QUARTERLY NEWSLETTER – April 2018

Major Indices

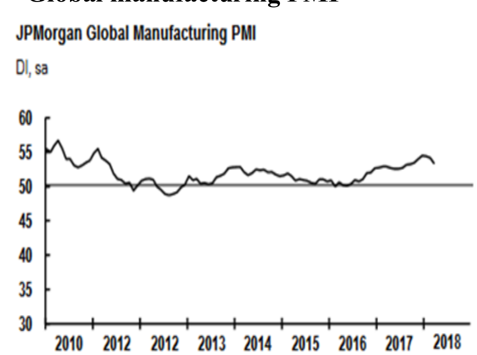
	Currency (AUD)	Interest Rate (%)	Share Index	*PE ratio (historical earnings)	Min daily wage (USD)	GDP Forecast (2018) IMF	Population (million)	Gov. Debt as a % GDP (as of 2016/17)
Australia	1.00	1.50	All Ords – 5,868	15.0 (All Ords)	136	2.9	24.9	41
USA (Dollar)	0.77	1.75	S&P 500– 2,641	22.6	58	2.7	327	105
Japan (Yen)	82	-0.1	Nikkei 225 – 21,454	15.7	85	1.2	126 (stagnant)	253
China (Yuan)	4.84	4.35	CSI 300 -3,898 Hang Seng 30,093	China-13.7 Hong Kong- 11.9	9.60	6.6	1,390	46
India (Rupee)	50	6.00	BSE 200– 4,432	22.1	3.40	7.4	1,330	69
Europe (Euro)	0.62	0.00	DJ Stoxx 50 3,361	13.9	56	2.1	733 (stagnant)	65 (Germany)
UK (pound)	0.55	0.50	FTSE 100 – 7,057	12.3	80	1.5	66 (stagnant)	88
Global	N/A			19.1		3.9	~7,600	

*PE ratios (based on historical earnings),
10 Yr Bond Rate – 2.74% US 30 Yr Bond Rate – 2.97% Source: Bloomberg NB: Fastest growing population is by far Africa.

Commodities

Oil –Nymex (WTI) (USD/barrel)	69.55	**Iron Ore** ($/tonne) spot price	65
Natural Gas ($per million mbtu)	2.73	**Copper** (USD/pound)	3.02
Lithium(contract) ($/tonne)	13-16,000	**Nickel** (USD/pound)	6.01
Uranium (USD/pound)	21.5	**Zinc** (USD/pound)	1.49
Gold (USD/ounce)	1,325	**Aluminum** (USD/pound)	0.90
Wheat (cents/bushel)	452	**Corn** (cents/bushel)	388
Baltic Dry Index(BDI) +	1,055 (lower)	**Dow Jones Transport Index(DJT)**	10,396 (slight fall)
US ISM manufacturing index	Jan 59.1	Feb 60.8	March 55.6
Chinese PMI manufacturing	Jan (Caixin) 51.5	Feb (Caixin) 51.6	March (Caixin) 51.0

Global manufacturing PMI -



Commentary – Past 3 months

The past 3 months for share markets saw some falls especially in February and March. All major global stock markets fell over the quarter, with only Hong Kong rising. Australian commercial property fell.

Global share market Prices to Earnings (PE) ratios have fallen in the past 3 months. The US PE is now at 22.6 and still looking expensive relative to most other countries (except India which is on a PE of 22.1), especially as rates are rising. The Buffett Indicator (US market cap/US GDP) is at 137%, suggesting the US stock market is 37% overvalued. The Trump tax plan may reduce this overvaluation about 20% due to a boost in US corporate earnings.

Asia is on a PE of 12.7 and is quite cheap. China with a PE of 13.7 is also well valued. Hong Kong is a standout for value on a PE of 11.9. India is on a high PE of 22.1, but has a high growth rate.

Global GDP is forecast by the IMF at 3.9% in 2018, up from 3.4% in 2017.

USA economy is doing well, and the IMF forecast is for 2.7% GDP in 2018. President Trump has guided for 3-4% GDP in his term.

Europe is still improving slightly but still has slow growth, with Europe GDP forecast at 2.1% in 2018.

China is doing quite well despite reducing fixed asset spending, closing down polluting factories, and reducing debt. The IMF has 2018 China GDP forecast to reach 6.6%. China is also spending big on electric vehicles and infrastructure, building the Silk Road (railway and highway) from China to Europe under their "One belt One road" master plan.

Australia's economy continues to be mediocre. The IMF has forecast 2018 growth to reach 2.9%.

India has slowed slightly but is still doing well, with the IMF forecast 2018 growth at 7.4%.

Emerging Markets are doing well with the IMF still projecting 4.9% average growth in 2018.

Interest Rates remained the same in most of the developed world over the past quarter with the exceptions of the USA and Canada raising rates by 0.25%.

US employment was steady at 4.1%, and **Australia** rose by 0.2% to 5.6%. Both countries have high underemployment rates, suggesting their jobs markets are not as strong as the statistics would suggest.

US long term bonds rates were slightly lower this quarter.

Inflation has still been mild in most countries and currently not a concern.

Currencies over the quarter saw the Aussie dollar weakening slightly. The Trade Weighted Index (TWI) fell to 0.62 compared to the AUD at 0.77 indicating the AUD is still around 20% overvalued.

Population comment – It is interesting to note that India's population is growing quite rapidly and will soon overtake China as the world's most populous country. Asia is home to 60% of the World's population. The word's total population is now past 7.6 billion.

Commodities

Oil rose strongly this past quarter from USD 60 to USD 69.

Natural Gas fell slightly this past quarter from USD 2.95 to USD 2.73.

Lithium Carbonate China spot prices were slightly higher the last quarter, with China spot prices still around USD 20,000 a tonne, or around13-16,000 a tonne for large contract buyers.

Cobalt prices rose very strongly to reach USD 42.41/lb have now quadrupled in the past 2 years.

Copper fell this quarter from USD 3.26 to USD 3.02 per pound. Most of the other base metals also fell, except nickel and vanadium that rose strongly.

Iron Ore prices fell from USD 74/tonne to USD 65/tonne.

Uranium fell from USD 24.70 per pound to USD 21.50/lb.

Gold moved up from $1,303 to $1,325 per ounce.

Soft commodities (wheat and corn) both rose over the quarter.

Australian Resources price earnings ratio is good value at 14.4.

Commentary – Next 6 months

The Aussie dollar fall may finally happen

The US reserve bank interest rates (as of March 2018) are now higher than Australia for the first time in more than 10 years. This can be a large risk that money will now flow out of the Australian Dollar and back to the US dollar. Added to this the Trade Weighted Index (TWI) is 0.62 compared to the AUD at 0.77 indicating the AUD is still around 20% overvalued. So don't be too surprised if the Aussie dollar is only buying 62 cents to the US dollar by end 2018. It will mean imported goods and overseas holidays will about 20% more expensive.

Valuation discussion

The US historical Price Earnings ratio remains elevated (the historical 100 year average is ~15.5). Using the rule of 20 (which adjusts for interest rates) we could expect the US PE to be at 18.25 (20 - 1.75). The current US PE of 22.6 is therefore 24% above the 18.25 fair value figure. The graph below also highlights that the US stock market is still above its long term trend line, also suggesting some overvaluation, and fair value to be ~2,400 for the S&P 500, or 9.1% lower.

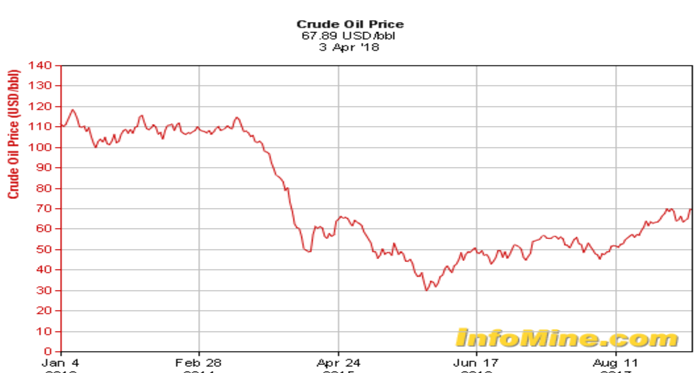
- US share markets are around 10-20% overvalued (PE of 22.6) still.
- Asian share markets are currently well valued (PE of 12.7), including Australia (PE of 15.0).
- Global Resources (PE of 14.4) are reasonable valuation.
- Australian commercial property is fair value (PE 15.02), but is being negatively affected by global rising interest rates.

US S&P 500 graph 1992 – 2018 – The US share market is above trend line = overvalued

Source: Yahoo Finance

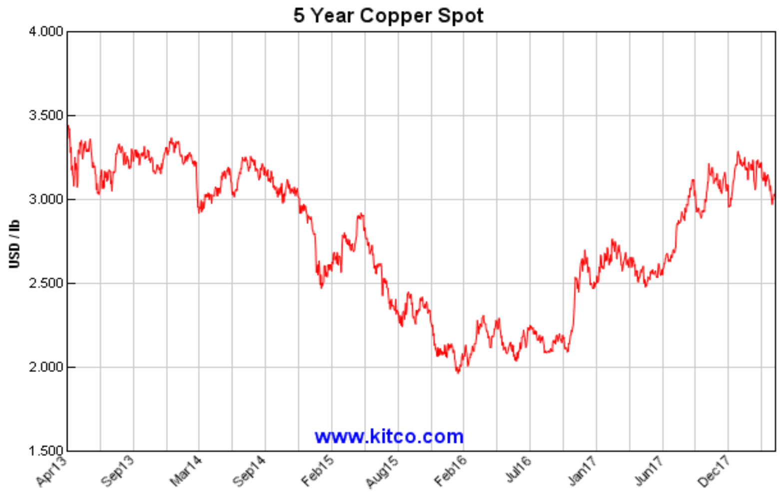
Commodities - Rising from 2016 lows

Crude Oil 5 year price graph - Recovering trend - USD 69.55



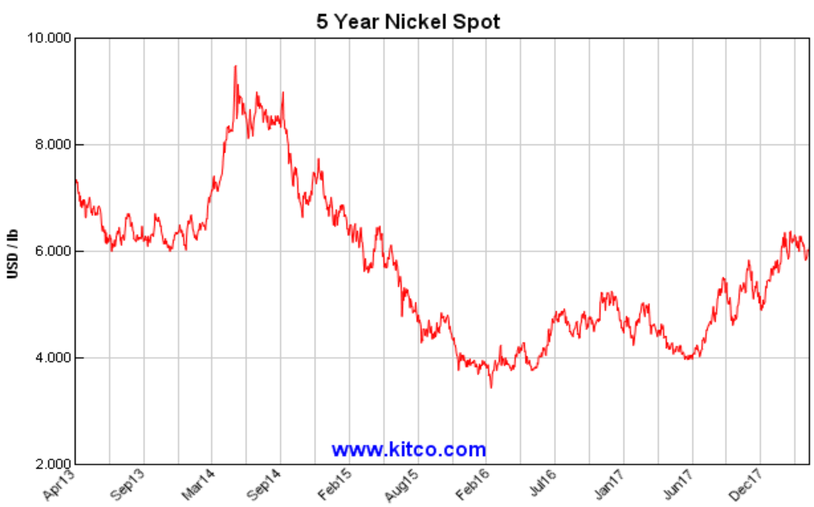
Source: InfoMine

Copper 5 year graph - Recovering trend (weak March) - USD 3.02/lb



[Source](): Kitco

Nickel 5 year graph - Prices recovering (weak March) - USD 6.01/lb

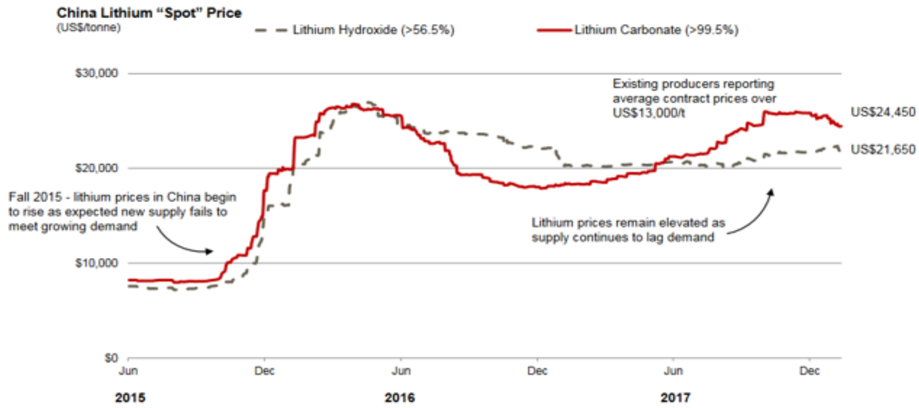


[Source](): Kitco

Zinc 5 year graph - Strong rising trend (weak March) - USD 1.49/lb

[Source](): Kitco

Lithium China Spot prices - 2015 to end 2017 - Steady above USD 20,000/t



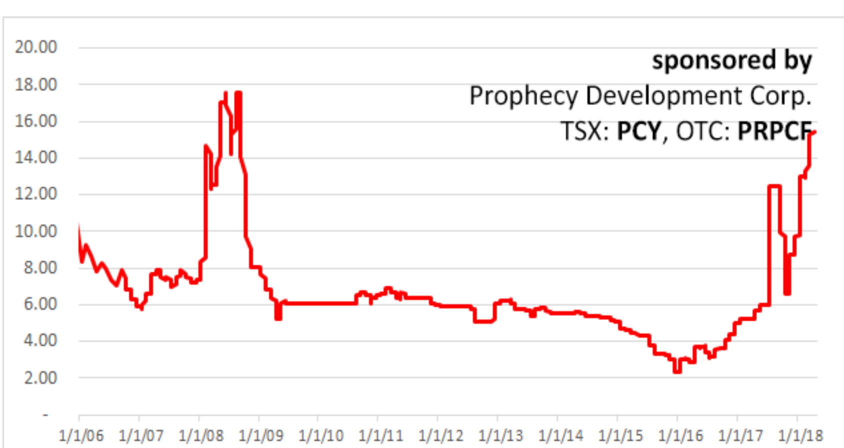
[Source](#): Lithium Americas January 2018 company presentation

Note: Global lithium carbonate 2018 contract prices are up about 20% to a range of USD 13-16000/t.

Cobalt 5 year price graph - Cobalt deficit is pushing prices much higher (very strong March) - USD 42.41/lb

[Source](#): InfoMine

China Vanadium Pentoxide [V2O5] Flake 98% Price - USD 15.20/lb - exponential rise and still rising



[Source](#): Vanadiumprice.com

The above graphs show the following trends

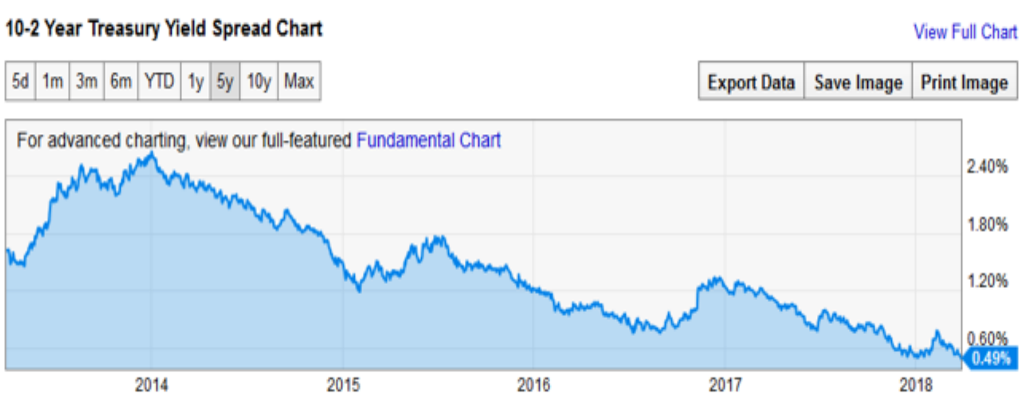
- The oil price has been in a long decline and appears to be recovering well. The oil price rose slightly in March.
- Most base metals have been recovering very well since early 2016 and are in an strong uptrend, however most fell back in March.
- New energy and electric vehicle [EV] metals are in a rising trend - Lithium prices were flat for the month, cobalt prices rose very strongly, and vanadium pentoxide prices rose strongly. Nickel prices fell slightly in March; however nickel and graphite prices are in a rising trend.

US Recession Indicator

10 yr minus 2 yr Treasury yield curve - If reaches zero = recession coming soon (after about1 year)

[Source]

10 yr-2 yr Treasury yield curve - Trending lower to [0.49%] - Down from 0.63% last month, close to warning of a recession coming - Watch closely.

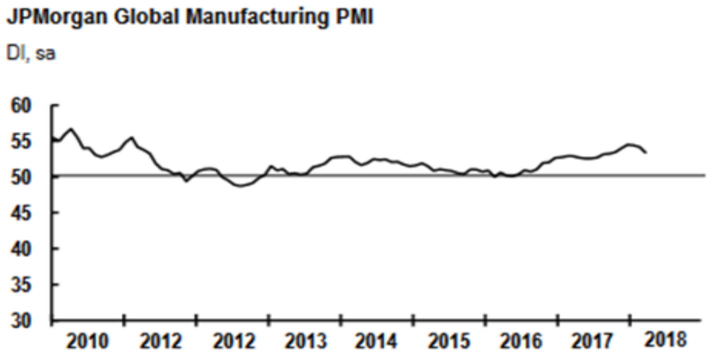


[Source]

6 Forward indicators - Global, USA and China

Four positive, one neutral, and one negative result for the **six** leading indicators. The four positives were Global PMI, US PMI, US retail and China PMI, the one neutral was US transports, and the one negative was the Baltic Dry shipping Index. Many of the positive signs weakened a bit suggesting the global growth outlook has deteriorated a bit in March, but remains mostly positive overall.

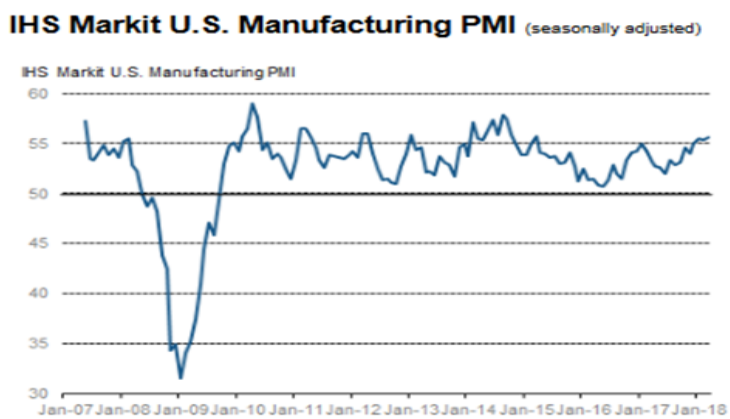
1) Global Purchasing Managers Index (PMI) - Positive - 53.4



Source

Note: From the monthly report - "Growth slowed in the euro area, China, Japan, India and Australia, but improved in the US, the UK, Brazil and Russia."

2) United States IHS Markit Manufacturing Purchasing Managers Index (PMI) - Very Positive - 55.6



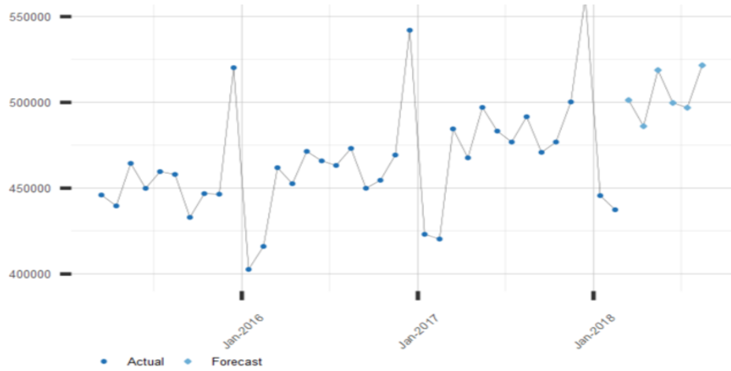
Source

Note: From the latest report - "The latest PMI reading indicated the strongest improvement in manufacturing business conditions since March 2015. The average PMI reading over the opening three months of 2018 meanwhile indicated the best quarterly performance since the third quarter of 2014."

3) US Dow Transport Index - Up only very slightly in March - Neutral - 10,396

Source

4) US Retail sales forecast - Forecast to rise after season weakness early 2018 - A slightly positive sign



[Source]()

5) China PMI - Markit - [51.0]() - A weak positive sign

[Source]()

Note: The Markitt/Caixin survey result stated "Manufacturing PMI dips to four-month low in March."

6) Baltic Dry Index (BDI) - Recent falls in an uptrend, down very slightly in March - 1,055 - A slightly negative sign

[Source]()

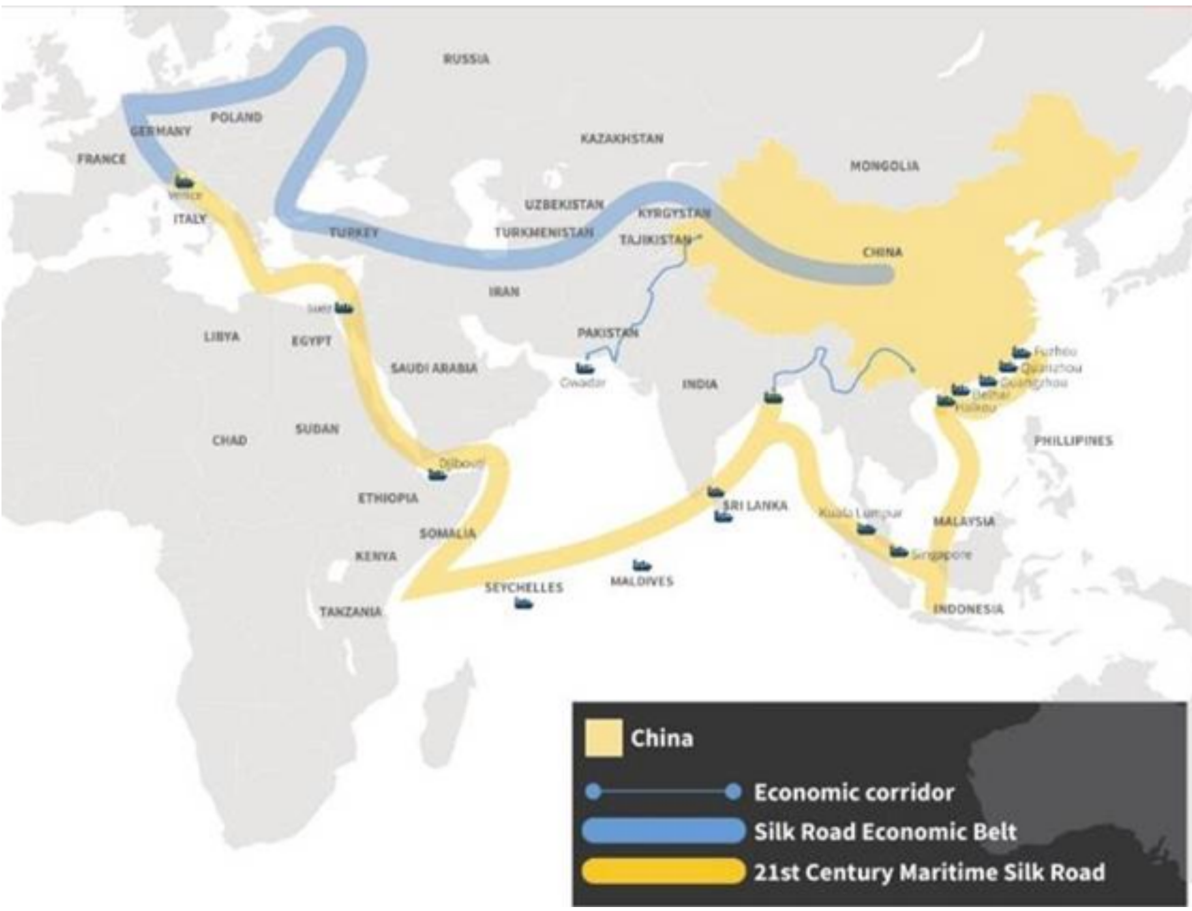
NB: The BDI measures the cost of shipping dry bulk goods such as coal, iron ore and grain. The BDI is often a sign of Chinese demand for commodities. Note it is usually weak in January-February (Chinese New Year holidays perhaps).

Upcoming catalysts

- US tax breaks to flow through. The US corporate income tax rate was cut to 21 percent from 35 percent.
- China's plan to ban ICE vehicles.
- China's One Belt One Road plan - Should underpin a strong decade of metals demand.

China's One Belt One Road plan has potential to significantly boost demand for metals

The One Belt One Road follows the old Silk Road and is a $900 billion initiative meant to open channels between China and its neighbors - including Central Asia, Eastern Europe, Western Europe, and Africa.



__Ideas__

- Growth and Aggressive investors could buy into the disruptive technology areas such as electric vehicles, lithium/cobalt/vanadium miners, solar/wind energy, energy storage and IT areas such as artificial Intelligence (AI), 3D printing, cloud, big data, and robotics.
- Moderate risk (and retiree) investors should be sure to have about 50% in safe areas, as valuations are still stretched in US markets (but ok in other regions), global debt elevated, and global interest rates starting to rise.
- All investors should still keep at least some money in cash or safe fixed interest.
- Sell Australian residential property unless it's your home.
- Invest in countries with good demographics, jobs growth, low debt and positive GDP.
- Buy direct property in countries that are benefitting from globalization and where property is still cheap.
- AUD still likely to fall long term, and is still overvalued.

Conclusion

Stock market Valuations - The past 3 month US stock market falls of a net ~8% has left the US stock market still overvalued. The US PE ratio and valuation remain elevated (US is about 24% above fair value based on historical PEs, and ~9% based on chart analysis). The current strong corporate earnings and corporate tax cut should soon help lessen the PE overvaluation, and it appears to me that about a 9% further market fall is necessary to get the US back to about fair value. Many other global markets valuations such as Europe, Japan, China, Australia and Canada have fallen and are now more attractive than the US.

Commodities - Rising from 2016 lows, EV metals and zinc are doing best. Commodity prices were mixed during March with oil rising and most base metals (copper, nickel, zinc) falling.

EV Metals - Lithium prices were flat for the month, cobalt prices were significantly higher, and vanadium prices also moved higher. My lithium and cobalt demand versus supply models forecasts a mostly balanced demand-supply picture to 2021, then potential deficits thereafter if new supply does not come online.

US recession indicator - The 10 yr-2 yr yield difference has narrowed to 0.49% in March. It is of some concern and close to warning of a US recession coming, so will need watching closely.

Forward indicators - Forward indicators are a mixed bag, which suggests investors should show some caution. The Global PMI is still quite positive. Many of the positive signs weakened a bit suggesting the global growth outlook has deteriorated a bit in March, but remains mostly positive overall. China forward indicators are weak, so will need to be watched closely. It appears for now that US manufacturers are gaining versus China manufacturers declining follows the latest US tariff moves.

The above data suggests to me the global economy should continue to do well in the short term provided a full on trade war does not begin; however we are currently experiencing a very mild slow down perhaps due to this uncertainty. The US equity market is still overvalued and vulnerable to a healthy further 8-10% correction - despite the 8.1% fall we have already had since January 26, 2018. Rising interest rates and bond yields also need to watched, with no panic needed as they are coming of a very low base. Recent US tariffs and a potential US-China trade war are a concern.

Wise investors will remain invested but will have (or be saving) some cash ready to deploy if markets fall further. It would also be wise to allocate some capital to other sectors away from US equities. Those fully invested should remain calm and be prepared to ride out the storm.

My latest Seeking Alpha articles
http://www.hnwfinancialadvising.com.au/hnw-articles.html

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