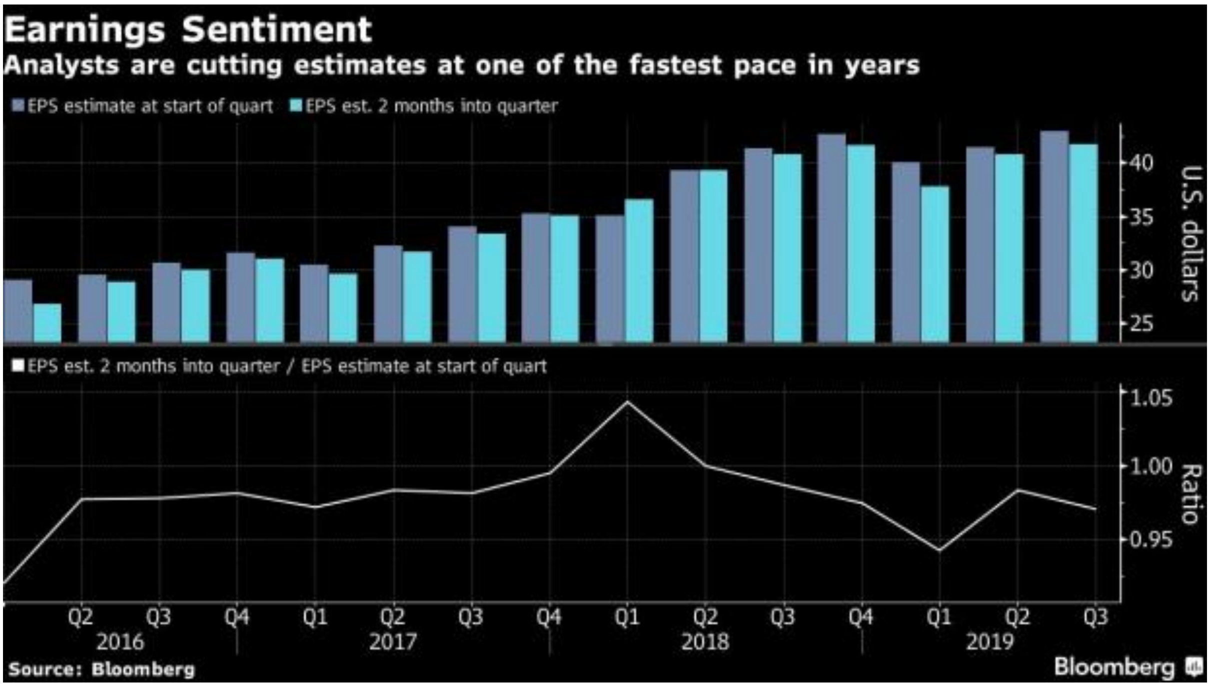
Closing Rates as at 30 November 2019					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	6,948.0	6,772.9	AOX Earnings Yield	5.78%	5.99%
PE Industrials (2020)*	20.2x	19.4x	Div Yld Indust (2020)*	4.0%	4.1%
PE All Ords (2020)*	17.3x	16.7x	Div Yield All Ords (2020)*	4.3%	4.4%

*Source – UBS

Stance: Neutral. To review direct banking share exposure.

International Shares

Wall Street analysts are slashing projections for fourth-quarter earnings at a quick pace, making it more likely that a profit recession will hit corporate America for the first time in almost four years. Two months into the quarter, analysts have shaved 4% off their estimates to US$41.12 a share, a drop of almost 1% compared with a year ago after a 1.3% decline last quarter. While they almost always lower expectations as a period progresses, the current pace has been exceeded only twice since 2015.



A US-China trade deal could boost the US equity market further. The possibility of a recession is a threat to the outlook for international equities.

Closing Rates as at 30 November 2019					
	Level	Level (Prev) [1]		Rate	Rate (Prev)
US Dow Jones	28,051.41	27,046.23	Nikkei Dow	23,293.91	22,927.04
S&P 500	3,140.98	3,037.56	Hang Seng	26,346.49	26,844.25
FTSE 100	7,346.50	7,257.70	MSCI	2,292.26	2,233.53

Stance: Neutral and to reduce exposure if overweight

Property

The Sydney and Melbourne property markets have driven the biggest monthly lift in national house prices in 16 years as falling interest rates and a shortage of supply combine to drive up values. CoreLogic's monthly measure of values showed dwelling values across the nation's capitals jumped by 1.7% in November, the biggest monthly lift since 2003. The increase was driven by the nation's two largest property markets.

House values in Sydney alone increased by 3.1%, taking the median house value to $956,249. It was the largest monthly increase in Sydney house values since 1988. Melbourne was not far behind with house values there jumping by 2.4% per cent, taking the median value to $774,023. It was the biggest monthly lift in Melbourne house values since May 2015.

Moody's latest view on the Australian REIT market is that low debt levels and ongoing cuts to interest rates mean the securities are likely to be able to weather any potential downturn better than previously. The analysis shows that net debt among REITs had increased over the past 12 months and was expected to increase over the coming year. While lower interest rates were leading to falling yields as property values increase, they were also resulting in lower borrowing costs, which meant companies were better able to service their debt and survive declining values in their portfolio more easily. The average interest coverage, measured by EBITDA against interest expense, is now 4.7 times, up from 4.4 times a year ago. Average cost of debt for REITs has fallen considerably over the last seven years. However, high levels of interest rate hedging mean the improvement in interest cover is slow. Moody's expects interest rate coverage to improve to around 4.9 times over the next 12 months.

The REIT sector has benefitted from a falling interest rate environment.

Closing Rates as at 30 November 2019		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,667.4	1,629.9

Stance:

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

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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