Market Commentary

October 2015

EXECUTIVE SUMMARY

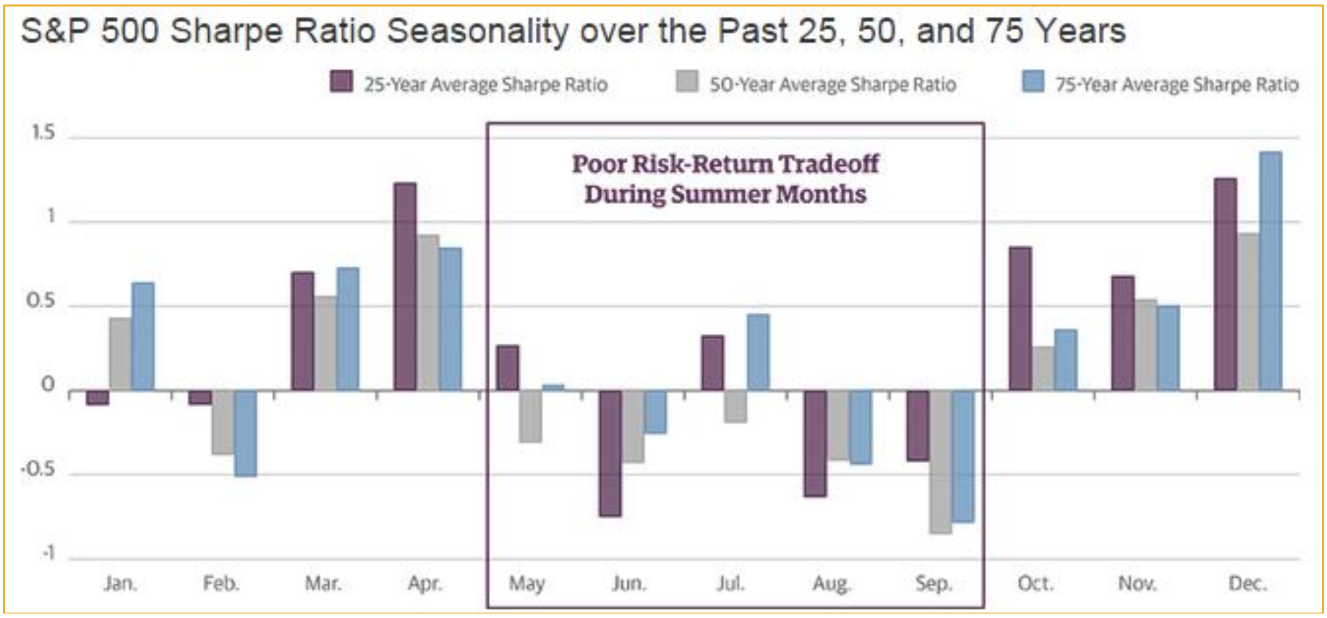
- September Quarter ASX 200 index down 8.7% with last 6 months -14.8%
- Weakness from Banks' capital raisings, together with China growth concerns
- Banks now at over 9% dividend yields inc franking
- Equity valuations discount many of the current fears
- China will still grow by over 6%
- Stabilization of oil and iron ore moderating deflationary fears in short term
- Asian emerging markets may surprise on upside
- New Prime Minister likely to assist business and consumer confidence
- Thematics remain in Global and domestic Technology, Healthcare, Infrastructure and Smaller Companies

Pessimism Induces Correction

As has frequently been the norm, the September quarter is often the worst for equity markets, and 2015 has been no exception with the ASX200 index losing 8.7% of its value. While major capital raisings by ANZ and CBA were major contributors to the weakness in the heavily weighted banking sector, international factors also played a role. Concerns over the impact of slower growth in China and the beginning of a Yuan devaluation, deflation risks in the developed world and the significance of a delayed start to Fed tightening in September have each played a role.

Having experienced two consecutive negative quarters of equity returns, it is our expectation that we will see a better outcome in the final quarter of 2015. The long term seasonality chart below clearly reflects this trend.

- **Equity valuations** now discount many of the risks, with many markets and stocks experiencing corrections of between 10% and 20%. Despite reduced earnings forecasts in most markets, forward PE multiples have fallen to 15x in Australia, 15.8x in US and 14.6x across Europe. Accordingly dividend yields in Australia have risen to over 5% plus franking. In all attractive valuations and dividends. Source: Goldmans
- Concerns over **China** are likely to moderate. In our view China will continue to grow in the 6-7% range over the next two quarters. The property sector appears to be stabilizing and retail sales are growing above 10% pa. The transition away from investment towards consumption and services continues. Internationalization of financial markets continues to gather pace, together with the deregulation of many domestic sectors.



- **Deflation** fears may also begin to moderate in the period ahead. Oil prices appear to have stopped falling, and while there remains an oversupply amid political tensions, the year on year rate of change will reduce. Similarly for iron ore, where recent price trends have been relatively stable, and are above levels forecast by many analysts. Another source of deflation has been a strongly rising $US, and this also appears to be moderating.
- **Emerging markets – (MSCI index)** Asia 69%, Europe 7%, Latin America 12%, South Africa 7% and Others 4%, have had a tough time of it through much of 2015, significantly underperforming developed markets. Much of this has been attributable to weak commodity prices, a strong $US and increasing credit spreads. With valuations now factoring in many of the risks, an end of year rally in Emerging Markets would not surprise.

New Prime Minister to inspire Confidence?

- The Australian economy remains in a delicate state as the resources sector investment boom winds down and we await the ramping up of the infrastructure investment phase. In the meantime, growth remains heavily dependent on consumption and housing and of course confidence
- Despite this delicate position, there are a number of factors that could improve Australia’s prospects.
- There is no doubt the lower $A is helping a number of sectors. Tourism numbers are up and spending has materially improved.
- Despite sluggish growth, overall employment trends remain robust. Admittedly much of the growth is taking place in the part time space, however it may also reflect underlying demographic and lifestyle trends as well. Strong growth is occurring in healthcare and business services. This augurs well for improved consumption.
- Under Malcolm Turnbull, it does appear that Australia can enjoy a period where reform is back on the agenda as we approach the next election at the end of 2016. We are also encouraged by the renewed focus on innovation and technology. This is likely to lead to an improvement in business and consumer confidence heading into the end of year that will encourage the market.

Strategy for the Final Quarter

After recent market declines and in expectation of a stronger final quarter, the ASX 200, having bounced off 4,920, may well revisit the 5,500 area by year end. Key drivers are expected to be:

- With Banks falling 12.2% during the winter capital raising period, we expect a stronger performance heading into year end. They are now on dividend yields of over 9% including franking.
- We continue to see attractive growth and dividend prospects across Healthcare, Infrastructure, Diversified financials (continued takeovers), Telecoms and certain Property related companies
- Conversely, we are cautious on Resources, Energy, Insurance, Retail, Airlines and domestic Building Materials
- We see opportunities in select Australian Small Cap companies. The Peak Smaller Companies Model portfolio continues to perform well, rising 16.8% over the last 12 months to 30 September 2015. Source: Praemium
- Internationally, we remain attracted to the key global thematics of Technology, Healthcare, Infrastructure, Financials and the Asian emerging markets.

We look forward to catching up with you soon to discuss your portfolio and any change of circumstances or issues that we might be able to help you with.

Ian Wenham
Director

Richard Nicholas
Director

Andrew Martin
Director

Contact details

Level 11, 56 Pitt Street, Sydney NSW 2000
GPO BOX 2058 Sydney NSW 2001
Phone: (+61 2) 8274 5800
Fax: (+61 2) 8274 5899
Email: info@peakinvest.com.au