

October 2018

Investment Committee Update

Forecast Returns

Asset Class	Forecast Return Oct 2018 (% p.a.)	Status Oct 2018
Cash	2.3	n/a
Fixed Interest	3.2	Fully Priced
A-REITs	8.1	Fair Value
Commercial Property	7.5	Fair Value
Australian Shares	8.1	Cheap Fair Value
International Shares – (Developed Markets)	5.7	Fully Priced
International Shares – (Emerging Markets)	6.6	Fair Value

In addition to the forecast returns above, your equity investments may also generate the following risk premiums:

- The additional premium from having exposure to value and/or small company sectors within Australian and International Shares.
- The additional premium from having exposure to value companies within Emerging Markets.

NOTE: Whilst research shows the small and value risk premiums are available to investors over the long term, there is no certainty as to when the premiums will be available. For example, the market may not pay a premium for having an exposure to value and/or small companies for a long period of time. As such, only time in the market and including these exposures in your portfolio will allow an investor to capture these risk premiums.

Market Commentary / Strategy Considerations

Market Volatility – over the September quarter we saw markets continue to recover from the fall in Global markets in early February 2018 to exceed previous highs for the calendar year. However, October saw markets experience similar falls as in February of 7% for Australian Shares and 9% in the US. These short-term “hiccups” in share markets tend to spook investors and it is as important as ever to stay disciplined to a proven investment strategy.

Risk vs Return – The majority of Growth/Risky asset classes have come back into our Fair Value territory, providing more attractive expected returns over the long term than our previous quarterly update. In equity markets, this is the result of significant underperformance of Emerging Markets, along with Australian Shares and Developed Markets also pulling back.

We continue to be in a low interest rate environment (domestically and globally), with low expected returns from Defensive assets. There is still a reasonably attractive risk premium available from Growth/Risky assets relative to low risk cash/term deposit rates. However, this risk premium is significantly lower than it was 2-3 years ago. For example, this risk premium from a ‘Balanced’ portfolio is 2.4% p.a. lower over 10 years than it was in October 2015. With an increase in risk measures over the past 6-12 months and a reduction in expected returns, investors are not expected to be rewarded as much for being towards the upper end of their risk profile.

Generally, we are continuing to reduce risk, particularly in equities, across all portfolios. In addition, the recent fall is not significant enough to warrant the implementation of an Asset Allocation Reserve (i.e. selling Fixed Interest investments to purchase cheaper shares).

Currency – The Australian dollar has depreciated slightly over the past few months and at the current exchange rate of about USD 0.70 - 0.74, we believe

the Australian dollar is close to its long-term fair value. Given this, we believe it is prudent to maintain a partial exposure to hedged International Shares. This will allow you to benefit from any further depreciation, while also providing you with the benefit of the interest rate differential between Australian and global interest rates.

Australian Shares – While the Australian market has come back in recent weeks, it is still a long way from its pre-GFC high. Forecast returns are relatively attractive and the asset class is currently Cheap to Fair Value. This, combined with a relatively high level of income (and franking credits), means we are comfortable to be overweight Australian Shares compared to International Shares. When reducing portfolio risk, we are conscious of maintaining sufficient diversification across global markets and may reduce Australian Shares as part of this.

International Shares (Developed) – From a Global perspective, US shares are still Overpriced, with markets near record highs. With forecast returns reducing from 3.2% p.a. to 2.9% p.a. over the quarter and the risks associated with any equity investment, we believe the US does not provide an attractive investment opportunity. Yet, from a diversification perspective, it continues to represent over 50% of global equity markets. As such, we will continue our process of underweighting the US, relative to the rest of the developed world. By comparison, the remainder of Developed Markets, including continental Europe, United Kingdom and parts of Asia, are Cheap and we are happy to increase our relative exposure to these sectors.

International Shares (Emerging) – Emerging Markets have recently moved into our Fair Value range after significant falls over the past 6 months. Whilst this results in higher expected returns over the long term, we remain concerned about geo-political risk, high levels of debt within most Emerging Market

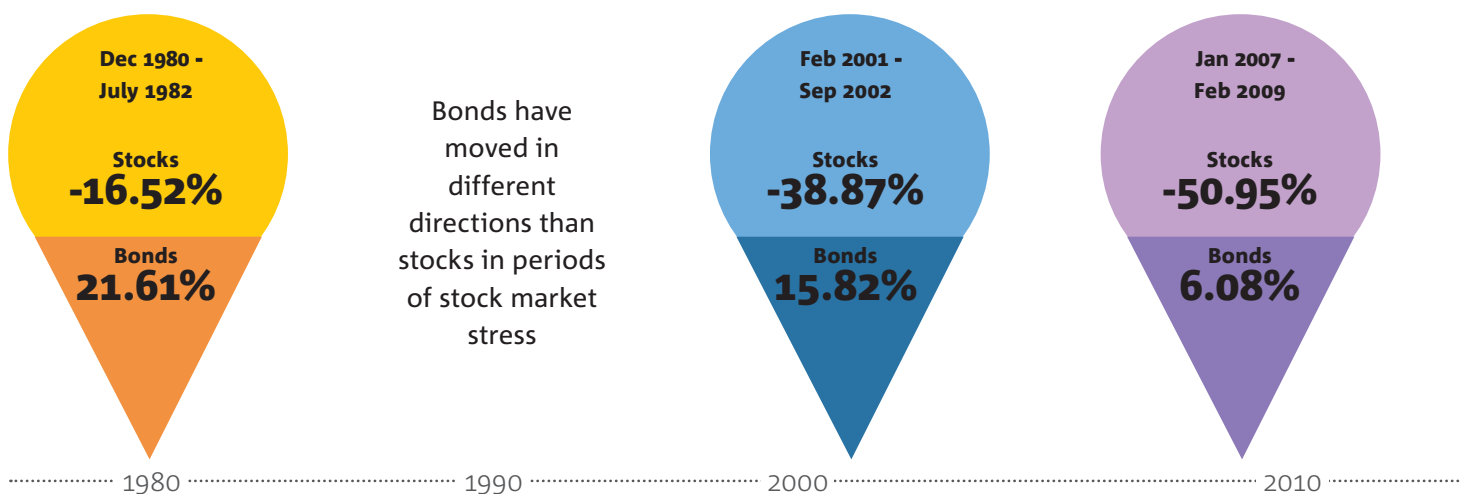
countries and rising global interest rates (particularly in the US). As such, we'll continue to exclude a standalone allocation to Emerging Markets at this time. Some of our portfolios will retain a small exposure to Emerging Markets, due to security selection decisions related to underweighting US share markets.

Commercial Property – Australian Commercial Property remains an attractive investment, producing relatively high yields, with a lower level of volatility than most equity investments. We are happy to hold (or slightly increase) our exposure to this sector, up to an appropriate limit dictated by risk profile and liquidity.

Fixed Interest – Although interest rates remain relatively low around most of the developed world, we still believe that high-quality Fixed Interest investments have a vital role to play in portfolios, due to the stability and liquidity they provide. We continue to prefer short and intermediate-dated Fixed Interest investments, in preference to longer-dated bonds. Term deposits may be used in some situations, although the premium they held over bonds has largely disappeared. Importantly, high quality bonds play an important role in managing the risks associated with significant market downturns.

With the role of protecting your portfolio, the focus on high quality Fixed Interest is important, acknowledging this may mean slightly lower returns from your defensive assets than if you were to be weighted towards low credit bonds. However, the purpose of defensive assets is to be DEFENSIVE, not to chase higher returns by taking on significantly higher risk (this is the purpose of investing in shares and property where the potential upside is generally commensurate with the level of risk). Holding true defensive assets is crucial, especially when markets are falling.

Cash – Due to low interest rates, cash remains an unattractive asset class for most investors, with quality Fixed Interest investments providing higher potential return, with slightly higher risks. We will continue to use cash, along with short-dated Fixed Interest investments, to manage liquidity in client portfolios.



Source: Bloomberg, PIMCO Stocks represented by S&P 500 Index. Bonds represented by Barclay's U.S. Aggregate index. Past performance does not guarantee or indicate future returns.

Tipping Points

Australian Equities			Developed Market Equities			Emerging Market Equities			A-REITs		
All Ords 6,452.7	10 yr F'cast return	Status	FTSE DM 318.36	10 yr F'cast return	Status	FTSE EM 699.3	10 yr F'cast return	Status	ASX REIT 1457.8	10 yr F'cast return	Status
10250	0.6%	Overpriced	390	2.8%	Overpriced	1000	1.2%	Overpriced	1950	3.2%	Overpriced
9750	1.3%	Overpriced	380	3.1%	Overpriced	950	1.8%	Overpriced	1900	3.5%	Fully priced
9250	2.0%	Overpriced	370	3.4%	Fully priced	900	2.4%	Overpriced	1850	3.9%	Fully priced
8750	2.7%	Overpriced	360	3.7%	Fully priced	850	3.1%	Overpriced	1800	4.3%	Fully priced
8250	3.5%	Fully priced	350	4.1%	Fully priced	800	3.9%	Fully priced	1750	4.7%	Fully priced
7750	4.4%	Fully priced	340	4.4%	Fully priced	775	4.3%	Fully priced	1700	5.1%	Fully priced
7500	4.9%	Fully priced	330	4.8%	Fully priced	750	4.7%	Fully priced	1650	5.5%	Fully priced
7250	5.4%	Fully priced	320	5.1%	Fully priced	725	5.1%	Fully priced	1600	5.9%	Fair value
7000	5.9%	Fair value	310	5.5%	Fully priced	700	5.5%	Fully priced	1550	6.4%	Fair value
6750	6.5%	Fair value	300	5.9%	Fair value	675	6.0%	Fair value	1500	6.9%	Fair value
6500	7.0%	Fair value	290	6.4%	Fair value	650	6.5%	Fair value	1450	7.4%	Fair value
6250	7.6%	Fair value	280	6.8%	Fair value	625	7.0%	Fair value	1425	7.7%	Fair value
6000	8.3%	Cheap	270	7.3%	Fair value	600	7.5%	Fair value	1400	7.9%	Fair value
5750	9.0%	Cheap	260	7.8%	Fair value	575	8.1%	Fair value	1375	8.2%	Cheap
5500	9.7%	Cheap	250	8.3%	Cheap	550	8.7%	Cheap	1350	8.5%	Cheap
5250	10.5%	Cheap	240	8.8%	Cheap	525	9.4%	Cheap	1325	8.8%	Cheap
5000	11.3%	Cheap	230	9.4%	Cheap	500	10.1%	Cheap	1300	9.1%	Cheap

Tipping Points

Developed Market Equities			US Equities			World ex US Equities			Emerging Market Equities		
FTSE DM 318	10 yr F'cast return	Status	S&P500 2898	F'cast return	Status	World ex US 270	F'cast return	Status	FTSE EM 699	F'cast return	Status
390	2.8%	Overpriced	2800	2.9%	Overpriced	480	1.9%	Overpriced	1000	1.2%	Overpriced
380	3.1%	Overpriced	2700	3.3%	Fully priced	460	2.4%	Overpriced	950	1.8%	Overpriced
370	3.4%	Fully priced	2600	3.7%	Fully priced	440	2.9%	Overpriced	900	2.4%	Overpriced
360	3.7%	Fully priced	2500	4.2%	Fully priced	420	3.5%	Fully priced	850	3.1%	Overpriced
350	4.1%	Fully priced	2400	4.7%	Fully priced	400	4.0%	Fully priced	800	3.9%	Fully priced
340	4.4%	Fully priced	2300	5.2%	Fully priced	380	4.6%	Fully priced	775	4.3%	Fully priced
330	4.8%	Fully priced	2200	5.8%	Fair value	360	5.3%	Fully priced	750	4.7%	Fully priced
320	5.1%	Fully priced	2100	6.3%	Fair value	340	6.0%	Fair value	725	5.1%	Fully priced
310	5.5%	Fully priced	2000	7.0%	Fair value	320	6.7%	Fair value	700	5.5%	Fully priced
300	5.9%	Fair value	1950	7.3%	Fair value	310	7.1%	Fair value	675	6.0%	Fair value
290	6.4%	Fair value	1900	7.6%	Fair value	300	7.6%	Fair value	650	6.5%	Fair value
280	6.8%	Fair value	1850	8.0%	Fair value	290	8.0%	Fair value	625	7.0%	Fair value
270	7.3%	Fair value	1800	8.3%	Cheap	280	8.5%	Cheap	600	7.5%	Fair value
260	7.8%	Fair value	1750	8.7%	Cheap	270	8.9%	Cheap	575	8.1%	Fair value
250	8.3%	Cheap	1700	9.1%	Cheap	260	9.4%	Cheap	550	8.7%	Cheap
240	8.8%	Cheap	1650	9.5%	Cheap	250	10.0%	Cheap	525	9.4%	Cheap
230	9.4%	Cheap	1600	9.9%	Cheap	240	10.5%	Cheap	500	10.1%	Cheap

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1. FTSE All World DM (Loc) 2. FTSE All World Ex US (Loc) 3. FTSE All World EM Ex US (Loc)

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Strategy First Financial Planning Pty Ltd

AFSL: 290771

ABN: 69 114 540 528

Grd Floor, Front Suite 55
117 Old Pittwater Road, Brookvale NSW 2100
PO Box 7418 Warringah Mall NSW 2100

Tel: 02 9091 0080

Fax: 02 9939 4730

Email: contact@strategyfirst.com.au

Website: strategyfirst.com.au

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