Fiducian Quarterly Investment Strategy Report

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ECONOMIC OUTLOOK

GLOBAL ECONOMY

The global economy was slowing even before the recent outbreak of the so-called Covid-19 coronavirus that in a short time has caused widespread investor and consumer panic. The IMF was forecasting minimal disruption to the global economy as late as 22 February. However, the outlook has deteriorated faster than expected.

The **global economy** was slowing even before the recent outbreak of the so-called Covid-19 coronavirus that originated in China late in 2019. In its January report, the International Monetary Fund (IMF) revised down its forecast for global growth for 2020 from 3.4% to 3.3% and for 2021 from 3.6% to 3.4%. On 22 February, the new Managing Director of the IMF, Kristalina Georgieva, stated that in the IMF's current baseline scenario, the impact on the world economy of the coronavirus 'would be relatively minor and short-lived'. It was expected that 'global growth would be about 0.1% lower (than previously forecast)'. However, Georgieva also noted that 'we are also looking at more dire scenarios, where the spread of the virus continues for longer and more globally and the growth consequences are more protracted'.

By early March, the coronavirus was spreading rapidly in countries other than China, its original source. With extreme measures being used to contain the virus, such as closing down whole regions, the potential for global recession was growing, even if only for a limited time.

By early March it was still unclear as to how far the virus would spread and how severe its impact on the global economy would be. Certainly, the spread of the virus within China, its original epicentre, appeared to be decreasing rapidly by this time, with the number of new diagnoses dropping dramatically. Elsewhere though, the virus was continuing to spread, with new cases up significantly in countries as far apart as Italy and Iran. As such, the more severe potential scenarios for the economic effects of the disease have increasingly come into focus. Recession (negative growth) has become more likely for a number of economies, if not for the entire world, even if such recession turns out to be short-lived in duration.

Europe is one region that appears especially vulnerable to a recession, given that it was already stalling prior to the spread of the virus. The ECB and regional governments have been slow to react to the virus crisis, although the Italian Government began a nationwide shutdown on 9 March to try to restrict its spread. More stimulus is expected from the ECB in the near-term.

Europe is one major region that appears particularly vulnerable to the spread of the coronavirus. In the December quarter, the Eurozone was already on the brink of recession, with the whole region growing by only 0.1%. During the quarter, the Continent's largest economy, Germany, had zero growth and is almost certain to record a contraction in the March quarter. France and Italy contracted during the December quarter and are also both likely to be in recession during the March quarter. Despite this, the new President of the European Central Bank (ECB), Christine Lagarde, had little to say on 2 March, other than 'the coronavirus outbreak is a fast developing situation….we stand ready to take appropriate and targeted measures, as necessary and commensurate with the underlying risks'. More positive was the announcement on 4 March that the ECB would expand its 'QE' program of 20 billion euros per month by another 120 billion euros over the year, while official interest rates remain at -0.5%.

The US has been growing at a faster rate than other major economies over recent years. However, the US too is expected to slow significantly under the impact of the coronavirus and measures taken to slow its spread. The 'Fed' dropped interest rates by 0.5% on 3 March but more measures could be needed, including tax relief and the re-introduction of 'QE' to counter deflation.

In contrast, growth in the US has been stronger, coming in at an annualised rate of over 2% in the December quarter and with far fewer diagnoses of the coronavirus by early March than in Europe or Asia. Nevertheless, the US central bank, the 'Fed', reacted to a slide in the share market and the potential for a more rapid spread of the virus by cutting interest rates by 0.5% to a range of 1.0% to 1.25% on 3 March. As 'Fed' Chairman, Jerome Powell, stated, 'the coronavirus poses evolving risks to economic activity. We saw the risks to the outlook and chose to act'. On 15 March, The 'Fed' went further and cut its 'Fed Funds' rate to 0% to 0.25%, while adding $700 billion in direct 'Quantitative Easing (QE)' to be injected into financial markets 'over coming months'. This followed the announcement by the New York 'Fed' on 12 March that it would be offering up to $1.5 trillion in 'repurchase' or 'repo' operations with banks, designed to keep interest rates low. All these central bank moves, designed to underpin economic activity, have been introduced in spite of strong employment growth, with the unemployment rate dropping to its lowest level in 50 years in February (3.5%). However, this may have been a highpoint for the time being and with global growth slowing and the virus spreading even in the US, even more stimulus could be forthcoming from both the 'Fed' and the federal government in the near-term, including tax relief, direct financial support to businesses in need and other fiscal support, as well as, potentially, even more 'QE'.

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China has been the country most severely affected by the coronavirus, with the most recorded cases and the most deaths resulting from it. However, the Chinese Government has been effective in halting the spread of the disease and by late February was already getting its factories back into operation, while its share market has barely moved

In Asia, China has seen a widespread shutdown of factories to help contain the spread of the virus and growth could fall to as low as 0% in the March quarter, after annualised growth of 6.0% in the December quarter. The better news is that new diagnoses of the disease began to drop significantly in China from late February, after peaking in mid-February, and factories have begun to re-open. This return-to-work program could accelerate over coming weeks and months, re-opening global supply chains and potentially allowing the supply of manufacturing inputs for companies around the world to flow once again. In the case of the world's third-largest economy, Japan, recession is likely to have taken hold in the March quarter, after a severe contraction of 1.6% in the December quarter alone. This contraction followed the government's implementation of a hike in the sales tax – an untimely move given current circumstances

The global economy was slowing before Covid-19 coronavirus became a pandemic but is now likely to slow faster than previously forecast, at least until the spread of the virus has been contained. Strong stimulus measures from central banks and governments are underway.

In summary, the global economy has hit what will hopefully prove to be a short-term wall, due to the growing spread of the Covid-19 coronavirus to countries around the world. The virus has caused a decline in travel and has led to the temporary closure of factories in the world's manufacturing hub of China, which in turn has had flow-on effects on the rest of the world. Key central banks, most notably in the US, have been quick to respond to the threat of a growth slowdown by cutting interest rates and re-introducing 'quantitative easing'. Other stimulus is likely to follow in short-order, including hefty government spending programs and short-term support measures for companies and individuals in need.

REGIONAL ECONOMIES

The US economy continued to expand at a solid rate through the December quarter and most indicators were pointing to a positive outlook, other than private investment, which was weak over the last three quarters of last year. Furthermore, economic data was encouraging into the first two months of this year, with February employment figures very strong and the February unemployment rate equalling its 50-year low. Average hourly wages were also continuing to grow at a solid pace above the rate of inflation. On the other hand, manufacturing data was signalling some weakness in the sector, despite solid export growth. However, the continued global spread of the coronavirus was beginning to agitate investors and the collapse of the oil price on 9 March ignited a share market rout that could damage investor confidence for some time.

The US economy experienced three quarters of annualised real (inflation-adjusted) growth of around 2% up to the December quarter. This was slower than in the preceding year, when annualised growth was around 3%. The question now is whether growth will slow much further, as it has in most other economies as a result of the coronavirus panic. Even before this panic began in February, some US economic data was looking fragile. In particular, private investment declined in each of the final three quarters of 2019, causing most of the decrease in growth over this period. Household spending also slowed in the December quarter and economic expansion would have been weaker but for a solid contribution to growth from rising exports. Also adding to growth was housing investment, which rose for a second quarter in a row after 5 years of decline. Bank lending for housing also grew over the year (up 4.5%) and house prices rose by 2.8%. Corporate profits though were flat over the year (national accounts basis and up only 1.7% MSCI basis). More positively, recent data has pointed to a strong jobs market and solid wages growth. In February, 273,000 new jobs were created, above expectations, while the unemployment rate dropped to a 50-year low of 3.5%. Average hourly wages growth has also been solid, rising 3.0% over the year to end-February, above the rate of inflation (2.5% to end-January). The manufacturing sector though has been struggling in recent months, with the ISM Manufacturing Purchasing Managers' Index (PMI) hitting near-stall speed in February. It could fall further in March, following the failure of the major oil-producing cartel (OPEC) and Russia to agree on production cuts and a consequent move by Saudi Arabia to increase oil production and cut prices. This led to a 30% drop in oil prices on 9 March to be followed by a slump in share markets. While lower oil prices would normally be regarded as a boon for consumers and for industry more generally, investors took fright on the assumption that a generalised deflation (fall in prices) could ensue.

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While lower oil prices are generally an advantage for consumers, the heavy falls in the oil price seen in early March point to the potential for deflation to take hold more widely in the world economy. This is regarded by central banks as anathema and is why they have minimum inflation targets, usually of at least 2%. One answer is for the 'Fed' to re-instate 'QE', as it has now done and as the ECB and the Bank of Japan already have. Given the coronavirus panic that has been spreading faster than the disease, other forms of stimulus are also needed, including tax cuts and direct support for business.

Any sign that deflation could take hold would require a major response from the 'Fed' and other central banks and the indications are already here that a major response is underway, with the 'Fed' re-introducing 'QE'. However, as recently as its 29 January meeting, the 'Fed' was expressing confidence that inflation would shortly 'return to the 2 percent objective on a sustainable basis'. The 'Fed' also noted at this meeting that 'key factors that influence consumer spending, including a low unemployment rate, the upward trend in real disposable income, high levels of households' net worth, and generally low interest rates, remained supportive of solid real private consumption expenditure growth in the near term'. Furthermore, it noted that 'recent readings on consumer confidence surveys were strong'. Behind this confidence have been actions by the 'Fed' itself, including dropping interest rates three times last year and then adding further cuts of 0.5% on 3 March and another 1.0% on 15 March this year, bringing the 'Fed Funds' rate to a range of 0% to 0.25%. The 'Fed' also followed its quiet return to a form of 'QE' in September, adding liquidity to the financial system until the start of this year, with a large $700 million program on 15 March to be injected 'over coming months'. This was warranted, given weakening investment and the developing threat of global recession. Furthermore, additional 'Fed' stimulus is likely to be needed over the near-term. The following recent data shed further light on the current state of the US economy:

- Industry capacity utilisation (76.8% in January) was 3.1% below long-run trend.
- Money supply (M1) growth was increasing by end-January (up 6.4% for the year).
- Bank lending to businesses has been slipping (up 0.7% for the year to December).

European economies mostly remained close to recession in the December quarter, with the largest regional economy, Germany, heavily affected by weak exports, especially autos. The ECB acknowledged the depth of stagnation in the Euro-zone by lowering interest rates and re-introducing a 'QE' program late last year. However, the ECB has been slow to react to the pandemic and needs to do more to lift investor confidence. Italy is in a form of quarantine, which increases the likelihood that recession will take hold there, while Japan is also in recession. China though appears to be already on the road to recovery and is an example to the world of how to overcome the coronavirus.

European economies mostly remained moribund in the December quarter (the whole Eurozone grew by only 0.1%) and some key economies are close to, if not technically in, recession. The region's largest economy, Germany, had no growth in the quarter, after growing by 0.1% in the September quarter and this key economy has barely grown over the last 2 years. Across Europe, consumer and business sentiment remains weak and uncertainty prevails about the general outlook, with the spread of the Covid-19 coronavirus likely to push the region into recession. Italy, which contracted by 0.3% in the December quarter, has since been hit hard by the virus, with the entire country being put into quarantine from 9 March until 3 April. During this period, travel is only being permitted for 'urgent verifiable work situations, emergencies or health reasons', while 'all forms of gatherings in public places' have also been banned. The UK also stalled during the December quarter and has responded to the coronavirus spread by announcing on 11 March a co-ordinated response from the Bank of England (interest rates cut to 0.25%) and the Government (fiscal stimulus) to relieve a likely slide into recession. The **Japanese economy**, the third largest in the world, is also likely in recession, after experiencing a severe 1.6% contraction in the December quarter after the country's sales tax was raised from 8% to 10% on 1 October. Inflation remains well below the 2% target (only 0.7% over the year to January) and more stimulus is needed. In **China**, the source of the recent coronavirus breakout, the economy stalled for a short time due to widespread factory closures. However, recovery was underway by early March as new virus cases had dropped dramatically and factories were re-opening. A raft of pro-growth measures have been put in place to boost recovery, including tax cuts, lower bank reserve requirement ratios and increased infrastructure spending.

ECONOMIC OUTLOOK

AUSTRALIAN ECONOMY

The Australian economy expanded at a reasonable pace in the December quarter, although a further decline in private investment detracted from growth. The terms of trade also declined during the quarter, due to falling commodity prices, with the exception of iron ore and coal. The Treasury warned on 5 March that the effects of the effort to avoid the spread of the coronavirus could detract significantly from growth at least over the March quarter and the potential for the economy to enter recession has become evident. In this deteriorating economic environment, stimulus measures are now necessary and the Government announced an $18 billion support package for employers and others on 12 March. The RBA has also come to the party, cutting rates and could soon need to add 'QE'.

The **Australian economy** did slightly better than expected in the December quarter, with growth of 0.5%, bringing growth for the year to 2.2%. On a per capita basis though, GDP rose by only 0.2% for the quarter, while what the Australian Bureau of Statistics calls 'a broader measure of change in national economic well-being', known as real net national disposable income, actually declined over the quarter (by 0.9%). This decline was due to a hefty fall of 5.3% in the terms of trade (the movement in export prices relative to import prices, expressed in the same currency). This decline (expected to continue in the March quarter) reflects falling commodity export prices due to a decline in global demand flowing from the spreading coronavirus epidemic. Flow-on effects from the virus include reduced trade, a severe decrease in travel and a general disruption to business. Despite the relatively few cases of the virus so far recorded in Australia, the potential for recession to take hold is clear and Treasury Secretary, Steven Kennedy, advised on 5 March that GDP could contract by at least 0.7% in the March quarter. Given this environment, stimulus measures have become necessary and so the Commonwealth Government announced a relief package on 12 March designed to keep people in employment that includes $11 billion being pumped into the economy before 30 June, with nearly $5 billion to be handed out to welfare recipients by the end of March. A further $7 billion is to be spent over the next financial year, with the whole program being 'scalable', so that it can be ramped up if necessary over coming months. The Reserve Bank (RBA) also cut its 'cash rate' to 0.5% on 4 March and may have to do more, including initiating 'QE' in the near-term.

The interest rate cuts implemented by the RBA last year have been successful in stabilising the housing sector, with house prices rising in the second half of the year. However, as Philip Lowe, Governor of the RBA, put it on 3 March, the effort to stop the spread of the coronavirus has 'delayed progress towards full employment and the inflation target (of over 2%)'. He added that 'the RBA is prepared to ease monetary policy further to support the economy'. Given the apparent rapid slowdown in global growth, the RBA could soon have to act on this promise to boost activity, especially because the very measures being taken to protect people from the spread of the virus (such as deferring group activities) detract from growth. This deteriorating outlook has driven the $A lower as investors have moved into the 'safe haven' of the $US. However, as the Deputy RBA Governor noted on 11 March, 'once we get beyond the effect of the virus, the economy will be supported by lower interest rates and the lower exchange rate'.

One sector that has been the beneficiary of the RBA's interest rate cuts that began last June has been housing, with lower mortgage rates putting a floor under house prices. Over the year to end-February, average dwelling prices were up by 10.9% in Sydney, 10.7% in Melbourne and 7.3% for the capital cities index (CoreLogic data). However, if the economy slips into recession as a result of the coronavirus pandemic (declared as such by the World Health Organisation on 11 March), this could put an end to housing price rises for the duration of any economic slowdown. As Philip Lowe, Governor of the RBA, noted on 3 March, while announcing a cut in interest rates, 'the global outbreak of the coronavirus is expected to delay progress towards full employment and the inflation target (2% to 3%)'. He then added that 'the (RBA) Board is prepared to ease monetary policy further to support the economy'. In the RBA's view, interest rates are unlikely to drop below 0.25%, although it has recently been analysing how a 'QE' program could be conducted in Australia, if further rate cuts prove insufficient to boost economic activity. Lowe also previously pointed out that 'monetary policy is not the country's only option', noting that 'spending on infrastructure, if done properly, can boost an economy's productivity'. Furthermore, 'there is no shortage of finance to do this, with interest rates the lowest they have ever been' (9 August 2019). As Guy Debelle, Deputy RBA Governor, explained on 11 March, 'once we get beyond the effect of the virus, the economy will be supported by the low level of interest rates, the lower exchange rate, a pickup in mining investment, sustained spending on infrastructure and an expected recovery in residential construction'. Furthermore, a lower $A (down 12% against the $US between 1 January and 13 March) could assist the country's international competitiveness, which has been held back by excessive imposts on business, including one of the highest corporate tax rates in the world, the highest minimum wage rates, some of the highest electricity prices in the world (with heavy industry being particularly hard hit), as well as over-regulation and excessive unionisation in some sectors.

STRATEGY FOR FIDUCIAN FUNDS

STRATEGY OVERVIEW

Our economic analysis set out above indicates that the world economy was slowing even before the outbreak of the Covid-19 coronavirus early this year. However, this virus has, at least for the time being, begun to put the brakes on global growth and has created an urgent need for strong monetary and fiscal stimulus measures to be introduced. Already by early March, the 'Fed' in the US had cut rates to 0%, ahead of a scheduled monthly meeting where further measures are likely. Other central banks have followed suit, including the UK and Canada (both with rate cuts of 0.5%) and Australia (0.25%). There is also an emphasis being put on infrastructure spending and short-term fiscal support measures (being pushed by the IMF), such as tax cuts and support payments to businesses hard hit by economy-wide cutbacks in spending. While these measures cannot be expected to prevent a recession that appears almost a certainty for some regions, notably much of Europe and Japan, such measures can help ensure that economies are in a position to rebound quickly once the spread of the virus has slowed significantly (as is already the case in China and South Korea). Although China was the source of the virus, strong containment measures have meant that the country is on the verge of being able to return to full industrial production, which could be highly beneficial to the rest of the world as well. However, Europe, where growth has been anaemic for some time, is going to require very strong medicine to achieve even modest recovery, as negative interest rates and the re-start of 'QE' from last September have not been enough to lift activity. In the Japanese case too, negative official interest rates and an enormous program of 'QE' have been insufficient to ignite growth or lift inflation in an environment of weak productivity growth and a declining workforce. These economies appear to need genuine structural reform as well. This could include de-regulation, the provision of incentives for private business investment (such as accelerated expensing and tax write-offs for the introduction of productivity-enhancing technology) and workplace reform (such as a winding back of union rules in the workplace, a lift in the retirement age and an increase in the minimum pension age). Nevertheless, given the reality that the world is facing the near-certainty of widespread recession (of unknown duration), highly expansionary monetary policy, preferably including 'QE', is going to be essential for most economies for some time. As well as being beneficial for the broad economy, expansionary monetary policy can boost, or at least stabilise, share markets (as appears to be the case for China's share market), lift investor confidence and reverse deflation. In turn, this can help to shift investment from the supposedly 'safe havens' of bond markets and get it back into productive enterprise. In other words, it is essential that asset markets receive every form of support in such deteriorating economic conditions as most countries currently face, even if these conditions are not expected to last for long. The IMF concurs, noting 'stimulus such as rate cuts or asset purchases ('QE') can support financial markets.' (9 March).

On the other hand, with some governments (including Germany, Japan, France and Sweden) able to borrow for 10-year terms at negative rates (and even countries such as the US able to borrow at historically low rates), it makes sense for them to do so on a large scale for productive projects, thereby sustaining employment, pushing up bond yields in time and re-storing incentives for both direct and portfolio investment. For some time now, most sovereign bond markets have been signalling that more expansionary policies have been needed. Yield curves were flattening and in some cases even inverting (where longer-term bond yields fall below the short-term rate), often a sign that economic activity is faltering. The onset of coronavirus fears drove even more money into these supposedly 'safe havens', with investor panic exacerbated by the oil price crash in early March. In Europe, where in some cases short-term rates and long-term sovereign bond yields are both negative, the case for urgent stimulus seems even clearer, while everywhere the looming risk of deflation adds to the urgent need for large-scale injections of liquidity into the financial system, even if only for the short-term.

While earnings forecasts were still relatively robust by late February, these will likely need to be downgraded in the current environment. After the market crash of early March, however, most share markets appeared to be more attractively valued than most bond markets, assuming economic recovery over coming months. The MSCI World Shares index by early March was trading at well below its long-term average price-to-earnings ratio of around 15 times forward earnings.

Current tactical asset allocation strategies have been developed as set out below.

STRATEGY FOR FIDUCIAN FUNDS

International Fixed Interest

Sovereign bond yields had been historically low for some time but in early March dropped to record lows on fears of the spreading coronavirus and after a large drop in the oil price. Inverted yield curves point to potential recession.

Government bond yields in major markets, which have been historically low for some time, fell to record levels in early March under the pressure of the dual crises of the coronavirus and an oil price crash. The yield on US 10-year Treasury bonds slumped to 0.54% on 9 March (after reaching an intra-day low of 0.35%), well below the Fed's short-term rate – in other words an inverted yield curve, reflecting fears of oncoming recession. German, French and Japanese yields were negative (-0.86%, -0.38% and -0.16% respectively).

International bonds appear to be over-valued and we remain under-weight this sector.

Australian Fixed Interest

Commonwealth Treasury bond yields have fallen to record lows, reflecting a rapidly weakening economy. The RBA has cut rates but may need to do more.

The RBA cut its official short-term interest rate three times in 2019 to 0.75% and then cut again to 0.5% on 4 March. The Commonwealth Treasury 10-year bond yield fell to a record low of 0.61% on 9 March, the yield curve then being almost flat, signalling a slowing economy. More rate cuts are likely this year unless rapid recovery can be engineered.

Domestic bonds still appear to be over-valued and we remain under-weight this sector.

Inflation-Indexed Fixed Interest (CPI Bonds)

Inflation-linked bonds could out-perform if inflation rises over time.

These bonds tend to be less volatile than conventional issues but can out-perform in times of inflationary pressure, which could be expected to increase along with economic recovery.

Australian Shares

The Australian share market took a severe hit in early March, falling nearly 20% in a few days, with panic selling following a 30% fall in the oil price on 9 March. Market weakness was exacerbated by heavy short selling, which appears to fuel panic in times of high market volatility. The rapid spread of the coronavirus has kept markets under pressure and by 12 March, all of the gains made during the 2019 bull run had been reversed in the space of a few days. The threat of recession, with the potential for rising unemployment and falling prices, has prompted efforts at stimulus which could support the share market in time. One positive to come out of the market adjustment, however, is that valuations have improved markedly.

Australian equities markets were jolted in early March by a coronavirus-induced investor panic that has spread around the world. From the start of the year to 16 March, the share market fell by 26%, with a 19% fall in just a few days in early March (to 12 March, ASX200 Accumulation index). This followed what had been a bull run in 2019, which saw the local market up 23%. The trend of the domestic market has followed other major markets, where panic began to set in from late February. While central banks have been moving to cut interest rates and governments have been formulating stimulus packages to support activity, this was still not enough to counter negative sentiment and declining economic activity, including in Australia. The major factor behind last year's bull market appears to have been a shift to expansionary monetary policy in the major economies, with the market rise reflecting lower interest rates in the US (and Australia) and a return to 'QE' in Europe. However, evidence of rapidly rising coronavirus infections in key economies in early March sent markets into a tailspin, with price declines exacerbated in Australia by heavy short selling. The largest declines this year (to 13 March) have been for the energy sector (down 36%) after a 46% drop in the price of oil (WTI in $US) and for the Resources sector (down 26%). Financials were down 20%, Technology 22% but Industrials 14%, while the healthcare sector was down a mere 4%. The hefty decline in the Resources sector was despite prices for iron ore and coal (our two largest merchandise exports) holding up very well (down 4% and 2% respectively from the start of the year to 11 March in $US terms). These price falls have improved valuations, so that by 12 March, the domestic market had an estimated price-to-earnings ratio (PER) of around 13.5 times forward earnings (Yardeni), well below its long-term average of 15, although any onset of recession could raise the PER.

Exposure to this sector is currently below benchmark.

STRATEGY FOR FIDUCIAN FUNDS

International Shares

Most global equities markets fell heavily in early March, with the one significant exception being the Chinese Shanghai market, which was down only 4% from the start of the year to 12 March. While valuations have improved, much will depend on how well earnings hold up over coming months.

Global equities markets mostly fell heavily in early March, with the one significant exception being the Chinese market, where the economy appears to be making a rapid recovery after being the first to be hit by the coronavirus. Up to 13 March, market movements included the Dow Jones Industrials index down 19%, the broad market (S&P500) down 16% and the technology-focused Nasdaq down 12% (all US). Elsewhere, market falls included the UK 29%, Germany 30%, France 31%, Japan 26%, India 17% and China down only 5%. These severe declines have almost succeeded in reversing the impressive gains that many markets experienced last year but at the same time have improved apparent valuation metrics, although much will depend on how earnings hold up over coming months.

By early March, valuations for most of the major markets had fallen below historical averages and, despite a likely fall in earnings, share markets appeared more attractively priced than other investment opportunities.

In valuation terms, by 5 March, the PER for the **major world markets** as a whole (based on the MSCI World index) was 15.5 times estimated forward earnings (excluding stocks without positive earnings), around its longer-term average of 15 times earnings. However, by 12 March this had dropped to well below the long-term average after heavy market falls. In general terms and assuming general economic recovery over the near-term, most share markets still appear to be better value than other investment opportunities, such as bonds, which appear very over-valued or cash (yielding almost nothing).

Exposure to this sector is around benchmark (aided by $A weakness).

Listed Property Trusts

The domestic listed property sector has been less affected than other sectors of the Australian share market. Rents, after all, tend to be relatively stable unless full-blown recession takes hold. The sector is now more conservatively geared and better cashed up (after large capital raisings) than it was prior to the global financial crisis.

The listed property sector fell in early March but from the start of the year had fallen much less than the broader share market (by 5% to 11 March, compared with 13% for the ASX200 index). This compared with a strong appreciation last year (up 19%), which had begun to stretch valuation ratios for the sector. Perceptions of the sector have greatly improved since its heavy falls in 2008 and 2009 during the global financial crisis. The structure of most listed property securities is now much stronger, with lower average gearing and more stable earnings. By 12 March, the sector's average PER was around 15 times forward earnings, with an earnings yield of 6.7% and a dividend yield of around 5.4% (2020 earnings, Macquarie estimate and based on an average pay-out ratio of 80%). Valuations for the sector now appear reasonable, assuming a full-blown recession can be avoided.

Exposure to this sector is around benchmark.

Australian Dollar

The $A has fallen but may need to go lower to counter our declining international competitiveness.

After falling from a high of $US1.10 in July 2011 to $US0.69 by January 2016, the $A began to rise, peaking at over $US0.80 in September 2017, before trending lower, ending 2019 at around $US0.70 before dropping sharply in early March this year to below $US0.62.

Investors should always opt for well- diversified, professionally managed portfolios.

As always, we **recommend that**, to counter market uncertainties, investors should **hold diversified portfolios**. These should give investors the best opportunities for capital growth with risk minimisation over the medium term. Portfolio asset allocation decisions and short-term market timing are also often best left to fund managers who exercise these decisions on a professional basis with the benefit of all available information.

Conrad Burge, Investment Manager, Fiducian Investment Management Services Limited

ASSET ALLOCATION FOR FIDUCIAN MANAGED FUNDS

CAPITAL STABLE, BALANCED AND GROWTH PORTFOLIOS

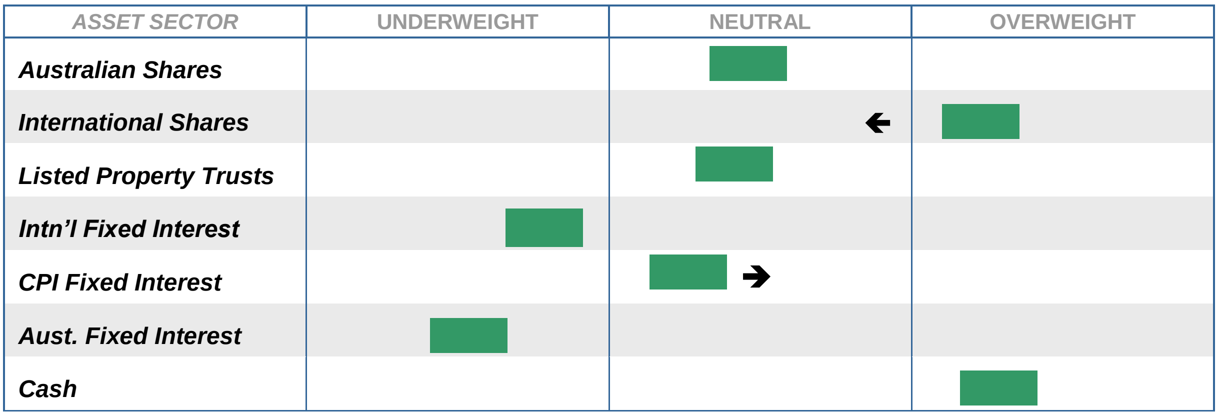
CAPITAL STABLE PORTFOLIO	Benchmark %	Range %	Sep 19 %	Dec 19 %	Previous 3 month activity
Australian Shares	15	8 – 19	15	15	➔
International Shares	10	6 –14	13	14	➚
Property	5	3 – 8	5	5	➔
International Fixed Interest	16	5 – 30	10	10	➔
CPI Fixed Interest	7	0 – 17	4	5	➚
Aust Fixed Interest	32	15 – 44	26	25	➘
Cash	15	5 – 42	27	26	➘

BALANCED PORTFOLIO	Benchmark %	Range %	Sep 19 %	Dec 19 %	Previous 3 month activity
Australian Shares	37	29- 45	37	37	➔
International Shares	23	15 – 32	27	27	➔
Property	9	5 – 17	9	9	➔
International Fixed Interest	7	4 – 12	5	5	➔
CPI Fixed Interest	3	0 – 8	2	3	➚
Aust Fixed Interest	16	10 – 22	13	12	➘
Cash	5	3 – 40	7	7	➔

GROWTH PORTFOLIO	Benchmark %	Range %	Sep 19 %	Dec 19 %	Previous 3 month activity
Australian Shares	42	34 –50	43	42	➘
International Shares	28	20 – 36	31	32	➚
Property	11	5 –15	11	11	➔
International Fixed Interest	5	0 – 14	3	3	➔
CPI Fixed Interest	2	0 – 7	1	2	➚
Aust Fixed Interest	10	5 – 16	7	6	➔
Cash	2	2 – 32	4	4	➔

Decrease ➘ Increase ➚ Hold Position (Less than 1% up or down) ➔ Significant change (5% or more) ↑/↓

NEXT LIKELY DIRECTION OF ASSET ALLOCATION CHANGE



Next likely direction in 3 to 6 months: ➔ Increase ← Decrease