

2019 outlook: Australian equities

Despite dire predictions, I believe 2019 will be a stronger year for the Australian equity market as much of the uncertainty we've experienced this year will have played out. Interest rates remain low, balance sheets are strong, earnings growth is still mid-single digits, valuations have improved and dividend yields are attractive. I would expect to see earnings growth combined with valuation expansion in 2019 driving solid investment returns for the calendar year.

To date the Australian Equity Market (ASX 200) has delivered a negative 2.5% return for the year following strong returns in both 2016 and 2017. ¹ Market concerns around higher interest rates, a US/China trade war and declines in the residential property market consumed positive returns from the first half of 2018.

Australian equities outlook

In 2019 I believe we'll see a returned focus to high quality businesses with strong cash flows and high certainty of earnings. Over the last few years low quality businesses have been pushed up by the stock market on higher inflation and growth expectations. I think this is unlikely to continue in 2019 as fundamentals re-exert their dominance.

Personally, I always love these periods in investments markets as it gives me the opportunity to buy the businesses I've always wanted to own at much more attractive valuations. Warren Buffet once said that as an investor, it is wise to be "Fearful when others are greedy and greedy when others are fearful". It certainly feels like a lot of people are fearful right now. Is it time to get greedy?

2019 is also looking like another important year for the banks and financial services with the Royal Commission releasing their findings on 1 February. While the report is unlikely to be pleasant reading it could also, interestingly, bring more certainty to the sector as companies start to put poor behaviour and bad press behind them. With more attractive valuations, low expectations and high dividend yields, banks could end up having a much improved 2019.

The resource sector looks to have more mixed prospects ahead. In general, balance sheets are strong and management teams are taking a disciplined approach to the cycle. In the past, the majority of blow-ups were caused by poor balance sheets so the sector's disciplined approach to capital is certainly positive. On the negative side, China is slowing with the potential US/China trade war further subduing demand and weakening commodity prices. So, strong balance sheets but vulnerable commodity prices translate to more mixed prospects for the sector and the need for investors to have a more selective approach. I remain focused on quality, strong cash flow businesses that have greater certainty in their earnings outlook.

The sectors I believe to be best positioned in 2019 are consumer staples and healthcare. Strong cash flows and greater certainty around earnings are attributes that will be in demand as the market's higher expectations on interest rates and inflation begins to moderate. In addition, companies and sectors that can deliver growth in this environment are also likely to be chased by the market as earnings growth is proving a rare attribute in these market conditions. I firmly believe that in strong economic conditions a rising tide is likely to lift all ships, in tougher conditions you really need to back the best management teams to deliver a strong strategy and execution.



Paul Taylor
Portfolio Manager
Fidelity Australian Equities Fund

Personally, I always love these periods in investments markets as it gives me the opportunity to buy the businesses I've always wanted to own at much more attractive valuations.

The residential property market is also likely to continue its soft landing in 2019. Residential property prices in Sydney and Melbourne are fundamentally over-valued however there isn't a catalyst for major declines but rather a soft deflating of prices. I would expect residential property prices in Sydney and Melbourne to be flat to slightly down in 2019 which points to a more subdued year for residential property services and construction related companies.

The other key event for markets in 2019 will be the Federal election. While there are concerns around some possible policy changes like Capital Gains Tax (CGT) discount, negative gearing and franking credit refunds, it is likely that the election results will bring more certainty. Australia has had considerable political instability over the last decade and the 2019 Federal election result has the potential to bring more stability. Political stability allows companies to make decisions and better invest for the future.

2019 is shaping up as a better year for investment returns in the Australian share market. More attractive valuations, solid dividend yields, strong balance sheets and a returned focus to quality, cash flows and fundamentals should provide investors the potential to reap good rewards.

Finally, I would like to take this opportunity to wish you all a wonderful holiday season and a fantastic 2019.

¹ As at 7 December 2018

fidelity.com.au

This document is issued by FIL Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL No. 409340 ("Fidelity Australia"). Fidelity Australia is a member of the FIL Limited group of companies commonly known as Fidelity International. This document is intended for use by advisers and wholesale investors. Retail investors should not rely on any information in this document without first seeking advice from their financial adviser. This document has been prepared without taking into account your objectives, financial situation or needs. You should consider these matters before acting on the information. You also should consider the Product Disclosure Statements ("PDS") for respective Fidelity Australia products before making a decision whether to acquire or hold the product. The relevant PDS can be obtained by contacting Fidelity Australia on 1800 119 270 or by downloading it from our website at www.fidelity.com.au. The issuer of Fidelity's managed investment schemes is FIL Responsible Entity (Australia) Limited ABN 33 148 059 009. Details about Fidelity Australia's provision of financial services to retail clients are set out in our Financial Services Guide, a copy of which can be downloaded from our website at www.fidelity.com.au. This document may include general commentary on market activity, sector trends or other broad-based economic or political conditions that should not be taken as investment advice. Information stated herein about specific securities is subject to change. Any reference to specific securities should not be taken as a recommendation to buy, sell or hold these securities. This document may contain statements that are "forward-looking statements", which are based on certain assumptions of future events. Actual events may differ from those assumed. While the information contained in this document has been prepared with reasonable care, no responsibility or liability is accepted for any errors or omissions or misstatements however caused. This document is intended as general information only. The document may not be reproduced or transmitted without prior written permission of Fidelity Australia. © 2019 FIL Responsible Entity (Australia) Limited. Fidelity, Fidelity International and the Fidelity International logo and F symbol are trademarks of FIL Limited.

