Quarterly Update DECEMBER 2018

EXCITING LiFE

Boring Money

.... and not the other way around

CARE QUARTERLY NEWSletter

- THE TIGHT LABOUR MARKET MEANS EMPLOYEES ARE FINALLY FEELING THE RECOVERY IN THE FORM OF HIGHER WAGES
- THE HIGHER INTEREST RATE AND REVERSAL OF MONEY PRINTING IN THE UNITED STATES DOES NOT APPEAR TO HAVE DERAILED ECONOMIC GROWTH THUS FAR

CAREphilosophy

GLOBAL OVERVIEW

EMMANUEL CALLIGERIS
Chairman of the CARE Investment Committee

Stock and bond markets had a weak last quarter in 2018 which began about the time we published our last CARE newsletter. Share prices fell sharply in the December quarter as too did the bond prices of lower grade corporations as their interest margin (also known as credit spread) relative to government issued bonds increased. The ebbs and flows centred around the themes of: nervousness around whether higher US interest rates will cause a recession in 2019, the degree of corporate leverage (borrowing) globally, the trade war between the US and China, a partial shutdown of the US government over funding to build a wall at its southern border and a continued decline in house prices in Australia leading to a material slowdown in economic growth here.

The higher interest rate and reversal of money printing (known as quantitative tightening) in the United States does not appear to have derailed economic growth thus far, although housing and investment spending suggests that the economy has slowed. Growth should be around its 2% trend in 2019. Reinforcing this view was the recent employment report. It showed that jobs growth was strong and suggested that the economy remained on solid footing. The tight labour market means employees are finally feeling the recovery in the form of higher wages and coupled with lower petrol prices, is a positive for consumer spending. With inflation only grinding higher, the pace

THE ODDS OF RECESSION HAVE RECEDED GREATLY ALTHOUGH THEY HAVE NOT GONE COMPLETELY.

of interest rate rises is set to slow in 2019. Last year, markets had expected up to 4 more interest rate rises (approximately 1%) in 2019. The possibility of recession towards the end of 2019 was high under this scenario. Expectations now centre around two interest rate rises in 2019. The odds of recession have receded greatly although they have not gone completely.

As was the case in the last quarter, economic settings suggest that the US dollar can continue to strengthen. This will be problematic for emerging markets with high levels of foreign currency debt that is denominated in US dollars because they must pay the higher (US) interest rate and they need to pay back more US dollars given that the US dollar is rising. This will ultimately cut into profits for companies or result in emerging market governments ultimately having to raise taxes to service the higher debt payments. This seems to be where the Chinese government is

- THE CHINESE AUTHORITIES ARE FOCUSED ON ENSURING THE THAT THEY WEAN THE ECONOMY OFF ITS DEBT ADDICTION WITHOUT CAUSING A DEEP RECESSION
- IN AUSTRALIA, HOUSE PRICE MOVES HAVE AND WILL CONTINUE TO BE IMPORTANT FOR THE OVERALL GROWTH RATE OF THE ECONOMY

heading over the next few years. For now, the Chinese economy is weakening, as shown by manufacturing data. The Chinese authorities are focused on ensuring the that they wean the economy off its debt addiction without causing a deep recession. Consequently, they will adjust the policy dials just enough to stabilise the slowdown. Fiscal stimulus (more government spending and/or lower taxes) should soon be in place to counter the risk of rising unemployment. At the time of writing, senior policy officials pledged that tax reductions on a "larger scale" are in the pipeline. Last May, the government cut value added taxes (VAT) for manufacturing, transportation, construction, telecommunications and farm produce industries, followed by a cut in personal income taxes and the introduction of more deductions.

Economic data in Europe continues to disappoint. The threat of a blowout in Italy's budget deficit has been resolved, however trade wars and Brexit remain substantial risks to growth, which is already suffering from a slowdown in the emerging world.

In Australia, house price moves have and will continue to be important for the overall growth rate of the economy. House price moves will affect investment spending as well as consumer confidence and ultimately consumer spending. According to the Westpac-Melbourne Institute consumer sentiment survey, confidence has soured with all the survey's key components including family finances, weaker. Housing finance approvals data softened again in the latest reading with weakness concentrated in investor activity and shrinking average loan size. The shrinking in average loan size reflects reductions in borrowing capacity following a tightening in bank lending assessments. Notably, the six months to November saw a 5.8% drop in the value of owner occupier loans but just a 1.5% decline in the number of loans, the difference being the implied average loan size. Despite the fall in prices in Sydney and Melbourne, affordability remains stretched. Government infrastructure spending has supported the economy and looks to continue to do so in the next few quarters, whilst the mining investment cycle seems to have levelled and positive prospects particularly around iron ore and lithium are boosting investment plans. Inflation data confirmed that the rate of inflation remains low. There remains the real possibility that the Reserve Bank reduces the official cash rate. This would be welcome news to mortgage owners that have been paying higher mortgage interest rates as a result of higher cost passed on by the banks. At the time of writing the NAB announced a rise of 0.16% in its variable mortgage rate.

The Australian share market fell 8.2% in the December quarter, and was down by 2.8% over the year. The market decline was all experienced in the final quarter, retracing the high point achieved in August. Amongst the companies that performed well over the quarter and had a positive contribution

GOVERNMENT INFRASTRUCTURE SPENDING HAS SUPPORTED THE ECONOMY AND LOOKS TO CONTINUE TO DO SO IN THE NEXT FEW QUARTERS, WHILST THE MINING INVESTMENT CYCLE SEEMS TO HAVE LEVELLED AND POSITIVE PROSPECTS PARTICULARLY AROUND IRON ORE AND LITHIUM ARE BOOSTING INVESTMENT PLANS.

via the VAS investment in the portfolios was gold company – evolution Mining which increased by almost 39% over the quarter thanks to the high market volatility. Also performing well were Newcrest Mining (12%), Northern Star Resources (+11%) and Healthscope (+7.7%). Companies that weighed on the Australian share market were the NAB spinoff CYBG Plc (banking operations are in the UK) which decreased 43%, Lend Lease Corporation (-40%) and IOOF Holdings Limited whose share price suffered 36% over the quarter as news broke of APRA's intention to disqualify a number of directors of the business.

In comparison to the Australian share market, international shares decreased by 11.1% over the quarter. Despite the overall weakness, Starbucks was one of the better performing companies rising by almost 16% after announcing faster than expected sales growth of 4% in the US and 3% globally. The coffee chain said it would cut about 5% of the workers based in its headquarters in Seattle to reduce costs. The losses in international shares over the quarter were led by the energy and IT sectors. The energy sector was weak because of the large fall in the oil price. In the IT sector, Apple shares fell after profit downgrades by key suppliers raised concerns about the strength of demand for Apple's latest devices and Facebook fell after media reports attacked the company's integrity.

The CARE Investment Committee rebalanced the portfolios by buying Australian Shares (VAS) and decreasing the portfolio's enhanced cash holdings via Realm Investments. We had sold out of US small company shares (IJR) in the Active portfolio the previous quarter and remain out of the asset class for now. The Committee assessed that performance had been very strong and prudent to invest the funds in the capital preservation strategy of Cash until such time that the opportunity presents itself to re-enter the asset class at cheaper prices. The gold price increased further towards the end of the quarter as investors remained nervous around the US/China trade wars.

AS WAS HIGHLIGHTED IN OUR LAST QUARTERLY UPDATE, VOLATILITY WAS LIKELY TO REMAIN HIGH IN 2019 WITH THE IMPORTANT DRIVERS OF GLOBAL FINANCIAL MARKETS IN THE COMING MONTHS AND QUARTERS BEING US INTEREST RATES, THE DIRECTION OF THE US DOLLAR, TRADE WAR TENSIONS AND THE LEVEL OF CHINESE POLICY STIMULUS.

Within the Enhanced International shares portfolio, Magellan performed well in light of the fall in the market. Consequently the Investment Committee rebalanced from the Magellan portfolio to WDIV which seeks to invest in high dividend yielding companies globally. These companies include Nestle, HSBC, Toyota Motor Corp and pharmaceuticals company Roche Holding AG just to highlight a few. Once again these rebalances are in line with the CARE Investment Philosophy that it is good practice to move back to the long-term strategic asset allocation of the portfolio when short term asset prices deviate from their long term expected returns.

The Enhanced Australian Shares portfolio remained defensively positioned with a high cash weighting around 19-20%, reflecting the manager - Joseph Palmer and Sons' views of overall valuations which remain stretched for some companies including CSL and A2 Milk. The recent fall in the market saw these company share prices fall significantly, justifying the manager's cautious approach. The performance was strong over the quarter having lagged around the middle of the year. Joseph Palmer and Sons outperformed the ASX 200 index by 2.26% over the year to December. Over the quarter, the manager added the shares of NAB to the portfolio in early January 2019 and reduced the amount of cash to 15% from 20%. Other top-ups included CBA, Westpac and ANZ Bank shares, due to their prices generally being below the manager's assessment of long-term fair value and high dividend yields. The strategy looks to provide reasonable growth and good dividends over the long term. In January, it was pleasing to see the Australian share market rebound strongly from the low point just prior the end of December, reflecting the moderate economic growth and low inflation environment.

As was highlighted in our last quarterly update, volatility was likely to remain high in 2019 with the important drivers of global financial markets in the coming months and quarters being US interest rates, the direction of the US dollar, trade war tensions and the level of Chinese policy stimulus. Financial markets became obsessed over the interest rate situation in the US for fear that recession is imminent and company profits will fall. The trade war between the US and China is another obsession. Recession could occur at some point but only if interest rates become restrictive. The economic indicators in the US are still firm and do not suggest that the interest rate settings in the US are likely to cause recession in the near term. The same is true for Australia. Employment growth is good and the official interest rate set by the Reserve Bank of Australia is low and shows no sign of rising any time soon, government spending is strong and investment intentions are also firm. Exports have slowed due to China's slowdown; however, it is a slowdown not a recession there too.

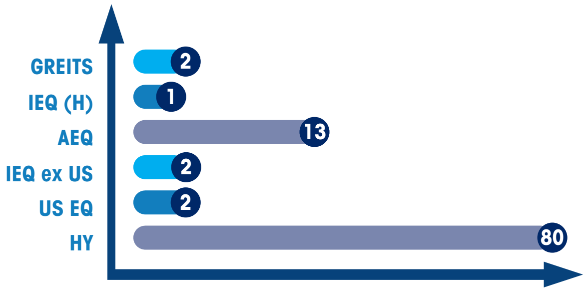
RETURNS TO THE 31ST DECEMBER 2018

GPS CORE PORTFOLIO RETURNS TO THE 31ST DECEMBER 2018

	1 year	3 Years	5 Years
CORE Conservative	1.18	3.84	4.29
CORE Moderate	0.10	4.62	5.00
CORE Balanced	-1.26	5.31	5.65
CORE Growth	-2.08	5.91	6.58
CORE High Growth	-3.24	6.44	7.05

by CARE Investment Strategy

YOUR CARE PORTFOLIO CONSERVATIVE



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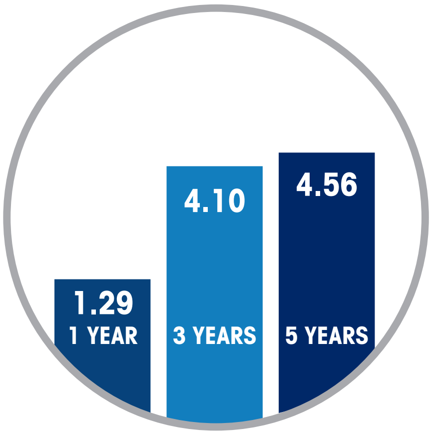
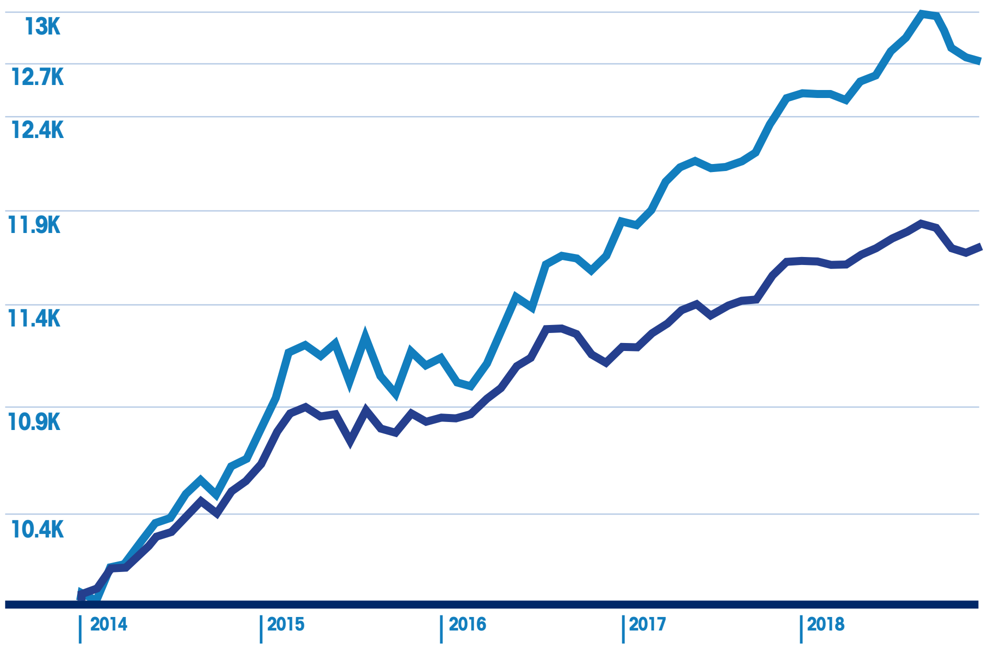


50% AEQ – 50% IEQ

CARE CONSERVATIVE STRATEGY

Growth of $10,000 over 5 years to 31 December 2018



INVESTMENT NAME	VALUE
CARE Conservative (50% AEQ - 50% IEQ) (Total Return, AUD12.71K)	Australia Fund Multisector Conservative (Total Return, AUD 11.71K)

Source Morningstar Direct

LEGEND

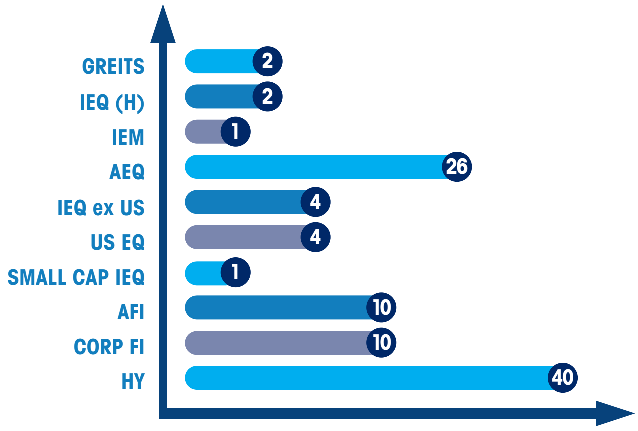
- International Real Estate .... GREITS
- International Shares (Hedged) .... IEQ (H)
- Australian Shares .... AEQ
- International Shares (ex-USA) .... IEQ ex US
- International Shares USA .... US EQ
- High Income .... HY
- International Emerging Market Shares .... IEM
- International Small Companies Shares .... Small Cap IEQ
- Australian Fixed Interest .... EFI
- Australian Corporate Fixed Interest .... Corp FI

* Returns are based on model portfolio, benchmark allocation & assumes investment over 1 , 3 & 5 years ending 31st December 2018. The E (enhanced) component is assumed to be 50% Australian Equities & 50% International Equities. Past Performance is not indicative of future performance.

* The CARE portfolio Returns are before tax, Adviser fee, and Platform Fees however net of CARE Investment Committee Fee.

* Returns are based on: C,A & E only – RESERVES is not factored into the return series.

YOUR CARE PORTFOLIO MODERATE



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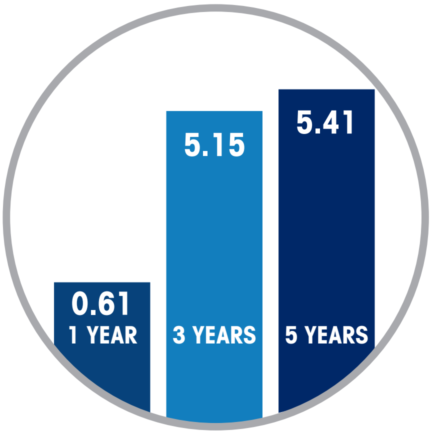
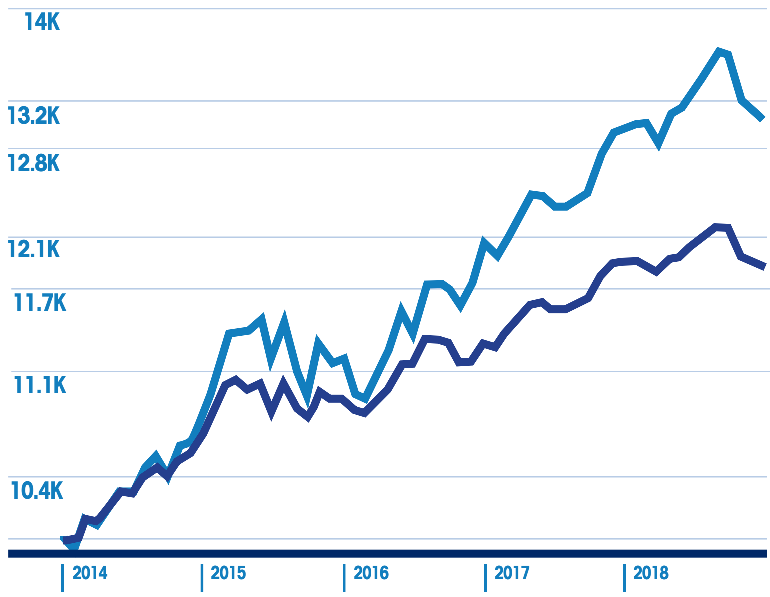


50% AEQ – 50% IEQ

CARE MODERATE STRATEGY

Growth of $10,000 over 5 years to 31 December 2018

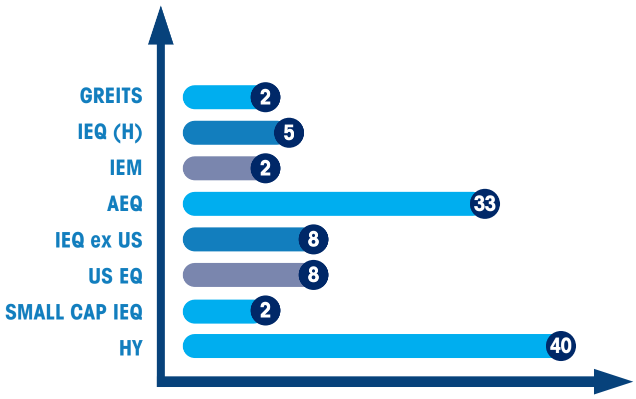


INVESTMENT NAME **VALUE**

CARE Moderate (50% AEQ - 50% IEQ) (Total Return, AUD 13.04K) Australia Fund Multisector Moderate (Total Return, AUD 11.88K)

Source Morningstar Direct

YOUR CARE PORTFOLIO BALANCED



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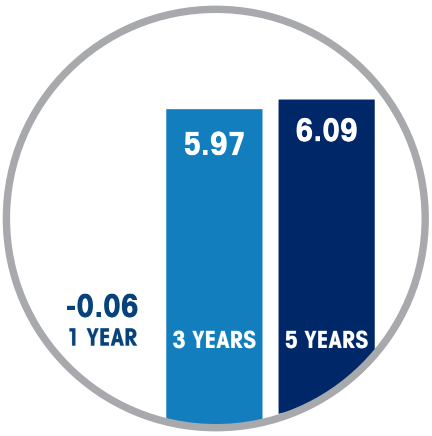
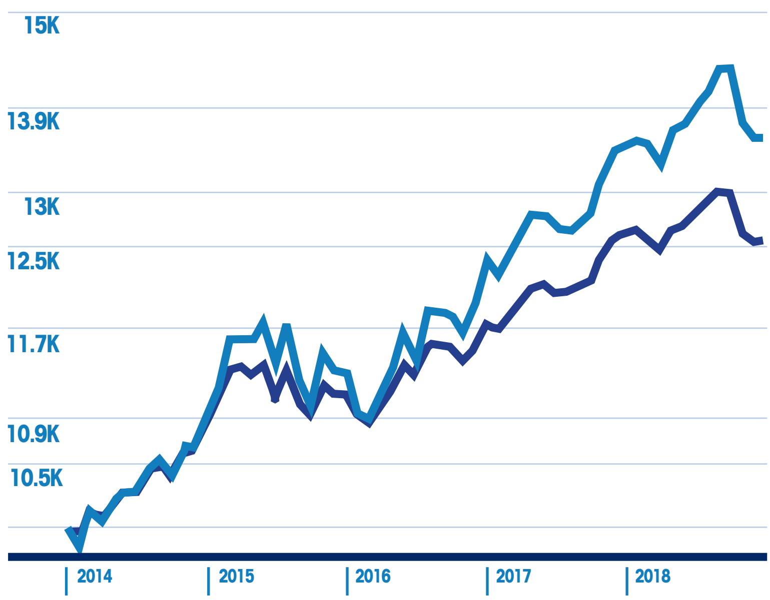


50% AEQ – 50% IEQ

CARE BALANCED STRATEGY

Growth of $10,000 over 5 years to 31 December 2018



INVESTMENT NAME **VALUE**

CARE Balanced (50% AEQ - 50% IEQ) (Total Return, AUD 13.6K) Australia Fund Multisector Balanced (Market Return, AUD 12.53K)

Source Morningstar Direct

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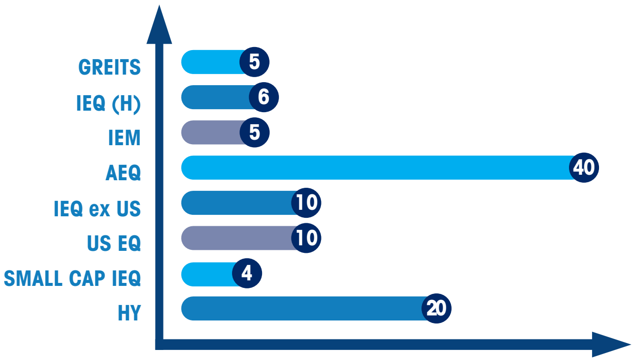
YOUR CARE PORTFOLIO GROWTH



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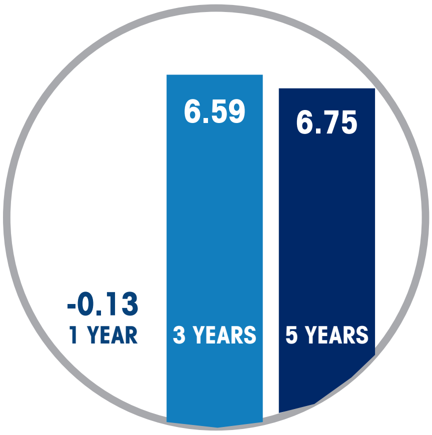
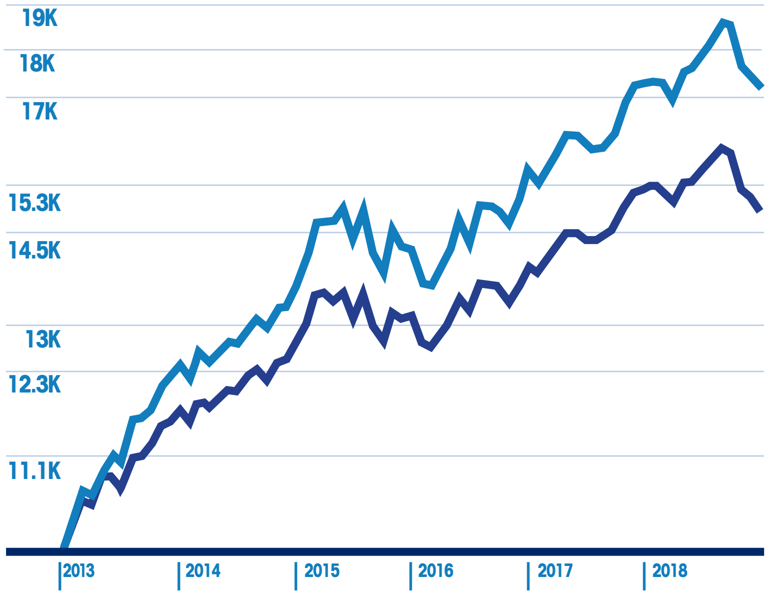


50% AEQ – 50% IEQ

CARE GROWTH STRATEGY

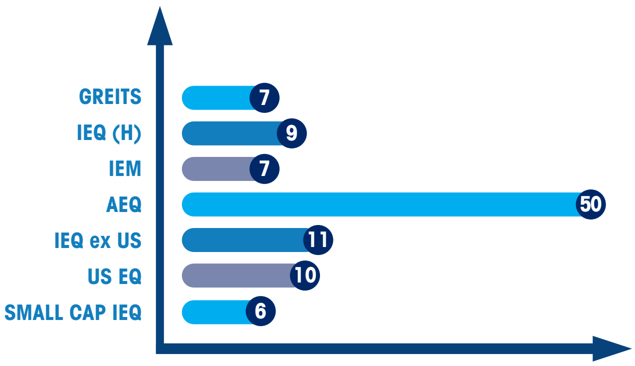
Growth of $10,000 over 5 years to 31 December 2018



INVESTMENT NAME	VALUE
CARE Growth (50% AEQ - 50% IEQ) (Total Return, AUD 17.22K)	Australia Fund Multisector Growth (Total Return, AUD, P ..14.88K)

Source Morningstar Direct

YOUR CARE PORTFOLIO HIGH GROWTH



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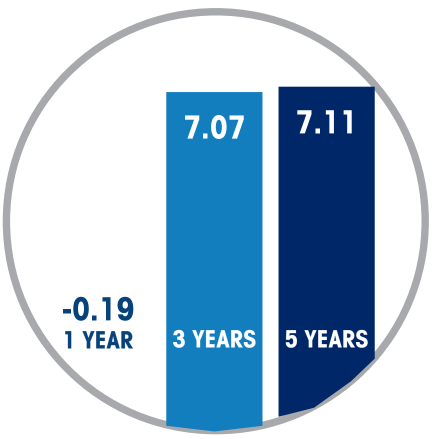
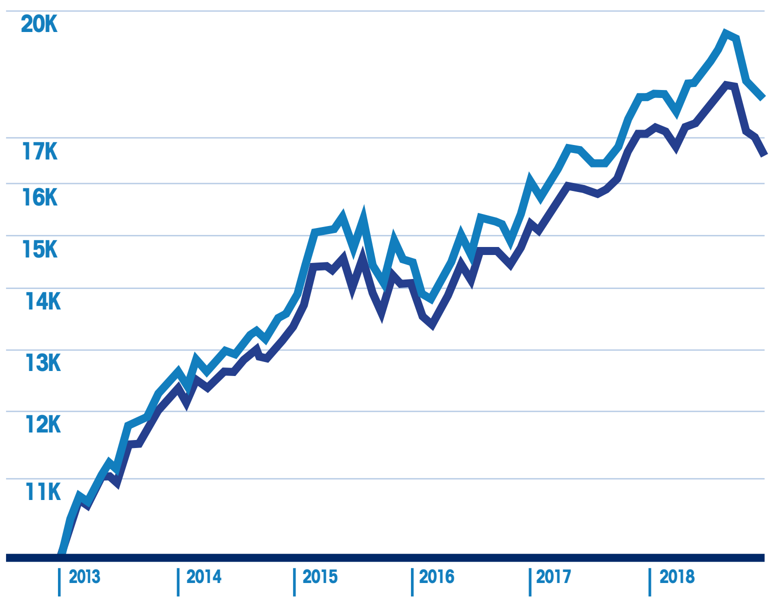


50% AEQ – 50% IEQ

CARE HIGH GROWTH STRATEGY

Growth of $10,000 over 5 years to 31 December 2018



INVESTMENT NAME	VALUE
CARE High Growth (50% AEQ - 50% IEQ) (Total Return A..17.83K)	Australia Fund Multisector Aggressive (Total Return, AU.. 16.53K)

Source Morningstar Direct

Meet the CARE Investment Committee

Emmanuel Calligeris BEc MBus (Finance)

Emmanuel is Chairman of the CARE Investment Committee. Emmanuel holds a degree in economics and previously had 20 years' experience as Chief Investment Officer for OnePath Investments (the investment arm of ANZ Bank) and was responsible for $13 Billion of funds under management.

Rob McGregor SIA (Aff) ADFP

Rob was a founder of GPS Wealth, developed the CARE Investment Philosophy over the last 15 years and successfully managed $100m in clients' funds during the GFC.

Grahame Evans GAICD DipSM MBA

Grahame is the Risk and Compliance member of the CARE Investment Committee. Grahame brings over 35 years of financial service industry experience.

Dr. Mark Brimble BCom(Hons) PhD CPA FFin

Mark is an independent member of the CARE Investment Committee. Mark holds a doctorate in capital markets and is keenly interested in investor behaviour.

GPS WEALTH

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