Monthly Economic & Investment Market Commentary
April 2019

There does appear to be some element of snatching defeat from the jaws of victory, as what was purported to be an imminent trade deal between China and the United States was thrown into turmoil via a series of tweets from President Trump. What is most alarming though is that if we take the president at his word (and we clearly shouldn't), he displays abject ignorance about how trade policy works and who bears the imposition of tariffs. He continues to state explicitly and unequivocally that the Chinese are paying billions of dollars to the US Treasury, and even went so far as to say this was an important contribution to America's economic growth in the first quarter of 2019. "Tariffs are NOW being paid to the United States by China of 25% on 250 Billion Dollars worth of goods & products. These massive payments go directly to the Treasury of the U.S."

The truth is that the tariffs are a tax paid by companies who import from China, almost all of which is ultimately borne by the US consumer. There are quite simply no payments being made from China to the US Treasury, as even the president's own economic adviser was forced to begrudgingly admit on Fox News recently.

We further know that President Trump has repeatedly equated a trade deficit with theft, that is if the US imports more from a country than it exports to it, then that country is stealing from the United States. So, conceding the lie in his tweet above, it is intriguing that the president had a solution for those US consumers who want to avoid paying tariffs. "There is no reason for the U.S. Consumer to pay the Tariffs, which take effect on China today," as "the Tariffs can be avoided if you buy from a non-Tariffed Country." He concluded the tweet with "Many Tariffed companies will be leaving China for Vietnam and other such countries in Asia." Using the president's reasoning (which again we shouldn't), why would it be acceptable to have Vietnam steal from America as they also have a trade deficit with the United States?

Can you imagine the internal conversations that must be taking place within the Chinese negotiating team and the upper echelons of their government? How do you deal with someone who is so erratic and clearly has such a limited grasp on the basic tenets of the matter being negotiated?

Those who know President Trump from his former life seem to recognise a pattern of behaviour. "Veterans of the high-stakes world of New York real estate have told me about what they described as Trump's standard negotiating practice — pitching some kind of fit at the very last minute, when the other party thought things were settled, in hopes of bullying his way to a better deal.

That might work with a subcontractor who doesn't have the power to say no, or even with a fellow developer who vows on the spot never to do business with Trump again. But would any skilled negotiator think such a stunt would work with China, the world's second-greatest economic power? Wouldn't the Chinese government have to react in kind, if only as a matter of sovereign pride?"[1]

Chinese state media have answered that question emphatically. In a video that has now been viewed well over 3 billion times they ask, "After 5,000 years of trials and tribulations, what kind of battle have the Chinese not been through?"[2]

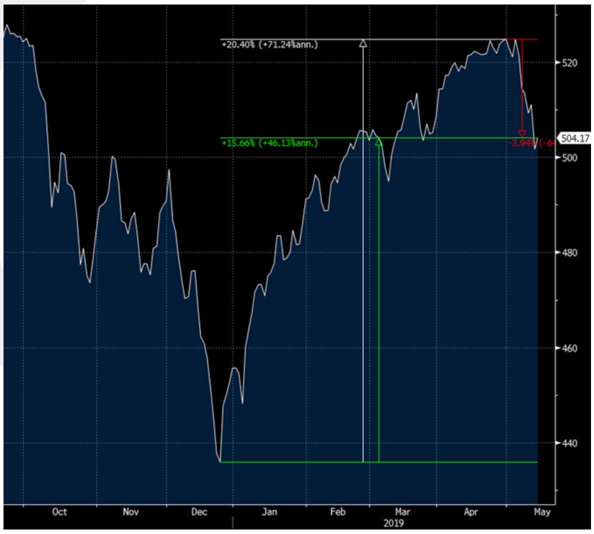
Meanwhile the communist party newspaper the People's Daily posted the following image with the caption "This is China's attitude!" The translation of the images is as follows:

"Negotiate— we can! Fight— bring it on! Bully us— YOU WISH!"[2]

As we have stated before, we should acknowledge the reality that President Xi never need face another election again, whereas President Trump is seeking reelection in 2020. It does however also remain true that it is in both countries' interest to end this 'squabble' as President Trump recently called it. The two leaders will both attend the G20 meeting to be held in Japan at the end of June and are expected to meet personally. Like their last meeting in Buenos Aires in November, it is impossible at this point to know what the outcome of that interaction will be, with the possibilities extending all the way from an escalation of hostilities to a ceasefire and comprehensive agreement.

Let us now consider what the impact of all the above has been on financial markets, as investors have again been confronted with a slew of negative headlines. It is also important to note here that the effects of the trade war come at a time when global growth was already slowing late last year, and that the impacts are not quarantined to just China and the United States. The interconnectedness of global supply chains means that trade wars are felt in for example Europe, where exports of capital goods has slowed appreciably.

This chart tracks a composite index of the world's equity markets, including both developed and emerging economies. The Q418 decline is clearly evident, but so too is the sharp rebound that started in late December. The annotations we have added to the chart show that the world's share market bounced by more than 20% in about four months, and this does not include the value of any dividends paid during that time.



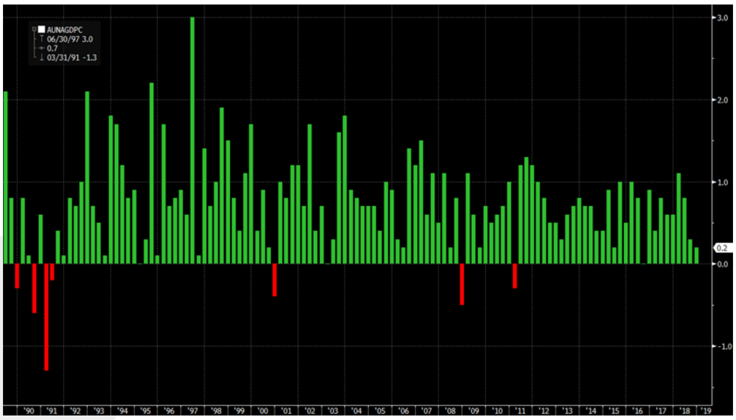
Since the end of April, the index has fallen back by about 4%, largely on the negative trade war news, though this still leaves the gain at nearly 16% in less than six months. Hopefully you will agree that it remains a productive time to be invested in equities, as is reflected in relatively strong recent portfolio performance.

Regular readers will know that we are not in the business of making short term predictions. In fact, looking through the short-term headlines and staying the course most often leads to a much better portfolio outcome. Our decision making as we manage your portfolio will always be based on our long-term view and underlying fundamentals, whilst being aware of the risks and alert to the opportunities.

AUSTRALIA

As mentioned above, Australia has not been immune from the global slowdown in economic growth, and this is reflected in the quarterly GDP results for 2018 being +1.1%, +0.8%, +0.3% and +0.2%. Current expectations are that the first quarter of 2019 will see GDP growth rebound somewhat to +0.6%, and a similar rate of quarterly growth will be maintained for the balance of the year. If accurate, the result of this will be that annualised growth

will dip to 1.7% as at the end of the June quarter, before picking up again to finish the year in the mid 2% range. At this time and based on these forecasts it does appear that Australia will extend its period of uninterrupted economic expansion, which dates back to the last recession we 'had to have' in the middle two quarters of 1991. Not having a recession is not the same though as saying we haven't had cyclicality in our economy. As this chart shows, such a slowdown is quite common in the 30 years depicted.



Despite this and referencing the chart of the global equity market above, the S&P/ASX200 index rallied by nearly 17% from late December to the recent peak, and has since given up less than 1% to be still showing a gain of 16% in a period of about 5 months. These figures are again before any dividends or franking credits are accounted for, which if included would increase the total return over that same period to 19%. Again, this is a pleasing contribution to performance from an asset class to which we have an overweight stance.

We will soon know the outcome of the federal election, and though the race has tightened considerable the likely result is a change of government. What we also know ahead of the vote count is that there is significant stimulus coming for Australian households, including in the form of tax cuts and other subsidies. Our economy is still growing and is likely to continue to do so, albeit at a slower rate for the next year or so. The weaker currency will provide meaningful support to exports and to industries such as tourism and export services including education. Prices for our key commodities remain at historically high levels, boosting government revenues and underwriting the fiscal support that is coming. Additionally, many observers expect that the correction in Sydney and Melbourne housing markets has mostly played out at this stage, and interest rates remain low (and possibly heading lower) meaning debt serviceability is still very manageable. The labour market remains relatively robust, though wages growth for households continues to be modest by historical standards.

We finish with a somber final note unfortunately, and one that also relates to observable patterns of behaviour. There is growing evidence that the United States is spoiling for war with Iran, having recently moved an aircraft carrier strike group and B52 Bombers to the region on intelligence that suggests Iran, perhaps through its proxies, is preparing to attack US soldiers and military assets or that they will begin to enrich uranium. One of the signature foreign policy achievements of the Obama administration was the agreement between all five permanent members of the UN Security Council and Germany commonly known as the Iran Nuclear Deal. Despite acknowledging that Iran was in full compliance with its obligations under this agreement, President Trump withdrew and re-imposed sanctions on Iran. It is apparent that the lessons of the Second Gulf War have not been learned, even by those that were present in both the George W Bush and now the Trump administrations. As Santayana said, "those that do not learn from history are doomed to repeat it." It is difficult to forecast what impacts this situation may have on markets, however we will of course monitor developments closely and respond as and when appropriate.

Kind regards
Asset Allocation & Investment Committee

ASSET CLASS TIPPING POINTS

The positioning of the asset classes within the respective valuation bands remains consistent with the immediate past version of the Tipping Points last month. Importantly, we also observe similar consistency in the relativity between the forecast returns and valuation of the range of risky asset classes depicted. The Asset Allocation and Investment Committee has therefore retained a steady active stance, continuing to favour Australian Equities and within that the Financials sector along with Europe and Japan as the primary other developed markets exposure. In Emerging Markets we continue to focus on the Asia-Pacific region and also remain comfortable with the overweight on Listed Property even with the valuation sitting in the middle of Fair Value.

Asset Class Tipping Points - April 2019

Australian Equities

All Ords	10 Year Forecast	Valuation	30-Apr
10,300	1.8%	Overpriced	
10,000	2.2%	Overpriced	
9,700	2.6%	Overpriced	
9,400	3.0%	Fully Priced	
9,100	3.5%	Fully Priced	
8,800	3.9%	Fully Priced	
8,500	4.4%	Fully Priced	
8,200	5.0%	Fully Priced	
7,900	5.5%	Fair Value	
7,600	6.1%	Fair Value	
7,300	6.7%	Fair Value	
7,000	7.3%	Fair Value	
6,700	8.0%	Cheap	
6,400	8.8%	Cheap	Aust 8.7%
6,100	9.5%	Cheap	
5,800	10.4%	Cheap	
5,500	11.3%	Cheap	Fin'l 11.1%

Income	6.1%	p.a.
Earnings	2.6%	p.a.
Valuation	-0.1%	p.a.
Forecast	**8.7%**	**p.a.**

International Equities - Developed

World ExAust	10 Year Forecast	Valuation	30-Apr
3,000	1.8%	Overpriced	USA 1.8%
2,900	2.2%	Overpriced	
2,800	2.6%	Overpriced	
2,700	3.0%	Fully Priced	
2,600	3.5%	Fully Priced	
2,500	3.9%	Fully Priced	
2,400	4.4%	Fully Priced	
2,300	4.9%	Fully Priced	
2,200	5.5%	Fair Value	Dev 5.6%
2,100	6.1%	Fair Value	
2,000	6.7%	Fair Value	
1,900	7.3%	Fair Value	
1,800	8.0%	Cheap	Eur 8.3%
1,700	8.8%	Cheap	Japan 8.7%
1,600	9.6%	Cheap	
1,500	10.5%	Cheap	
1,400	11.5%	Cheap	

Income*	2.5%	p.a.
Earnings	2.4%	p.a.
Valuation	0.7%	p.a.
Forecast	**5.6%**	**p.a.**

International Equities - Emerging

Emerging Markets	10 Year Forecast	Valuation	30-Apr
1,850	1.5%	Overpriced	
1,775	2.0%	Overpriced	
1,700	2.5%	Overpriced	
1,625	3.0%	Fully Priced	
1,550	3.6%	Fully Priced	
1,475	4.2%	Fully Priced	
1,400	4.8%	Fully Priced	
1,325	5.4%	Fair Value	
1,250	6.2%	Fair Value	
1,175	6.9%	Fair Value	
1,100	7.8%	Fair Value	Emrg 8.0%
1,025	8.7%	Cheap	A-Pac 8.4%
950	9.7%	Cheap	
875	10.8%	Cheap	
800	12.0%	Cheap	
725	13.4%	Cheap	
650	15.1%	Cheap	

Income*	0.0%	p.a.
Earnings	6.4%	p.a.
Valuation	1.6%	p.a.
Forecast	**8.0%**	**p.a.**

Listed Property

ASX200 Property	10 Year Forecast	Valuation	30-Apr
2,150	1.9%	Overpriced	
2,100	2.2%	Overpriced	
2,050	2.5%	Overpriced	
2,000	2.9%	Fully Priced	
1,950	3.2%	Fully Priced	
1,900	3.5%	Fully Priced	
1,850	3.9%	Fully Priced	
1,800	4.3%	Fully Priced	
1,750	4.7%	Fully Priced	
1,700	5.1%	Fully Priced	
1,650	5.5%	Fair Value	
1,600	5.9%	Fair Value	
1,550	6.4%	Fair Value	A-REITs 6.6%
1,500	6.9%	Fair Value	
1,450	7.3%	Fair Value	
1,400	7.9%	Cheap	
1,350	8.4%	Cheap	

Income	4.6%	p.a.
Dist Grwth	2.9%	p.a.
Valuation	-0.8%	p.a.
Forecast	**6.6%**	**p.a.**

** Income for International Equities includes dividends and forecast currency impact.*

Sources

1. E Robinson, "Trump has no idea what he's doing" – Washington Post. 13-May-19.
2. M Fitzgerald, "Chinese state media touts '5,000 years of trials and tribulations,' gearing up for a long trade war" CNBC. 14-May-19.

NOTE: It is important to note that each portfolio is managed to its own mandate, which can mean that activity mentioned above is not reflected in your own portfolio. This may be because it is more beneficial to your portfolios after tax performance to complete the trading at a different time, or may be due to individual customisation that you have requested. This flexibility is an integral part of the investment process. If you would like to discuss the tailoring of your portfolio please contact your Adviser.

DISCLAIMER: The information in this commentary has not been verified by Implemented Portfolios but is believed to have come from reliable sources as noted in the acknowledgements. No Liability is accepted by Implemented Portfolios, its Directors, officers, employees or contractors for any inaccurate or incorrect information. The information is a broad commentary and there is no intention that a client should act on the information without seeking professional assistance from their own advisers (legal, tax, accounting, financial Planning) for suitability in respect of their unique circumstances.