SPECIAL MARKET UPDATE

26 OCTOBER 2018

RECENT MARKET VOLATILITY

Global Stock Markets Fall

Global stocks have fallen sharply during October, wiping out all gains from earlier in the year. The MSCI World index is down 7.6%, in local currency terms, over the month to the 25th October and is down 1.5% year to date. This has created an unsettling time for investors after six months of relatively steady growth in the stock markets.

In the US, the S&P 500 is down 7.2% month to date amid concerns about rising US interest rates and the US trade conflict with China. Investors are beginning to worry that the strong US economy will lead to the Federal Reserve raising interest rates further, which could cause a further rise in bond yields that would have a knock-on effect of threatening growth and equity market valuations. In addition, the escalating trade tensions between the US and China, which have included the US adding tariffs to $250bn of Chinese imports and China retaliating with $110bn of its own tariffs, have led to a weakening global economic outlook and the Shanghai Composite falling to a four year low.

In Australia, the S&P/ASX indices have been following the lead of their US counterparts and have fallen significantly during October. On Thursday, the S&P/ASX 200 index fell 2.8%, its worst performance since February, which wiped $49bn from the value of the market. The S&P/ASX 200 is down 8.7% month to date.

Elsewhere, concerns around Italy's budget proposals, the ongoing struggles between the EU and UK coming to an agreement over Brexit and the killing of a Turkish journalist in a Saudi Arabian consulate have led to further unsettlement.

We are not yet in a market downturn

We have been concerned for some time about the prospective of a fall in equity markets, so the equity market valuations in October are not altogether unexpected. The equity market has been on a bull run since the Global Financial Crisis, with historically low levels of volatility, and therefore a sell-off was due to occur at some stage. The level of the current sell-off in the markets means that we are technically in a correction, rather than in a market downturn, and the bulk of market corrections don't go on to become major bear markets. Historically, major bear markets have occurred when there has been a US recession and, for the moment, economic conditions are strong in the US.

How this has impacted the Profile Portfolio Solutions (PPS)

The Profile managed portfolios have exposure to a range of return drivers, which aims to ensure a "smoother ride" compared to a pure equities portfolio. This diversified approach means the portfolios are exposed to asset classes such as property, infrastructure and alternative credit. Investing in these asset classes should provide some diversification benefits to the overall portfolio, particularly in the case of a sharp downturn in equity markets.

We also manage foreign currency exposure carefully, and believe that foreign currency can offer diversification benefits in the time of stressed economic scenarios. We have strong conviction that the multi-asset approach we have taken in building the portfolios will lead to their returns being less volatile than what you see in the headlines.

The Profile Accumulation Portfolio ("PAP") is a high return-seeking portfolio. In order to meet this return objective, PAP has a sizeable allocation to equities (56% of the portfolio at 22nd October). We continue to believe that equities will have strong returns over the medium to long term, though we have maintained a cautious stance for some time. We estimate that PAP has returned -3.5% over the month to 25th October, which is significantly better than the headline equity market losses.*
The Profile Preservation Portfolio ("PPP") is a lower risk portfolio. PPP had 35% of its assets invested in equities at 22nd October which, similar to PAP, are held to aid PPP in meeting its return objectives. We estimate that PPP has returned -2.2% over the month to 25th October.*

*We have used index returns and actual returns, where available, to estimate the performance to 25th October. Note that some of the assets invested in PAP and PPP are priced on a monthly basis so the final performance for October will differ to that above.

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