A WORLD IN TRANSITION
"Free Money and Technology"
July 2017

Gold Coast

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Transition – Some predictions

- The bond market has woken up. The US FED has moved cash rates , Europe will follow in 2018 but Japan remains in a coma;
- The Trump “bump” moves from positive to anguish. How long will the Industrialists of the US wait before they pull the plug and overrule Wall Street and the Republican Party?
- QE continues – sanitized in Europe (FY19) – madness continues in Japan
- China moves aggressively to clean up its environment. With this comes technological advancements that will shake the industrial world at a time when the US threatens to withdraw from its global leadership role;
- Technology ensures that inflation is not a present or discernable problem. This is important to understand as bond yields retrace to above inflation over the next few years;

Transition – Some predictions

- Technology will ensure more energy, with more storage and which is cleaner and continually develops over the next decade;
- Russia and the Middle Eastern block, historically funded by oil and energy, will enter a "fiscal down draft" caused by abundant and cleaner energy sources that hold down the cost of energy;
- Government debt everywhere increases and no one seems concerned.
- Low inflation means that whilst world interest rates will rise – they don't have far to travel.
- Meanwhile Australia rolls along with a hideously high level of household debt – hoping that my prognosis for interest rates is correct!

What I am thinking about

- The PER expansion cycle for equity markets is at a mature stage. Higher bond yields will become a feature of FY 18. Earnings will need to lift to offset the PER pressure.
- PER contraction is not good for Australian equities as we do not have earnings growth.
- US corporations are cashed up and were being “encouraged” to repatriate trillions of cash (estimate of US$2 trillion) but Trump’s leadership now puts this in doubt.
- Chinese hold over $1 trillion of US bonds. Could Trump create a Chinese sell down and weaken US bonds?

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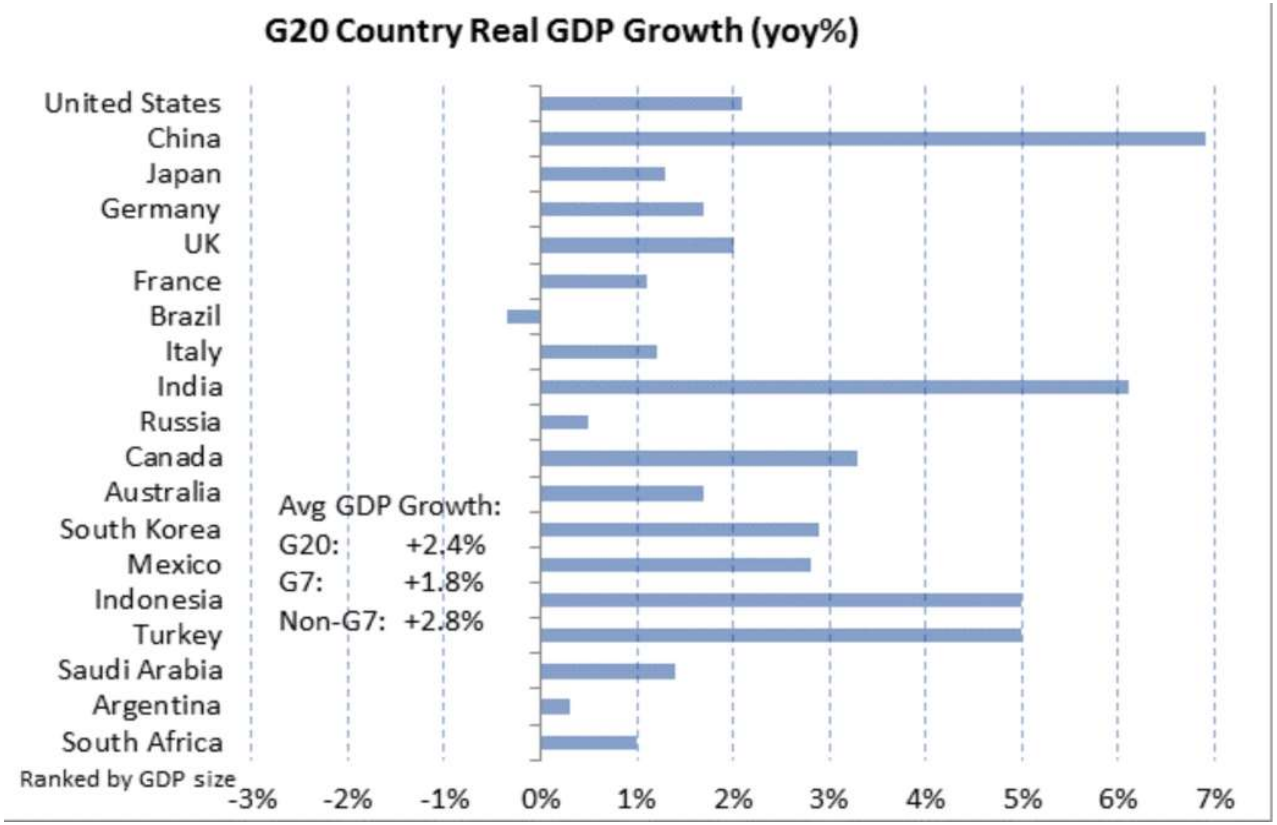
What I am thinking about

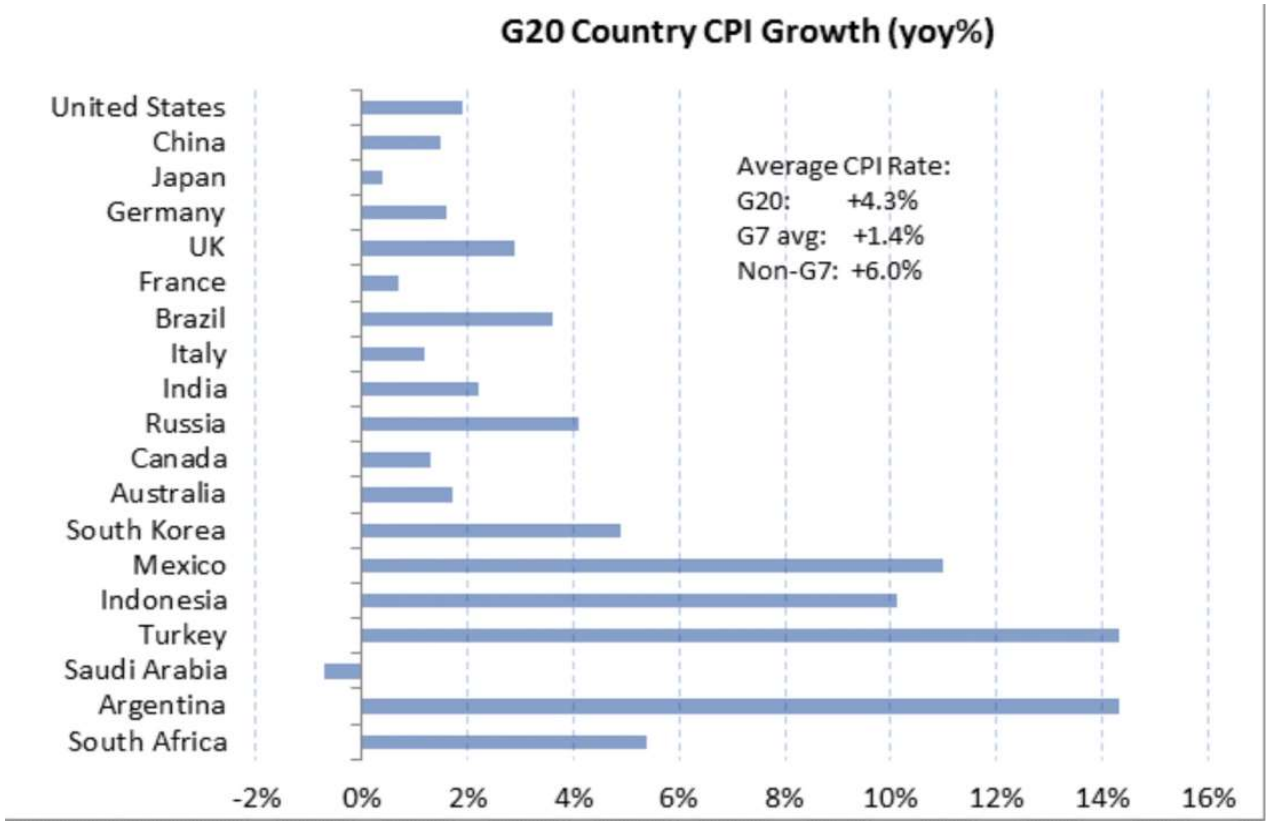
- Energy (oil) market continues to be destabilized – OPEC and Russia can't engineer a price rise.
- Fiscal policy to return. The ongoing role of QE will be questioned in 2018 – but not in Japan.
- Excessive Australian household debt maintains concerns for the residential property market.
- Meanwhile Australia is aging and too many retirees are underfunded.
- Australian investment cycle not robust, employment and wages growth moderate.
- Chinese outbound tourism the stabilizer for Australia economy in a low growth period.

Well – we were warned!

The world is growing – but slowly – G20 2.4%

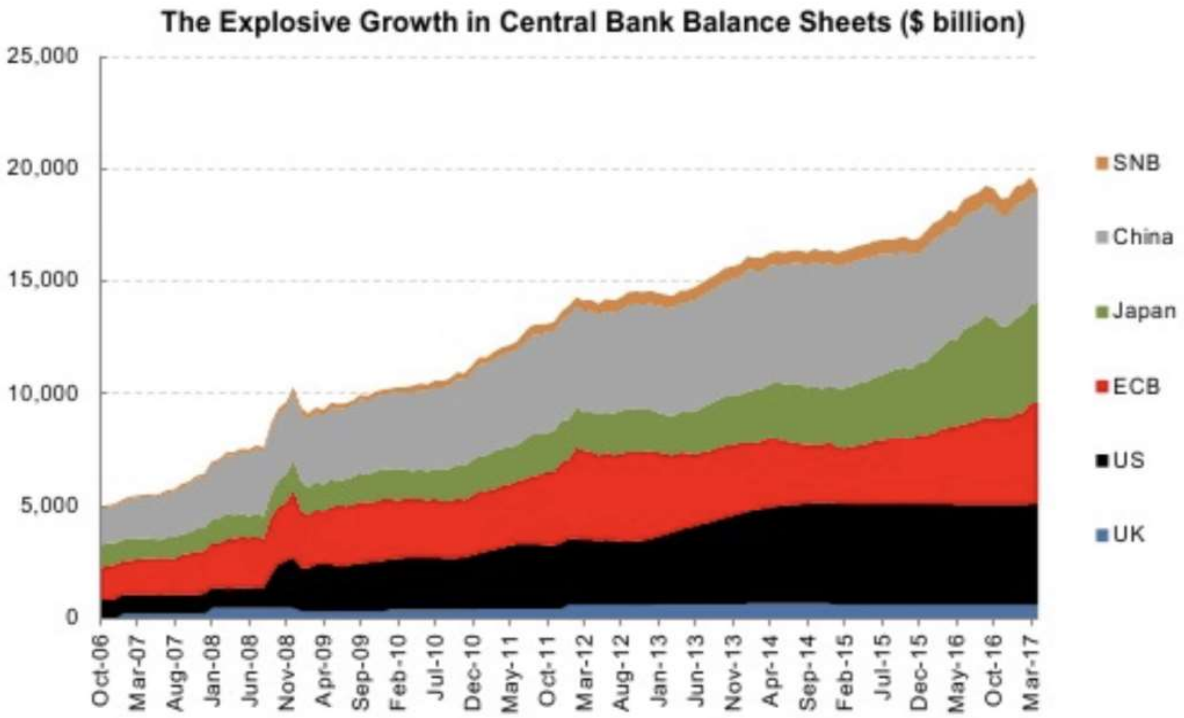


Inflation under control in major economies – G7 1.4%



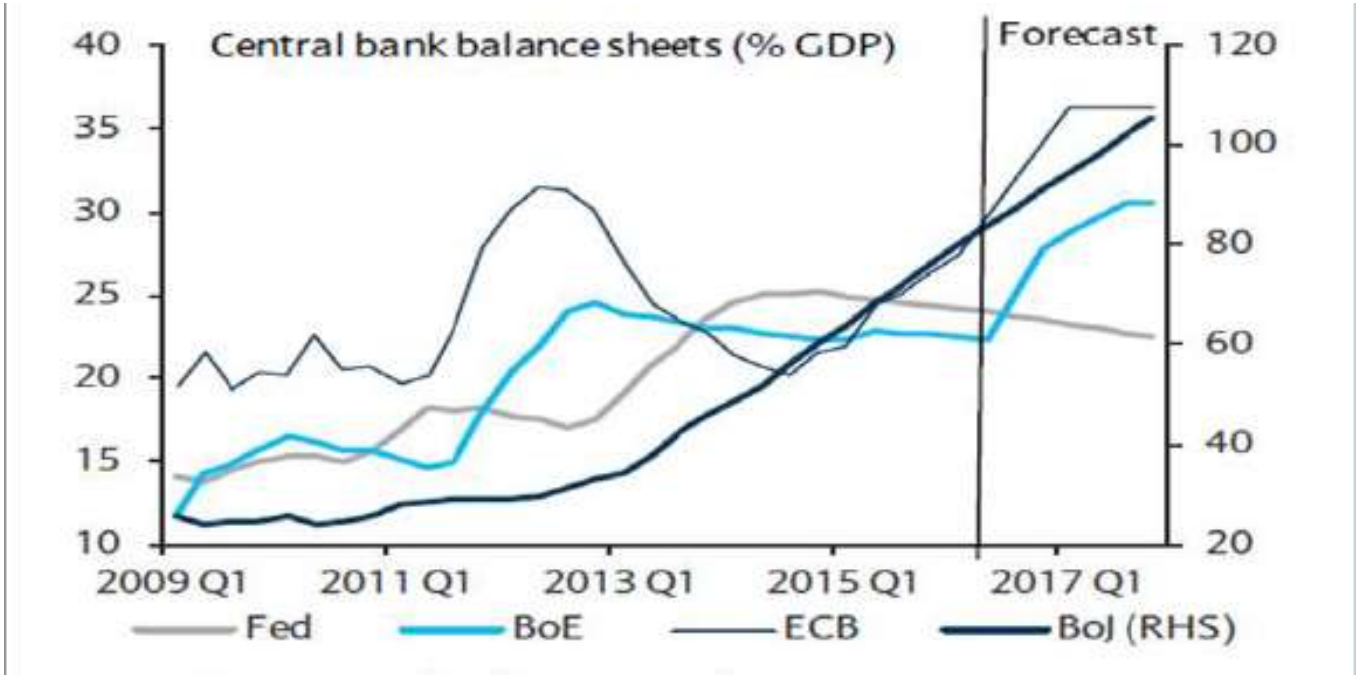
Fund Managers not on the list!

The creation of free money – Central Bank balance sheets



QE to continue – ECB to sanitize – Japan on drugs

… while monetary expansion could be reaching its limits



Source: National central banks, Haver Analytics, Barclays Research

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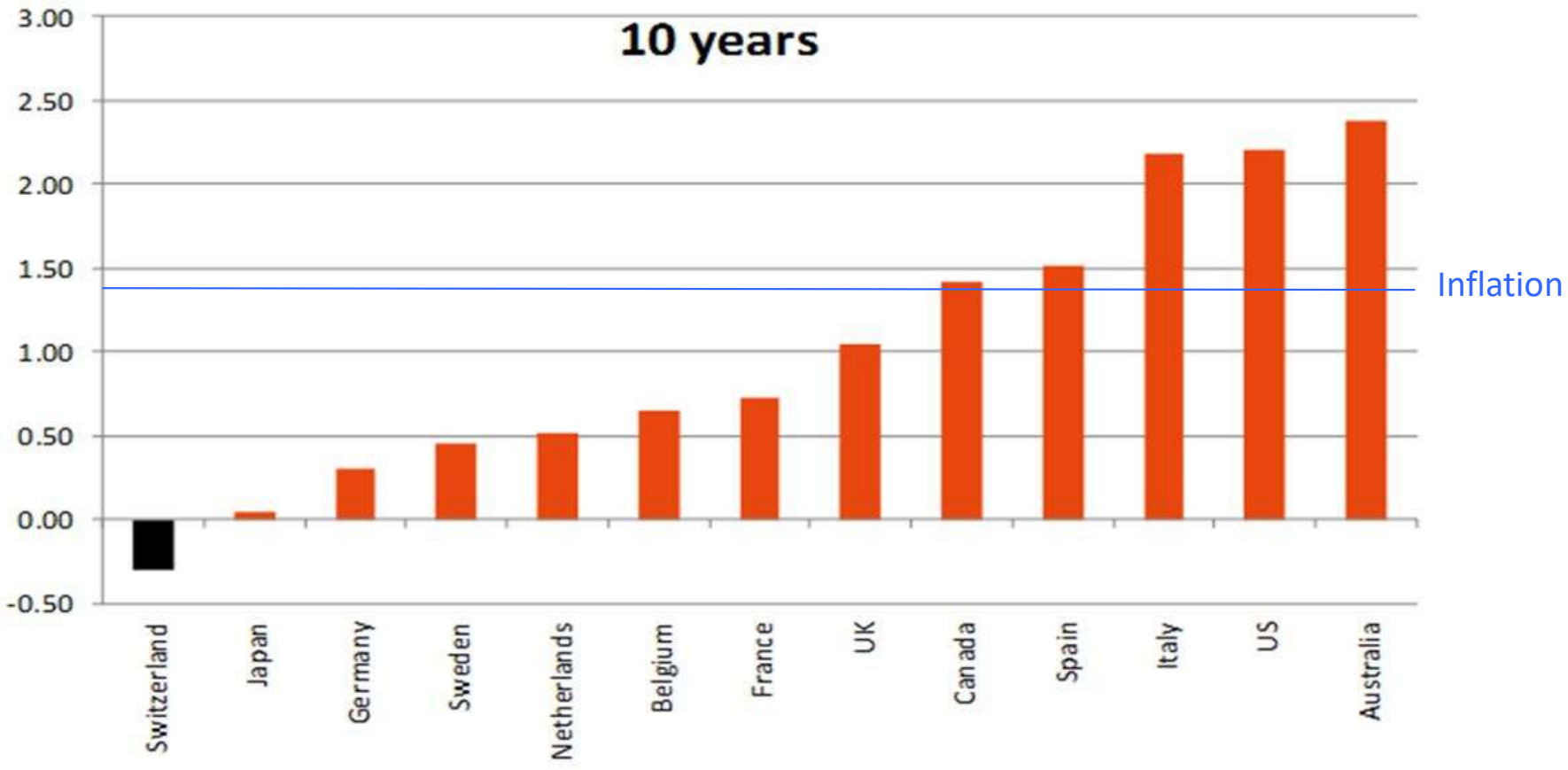
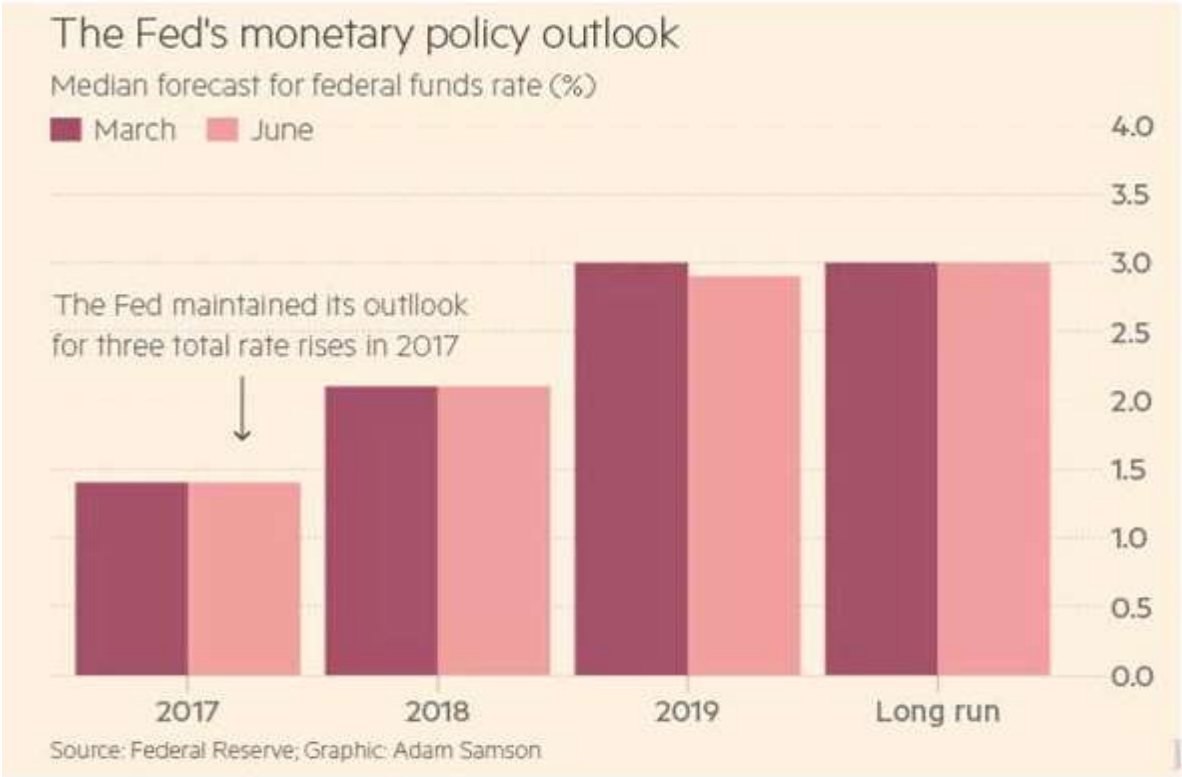
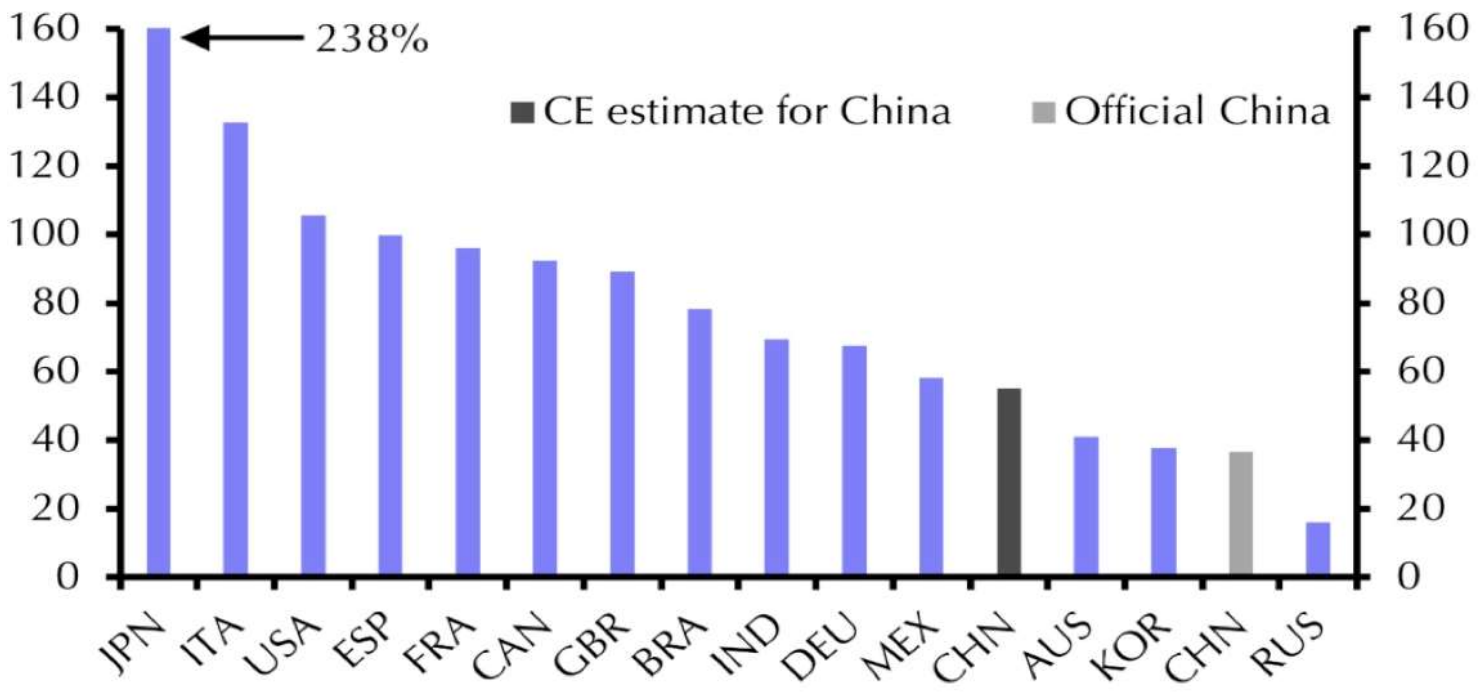
Yields on ten year bonds – most below inflation



US cash rates expected to be 3% by late 2019 – Australia?

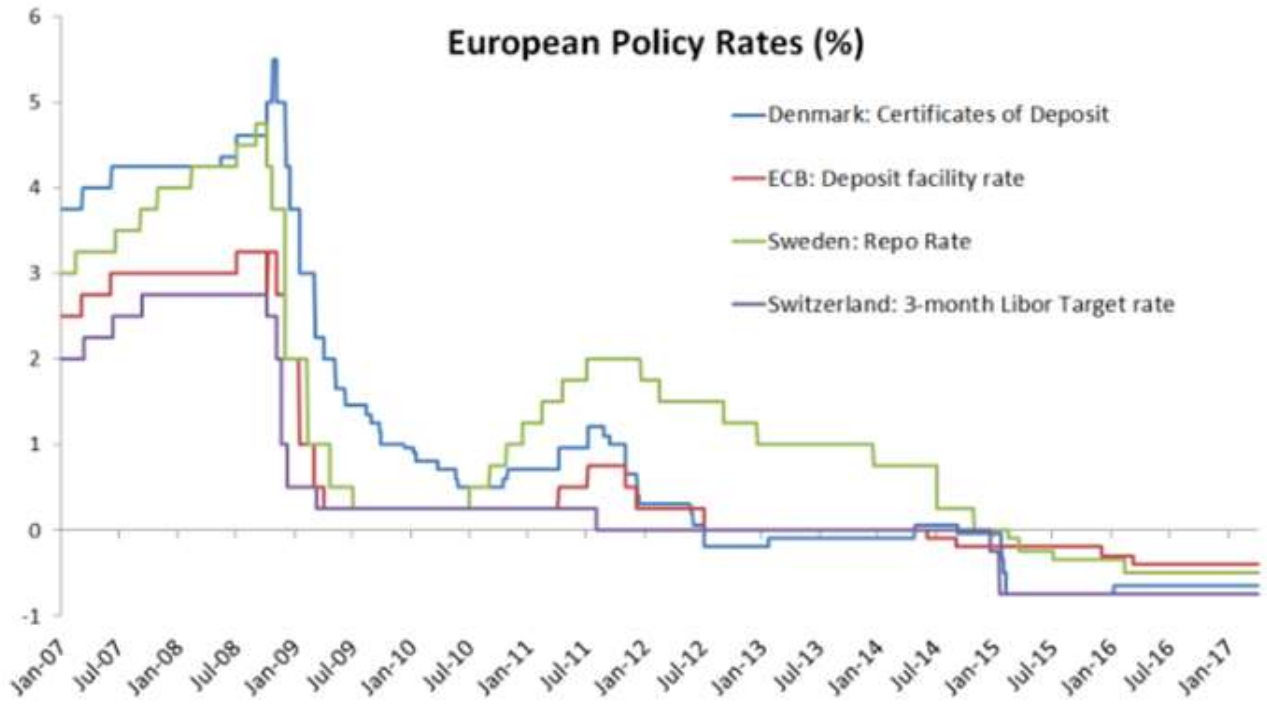


Government debt – does anyone care?



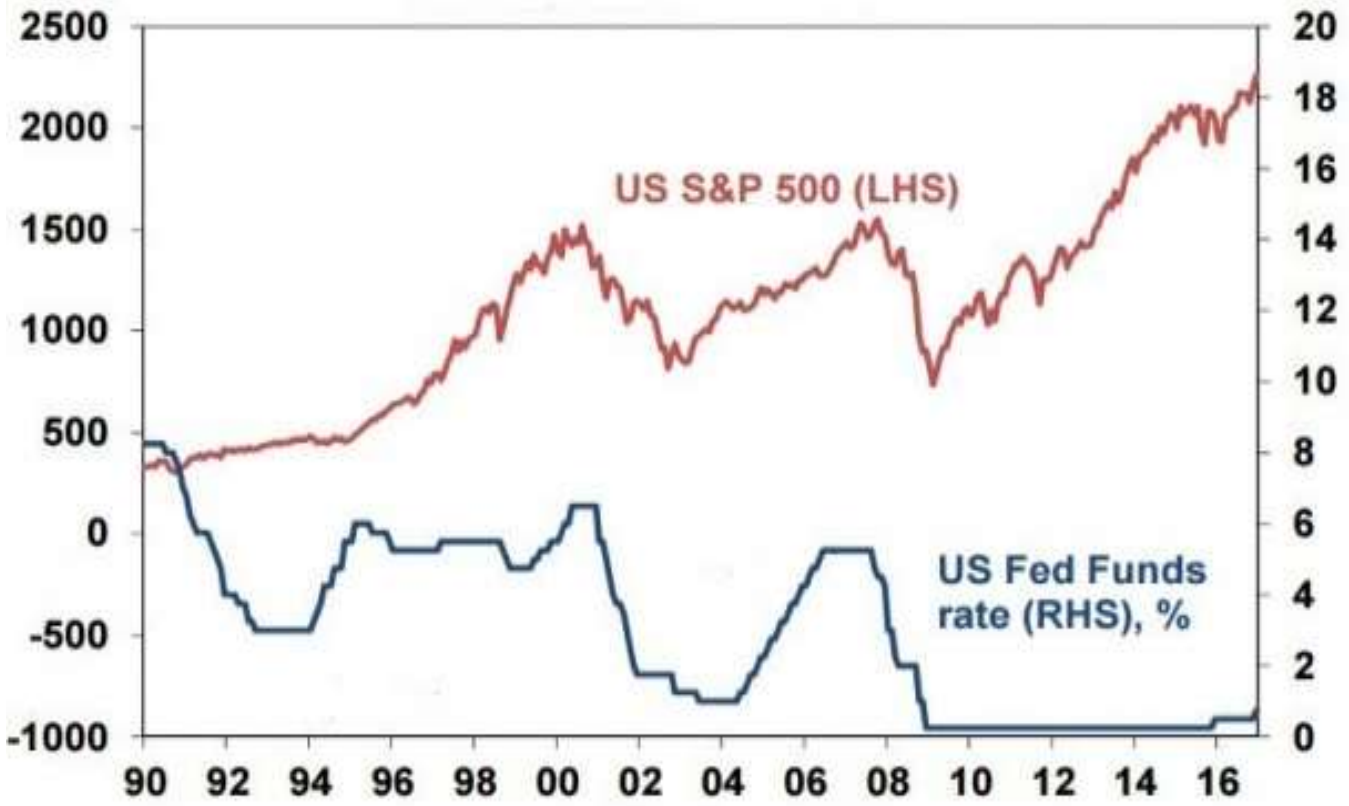
Source: IMF, Bloomberg, CEIC, Capital Economics

European cash rates - NEGATIVE – Won't move till 2018

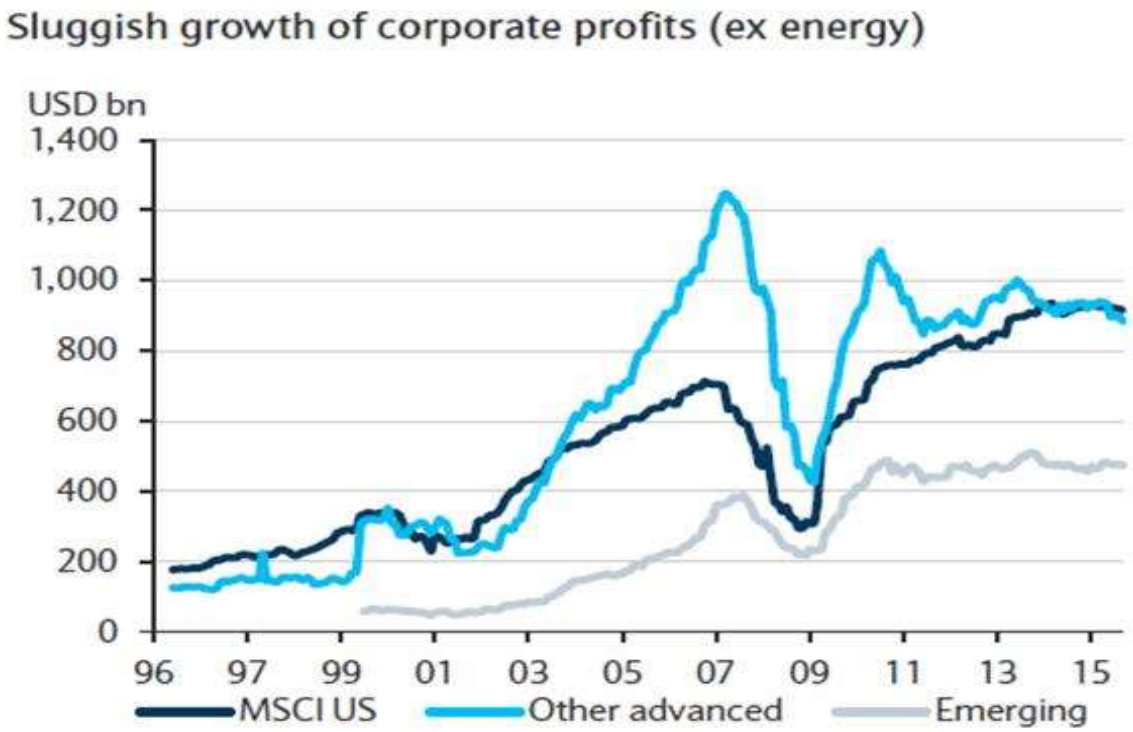


Source: Bloomberg & Alphinity

US stock market supported by ultra low interest rates



Corporate earnings across the world have stalled for over 3 years



Source: Capital Economics

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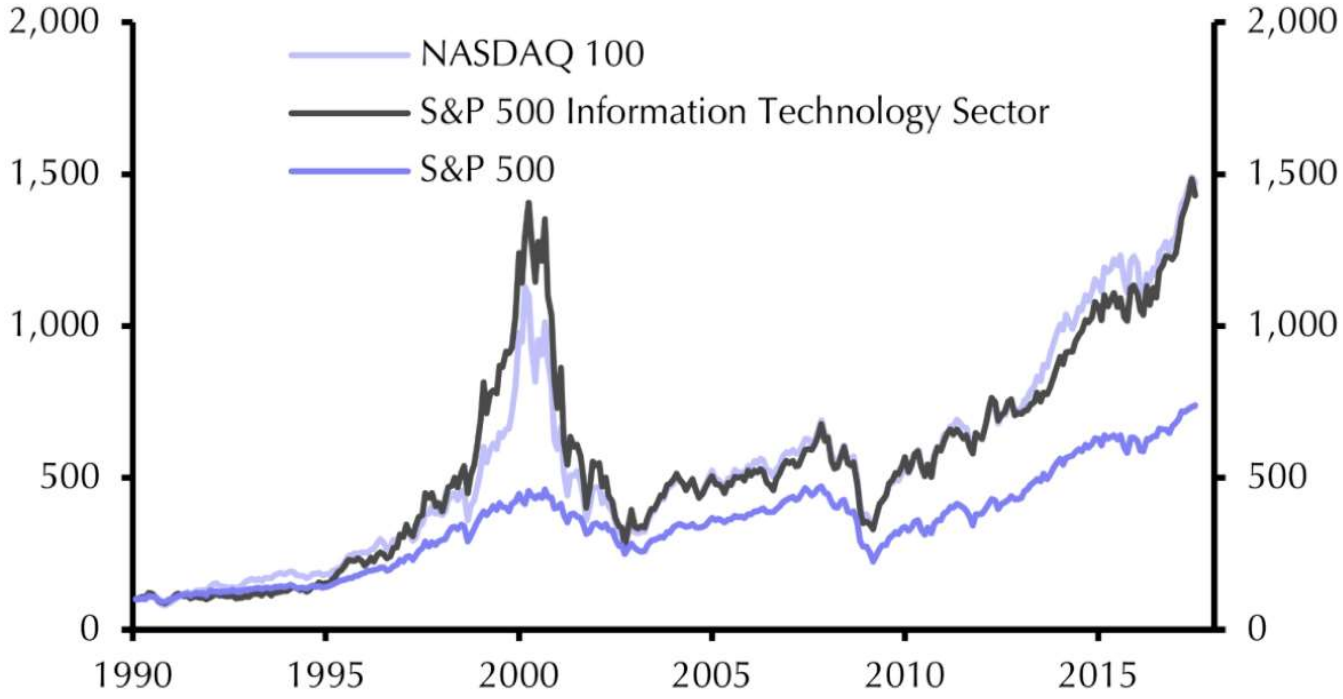
US market – 22% are IT companies

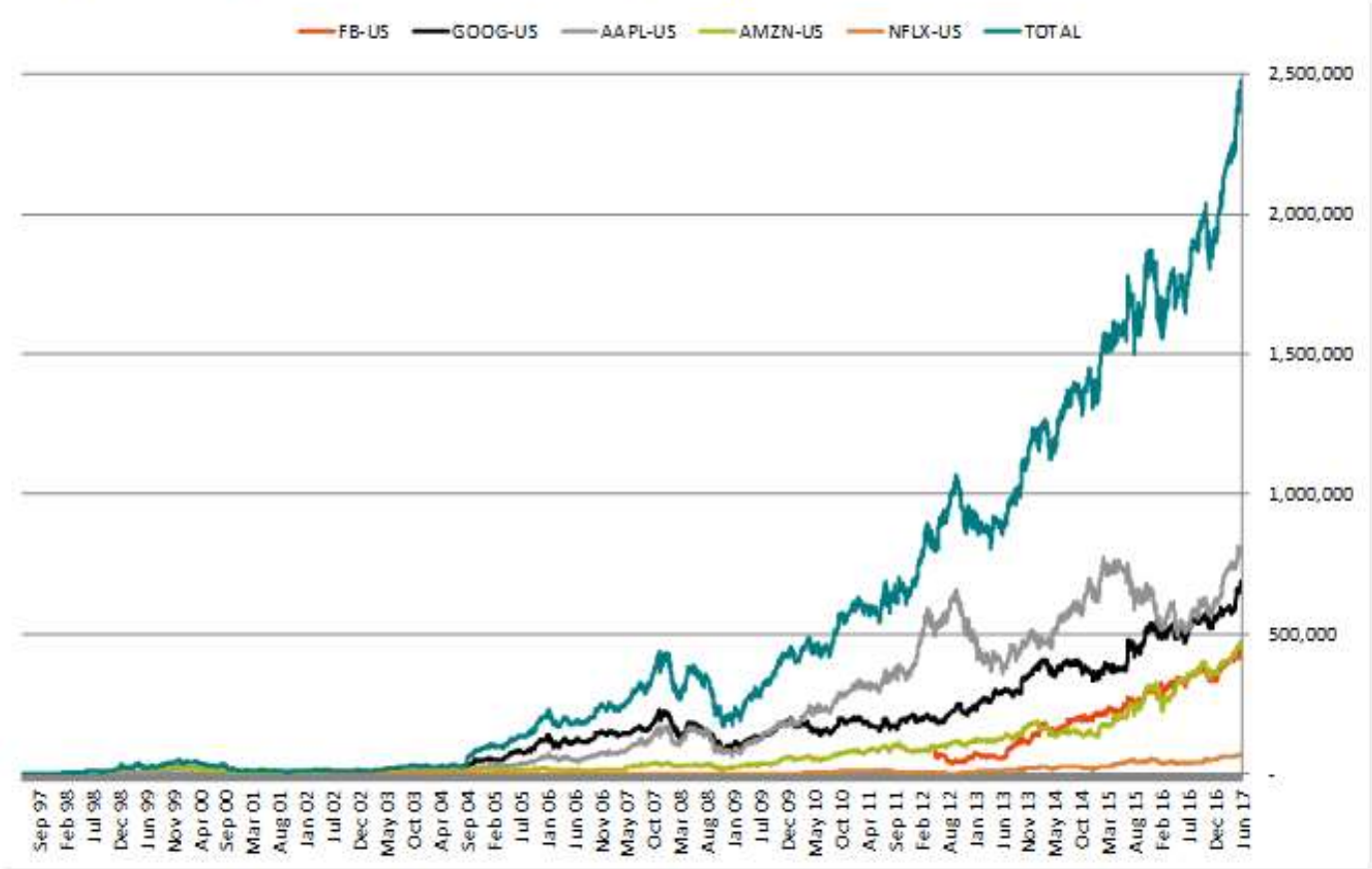
Sector Name	Stocks	Market Cap	PE Ratio	PS Ratio	PB Ratio	Dividend Yield
Computer and Technology	753	$7,062,258	25.9	4.02	4.42	0.63%
Finance	1178	$6,520,851	15.43	3.93	2.33	3.41%
Medical	734	$3,901,787	12.67	150.44	6.95	0.21%
Oils/Energy	334	$3,379,277	19.44	3.11	14.88	3.44%
Retail/Wholesale	243	$2,439,281	25.2	1.22	5.26	1.04%
Consumer Staples	157	$2,292,776	23.58	9.84	17.76	1.56%
Consumer Discretionary	275	$1,731,762	20.27	2.22	23.68	1.04%
Utilities	130	$1,323,968	21.93	3.09	2.22	3.34%
Basic Materials	181	$1,087,333	24.43	2.11	3.05	1.72%
Construction	167	$990,851	25.33	1.9	4.38	1.21%
Industrial Products	213	$707,447	24.13	1.61	3.4	1.09%
Transportation	139	$674,968	11.54	1.59	2.11	2.97%
Multi-Sector Conglomerates	20	$622,000	19.86	1.6	2.44	1.94%
Auto/Tires/Trucks	62	$603,674	12.68	0.91	4.45	1.18%
Aerospace	44	$401,737	28.29	1.28	6.57	0.83%
Construction	110	$342,935	19.75	1.45	6.53	0.67%

Technology stocks driving the US equity market



FAANGS – THE "IT REVOLUTION"

NASDAQ – Powered by FAANG…2.468 trillion in market cap.



US corporations stockpiling $2 trillion in tax havens

Source: SEC Filings, Audit Analytics, CE

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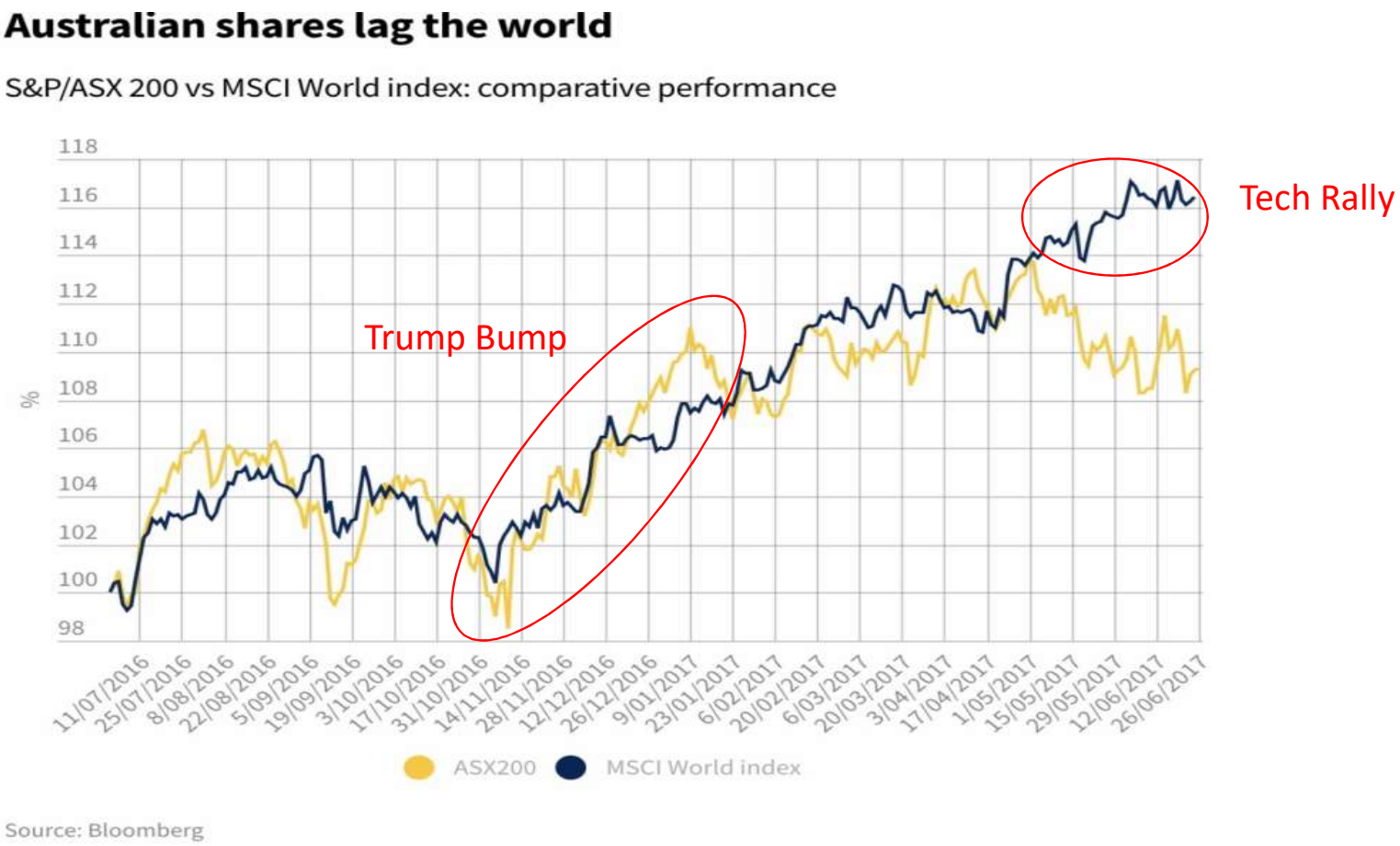
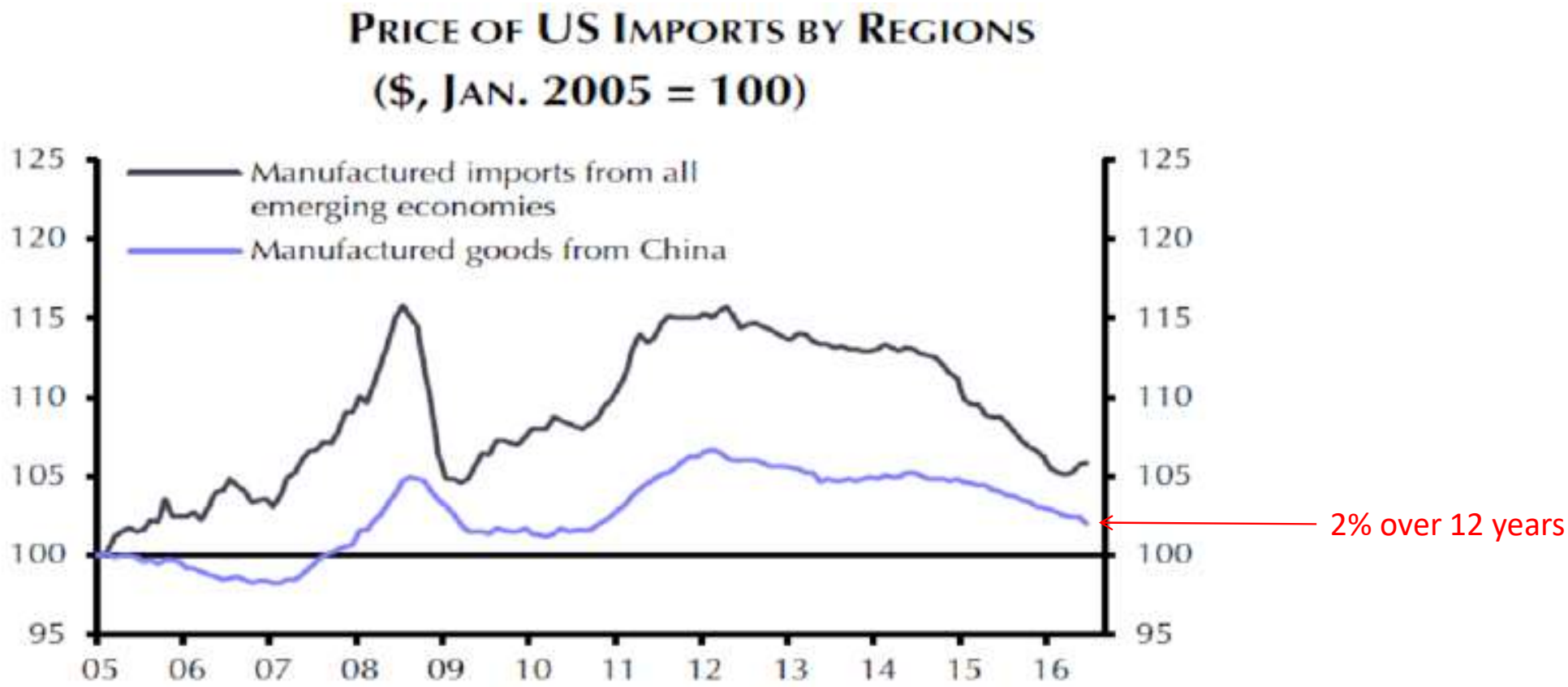
Technology absent from the Australian market



Source: Bloomberg

CHINA v TRUMP - Cheap Chinese imports into US



Source: Thomson Datastream, Capital Economics

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Chinese trade surplus continues to grow – mainly with the US

$40 billion per month. $20 billion against US

Source: CEIC, Capital Economics

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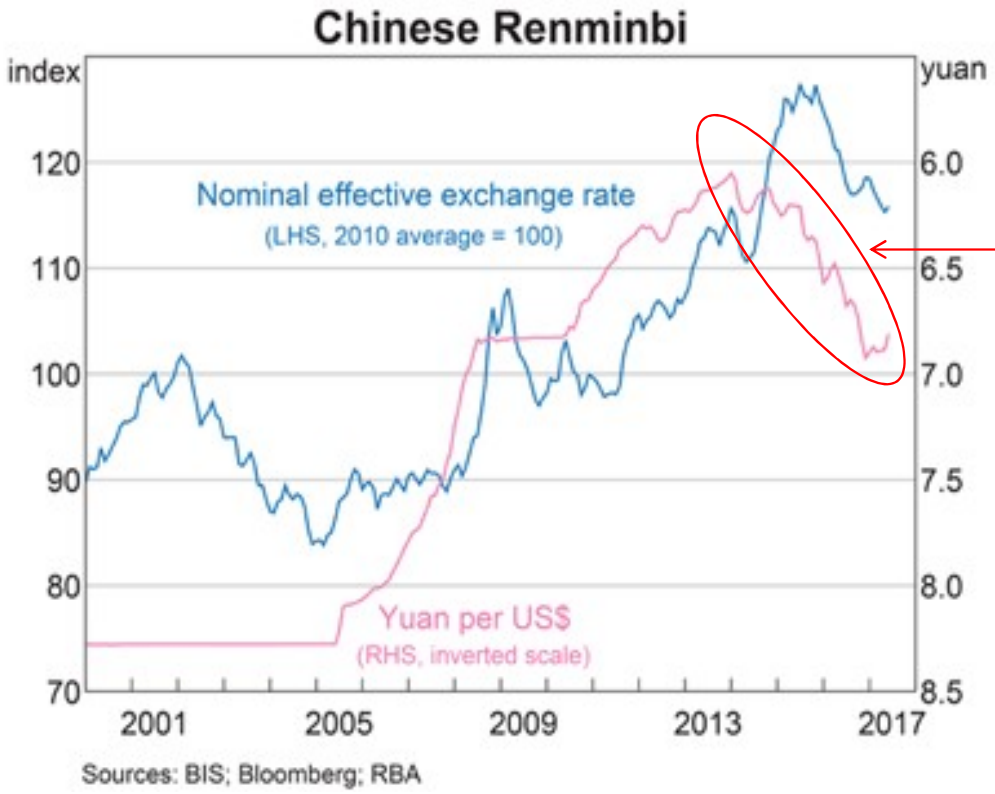
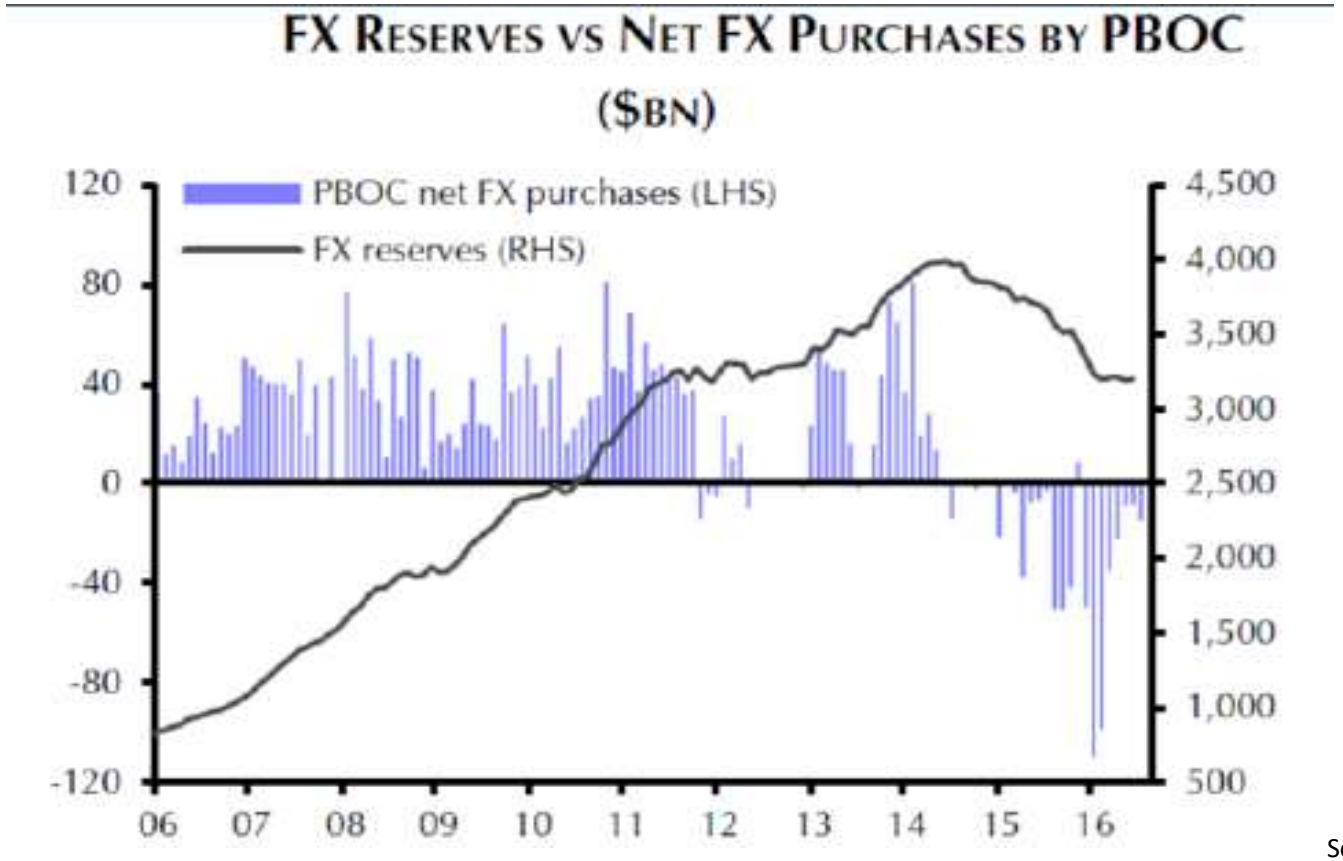
Chinese devaluation against USD – Trump has a point



15% devaluation over 3 years

Chinese capital outflows hold down Yuan



Source: CEIC, Capital Economics

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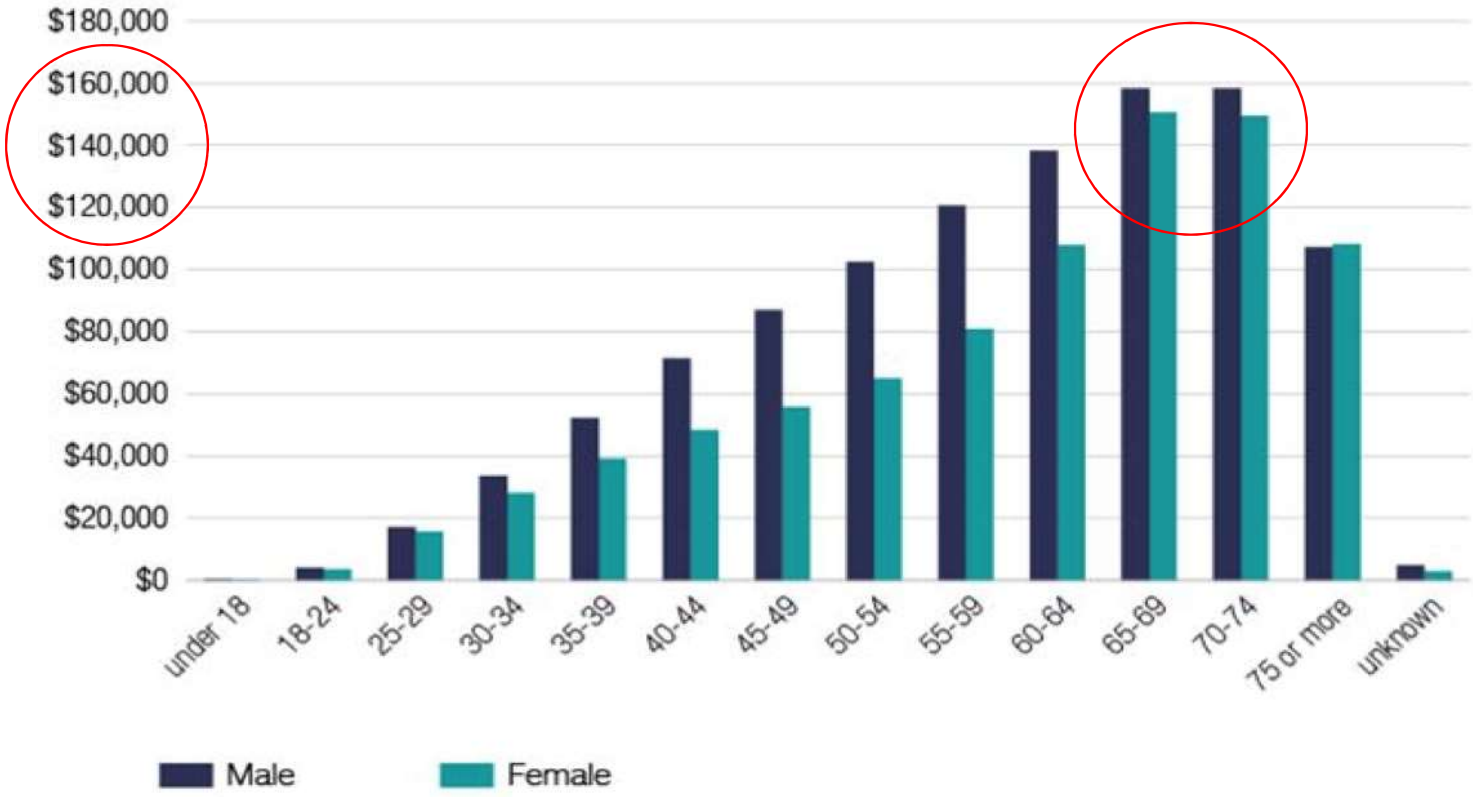
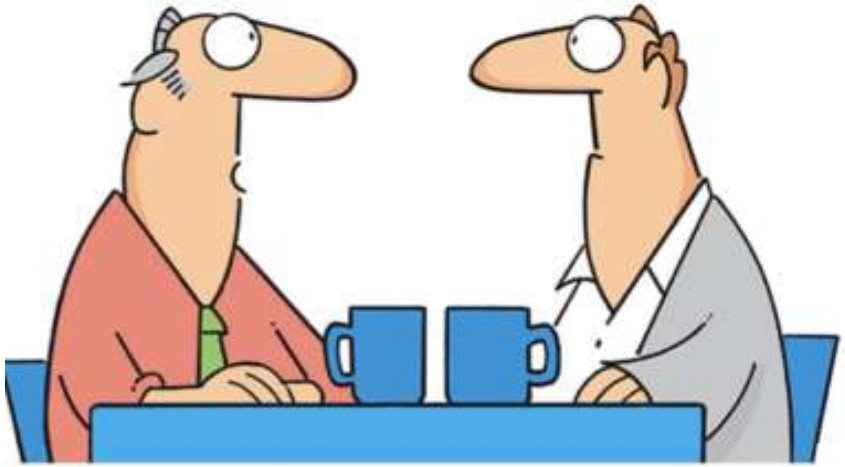
AUSTRALIA - Our super balances – Average retiree underfunded





"At age 65, I'm having my age legally changed to 22 so I can start saving for my retirement."

Australia's equity returns

		Absolute Price Performance (%)								
	Price	1-Mo	3-Mo	6-Mo	12-Mo	3-Yr*	5-Yr*	10-Yr*	FYTD	CYTD
Size Indices										
All Ordinaries	5764.0	0.05	-2.37	0.79	8.54	2.31	6.87	-0.90	8.54	0.79
S&P/ASX Small Ordinaries	2371.9	1.62	-0.83	-0.44	3.71	3.63	2.26	-5.04	3.71	-0.44
S&P/ASX 20	3236.0	-0.14	-5.08	-1.69	8.58	-1.62	5.46	-0.26	8.58	-1.69
S&P/ASX 50	5667.0	-0.44	-3.50	0.08	9.12	0.62	6.47	-0.65	9.12	0.08
S&P/ASX 100	4745.3	-0.18	-2.59	1.05	9.75	1.87	7.17	-0.62	9.75	1.05
S&P/ASX 200	5721.5	-0.05	-2.45	0.98	9.33	1.97	6.92	-0.92	9.33	0.98
S&P/ASX 300	5668.8	-0.01	-2.43	0.91	9.11	2.01	6.78	-1.05	9.11	0.91
S&P/ASX MidCap 50	6258.5	1.54	3.81	7.92	14.22	11.49	12.23	-0.36	14.22	7.92
Macro Indices										
S&P/ASX Small Industrials	2627.0	1.99	-0.47	0.31	4.06	5.20	7.20	-3.61	4.06	0.31
S&P/ASX Small Resources	1981.2	-0.01	-2.08	-3.26	2.30	-2.89	-11.83	-9.83	2.30	-3.26
S&P/ASX 100 Industrials	5081.2	0.23	-2.58	1.60	7.90	3.83	9.79	0.16	7.90	1.60
S&P/ASX 100 Resources	4665.3	-2.36	-2.70	-1.87	21.16	-6.95	-2.87	-4.13	21.16	-1.87
S&P/ASX 200 Industrials	9350.3	0.34	-2.44	1.54	7.58	3.91	9.66	-0.08	7.58	1.54
S&P/ASX 200 Resources	3290.3	-2.10	-2.50	-1.89	19.77	-6.76	-3.44	-4.65	19.77	-1.89
S&P/ASX 300 Industrials	9226.5	0.40	-2.39	1.49	7.52	3.93	9.59	-0.21	7.52	1.49
S&P/ASX 300 Resources	3288.4	-2.10	-2.66	-2.07	18.53	-6.61	-3.68	-4.73	18.53	-2.07
S&P/ASX MidCap 50	6258.5	1.54	3.81	7.92	14.22	11.49	12.23	-0.36	14.22	7.92
S&P/ASX MidCap 50 Industrials	6192.8	1.23	2.92	5.47	7.83	10.13	13.01	-0.71	7.83	5.47
S&P/ASX MidCap 50 Resources	5557.7	3.70	10.39	23.58	70.51	21.10	10.54	0.60	70.51	23.58
S&P/ASX 200 A-REIT	3108.6	-5.83	-4.20	-4.83	-8.49	7.11	8.91	-5.61	-8.49	-4.83
S&P/ASX 200 FINANCIAL-x-A-REIT	7211.9	1.63	-5.97	-1.39	13.49	0.25	8.88	-0.17	13.49	-1.39

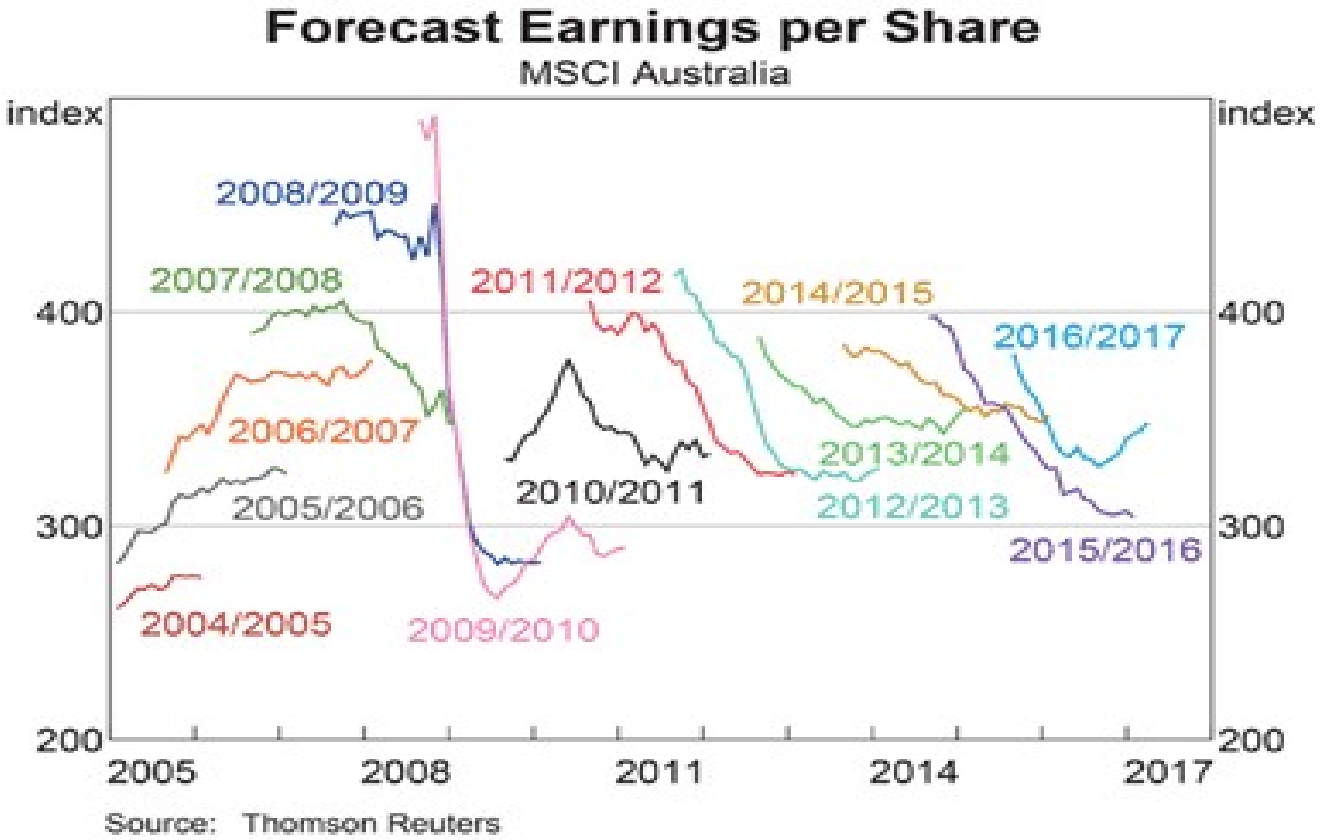
No capital gain for 10 years

Negative return for 10 years – despite 20% return last 12 months

REITs recovered GFC disaster – but overshot

Australian share market returns dominated by dividends

Biggest challenge for Australian investors – earnings growth



Source: MSCP, RBA, Thomson Reuters

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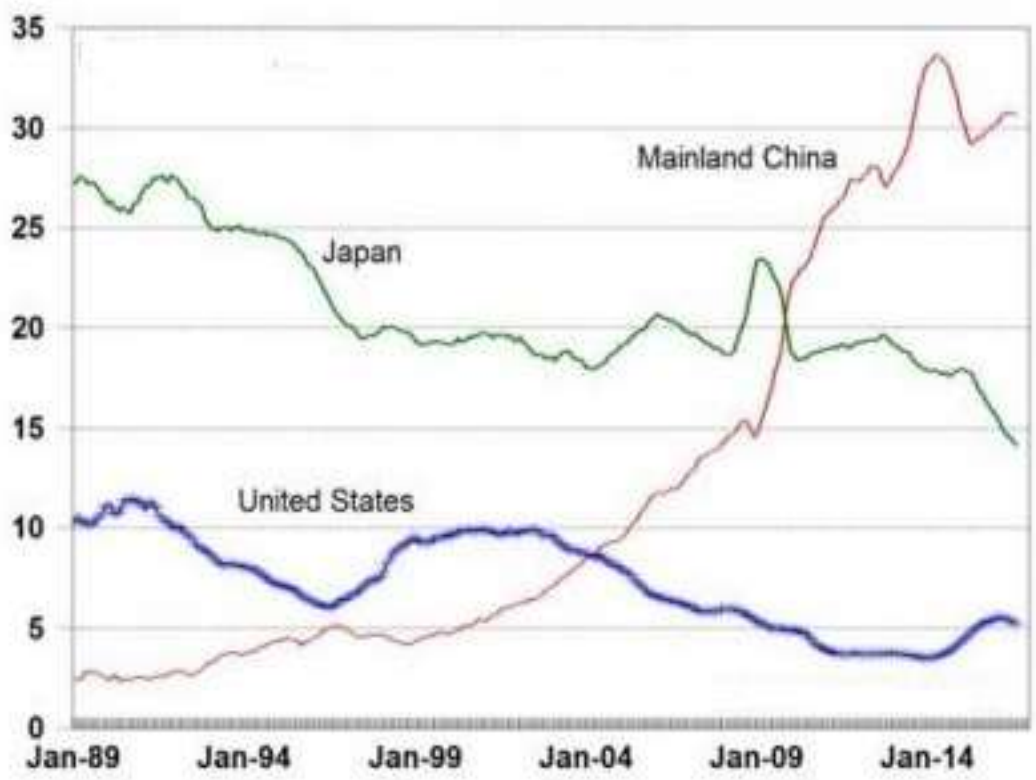
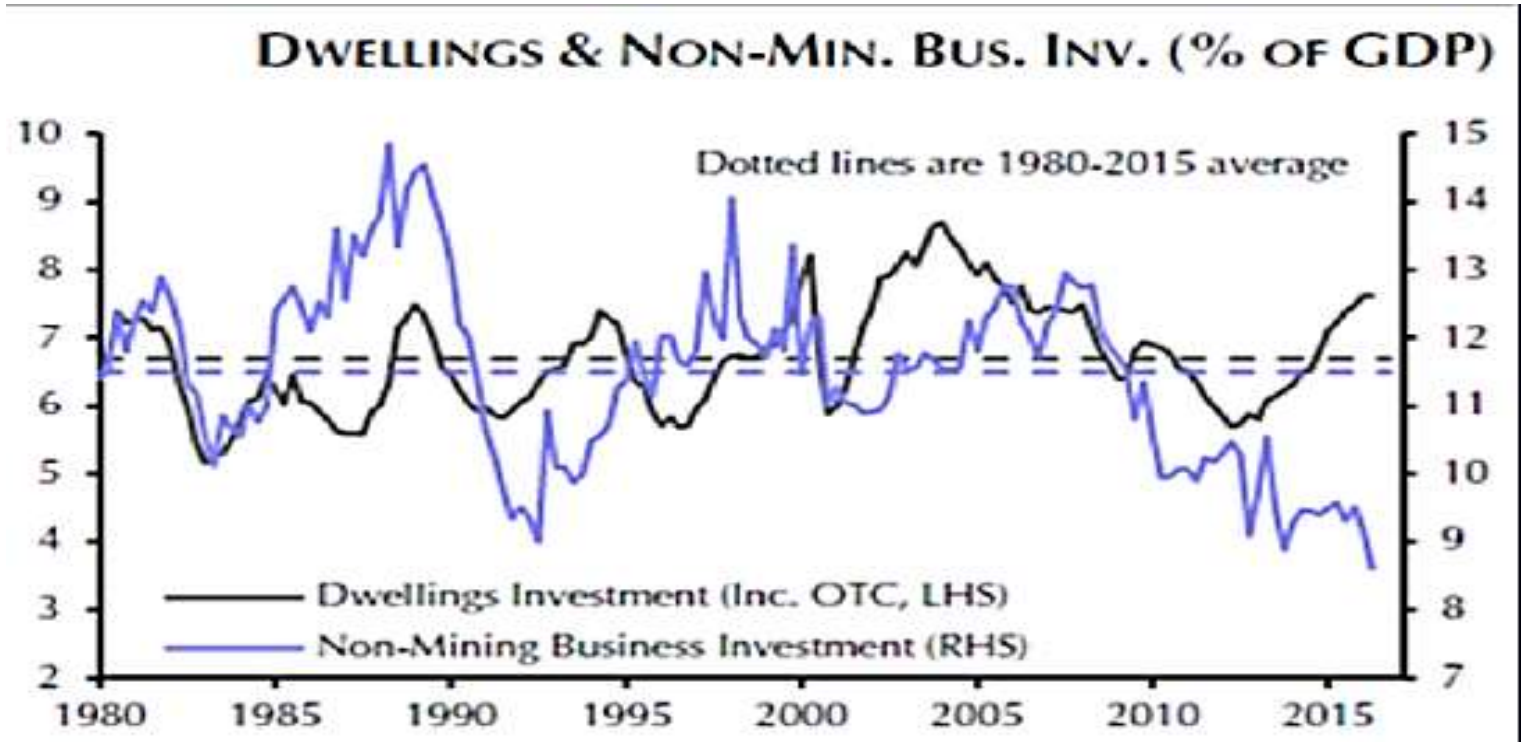
The Australian Share Market

Australia's trade destination – its China by a mile



Australia's investment focus on dwellings not production



Source: Thomson Datastream

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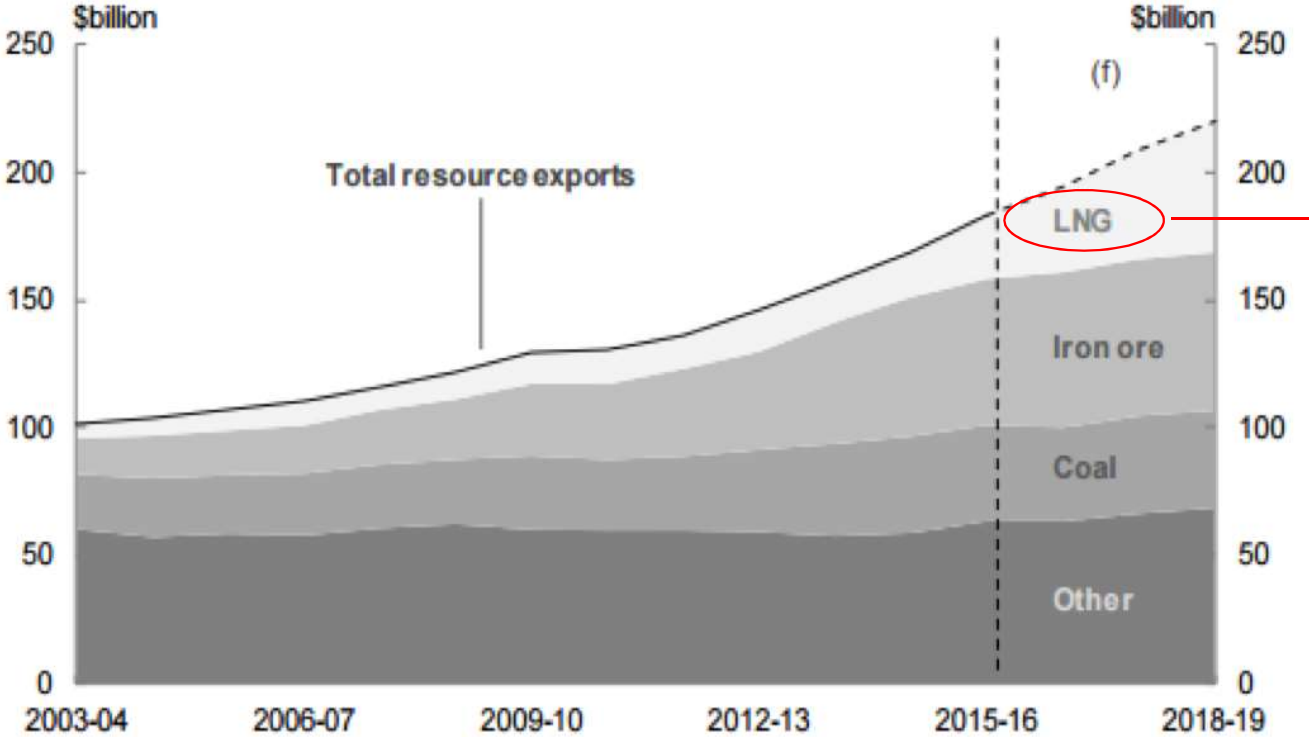
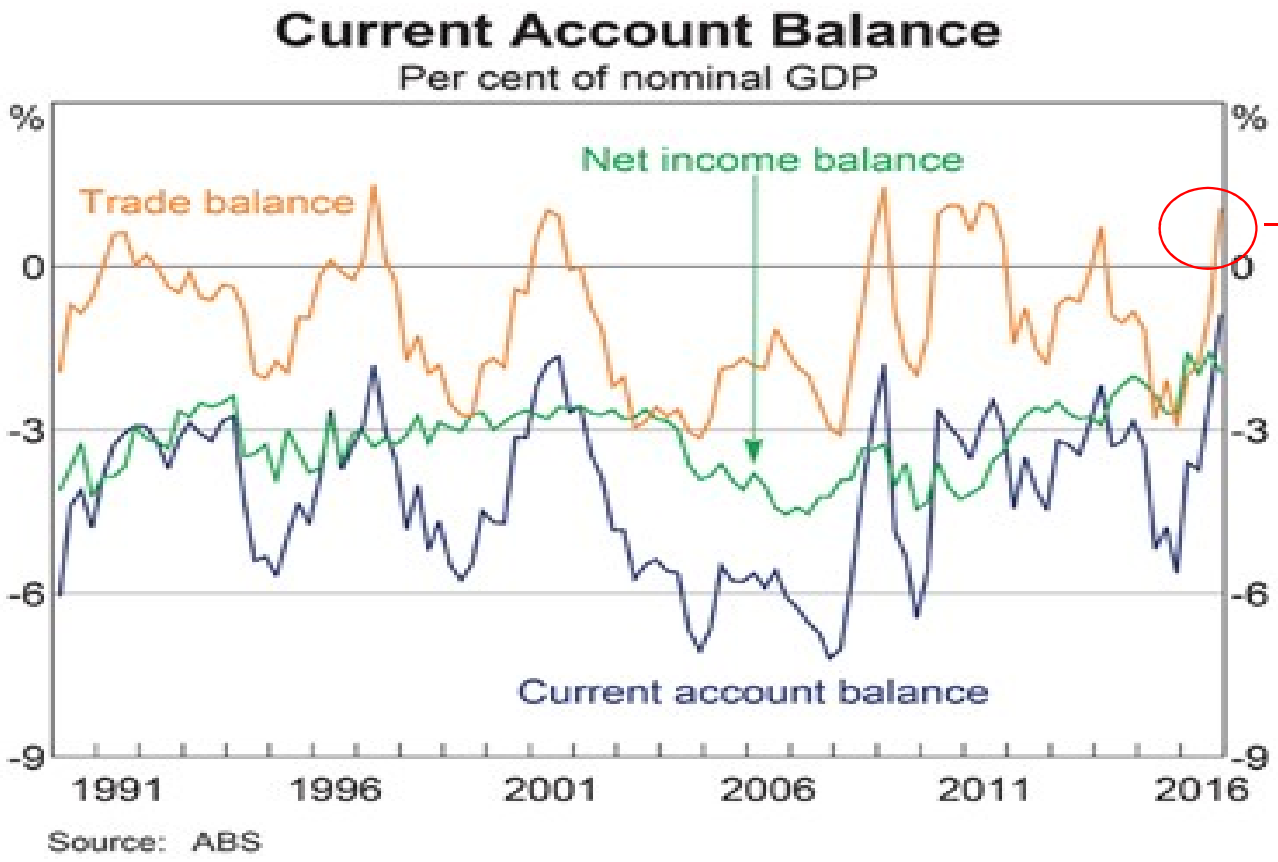
Australia's major exports – the third leg is LNG



Note: 2014-15 prices. Other category includes a combination of smaller commodities such as metals, metal ores and mineral fuels.
Source: ABS cat. no. 5302.0, ABS Trade Data and Treasury.

$50 billion export earner

$A holds until 2018 - LNG peaks – then import consumption grows



Trade surplus appears

Source: RBA Chart Book

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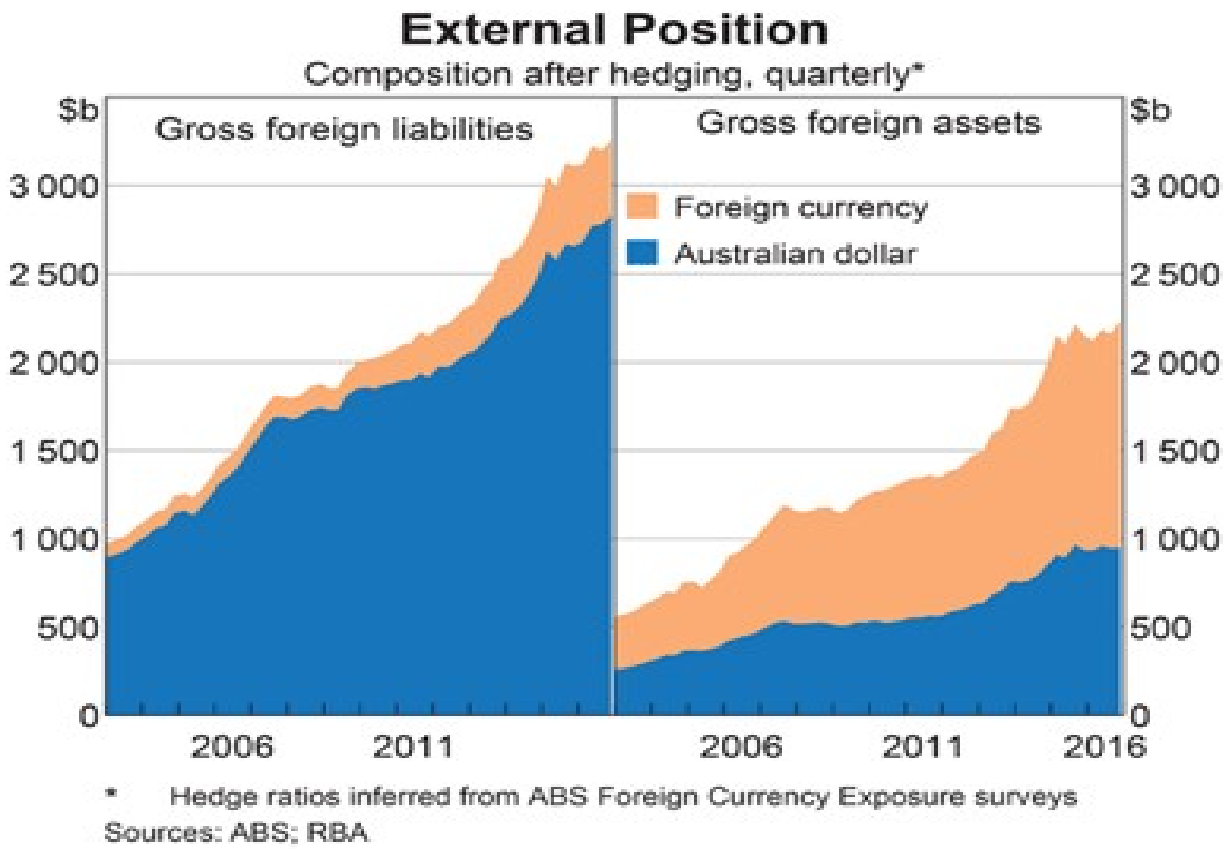
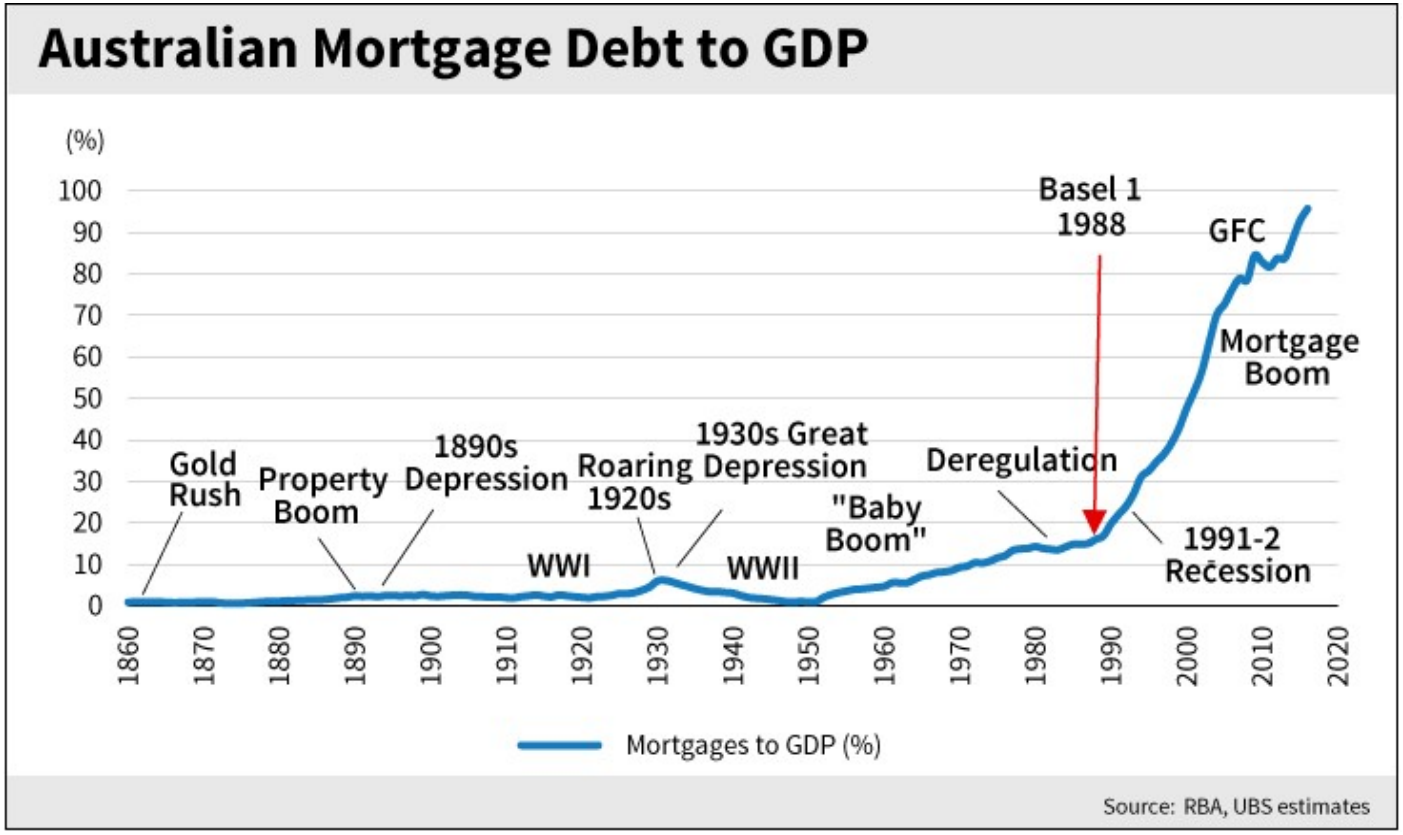
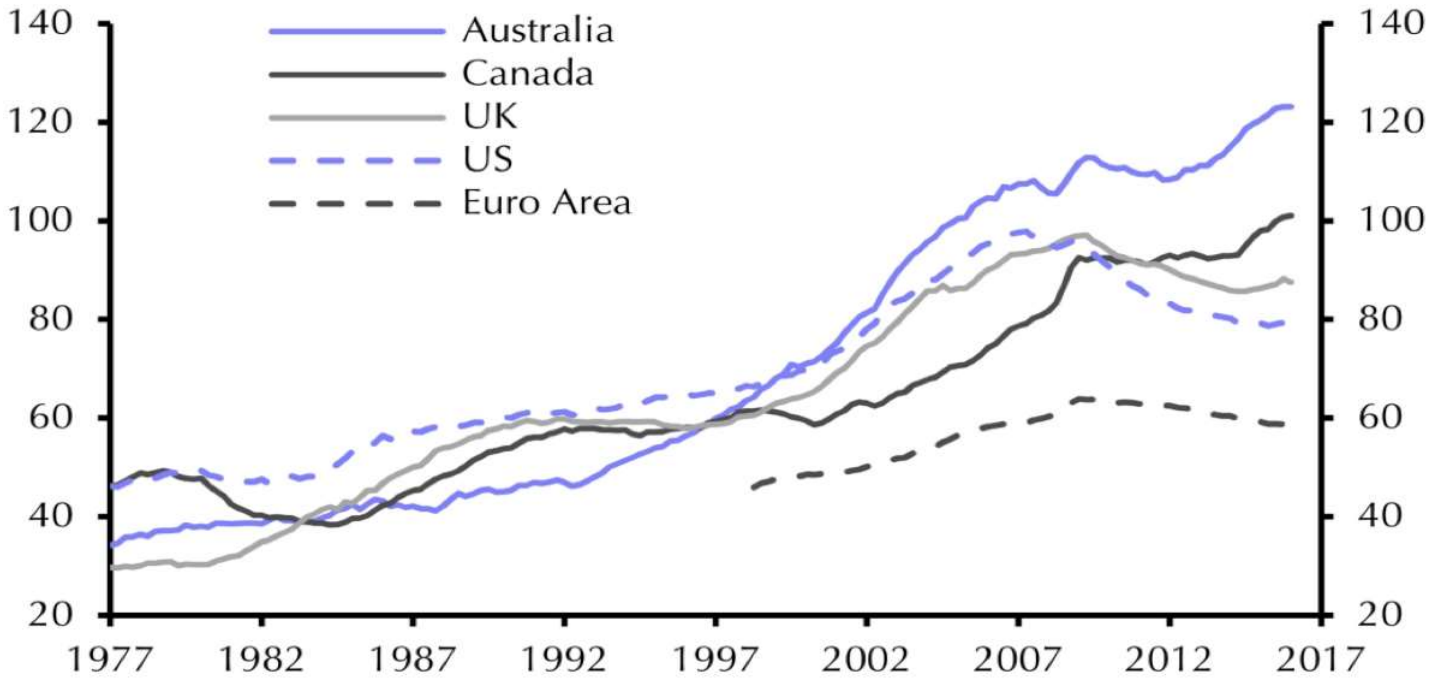
Net foreign liabilities $1 trillion



20 years of growth and household debt



Australia's household debt



Source: BIS

Sydney average house at 14 times average income

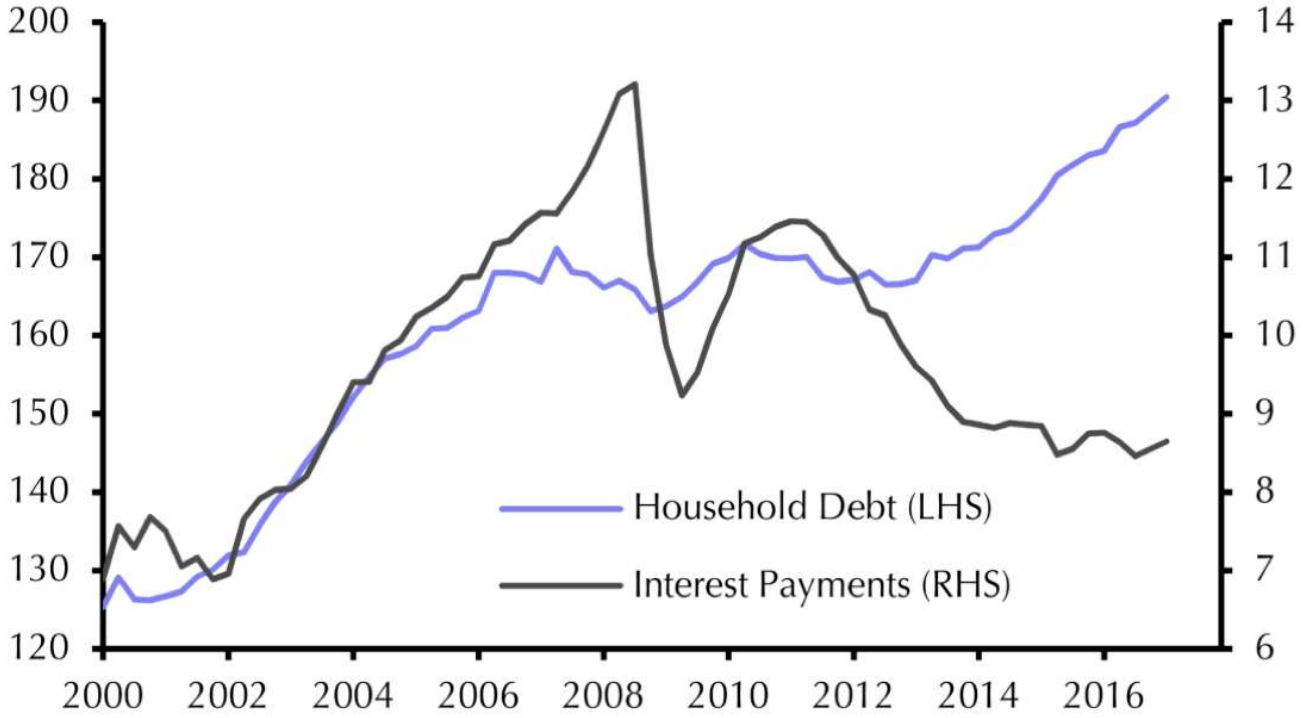
Highlights

- Average of 5 capital cities - +10.3% for the year, no crash yet. Sydney +1.8% for the month, Melbourne +2.8%.

	Houses			Units		
30/06/2017	000's	% MoM	% YoY	000's	% MoM	% YoY
Sydney	$1,220	1.8%	13.0%	$797	4.5%	8.6%
Melbourne	$980	2.8%	15.0%	$536	2.3%	1.5%
Brisbane	$580	-1.0%	3.3%	$406	1.1%	1.2%
Adelaide	$495	-1.6%	2.7%	$342	-3.7%	-1.3%
Perth	$585	1.4%	-1.9%	$459	0.7%	0.5%
5 City	**$875**	**1.5%**	**10.3%**	**$622**	**3.2%**	**5.4%**

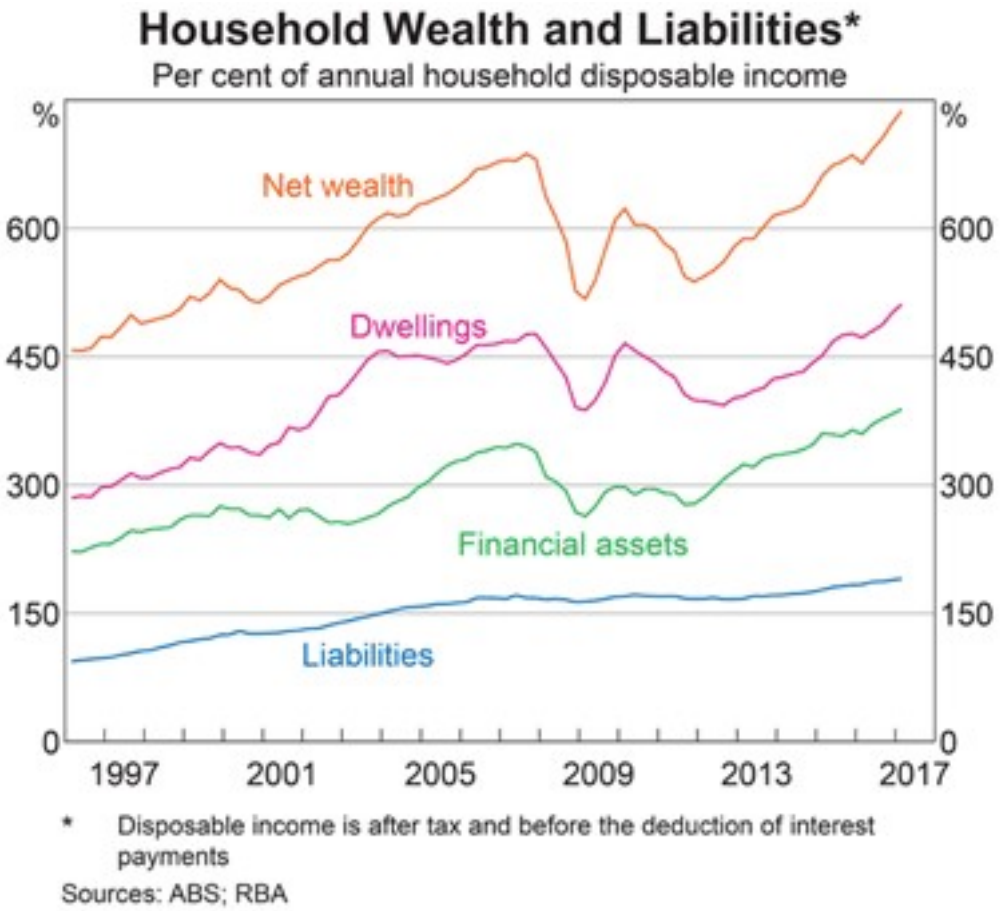
Source: Corelogic

So long as interest rates stay low – we are safe!



Source: Reserve Bank of Australia

Understanding the household sector – disposable income $1 trillion



Net wealth $7 trillion

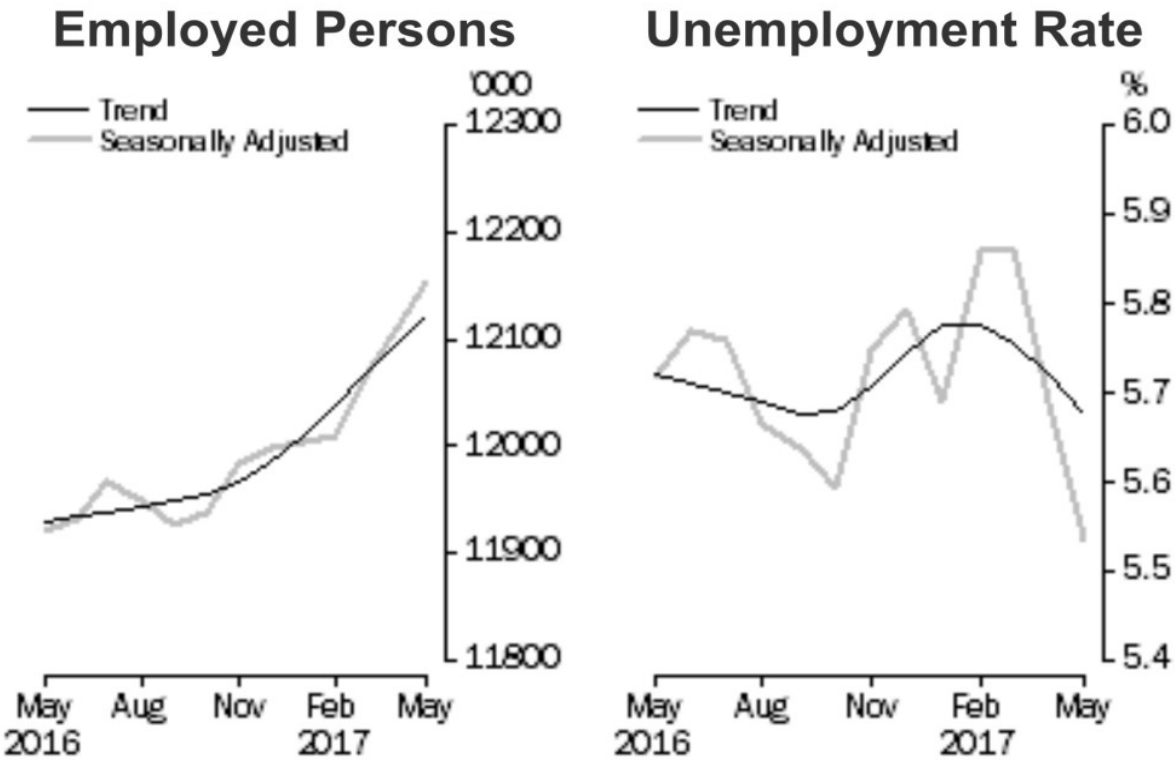
Dwellings $5 trillion

Financial assets $3.5 trillion of which super is $2.1 trillion

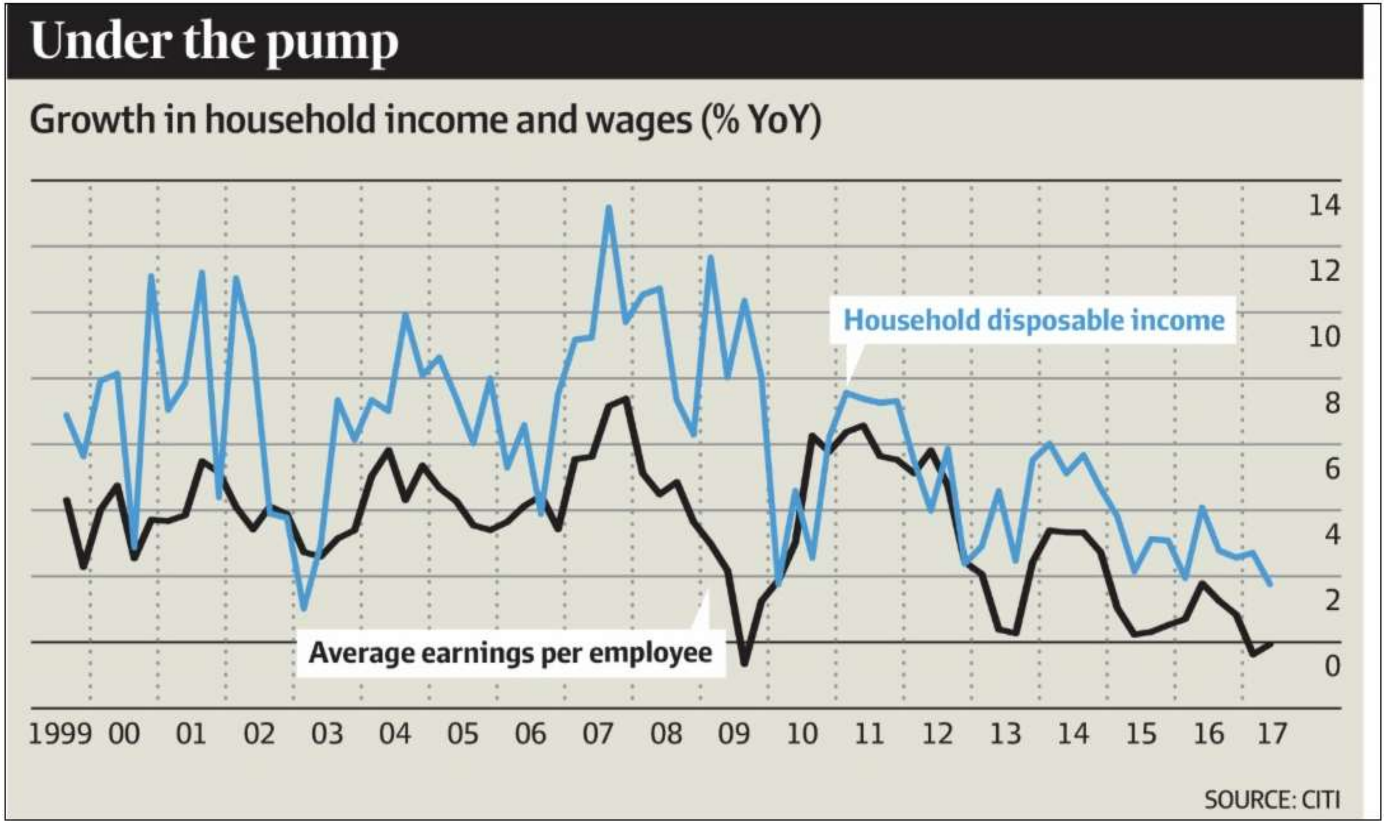
Mortgage debt $1.6 trillion

"When you're done saving for my education, don't forget to start saving for my retirement."

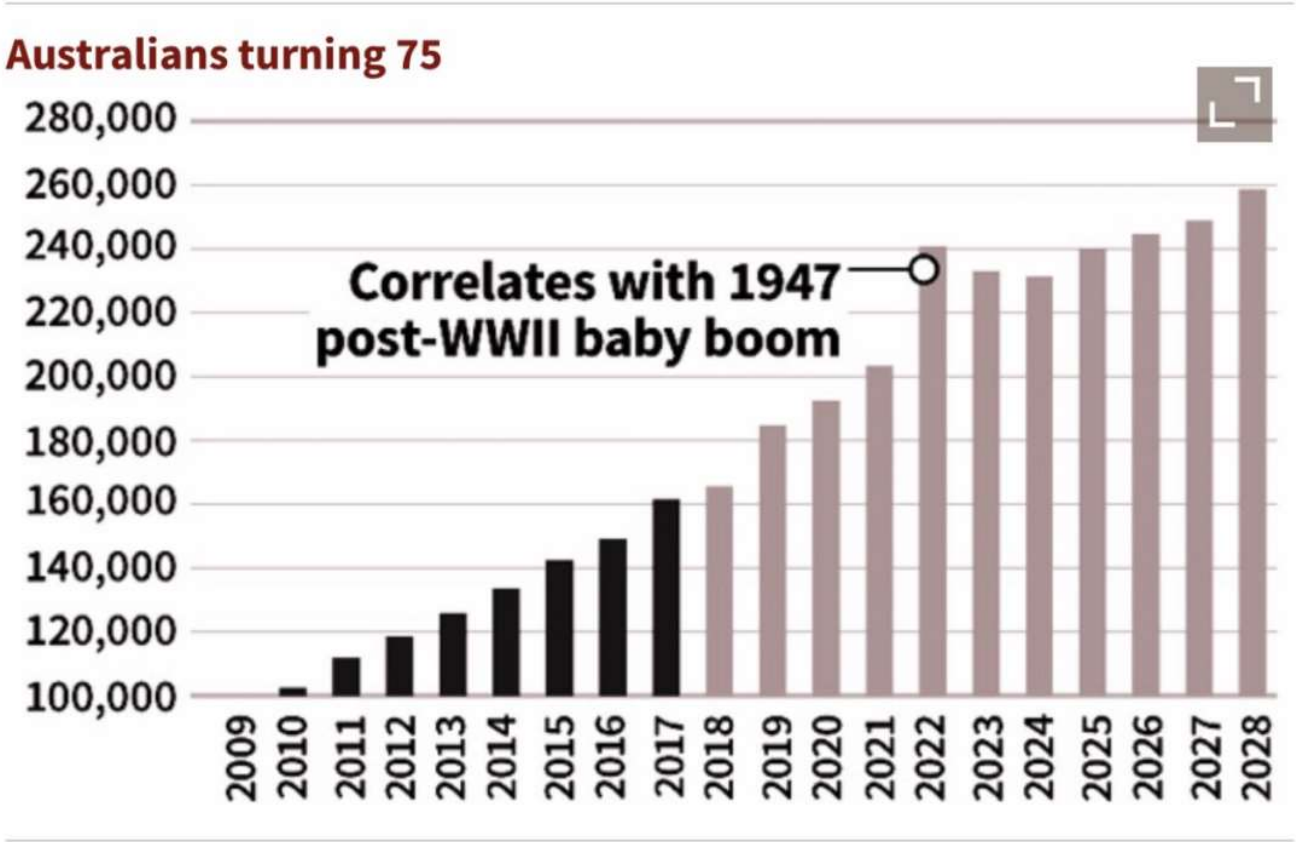
Employment growth – 200,000 net increase in 12 months



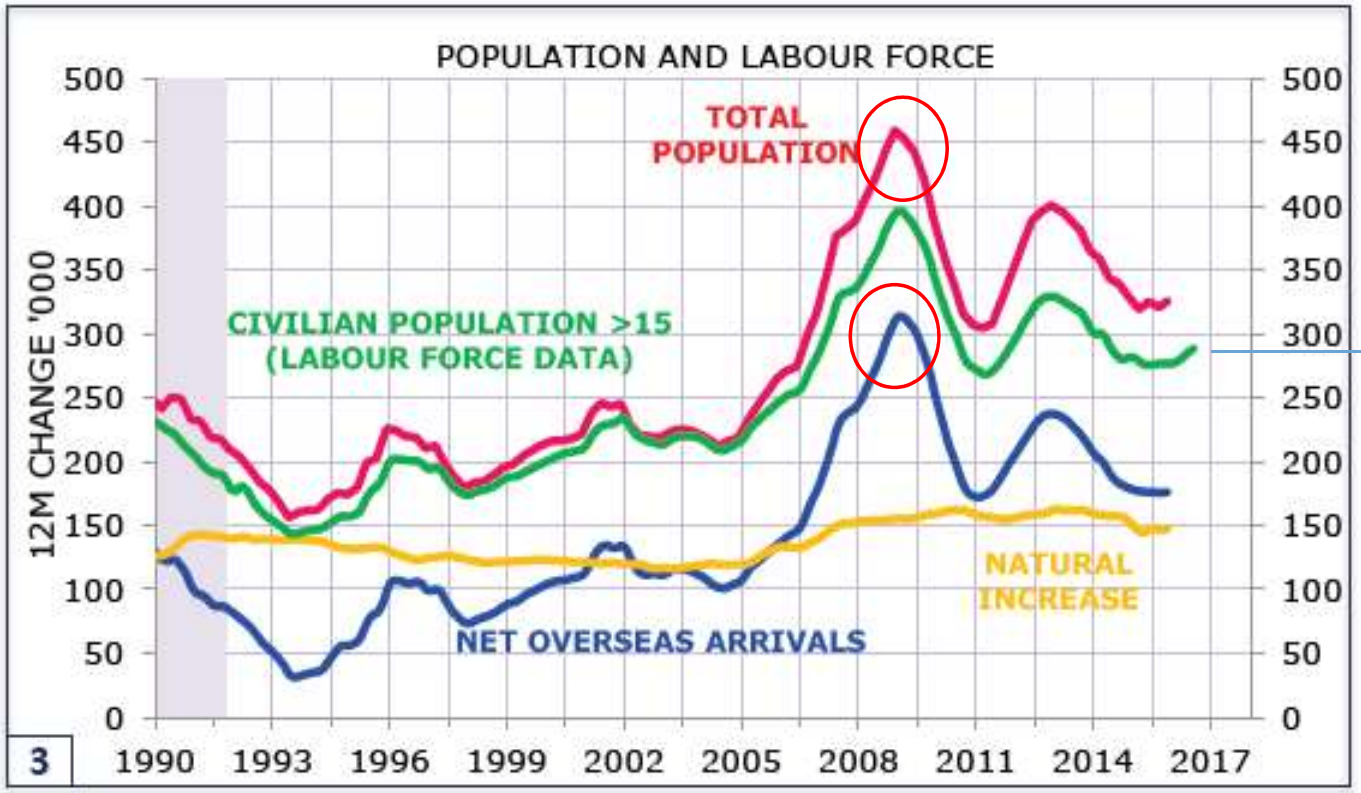
Wages growth is slowing



Aging baby boomers – 1.1 million passing 75 in next 5 years



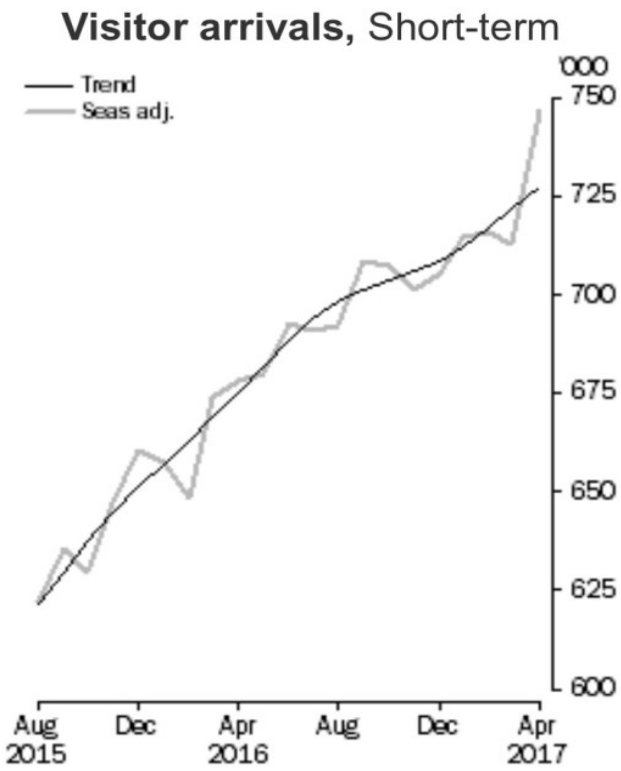
Australia's population growth – 300k immigrants in 2009

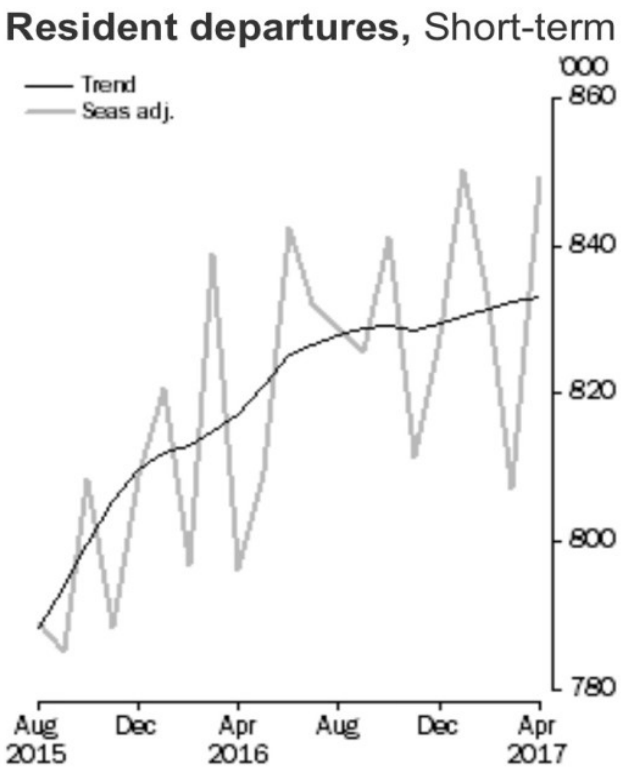


Workforce growth 270k per annum

Tourism boom - Lots of visitors – but too many departures!

Chinese arrivals





Baby boomers travelling

Chinese tourism – but Australia still not in top ten

Source: FT

THE BIG FORECASTS – NEXT 3 YEARS

- TRUMP WON'T LAST THE DISTANCE
- INTEREST RATES WILL TAKE 3 YEARS TO NORMALISE
- OIL IS IN TROUBLE
- COAL IS IN BIGGER TROUBLE
- INFLATION IS NO WHERE TO BE SEEN
- TECHNOLOGY, DISRUPTION, TECHNOLOGY, DRAMATIC CHANGE!
- AUSTRALIA IS A PEDESTRIAN ECONOMY FOR NEXT FEW YEARS SUPPORTED BY TOURISM

NO ONE TALKS IN MILLIONS ANYMORE
BILLION DOLLAR BAILOUT
TRILLION DOLLAR STIMULUS

Suggested Viewing – Fireside Chat: Robert Friedland

Available from the Clime Investing Report –

www.clime.com.au/investing-report-archive/fireside-chat/

Thank you.
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