	Price	5 Day % Change	3 Month % Change	1yr % Change
S&P/ASX300	64,012	0.77%	9.42%	8.65%
MSCI World Ex-Aus. (Unhedged)	9,593	1.09%	8.15%	11.70%
MSCI World Ex-Aus. (Hedged)	1,687	0.48%	3.56%	4.60%
Bloomberg AusBond 0+ Composite	9,677	-0.22%	2.88%	5.68%
BloombergBarclays Global Agg. (Hedged)	996	-0.33%	1.95%	3.50%
S&P/ASX300 Property	53,372	0.43%	10.29%	21.02%
FTSE/Epra NAREIT (Hedged)	2,698	-1.23%	3.99%	14.60%
S&P Global Infrastructure (Hedged)	5,055	-0.04%	7.52%	11.14%
BarclayHedge Global Hedge Fund Index (USD)	5,605	N/A	0.57%	-3.59%
AUDUSD	0.7079	-0.70%	-3.79%	-8.73%
AUDEUR	0.6228	-0.98%	-4.05%	-1.51%
AUDNZD	1.0411	-0.02%	-2.03%	-2.76%
AUDGBP	0.5362	-1.85%	-7.85%	-5.02%
AUDJPY	79.2280	0.42%	-5.55%	-4.00%

Source: Bloomberg, S&P Dow Jones, MSCI, FTSE/EPRA, Barclays, 3rd March 2019

As macro concerns wane and central banks present less of an obstacle, equities and listed property continue to perform well. However, Australian assets appear to be more supported by interest rate expectations than fundamentals. Investors should, therefore, be aware of the high levels of interest rate risk across asset classes. While this may not be a major concern in the short-term, longer-term inflation expectations are beginning to rise again. So far, this is on the back of less weak data, rather than any real indication that growth has bottomed.

In any event, given the lack of support from fundamentals, equities and property may see some profit-taking as portfolios are rebalanced at the end of the first quarter.

Equity markets have delivered very strong returns since the beginning of the year. There are a number of reasons for the good performance; the market was oversold in December, the combined headwinds of a US government shutdown, trade disputes, and Brexit have substantially diminished, and central banks have adopted a friendlier tone.

On Friday, the S&P/ASX300 Accumulation Index made a new all-time high. The more dovish tone from the RBA has no doubt helped lift the market and compress dividend yields. This tone is likely to continue at the RBA meeting on Tuesday, though it appears that the RBA would like to see more data before making any changes to the cash rate.

As the first half reporting season draws to a close, however, it is unfortunately obvious that the market's strong performance is a result of multiple expansion rather than an improvement in fundamentals. With 271 of 289 members having reported, earnings decreased by 1.6% on the previous period. 60% of companies missed analysts' forecasts for an aggregate surprise of -34%[1]. Hardly time to crack open the champagne. The S&P/ASX300 is now trading on a one-year-forward PE of over 16x, roughly a 9% premium to the long-term average of 14.5x-15x[1]. The previous discounts offered by the financials and materials sectors have now closed.

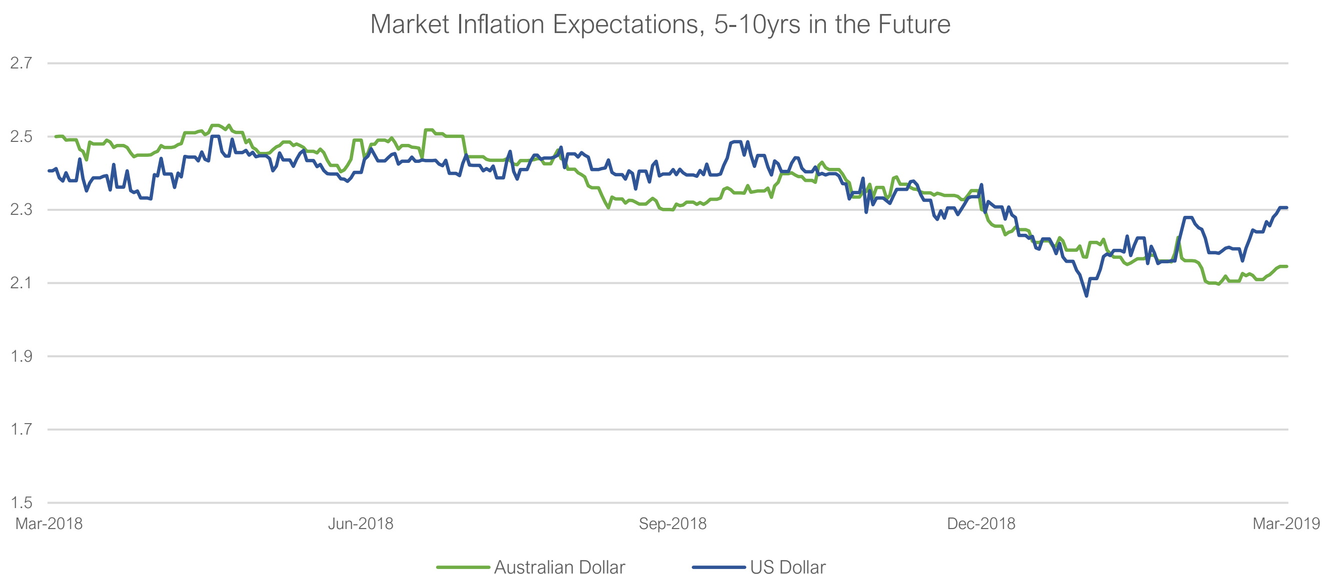
Beyond the prospect of lower interest rates, it is difficult to see why investors are so optimistic. House prices are continuing to fall at an alarming pace, and January's housing credit numbers showed the lowest growth since the 1980s. The business surveys continue to highlight a very weak domestic economy, leading indicators are declining, and the signs of improvement in the labour market are nascent and slight. After the previous dire Q3 GDP print of 0.3%, economists are expecting to see only a marginal improvement of 0.5% for Q4 2018 when the number is released on Wednesday.

Consensus earnings estimates are for 10% EPS growth over the next twelve months, less than 1% in year two and 3% in year three. On these numbers, the market is trading at 14.8x earnings three years away. By comparison, the MSCI All-Country World index is trading at 15.1x one-year-forward earnings, almost exactly the long-run average. EPS are expected to grow by 10.7%, 10.4% and 7.9% over each of the next three years respectively. From a valuation perspective, international shares are much more attractive than the domestic market, not least since Australian analysts tend to overestimate forward earnings.

On the other hand, Australia's gross dividend yield of 4.63% appears attractive relative to cash, and indeed the 2.18% yield-to-maturity of Australian bonds. A similar argument can be made for listed property. Australian REITs offer a gross yield of 4.55% but are trading at a 13% premium to the historical average multiple. Again, for comparison, global REITs are yielding 4.1% on a forward PE of 23x. That may seem a very high multiple, but it is based on an expected EPS decline of 20.7% in 2019, with a 3.7% and 17.4% rebound in earnings forecast for the next two years. The long-run average forward PE is 25x, illustrating that the high multiple is not in itself a barrier to further positive performance.

Despite high valuations in Australian shares and REITs, there is probably room for further yield compression in the short-term. But investors should be wary that a neutrally-positioned portfolio now carries very high levels of interest rate risk. This is a growing concern since the longer-term inflation expectations are beginning to rise from the February lows. However, it's too early to say that inflationary pressures are building.

A more pressing concern may be that the strong performance of property and shares so far this year brings about some profit-taking as portfolios are rebalanced at the end of the first quarter.



Source: Bloomberg, 3rd March 2019

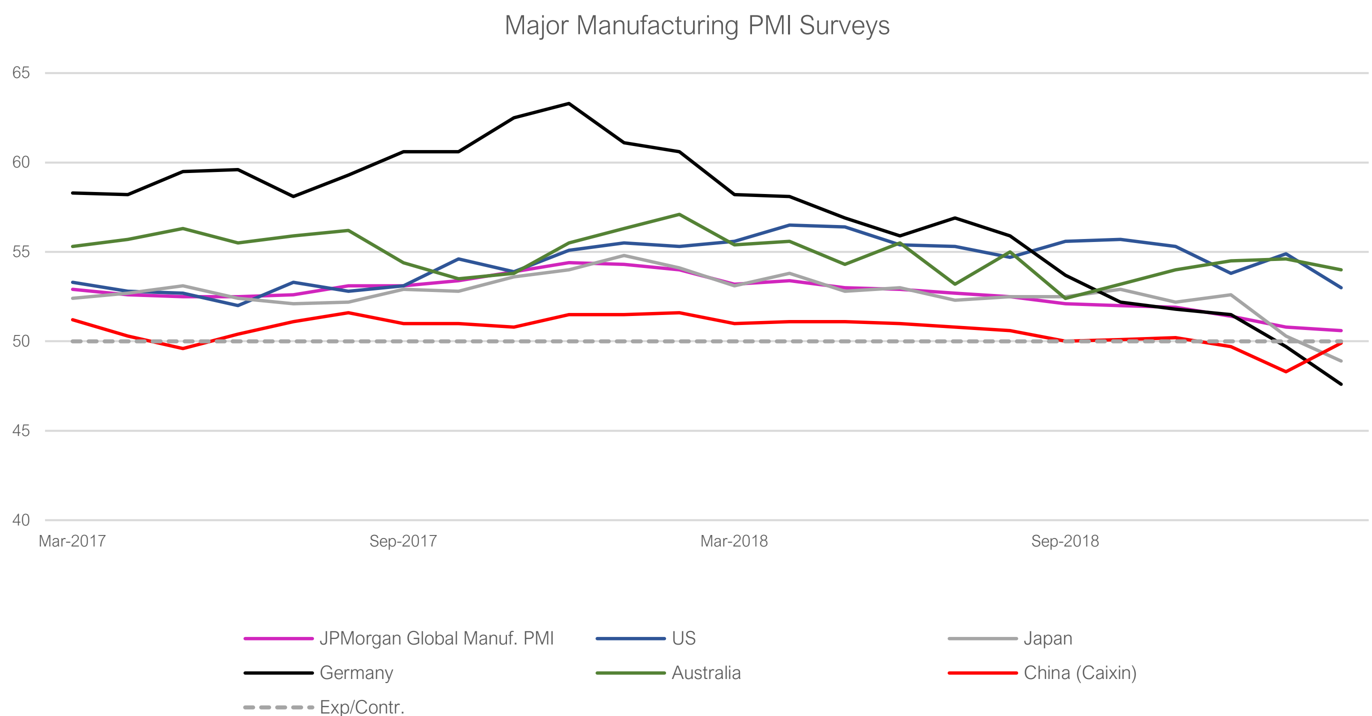
Last week, US GDP beat estimates for the fourth quarter. The economy grew by an annualised (real) 2.6%, versus forecasts of 2.2%. The strength in the economy is likely to fade somewhat. Interest-sensitive sectors are feeling the effects of previous Fed hikes, especially housing. We expect this Friday's labour report to show continued growth in the

participation rate and, as a result, less pressure from wage inflation. Weekly jobless claims suggest that job growth might be a little weaker than expected, but not so much as to signal a change in the trend. The market is expecting 185k new jobs in February, following January's 304k result. Statistically speaking, differences of 100k in a single print do not mean a great deal, although the market would probably react as if it did. Given the recent government shutdown, the chances of a headline-grabbing anomaly seem quite high. With further distortions likely to persist in several data series, the market is now pricing a 90% chance that the Fed remains on hold at 2.5% for the rest of 2019[1] as it waits for a clearer picture to emerge.

The market also reacted positively on Friday to both stronger-than-expected German retail sales and Chinese Caixin PMI. It would probably be correct to say "less bad" in both cases since both series saw considerable falls in January. German retail sales jumped 3.3% after falling 3.1% in January while the Caixin PMI registered a very slightly contractionary 49.9, up from 48.3 a month earlier. Nevertheless, China has been engaging in targeted stimulus for some time, and one possible interpretation would be that the economy may be turning around.

MSCI announced on Thursday that it would increase the weighting of Chinese "A" shares in the Emerging Market indices over the next two years to a little over 3%. Recovering growth and greater index representation would be powerful tailwinds for the A-share market, although it remains a challenge for non-institutional foreigners to invest directly.

Japan and Germany are very sensitive to Chinese economic growth, so the benefits of a Chinese recovery would extend to other developed markets. This week, the Chinese are expected to announce their new GDP targets at the annual National People's Congress, while the ECB is not expected to make any policy changes on Thursday.



Source: Bloomberg, JP Morgan, Markit, 3rd March 2019

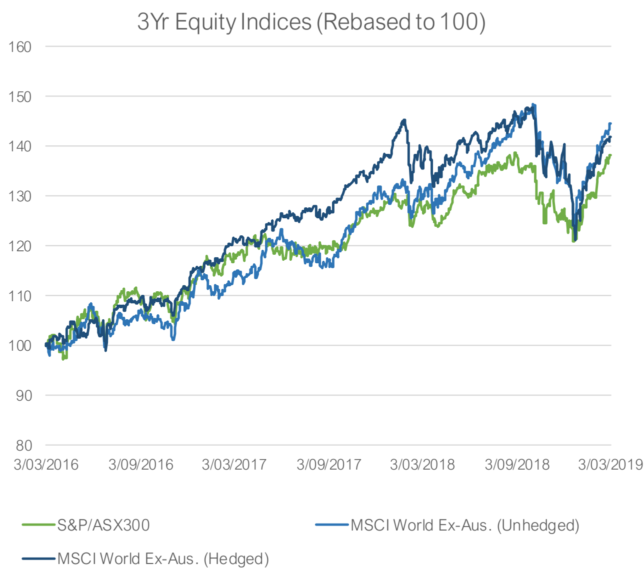
Also in Europe, albeit with one foot out the door, the UK may see a slightly calmer week ahead. Theresa May's has set the next vote on the negotiated deal for the for the following week on Tuesday 12th March. If this fails (again), then there will be votes on the subsequent days to avoid the prospect of "no deal" (which most of parliament is likely to support) and an extension to negotiate and prepare beyond the 29th March deadline. If her deal fails once more, the switch to supporting a new referendum by the opposition Labour party implies roughly a 50/50 split between the probability of leaving at some

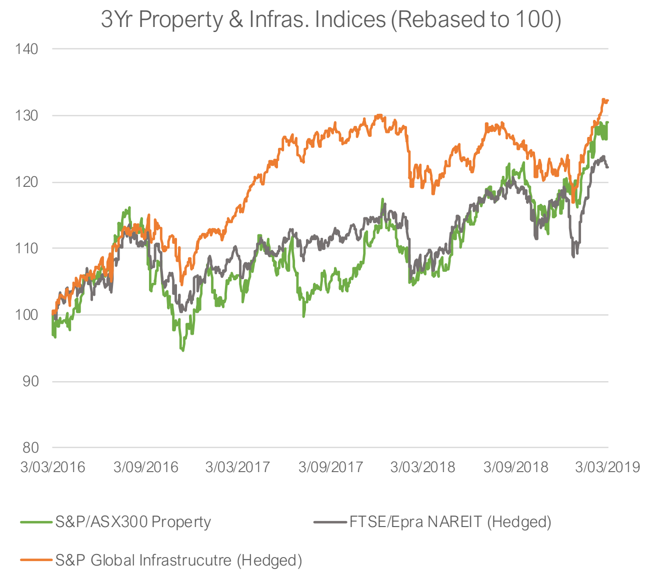
time after the end of March and of not leaving at all. Faced with this prospect, Brexiteers may be tempted to support her deal after all. Whether they can muster the hundred or so votes to succeed remains to be seen. Most importantly for the market and for sterling, the probability of a "no deal" Brexit has all but disappeared.

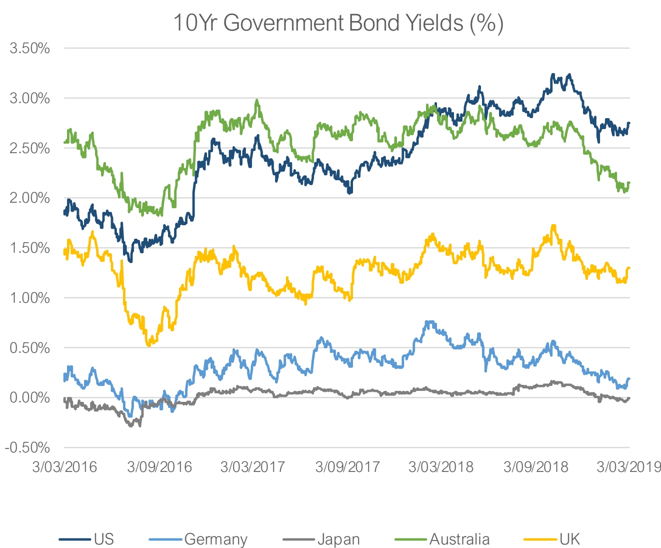
[1] Bloomberg, 3rd March 2019

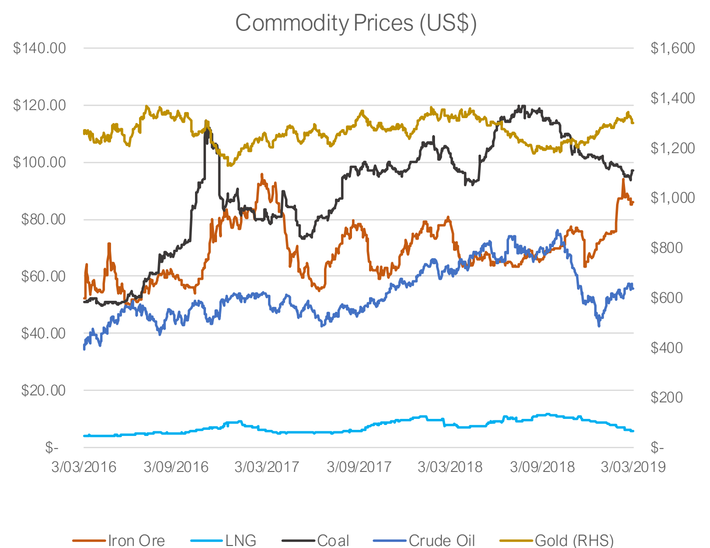
Significant Upcoming Data:

	Monday	Tuesday	Wednesday	Thursday	Friday
Australia	**Building Approvals;** Melbourne Institute Inflation; Quarterly Company profits & Inventories; ANZ Job Advertisements	**RBA Cash Rate Target; Net Exports of GDP;** CBA PMI; ANZ Roy Morgan Weekly Cons. Conf.	**GDP**	**Trade Balance; Retail Sales**	
US	Construction Spending	**New Home Sales;** ISM Non-Manufacturing; Markit US Services & Composite PMI	**Fed Beige Book; ADP Employment; Trade Balance;** MBA Mortgage Applications;	Challenger Job Cuts; Non-Farm Productivity; Unit Labour Costs; Initial Jobless Claims; Consumer Credit	**Labour Report inc. Non-Farm Payrolls, Ave. Hourly Earnings & Unemployment;** Building Permits; Housing Starts;
Europe	UK Construction PMI; Spanish Unemployment	**Italian GDP;** Services & Composite PMIs for Eurozone, UK, Germany, France, Italy, & Spain	German Construction PMI;	**ECB Meeting;** Eurozone GDP; Italian Retail Sales; Dutch CPI; Swiss Unemployment; Norwegian Ind.Prod.	German Factory Orders; French, Spanish, Finnish & Italian Ind.Prod.; Norwegian GDP
Japan	Monetary Base	Nikkei Services & Composite PMI		Leading & Coincident Indices	**GDP; Balance of Payments**
China				Foreign Reserves	**Trade Balance; [CPI & PPI to follow over the weekend]**









Source: Bloomberg, S&P Dow Jones, MSCI, FTSE/EPRA, 3rd March 2019

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