Client Ready

OUTSIDE THE FLAGS

Jim Parker
Vice President
Dimensional Fund Advisors

July 2018

Many Happy Returns

As a new financial year gets underway in Australia, the media tends to be full of outlooks about what investors can expect for the coming 12 months. These pieces are often entertaining to read, but can be even more so a year later.

Given Australians' large exposure to the housing market, a perennial talking point in the business pages is the outlook for official interest rates. And market economists employed by financial institutions are always ready with an opinion.

Fairfax Media in early July last year featured a survey of 26 economists about their expectations for interest rates, alongside their forecasts for the Aussie dollar, shares and the economy generally in the 2017/18 financial year.[1]

Of the sample, five predicted the Reserve Bank of Australia would *cut* rates, another five expected an *increase* in rates and the remaining 16 expected no change. As it turned out, cash rates remained at 1.5% throughout the financial year.

The panel of economists also warned that Australia faced a one-in-five chance of falling into recession, most likely due to a sharp fall in domestic property prices or a weakening in the Chinese economy.

As it turned out, the Australian economy accelerated through the year, with investment rising, commodity prices boosting incomes and employment growing strongly, according to the RBA's most recent policy announcement.[2]

Economists on average forecast the Australian dollar to fall from 77 US cents to 72 US cents over the year. What transpired was that the currency moved in an eight-cent range between 73-81 cents before ending 2017-18 at 74 US cents.

Where the economists really came unstuck, though, was on the share market. For the S&P/ASX-200 index, the consensus forecast was a meagre rise for the year of less than 2%. The most pessimistic respondent foresaw a slide of 12%.

But the Australian share market in fact gained 8% in price terms for 2017/18 or about 13% on a total return basis. This represented the most optimistic individual forecast from the panel of economists and came despite weakness in traditional market leaders like Telstra and the major banks.

Offsetting the weakness in those sectors were big gains in areas like energy, materials, consumer staples, healthcare and information technology. Individual strong performers included Santos, BHP Billiton, CSL and Flight Centre.

1. 'The Year of Muddling Through', Economic Survey, Fairfax Media, 1 July 2017.
2. Statement by the Governor, Reserve Bank of Australia, 3 July 2018.

While the panel also had doubts about the global market outlook, there were double-digit returns in major overseas developed markets, including the US, the UK and Japan. The MSCI World-ex Australia index rose more than 15% over the year.

It's a tough business being a market forecaster and, to be fair, economists polled by the media tend to add a lot of qualifications to their baseline assumptions.

But it just goes to show that basing your investment strategy on what the gurus expect probably isn't going to be a sustainable approach. Sometimes they get it right. More often they get it wrong. And the ones who do pick the market movement tend to change from year to year. Who are you going to back?

A better strategy is to build a diversified portfolio with exposure to many countries, sectors and stocks. Add an exposure to bonds, listed property and cash – and you are providing a cushion for the inevitable bumps along the way.

Finally, exercise discipline and change your allocation according to what's going on in your life, not what's being projected in the news pages.

Many happy financial year returns!

"Outside the Flags" began as a weekly web column on Dimensional Fund Advisors' website in 2006. The articles are designed to help fee-only advisors communicate with their clients about the principles of good investment—working with markets, understanding risk and return, broadly diversifying and focusing on elements within the investor's control—including portfolio structure, fees, taxes, and discipline. Jim's flags metaphor has been taken up and recognized by Australia's corporate regulator in its own investor education program.

For more articles, visit Dimensional's client site at my.dimensional.com/insight/outside_the_flags

This article has been prepared and is provided in Australia by DFA Australia Limited (AFS Licence No.238093, ABN 46 065 937 671). The article is provided for informational purposes only. Any opinions expressed in this article reflect the authors judgment at the date of publication and are subject to change. No account has been taken of the objectives, financial situation, or needs of any particular person. Accordingly, to the extent this material constitutes general financial product advice, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to the investor's objectives, financial situation, and needs. This is not an offer or recommendation to buy or sell securities or other financial products, nor a solicitation for deposits or other business, whether directly or indirectly. ©2018 Dimensional Fund Advisors LP. All rights reserved. Unauthorised copying, reproducing, duplicating, or transmitting of this material is prohibited.