# Our Wrap up of the 2016/17 Financial Year


Here's a list of just some of the major events that played out though the 2016/17 financial year:

- Global economic growth lifted on the back of a recovering United States economy.
- The world was "Trumpified" and we're still waiting to see what the true ramifications will be.
- Economic Growth in China has remained higher than we expected sitting at around 5.5% pa.
- Global Inflation remains low, but wages growth is even lower.
- We saw the Federal reserve lift interest rates for the first time since the GFC.
- We've seen fluctuations in the oil price as OPEC lose their pricing power.
- Volatility in global shares markets has been at record lows.
- If you lived in the south east corner of Australia, your house price soared.

## The Rise in Global Economic Growth

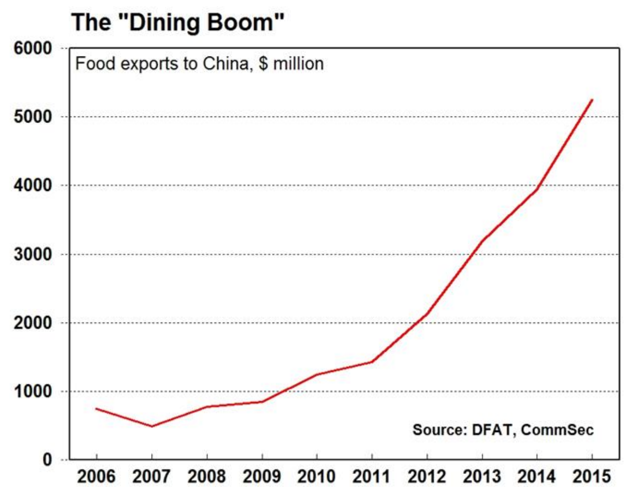
The calendar year 2016 saw the lowest global growth since 2009 at just over 3%, but 2017 has got off to a great start and economists are now forecasting global growth (GDP) to rise at 3.5% for the 2017 year and 3.7% for 2018. The biggest contributors to global growth are China, the United States and India, in that order. To say that these economies are firing on all cylinders would be an overstatement, however they are certainly firing on *more* cylinders with room for further upside.

This is positive news and provides comfort at a time when good news seems to be quite rare. GDP growth is a key factor in determining the likely return from sharemarkets. With GDP at 3.5% we would expect to see share markets deliver a return of around 9.5% to 10% per annum over the next few years. But as we know, the return from shares is never predictable and never linear, we can expect a few bumps along the way but with a general upward trend.

## The world's longest expansion!

Australia has just powered through its 104th consecutive quarter without a recession, which makes it the longest expansion period for any developed country in the world. This is a testament to the diversity and resilience our country enjoys. But, our current growth rate is well below the global average, sitting at a miserly 1.8% to the end of the March quarter.

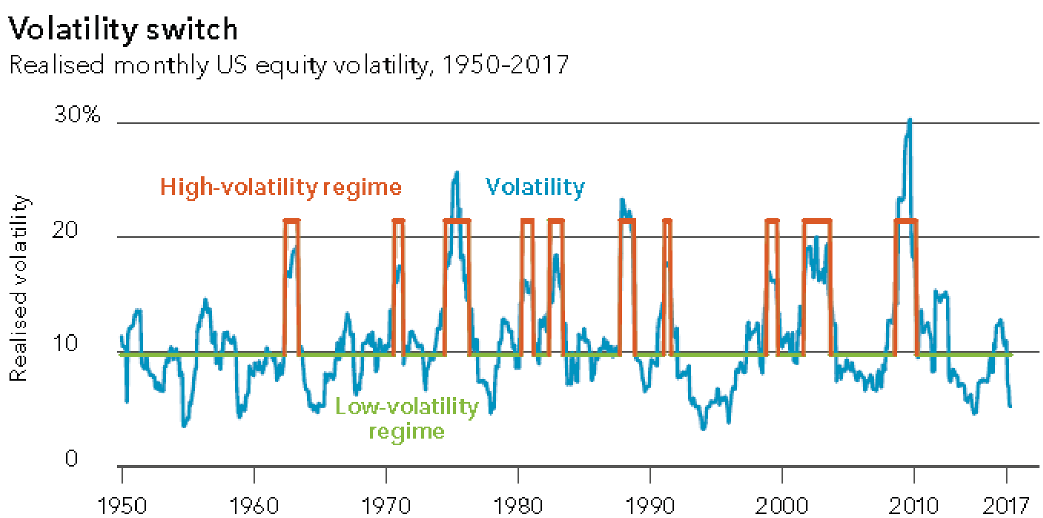
Looking forward there are many reasons to get excited about future growth. Our employment market is very healthy, currently at a 4 year low of 5.5% which coincides with a peak in job vacancies. Those two statistics when put together tell us that it is one of the easiest times to find employment in Australia. But that is also keeping wage inflation low, employers have the luxury of being able to replace employees if they aren't happy with their current salary package. We can therefore conclude that these low inflation and low wage growth conditions are likely to continue for the foreseeable future.




The mining Boom might be 'done and dusted' but **can it be replaced by the *'Dining Boom'?*** Well, the short answer is probably No. However the numbers suggest that it is providing a significant contribution to our economic growth and helping to push our 'Terms of Trade' into the black. This chart shows the growth in food exports to China over the past 10 years. If you focus on the past 5 years you will see that total food exports to China has increased more than 4 times and contributes more than $5billion to our total exports each year.

## Financial market volatility is at an all-time low.

The volatility measures for our markets (both domestic and global) are stuck at the bottom of their long-term ranges. Some might argue that the lack of 'fear' in our markets is a reason to be fearful. Sooner or later volatility will revert back to normal levels, and this rarely occurs without economic expansion coming to an end.




Sources: BlackRock Investment Institute, with data from Robert Shiller, June 2017. Notes: realised volatility is calculated as the annualised standard deviation of monthly changes in US equities over a rolling 12-month period. Using a Markov-Switching regression model, we calculate two volatility regimes: a high-volatility regime (orange) and a low-volatility regime (green). The orange and green lines plot the average level of volatility during each regime based on data from 1872 to 2017.

This chart shows that markets generally go through prolonged periods of low volatility (Green lines), dissected by short, sharp periods of abnormally high volatility (orange lines). These short periods almost always coincide with an economic disruption. You can also see that the low volatility periods, with the exception of the post World War II period in the 1950's, rarely lasts more than 8 years. This current period of low volatility commenced in late 2009!

## Has the dream run for Residential Property come to an end?

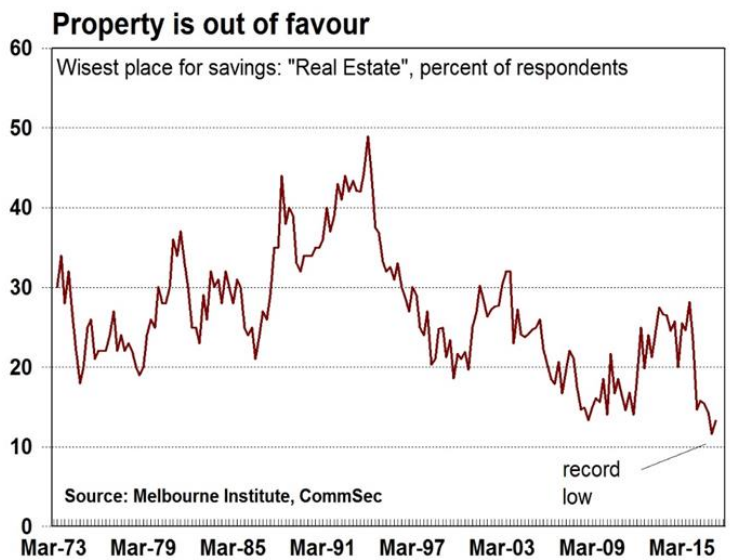
| State | % Change |
|---|---|
| Victoria | 13.7% |
| New South Wales | 12.2% |
| Australian Capital Territory | 9.6% |
| Tasmania | 6.8% |
| South Australia | 2.4% |
| Queensland | 2.0% |
| Western Australia | -1.7% |
| Northern Territory | -7.0% |

The direction of the property market is a popular 'Backyard BBQ' discussion topic, because it affects most of us. This table shows the annualised movement in property prices for June 2017.

If you live in the South East corner of the country, you are doing quite well out of your property investments, but if you live anywhere else, you're actually losing money after inflation.

But what are the prospects moving forward? A recent report suggests that there are more houses in Sydney for sale today than at any other time in history. That may be as a result of the a survey conducted by the Melbourne Institute showing that **sentiment in the property market is at an all-time low.**

A group of investors were asked, *'If you had any spare savings, what would be the best place to invest?'* As you can see from the chart, only 12% thought the Real Estate market would be the best place for their savings, and since 1973 when data was first collected, this is the lowest response. We think they've got it right.




When you factor in record numbers of building approvals and the lowest rental rate increases in 22 years, you have to get the feeling that things are not looking bright for the residential property market.

## Our conclusion

We get the feeling that Australian investors do a very good job of finding the negatives. We talk the market down and talk ourselves out of decent returns. This is not helped by the media, but there are plenty of reasons to be cautiously optimistic about the prospect for better than average returns in the medium to long term.

Cash remains a significant part of most investors' portfolios, but it should only be there for capital preservation purposes. If it makes up any part of your longer term wealth accumulation strategy, it's likely to fail in our opinion. With current rates of return sitting at 2.0% to 2.5% for cash investments, after tax and inflation you are losing wealth rather than creating wealth.

For longer term investment strategies we favour the Equity markets. In Australia, it's the mid-cap or ex-50 stocks that represent the best value. We recommended using active fund managers with a tried and tested track record.

Globally we prefer the Emerging Markets while they dominate the contribution to global growth. Also, Japan and Europe both represent good value over an expensive US share market.

SOURCE: CommSec, BlackRock Research, Melbourne Institute.