

Market Overview

The sentiment towards share markets turned negative for a number of reasons including:

- Rising U.S. interest rates and the fear the US Fed would overtighten (lift US interest rates too high)
- Fears that the US-China trade war is likely to become prolonged and nasty
- Increasing concerns about global growth with weaker economic indicators recently coming out of China and Europe increasing fears that global activity is slowing
- Cooling sentiment around the digital giants or FAANGs (Facebook, Apple, Amazon, Netflix and Google) with recent earnings updates from (Google parent-company) Alphabet, Amazon and particularly Apple disappointing the market

2018 reminded us that geopolitics remain a significant driver of markets, but we suspect there has been an overreaction to these factors. Investors seemingly continue to find it easy to fear the worst, still bearing the scars of the GFC (which was now 10 years ago) although current conditions bear no resemblance.

Looking into 2019, global growth is likely to weaken a bit further before stabilising. The biggest risk to the downside is China. A continued slowing in China would be a major concern for global growth and commodity prices. Domestically, the most significant fears are currently focused on the price falls in the Sydney and Melbourne residential property markets where falls of somewhere between -5% to -10% have occurred.

On the flip side, global inflation is likely to remain benign helped by the 2018 growth slowdown and fall in energy costs. Valuations are now improved, and solid corporate profits should see a recovery through 2019. Pleasingly, at the time of writing share markets in January have seen a decent recovery.

Please don't hesitate to give me a call if you would like to discuss any part of this report.

Australian Shares

- The Australian equity market, as measured by the S&P/ASX 300 Accumulation Index, fell 8.24% over the December quarter:
 - The sell-off was in-line with a broader decline across global markets
- Discretionary retail sales figures were stagnant, and related stocks lost ground due to the anticipation that Christmas sales will fail to meet expectations
- Resource stocks were mixed over the quarter, and energy stocks lost ground as oil prices slumped on concerns of reduced demand from a slowdown in global economic growth and increased OPEC supply:
 - This saw crude oil fall 40.6% from its peak reached in October
 - Base metals weakened as the London Metals Exchange index fell 6.5%:
 - However, iron ore gained 5.1% on rising Chinese steel prices
 - Gold miners witnessed a strong quarter as gold rallied 7.5% on the back of risk-off selling across equity markets.
- In economic news, the latest national accounts confirmed that the Australian economy grew strongly over the past year, with GDP increasing by 3.4%:
 - However, the most recent employment figures showed a slight softening to a 5.1% unemployment rate
- The Commonwealth Treasury's Mid-Year Economic and Fiscal Outlook provided an improved 2019/20 budget surplus forecast from A\$2.2b to A\$4.1b, along with net debt expected to decline from 18.2% as a percentage of GDP in 2018/19 to 1.5% in 2028/29

Market Overview

- The best performing sectors for the quarter were Utilities (-3.1%), Materials (-5.1%) and Real Estate (-5.3%). The worst performers were Energy (-21.6%), Communication Services (-14.9%) and Information Technology (-14.1%)
- As a whole, industrial stocks (-8.4%) outperformed resource stocks (-8.5%) and large cap stock (-6.8%) outperformed small cap stocks (-13.7%).

International Shares

- Global stocks in the December quarter staged their worst quarterly performance in more than seven years after tighter US monetary policy, tensions between China and the US, key resignations from the US administration, and political uncertainty in Europe fanned doubts about the global economic outlook:
 - During the quarter, 10 of the 11 sectors fell in US-dollar terms
 - Energy (-22%) and IT (-17%) fell most while utilities (+0.5%) rose.
- US stocks slumped as political uncertainty intensified and the Federal Reserve disappointed those who hoped the central bank would end its rate increases when it delivered an expected increase in December:
 - Concerns about the stability of the administration of President Donald Trump swelled
 - Concerns rose further when an impasse with Congress about paying for a wall along the Mexican border led to a partial government shutdown, and Trump reportedly looked into sacking Jerome Powell, his appointee as Fed chairman, for raising US rates too fast
 - The US ended 2018 with the jobless rate at a 49-year low of 3.7%, and inflation contained to about 2% on key barometers.

Market Overview

- European stocks fell as political concerns grew, and the risk of a recession in the eurozone rose after Germany's economy contracted in the September quarter:
 - In France, Emmanuel Macron's credibility was dented after he buckled to the widespread demands of yellow vest protesters
 - German politics was jolted when the political party led by Chancellor Angela Merkel fared so poorly in two state elections in October she said she would step down as the leader in December
 - Italy's new government created uncertainty when the EU rejected its proposed budget deficit for fiscal 2019, an unprecedented step against any EU member
 - In the UK, the government of Theresa May postponed a parliamentary vote on Brexit, heightening talk the UK will depart from the EU without any agreement
 - Even though concerns grew that the eurozone economy is stalling, the European Central Bank said it would end its net asset-buying by year end:
 - Reports showed the eurozone economy only expanded 0.2% in the third quarter, as Germany's economy contracted the same amount.
- Japanese stocks tumbled after the Bank of Japan trimmed its inflation forecast for fiscal 2020 to 1.5%, which is under its goal of 2%
- Chinese stocks fell as the trade dispute with the US and a crackdown on shadow lending intensified doubts about the strength of its economy while Emerging markets overall slid on the gloomy global outlook.

Australian Property

- Listed property has handily outperformed the broader sharemarket for a variety of reasons:
 - As equity markets became more nervous in October and November, investors shifted to more defensive sectors, and listed property got a further boost from the drop in bond yields
 - As a result, the S&P/ASX 200 A-REITs delivered a total return of 2.91% for the Calendar Year, well ahead of the broader market's 2.84% loss.

Australian Cash and Fixed Interest

- A "steady as she goes" monetary policy stance means that, yet again, short-term interest rates have shown little change, with the 90-day bank bill yield trading at 2.02%:
 - Long-term interest rates have followed the lead of the U.S., peaking in November and falling since, with the 10-year yield going a little over 2.75% on November 9, but has since dropped back to 2.32%

International Cash and Fixed Interest

- Developments in the asset class continue to be dominated by what is happening in the U.S. bond market with interest rate movements much more modest in both the Eurozone and Japan:
 - In the U.S., bond yields rose up to the first half of November:
 - The 10-year Treasury yield got as high as 3.24% on 8 Nov.
 - Since then, however, yields have fallen markedly
 - The 10-year yield dropped back to 3.01% on November 30 and ended the quarter at 2.69%

Australian Dollar

- The Australian dollar has risen against the U.S. dollar in recent weeks, and was trading at USD 70.52 cents:
- This recent rise has not, however, made up for currency weakness earlier in the year

Market Outlook 2019

Numerous events rattled share markets in late 2018:

- A US-China trade war.
- A slowing economy in China.
- Brexit.
- Mixed signals from the US Federal Reserve.
- Pockets of significant leverage.
- A fall in residential property prices in Sydney and Melbourne.
- Unsettled politics in Australia and globally, with Federal and State elections in Australia in 2019.

As a consequence of a combination of these factors, negative returns from most asset classes were generated in 2018 calendar year. This cocktail of events led to a reasonably significant liquidation of positions and selling that was unusually indiscriminate. After it all finished, 2018 will be remembered as a year where market volatility returned, underpinned by the multitude of investor concerns, but also as a year that leading into 2019 there was a loss of three vital multi-year anchors – rising economic growth, massive central bank liquidity injections and investor's 'buy the dip' mentality.

2019 is now shaping up to be a likely inflection point. Will US growth slow and other economies pick up the baton? What impact will trade tensions, tightening monetary policy, and potential inflation have on asset classes?

Our outlook for each of the assets classes are as follows:

Australian Shares

After six straight years of positive returns, the Australian share market experienced its first negative year since 2011.

At the start of 2019, Australian economic conditions are reasonable. Unemployment has fallen to five per cent, which is quite low by Australian standards. GDP growth is OK at 2.80% year on year, and inflation remains in check.

However, one of the primary reasons why GDP growth continues to struggle to break above 3% is a constant 'desynchronisation' across key sectors in the Australian economy –one part of the economy is weakening while another picks up.

A perfect example of this during 2018 was the housing boom is coming to an end, and looking into 2019 the critical drivers for weaker housing prices remain in place:

- Credit tightening
- Rising supply in the unit market
- Reduced foreign buyer demand
- Many investors have to switch from interest-only loans to principal and interest loans.
- Uncertainty around changes to tax concessions (negative gearing and capital gains) if Labor wins the next federal election
- A psychological shift in attitudes to the housing market from fear of missing out or (FOMO); to fear of not getting out (FONGO).

Market Outlook 2019

We are likely to see further weakness in housing prices through 2019, particularly in Sydney and Melbourne, probably more in Melbourne which has lagged a little bit going into this downturn.

The implications of falling residential property markets are quite significant and will likely have an impact on the returns of several of the sectors of the Australian share market in 2019. Falling residential property prices cause weakness in consumer spending due to the adverse wealth effect. When house prices fall, people feel less wealthy and trim their consumption.

Share Market Sector Outlook – Key Themes and Preferred Stocks

Banks

- The operating environment for the major banks is becoming increasingly uncertain. The combined effects of increased regulatory oversight, potential government change, a weakening housing market, slowing credit growth, slowing Chinese economic growth, rising global interest rates, and investment market jitters should keep the major banks under pressure in 2019.
- Widespread competitive funding and regulatory pressures should keep net interest margins (NIMs) under pressure, limiting earnings growth in 2019. Rising loan losses should also detract from profits, though the timing and extent are uncertain.
- Balance sheets are well-capitalised with key metrics in the top quartile of global peers. The feared capital deficit is quickly turning into a surplus, with little likelihood the bank will raise capital now.
- Despite concerns from increased public and political scrutiny due to the Royal Commission, we are confident the risks to the highly profitable banking oligopoly are well contained.
- The major banks still offer attractive dividend yields relative to alternatives, but we suspect growth will be anaemic.

Telecommunications

- The competition will remain elevated, as the fight for demanding customers (more data, greater value-add, less cost) continue across all segments. However, the intensity of the competition is likely to be tempered by operators' increasing inward focus, with Telstra busy executing its simplification and the AUD 2.5 billion cost-out programs.
- While that may present an opportunity for Optus to be more aggressive in the market, the number-two player will itself be engrossed in planning for 5G mobile deployment—a critical industry upgrade also adding to other operators' exercise in introspection.
- The NBN's economics remain unsustainable. Maintaining the status quo risks the \$51 billion project becoming a white elephant, in the face of 5G technology which could bypass the NBN's fixed-line infrastructure over time. A write-down of the project value and a cut in its pricing would be a very positive catalyst for the industry and the consumers, not to mention the NBN itself.
- With Telstra, heightened competitive intensity and NBN's margin-crunching impact are well-known. What are the potential benefits of Telstra's fightback plan for customers? Critically, the pending TPG Telecom-Vodafone merger has a positive implication for the industry, ensuring the \$7.8 billion Australian mobile annual profit pool remains a three-player market, as opposed to sharing it with the aggressive TPG Telecom as a stand-alone new entrant.

Retail

- We expect consumers to continue their migration from brick-and-mortar to e-commerce. This trend continues to be the overarching structural challenge facing the retail industry globally, and Australia is no exception. We expect the impact on the listed retailers to vary. Retailers in categories more amenable to online shopping, such as consumer electronics, are more exposed to inroads made by pure online plays including Amazon.
- We anticipate more store closures. Besides the investment required to build and strengthen online platforms, retailers are also confronted with declining foot-traffic weighing on store productivity. We expect most discretionary retailers are now at their peak footprint concerning store count. Discount department store Target recently announced it is aiming to reduce its selling area by 20% over the next five years.
- Unfortunately, in addition to the structural disruption from e-commerce, a cyclical storm is also brewing. We anticipate weakening housing markets in Sydney and Melbourne to crimp consumer confidence and restrain sales growth for discretionary retailers.
- We don't expect profits of consumer staples retailers to rebound, with risk to the downside. For investors seeking exposure to the retail sector, hardware should be a safe place to hide from the above themes.
- Supermarkets appear to be a worry. Near term, they must fend off Aldi's and Costco's market grab, and in the medium term hypermarket Kaufland and Amazon Fresh pose formidable new threats.

Healthcare

- CSL should continue to grow revenue at high-single-digit rates, underpinned by several new product releases and by focusing on future areas of unmet needs. We like the company's strategy, discipline, and commitment to Research & Development (R&D).
- We don't believe that the market recognises CSL's strong product pipeline focused around five key therapeutic areas in immunology, haematology, transplant, respiratory, and cardiovascular, leveraging expertise in plasma fractionation and recombinant technology. Gene and cell therapy is another emerging area of proprietary knowledge.
- We continue to believe the long-term earnings outlook and competitive positions of hospital operators such as Ramsay Healthcare is good although several short-term challenges such as declining private health insurance participation rates as the cost of healthcare has risen, but the federal Labor party's proposal to cap private health insurance premium growth at 2% could help. We continue to believe long-term earnings growth will be supported by population growth, the ageing population, rising demand for healthcare services, and economies of scale.

Transport and Transport Infrastructure

- Transport and Transport Infrastructure should enjoy solid demand growth. Expectations for moderate GDP growth, mild inflation, low unemployment, population growth around 1.5%, and rising foreign tourism suggest robust momentum in trade volumes and passenger transport will continue.
- Strength in the resources industry and containerised trade volumes point to robust earnings growth in fiscal 2019 for QUBE, particularly in the bulk and stevedoring businesses. Early warehouses and the import/export terminal at Moorebank will start operating in mid-2019, with the rest being developed progressively over several years. We are fans of the project, although caution ramp up in activity might be protracted.
- Infrastructure stocks are looking better value, after tracking sideways to down for the past couple of years, despite ongoing earnings and distribution growth. Transurban looks the best option in this sector

Utilities

- The key headwinds of rising bond yields as central banks normalise monetary policy and regulatory attacks to improve utility bill affordability will continue over the long term. However, it's not all bad news with utility share prices better value after some significant falls. Given the political attention on electricity prices, expect the 2019 Federal election to create uncertainty and volatility for utilities.
- Earnings growth is petering out as governments try to protect households and businesses from expensive electricity bills. However, the degree to which governments can reduce retail prices is limited by stubbornly high wholesale electricity prices. AGL Energy is likely to report flat earnings. Of more interest will be what it does with its balance sheet capacity; an acquisition or a special dividend is possible in 2019.
- Utilities are fairly valued. Attractive yields, defensive earnings, and modest growth are on offer across the sector. As such, we lean towards AGL.

Metals and Mining

- The demand boost from high levels of investment in China started to wane in the second half of 2018, and we expect this to continue as debt growth slows from unsustainable levels.
- The S&P/ASX 200 resources index has sold off nearly 15% since its early October peak, driven by lower commodity prices, particularly oil and base metals. Bulk commodities, especially iron ore, have proven more resilient, supported by buoyant steel spreads. More recently, steel spreads have contracted, suggesting potential demand weakness.
- Despite the general commodity sell-off, prices for iron ore, coking coal, alumina, and thermal coal remain elevated. Producer margins generally remain high and above mid-cycle levels.
- Returns on invested capital are generally high across the industry, which we think is likely to incentivise new supply given the limited barriers to entry to build new mines. Rio Tinto's earnings, for example, are close to 2012-13 levels typical of the China boom heights.
- Chinese government policy will be important, especially where China is a substantial supplier such as for coal, steel, and aluminium. Production cuts have supported near-term margins in those industries, but overcapacity remains, and new supply is being added, particularly for coal.
- Of the majors, we remain comfortable with BHP and RIO.

Energy

- The Brent crude price has fallen 30% from US\$86.00 September highs.
- China's goals to address environmental concerns are potent drivers for long-term gas and LNG demand, especially since domestic natural gas production cannot meet the country's consumption needs. The country's natural gas production is unlikely to repeat the success of the shale revolution in the U.S. China's current five-year plan calls for natural gas to increase as a percentage of the overall energy mix to 15% by 2030 from 7% in 2017.
- The LNG infrastructure necessary to support demand forecasts should be in place both within China and globally. In addition to the supply gap, a lack of natural gas storage capacity, the inability of pipeline imports to respond effectively to demand changes, and the lack of a fully liberalised market for pricing gas will support LNG growth.
- The Australian energy sector offers attractive value at current levels. We think the sharp pull-back in sympathy with a weaker Brent price unwarranted. Australian energy companies are most leveraged to natural gas and LNG prices where the demand outlook is more favourable than for crude. While Asia LNG prices are for now still substantially tied to crude prices, growth in gas markets will increasingly encourage pricing that is based on gas fundamentals, including in spot pricing.
- Woodside appears the best value of the largest local names.

Market Outlook 2019

What about Labor's franking credit policy? What does this mean for Australian dividends in 2019?

Overall, we think the outlook for dividends is healthy for the Australian market in 2019.

However, it would be remiss not to mention the potential political risk of Labor's franking credit policy.

The polls are currently strongly leaning towards a Labour victory in the next federal election, and ALP policies include an increase in capital gains tax (smaller discount for long-term capital gains), restrictions on negative gearing and limitations on the refunding of franking credits. The latter may impact dividends, but not until at least the 1st July 2020.

However, a lot must happen before any change occurs. Not only does the ALP need to win the election, but they also need to persuade cross-bench senators that the policy is a good one. So, we caution clients not to react too quickly. The silver lining may be that some companies flush out franking credits before 30 June 2020, and to do that they need to pay fully franked dividends. It could be that 2019, particularly the first half, may be a bumper period for franked dividends, including dividends released via off-market buybacks.

Market Outlook 2019

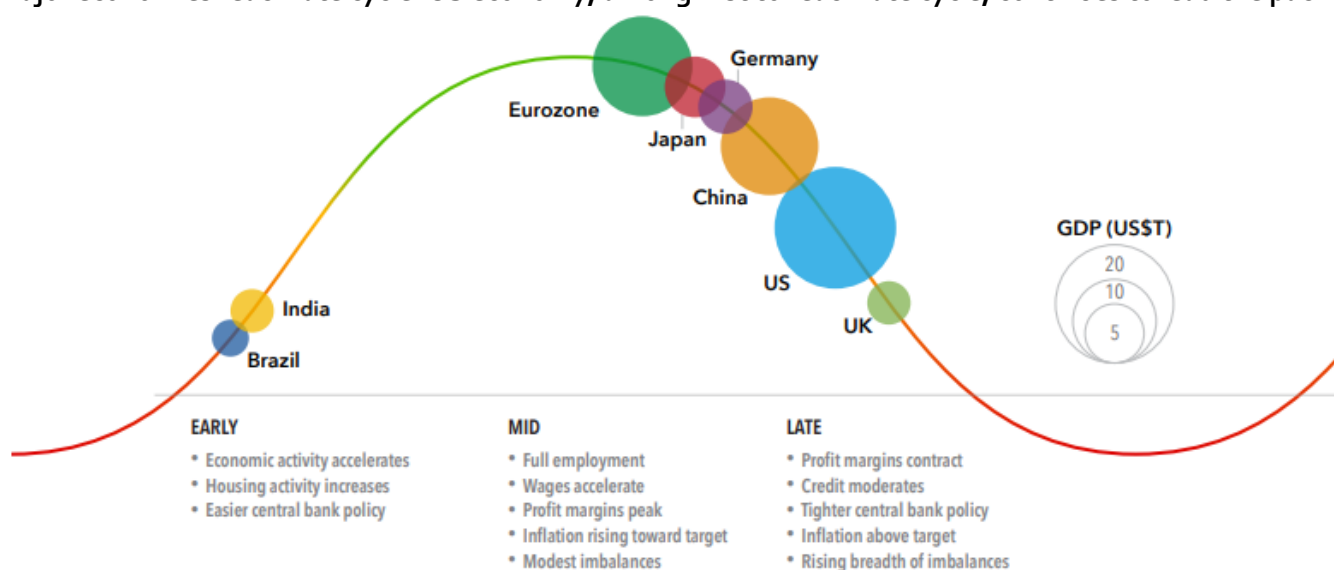
International Shares

Again, International shares outperformed Australian shares, having done so now over the last five calendar years.

The U.S.

The US economy appears to be benefiting from some key supports that include low unemployment, strong consumer sentiment, a boost in corporate earnings, and rising business investment coming into 2019. Recent tax law changes have helped some of these. However, it's our view that the rate of economic growth will slow as the late cycle Trump stimulus is nearing maturity.

Major economies reach late cycle: US economy, among first to reach late cycle, continues to lead the pack



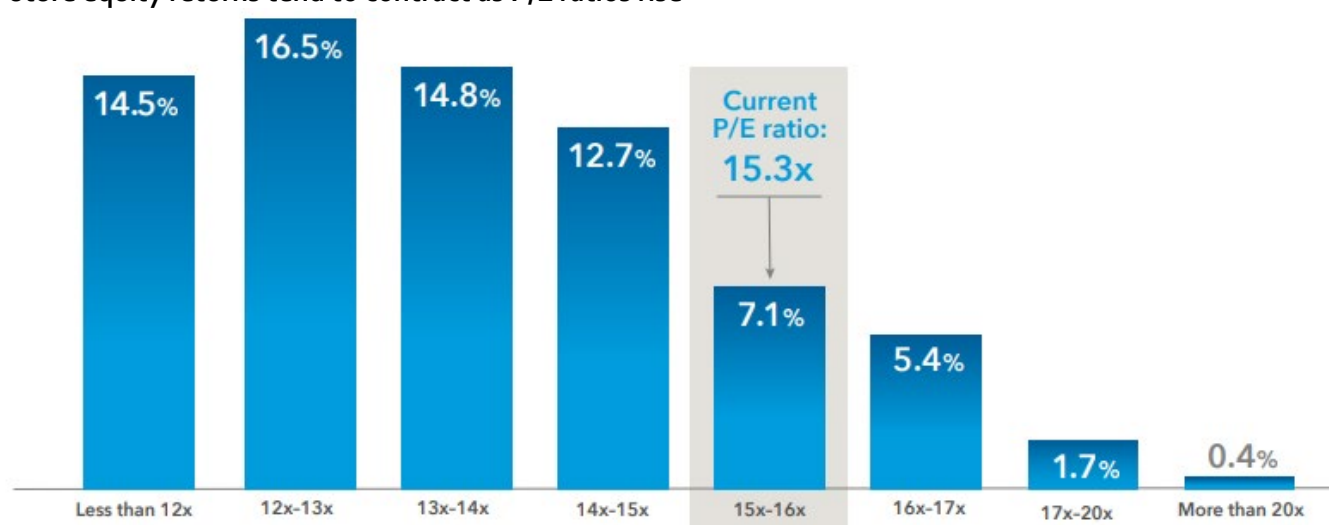
Source: Capital Group

It's been more than nine years since the broad market S&P 500® Index experienced a bear market, defined as a decline of at least 20%. The prolonged nature of this bull cycle has pushed US stocks to become expensive. Even after bouts of unsettling volatility in 2018, the Standard & Poor's 500 Composite Index has advanced nearly 400% since the March 2009 start of the bull market.

Although company earnings in recent years have soared along with stock prices, valuations have expanded considerably. As at 30 November, the forward price-to-earnings (P/E) ratio for the S&P stood at 15.3 – which is elevated by historical standards. Moreover, while past results are not predictive, history suggests that investors may want to temper expectations for returns going forward.

Market Outlook 2019

Future equity returns tend to contract as P/E ratios rise



Source: Capital Group

That said, a small handful of innovative technology and consumer companies have driven much of the market return (online retailer Amazon has soared about 2,700% since the end of the last bear market), leaving valuations in other areas of the market at more modest levels. Of course, given that many other companies have more modest growth prospects and the likelihood of elevated volatility, selective investing will be critical. Any broad-based negative earnings surprises would put further pressure on likely future returns for the US market.

Eurozone

A calendar of political issues continues to cloud Europe's horizon. Brexit negotiations are entering a decisive phase, and we could see fireworks ahead of the planned March 2019 departure date. While the most likely scenario is that the UK and European Union (EU) will agree on a withdrawal arrangement, there is still a risk of a no-deal departure. Italy is too important to ignore and too big to bail out.

The question is how does the EU contend with the current national populist government as it pushes for more fiscal room? National populist parties across Europe could disrupt the hold of traditional mainstream parties at the European Parliamentary elections in May 2019. The European Central Bank (ECB) intends to stop its quantitative easing programme in 2019 and interest rates should remain unchanged until the summer of 2019. If growth and inflation behave as expected, the ECB will likely raise rates modestly in late 2019. The Bank of England has a tightening bias, but Brexit uncertainty will probably defer any tightening until there is more clarity on its future relationship with the EU.

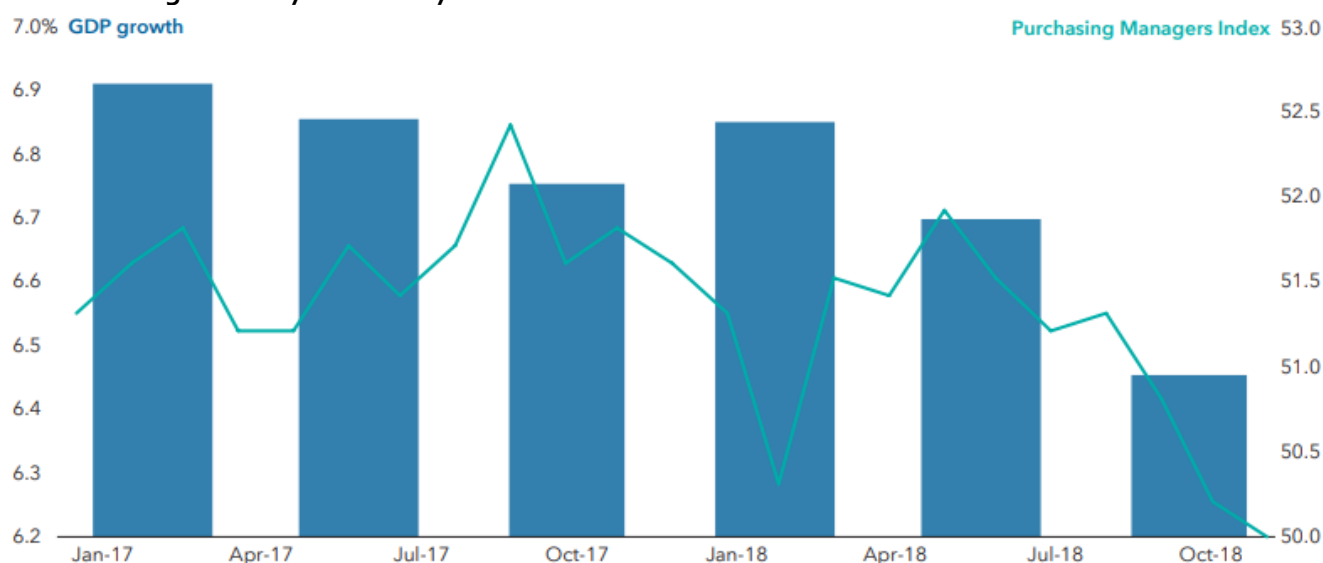
As a consequence, European equity markets have traded at a substantial discount to the US. This is at least partially due to European markets requiring a more significant political risk premium. However, selective opportunities exist. Across a range of sectors, comparable companies are trading at lower valuations than their US counterparts. However, it takes a brave investor to invest heavily in Europe right now.

China

There are concerns about valuation in the U.S, and political instability in Europe as these issues are prominent on the list of investor concerns for 2019. However, number 1 has to be China's slowing economy and the impact it has everywhere else, particularly other emerging nations that supply the raw materials needed to support China's growth. A disruptive trade dispute with the US also doesn't help matters.

China's economy is still growing at a decent rate: 6.5% (annualised), according to the official numbers. However, that's a far cry from double-digit growth just a few years ago, and there are signs of more trouble ahead. Consumer spending, manufacturing, credit growth and the housing market are all showing signs of weakness in early 2019. If these trends continue, China's economic struggles could export more volatility to other parts of the world.

China's slowing economy is the story to watch in 2019



Source: Capital Group

Australian Listed Property (A-REITs)

While overall returns from the A-REIT sector for Financial Year 2018 were anaemic, A-REIT's again outperformed the broader Australian share market in 2018.

A-REIT's have now consistently outperformed the broader Australian share market over the last five years returning 7.18% per annum over the previous three years and 12.33% over the last five years.

AREIT's continue to be a model of consistency due to the lack of surprising for the sector. If anything, fundamentals for the sector continue to remain extremely sound as evidenced by the last reporting season for AREIT's no surprises, strong fundamentals and lowering risk.

The three key takeaways from the last A-REIT's reporting season were:

- Earnings and distributions are going up:** AREIT earnings per share (EPS) increased 3.4% over FY18 with similar growth expected for FY19. While the extent of this growth was slightly moderated, the consistency for this year's forecast is a good sign.
- Asset values are rising:** Real estate values continue to increase across most commercial asset classes. Net tangible asset values (NTA) were up 9.7% across the sector over the year. The office sector, driven by strong capital appreciation along the eastern seaboard, was the best performing. Industrial assets values also performed well with logistics assets leading the charge.

3. **Debt is coming down:** Gearing (debt to gross asset values) was 25.9% across the sector, 1% lower than a year ago and, according to JPMorgan, the lowest since 1999. A-REITs are well positioned to deal with future higher interest rates, with average debt terms over 5.5 years. Reliance on bank debt – so detrimental during the GFC – has also been significantly reduced.

The following is an update on each sector of the A-REIT market:

Retail

- A stark variation in performance is beginning to emerge in retail. Flagship shopping centres are continuing to prosper while sub-regional malls appear to be suffering.
- Lower wages growth, declining house prices and rising household expenses (primarily in utilities, mortgages and health expenses) aren't conducive to heading to the mall to buy big ticket items. Sub-regional centres and high street retailers are bearing the brunt of these headwinds. The weaker performance of these assets was in contrast to flagship shopping centres, which enjoyed good valuation growth.
- Surprisingly, convenience/Neighbourhood retail has held up reasonably well, along with CBD retail which is enjoying a resurgence, driven by tourism and higher inner-city densities.
- However, overall, retail assets delivered mixed results with income growth overall being 2.1% lower than a year ago at 2.8%.
- It's not a great environment for retail right now, but some areas offer better protection than others.

Office

- Sydney and Melbourne office markets are performing exceptionally well, where vacancy rates are at almost all-time lows at 4.7% and 5.0% respectively. As such, these markets experienced solid rental growth of nearly 8% in 2018. Without the glut of supply coming to markets, there's every chance rental growth will continue.
- Income growth of 3.6% for the year was up from 1.4% in 2017. Sydney and Melbourne's tenants are paying far higher market rents to remain in their buildings or as new tenants are signed up. The effect is to smooth out earnings growth, improve its sustainability and will assist shelter investors from the volatility of the business cycle.

Industrial

- Industrial income growth and capital returns were the strongest of each sector in 2018.
- Industrial property owners are continuing to enjoy the benefits of tightening occupancy levels and strong market rental growth driven by expanding e-commerce and third-party logistics tenant demand. High-quality industrial space located in urbanised metropolitan markets remains in tight supply, which is hugely positive for the outlook of the Industrial property sector.

Looking forward, we continue to see value in A-REITs, particularly in the Office and Industrial sectors. Fundamentals for office assets in Sydney and Melbourne remain very strong as vacancy in both markets will head to a 10-year low of 4%, leading to strong rent growth for the next one to two years before new supply is delivered

For retail assets, modest growth in retail sales is the worry. Many commentators put this down to Amazon's arrival and poor retail management. However anaemic wage growth is likely a better explanation of modest retail sales. We remain cautious about the retail sector. Shopping centre landlords are adopting cookie-cutter strategies to reallocate space to beauty services, medical, and dining. However, there is a limit to how much space can be converted to these new categories, which points to lower long-term rent growth.

Australian Cash and Fixed Interest

It was another quiet year in cash and fixed interest markets, much like the last couple of years.

The Reserve Bank of Australia (RBA) started the 2018 calendar year with no official conditional bias. However, with the consensus at the start of the year that global growth was improving and domestic economic conditions were likely to remain stable, most analysts were convinced that interest rates were not going to go lower and the RBA would keep the official cash rates stable. This eventuated with the RBA leaving the cash rate in the 2018 calendar year unchanged at 1.50%. The RBA has now been on hold since August 2016.

At this point, the RBA has not shown any indication it is about to take the same path as the US Fed (by increasing the official cash rate). In mid-2018 some Australian banks lifted home lending rates despite no policy move from the RBA. As a consequence of this out of cycle increase in home lending rates, credit conditions tightened which has ensured pressure to increase interest rates is not high.

We believe the RBA will keep rates on hold at 1.5% with no official conditional bias for 2019 while continuing to gauge inflation, GDP, unemployment numbers and the movement of residential property prices. At present inflation remains in check and residential property prices are decreasing, so the case for rates going up is not high. Should Australian GDP surprise to the downside or residential property prices continue to decline (contrary to what many believe) a conditional bias towards rates decreasing again may emerge.