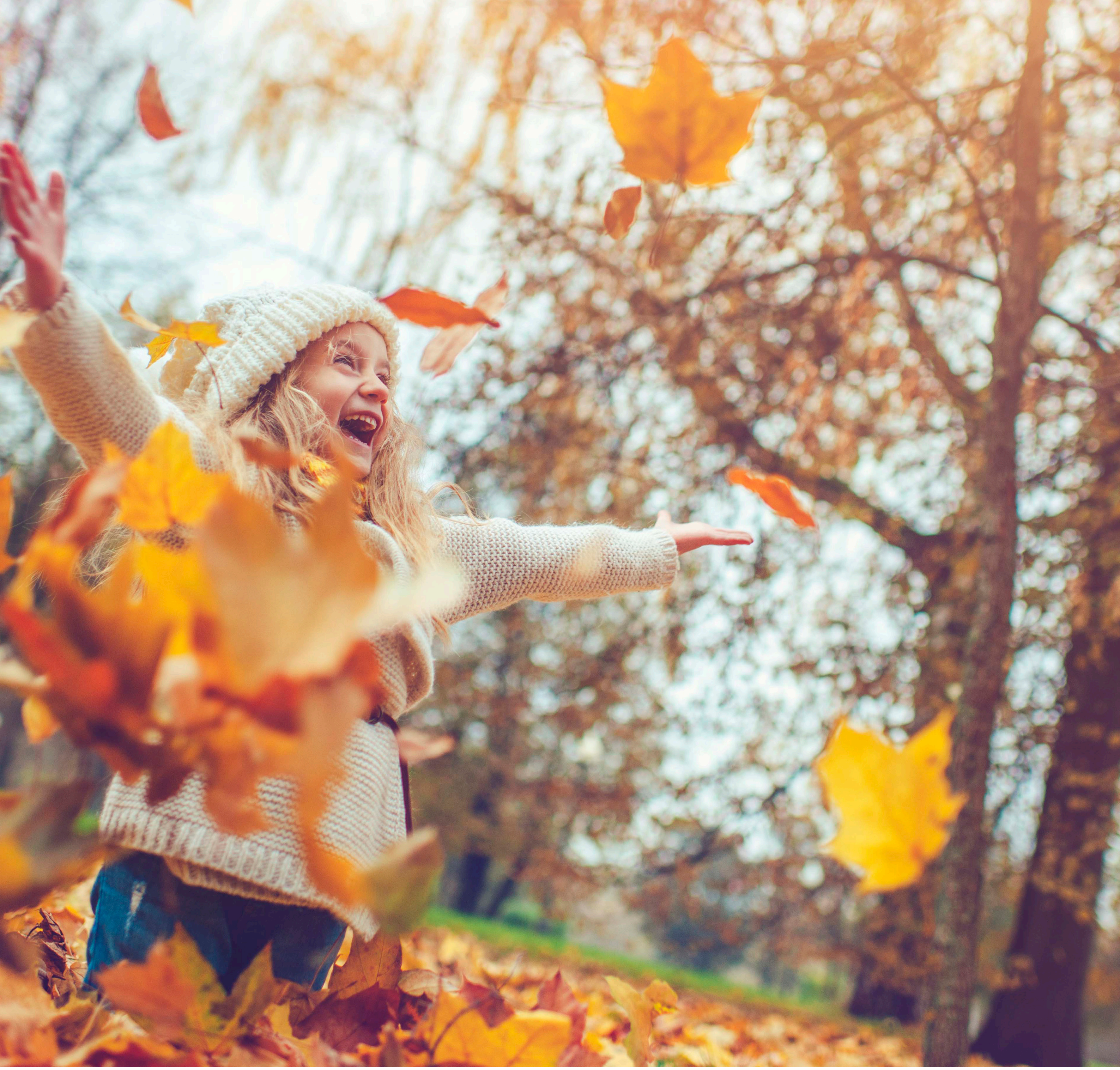

Story wealth management

Investment Solutions

Autumn 2019

Welcome

In this edition of Investment Solutions magazine BT Financial Group Investment Specialist, Riccardo Briganti, provides us with a market update on local and international markets.

We take a deeper look at the US China trade wars.

Finally, we share ways to help you protect your income.

Until next time – happy reading.

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Market update

Global share markets rebounded strongly at the start of 2019 but have yet to recoup losses suffered at the end of last year.

The S&P/ASX200 peaked at 6352 at the end of August 2018. Over the next four months, it declined each month to hit a low of 5468 on 21 December. The US market followed a similar trajectory with a substantial leg down following the US Federal Reserve's meeting on 19 December, which saw a 25 basis points increase in official rates.

The concerns that led to the market downturn have not necessarily been resolved, but the panic that gripped markets late last year appears to have passed. Interest rate fears as the US Federal Reserve tightened monetary settings in December have been replaced by a level of composure after the Fed suggested there may now be less of a tightening bias. Unease about the ongoing US/China tariff battle diminished as both parties took a more conciliatory approach while Chinese growth concerns were replaced with an acknowledgement that the Chinese leadership would likely instigate policies to avoid a substantial slowdown.

Recent economic data has been mixed with household and business sentiment data matching the ebb and flow of the share market. US consumer confidence as measured by University of Michigan's consumer sentiment survey fell sharply to 91.2 in January from 98.3 in December, but managed to bounce back to 95.5 in February. Similarly, manufacturing sector confidence rebounded with Institute for Supply Management manufacturing survey increasing to 56.6 in January from 54.3 a month earlier. The new orders and production components of the index both increased sharply while the employment component was slightly lower.

Officially reported US employment remains strong with non-farm payrolls increasing by 296,000 in January following a 206,000 increase in December, while the unemployment rate increased slightly to 4%.

Chinese growth continues to show signs of slowing with annual growth of 6.4% in the December quarter compared to 6.5% and 6.75% in the previous quarters.

While this continues the recent trend of a measured deceleration in overall growth, concerns have been elevated as other indicators such as vehicle sales have posted considerably steeper falls. This has reignited questions as to the accuracy of the official economic statistics.

Domestically, the most significant recent economic news came from the Governor of the Reserve Bank of Australia (RBA) who stated that rate hikes or rate cuts were now equally likely. This comes after a period where the RBA had encouraged the view that the next move was likely to be a monetary tightening. The change in stance was partly prompted by a downgrade in growth forecasts compared to three months ago, while inflation forecasts have also been lowered so that they will barely be within the RBA 2-3% target range until the end of 2020. Governor Lowe broached the subject of falling residential property prices, suggesting they would likely not have a huge bearing on the setting of monetary policy until there were clearer indications that broader consumption trends were impacted.

US-China Trade War – where to next?

As the US-China trade war continues, we take a look at the triggers for the tensions, what happens after the ceasefire and the implications for Australia's economy.

The US-China trade war may stem from a deeper rivalry between the two countries, with the US striving to protect its position as the world's largest economy. This was evident during President Trump's election campaign where he promoted a list of accomplishments for his first 100 days in office. Featured on the list was a pledge to "stand up to countries that cheat on trade"[1] Fast forward to today, and the two countries are locked in trade talks with each side wanting an outcome to be resolved in their best interests.

US-China trade war takes hard line on China

The US-China trade war began when President Trump commissioned the United States Trade Representative (USTR) Robert Lighthizer to produce a special report on China's trade behaviour.[2] It is the view of some in the US that Lighthizer's report set in motion the opening skirmish of the trade war in July 2018, when the US implemented its first China-specific tariffs, to which China retaliated with its own tariffs on US products.

So far, the US has applied tariffs on US$250 billion (AU$352 billion) worth of Chinese products, and has threatened tariffs on US$267 billion (AU$376 billion) more.[3] In turn, China has slapped tariffs on US$110 billion (AU$155 billion) worth of US goods, and is threatening a range of "quantitative and qualitative" measures that would affect US businesses operating in China.[3]

Where is the US-China trade war now – 90 day ceasefire

After a dinner meeting between President Trump and his Chinese counterpart, Xi Jinping, at the G20 summit meeting in Argentina in December 2018, the leaders agreed to a 90-day ceasefire in the US-China trade war, which expired on 1 March 2019.

According to the Wall Street Journal, both sides are in the final stages of negotiating a trade deal that would involve the lowering of Chinese tariffs on a range of US goods if the Trump administration removes most, if not all, sanctions against Beijing.[5]

What the US wants from the US-China trade war

It is expected that the US would like China to be specific about what it will buy, by specific dates. The US also wants China to list fully its subsidies, in particular those offered by provincial and municipal governments. US negotiators are pressing their Chinese counterparts for concrete means of verifying that China is meeting its promises, and that hurdles for US and other foreign firms operating in China actually decrease.[6]

1 https://www.cnbc.com/2016/11/09/trumps-first-100-day-agenda-may-be-stymied-by-his-own-party.html

2 https://www.scmp.com/news/china/diplomacy/article/2179572/ideological-soul-mates-how-china-sceptic-robert-lighthizer-sold

3 https://www.scmp.com/news/china/diplomacy-defence/article/2151502/donald-trump-can-outgun-china-trade-tariffs-beijing-has

4 https://asia.nikkei.com/Economy/Trade-War/Trump-hails-tremendous-success-in-China-talks

5 Refer to 'Constructive talks bring US, China closer on trade,' Lingling Wei, Wall Street Journal, republished in The Australian, 9 January 2018 – print only.

6 https://www.cnbc.com/2019/01/21/china-2018-gdp-china-reports-economic-growth-for-fourth-quarter-year.html

And China...

For its part, it's believed that China does want to end the US-China trade war on favourable terms. Particularly as the Chinese economy needs this resolution in light of its slowing economy. China's economy grew by 6.6% in 2018, down from 6.8% in 2017, to its slowest growth rate since 1990.[6] Its exports were down by 4.4% in 2018[7], the worst result since 2016 in US$ terms – likely due to pressures stemming from a slowdown in global trade growth and the increasing impact of US trade sanctions.

China's massive manufacturing sector also contracted in December 2018 for the first time in 19 months.[8] And although China is on track to surpass the US in retail sales in 2019 for the first time[9], a continuation of the trade war may impact these expectations.

In terms of the future, China also has several very big-ticket economic strategies in motion. Firstly, it's 'One Belt, One Road' infrastructure plan[10] which is a global development strategy adopted by the Chinese government involving development and investments in countries in Europe, Asia and Africa.

The second is the 'Made in China 2025' plan[11], which is Beijing's push to dominate high-tech industries in the next decade across ten sectors: robotics, maritime equipment, new energy and energy-saving vehicles, aviation and aerospace equipment, railway transportation, energy, IT, agriculture, new materials, and bio-pharmaceuticals and high-tech medical devices.

There is also the great set-piece of the festivities planned for October, when China's ruling party will celebrate the 70th anniversary of the establishment of the People's Republic. It's understood President Xi would not want this event over-shadowed by the economic turmoil that a prolonged trade war could bring.

How could Australia be affected from the US-China trade war?

China's trade data in January showed decreases in imports and exports, the first fall in iron ore imports in eight years, and the biggest fall in total imports from Australia since mid-2016.[12] The country is both constraining supply from its less environmentally justifiable domestic supply sources, while simultaneously paying a premium for higher-quality Australian products, particularly iron ore and coal.[13]

Modelling prepared by KPMG Economics Australia[13] suggests an escalation in the US-China trade war could be extremely serious for Australia. The impacts could last almost a decade, with an estimated loss of national income of nearly half-a-trillion dollars over 10 years, or the equivalent of losing just over 40% of last year's household disposable income. Job losses in Australia would also be significant under such a scenario, falling almost 60,000, and pushing real wages down by about $16 per week for the average worker.

In a limited US-China trade war, where the tariff increases are restricted to those already announced, KPMG's modelling suggests Australia's GDP would be about 0.3% lower after five years and we would incur a real GDP loss of A$36 billion over a decade. This is mostly due to the reliance of Australian commodities as intermediate inputs in the production process in China, and the likely loss of services exports in education and tourism to China.[14]

7 https://www.reuters.com/article/us-china-economy-trade/chinas-exports-shrink-most-in-two-years-raising-risks-to-global-economy-idUSKCN1P8047

8 https://www.cnbc.com/2019/01/02/china-reports-december-caixin-manufacturing-purchasing-managers-index.html

9 https://www.cnbc.com/2019/01/24/china-to-surpass-the-us-in-retail-sales-for-the-first-time-forecast.html

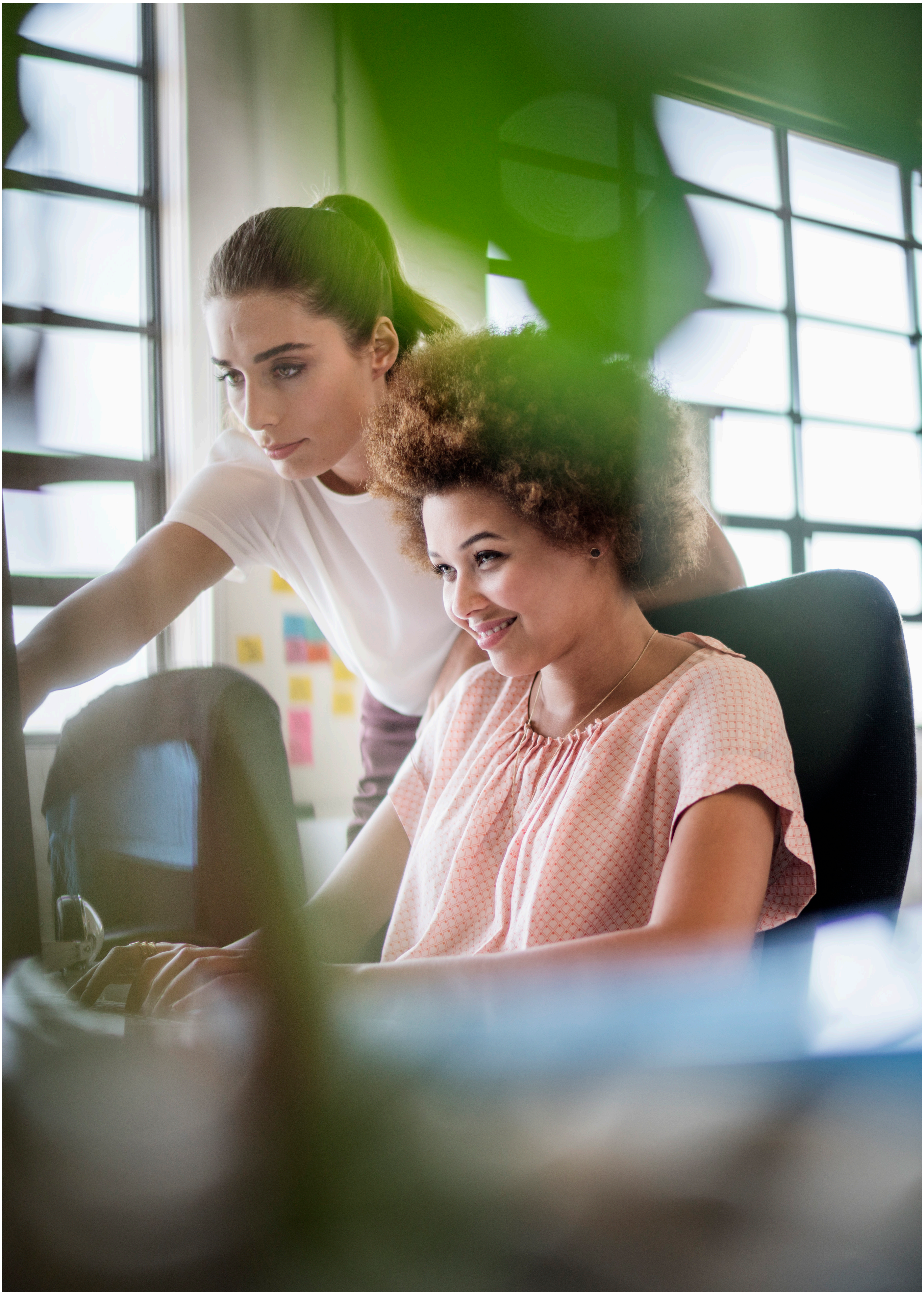
10 https://gbtimes.com/chinas-belt-and-road-initiative-explained

11 https://www.scmp.com/economy/china-economy/article/2183188/chinas-plans-dominate-hi-tech-sector-hit-stumbling-block-us

12 Refer to 'Chinese exports decline as US trade war bites' David Rogers, The Australian, 14 January 2019 – print only.

13 Rio and BHP to win from China's blue-sky wars: https://www.afr.com/business/mining/iron-ore/rio-and-bhp-to-win-from-chinas-bluesky-wars-20180705-h12ah3

14 Trade wars there are no winners, KPMG Australia, refer to page 3: https://assets.kpmg/content/dam/kpmg/au/pdf/2018/trade-wars-no-winners.pdf



4 steps to help you protect your income

Many of us don't hesitate to insure physical assets such as our home, contents and vehicles, but what about our greatest asset of all – our ability to earn an income?

While we'd all like to picture a smooth road ahead, sometimes that's just not the case. Protecting your income along the way isn't a luxury: anyone with financial obligations could consider their back-up plan should job loss, business closure, sickness or injury, strike.

Because of this, planning ahead for the unexpected may be something to think about for your and your family's financial security. Read on for some tips on protecting your income.

1. Save for a rainy day

Saving is a potential way to insure yourself against setbacks, such as losing your income or unforeseen emergencies. Get into the habit of saving on a monthly basis; you could keep these funds in an easily accessible savings or cash account with the best interest rate you can find, so you can access your money if needs be.

2. Consider Income Protection insurance

Income Protection insurance is designed to replace a percentage of your monthly income if you're unable to work for a period of time due to sickness or injury. This may cover your day-to-day living expenses, giving you the financial peace of mind to focus on what's more important: your recovery.

One thing to consider is the level of income protection cover you may already have through your employer or your super. If your employer or your super fund offers some form of income protection cover, you may still need to apply for additional income protection insurance or another type of insurance cover, so that in the unfortunate event of sickness or injury, you can protect your financial position.

3. Invest in yourself

Building up your skills could be a form of insurance. Developing more expertise and updating your skills in your chosen field makes you arguably a more valuable candidate, in case you need to find a new job due to redundancy. Even if you don't lose your job or get sick or injured, broadening your skills can give you more career options down the track.

4. Find ways to boost your earnings

Finding ways to increase your regular earnings may improve your current financial situation and make it easier to save. By doing so, you could be providing financial protection against loss of income or unforeseen emergencies. Sometimes it even lets you follow your passion as a secondary source of income. Some people make extra money by taking up part-time employment such as a part-time tutor or coach, while others create and sell arts or crafts at local markets or online. With all the opportunities out there, there's bound to be something to suit you.

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