WEEKLY UPDATE

4th FEBRUARY 2019

	Price	5 Day % Change	3 Month % Change	1yr % Change
S&P/ASX300	60,113	-0.03%	0.95%	-0.32%
MSCI World Ex-Aus. (Unhedged)	9,015	-0.37%	-1.34%	3.80%
MSCI World Ex-Aus. (Hedged)	1,622	1.06%	-1.17%	-3.02%
Bloomberg AusBond 0+ Composite	9,625	0.07%	2.70%	5.58%
BloombergBarclays Global Agg. (Hedged)	997	0.48%	2.85%	3.48%
S&P/ASX300 Property	51,204	1.17%	9.53%	13.52%
FTSE/Epra NAREIT (Hedged)	2,694	2.43%	7.20%	9.53%
S&P Global Infrastructure (Hedged)	4,898	1.24%	5.71%	1.61%
BarclayHedge Global Hedge Fund Index (USD)	5,403	N/A	-6.25%	-5.15%
AUDUSD	0.7250	0.99%	0.61%	-9.81%
AUDEUR	0.6326	0.51%	0.16%	-1.60%
AUDNZD	1.0510	0.13%	-3.04%	-3.39%
AUDGBP	0.5542	1.82%	0.05%	-1.71%
AUDJPY	79.3840	0.92%	-2.31%	-10.80%

Source: Bloomberg, S&P Dow jones, MSCI, FTSE/EPRA, Barclays, 2nd February 2019

Attention this week will focus on the Hayne Royal Commission report, due to be released this evening, and the return of the RBA from the summer break. Tomorrow's meeting will be followed by Governor Lowe's address to the National Press Club in Sydney on Wednesday and the quarterly Statement on Monetary Policy on Friday.

As usual, we also provide an update on some of the key data from last week including CoreLogic house prices.

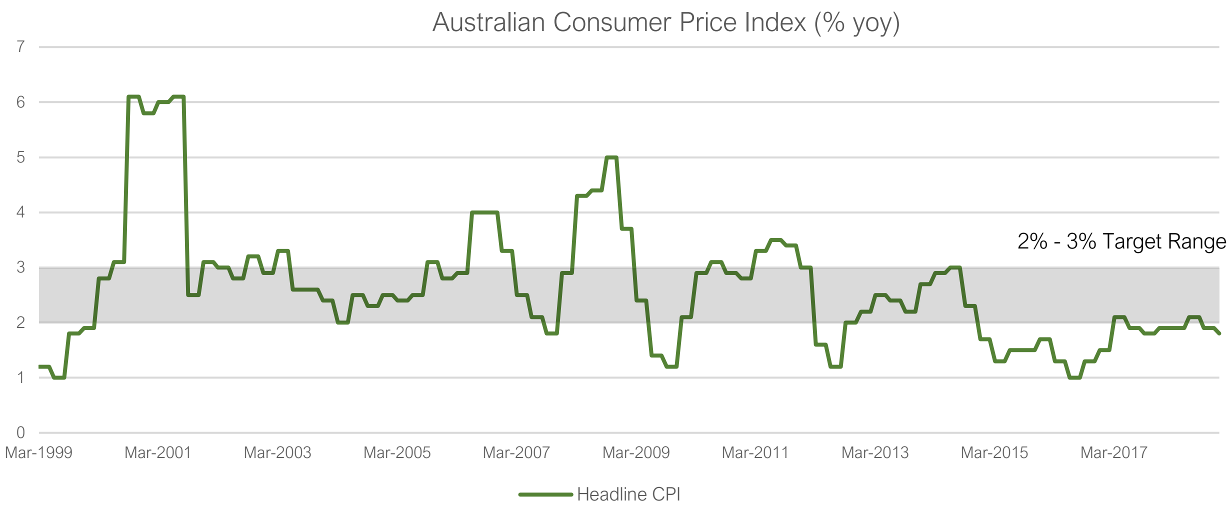
This week we also discuss some of the current stock index and sector valuations and highlight the rebound in oil and iron ore prices.

Last Thursday's Australian inflation numbers surprised the market by coming in a little stronger than expected. The 2018 fourth quarter headline figure was 1.8%, rather than the forecast figure of 1.7%. 1.8% is still below the RBA's target range of 2%-3%. So, although the number may appear to ease some of the pressure on the Board before this Tuesday's meeting, it is important that the trend over the last two quarters was downwards, and inflation has generally been in below the target range since 2014.

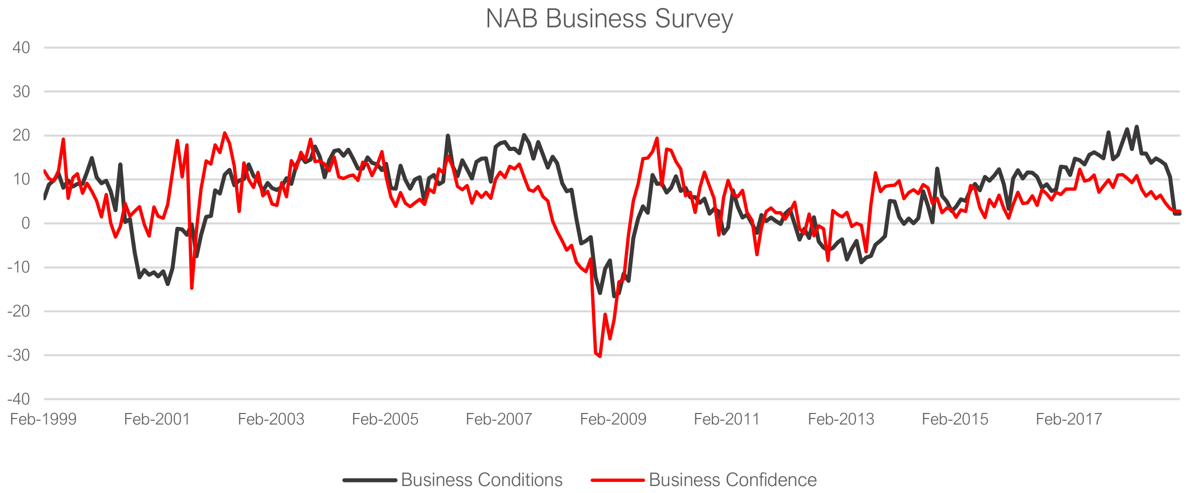
Earlier in the week, the NAB Business survey indicated a rapid and very concerning deterioration in business conditions. Thursday's private sector credit also showed continued weakness in broad money growth, illustrating that lending is weak across every category, with particular weakness in investor housing loans and consumer credit.

The Australian consumer is obviously experiencing discomfort. The Consumer Discretionary sector has been the worst performing sector in the S&P/ASX300 this financial year, returning -10.9%, closely followed by Financials.

Friday's CoreLogic house price data added to the sense of gloom. Unfortunately, just about every measure in residential property is pointing to more downside price risk for Sydney and Melbourne. National auction clearance rates are very low, and economists are not expecting building approvals to improve this week.



Source: Bloomberg, NAB, 2nd February 2019



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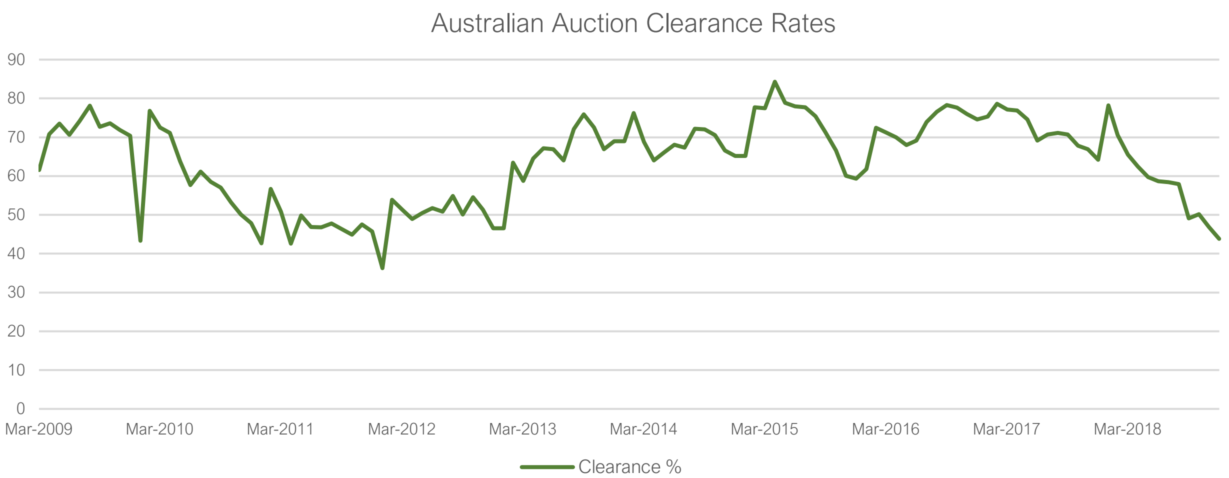


Source: Bloomberg, CoreLogic, 2nd February 2019

Index results as at January 31, 2019

	Change in dwelling values			Total	Median
	Month	Quarter	Annual	return	value
Sydney	-1.3%	-4.5%	-9.7%	-6.5%	$795,509
Melbourne	-1.6%	-4.0%	-8.3%	-5.1%	$636,048
Brisbane	-0.3%	-0.4%	0.0%	4.0%	$494,345
Adelaide	-0.3%	-0.1%	0.9%	5.4%	$430,711
Perth	-1.1%	-2.7%	-5.6%	-1.9%	$441,920
Hobart	-0.2%	1.0%	7.4%	12.9%	$457,785
Darwin	-1.7%	-2.8%	-3.5%	2.3%	$412,940
Canberra	0.2%	0.8%	3.8%	8.5%	$596,933
Combined capitals	-1.2%	-3.3%	-6.9%	-3.5%	$604,173
Combined regional	-0.2%	-0.6%	-0.8%	4.2%	$377,422
National	-1.0%	-2.7%	-5.6%	-1.9%	$528,553

Highlights over the three months to January 2019

- Best performing capital city: **Hobart +1.0%**
- Weakest performing capital city: **Sydney -4.5%**
- Highest rental yield: **Darwin 5.9%**
- Lowest rental yields: **Sydney 3.4%**

Source: CoreLogic, 2nd February 2019

The Hayne Royal Commission report will be published after the close of business on Monday. The market has drawn strong links between the Royal Commission and the tightening in lending. No doubt this is true, but Sydney and Melbourne remain in the top five most expensive cities in the world on a price-to-median-income basis. When prices begin to fall, it is difficult to persuade Chief Risk Officers at the lenders to turn on the taps.

The international context also poses challenges to Australia, since exports are unlikely to lead to a stronger domestic economy. The Chinese PMIs showed further contraction last week, as expected. Italy has dipped into recession, while the Eurozone as a whole saw only 1.2% year-on-year GDP growth.

Continuing the recent trend of comparatively stronger US data, Friday's jobs report showed further significant employment gains despite some large prior revisions and a headline unemployment rate that rose. The positive payrolls report is unaffected by the shutdown or the recent cold spell, while the increase in the unemployment rate is almost entirely attributable to workers affected by the shutdown. Continued gains in the participation rate bode well for the coming months and we will have to take some faith from this, as the next few months' data continue to be distorted.

Given this backdrop, the turnaround by the Federal Reserve this week was astonishing. After raising rates to 2.5% in December, Jerome Powell read an incredibly dovish statement last week, indicating that the Fed will stay on hold for some time until they can get an accurate read on the economy. He joined the ECB and Bank of Japan who had also adopted a dovish stance the week before, also citing geopolitical risks and financial market volatility.

As well as the RBA meeting and Friday's Statement on Monetary Policy, we will be watching Governor Lowe's National Press Club address on Wednesday with a great deal of interest. In the last two weeks, we have repeatedly stated that we cannot rule out a rate cut from the RBA on Tuesday, although that is not our base case scenario. We have not altered our view. Although the inflation data probably reduces the chances of a rate cut, the dovish stance adopted by the G4 currency block has seen the Australian dollar carried higher, effectively tightening Australian financial conditions a little more. Market pricing has not changed materially over the week, with a roughly 40% chance of a cut priced in before year-end.

As growth and inflation expectations have receded, longer-term bond yields have continued to fall, supporting both the local bond index and REITs. In fact, most asset classes have performed well since the Christmas lows. International equities have rebounded at least 10% on both a hedged and unhedged basis, and some 6% since we recommended increasing exposure back up to neutral. Forward PE ratios remain at a 4% discount to the long run average.

Australian equities have not rebounded as far. The S&P/ASX300 is up 7.4% from the lows, including dividends and 4.3% since our call to increase weightings to neutral in early Jan. The 1yr Forward PE now stands at 15.2x, above the long-run average of around 14.5x. What is interesting is that almost every sector is currently trading at or above its long run average, save for Energy, Materials and Financials (ex Real Estate). The Financials sector is trading at 12x forward earnings, hardly surprising given the Royal Commission.

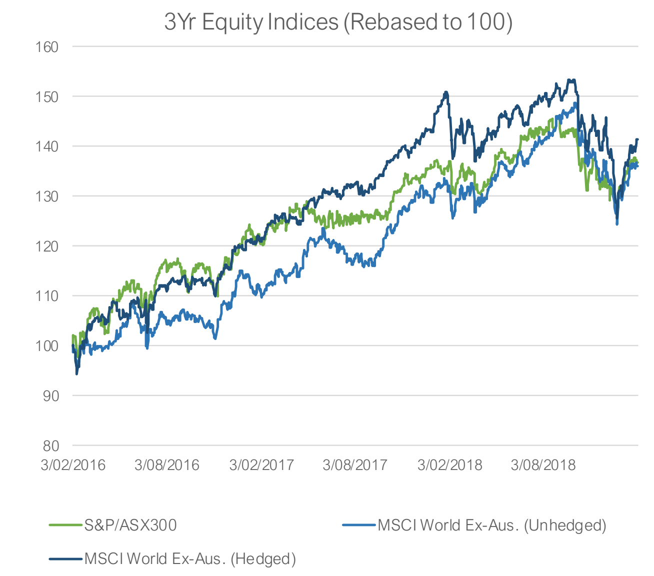
Energy (13.0x) and Materials (13.9x) appear to offer better value, especially given the rebounds in both the oil and the iron ore price (see chart below). Gold now seems in a clear uptrend, supported by the dovishness of central banks. Last week we suggested adding some gold to portfolios and Australian equities are a good candidate to fund the holdings, based on valuations and the slightly higher dollar.

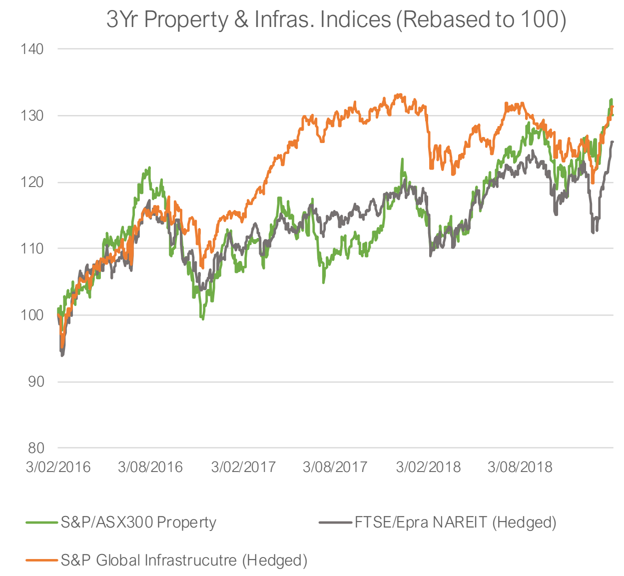
Since early January, Emerging Markets have also rallied 10%, most likely following the more dovish stance from the Federal Reserve in particular. The forward PE for the index is now at 12x, but the long-run average is only 11.4x. There is probably a case for this to drift upwards, as China and other Asian markets mature. But there is not really a strong valuation case to invest.

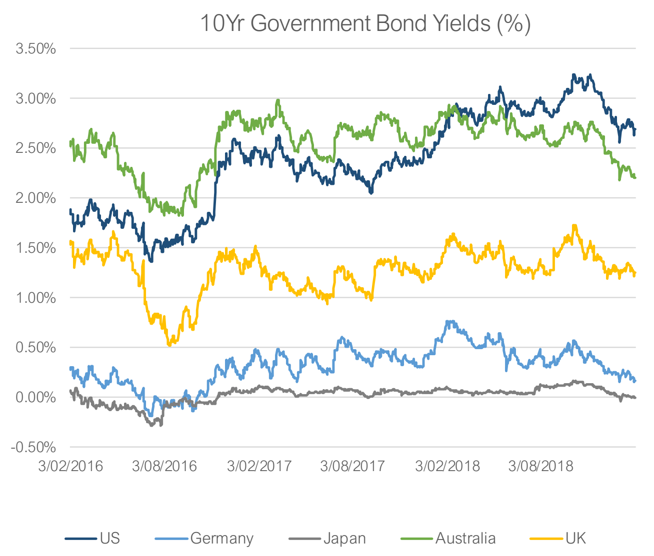
We continue to favour the broader index of international stocks, with a focus on Quality. The MSCI World Quality index trades at a slightly higher level of 17.8x, as you would expect. Currently the Quality index is trading at a slight discount of 17.6x. The broad index is trading at a more attractive discount. But given the slowing growth, and no guarantee that central banks will be able to stave off a recession, we continue to favour the downside protection that more profitable stocks offer.

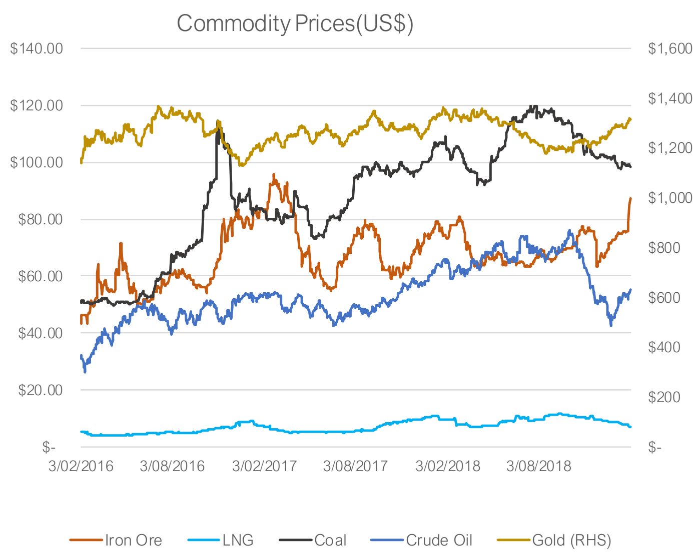
Significant Upcoming Data:

	Monday	Tuesday	Wednesday	Thursday	Friday
Australia	**Building Approvals;** Melbourne Inst. Inflation; ANZ Job Ads; **Hayne RC Report (after close)**	**RBA Cash Rate; Retail Sales; Trade Balance;** AiG and CB Services PMIs	**Governor Lowe at the National Press Club**	NAB Business Conf.; AiG Performance of Construction; Foreign Reserves	**RBA Statement on Monetary Policy**
US	**Durable Goods;** Factory Orders	**MBA Mortgage Apps.**; ISM Non-Manufacturing Survey; Markit US Services PMI	Trade Balance		
Europe	UK Construction PMI; Italian CPI	Major Services & Composite PMIs	German Factory Orders	**Bank of England Meeting; German, Dutch, Spanish, & Norwegian Ind. Prod.; French Trade Balance;** Italian Retail Sales;	**German Trade; French & Italian Ind.Prod.;** Swiss Unemployment; Norwegian GDP
Japan	Monetary Base	Nikkei Services & Comp. PMI			**Balance of Payments**
China					









Source: Bloomberg, S&P Dow jones, MSCI, FTSE/EPRA, 2nd February 2019