ISSUE 88

PITCHER PARTNERS

Investment news

Pitcher Partners Investment Services Pty Ltd

Q3: investment markets in review

By Kellie Davidson - Partner

Risk assets continued to advance higher over the quarter, despite issues confronting investors over the period.

The ongoing global Trade dispute, led by the U.S and China, is now weighing on global economic activity, which has slowed over the period. This prompted many major central banks to further loosen already accommodative monetary policy settings, including the Federal Reserve, the RBA (cash rate now 0.75%) and the ECB, which relaunched its quantitative easing program and widened its negative rate setting.

On the political front, the UK's attempts to secure BREXIT has lost one prime minister and may claim a second depending on events in coming weeks, with the 30th October deadline looming fast. Threats of impeachment around President Trump increased following his efforts to force the Ukranian Government to investigate a political rival and his son. Many political relations with Iran deteriorated over their alleged involvement in the bombing of two Saudi Arabian oil plants. Meanwhile, protests in Hong Kong continued around its anti-extradition laws, spilling over in the celebrations covering the 70th anniversary of Communist party rule in China.

Perhaps unsurprisingly, it was generally the more defensive markets that performed the best. Large investment flows were witnessed in traditional 'safe haven' assets including gold, Japanese Yen and fixed income. Our global and local fixed interest benchmarks have delivered 9.8% and 11.1%, respectively, over the last year alone.

Australian equities (+3%) shrugged off a lack lustre reporting season, highlighting the stagnant levels of revenue growth and business investment amongst corporate Australia. Global equities were buffered by a weak $A. Political and trade issues weighed on emerging markets, which underperformed developed markets such as Japan and the U.S. Global REITS outperformed our local property trusts.

Investment market performance summary – 30 September 2019

Indices	Current	3 months	1 year
ASX 200	6,688.3	1.1%	7.7%
ASX 200 (Acc)	71,954.5	2.4%	12.5%
US S&P 500	2,976.7	1.2%	2.2%
Japan Nikkei	21,755.8	2.3%	-9.8%
UK FTSE 100	7,408.2	-0.2%	-1.4%
MSCI World	2,180.0	0.1%	-0.2%
German Dax	12,428.1	0.2%	1.5%
French CAC	5,677.8	2.5%	3.4%
HK Hang Seng	26,092.3	-8.6%	-6.1%
Shanghai Comp	2,905.2	-2.5%	3.0%
ASX 200 Prop (Acc)	58,547.5	0.9%	18.3%
Global Prop	2,949.7	5.6%	13.5%
Australian Bonds	10,377.2	2.0%	11.1%
International Bonds	1,066.5	2.3%	9.8%
Commodities			
Gold (oz)	1,472.5	4.5%	23.6%
Oil (Barrel)	54.1	-7.5%	-26.2%
Iron Ore (Tonne)	92.5	-17.9%	40.0%
Aluminium	1,721.5	-4.4%	-16.5%
Copper	5,725.0	-4.5%	-8.5%
Lead	2,135.0	10.5%	4.9%
CRB Index	173.9	-3.9%	-10.9%
Currency			
AUD/USD	0.6750	-3.8%	-6.6%
AUD/EUR	0.6193	0.3%	-0.5%
AUD/GBP	0.5492	-0.7%	-0.9%
AUD/JPY	72.9520	-3.6%	-11.2%
AUD/RMB	4.8227	0.2%	-3.0%

Source: Bloomberg.

In this newsletter we cover an array of different subjects including a review of the Australian equity reporting season, the impacts of demographics on property markets, dividend investing, Gold and the risk of the RBA launching its own form of Quantitative Easing.

Australian corporate earnings continue to disappoint - FY19 reporting season overview

Duncan Niven – Director, Research

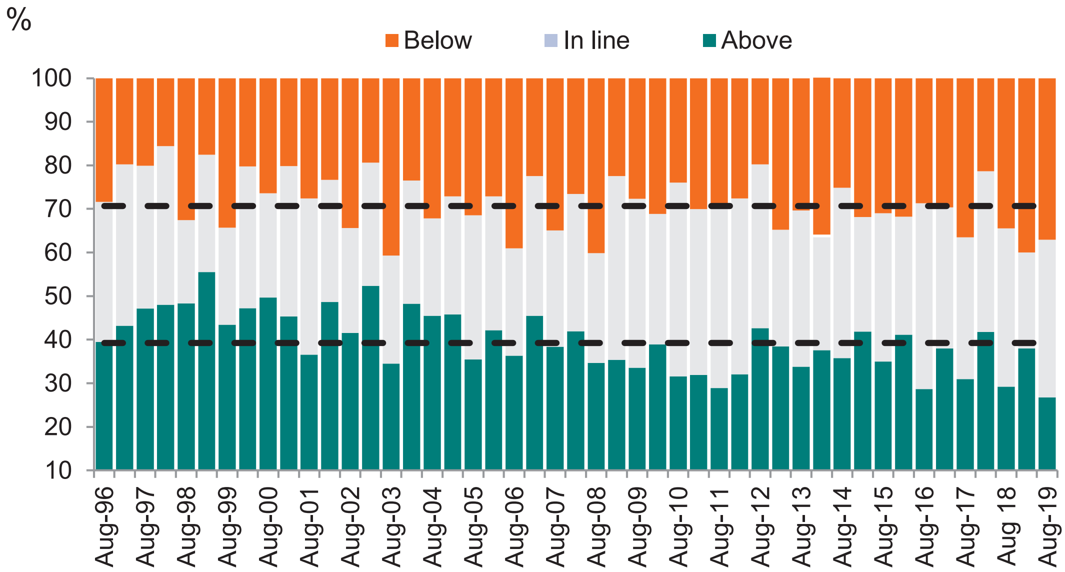
The FY19 reporting season was a relatively disappointing one for investors. Against a backdrop of slowing economic momentum both here and offshore, the quality and level of earnings in aggregate (and relative to broader market expectations) was weaker than expected.   Every sector witnessed cuts to FY20 forecasts and less than half the market saw their earnings grow over the second half of the year.

Revenue pressures were evident through a low 2.7% growth for the ASX 20, while the expense line was generally pretty stubborn. Sectors such as financials, telecommunications, housing construction, packaging and mining facing headwinds including rising input costs, regulatory challenges, weaker demand and lower interest rates (bank net interest margins).

sn't necessarily all doom and gloom however. One of the key highlights was sectors exposed to discretionary spending, where many companies reported improving operating metrics, especially into the early new fiscal year, which has been assisted by lower interest rates and tax cuts.

As outlined in the chart below, more firms missed earnings expectations compared to the historical average, while in addition, a lower number of companies were able to beat the market's expectations, which we note is becoming increasingly more volatile a trend year on year. We feel this in part may also be due to the ongoing contraction in experienced sell side research analysts operating in Australia, however even allowing for some greater forecasting error than perhaps in the past, the trend is still pretty clear cut.

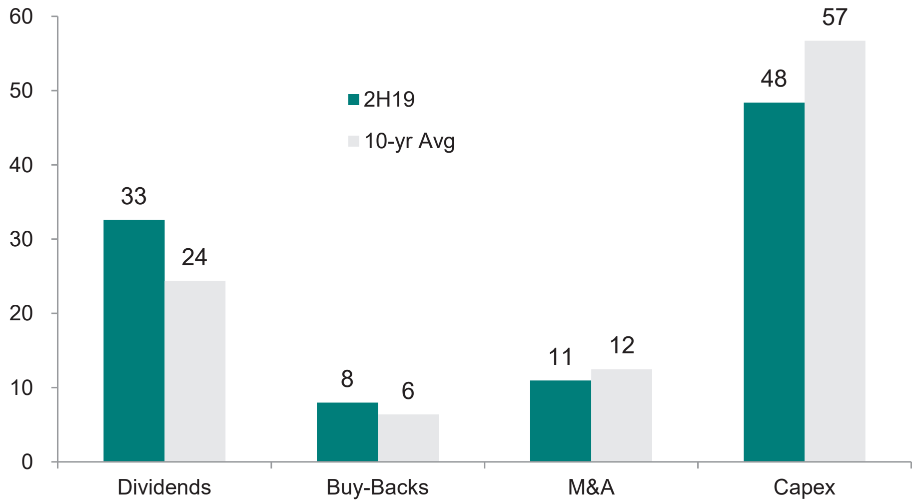
Chart 1. % of ASX 200 firms missing / beating consensus estimates.



Source: Bloomberg.

Companies continued to eschew paying capital back to investors as opposed to reinvestment, which whilst a multi-year trend, has been reinforced through the uncertain regulatory environment that led into the May general election. Fading business investment has been a feature offshore too, reflecting the ongoing trade disputes led by the U.S.

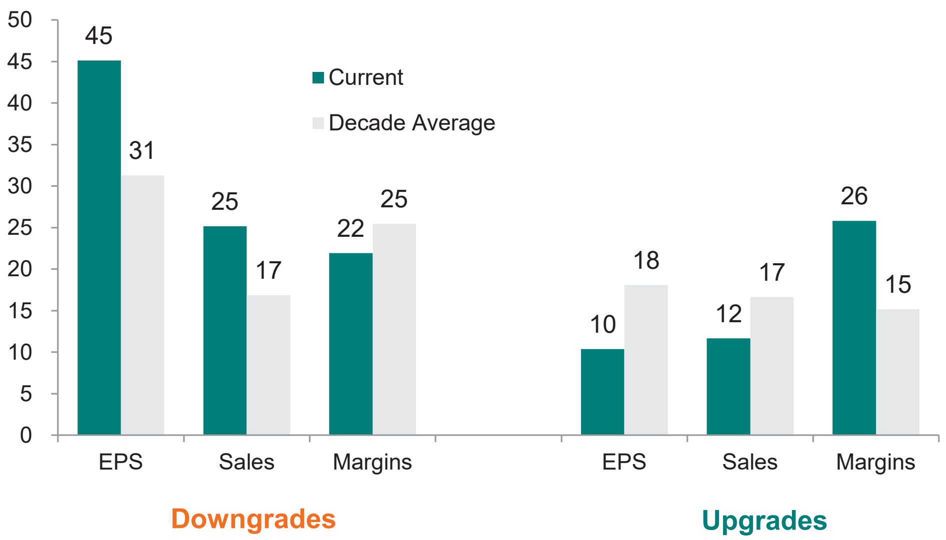
Chart 2. Usage of Free Cash Flow by ASX 200 firms (ex-financials)



Source: Goldman Sachs Global Investment Research

A particularly interesting thematic through the reporting season was the sell side analyst's inclination to downgrade revenue/sales forecasts, but they have upgraded their guidance for profit margins. In other words, they are banking on corporations to continue to cut costs to offset a decline in revenue.

Chart 3. Breakdown of consensus FY20 revisions



Source: Goldman Sachs Global Investment Research

Many Australian corporates have been in cost cutting modes for years now and whilst the banks and Telstra have particularly aggressive programs in play, we remain sceptical that this scenario will play out and how much juice is left in the 'lemon'. In addition, carrying down this path will significantly increase a company's operating leverage, which becomes more exposed to higher levels of fixed costs. This substantially increases the probability of large profit downgrades for such businesses if growth deteriorates.

Another area of concern was earnings quality. The number of 'one offs' accounted were about a quarter of 'underlying profit' which, while below the decade average of ~32%, was an increase on the last two full year periods. Secondly, we note that company profits this year were fuelled by the lowest effective tax rate in the last decade as well. Cash conversion and accruals analysis also continue to highlight ongoing evidence of more aggressive accounting and revenue recognition than in the past.

So all in all, it was a fairly downbeat season. Despite that, the market remains optimistic with the ASX 200 close to historic highs. For next financial year (FY20), consensus forecasts are for revenue growth (+3.7%) and EPS growth (+6.7%) to be above recent trend. We feel this is perhaps a little aggressive given the current growth trajectory of the economy and will continue to watch earnings revisions closely going forward, especially in the wake of current valuations.

The importance of understanding demographics when investing in real estate markets

Alistair Francis - Senior Investment Analyst

The analysis of populations, how and where people move, the changes in age cohorts and how individuals live is integral to real estate economics. The slow-moving pervasive effects of demographics on the economy influences property sector demand and ultimately, resource allocation.

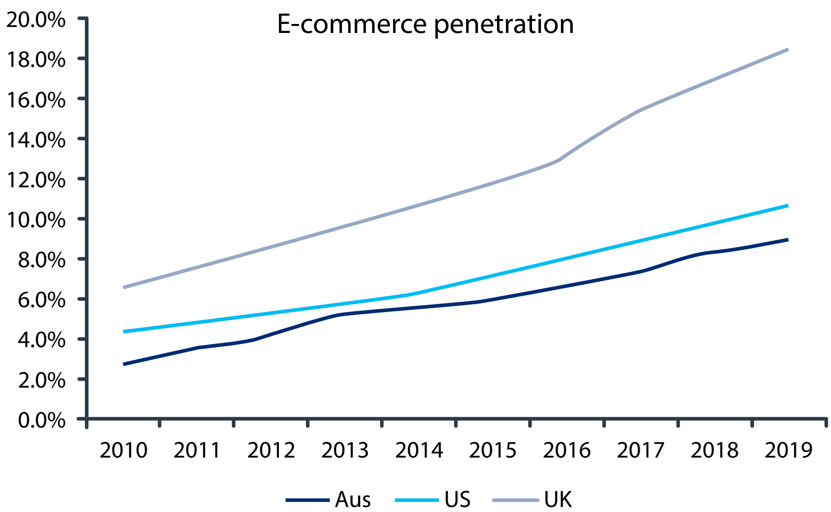
Demographics is a broad topic, but its influence impacts all property classes including retail, office, industrial, residential, healthcare and lifestyle assets. An increasing population leads to real growth in rents, sales, cashflows and yields which supports lower capitalisation rates and therefore ultimately higher investment returns compared to the negative experience of minimal to falling population growth within age cohorts/ communities.

Landlords will need to adapt as to how they operate, locate and design their assets.

Retail

Starting with retail property, the UK economy provides a fascinating insight into the evolution of the e-commerce world, with a penetration level that is higher than any other market in the world. The rising influence of millennials and subsequent generation Z have enthusiastically embraced online retail and thus far have had a dramatic impact on retail property dynamics. The more traditional “bricks & mortar” retail sales outlets along with shopping centres have responded by integrating their own e-commerce offerings into their business strategies.

E-commerce continues to take share, weighing on brick and mortar sales growth.



Source: Citi Research, NAB-Quantium, ABS, US Census Bureau, Thomson Reuters Datastream

At the other end of the spectrum, retail property in Japan is increasingly adapting to an ageing population. At shopping centres and other retail outlets, landlords organise exercise classes and seminars on healthy eating in conjunction with the local healthcare agencies. Landlords and retailers can also adapt to meet the needs of older customers in more discrete ways, by providing wider aisles, lower tables, more seating, easier to read menus along with the recruitment of older salespeople.

Office

As working populations of many of the global cities evolve, landlords of office space need to respond to the changing needs of employers and employees. With the demand dynamics driving higher lease rates for office space, employers are forced to become more innovative with employee work spaces. More recent examples are CBD fringe office developments, energy efficient buildings, changing office floor plate configurations to suit a modern workforce, flexible desk policies which result in smarter use of office space and providing end-of-trip facilities.

For Australia in particular, with its above average population growth, some of the more recent tightness in the Sydney and Melbourne CBD office markets was brought about by the excess space carried over from the previous cycle being converted into residential apartment towers.

Industrial

Today, the industrial real estate market is typically about the reconfiguration of supply chains and it's at a multi-level. The heavily industrialised inner-city suburbs that historically dominated the landscape have now become redundant as population growth and lifestyle choices have seen this space converted to residential or office opportunities. For this very reason, the supply of industrial land close to the end consumer, has been shrinking. And that's a global issue at a time when the customer expects delivery of their recently purchased goods (most likely online) in a very short time-frame.

Accordingly, large logistics warehouses and inland terminals are now being created on the suburban fringe which are typically highly automated and convenient to critical transport infrastructure.

Residential

It's the residential property market that has seen the demographic forces drive the most dramatic change in the past 20 years. The growing demands of the rapidly evolving age cohorts has caused residential solutions to be created in various forms. This would include inner city apartments, manufactured housing estates, retirement villages, aged care facilities, multi-family dwellings (known as build-to-rent in Australia) and student accommodation.

Furthermore, the growth in overall population and the decline in the average size of new homes has been one of the factors propelling the demand for self-storage property parks as people increasingly run out of space at home to store those items which they use occasionally.

In conclusion, as the demographics of nations and communities evolve over time, this powerful force should not be ignored as it will ultimately determine both the resource allocation and investment returns for property investors.

Unconventional monetary policy in Australia

Louise Hollingsworth - Senior Investment Analyst

Since the RBA began cutting interest rates earlier in the year there has been increasing debate over whether unconventional monetary policy measures such as negative interest rates and quantitative easing would be deployed in Australia.

Sitting at a record low interest rate of 0.75% and with further cuts expected by market participants, the RBA recently confirmed that the Bank has analysed unorthodox monetary stimulus experiences of other countries such as Japan, UK, Europe and the United States. While these policies are unlikely at this stage, RBA Governor Philip Lowe said that the Bank would not shy away from going down this path if deemed necessary and has been studying what unconventional monetary policy could look like in Australia.

So, what exactly are these unconventional monetary policy measures?

Conventional monetary policy in Australia involves using interest rates to influence demand, employment and inflation in the economy. However, when interest rates near zero, the effectiveness of this tool is capped which forces central banks to look to "unconventional" methods to stimulate a slowing or stagnant economy. There are many different forms of unconventional policy but the three main types currently being debated in Australia include forward guidance, negative interest rates and quantitative easing:

Explicit Forward Guidance

Forward guidance is a tool that has been used by the likes of American, European and Japanese central banks as a way to bolster the effectiveness of monetary policymaking as rates approached zero. With forward guidance, central banks explicitly state their intentions, such as keeping rates low for a substantial amount of time. It can also include specifying what conditions would cause the central bank to change its approach. The aim of explicit forward guidance is to influence long term interest rates and market expectations. Forward guidance also helps to remove any surprises that may disrupt the market and cause significant asset price volatility which can help improve investor confidence.

Negative Interest Rates

Under a negative interest rate policy, financial institutions are required to pay interest for parking excess reserves with the central bank. That is, any surplus cash beyond that which regulators say banks must keep on hand. That way central banks penalise financial institutions for holding on to cash in the hope of prompting them to boost lending to businesses and consumers.

The ECB officially introduced its negative interest rate policy in 2014, and in January of 2016 the Bank of Japan unexpectedly followed suit, cutting its benchmark rates below zero in a bold move to stimulate its economy and overcome persistent deflationary pressures.

Quantitative Easing

Quantitative easing (QE) is where central banks add money to the banking system by purchasing assets from banks, such as government bonds and securitised assets such as Residential Mortgage Backed Securities. Like lower interest rates, the hope of QE is to stimulate the economy by encouraging banks to make more loans. The idea is that banks take the new money and buy assets to replace the ones they have sold to the central bank. This raises asset prices and reduces interest rates, which in turn boosts investments.

Quantitative easing has been used extensively across the world by central banks who have bought trillions of dollars of financial assets. The Bank of Japan began an aggressive QE program in 2000 to curb deflation and stimulate the economy. The US also began QE in 2008 in an attempt steer the economy through the depths of the financial crisis, while the European Central Bank and Bank of England followed shortly after and have been using QE in various forms over the past decade or so.

The impact of unconventional monetary policy in Australia

Currently in Australia the RBA is already providing forward guidance by stating that rates will remain low for some time. However, to provide explicit forward guidance, the RBA could state that rates would remain low for a specific amount of time or when inflation returns to its target. This would likely lower medium-term interest rate expectations and would likely see the yield curve to flatten.

The RBA has publicly stated that negative rates are unlikely here in Australia, but in the event rates do go negative, the Australian dollar would depreciate which would benefit exporters as well as visitors to Australia. However, negative rates could also inadvertently harm the economy as negative rates are essentially a tax on banks. This tax may force banks to raise loan rates or reduce deposit rates to pay for additional business costs. For this reason, negative rates remain an unlikely option at this stage.

If the RBA does deploy unconventional measures, quantitative easing is predicted to be the RBA's weapon of choice. The RBA has said that if the Bank deployed a QE program here, it would most likely involve buying government bond securities. This would likely flatten the risk-free curve and put significant pressure on the Australian dollar.

Type of Policy	Impact
Explicit Forward Guidance	This would most likely cause the curve to flatten as medium-term interest rate expectations would likely fall
Negative Interest Rates	Depreciation of the Australian dollar, bank loans may increase due to higher bank funding costs
QE – with govt securities	The risk-free curve would most likely flatten and would put downward pressure on the Australian dollar
QE – with RMBS	Lowers funding costs & the rate of borrowing for consumers

Is helicopter money an option?

Helicopter money is a strategy that involves central banks attempting to increase spending by supplying large amounts of money to consumers. The idea is that it generates demand, which comes from the ability to increase spending without having to worry how the money would be funded or used.

If helicopter money was employed in Australia, it would most likely involve the RBA financing government expenditure such as tax cuts or "gifts" to households. While helicopter money might increase consumer consumption, it is generally considered a last resort because it could lead to currency devaluation due to the creation of more money. The RBA has not publicly considered helicopter money at this stage.

Where to from here?

While the RBA is still confident unconventional measures remain unlikely, the debate over whether unconventional monetary policy measures would be deployed here in Australia continues to heat up. There is growing expectations from some economists that unconventional measures will begin as soon as the first half of 2020 starting with forward guidance and then potentially QE. However, opinion is still divided with many believing extreme measures won't be seen here in Australia. In any case, the fact that their tools are being more widely contemplated underpins the dilemma central banks face across the world, as global slowdown forces them to go to extremes in shielding their economies from a strengthening currency.

Understanding dividends – what you need to know

Tina Wilson - Senior Investment Analyst

Dividends are a source of income and form part of the total return consideration for investing in equities as an asset class. Right now, investors are facing a low interest rate environment, choosing to invest in equities that can pay attractive dividends can be an important consideration for some investors, especially where income generation is paramount.

Generally, industrial companies, as opposed to resources companies, are likely to have more stable earnings and hence dividends paid. This is because resources companies' earnings are linked to underlying commodity prices, which can be unpredictable, making dividends paid more volatile. Industrial companies in a mature economy like Australia typically have earnings linked to the broader economy and typically pay more stable dividends.

The current low rate environment has prompted a sharp rotation of investments into higher absolute yielding sectors such as infrastructure and REITS (Real Estate Investment Trusts). However, investors should also look at the underlying profile of the dividends, not just the absolute level but a quality assessment.

Questions investors should look to consider are:

1. What is the payout ratio? Is it sustainable? Does it leave the company with sufficient capital to grow?
2. What is the dividend coverage ratio? Lower and declining dividend coverage could indicate the risk of a future dividend cut.
3. What are the franking levels?
4. What is the expected growth of the dividend stream?
5. Are the dividends sustainable and reliable going forward?

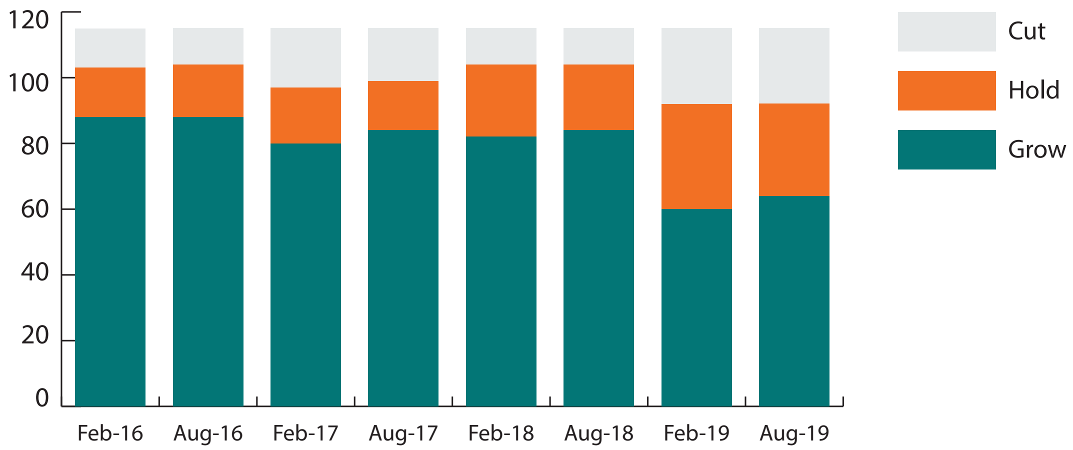
Looking at the Australian market, 115 industrial companies which have consistently paid dividends each reporting period (February and August each year), were analysed in the table below. These ordinary dividends (excluding buybacks, special dividends and capital returns) paid by the companies should typically be stable and reflect the underlying profitability of the companies.

Ideally, the chart should have more companies "Grow" their dividends overtime, as oppose to "Hold" or "Cut". That would mean a growing stream of income for investors overtime. However, in the last 12 months, the number of companies growing their dividend has slowed, while the number of companies cutting dividends has stepped up slightly. This is not surprising given a number of companies have experienced pressures both on the revenue and cost sides, resulting in reduced earnings and dividends paid. In the last reporting period August 2019, the number of industrial companies that have grown dividends have dropped to 64 (55%) from 84 (73%) a year ago. While the number of companies that cut their dividends have increased to 23 (20%) from 11 (10%) a year ago.

Whilst the low interest rate setting has encouraged investors to seek higher yields within the equities asset class, we remind investors, particularly those that have reallocated capital from cash and fixed income, that not all companies and all risks are created equal – as per the table showing that one in five industrial companies reduced their dividends.

Investors should be selective as to which high dividend paying companies they choose to invest in and be aware of the sustainability and drivers of that income stream going forward. A blind approach to just focussing on the highest yielding companies may well deliver disappointment if income is the sole focus of any investment decision.

Dividend changes amongst Industrial stocks



Source: Morgans Equity research report September 2, 2019

Gold – defensive or speculative

Regan Burrows – Investment Analyst

Trade wars, central bank easing, geo-political disputes, rising nationalism all have one thing in common, that is they all are contributing to rising uncertainty around global economic growth. Whilst this can deliver heightened volatility for most asset classes, this environment is often viewed in a positive light for one of the world's oldest defensive assets - gold. This article analyses the relationship between physical gold and historical equity market corrections, and how this relationship differs for the companies mining the precious metal.

Historically, the main purchasers of physical gold, in order of market demand, have been the jewellery industry, investment products, central banks and the technology sector. Supply and demand have remained relatively flat since 2010 at roughly 4.5k tonnes per annum and appears rather immune from the fluctuations in price over that period. What has changed more recently in the purchases of physical gold has been the increase in investment purchases, specifically from ETF products.

The increase in investment purchases more recently can be attributed to my first observation on a rise in global economic uncertainty. During times of heightened volatility, gold is seen as a defensive asset, which is a long held belief driven by its relative scarcity, physical attractiveness and its perceived benefits as an inflation hedge for US investors.

Since 1976, physical gold has outperformed the US equity market (S&P 500) in 8 out of 9 market corrections by an average of 37%. The only period it failed to outperform equity markets was the crash of 1980, due in part to the bull market rally that saw the commodity gain +2,300% in the preceding decade . More recently, during the correction in October 2018, gold outperformed the S&P 500 by 26%.

Period	SPX Index	ASX 200	Gold Spot	Outperformance to S&P 500
21 Sep 76 - 06 Mar 78	-19%		54%	73%
28 Nov 80 - 12 Aug 82	-27%		-46%	-19%
25 Aug 87 - 04 Dec 87	-34%		8%	42%
16 Jul 90 - 11 Oct 90	-20%		7%	27%
17 Jul 98 - 31 Aug 98	-19%	-12%	-6%	13%
27 Mar 00 - 09 Oct 02	-49%	-10%	14%	63%
09 Oct 07 - 09 Mar 09	-57%	-53%	25%	82%
10 May 11 - 03 Oct 11	-19%	-18%	9%	28%
03 Oct 18 - 24 Dec 18	-20%	-11%	6%	26%
			Average	***37%***

Source: Bloomberg

However, the relationship between economic slowdowns and listed gold mining company's performance isn't as strong. The data set for Australian companies in the table below illustrates this point. During the GFC, the Australian dollar gold price rallied 78%; despite this, the ASX300 Gold Index underperformed the physical commodity by 95%. The same occurred in 2011, only recently has the underlying index outperformed the physical commodity.

Period	ASX 200	AUD Gold Spot	ASX 300 Gold Index
	-53%	78%	-17%
10 May 11 - 03 Oct 11	-18%	24%	-13%
03 Oct 18 - 24 Dec 18	-11%	7%	11%
Year to date performance	20%	22%	36%

Source: Bloomberg

The reasons are simple: listed gold mining companies are still at the end of the day an equity investment. Their main performance driver may be the price achieved for the underlying commodity, but they are also driven by operational performance, grade quality, sovereign risk, management capabilities, input costs and supply chain management to name a few, all of which can test an investor's valuation during an economic slowdown.

The recent collapse of two well known names in the Australian gold mining sector are testaments to this. At a time when the Australian dollar gold price is at near record highs, we have seen Dacian Gold and Gascoyne Resources fall from grace due to disappointing operating and management decisions. Herein lies the issue with gaining "defensive" exposure to gold mining companies.

This dispersion in performance has created a demand for listed exchange traded funds (ETFs) which track the price of the underlying commodity itself and are often physically backed. Gaining exposure to a physically backed ETF helps to address the equity specific issues in a cost-effective manner. According to the World Gold Council, year-on-year demand of physically backed gold ETFs has been driven by purchases in the UK and Europe spurred by Brexit drama and the sensitivity of the German auto industry to the US-China trade war.

Physically-backed gold ETF AuM by region in tonnes

	Q2'18	Q3'18	Q4'18	Q1'19	Q2'19		Year-on-year tonnage change		Year-on-year % change
North America	1,248.6	1,173.3	1,231.5	1,257.9	1,262.7	▲	14	▲	1
Europe	1,052.3	1,037.6	1,096.7	1,116.7	1,183.8	▲	131	▲	12
Asia	95.5	84.3	79.5	74.7	70.5	▼	-25	▼	-26
Other	35.5	32.4	32.7	31.5	31.0	▼	-4	▼	-13
Global Total	**2,432.0**	**2,327.6**	**2,440.5**	**2,480.8**	**2,548.0**	▲	**116**	▲	**5**

Source: Respective ETP providers, Bloomberg, ICE Benchmark Administration, World Gold Council

So where are we now? Driven by a weakening AUD/USD and rising economic uncertainty, the ASX300 Gold Mining Index is now outperforming the underlying Australian dollar gold price by 14%, stretching the valuations of some of the higher-quality companies within the space. Notwithstanding the momentum and appeal of this sector at this time, it is during times like this we warrant a very selective approach to assessing possible investments. We continue to monitor this closely.

The Melbourne Pitch Report

Pitcher Partners Investment Services Pty Ltd

The Pitcher Partners Investment Services Pty Ltd Investment Strategy Committee is composed of senior advisers and researchers with the purpose of framing the near to medium term investment outlook. The committee's views are summarised below.

Defensive Assets	
Cash	We believe this asset class provides optionality / flexibility in wake of higher levels of volatility. However, reflecting the high opportunity cost given current interest rate settings, we believe a neutral allocation is warranted at this time.
Fixed Interest	The RBA has shifted clearly to an easing bias, with the economy having slowed considerably over the past six months. Without stronger fiscal policy support (and impact), the probability exists for further cut(s) over the coming 6-12 months should employment conditions not tighten further from current levels. We still recommend an underweight stance toward rate duration, but note its diversification attributes, especially until there is greater alignment between the macro views of the RBA and the market more broadly. We like credit, however tight spreads indicate a low probability of capital gains from here, although the primary market still remains well bid. Hybrid margins are close to historic lows and could be at risk of widening in anticipation of upcoming issuance this quarter. We still favour a floating rate bias over fixed, over the medium to long term. Balancing consumption and labour market strength against weak trade and business investment, the Federal Reserve, after making two rate cuts in Q3, has hinted any future moves will be determined via upcoming data releases. While there is a wide split in board members' views, the dot points indicate further downward pressure on current rate settings. The ECB has reignited its Quantitative Easing program, however we believe fiscal policy will need to augment this approach to try and reflate the European economy, which is suffering from the global trade overhang, sagging domestic demand and savings/investment imbalances. Supported by strong investment flows, we believe credit can still provide selective opportunities for skilled fund managers, especially within the private debt sector. We continue to expect further yield curve volatility as sentiment towards global growth oscillates.
Growth Assets	
Australian Equity	We retain our neutral stance, balancing on one hand, accommodative monetary & fiscal policy and ongoing yield support, while on the other, we see premium valuations, a slowing global economy and a potentially weaker earnings outlook. Domestic cyclicals may be a clear beneficiary of the positive local policy backdrop, whilst we believe pockets of the materials sector will remain leveraged to ongoing Chinese stimulus programs. Bank profit margins are likely to remain under pressure due to a flattening of the yield curve and ongoing wealth management remediation efforts. The wide dispersion between cyclicals and high growth stocks should provide alpha opportunities for active management, while the share price of bond proxy stocks will remain sensitive to current interest rate settings.

Growth Assets (continued)	
International Equities	While we acknowledge that risks are building, we favour global over domestic equities, reflecting superior earnings growth, valuation and diversification. We expect geopolitical tensions to remain omnipresent and dominate news flow, especially around issues such as Brexit, Iran, impeachment and trade. Global economic activity has clearly dipped, with the trade disputes dragging on business investment and confidence. Valuation support has moderated in markets such as the US, but it provides exposure to defensive high quality and growing companies, a thematic that continues to perform strongly. Other regions offer more compelling valuations, especially Europe and China, but exhibit greater macro and earnings risk - this supports our headline preference for active over passive management. Any moderate and sustained resolution in the 'trade wars' could see those markets re-rate quickly, although we assign a lower probability to this outcome at this point in time. We prefer a tilt toward unhedged exposures reflecting its downside protection attributes.
Property	Our views on local and offshore property remain unchanged (neutral). Positive fundamentals remain but valuations (in absolute terms) remain stretched post recent strong returns. The anchored rate environment may well provide a floor for yield sensitive investors, however we remain wary around lower quality retail and residential exposed investments at this point in the cycle, as well as those companies trading on higher valuation multiples priced on more cyclical earning streams. Some unlisted products may provide a buffer against any short-term volatility, but product and asset selection is critical. Clear preference for active management, given highly concentrated nature of the A-REIT Index. G-REIT valuations are full but arguably justifiable given the current market cycle and most major central banks in 'pause' or 'easing' modes. We continue to seek complementary offshore exposures when blending alongside local property investments - given the deeper and broader construct of G-REIT markets. Clear preference for active over passive. Any bouts of volatility may present selective opportunities for investors to gradually rebuild an exposure to this sector.
Alternatives	Overweight alternatives. This asset class provides an attractive source of absolute returns that are uncorrelated with traditional asset classes such as shares or bonds, with the ability to help cushion portfolios in the event of market stress. Product selection is crucial to maximise diversification benefits.

This is our high-level view, and we recommend clients speak to their advisers as to how this may guide or impact your individual investment portfolio.

Kellie Davidson
Partner
p. +61 3 8610 5334
e. kellie.davidson@pitcher.com.au

Sue Dahn
Partner
p. +61 3 8610 5124
e. sue.dahn@pitcher.com.au

Adam Stanley
Partner
p. +61 3 8610 5517
e. adam.stanley@pitcher.com.au

Duncan Niven
Director of Research
p. +61 3 8612 9541
e. duncan.niven@pitcher.com.au

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