	Price	5 Day % Change	3 Month % Change	1yr % Change
S&P/ASX300	63,525	1.84%	8.57%	6.96%
MSCI World Ex-Aus. (Unhedged)	9,490	0.77%	7.43%	8.99%
MSCI World Ex-Aus. (Hedged)	1,679	0.81%	5.25%	1.66%
Bloomberg AusBond 0+ Composite	9,698	0.12%	3.49%	6.50%
BloombergBarclays Global Agg. (Hedged)	1,000	0.12%	2.86%	3.98%
S&P/ASX300 Property	53,144	0.08%	9.36%	20.87%
FTSE/Epra NAREIT (Hedged)	2,731	0.48%	6.16%	14.27%
S&P Global Infrastructure (Hedged)	5,057	1.79%	9.53%	8.42%
BarclayHedge Global Hedge Fund Index (USD)	5,403	N/A	-6.25%	-5.15%
AUDUSD	0.7129	-0.17%	-1.72%	-9.14%
AUDEUR	0.6289	-0.51%	-1.14%	-1.18%
AUDNZD	1.0413	0.19%	-2.25%	-2.62%
AUDGBP	0.5461	-1.45%	-3.15%	-2.96%
AUDJPY	78.8920	0.00%	-3.86%	-6.17%

Source: Bloomberg, S&P Dow jones, MSCI, FTSE/EPRA, Barclays, 24th February 2019

Markets have recovered well since the December lows and all asset classes have delivered positive returns over 3 months and 1 year.

Looking ahead, we expect that there will be positive developments in US-China trade talks in the next week. In anticipation, we recall that economic activity has yet to improve and that central bankers are not actually on an easing path, save perhaps in Australia. Reproducing the strong returns of the last few months looks increasingly difficult as growth asset prices move higher.

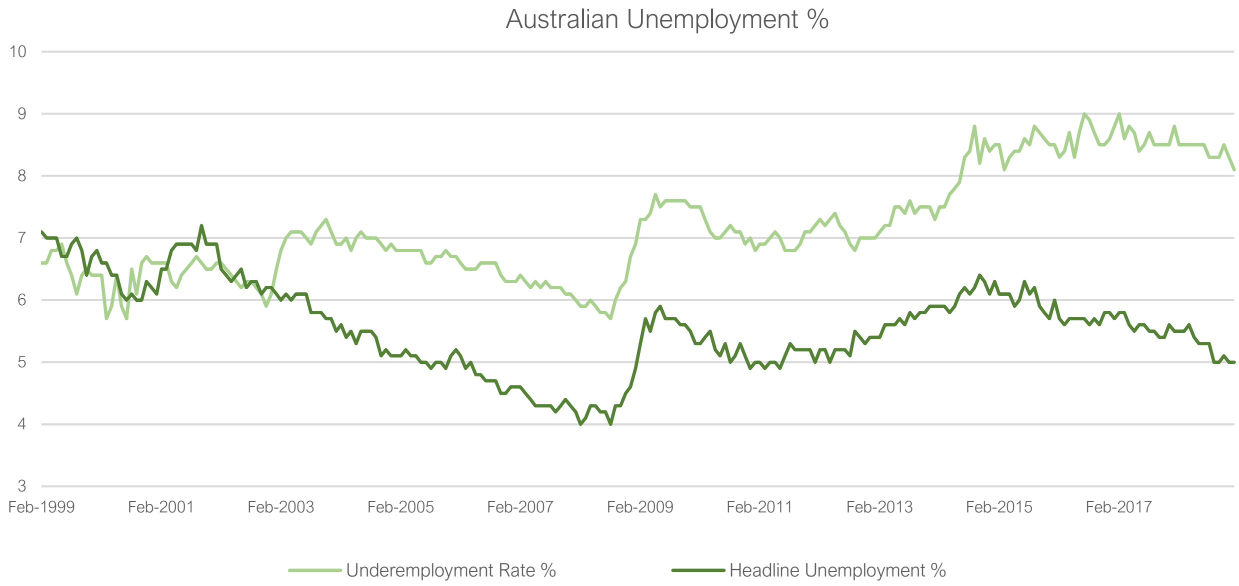
All major asset classes made gains last week and are have delivered positive returns over 3 months and 1 year. Australian property remains the standout performer, driven largely by falling interest rate expectations and yield compression.

Australian 10yr bond government bond yields have fallen below 2.1%, reflecting the sharp fall in inflation expectations and the more balanced outlook for interest rates that the RBA has adopted since the beginning of the year. That outlook was reiterated by Governor Lowe in Canberra last week. The Reserve Bank continues to focus on household spending, which is heavily influenced by the opposing forces of falling house prices in Sydney and Melbourne and gradual improvement in the labour market. From Banks's perspective, both areas saw a slight improvement in last week's data.

Thursday's unemployment rate held firm at 5%, while there was a large increase full-time employment in January. More importantly, we saw the first signs that the broader underemployment figure might begin a declining trend. But there was little to suggest that the RBA is wrong in concluding that the pace of improvement is likely to be very slow (see chart below).

Both Sydney and Melbourne have also seen improvements in auction clearance rates in the last two weeks. But February is usually seasonally strong and the total number of properties up for sale is not indicating renewed strength in the market.

This month's CoreLogic house prices will be released on Friday. On Thursday, private capital expenditure figures may indicate whether firms are investing and creating new jobs, as the RBA maintains. Economists are forecasting only a 1% increase in capital expenditure for Q4 2018.

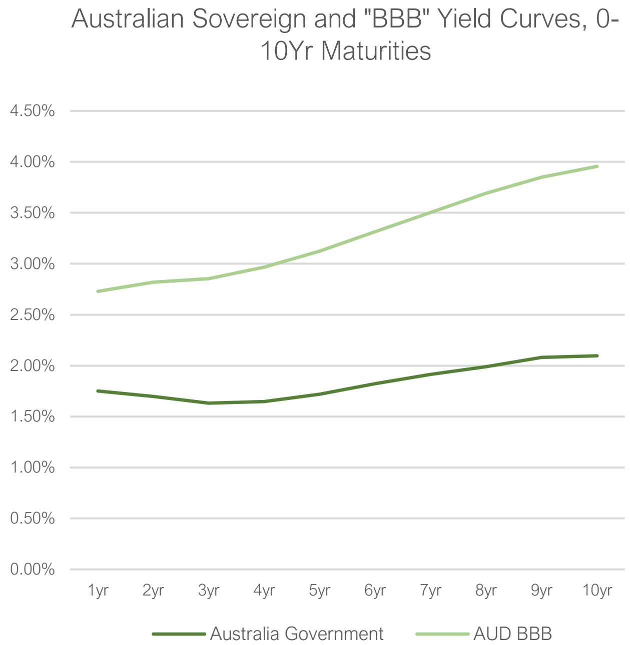


Source: Bloomberg, ABS, 24th February 2019

The market has now fallen into line calling for the next move in the cash rate to be down. Currently the market is pricing a 60% chance of a cut by the end of 2019, according to Bloomberg. This week, Westpac also released a note suggesting that there would be two cuts before year-end.

The bond market has reacted as you would expect. The Australian government yield curve is now downward-sloping up to 3yr maturities. Lower-rated credits are still seeing an upward-sloping curve, reflecting increasing credit risk and also allowing investors some positive roll yield.

The difficulty, however, lies in the fact that the Australian corporate credit market is relatively thin and heavily skewed towards financials. So, gaining diversified exposure away from the banks (that also attract high equity index weights) becomes a challenge.



Source: Bloomberg, 24th February 2019

Nevertheless, Australian bonds still appear relatively attractive compared to international bonds. The Australian Bloomberg Composite 0+ index has a yield to maturity of 2.14% with duration of 5.4 yrs. The Bloomberg Barclays global bond index (AUD hedged) has an equivalent yield of only 1.93% and higher duration of 7.1yrs.

Despite very low yields, bonds still deserve their place in portfolios. There was little in this week's data to suggest that we will see any short-term improvement in the global economy. There is plenty of evidence that global manufacturing remains weak. Sooner or later, this is likely to show up in earnings.

For the time being the market seems convinced that the US will secure some kind of deal with China and that central bankers will prop up the equity market. On trade, we expect the talks to continue in Washington this week. As far as central banks are concerned, we fear that the market may be a little too optimistic.

Last week the Federal Reserve, the world's most influential central bank, published the minutes of the previous meeting. The great revelation was that the Fed plans to end balance sheet normalisation (also known as quantitative tightening) by the end of 2019. While this is notionally good news for markets, the key point to bear in mind is that "not tightening" is not the same thing as "easing". It will take more than "not tightening" to turn global growth around, especially with China reluctant to engage in broad stimulus.

While the Fed may soon cease to exert upward pressure on US Treasury yields, the same cannot be said for the White House. Trump's tax reforms are resulting in very large volumes of new Treasury issuance. US public debt has expanded by more than US$ 1.5 Tr, or more than 7%, since the beginning of 2018. This pace of expansion is likely to continue. Franklin Templeton's Michael Hasenstab has famously taken a large short position in the Treasury market, expecting yields to rise simply because of supply and demand. Of course, all else being equal, an increase in supply without an increase in demand should lead to higher bond yields. But we are not yet convinced that things will evolve as Dr Hasenstab predicts. We fear that higher US Treasury yields will attract buyers and capital flows away from other asset classes, notably those on the so-called global periphery. This may include emerging markets, high yield bonds and leveraged loans for example, but also Australian, New Zealand, Canadian, Swedish and Swiss housing.

In other words, despite the decent returns that assets have recently offered, global market liquidity is a still presenting a headwind. Equities are trading on reasonable multiples, but earnings growth is likely to slow significantly this year. We may see better news on trade this week, or even vote in the UK for the government to delay Brexit on Tuesday. Both would surely lift equities. But investors would be wise to focus on the underlying trends in fundamentals which, given the recent strength in performance, should prompt a much more cautiously-positioned portfolio.

Significant Upcoming Data:

<table>
<tr><th></th><th>Monday</th><th>Tuesday</th><th>Wednesday</th><th>Thursday</th><th>Friday</th></tr>
<tr><td>Australia</td><td></td><td></td><td></td><td>Private Capital Expenditure; Private Sector Credit</td><td>CoreLogic House Prices; RBA Commodity Index</td></tr>
<tr><td rowspan="2">US</td><td rowspan="2">Chicago and Dallas Fed Activity Surveys; Wholesale inventories</td><td rowspan="2">Fed Chair Testimony; S&P CoreLogic House Prices; Housing Starts; Building Permits; Conf. Board Cons.Conf.</td><td colspan="2">US - North Korea Summit, Hanoi</td><td rowspan="2">PCE Inflation (2); ISM Manufacturing; PMI; U.Mich Sentiment</td></tr>
<tr><td>Durable Goods; Factory Orders; Pending Home Sales</td><td>GDP; Core PCE Inflation; Chicago PMI; Kansas Fed. Manf. Activity</td></tr>
<tr><td>Europe</td><td>Austrian Industrial Production</td><td>UK PM Brexit Statement to Parliament & Debate; French, German Consumer Confidence</td><td>Eurozone M3; Italian Cons. & Manf. Confidence; Eurozone Cons. Conf.</td><td>Eurozone CPI; French, Siss, Swedish, Danish & Finnish GDP</td><td>PMIs; German Retail Sales</td></tr>
<tr><td>Japan</td><td></td><td></td><td></td><td>Industrial Production; Retail Trade; Housing Starts</td><td>Unemployment; Job-to-Applicant Ratio; Capital Spending; Tokyo CPI</td></tr>
<tr><td>China</td><td></td><td></td><td></td><td>Official and Caixin PMIs</td><td></td></tr>
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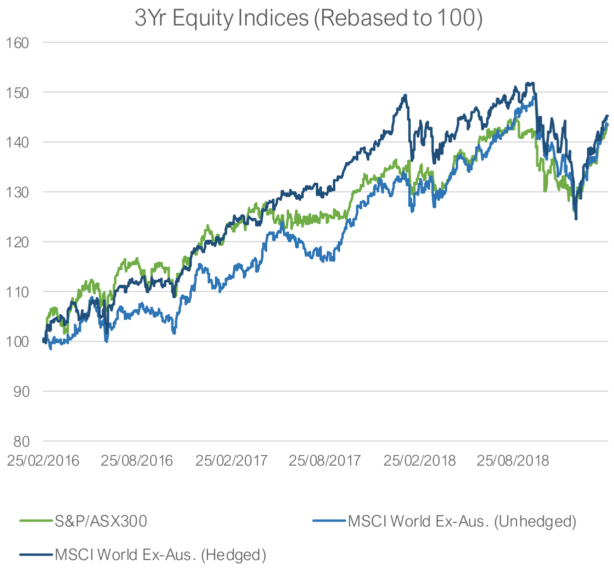

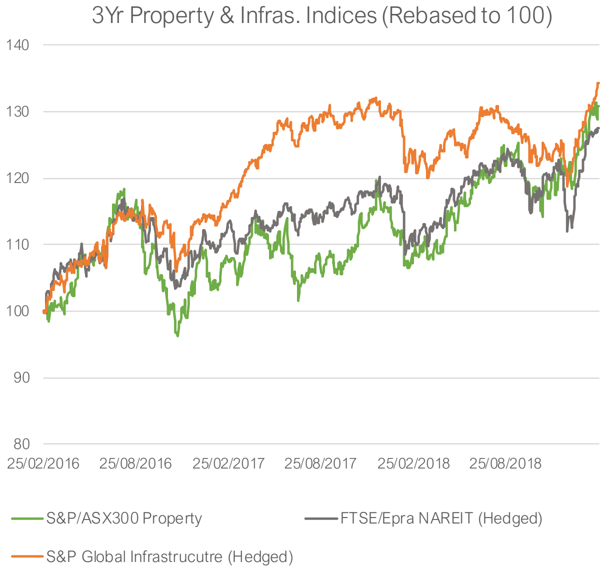

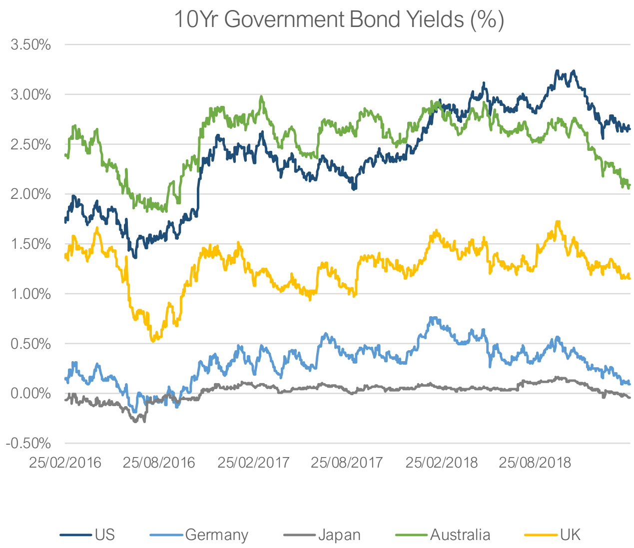

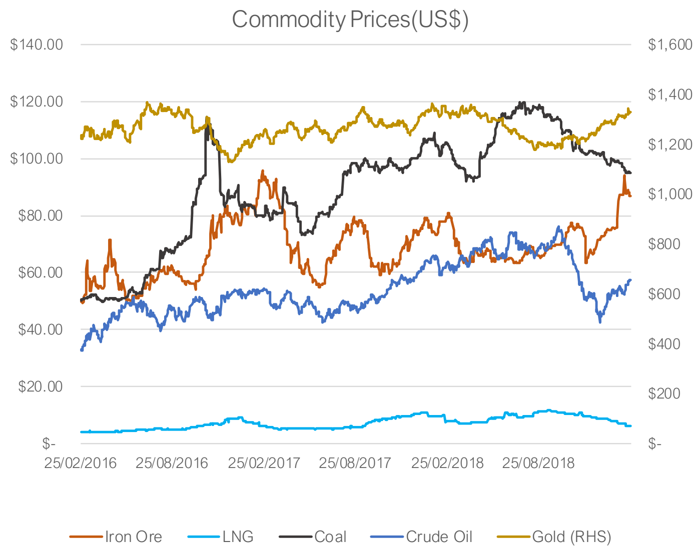

Source: Bloomberg, S&P Dow jones, MSCI, FTSE/EPRA, 24th February 2019