HORIZON
INVESTMENT SOLUTIONS

July 2018 — Over the Horizon Market Commentary by David Offer

Last financial year was a good year for the Australian share market, with the All Ordinaries Index appreciating 9.1% and 13.7% with the inclusion of dividends. The market mantra of 'sell in May and go away' did not apply, with the June quarter returning 7.2% and thus providing much of the annual return. However, returns across the share market were not uniform, with a polarising gap in performance emerging between 'growth' versus 'value' or yield orientated shares. For example, at the large end of the market, high price to earnings growth shares like CSL and Macquarie Group both appreciated 40%, whereas value (and generally more dividend orientated shares) like Telstra suffered.

Looking at some of the different market sectors, Bank shares had a tough year as they grappled with both a slowing lending environment and increasing compliance obligations stemming from the ongoing Banking Royal Commission. Of the big 4 banks, ANZ held up best, off 2% while CBA fared the worst, off 13.4%.

Energy shares had a stellar year on the back of rising oil prices. This allowed, financially extended companies like Santos and Origin to make material progress in strengthening their balance sheets and their share prices reacted accordingly, up 77% and 30% respectively. Oil and gas bell-weather Woodside Petroleum returned 20%. Diversified resource shares also had a great year, with RIO Tinto up 31% and BHP up 28% respectively.

Infrastructure shares had a subdued year. Notwithstanding US China trade war fears dampening rising interest rate expectations and this allowing a strong share price recovery to occur in the June quarter, shares like Transurban and Sydney Airports finished the year flat.

Globally, the US share market's record breaking bull market run continued. Despite a more volatile second half, the Dow Jones Index still returned 13.7% for the financial year. Conversely, the Chinese share market had a tough year, falling 11% over fears of an escalating US China trade war.

Recently there have been some notable company specific announcements. One being Wesfarmers, which has announced it is spinning off its low growth Coles business into a separate company by the end of the calendar year. Another is BHP, announcing the sale of its shale oil and gas assets and thus denying itself the ability to waste further billions on these assets and instead return the proceeds to shareholders. Both announcements have been received favourably. Less favourably received has been AMP's recent market announcements as it reacts belatedly to its misconduct as exposed by the Royal Commission. The Company has a difficult 5 years ahead as it looks to rebuild to a fraction of its former self under a new stringent regulatory framework. Recent key company appointments in David Murray as Chairman (former CEO of CBA and chair of the Financial System Inquiry) and Mike Wilkins as CEO (former CEO of Insurance Australia Group) suggest the Company has appointed the right people to facilitate the turnaround.

As we progress into the new financial year, a number of investment themes are front of mind when selecting suitable investments for portfolios;

- Given the lofty valuations now enjoyed by growth shares across the board, it would not surprise if the relative outperformance of growth shares to value shares reversed in the financial year ahead. We are wary of investing in growth shares that are on high earnings multiples as any earnings disappointment stands to be treated harshly by investors.

- The inflated East Coast property market, the basis for much national economic activity, is now falling and this is likely to have adverse economic implications for the national economy. This risk is compounded by high government and consumer debt. We are looking to minimise exposure to businesses that are exposed to a residential building downturn and reduced consumer spending.

- Many large corporations, and particularly those in the finance sector which make up a material portion of our share market index, are struggling to generate earnings growth in the face of increasing competition (often internet based), higher energy costs and rising regulatory burden. Overall, we expect little earnings growth this year for most top end industrial shares. We think better growth prospects exist within midcaps and emerging green-chips.

- Despite a recent pull back in commodity prices over global trade concerns, we feel that this will be temporary. Longer term, we expect resource producers to benefit from reasonable commodity prices due to underinvestment by resource companies in recent years as well as the low Australian dollar, which we expect will continue to trend down.

- Overall, by default that share markets have been unusually stable in recent years, we expect at some point that there will be a pick-up in volatility. We consider it prudent to hold some liquidity within portfolios to take advantage of any future share market sell off.

Please don't hesitate to contact our office should you wish to discuss your investment portfolio in detail.

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