Your Personal Wealth SUMMER

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MARKET VOLATILITY IS NOTHING NEW - *So what have we learnt from past experience ?*

Sudden financial market movements can be unnerving for even the most hardened investor, and it's difficult not to panic when trends in the market take a downturn. Unfortunately, it's not unusual to see investors over react in volatile markets, unnecessarily selling various quality assets. Investors need to accept that investment markets can often be subject to periods of high volatility during which their confidence can be tested.

So, what can investors better understand to help alleviate some of the concern during these downturns.

Firstly, accept that **Volatility is a normal part of any investment cycle.** From time to time investors will react nervously to external forces such as changes in economic conditions, political uncertainty and prevailing business conditions. Financial markets dislike uncertainty, and investors are also prone to over-react to events that cloud the short-term outlook.

Investor sentiment can be heavily influenced by the prevailing messages in the market, it is important to take a step back in these periods and keep a level head as traditionally there are also opportunities in such conditions. Understanding investment cycles allows investors to begin to exploit lower prices rather than lock in losses by selling based on emotion rather than logic.

Market corrections can create attractive opportunities as a stock market correction can be a good time to invest in equities as valuations become more attractive, giving investors the potential to generate above-average returns when the market rebounds.

Inexperienced investors should also refrain from selling down their assets in their entirety with a view to re-entering the markets when conditions improve. When inexperienced investors try to time the market they can run the risk of missing opportunities that are often a feature during periods of pessimism.

Understand the benefits of diversification. Volatility can make asset allocation very difficult to perfect as market cycles can be short and subject to bouts of volatility.

Investors can spread the risk associated with specific markets or sectors by investing into different investment options to help mitigate the likelihood of concentrated losses. Defensive assets traditionally have a role in most investment portfolios. They are often used to help smooth the overall portfolios return and ensure other elements such as the liquidity of the portfolio, reducing any need to sell out of risker assets when values are diminished.

Don't get lost in the emotional hype. Whether seeking to buy best performing assets or to sell down when times are at their toughest, don't be swayed to what you see and hear around you as the opportunity to gain value from these steps is often long gone. One of the most serious investment implications of following the herd is that investors end up buying when prices are high and selling when prices are low.

Ensure you are reinvesting the income received through your investments to increase the overall return. Reinvesting dividends can provide a considerable boost to total returns over time, thanks to the power of compound interest.

For some investors the need to generate regular stable income is of greater importance. While the value of the asset may fluctuate in volatile times, the value of investing in quality, dividend-paying assets for regular income remains of paramount importance. Sustainable dividends paid by high quality, cash-generative companies can be especially attractive, because the income element tends to be stable even during volatile market periods.

The benefits of regular investing. it makes sense to regularly invest a certain amount of money in a fund, for example each month or quarter. This approach is known as dollar cost averaging. While it doesn't promise a profit or protect against a market downturn, it can help lower the average cost of fund purchases.

What often happens behind the scenes during these times with **quality fund managers that can be very successful is "active investment"**. When volatility increases, the flexibility of active investing can be especially rewarding compared to the rigid allocations of passive investments. In particular, volatility can introduce opportunities for bottom-up stock-pickers, especially during these times of market dislocation.

Remember too, that the stocks you do not own in a portfolio can be as important as the ones you do own. The value added by avoiding some of the worst stocks in the market builds over cycles and with the passage of time, making research-driven active strategies particularly appealing for long-term investors.

Flight or Fight.... . There are two principal behavioural biases that can kick in during times of market stress, causing investors to capitulate and sell at the wrong time for the wrong reasons: herding and loss aversion. The urge to do as others are doing is a particularly powerful bias in human behaviour that is not always helpful in investing.

More seriously, following the herd means that investors end up buying when prices are high & selling when prices are low.

The second bias, loss aversion, is one of the most significant behavioural biases that can affect investment.

Feeling uneasy during times of volatility is only natural, however always try to remember to take a longer term view, and at the very least appreciate that if your asset allocation is aligned correctly to your risk profile, to a large extent your portfolio should reflect allocations that are already factoring in various levels of volatility that are normal in any investment cycle.

Source: Lifespan

IMPLICATIONS OF THE US MIDTERM ELECTIONS - *Where to now for the House on the Hill?*

The US midterm election results largely met the expectations of pollsters and pundits. The republicans have increased their majority in the senate, easing the path for future judicial and political nominations. However, the democrats took control of the House of Representatives, which will likely bring two years of political gridlock and far more stringent oversight of the Trump administration. Interestingly, equity markets rallied the day after the election in what might have been an example of sell the rumour and buy the news.

While the election is shifting the political environment, it does not materially change our economic and market outlook.

The biggest policy risk investors face remains the Trump administration's trade policy towards china, and the midterms provided little additional clarity. Congress ceded significant trade authority to the executive branch over the last few decades, and it is highly unlikely to take that authority back. As a result, trade is an area where Trump can affect change without congress. What is anyone's guess at this point is whether the midterm results make a favourable resolution more or less likely.

There seemed to be a thaw in relations in early November as a result of a conversation between president Trump and premier XI. A subsequent leak suggested that Trump hoped to make a deal at the G20 meetings in late-November, but cynics speculated that it was simply an effort to push stocks higher in advance of the election.

The successful renegotiation of NAFTA showed that Trump is willing to make reasonable trade deals even with his long history of protectionist views. That may augur well for the prospects of a deal with China. On the other hand, there may also be a geopolitical angle, with the opportunity to constrain china. If Trump is sympathetic to this view, then relations could deteriorate further.

The US is in the later stages of the cycle, and the fed is raising rates to reduce inflationary pressures, which could put downward pressure on elevated equity valuations. While US growth remains strong, it will likely decelerate in 2019 and 2020 as monetary policy becomes more restrictive and the impact of fiscal stimulus fades.

Nevertheless, given the risks to the outlook, in our latest global dynamic asset allocation report we suggested modestly reducing exposure to risk assets by underweighting corporate credit securities, where spreads leave little upside potential, in favour of cash or alpha-oriented strategies with low beta to equity, credit and duration.

Source: Mercer

CROWD FUNDING - *Supporting a project can be rewarding; but mind the details*

Contributing money to a crowd funding project can be a great way of showing your support for a creative, social or business initiative you believe has merit. However, you need to do some research to ensure your money is being used for a legitimate project.

Crowd funding is used by artists & entrepreneurs to find money to fund their projects. Money is usually raised through a crowd funding website, which enables people who are not professional financiers to pool their money towards their project.

A good crowd funding website will have information on the project's aims and objectives, how it will work and its budget.

There is no monetary reward for supporting a crowd funding project & sponsors are often enticed with a small gift such as a free promotional item or a discount on new products in return for their support. Once the project has reached it's target, the money pledged will be deducted from your account. Most, but not all sites return funds if the target amount is not reached.

You should note crowd funding is different to crowd-sourced funding (CSF) (also called equity crowd funding), which is used by start-ups and small and medium-sized companies to raise money from the public to finance their business. In exchange investors receive securities in the form of shares.

Most crowd funding websites do not have Deductible Gift Recipient (DGR) status, so you will not be able to claim a tax deduction. If a project creator does have DGR status, it is up to them to provide you with a tax deductible receipt if you request one. You also cannot claim a tax deduction if you have received a gift, reward or discount.

Raising money for a crowd funding project relies heavily on trust. If you've heard about a crowd source funding project that you'd like to support make sure you check the legitimacy of any website or social media page you're directed to. You should also try to find out as much information as you can about the project and its owner before you sponsor them; Have they used crowd funding before? Have they been involved in successful projects in the past? Remembering; don't give your credit card details unless you're comfortable that the website, the project and its owners are legitimate.

Source: Money Smart

INVESTMENT MARKETS - where to from here ?

US Federal Reserve Blinks - Maybe. Markets have taken a turn for the worse lately with pretty much all growth assets down significantly in October and so far in November. For the month of October, the falls were -6.0% for Australian Equities, -5.6% for unhedged Global Equities and -6.8% for Emerging Market Equities. Australian Small cap Equities were one of the worst performers, down -9.6%. Also, the oil price has tumbled and is down around 30% from its recent peak.

Growth markets have been definitely been 'risk-off' with many factors weighing on equities. Some of the concerns are slowing global growth, particularly in China and Europe, trade concerns, a stronger US dollar and rising interest rates in the US and concerns about the messy UK Brexit negotiations.

Economy - The US remains the bright spot with its economy expanding at an annualized 4.2% rate in second quarter of 2018. Wages growth at 3.1% over 12 months is the highest rate since 2009 while the unemployment rate fell to 3.7%, close to a 50-year low.

Australia's economy grew strongly over the past year, with GDP increasing by 0.9% in the second quarter and 3.4% for the year as a whole. House prices continued to decline with this trend likely to persist given that it is now harder to secure a loan. National house prices fell by 3.5% in the year to October.

The estimate for third quarter Eurozone GDP growth was 1.7% year on year, below expectations of 1.8%. Chinese GDP growth slowed to 6.5% over the year in the third quarter of 2018, missing expectations of 6.6% growth. This was the slowest pace since the first quarter of 2009.

Markets and Outlook - At the beginning of the year markets were only pricing in a 20% probability that the US Fed would raise rates 3 times in 2018. Despite the strength in US earnings during the period, the PE for that market is down in 2018, from the high 18 times in January to around 15.7 times currently.

The US market has in fact been propping up global equities while the worst performer has been Emerging Markets which have been impacted by trade concerns, rising US interest rates and a strong US dollar. In fact, for the 6 months to 30 September 2018, US equities accounted for almost 10.0% out of the 11.1% return of Global equities (MSCI AC World Index).

Up until recently the Australian market had also held up while valuations were pulling back in most global markets. This started to unwind in the 3rd quarter and has continued in October and November. This has been exacerbated by the negativity around the banking sector which is around 20% of the Australian market.

Adding to the worries has been slowing of growth in Europe and China with the IMF lowering its 2019 Global growth estimate from 3.9% to 3.7%. Obviously, any US-China trade deal would be extremely positive for Emerging markets which have massively underperformed in 2018.

As we write this note, the US fed Chair Jerome Powell has indicated that US short term interest rates are just below what they would consider to be the neutral band, i.e. the level of interest rates that neither slow or cause the economy to expand faster.

We believe this neutral band is between 2.5% to 3.5%. We have been of the view lately that the US Fed is unlikely to robotically raise 5 more times to get to a 3.5% interest rate. We believe the recent behaviour of equity markets, slowing global growth and the pullback in the US 10-year bond yield would lead to the Fed pausing in its rate hikes.

We do not believe that the recent return to what are more normal levels of volatility means that there is likely to be a recession in the US in the short term. Equities are being repriced for slightly lower global growth next year as well as higher interest rates. US equities have now had year over year growth of well over 20% for the last 3 quarters. However, this is estimated to drop to around 9% for 2019 as a whole and it is highly likely that we are past peak earnings growth for the US at least.

We believe that the recent sharp pull back in equities is simply a correction that that reflects the unusual number of unresolved issues in the markets right now. Global equity valuations are actually very reasonable right now, even attractive if you exclude the US market.

Among the more important unresolved questions for portfolios right now is whether Growth continues to outperform Value as it has done since the GFC. Global equities have been powered by the performance of the tech giants in the recent past, if that were to change it might signal a rotation to Value stocks which have outperformed Growth over the long term. While there is a lot of uncertainty at this time, we believe that the current volatility will continue and it should provide opportunities for investors going forward.

Source: Lifespan

CHART: INVESTMENT RETURNS TO 31 OCTOBER 2018 (% P.A.)

Asset Class	1 Mth	3 Mth	1 Yr	3 Yr	5 Yr
Australian Shares	-6.05	-5.92	2.94	8.25	6.02
Global Shares	-5.56	-1.78	7.62	7.98	12.48
Listed Property	-3.11	-2.25	7.27	7.08	11.12
Fixed Interest	0.48	0.87	3.09	2.92	4.35

Source: Mercer

To all of our readers we wish you and your family a joyous Festive Season & a Happy New Year

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