ELSTON
Customised Financial Solutions

Elston Australian Equities - EL0001

Elston Asset Management

March 2018 Quarterly Update

Performance as at 31/03/2018				
	3 Months	1 Year	2 Years	Since Inception (20/07/2015)
Gross Performance	-1.54%	5.33%	13.98%	8.81%
High Growth Benchmark	-3.9%	1.02%	11.7%	4.82%
Relative Return	2.36%	4.31%	2.28%	3.99%

Market review

Following a remarkable year for equity investors in 2017, the positive momentum continued into the new year as most equity markets started 2018 strongly. Volatility however spiked in both equity and fixed income markets in February not because of weak economic data, but because accelerating US wage growth figures caused investors to worry about inflation and hence that interest rates would be raised more than expected and slow the economy. Then, just as markets appeared to be settling, investors were spooked mid-March by concerns over a possible trade war as the Trump administration announced broad based aluminium & steel tariffs and targeted tariffs on Chinese imports.

The MSCI World ex-Australia NR Index (A$) nonetheless managed a gain during the quarter, driven by a weaker currency as the Australian dollar depreciated against the US dollar. Emerging markets outperformed developed market peers, and despite the concerns emanating from the US, it was the European in Japanese equity indices that suffered the largest losses (in local currency).

The domestic market was also amongst the worst performers even after including the contribution from dividends, dragged down by poor performances from its two largest sectors, financials and materials. Banks were weighed down by regulatory concerns in the wake of the Royal Commission into misconduct, while miners suffered in the wake of the significant decline in the iron ore prices over March

The portfolio outperformed its benchmark as both stock selection and sector positioning contributed to relative performance. The largest contributors from sector positioning were being overweight Healthcare and underweight Financials. On an individual stock basis, the biggest positive contributors to relative performance were overweight positions in Flight Centre, Macquarie & Lend Lease and not owning Tabcorp, Ramsay Healthcare or Westpac. The largest detractors were positions in Heathscope, Janus Henderson & Aurizon and not owning CSL, A2 Milk or Qantas.

Market Outlook

While the losses experienced recently across global equity markets are certainly unsettling, it should not be forgotten that it is near impossible to determine market direction in the very short term as changes in sentiment can cause over-reactions. As investors we need to focus on the fundamentals.

From an economic perspective, the first quarter GDP releases demonstrated that the synchronised, above-trend global growth of 2017 has continued, although at a moderating pace. Global monetary policy remains accommodative notwithstanding hikes by the Fed and profit growth continues to accelerate with earnings estimates revised higher, due partly to the expected benefits from US tax reform. Local company earnings growth estimates admittedly remain comparatively lacklustre, but that said, the recent domestic reporting season did finish better than expected with earnings beats outweighing misses amongst the large caps. It also provided reassurance on dividend sustainability and highlighted the potential for further capital management given solid balance sheets and cashflow generation. The fundamental backdrop has essentially not changed.

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Obviously rising protectionism could derail the supportive economic backdrop for risk assets, and the final outcome is difficult to predict. While negotiations are likely to be protracted, at this stage we do however not anticipate a trade war. As for the direct impact from tariffs announced to date, these should be relatively minor and unlikely to permanently undermine confidence. A “Fed mistake’ remains a risk as members of the committee have revised up their expectations during the quarter of the pace at which they will increase interest rates – as noted before it’s impossible to fully predict the impacts of central banks unwinding the distortions they have created.

In conclusion, caution is warranted as the road ahead is almost certainly to be bumpier, but we have not reached the end of the road just yet.

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