

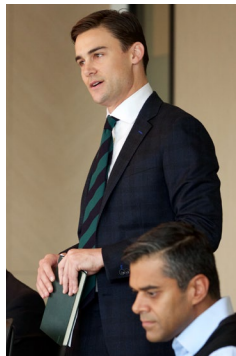
**crestone.**

## AROUND THE TABLE

AN EXCHANGE OF INVESTMENT IDEAS  
CRESTONE INVESTMENT FORUM / JUNE 2016



**which way**  
*from here?*



## Around the table

Anne Anderson  
HEAD OF FIXED INCOME, ASIA-PACIFIC  
**UBS ASSET MANAGEMENT**

David Cassidy  
CHIEF EQUITIES STRATEGIST  
**UBS GLOBAL RESEARCH**

Sam Churchill  
HEAD OF MACRO RESEARCH  
**MAGELLAN FINANCIAL GROUP**

Vimal Gor  
HEAD OF INCOME & FIXED INTEREST  
**BT INVESTMENT MANAGEMENT**

Michael McCorry  
CHIEF INVESTMENT MANAGER  
**BLACKROCK AUSTRALIA**

Warryn Robertson  
PORTFOLIO MANAGER & ANALYST  
**LAZARD ASSET MANAGEMENT**

Paul Skamvougeras  
HEAD OF EQUITIES / PORTFOLIO MANAGER  
**PERPETUAL**

Hasan Tevfik  
EQUITY STRATEGIST, AUSTRALIA  
**CREDIT SUISSE EQUITIES (AUSTRALIA)**

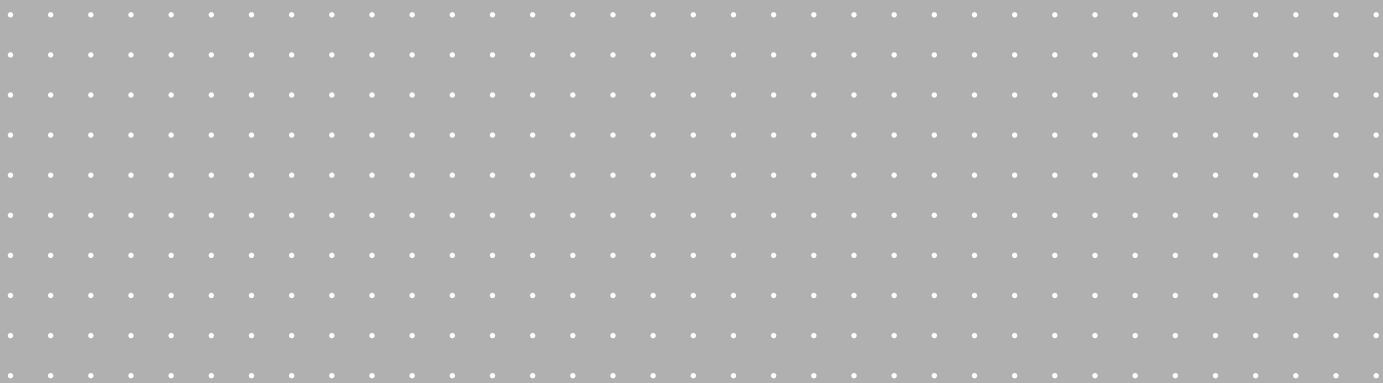
## CRESTONE WEALTH MANAGEMENT

David Sokulsky  
CHIEF INVESTMENT OFFICER

John McDonald  
EXECUTIVE CHAIRMAN

Mike Chisholm  
CHIEF EXECUTIVE OFFICER

Ed Blight  
HEAD OF INVESTMENT SALES



# CONTENTS

<b>Crestone Investment Forum</b>	<b>3</b>
<b>Which way from here?</b>	<b>4</b>
<b>Questions to the table:</b>	
Interest rates—which way for the RBA?	5
Is Australia's credit rating at risk?	6
Are we likely to see lower growth and lower inflation?	7
Where does equity market value reside?	8
What does this mean for asset classes?	9

# crestone

## *investment forum*



**MIKE CHISHOLM**  
CHIEF EXECUTIVE OFFICER  
CRESTONE WEALTH MANAGEMENT

*You can only have a really solid and robust investment process by considering a lot of diverse views across both asset classes, and geographies, and this forum does exactly that.*

Welcome to the inaugural edition of *Around the table*. In this report we provide you with insights on the important issues driving markets from leading investment managers.

These diverse perspectives are captured during the Crestone Investment Forum, a quarterly event which brings together some of the smartest minds in the investment industry. The forum promotes diversity of opinion, and the global insights which emerge act as important inputs to the Crestone investment process.

In June 2016, the Crestone Investment Forum focussed on challenges facing the investment industry, and the global outlook for markets against a backdrop of an ever-changing political and economic landscape. Drawing on the diverse views of 12 participants from nine organisations, we discussed the key drivers for markets over the next six months, and looked at the major risk events which could affect investors and market volatility. We also discussed how effective an easing bias by the Reserve Bank of Australia (**RBA**) would be at stimulating inflation and growth within Australia.

# *which way* from here?

A commonality of views emerged from the Crestone Investment Forum. This reflected the divide between equity and fixed income managers, and the diversity of views across these asset classes and individuals. At the core of these views were:

- **Australian interest rates**—the Australian cash rate will likely be cut further by the RBA. The unknowns are the timing and extent of the cuts in addition to the impending interest rate moves by the US Federal Reserve (**Fed**). Australian inflation is seen as the trigger to further cuts to the target cash rate;
- **Australia's credit rating**—Australia's AAA credit rating is likely to be downgraded. This could lead to the Australian dollar falling further to below USD0.60. A substantially lower dollar should benefit the Australian economy;
- **The Fed funds rate**—this will undergo a normalisation process during the next three to five years with rates likely to be capped at between 2.0% and 2.5%;
- **Ascension of Donald Trump to White House**—the ascension of Republican Party nominee Donald Trump to the White House is largely considered unlikely. But should a Trump presidency transpire, investors will need to be cautious of any policy implications, particularly trade and foreign affairs between the US and China. This could have an impact on the global economy. While Trump's foreign policy rhetoric should tone down during the presidential campaign, some ensuing market volatility cannot be ruled out;
- **Low inflation**—global fiscal responses are anticipated in order to combat the low inflation environment worldwide. This is expected to start with Japan followed by many of the world's other major economies;
- **Australian equities**—these appear overvalued and in expensive territory. There is also concern around the banks given that the low levels of bad debt seem unsustainable, and overly high dividend pay-out ratios may need to be reduced; and
- **Active versus passive management**—selective opportunities are present in the current market but a highly active approach is required. Passive investment should be taking a back seat to active investment given the current environment.

# INTEREST RATES—WHICH WAY FOR THE RBA?

Australian interest rates should move down on the back of lower inflation expectations—but the timing and extent is still uncertain.

UBS Asset Management's **Anne Anderson** believes the RBA will move on interest rates but that the market has "got a bit ahead of itself" in anticipating a faster easing than what will eventually transpire. Her base case is for the next downward movement in cash rates to take place in August. However, the downside in rates may be limited given the latest GDP numbers have painted a stronger picture of the local economy and 1% might be too low. Crucially, an August easing will depend on employment. "I think that the move which we experienced most recently was predicated on a game changer with regard to inflation," **Anderson** says.

Some of the 'more outlandish forecasts' suggest a move to 1%, and while this is entirely possible, most underestimate just how long such a move would take. Says **Anderson**: "Whether or not we do move to 1%, that game plays out through next year, and I think importantly the only way that would ever happen is if we have a recession—most likely driven by a spike in unemployment and the property market starting to unravel. But I just don't see any signs of that in the near term."

So what does a cut to 1.00% or 1.25% mean for the equity market? Credit Suisse's **Hasan Tevfik** believes that the Australian equity market is performing well and doesn't need a rate cut, and didn't need the preceding cuts. Australian equities are, he says, "still one of the highest-yielding asset classes almost anywhere in the world right now", and any further rate cuts will "just accentuate the gap between Australian dividend yields and every other investment out there". That's a clear positive for equities and supports his index target of 6,000 points. This will drive end-of-year dividend yields to a more normal level of around 4%.

Perpetual's **Paul Skamvougeras** questions whether valuations in some sectors "are getting too extreme" (**Tevfik** agrees). He questions where the earnings per share (**EPS**) growth will come from. While noting that in terms of price-to-earnings ratios (**PER**) Australian equity markets appear expensive, **Skamvougeras** says equities appear cheap based on dividend yields.

**Vimal Gor** sees the Australian cash rate easing to 1%, and potentially lower. He takes a global view on what affects Australia, including the knock-on impacts from Japan and Asia, and what a high-value Australian dollar means for trade. He is bearish on the economy because of overseas events. In general, he regards the Australian economy as "ticking along slowly" despite recent weak inflation numbers, and notes that the RBA cutting rates due to low inflation is unprecedented, and that cutting rates doesn't remove the weak inflation problem. The inflation picture panned out differently to what was expected, and he believes that the RBA needs to be cognisant of what's happening in the rest of the world, and will next act because of a strong Australian dollar. This will lead to further depreciation of the local currency. **Michael McCorry** also believes the RBA will be looking to what action the Fed takes in June-July.



**ANNE ANDERSON**  
HEAD OF FIXED INCOME, ASIA-PACIFIC  
UBS ASSET MANAGEMENT

*...there is a 'floor' at 1% for Australian banks beyond which they won't pass on the interest rate cuts.*



**PAUL SKAMVOUGERAS**  
HEAD OF EQUITIES / PORTFOLIO MANAGER  
PERPETUAL

*...you can't make enough money in bank deposits to fund yourself in yield flows...You're going to have to look for more assets, and equities are really the only asset out there.*

# IS AUSTRALIA'S CREDIT RATING AT RISK?

**Australia's credit rating will likely be cut but the impact on markets remains uncertain.**

**Gor** believes that Australia's AAA credit rating (as currently rated by Standard & Poor's, Moody's Investor Services and Fitch Ratings) will be downgraded by July 2016, and that once the rating has been downgraded, the Australian dollar will shift into the below USD0.60 zone. "You've got twin deficits which are both moving in the wrong direction. Now the AAA is great when you have twin deficits because it helps you to support your currency. But when that goes, I just think the currency has got below-60 written all over it."

**Anderson** holds a more sanguine view that "life continues" without a AAA credit rating and that the Australian dollar adjusts. "There are lots of countries that have lost their AAA (like Japan). That hasn't meant anything. But our currency adjusts as well." Her view is that if the currency is cheap enough, people will still fund it in a world in which yields are low.



# ARE WE LIKELY TO SEE LOWER GROWTH AND LOWER INFLATION?

Lower for longer is set to be a key theme for some time.

**Sam Churchill** sees the wholesale funding cost issue affecting the corporate sector more broadly and not just the banks, as corporate borrowings from abroad have expanded significantly since the crisis. He sees an inflationary and interest rate downside risk for Australia as China slows. Interest rate normalisation in the US could be pro-cyclical and poses a risk to Australia: "I think rate normalisation is a key risk. I think that you've got to remember that there's still quite a bit of slack in the US labour market and the US is going to be driving global inflation pressures. They're not quite there yet, despite the huge deflation pressures coming from commodities, the normalisation in oil prices, ongoing deflation pressures from China, emerging market currency falls, the strength of the US dollar—despite all these factors, US inflation is now 1.6%, not far below target. It's not much of a stretch to think they will be back at normal inflation rates soon."

**Churchill** doesn't believe we're near the end of a labour market tightening cycle. Jobs are continually being added and labour force participation is continuing to normalise. This is likely to lead to wage and inflation pressures that could be transmitted around the world. For **Churchill** the question is when it's going to happen really, rather than if."

**Anderson** believes that normalisation will take a long time and that the cash rate will peak at between 2.0% and 2.5% in the US due to the "global savings glut and global deflation. This will keep rates low everywhere—particularly in Europe but also in the US".

For **Churchill** a potential 2.5-3.0% Fed funds rate is materially above what markets are expecting (less than 1% on a three-year horizon) which to him seems low given where the US sits in its labour market cycle. He believes that growth in the US is sustainable. Savings rates are up compared to pre-global financial crisis levels, and there's continuing rising disposable incomes plus significant de-leveraging and lower interest rates that's raised spending capacity in US households. The fundamentals for US consumers and the economy remain good, and while he is not expecting a rapid pick-up in economic growth, he expects the sound fundamentals to continue for some time yet.

**Churchill** says that despite the solid fundamentals, the real issue is market pricing and concerns around interest rate risk. These are the key drivers to Magellan's positioning. Whether interest rate normalisation plays out over three or five years poses a risk: "A lot of markets are starting to price in lower for longer and this is increasingly bidding up multiples, and to us that's the biggest risk out there for markets at the moment." As a result, he remains very cautious and this explains why Magellan is at a 15% cash holding in its portfolio.



**SAM CHURCHILL**

HEAD OF MACRO RESEARCH  
MAGELLAN FINANCIAL GROUP

*I think interest rate normalisation is the opportunity.*



# WHERE DOES EQUITY MARKET VALUE RESIDE?

Valuations are currently high so investors need to be cautious. However, with interest rates so low, equities are basically the only game in town.

The question is whether the Fed will deliver more hikes than the economy needs in the normalisation process. If it does, **Gor** will buy the back end of the US yield curve. Given the state of the US economy, he does not foresee multiple rate hikes in the coming year. The Fed's decision will also affect the RBA's future decisions and its pace of monetary policy tightening.

Lazard's **Warryn Robertson** says that from an equities perspective he likes some quality resources stocks given that they're currently trading at good prices. He sees potential issues with the Australian major banks, particularly in relation to bad debt positions. Australian banks have had "25 years of really good banking history" but that's an insufficient reference point with regards to bad debt positions. It's important to look at the US and UK banking sectors to get better guidance as to where bad debt provisioning should be.

**Robertson's** view is that equities are the forward path for retirees to fund their retirement. "You look globally at where people are going to be able to fund retirement from an income perspective, and equity is the way now". He says that if cash rates go to 1% it is likely over the short term the market will further bid up defensive, high-yield stocks that are factoring in GDP growth. **Robertson's** take is that equity investors tend to be more optimistic than bond investors, and they will chase yield.

His framework for valuing businesses is predicated on the world needing to undergo an adjustment phase: "We don't try to time when or how that's going to happen. But we think the only way to invest our money today is to say, let's assume there is an adjustment, then let's go out there and try and buy businesses we think are still fundamentally cheap." For **Robertson**, the multiple you pay is the most important thing: "So when we're normalising earnings and cash flows below where most companies are at today, we've got recessions in our forecast and we see that as an over-reaction. We see it as a buying opportunity. It is also important to note that we have the desire to invest with a long term orientation."

**Skamvougeras** says Perpetual agrees with this view about the banks in terms of bad debt levels being unsustainable and pay-out ratios too high. Australian banks are over-earning, and increased capital requirements and regulation are also marginal negatives to be considered: "We haven't had a housing credit cycle since the 1990s. You can't stretch earnings any more without things going wrong". And on the Australian election front, **Skamvougeras** noted that the market is not yet considering the possibility of a change of government bringing in the risk of a Royal Commission into the financial system.



**WARRYN ROBERTSON**

PORTFOLIO MANAGER & ANALYST  
LAZARD ASSET MANAGEMENT

*...it's vital to look at the US and UK banking sectors to get better guidance as to where bad debt provisioning should be.*

# WHAT DOES THIS MEAN FOR ASSET CLASSES?

A good thesis can still be written for most asset classes but, overall, a diversified global portfolio is the best way to navigate what is destined to be an uncertain investment environment.

For **Anderson** fixed income is not the only game in town but, as a broad asset class, investors can flick between Australian and global markets. "Australia is the most attractive. But the forward points are still your friend...investing in global fixed income hedged back to the Australian dollar still gives you a 2% uplift depending on where our cash rate is, maybe 1.5%. That's still quite attractive and the hunt for yield is still important. You can still get returns of 4% from a diversified fixed income strategy. I still think that in the next six months that's where you should have some of your money."

**Tevfik** likes those companies that should benefit from the low cost of debt, (for example Macquarie Group and Amcor), commodities stocks and large companies that have restructured significantly during the past few years. He is positive on China and believes that further stimulus in its economy will help at the very least to keep resource stock prices relatively high.

**Gor** is long the front of the Australian yield curve, and short the front of the US yield curve, and "very long European bonds". He says that "volatility is cheap" and he is long here.

**Churchill** believes that Australian investors are overexposed to China risk and an unwinding property market in Australia. Prices remain challenging. It's therefore a good time to be invested in conservative global equities to diversify exposure. While market prices may seem high, attractive opportunities nonetheless exist: "Certainly market prices do seem on the high side but there are still attractive opportunities...We have two core objectives: one is to protect investors' capital on the downside; the second is to achieve a 9% per year return net of fees objective through the cycle. We still think, based on our numbers and based on the companies we've invested in on clients' behalf, that we can hit that second objective pretty comfortably through the cycle. So, we still think there are good opportunities out there for global investors over the next three years."



**SAM CHURCHILL**

HEAD OF MACRO RESEARCH  
MAGELLAN FINANCIAL GROUP

*...a good time  
to be invested in  
conservative global  
equities to diversify  
exposure...there are  
good opportunities  
out there for  
global investors.*



**MICHAEL MCCORRY**

CHIEF INVESTMENT MANAGER  
BLACKROCK AUSTRALIA

*With equities we're  
active. We've moved  
a lot of the risk budget  
towards the active...  
using the risk budget  
within active security  
selection...*

# WHAT DOES THIS MEAN FOR ASSET CLASSES?

**McCorry** says that several strategies within Blackrock have recently “neutralised” their equity positions (squaring up the overweights and underweights) in expectation of higher volatility. He says he’s “watching volatility” across US and global securities. He believes there is certainly a place for alternative investments (both in terms of hedge funds and real assets) over the medium to long term, and that there are many firms around the globe who are “looking for that liquidity premium and chasing it”. So, while there are some good real asset investment opportunities, it all depends on pricing and securing a liquidity premium over time. “With equities, we’re active. We’ve moved a lot of the risk budget towards active security selection. In terms of the directional calls we’re currently neutral on equities and using the risk budget within active security selection...absolutely.”

**Skamvougeras** is cautious and is avoiding infrastructure and healthcare due to what he sees as their “stretched valuations”. His search is for companies with strong balance sheets that can withstand the cycle and continue to pay a dividend stream. Selective turnaround stories (such as Woolworths) trading at low valuations are also of interest. His overall tone remains “quite cautious”.

**Robertson** says the art is in being highly selective and not investing in entire indices if you are seeking growth. The Australian equity market “looks ok but is not exceptionally cheap based on our valuations. He is wary of a pullback in some of the more defensive stocks.

**David Cassidy** sees the Australian equity market as “flat to moderate” but still foresees a further burst of equity market volatility, but not a “bull market-ending burst of volatility” with a major enduring impact. “I still think the backdrop is low to moderate growth and low rates. I still think that’s a pretty bullish backdrop to stocks, albeit I think the valuations are a little bit full at the moment.” His best ideas, he says, are stock-specific picks (one example being QBE) and he retains a watching interest in the resources sector, but thinks the iron ore price has further downside. He wouldn’t be looking at the resources sector if the iron ore price was USD45/tonne or USD40/tonne.



**DAVID CASSIDY**  
CHIEF EQUITIES STRATEGIST  
UBS GLOBAL RESEARCH

*...the backdrop is low  
to moderate growth  
and low rates...  
that's a pretty bullish  
backdrop to stocks...*

# deep insights *are driven by* diverse perspectives

---

In delivering advice and views on markets, the insights of our experienced investment team are complemented by market-leading research providers from across the globe, as well as the insights from the Crestone Investment Forum. These perspectives are then integrated into our robust, institutional investment process.

To find out more about our views on markets, and how this is driving our portfolio positioning, please ask your investment adviser for a copy of our latest *Core Offerings* report.

## IMPORTANT INFORMATION

This document has been prepared by Crestone Wealth Management Limited (ABN 50 005 311 937, AFS Licence No. 231127) (**Crestone Wealth Management**). The information contained in this document is provided for information purposes only and is not intended to constitute, nor to be construed as, a solicitation or an offer to buy or sell any financial product. To the extent that advice is provided in this document, it is general advice only and has been prepared without taking into account your objectives, financial situation or needs (your **Personal Circumstances**). Before acting on any such general advice, Crestone Wealth Management recommends that you obtain professional advice and consider the appropriateness of the advice having regard to your Personal Circumstances. If the advice relates to the acquisition, or possible acquisition of a financial product, you should obtain and consider a Product Disclosure Statement (PDS) or other disclosure document relating to the product before making any decision about whether to acquire the financial product.

Although the information and opinions contained in this document are based on sources we believe to be reliable, to the extent permitted by law, Crestone Wealth Management and its associated entities do not warrant, represent or guarantee, expressly or impliedly, that the information contained in this document is accurate, complete, reliable or current. All information, including any opinions or recommendations, is current as at the date of this report, but is subject to change without notice and we are under no obligation to update or keep it current. The value of financial products can go up and down. Past performance is not a reliable indicator of future performance and any forward-looking statements are not guaranteed. If you intend to rely on the information, you should independently verify and assess the accuracy and completeness of the information and obtain professional advice regarding its suitability for your Personal Circumstances, including as regards taxation matters. We do not advise on the tax consequences of investments (except to the extent we may be authorised to do so under Tax Agent Services legislation) and you should contact a tax adviser if you have any questions about this.

The opinions and recommendations contained in this document may differ or be contrary to the opinions or recommendations expressed by other parts of our business. The analysis contained in this document, in particular any valuations, projections and forecasts, are based on estimates and numerous assumptions. Different assumptions and estimates could result in materially different results. Crestone Wealth Management and its associated entities make no representations or warranties that any such estimates or assumptions will be met. We express no opinion and do not endorse nor accept any responsibility or liability for any statement, opinion or recommendation given by a third party in this document.

Credit ratings contained in this report may be issued by credit rating agencies that are only authorised to provide credit ratings to persons classified as 'wholesale clients' under the *Corporations Act 2001* (Cth) (**Corporations Act**). Accordingly, credit ratings in this report are not intended to be used or relied upon by persons who are classified as 'retail clients' under the Corporations Act. A credit rating expresses the opinion of the relevant credit rating agency on the relative ability of an entity to meet its financial commitments, in particular its debt obligations, and the likelihood of loss in the event of a default by that entity. There are various limitations associated with the use of credit ratings, for example, they do not directly address any risk other than credit risk, are based on information which may be unaudited, incomplete or misleading and are inherently forward-looking and include assumptions and predictions about future events. Credit ratings should not be considered statements of fact nor recommendations to buy, hold, or sell any financial product or make any other investment decisions.

Crestone Wealth Management, its associated entities, and any of its or their associated entities' officers, employees and agents (**Crestone Group**) may receive commissions and distribution fees relating to any financial products referred to in this document. The Crestone Group may also hold, or have held, interests in any such financial products and may at any time make purchases or sales in them as principal or agent. The Crestone Group may have, or may have had in the past, a relationship with the issuers of financial products referred to in this document and may provide, have provided or seeks to provide financial services to any companies or their associates mentioned in this document. Directors or employees of the Crestone Group may have served as officers of the companies mentioned in this document. The Crestone Group accepts no liability for any loss or damage relating to the distribution of this document or for any use or reliance on the information contained within it.

This document has been authorised for distribution in Australia only and is not intended or permitted to be distributed, or otherwise directed, made available to, or used by, any person in any jurisdiction where the distribution, publication or use would be contrary to law or regulatory requirements or which would require Crestone Wealth Management or any associated entity to be registered or licensed in that jurisdiction. In particular, this document may not be distributed directly or indirectly in the United States or to any US Person (as defined in the *Securities Act 1933* (USA)). This document is intended for the use of Crestone Wealth Management clients only and may not be distributed or reproduced without consent.

© Crestone Wealth Management Limited 2016

T 1800 784 614  
E [info@crestone.com.au](mailto:info@crestone.com.au)  
W [crestone.com.au](http://crestone.com.au)

**BRISBANE**  
Level 11, 1 Eagle Street  
Waterfront Place  
Brisbane QLD 4000

**MELBOURNE**  
Level 18  
120 Collins Street  
Melbourne VIC 3000

**SYDNEY / REGISTERED OFFICE**  
Level 32, Chifley Tower  
2 Chifley Square  
Sydney NSW 2000