newell palmer

Trusted since 1983

May 2016

Market Overview and Outlook

Economic Overview

The emerging view is that the world has relied on monetary policy for too long and governments will have to embark on fiscal stimulus to boost their economies. Some central banks have pushed interest rates into negative territory, and it is now debatable whether further reducing already negative interest rates would further stimulate the economy. Low and negative interest rates are harming savers and reducing their capacity to spend, and this is contractionary for the economy. The next step in policy would have to target spenders, rather than investors and savers, through measures that may include sending money to people directly or other fiscal measures.

JPMorgan's Global Manufacturing Purchasing Managers' Index, produced with Markit, came in at 50.1 in April, only just above the 50 level that separates growth from contraction. It was 50.6 in March. The global PMI combines survey data from countries including the United States, Japan, Germany, France, Britain, China and Russia. The latest PMI data indicate global manufacturing output is growing at an anaemic pace, similar to the past year.

US housing starts fell more than expected in March and permits for future home construction hit a one-year low, suggesting some cooling in the housing market in line with signs of a sharp slowdown in economic growth in the first quarter. Ground breaking decreased 8.8% to a seasonally adjusted annual pace of 1.09 million units, the lowest level since October. The US economy grew at its weakest quarterly pace in two years between the months of January and March, as consumers and businesses alike showed new caution with their spending. The nation's GDP expanded just 0.5% on an annualised pace. Businesses cut back on investments with a severity not seen since the financial crisis.

Eurozone growth will be slower than previously expected with subdued inflation this year, the European Commission said. The GDP of the 19-country currency area is predicted to expand 1.6% this year, less than the 1.7% growth of 2015 and also 0.1 percentage points below its February forecast. Next year the GDP is projected to expand 1.8%, down from a 1.9% estimate three months ago. Consumer prices are also expected to increase by less than previously estimated. They are now seen up 0.2% this year, significantly below the 0.5% increase forecast in February by the Commission.

Japan's consumer prices fell in March at the fastest pace in three years and household spending declined at the fastest pace in a year, keeping the Bank of Japan under pressure to implement more stimulus to support the economy. The core CPI, which includes oil products but excludes volatile fresh food prices, fell 0.3% in March from a year earlier. That marked the fastest decline since April 2013 due to lower prices for gasoline and slowing gains in prices for durable goods and overseas travel. Household spending in March fell 5.3% from a year earlier due to lower spending on clothes, leisure activities and gasoline.

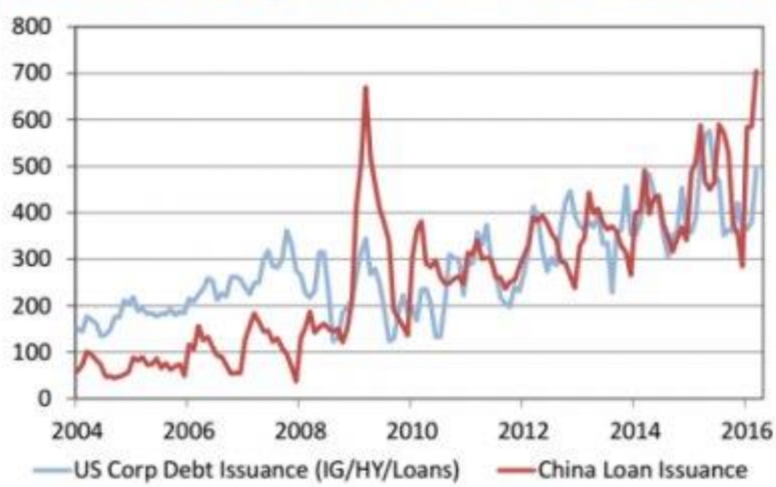
Market Overview and Outlook

Japanese manufacturing activity contracted in April at the fastest pace in more than three years and output fell the most in two years, after earthquakes halted production in the southern manufacturing hub of Kumamoto. The Markit/Nikkei Japan Manufacturing Purchasing Managers Index fell to a seasonally adjusted 48.2 in April.

Activity in China's manufacturing sector expanded for the second month in a row in April but only marginally, raising doubts about the sustainability of a recent pick-up in the world's second-largest economy. The official Purchasing Managers' Index rose to a less-than-expected 50.1 in April, easing from March's reading of 50.2. Lending in the country has exploded: Chinese banks have extended more loans in the last three months than the entire US corporate-financing market ever has on a rolling 3 month basis (see chart below). The government has stepped up spending too, with the fiscal spending-to-GDP ratio increasing 2% since March 2015. The risk is that the stimulus could wear off quickly. This current boost in growth has been a government-led recovery in investment growth, especially infrastructure and property. It does not solve the structural problems of high debt and excess capacity, as this boost actually increases capacity when the opposite needs to happen.

Figure 2: Bank lending in China, trailing 3mo cumulative, US$bn

Relative to US gross IG+HY+loan issuance



Source: Deutsche Bank

Market Overview and Outlook

The IMF expects the global economy to expand 3.2% this year, up from 3.1% in 2015 but below its 3.4% estimate in January. It anticipates 3.5% growth in 2017, down from its 3.6% projection in January. The IMF, which has pared its forecasts for several straight quarters, made similar cuts to its US forecast, estimating the nation's economy will grow 2.4% this year and 2.5% in 2017. The fund largely attributed the weaker outlook to China's slowdown, the effect of falling oil and other commodity prices on emerging markets, and weak productivity growth and aging labour forces in advanced economies such as the US. Advanced economies are projected to grow about 2% in both 2016 and 2017, down slightly from the fund's estimate in January.

Interest Rates & Currency

The Federal Reserve left interest rates unchanged in April, but kept the door open to a hike in June while showing little sign it was in a hurry to tighten monetary policy amid an apparent slowdown in the US economy. In a statement that largely mirrored the one issued after its last policy meeting in March, the US central bank's rate-setting committee described an improving labour market but acknowledged that economic growth seemed to have slowed. It also said it was closely watching inflation and noted that global economic headwinds remained on its radar, though it made no mention of the risks they posed, as it had the previous month.

Bank of England policymakers voted unanimously in April to keep interest rates on hold amid concerns about whether Britain will leave the European Union. The June 23 referendum has added uncertainty to an already weakening economic outlook, prompting some economists to downgrade their growth forecasts.

The Bank of Japan (BOJ) held off on expanding monetary stimulus, as Governor Kuroda and his colleagues opted to take more time to assess the impact of negative interest rates. The move comes as a surprise to the slight majority of economists who had projected some action from the central bank in response to a strengthening in the yen. The central bank left unchanged three key easing tools -- the 80 trillion yen (US$732 billion) target for expanding the monetary base, mostly through government-bond purchases, the 0.1% negative rate on a portion of the cash banks park at the BOJ, and a program to buy riskier assets including stocks.

The RBA at its May Board meeting reduced the cash rate to 1.75%. UBS' view is *"Given the RBA failed to meet its own repeated criteria for "easier policy", i.e., if 'demand needed support' (not evident with GDP rising to 3% & unemployment falling to 5.7%), the cut likely reflects their concern recent lower than expected sub-target inflation is likely to persist for longer than desired. Given our view that structural disinflationary forces have likely.*

intensified in Australia, and the RBA's concern about the risk of persistent low inflation, we now look for a follow-up 25bp cut to 1.5% in August, post Q2 CPI. Thereafter, we expect the cash rate to remain unchanged until at least end-2017."

Another reduction in the RBA cash rate is expected in the coming months. Our preference remains for both short dated fixed-rate and floating-rate securities of high investment grade corporates.

Closing Rates as at 30 April 2016

	Rate	Rate (Prev)[1]		Rate	Rate (Prev)
Cash	2.00%	2.00%	US Fed Funds Rate	0.3700%	0.2500%
90 Day Bank Bills	2.17%	2.30%	AUD/USD	76.55	76.51
180 Day Bank Bills	2.10%	2.23%	US 10 Year T-Bond	1.82%	1.76%
5 Year Govt Bonds	2.083%	2.083%	US 30 Year T-Bond	2.67%	2.59%
10 Year Govt Bonds	2.524%	2.474%	Japan 10 year yield	-0.108%	-0.076%

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

<u>**Australian Shares**</u>

UBS' comment is, *"Overall the market is still moderately cheap in our view despite an above average headline P/E (price to book looks particularly cheap). The prospect of a return to positive EPS growth in FY17 should ultimately support the market. Domestic economic conditions still appear benign, which should support the key bank sector. A significant retracement in the iron ore price would present a headwind for the market – however this would likely be offset to some extent by a renewed weakening in the A$. We retain our c5500 ASX200 year-end target."*

The franked dividend yield above the term deposit rate continues to provide support for equity valuations. With the falling cash rate rate, 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.

Market Overview and Outlook

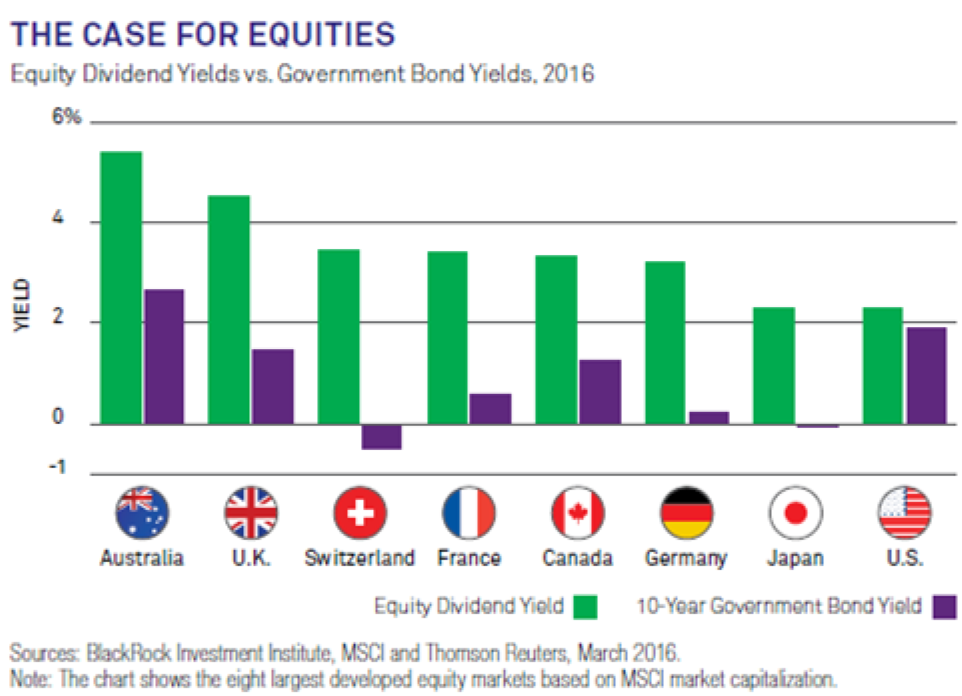
Closing Rates as at 30 April 2016					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
All Ordinaries	5,316.0	5,151.8	AOX Earnings Yield	5.56%	5.75%
PE Industrials (2016)*	15.4x	14.9x	Div Yld Indust (2016)*	5.0%	5.1%
PE All Ords (2016)*	18.0x	17.4x	Div Yield All Ords (2015)*	4.3%	4.5%

*Source – UBS

Stance: Neutral

International Shares

Blackrock's view is *"Equities look attractive versus government debt, offering dividend yields above the yield on 10-year government bonds in all major markets. The gap is widest in negative-rate countries such as Japan and Switzerland. The U.S. is the only major region where bond yields rival equity dividends."*



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

Market Overview and Outlook

We expect geopolitical events occasionally giving rise to market volatility. Take advantage of market volatility and the elevated AUD to purchase international shares, but to be aware of the rising risks of a price earning ratio (PE) contraction in the US market.

Closing Rates as at 30 April 2016					
	Level	Level (Prev)[1]		Rate	Rate (Prev)
US Dow Jones	17,773.64	17,685.09	Nikkei Dow	16,666.05	16,758.67
S&P 500	2,065.30	2,059.74	Hang Seng	21,067.05	20,776.70
FTSE 100	6,241.89	6,174.9	MSCI	1,670.8	1,648.1

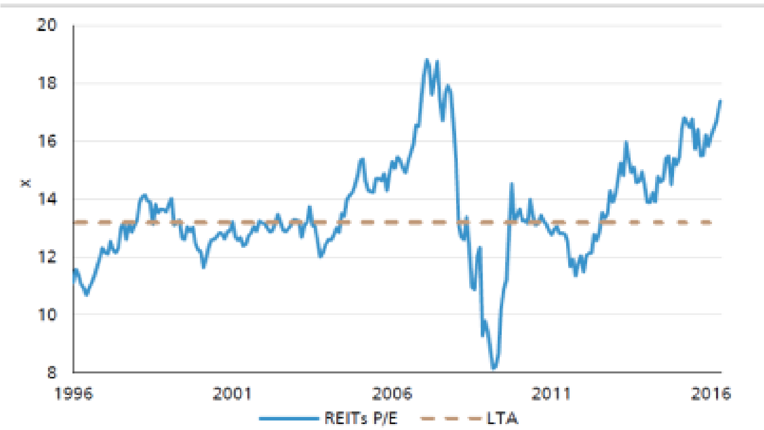
Stance: Neutral with positive bias

Property

The CoreLogic RP Data Home Value Index rose 1.7% in April from the previous month. In April, prices rose 2.4% in Sydney, 1.1% for Melbourne. Brisbane and Adelaide also showed growth of 2% or more for the month. Even Perth, which has been hit by the end of the mining boom, rose 0.5%. Recent housing data shows investors are starting to return to the market. The cut in the cash rate by the RBA is expected to boost housing prices.

According to UBS, *"The REIT sector remains a key beneficiary of low interest rates and the global search for defensive yield. Therein also lies its key vulnerability if global interest rate expectations shift. We expect the Fed to raise rates twice in the second half of this year which if correct should put a degree of upward pressure on bond yields. REITs have rarely been more expensive versus the broader market as shown below but a backdrop of ongoing very low interest rates is the obvious support for the sector with the search for yield seemingly continuing for now despite some rotation back to cyclicals in recent months."*

Figure 25: Forward P/E of REITs

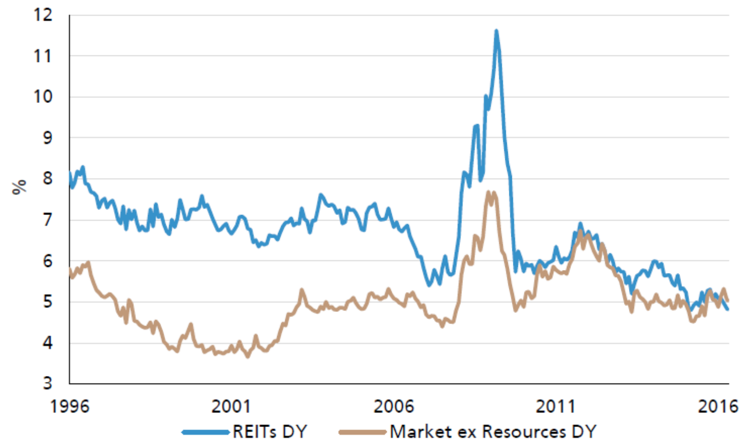


The REIT sector PE is high in an absolute sense.

Source: Factset

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

Figure 27: Forward Dividend Yield of REITs versus the Market ex Resources



Source: Factset, Datastream

Dividend yields have converged

The yield advantage in owning the REIT sector is narrowing as long term bond yields increase. Earnings per share growth will be key in determining whether distributions can grow.

Closing Rates as at 30 April 2016		
	Level	Level (Prev)[1]
S&P/ASX 200 A-REIT	1,400.2	1,362.0

Stance:

Commercial/Listed:	**Neutral and Trim if overweight**
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***

ABN 89 050 040 232
Australian Financial Services Licence No. 229264
Principal Member Financial Planning Association of Australia
Member Financial Ombudsman Service Limited