

CIO MONTHLY NOTE

January 2017

Plenty to crow about in the year of the rooster



Last year ended with the well-anticipated December rate hike from the US Fed, and this year looks like it will see at least three more rate increases as the US economy continues to show steady growth, buoyed by the expected fiscal stimulus from the incoming Trump presidency.

While the US President-elect may continue to attract attention via twitter, financial markets are still reacting positively to the strong pro-growth message which will help drive US earnings higher.

One of the risks for global equity markets in 2017 is how China navigates through some challenges within their economy. Chinese policy makers will continue to be proactive as they try to engineer outcomes to smooth out the volatility and ensure there is no big bursting of a China credit bubble. It will remain a challenge.

Europe also has the potential to provide downside risks but early signs indicate we won't be in for as many shocks as 2016. If the status quo is maintained, and there are no more Brexit-type surprises, then growth will stay on track, creating an opportunity for investors to add to their European exposure.

In my last note for 2016 I forecasted the ASX/S&P 200 would get to 6250. We still believe this is very achievable by year end, on the preconditions that there is no rate hike, an AUD around US\$0.70 and economic growth is maintained.

Therefore, an overweight to both domestic and global equities is the preferred allocation for the year ahead.

The local equity market has rallied in anticipation of the improved commodity price performance over the past

year, and has helped drive the long overdue earnings recovery. Following two consecutive fiscal years of earning contraction, we are well on the way to a strong earnings-led recovery in the current fiscal year.

Conveniently, the improved commodity price performance has not resulted in the typical sharp appreciation of the AUD. This will be supportive for corporate Australia which needs a lower Australian dollar to maintain its momentum.

We still believe that the best equity market over the next year will be the US. But locally, another theme for 2017 will be continued strong IPO activity in the mid and small-to-micro-cap market. The challenge for the investor will be picking the right company that can offer a good pathway to earnings growth.

Corporate activity will also be sustained. Last year we saw the bidding war for Tatts Group and the premium paid for SAI Global and DUET. But there are still offshore investors seeking either established companies with constant cash flow, or newer companies with good growth prospects. Also, we anticipate that the major banks will continue to spin off non-core business units that are a drag on their ROE targets.

There is real potential for more global companies to pay good prices for Australian businesses in 2017.

We will be positioning our portfolios to take advantage of these outcomes as they arise, and are confident our funds will continue to perform well. Wishing you the best for 2017, the year of the rooster.

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