CIO MONTHLY NOTE

March 2017

A strong report card so let the good times - and dividends - roll…

The recent Australian reporting season certainly delivered. We got a long overdue earnings rebound following two previous years of earnings contraction.

With the earnings recession of the past two years behind us, we can now watch the dividends roll in. But the question is - what impact will they have?

The very strong acceleration in headline earnings growth implies we are on target for a 20% spike in FY17 following a negative 9% from the previous FY16. The consistent upgrades since the December quarter have been driven predominately by the resources sector following a strong rebound in commodity prices. This recent rebound has allowed these companies to repair their balance sheet, pay down debt levels and deliver special dividends where possible.

The banks have also been a solid contributor. They will continue to offer a very reasonable dividend but will face challenges to their margins. I would expect to see the major banks continue to exit non-core business units that have a higher cost income ratio and higher regulatory capital requirements. An overweight position to the banking sector remains our view.

Overall, reporting season tells us that momentum is positive and the foundations have improved.

On the interest rate front, the RBA kept interest rates on hold in March as expected, as the Australian economy continues to transition from the end of the mining boom, expanding by around 2.5% in 2016.

We expect no change in interest rates until mid-2018, as both households and corporates in Australia are still unlikely to withstand the prospect of higher cash rates.

Globally, activity has been more positive over the past six months. With the economic pulse of manufacturing in North America improving. amid expectations of further stimulus and proposed tax cuts, the outlook for US earnings remains promising. These improved conditions will drive the US Federal Reserve to raise rates three or four times this year. Indeed, the market has put the probability of a March rate hike now at over 80%, up from less than 25% a month ago.

In China, the National People's Congress has started and there will be plenty of grand statements reinforcing a positive outlook where possible, however they have (finally) lowered their growth target for 2017 to 6.5%, as expected. We do anticipate further infrastructure spending which will be beneficial to Australia.

There will be many opportunities across many different sectors for the investor in 2017, and while Australian (and global) equity valuations may challenge cashed up investors, buying the dip remains this year's investment theme.

Now we simply watch as a large number of dividends drop in March and April. As John D Rockefeller famously said "Do you know the only thing that gives me pleasure? It is to see my dividends coming in". Sounds very appropriate.

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