GRANT SAMUEL
FUNDS MANAGEMENT

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MEDIA RELEASE

Global economy to stagnate, but pockets of opportunity remain as post Royal Commission credit tightening squeezes house prices

US growth will likely return to trend and Europe will avoid a recession but the Reserve Bank's forecasts for the local economy will prove optimistic, and the credit tightening following the Royal Commission will squeeze house prices in Australia, according to Grant Samuel Funds Management and its fund manager partners.

Nick Griffin, chief investment officer with Munro Partners, says global markets have sold off in preparation for earnings downgrades that have not yet occurred.

"Markets tend to struggle to do well as earnings estimates come down, and we expect a significant number of earnings downgrades and realignments as the year unfolds.

"The good news for markets is equities are still cheap versus bonds. The US 10-year bond rate has stopped going up. Rates are going to stay low and that is ultimately good for equities as it makes them the asset class of choice.

"Looking forward, we lean towards developed markets over emerging markets. We know developed markets are more expensive but in all cases, we feel purchasing managers around the world will favour developed market companies.

"IP Wars and security concerns will probably make managers lean towards a more expensive developed market product over an emerging market product, with the shunning of Huawei in 5G deployments the most obvious recent example.

"Looking for investments that are expecting earnings growth is the key, as earnings growth drives stock prices over the long run. Digital enterprise, digital payments and food revolution are three areas where we are expecting a strong structural earnings growth dynamic over the next three years," Mr Griffin says.

Stephen Miller, adviser with Grant Samuel Funds Management, says the risks to the global economic outlook are asymmetrical to the downside.

"US growth will likely return to trend, or thereabouts, while the rest of the world - including China, Europe, Japan and the emerging markets - will experience lacklustre growth but will avoid a recession.

"But the downside risks are real. They include trade tensions between US and China; persistent effects from the US government shutdown and ongoing difficult US domestic political circumstances as well as unsettled European politics combined with ongoing sluggish European growth.

"Add to this mix China's slowdown as well as problematic geopolitics more broadly – such as cyber wars, ongoing tensions in the South and East China Sea and tensions between Russia and the West and the Middle East – and it is clear that there are a number of factors that may derail a soft but bumpy landing.

"For Australia the Reserve Bank's forecasts are likely to prove optimistic as a housing downturn, and a slowing China, drag growth back to 2 per cent, with further risk remaining to the downside.

"In this environment we can expect the Australian dollar to decline to around the 65 cent mark," Mr Miller says.

Tribeca Investment Partners portfolio manager, Jun Bei Liu, says there are concerns around the outlook for the Australian economy and particularly the housing sector.

"The Federal election will be a big swing factor in terms of investment thesis for Australia in 2019. While the May budget is expected to be stimulatory, we do expect the ALP to match with stimulus promises leading up to the election.

"Current polls suggest a victory by the ALP and it's important to note some of ALP's more controversial and potentially disruptive proposed policies. Two key policies we view as having meaningful impact are changes to the dividend imputation refund and changes to negative gearing.

"Changes to the imputation refund will shift companies' capital allocation decisions, particularly in a low growth environment. We expect increased off market buy back from companies with large franking credits, which in term will support prices.

"On the other hand, the implication of potential changes to negative gearing will be far more negative with risk of adding significant pressure on an already softening housing market. The flow on impact will be substantial pressure on our economy and our fragile banking system. Our base case investment thesis includes a softening housing outlook without changes to negative gearing.

"Ongoing credit tightening post the Royal Commission is pressuring house prices which will lead to weaker housing construction and flow-on effects to retail and consumption.

"It is difficult to get excited about the attractive valuations in the banking sector with this backdrop, as they are cycling low bad debt charges and face higher regulatory capital, and higher funding and compliance costs.".

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Since 2007, GSFM has formed alliances with following investment managers to distribute investment products to Australian and New Zealand clients:

- *New York based Epoch Investment Partners, Inc.*
- *Tribeca Investment Partners, a successful Australian boutique manager*
- *Payden & Rygel, a Los Angeles based independent investment management firm*
- *Triple Three Partners Pty Ltd (Triple3) a boutique research and investment management firm*
- *Munro Partners, an independent global equity manager*
- *London-based Man Group plc*

GSFM currently represents $5.9 billion funds under management (as at 31 December 2018). For more information about GSFM please visit the website: www.gsfm.com.au