MORNINGSTAR®

Your Money Weekly

Forecast 2018–19
Global trade tensions could escalate – Financial markets in the firing line

Introduction
In Forecast 2018 of 14 December 2017, I wrote "Without forecasting closing year index levels, I believe the US and Australian equity markets will close 2018 at a lower level than the exit level of 2017. The magnitude and cause of a market correction is difficult to predict. Investors are currently oblivious to an exogenous factor but there is abundant fertile ground in which one can sprout."

This was a brave (or stupid) call at the time, as global markets, led by the US were on the tear. By 26 January, all three major US indices were at all-time highs, the Dow Jones was up 7.7%, S&P 500 7.5% and Nasdaq Composite 8.7%. This, on top of a very strong Trump-bump performance in 2017. But when US wages growth spiked to 2.9% annualised in January and bond yields surged, markets corrected as investors feared a possible inflation breakout.

The markets recovered some of the lost ground and remained nicely positive for the year until President Trump shook global trade relationships to their foundations by introducing tariffs on steel and aluminium products of 25% and 10% respectively. A possible exogenous factor had emerged.

Australia's S&P ASX 200 index is up 2.1% for the half year to 30 June, after a stellar May and June added 3.9%, pulling the index from negative territory in the first four months. Including dividends, the Accumulation index is up 4.3%. For the 2018 financial year the market performance slowed noticeably in the second half. The Hayne Royal Commission impacted the heavily weighted banking sector. S&P/ASX 200 is up 8.3% (+6.0% 1H/+2.1% 2H) and the Accumulation index 13% higher (+8.4% 1H/+4.3% 2H).

Since January, resources, mining service and energy companies have continued to perform strongly as have international healthcare stocks led by CSL, Cochlear and ResMed. Retail majors Woolworths and Wesfarmers have recovered solidly. Selected REITs Goodman and Scentre benefited from reinvestment of proceeds from the Westfield/Unibail-Rodamco merger. Infrastructure also contributed, while Macquarie Group and Insurance Australia Group were the features in a disappointing financial services sector. These outperformers have offset a royal commission dominated banking sector, an unwanted Telstra and orphaned AMP.

Morningstar sees the market as modestly overvalued at present with the average price to fair value ratio over our 200-stock coverage at 1.1. Stocks in the five-star (Buy) zone screening as meaningfully undervalued include last year's dogs Telstra and Ramsay Health Care. Four-star (Accumulate) recommendations include three major banks, Commonwealth, National and Westpac; wealth managers Magellan, Pendal and Platinum; technology companies Link, MYOB and Technology One; and funeral service provider InvoCare.

I don't see any reason to change my forecast for 2018. The next six months could be even more volatile than the past six. There is a possibility tensions could escalate further as the president steels the US against what appears to be the rest of the world, from the closest of neighbours to those across oceans. Interestingly while implementing aggressive trade policies, an arrogant president asks the Saudi king to double oil production and put downward pressure on the price of his major export.

The US/China trade clash and continued strength of the US$ could affect commodity prices. While resource stocks have done well over the past year, outperformance may be more difficult in an environment of potentially lower commodity prices. Volumes are unlikely to increase. The energy space is quite different as geopolitical issues on several fronts could impact supply and therefore the oil price.

Australia's Leading Independent Investment Newsletter Since 1973

Peter Warnes
Head of Equities Research

This bi-annual feature is written on the premise of a subscriber asking what could be the key issues, trends and risks in the share market and economy over the next year. It will help you understand how we approach the issues and how we update them during the year in our Weekly Overview. We look at many trends both local and international that influence global financial markets. The goal is to provide investors with the necessary information and investment ideas to generate satisfactory long-term returns by the prudent management of a growing pool of investable funds.

Exhibit 1: Markets Snap Shot 30 June 2018

Markets	30/6/17	31/12/17	%Change 1H	30/6/18	% Change 2H	% Change full year
Dow Jones	21,350	24,719	+15.8	24,271	-1.8	+13.7
S&P 500	2,423	2,674	+10.3	2,718	+1.7	+12.2
Nasdaq	6,140	6,903	+12.4	7,510	+8.8	+22.3
FT 100	7,313	7,688	+5.1	7,637	-0.7	+4.4
DAX	12,325	12,918	+4.8	12,306	-4.7	-0.2
Nikkei	20,033	22,765	+13.6	22,305	-2.0	+11.3
Shanghai	3,192	3,307	+3.6	2,847	-13.9	-10.8
S&P/ASX 200	5,722	6,065	+6.0	6,195	+2.1	+8.3
S&P/ASX 200 Accum	55,759	60,426	+8.4	63,015	+4.3	+13.0
Commodities						
WTI	US$46.33	US$60.10	+29.7	US$74.37	+23/.7	+60.5
Brent	US$49.00	US$66.52	+35.8	US$79.42	+19.4	+62.1
Copper	US$2.71	US$3.30	+21.8	US$2.97	-10.0	+9.6
Iron Ore 62%	US$64.95	US$72.42	+11.5	US$64.44	-11.0	-0.8
Bond Yields						
US – 2-year	1.38	1.88	+50 bps	2.53	+65bps	+115bps
10-year	2.30	2.41	+11bps	2.86	+45bps	+56bps
30-year	2.83	2.74	-9bps	2.99	+25bps	+16bps
Aust – 2-year	1.72	1.96	+24bps	1.98	+2bps	+26bps
10-year	2.59	2.63	+4bps	2.63	unchanged	+4bps

Source: Morningstar

It is likely global trade tensions and their far-reaching implications, will be mentioned more in the coming year than any other topic. They have the potential, if unchecked, to exert sufficient pressure to trigger a global economic recession within the next two years.

Battle lines have been drawn, but with the terms of engagement changing almost daily, financial markets are being whip-sawed, draining investor confidence. The stakes are high. The benefits of globalisation under threat. This is potentially the financial markets nuclear war.

The good times experienced over past decades have been the product of increasing globalisation and more recently by historically low interest rates driven by stimulus programs of central banks. President Trump's hellbent drive to protectionism could unwind these benefits. Central banks led by the US Federal Reserve (the Fed), have or are in the process of withdrawing stimulus and tightening monetary policy. Interest rates are on the rise.

Risk assets, whose valuations are closely tied to interest rates and associated discount rates, including equities, are in the firing line, particularly as perceived risk-free rates of return increase. The sugar hit from Trump's tax cuts will wane, so will the massive share buybacks so supportive of US markets.

In recent months, the synchronisation in global growth has shown signs of fragmentation. GDP growth in advanced economies eased in the March quarter, but still strong enough to absorb spare capacity. Recent wobbles in Chinese markets on trade fears and slowing growth may slow the absorption rate.

Political uncertainty in Italy and Spain and more recently in the European Union's powerhouse Germany is unsettling. Historically makeshift coalition governments across the European Union have lacked both success and sustainability.

Major central bank policies are not synchronised. The Fed has increased official rates seven times since its initial tightening from a 0.0%–0.25% setting in December 2015. The European Central Bank (ECB) will finally cease its asset purchase program by year end, but an interest rate increase is unlikely before the December half of 2019. The Bank of Japan sits pat, still adding stimulus to the economy. For the 21st consecutive meeting, the Reserve Bank of Australia (RBA) left the official cash rate at 1.50% at its July meeting and despite calls from the bleachers, is unlikely to lift rates before June 2019.

The stage is set for a very interesting year ahead.

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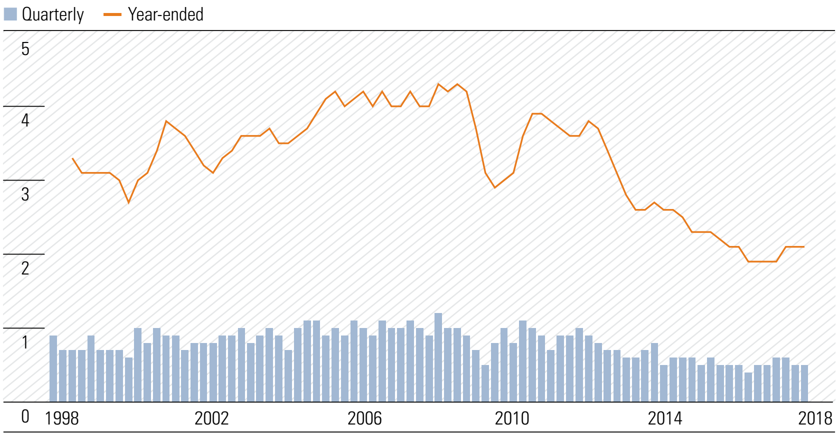
Morningstar Rating for Stocks

Significantly overvalued	★
Overvalued	★★
Fairly valued	★★★
Undervalued	★★★★
Significantly undervalued	★★★★★

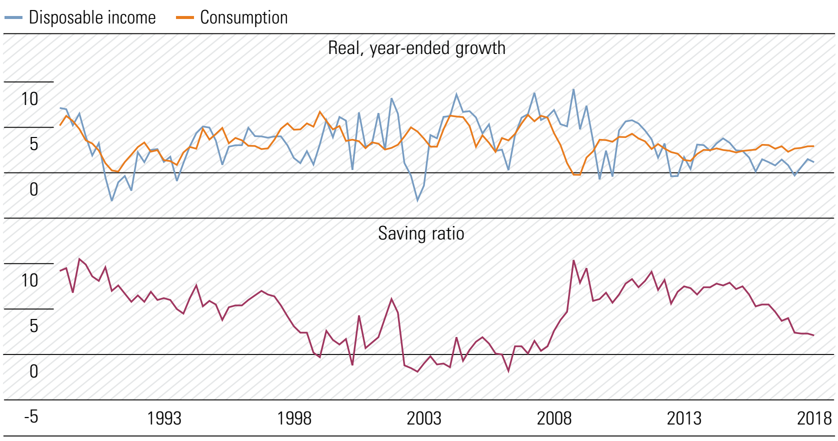
Any feedback on this week's Overview is always welcome. Send your comments to YMW@morningstar.com. We'd love to hear from you.

Exhibit 2: Wage price index growth* (%)



Source: ABS
* Total pay excluding bonuses

Exhibit 3: Household income and consumption* (%)



Source: ABS; RBA
* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; income level smoothed with a two-quarter moving average between March quarter 2000 and March quarter 2002; saving ratio is net of depreciation

Australia – Households and RBA hold domestic attention

RBA Governor Philip Lowe has warned China's rapidly increasing debt and opaque financial system hangs as a threat to Australia's well-being. His concerns focus on the banking system as the likely cause of an economic shock. "Not surprisingly, this risk has become a priority of the Chinese authorities – we all have a strong interest in their efforts being successful." "It is too early to tell whether the authorities will be successful in managing the transition from a growth model heavily dependent on the accumulation of debt to one where credit is less central. It is a very significant task. The experience of other countries suggests caution and, elsewhere, there have been serious accidents along the way."

A trade war that disturbs an already highly leveraged financial system could have dire consequences, enveloping Australia. Disruption to the critical import/export industries, which provide meaningful support to final consumption through employment, will affect our trade with China. Our terms of trade would decline, as would the currency.

Domestically focus remains on wages growth, household leverage and disposable income. The theme from the minutes of the last four Monetary Policy Meetings of the Reserve Bank Board sum up the outlook for wages and households and require little further comment. "Wages growth remains low. This is likely to continue for a while yet." At the recent ECB forum in Portugal Lowe cited falling union membership, increasing fear of competition and rising labour supply (probably due to immigration) for the lack of wages growth. He told the forum, "I think those factors are going to be around for a long time". Lowe's press statement after a recent board meeting included, "One continuing source of uncertainty is the outlook for household consumption. Household income has been growing slowly and debt levels are high."

While the RBA's hands may be tied regarding lifting official interest rates, the cost of funding is increasing for Australia's banks and there is an air of certainty around out-of-cycle increases to variable mortgage rates. Household disposable income will come under greater pressure over the next year which should impact consumption particularly as the savings ratio is far from healthy. Strong net immigration is the most significant driver of household consumption at present.

GDP growth is forecast between 2.75% and 3%, the volatile net exports contribution a swing factor. Dwelling investment has turned, while non-mining and public investment are positive contributors. But the key is household consumption and with the house price surge of recent years reversing, the wealth effect, which does affect consumer behaviour, has peaked. This has the potential to add to already elevated pressure on disposable income and consumption. (Exhibits 2 and 3)

Australian LNG exporters could ultimately be winners from the escalating US/China trade battle. In the first half of 2018 US LNG producers have exported 1.6 million tonnes of LNG to China, more than the total shipped in 2017. Producers were confident China would continue to increase imports significantly. However, the widening in tariffs on Chinese imports from US$50bn to US$200bn and moves to restrict Chinese investment in the US are likely to have repercussions and US LNG exports may be impacted. Chinese importers could turn to Australia.

Exhibit 4: Differential between Australian and US 10-year Government Bond Yields

Source: Bloomberg, RBA

The outlook for A$ is rather sombre. Interest rate differentials, particularly between Australia and the US, suggest further weakness. The Australian 10-year bond yield is lower than its US counterpart. When this occurred previously in 1998 and 2000, the A$/US$ cross rate was below 0.60. While the situation is not strictly comparable, as the China infrastructure boom has meant our terms of trade have improved significantly since then, a rate closer to 0.70 is likely over the next year. (Exhibit 4)

The United States – Markets face the Three Ts: Tariffs, Trade and Trump

The financial landscape of the US, dare I say the world, is in the hands of the unpredictable, twitter fanatic President Donald Trump. His bully-boy, my-way-or-the-highway negotiating tactics could have profound implications for global trade. Winners will be hard to find. The US unlikely to be one of them.

Tensions on the global trade front will run parallel with tensions in global bond markets. The clash of fiscal and monetary policy in the US will see interest rates rise, the speed of the rise the only issue. I began warning of this clash in September and many more commentators have joined the chorus. A similar situation, but on a lesser scale, will begin to play out in the Eurozone. Political uncertainty adding to the complexity.

How equity markets adapt is anyone's guess, but I believe there's a bad moon rising. The sugar hit from the meaningful corporate tax cuts and the support from unparalleled share buyback activity will be on the wane as 2019 dawns.

The punch and counter punch tactics of the US and China are dangerous as each round sees the stakes increased. After starting with tariffs on US$50bn of Chinese imports, the figure has quickly escalated to US$200bn. This is not encouraging or positive for either side. Economic growth of both will be sacrificed at the altar of EGO.

A recent report from Moody's concludes Trump's 25% tariff on imported autos and parts will be credit negative for all segments of the global auto industry. In response to the EU's tariff retaliation, Harley Davidson (HOG) will transfer the production of motorcycles shipped to the EU from the US to its international facilities in Asia and South America. The imposition of the 25% tariff by the EU will cost the company US$90–US$100m annually. The US will lose jobs from transferred production. The EU accounts for over 16% of HOG's sales. HOG's share price is down 19% year-to-date. Brown-Forman, the maker of Jack Daniel's, is reeling from the EU's 25% tariff on US whiskey. The tariff will increase prices by 10%. Brown-Forman's share price is at a seven-month low. No winners here. The crossfire is deadly with casualties on both sides. Despite Trump saying a tariff war is an easy win, it will likely turn out more prolonged and expensive than first thought.

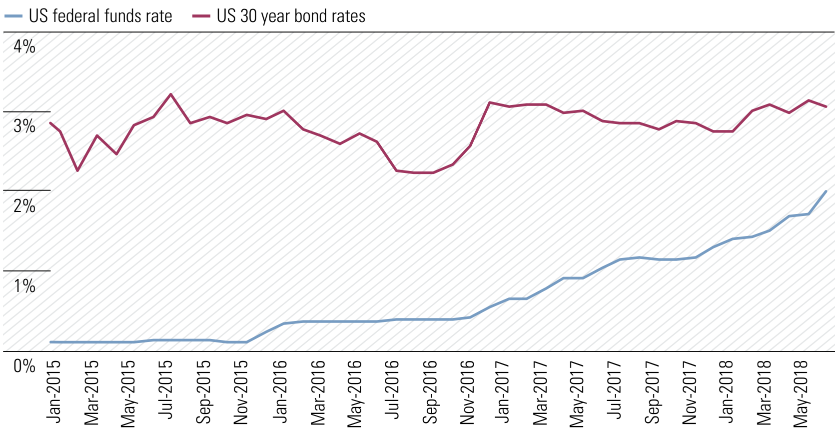
Initially, President Trump cited national security reasons form imposing tariffs on steel and aluminium. In the ensuing months, as tensions escalated, the playing field widened and now includes Chinese investment in the US. The US Treasury Department plans to raise the scrutiny of Chinese investments in sensitive US industries. Rules blocking companies with over 25% Chinese ownership from buying US companies "with industrially significant technology" were drafted. Treasury Secretary Steven Mnuchin took to his boss' favourite communication method, tweeting the restrictions would not apply specifically to China but "to all countries that are trying to steal our technology". The stakes are sky rocketing, making the fallout potentially much greater.

Given the President's significant business interests, the Trump administration is more focused on the reaction of Wall St than most previous administrations. The administration does not want to disturb the stock market or the economy. Trade tensions have had an unsettling effect on markets and volatility could intensify when tariffs on both sides kick in from 6 July.

The Federal Reserve gets more aggressive

Meanwhile the Fed upped the ante at its June meeting, raising the Fed funds rate as expected but signalled two more rises in 2018, up from indicating one at the May meeting. Rising US inflation

Exhibit 5: US Federal funds rate versus 30 year bond yield



Source: Reuters, Morningstar

influenced the thinking and behaviour of the Federal Open Market Committee (FOMC). While May's headline and core CPI readings came in as expected, both rising by 0.2%, the year-on-year readings show acceleration. Annual headline inflation rose 2.8%, after rising by 2.5% in April, the largest advance since February 2012. Core inflation increased to a 15-month high at an annualised 2.2% in May, from 2.1% in April and the biggest rise since February 2017. The annual rate is rising as 2017's weak readings fall out of the calculation.

The US jobs market is at its tightest for almost two decades with 6.7 million job vacancies and 6.1 million people unemployed. Wages growth has the potential to break out fuelling inflation as tariffs also add to upward price pressure. In 2009 there were two million vacancies and 15 million unemployed. As increasing evidence of the tightness in the jobs market, employers are reported to be hiring recently released prisoners and felons, particularly in the construction industry to address the shortage of available labour.

In normal circumstances bond yields would be rising given the combination of inflationary pressure, record Treasury issuance and selling by the Federal Reserve to normalise its post-GFC bloated balance sheet. But widespread uncertainty spawned by global trade tensions and geopolitical issues sees safe-haven buying of some currencies (yen, swiss francs and US$) and investment grade sovereign bonds, keeping yields in check. The US 2-year -10-year bond spread has more than halved since February from 70 to 31 basis points. But at some point, yields will rise, putting pressure on risk asset valuations.

Home buyers have been fortunate. US mortgage rates have hardly moved since December 2015 despite the Fed increasing the federal funds rate range seven times, 175 basis points, from 0.00%–0.25% to 1.75%–2.00%, or by 700%. The short end of the bond curve shows the Fed tightening with the 2-year yield up from 0.60% in mid-October 2015 to 2.55%, the 30-year yield up a mere 12 basis points from 2.87% to 2.99%. A very flat yield curve. (Exhibit 5)

A meaningful rise in the 30-year yield will put pressure on residential activity, both sales and construction. Housing starts are running at an annualised rate of 1.35 million, well below the 2.3 million of 2005, and below the long-term (1959–2018) average of 1.43 million.

The Eurozone – Political uncertainty as the ECB winds down the stimulus

The two major issues facing the Eurozone over the next year will be the implications of tightening by the ECB and the uncertain political landscape. The former sees Italian Mario Draghi steering the ECB's course in ceasing stimulatory asset purchases and ultimately raising interest rates, while the latter sees Draghi's homeland at the forefront of political unease.

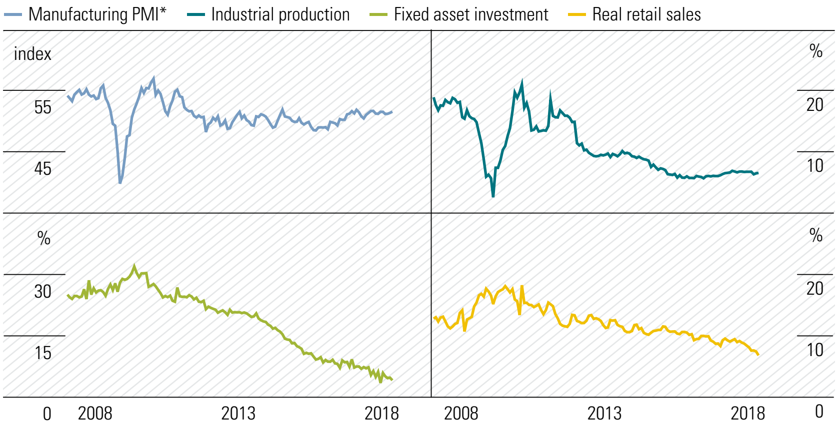
While political tensions in Italy have abated, it is still possible the coalition of the Five Star Movement (M5S) and the League (Lega) could disintegrate triggering new elections by years' end. Should this scenario unfold, the elections are likely to be a vote on whether Italy remains a member of the European Union and the euro.

A public spat over Germany's immigration policy between Chancellor Angela Merkel and the leader of her coalition partner Horst Seehofer of the Christian Social Union has been settled, at least in the short term. But it does appear Merkel's hold on the top job has loosened.

The EU has also been caught up in Trump's attack on global trade. As with China, punches and counter punches are being thrown between the US and the EU in rapid succession. China is looking for allies in its war with the US and has offered to join forces with the EU in its battle against Trump's protectionist attack on global trade.

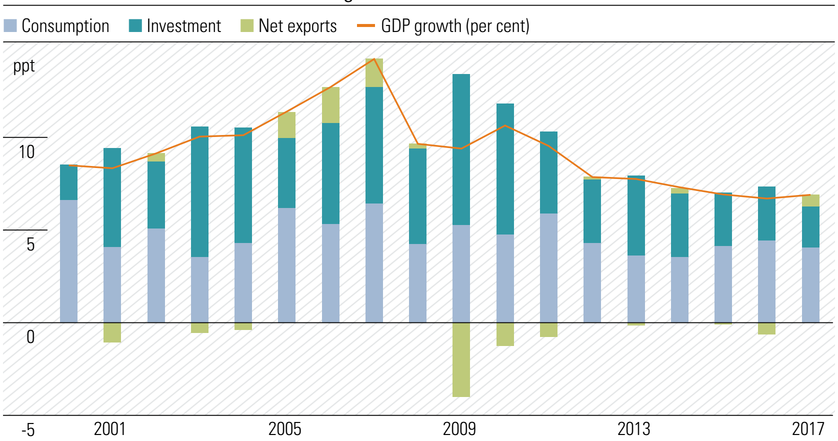
The EU is China's second largest trading partner. In 2017 the EU represented 15.3% of all Chinese trade, slightly below the US at 16.9%, with a value of €573bn. It was China's largest importer at €375bn and exported €198bn. Manufactured goods dominate EU/China trade, representing over 80% of total exports and over 90% of total imports. China is the world's largest exporter, the EU second, US third. The

Exhibit 6: China – Activity Indicators, year-ended growth



Source: CEIC Data; Markit Economics; RBA
*Diffusion index; average of the official and Caixin

Exhibit 7: China–Contributions to GDP growth



Source: CEIC Data, RBA

US is the world's largest importer, the EU second, China third. A Chinese/EU axis would be a powerful opponent to Trump.

US imports are falling with the growth of shale oil production significantly narrowing the import of petroleum products.

The ECB plans to cease asset purchases under its quantitative easing program by the end of 2018. By then the central bank would have purchased €3 trillion of financial assets. Its balance sheet is bloated and will need to be normalised over time.

China – Trade tension, slowing growth and debt

Given the increasing tension on the trade front with the US and signs economic growth is slowing, the year ahead could be a defining one for world's second largest single country economy. China's debt problem is well known. Economic growth has been stimulated by increasing debt, particularly in state-owned enterprises (SOEs).

In June the more reliable Caixin manufacturing PMI slipped slightly from 51.1 in May to 51. The official PMI declined from 51.9 to 51.5. This weakness while marginal, is before the 6 July imposition of US tariffs and with credit growth still softening it is likely further weakness is ahead. But growth in the world's second largest economy is meaningfully stronger than any developed economy. (Exhibit 6)

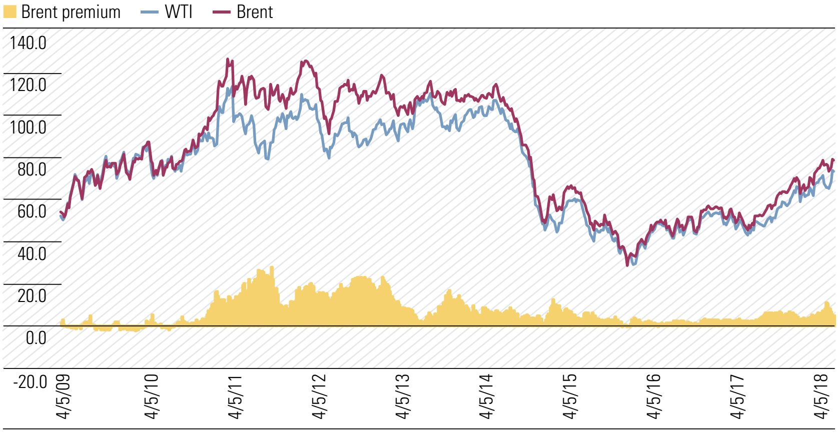
The Shanghai Composite has taken a beating in 2018. So far, in the Year of the Dog, it has been a dog of a year. The index is down 13.9% from 31 December; 22% from the year's high on 24 January; and 10% in June alone.

The heightened rhetoric around US/Chinese trade tends to focus on the magnitude of the imbalance, and the desire of President Trump to even up the scorecard. In 2017 the US trade deficit with China was US$375bn – imports from China US$506bn with consumer electronics, clothing and machinery, exports to China US$131bn. The deficit with Mexico was the second largest at US$71bn, Japan US$69bn and Germany US$65bn. The US trade (goods and services) deficit with the world was US$566bn rising to US$810bn excluding services. Imports totalled US$2.895 trillion with main categories autos, petroleum and cell phones, while exports of US$1.551 trillion were led by commercial aircraft, autos and food.

President Trump cites the imbalance with China as the justification for his protectionist policies and the imposition of tariffs. While trade tensions are a focal point for global financial markets, the contribution of net exports to China's GDP growth is of minor importance. In 2017, net exports contributed 0.6% (or almost 9%) to China's GDP growth of 6.9% growth. Final consumption accounted for almost 59% and capital formation (investment) 32%. Net exports were negative (6.8%) for growth in 2016, with final consumption at 64.6% and capital formation 42.2%. In 2017 exports totalled US$2.27 trillion and imports US$1.84 trillion for a net trade surplus of US$430bn. (Exhibit 7)

But the import/export industries are critical to China's overall economic health. Employment by these industries creates meaningful consumption, the major driver of economic growth particularly as the economy becomes more western-like in its composition. Any significant disruption, which affects exports, will impact economic growth and add pressure to an already debt-loaded economy.

Exhibit 8: Crude price differentials (US$ per barrel)



Source: Morningstar

The Peoples Bank of China, China's central bank has reduced the reserve requirements of many banks creating some 700 billion yuan (A$144bn) of liquidity to support smaller companies. This follows President Trump's new tariffs on goods worth another US$200bn. Authorities appear comfortable supporting consumption and fixed asset investment via infrastructure and property.

As trade tensions have escalated authorities have allowed the yuan to depreciate. This could be another weapon in the retaliatory armoury against Trump's tariff blitz. A lower yuan makes Chinese exports cheaper in US$ and provides an offset to tariffs. Additionally, it makes US exports to China more expensive in yuan terms potentially impacting demand for US goods. The fear of capital outflows as the yuan weakens seems to have waned.

Oil and Gas commentary

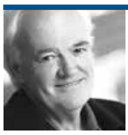
The world's two major crude benchmarks are West Texas Intermediate (WTI), sourced from the US primarily from Texas, Louisiana and North Dakota; and Brent, originating from oil fields of the North Sea. Both are light (flow at room temperature) and sweet (low in sulphur) making them ideal for refining into gasoline. So why then the price differential, with Brent having traded at an average US$7.00 per barrel or ~10% premium to WTI over the past nearly 20 years? (Exhibit 8)

As is often the case, the reasons are many and varied. Prior to oil's push towards US$130 per barrel peaks toward the end of last decade, the two benchmarks were reasonably close. But from early 2011, a spread suddenly opened to a peak Brent premium of nearly US$30 per barrel by late the same year. Drilling and fracking advancements made West Texas cheaper with supply growing but pricing capped by export bans and constrained infrastructure, including pipelines and refining at various stages. But as infrastructure was further developed and US exports rose with the 40-year ban relaxed in 2016, the Brent/WTI gap narrowed, and was all but erased by 2016.

However, over the last year the spread has widened again, exceeding US$10 per barrel in late May/early June this year, before more recent retreat to ~US$5. The WTI price discount again reportedly reflected pipeline constraints as shale production booms, and geopolitical risk only adding fuel to the fire. Unlike US landlocked West Texas, Brent is produced near-ocean, with transport costs lower, and Brent is more ubiquitously traded globally. Geopolitics – think Trump, Syria, Venezuela and Iran sanctions – can see the Brent/WTI spread blow-out with West Texas less affected.

Morningstar's unchanged and sub-consensus mid-cycle US$60 per barrel (2021 dollars inflated at 2.25% per annum) Brent price forecast stands at a US$5 per barrel or 10% premium to our US$55 per barrel WTI forecast. That premium matters as it is Brent against which most of the world's LNG prices are pegged, particularly important for Australia's gas exporters including Woodside and Santos. Our mid-cycle LNG price forecast is unchanged at US$8.40 per mmBtu, effectively a 14% slope to the Brent price, or a 20% discount to Brent in energy equivalence. We remain cognisant of the growing importance of US gas prices on export LNG markets. But even were the long-standing Brent-LNG pricing mechanism to erode faster than anticipated, we still think strong Asia-Pacific demand growth will support US$8.40 LNG prices on a cost basis. US LNG is cheaply made, but is considerably more expensive to ship to Asia, and most Australian projects are underwritten by 20-year take or pay contracts at near our mid-cycle forecast in any case.

Woodside, Santos and Oil Search are all materially exposed to Asian gas prices following completion of LNG export infrastructure. Recent share price appreciation has crimped the value that was on offer, with Woodside marginally the cheaper in our view. Since we published our special report in December 2017, Woodside shares have risen 12% and at $35.20 trade at a reduced 10% discount to fair value. Geopolitics, supply disruption and OPEC restraint have helped push Brent towards US$80 per barrel. But ultimately, we think US shale growth is likely to see Brent revert to our mid-cycle forecast, where production is incentivised to meet demand but not to the point of over-production as is likely now.



Ian Huntley

Ian Huntley's Forecast
I am a short-term bear, long term bull, extremely cautious in the near term.

My reasons are:

1. US unemployment is now equal to the lowest level in five decades, and the Trump administration has unleashed a powerful fiscal stimulus just as the Federal Reserve (the Fed) is hiking interest rates to slow the economy, and to build interest rates to levels where cuts can again be used to re-stimulate. Trump's fiscal splash simply means higher interest rates are required to slow the economy. Low unemployment is good, but very low unemployment, as is now the case, is a first-class indication of very high levels of capital utilisation – the next step is inflation. That's why central bank tightening cycles coincide with very low unemployment levels – conditions of the current US economy.

2. The Fed has a difficult task, for due to the immense and correct monetary stimulation required to stop another great depression and get the economy moving, there is a giant balloon of money in the economy. The Fed must deflate it. The history of Fed tightening has usually showed an excess tightening driving the economy down. Now the task is even harder. To judge the deflation of the balloon and its delayed stimulus makes a difficult accident-prone exercise just that much more difficult.

3. Australian household debt is far too high. The Reserve Bank of Australia (RBA) has gone too far dropping interest rates to encourage households to spend and keep the economy moving. The last cut or two were unnecessary. Now when the proverbial hits the fan, the RBA has little ammunition in the way of potential interest rate cuts, and the household sector is all "debted out". Sure, the RBA can follow the US example of 2008/9 and buy the economy out of trouble with printed money. But, I think the current RBA leaders have forgotten former excellent RBA head Ian Macfarlane and his strictures on that other inflation – asset inflation, possibly the worst of which could be coupled with high levels of household debt after it fuelled a decades-long house price inflation.

4. Extremely low interest rates, for what is now the longest business cycle in several hundred years, persuades just too many individuals and investor groups to chase high risk yield, many of whom either do not understand the risk in the first place, or who become mesmerised for some odd reasons, GREED in many forms being just one. When the Wile E. Coyote (the cartoon character who falls off a cliff) moment strikes former Fed chairman Ben Bernanke's phrase for the next downturn, which he put at 2020, it is then we will see who has been swimming naked.

   So, my investment view is to sharply reduce any debt you may have and build cash. Keep the availability of that debt to pick up the pieces as Wile E. hits the bottom. Do NOT use margin debt, as you may then end up just as splattered as Mr. Coyote. The conservative investor may simply opt for cash, and my golden rule is to go no more than 50% liquid, and make sure you are holding quality assets. Capital gains tax considerations may dictate holding far larger percentages of your quality portfolio, which is always an option. Quality, in terms of modest debt and a strong, enduring business, is critical.

5. In many ways, I feel the bear market has already started. A broad array of non-resource stocks is well down on their highs…dividend favourites such as the banks and Telstra stand out, as do some high PE stocks such as Ramsay Health Care (the culprit here, slower earnings growth). (I own banks shares, Telstra and Ramsay). Strength in BHP and Rio disguise broad weakness in the non-resource sector, just as the FAANGS (Facebook, Amazon, Apple, Netflix, and Google) perform a similar role in the US market. There can be quite a considerable bear market downturn before the Wile E. Coyote moment strikes. I feel Bernanke is pointing to the round of disasters, which mark the worst of the downturn, often the low point in asset markets.

6. The 10-year and 30-year bond yields have gone as low as they can, I would think, and apart from a rally during the bear market, driven by a flight to safety, I think the longer term holds out for a, hopefully gradual, upward swing in yields.

7. Long-term bull? Essentially quality asset valuations at least keep in line with inflation over the decades, some beat it handsomely. The US Defence umbrella is the other equally important mainstay. M