

December 2017 — Over the Horizon Market Commentary by David Offer

December was a positive month for the Australian share market, with the All Ordinaries index rising 1.82% to close at 6,167 points. For the 2017 calendar year, the All Ordinaries Index returned 7.84% (12.47% including dividends), with nearly all of this growth achieved in the final quarter.

As the table below illustrates, 2017 was another good year for investors, with satisfactory returns achieved against a backdrop of below average volatility.

Benchmark	1 Month	3 Months	Calendar Year
<i>Multi Asset Class Benchmarks</i>			
Multisector Aggressive Market Index	-0.02%	5.97%	11.17%
Multisector Balanced Market Index	-0.04%	3.91%	7.70%
Multisector Defensive Market Index	0.31%	1.87%	4.26%
MSCI International World Index Net Div AUD	-1.63%	5.84%	13.32%
Australian Composite Bond Index	-0.52%	1.44%	3.66%
Australian Bank Bill Index	0.14%	0.42%	1.75%
<i>Australian Share Market Benchmarks</i>			
All Ordinaries Accumulation Index	2.03%	8.2%	12.47%
Australian Property Trusts – Accumulation	0.12%	7.79%	6.44%
Australian Resources – Accumulation	7.18%	15.57%	25.94%
Australian Industrials – Accumulation	0.63%	5.6%	8.48%

Going forward, Australia's market will continue to be heavily influenced by global events. Barring a left field event such as a Korean conflict, we view the main threat to share markets this year will be the spectre of rising global interest rates. This will most likely stem from an already strong US economy supercharged further by the current White House tax cut stimulus package, along with a reduction in quantitative easing (printing of money) by major Central Banks. Late 2018 and into 2019 could be when global markets finally misjudge and undershoot actual US Federal Reserve interest rate rises. Unexpected rate rises in the US will flow through to higher interest rates globally. This will make alternative asset classes more attractive as well as put budgetary pressure on indebted nations around the world ... being most developed Western nations including Australia.

With interest rate rises likely to be a second half of the calendar year topic, it is quite possible the share market will continue to rise *short* term. The line of least resistance is up and if there was a time for the Aussie market to approach its 2007 high, the first half of 2018 would be it. We have a reasonable (national) domestic economy, synchronised global growth, low interest rates, strong global share markets and investor appetite for risk is high.

Longer term however, with limited growth for Australia's major corporates, we feel our share market will continue to range trade in a shallow uptrend. The All Ordinaries trading range now appears to be 5,600 to 6,600 points, which suggests a fair value of approximately 6,100 points. This is up approximately 10% on a year ago and predominately reflects a strong rebound in resource share profits over the year off the back of higher than expected commodity prices.



Some current investment themes we are running within portfolios at this time are as follows;

Australian Equities

- Supported by dividend yield and cost cutting, Banks may perform solidly in the short term with expectations of 10% share price growth from current levels. We believe the upcoming Royal Commission is unlikely to uncover anything new and that Bank share prices may climb the wall of negativity generated. The exception could be CBA, which may be hit with a larger than expected multibillion dollar fine for facilitating money laundering. However, a \$2.5 billion fine (our guess and significantly above the market) would still only amount to 3 months profit and we would view any resulting sell off as a buying opportunity; sub \$75 CBA is on a fully franked yield of 6% plus.
- After 2 years of strong share price performance, Resource shares are starting to appear expensive and we are willing to take part profits, particularly into off-market share buybacks. BHP is a good candidate to announce an off-market share buyback at its upcoming interim profit result. If so, we would be inclined not to repurchase shares accepted into the buyback. Our preferred resource share is Fortescue Metals, which is trading at a substantially lower price earnings ratio and higher dividend yield to its peers.
- Some unloved sectors could have some time in the sun this year. This includes telecommunication companies such as Telstra, with could outperform with issues associated with the NBN rollout arguably more than factored into current share prices. Likewise, insurance companies such as QBE would benefit from higher interest rates and repricing of premiums following last year's abnormal run of natural disasters.

International Equities

- We are wary of US share market valuations and that the US market has been appreciating at a much faster rate than corporate earnings. Likewise, the focus of index funds (passive investment money) that is concentrating investment monies on companies based on their size and not valuation fundamentals. We expect a material pull back at some point in headline US indices with our best guess this will occur sometime in the second half of the year with higher than expected interest rates a possible catalyst.
- While our exposure to global share markets is low, longer term and in the event of global share market weakness, we would like to build our exposure to China, which has continued to demonstrate strong growth and economic management far superior to most Western nations. As well as more attractive investment fundamentals, the Chinese share market will gradually build in global index weightings, providing a favourable tailwind for Chinese share investment.
- A focus this year will be to build our portfolio exposure to investments not necessarily correlated with share market performance such as Long/Short funds. While such funds have underperformed relative to Long only share funds, we expect relative performance may reverse should global share market volatility rise.

Commercial Property

- We view commercial property as fully valued with property yields unlikely to compress further. Commercial property has been a major beneficiary of low interest rates so its stands to reason that this sector will be susceptible to weakness should interest rates rise. As well as being underweight, we have endeavoured to minimise risk by focusing on unlisted investments that are more conservatively valued to comparable listed properties. Likewise, we are maintaining a focus on property investments that also have a business focus such as Lend Lease, Crown Resorts and Aveo Group.

Fixed Interest

- Unlike most diversified investment portfolios, we have zero exposure to long term fixed interest investments and feel this asset class will underperform for the foreseeable future as interest rates gradually move back to more normalised levels.
- Our focus on variable interest rate investments is in major Bank hybrid securities. While not vanilla interest securities, as Banks can convert hybrids to equity in extreme circumstances, Australian Banks currently have very strong balance sheets and so should continue to maintain their perfect track record of redeeming income securities at stated maturity dates. With strong demand hybrids are presently relatively expensive. As such we are open to selling long dated hybrid securities and replacing them with shorter dated securities (12 / 24 months in duration) so that, should yields rise, we can capture this in the repricing of the new preplacement hybrids issued.

It is interesting to note the optimism that now abounds with respect to share markets globally, with the consensus view now that markets will continue to rise. Optimism is a bull market trait and usually the stronger the optimism the later we are in the bull market cycle. Coupled with investment volatility being abnormally low, investors can easily be lulled into a false sense of security at the current time. We need to be mindful not to be suckered into this optimism. As such, as global markets continue to rise, so too does our contrarian defensive focus on investment asset classes. We continue to focus on asset selection to endeavour to maintain an acceptable level of overall portfolio performance.

As a final note, following a recent engagement to Jacob White, our receptionist Bryony Ross is moving to Busselton and regrettably leaving our firm.



Congratulations Bryony and we wish you all the best for the future. Bryony's last day with us will be Thursday 25th January. We welcome Stefany Grant to the team who will be starting this Monday to take on Bryony's role.

Please do not hesitate to contact our office if there are any matters you wish to discuss relating to your investment portfolio. Please note that I will shortly be taking annual leave and will be out of the office from Wednesday 16 January and returning Thursday 25th January.

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



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

David Offer (Authorised Representative 259188) is a Director of Horizon Investment Solutions Pty Ltd (ACN 083 142 438, ABN 79 668 031 212, AFSL 405897).

This email is confidential. If you are not the intended recipient, you must not view, disseminate, distribute or copy this email.

Please assume that any advice provided in this email is GENERAL ADVICE only and that the information or advice given does not take into account your particular objectives, financial situation or needs. Before you act on any of the information provided in this email, you must consider the appropriateness of the information having regard to your particular objectives, financial situation and needs and if necessary seek appropriate professional advice. Opinions, conclusions and other information expressed in this email are not given or endorsed by Horizon Investment Solutions, unless otherwise indicated. Horizon Investment Solutions does not accept any liability in connection with any computer virus, data corruption, incompleteness, or unauthorised amendment of this email.