September 2017 — Over the Horizon Market Commentary by David Offer

September was a slightly negative month for the Australian share market, falling 31 points or 0.54% to close at 5,744 points. This low overall market volatility represented the September quarter in general, with our share market off 0.33% for the first three months of the financial year. Pleasingly, for October to date our market is up 3.34%. This equates to more share market gain than has been achieved in the first 9 months of this calendar year.

While the Australian share market has flat lined for the year to date, the same can't be said for the US share market, which has continued to appreciate on a month on month basis and has hit no less than 66 new record highs since the 2016 US presidential election. This extraordinary run, equally matched by extraordinary low volatility, is highlighted in an article written by Ben Carlson and published on Bloomberg on 9 October.

''With a 2 percent gain in September, the S&P 500 Index has set a record: positive returns in each of the first 10 months of the year. There's never been a full calendar year when this has happened every month.

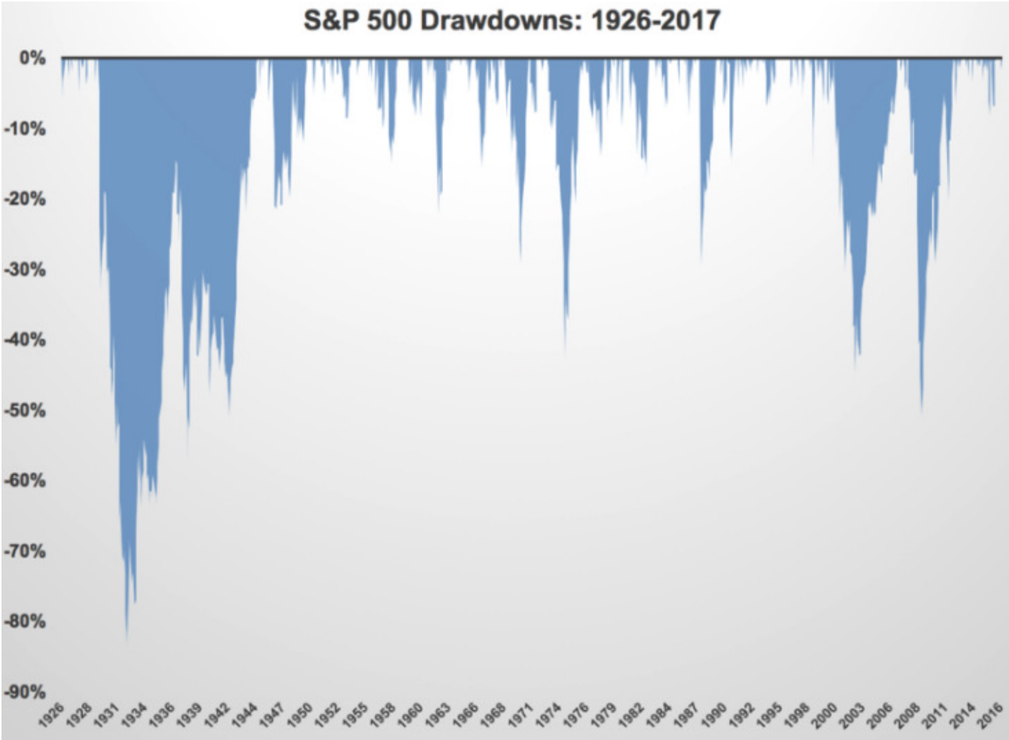
Going back to November 2016, the index has ripped off 12 consecutive monthly gains. The S&P hasn't had a down quarter since the third quarter of 2015, a streak of eight in a row without a loss. Since the start of 2013, 18 of the past 19 quarters have been positive. And it's not like stocks are melting up either. They are going up slowly as volatility is slowly going down.

This year, there has yet to be a 2 percent move up or down on the S&P 500. For a frame of reference, in 2009, there were 55 separate 2 percent up or down days and there were 35 in 2011. The annualized volatility of daily returns on stocks since 1928 has been 18.7 percent. For 2017, that number is 7 percent, a little more than one-third of the long-term average.

The average absolute daily price change this year on the S&P 500 is just 31 basis points. If the year ended right now, that would be the lowest daily price change on record since 1965. The worst peak-to-trough drawdown is just 2.8 percent this year. Over the past 100 years, the average intra year drawdown in stocks has been around 16 percent. The shallowest calendar-year peak-to-trough drawdown was in 1995, when the worst loss in stocks was just 3.3 percent for the year.

So investors in U.S. stocks have had double-digit gains three-quarters of the way through the year, with increases every month, non-existent volatility, and nothing even approaching a 5 percent correction. It's looking like a record-breaking year in terms of a calm market. As far as investing in stocks goes, this year has been about as good as it gets - so far.

It's worth remembering that stocks are cyclical, even if those cycles don't run on set schedules. The following shows the historical drawdown profile of the S&P 500 going back to just before the Great Depression:



Your eyes are likely immediately drawn to the enormous losses seen in the 1930s, 1970s and back-to-back crashes of the 2000s. But these are fairly rare events. Since 1980, the S&P 500 has had 13 double-digit declines with an average loss of 24 percent. Nine of those 13 corrections were declines of less than 20 percent. That would amount to a double-digit drawdown every three years or so. Taking the data back to 1928 would give stocks a double-digit loss every two years, with an average decline of 24.3 percent. The longest drought occurred in the 1990s, when stocks went almost 8 years without a double-digit loss from 1990 to 1998."

The point of Ben's article is that the present calmness surrounding global share markets and smooth upwards trajectory of the US share market in particular is not normal and as such will not last forever. The longer share markets continue in this manner the more nasty the surprise will be for investors when reacquainted with more normalized levels of share market volatility.

A famous Warren Buffett saying is 'be fearful when others are greedy and greedy when others fearful'. The trouble with this bull market is that investors have not been greedy. Despite being the second longest bull market in history, this is arguably the most unloved bull market experienced. There is certainly no investor euphoria. This is typified by share fund outflows greater than share fund inflows for much of 2017. Global investors are holding substantial cash to balance global concerns and share market risks are well documented and known by investors. As such, the US share market continues to climb its 'wall of worry'.

What is aiding the US share market performance is rising corporate profits, albeit profits are not growing at the same rate as share prices. That Australia's corporate profits remain flat perhaps highlights the key difference between the Australian and US share market. Ultimately for share markets to go up, underlying earnings need to rise. Because US Corporate earnings are steadily rising and this has been achieved in an almost deflationary environment, the US share market is being progressively awarded with higher valuations. At some point we expect that this widening premium will be reduced but knowing what the specific catalyst will be to facilitate this and when it will apply are our current unknowns.

When it eventuates, increased global share market volatility will flow to the Australian share market. However, given our market is already marked down due to our low growth prospects, we would expect a more muted response on the downside.

While we wait for the inevitable share market bump in the road, we continue to invest cautiously and selectively.

Please do not hesitate to contact our office if you would like to discuss any aspect of your investment portfolio.

David Offer

Investment & Financial Advisor

phone: 08 9791 9188

fax: 08 9791 9187

email: david.offer@horizonis.com.au

website: www.horizoninvestmentsolutions.com.au

HORIZON INVESTMENT SOLUTIONS

UNIT 4, 2-4 JETTY ROAD,
BUNBURY WA 6230