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Market Update

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MARCH 2019

- The US economy is generally performing well, although recent GDP and PMI figures indicate growth is slowing, and February's payroll numbers disappointed.
- Much of the bad news coming from China appears to have been priced in, with markets largely unperturbed by the latest downward move in China's growth target.
- Markets appeared satisfied with the direction of US-China trade talks, but uncertainties remain for the global trade situation, which may be exacerbated by Brexit.
- Australia's RBA has signalled a more neutral stance on monetary policy, with markets now pricing in a rate cut by the end of November 2019.
- While unlikely to be as significant as previous measures, China has begun to implement more serious fiscal and monetary stimulus to combat slowing growth.

February market performance

Equity Markets - Index Returns *	Index	At Close 28/02/2019	% Return 1 Month	% Return 12 Months
Australia	S&P/ASX 200 Index	6168.99	5.98%	7.05%
United States	S&P 500 Index	2784.49	3.21%	4.68%
Japan	Nikkei 225 Index	21385.16	3.02%	-1.10%
Hong Kong	Hang Seng Index	28633.18	2.71%	-3.84%
China	CSI 300 Index	3669.37	14.64%	-6.75%
United Kingdom	FTSE 100 Index	7074.73	2.29%	2.15%
Germany	DAX 30 Index	11515.64	3.07%	-7.40%
Europe	FTSE Eurotop 100 Index	2838.18	4.53%	2.93%

Property - Index Returns *	Index	At Close 28/02/2019	% Return 1 Month	% Return 12 Months
Listed Trusts	S&P/ASX 200 A-REITS	1477.90	1.75%	18.86%

Interest Rates	At Close 28/02/2019	At Close 31/01/2019	At Close 28/02/2018
Australian 90 Day Bank Bills	1.87%	2.06%	1.79%
Australian 10 Year Bonds	2.10%	2.24%	2.81%
US 90 Day T-Bills	2.43%	2.38%	1.65%
US 10 Year Bonds	2.72%	2.63%	2.86%

Currency**		At Close 28/02/2019	% Change 1 Month	% Change 12 Months
US dollar	AUD/USD	0.71	-2.38%	-8.89%
British pound	AUD/GBP	0.54	-3.45%	-5.32%
Euro	AUD/EUR	0.62	-1.81%	-2.26%
Japanese yen	AUD/JPY	79.03	-0.14%	-4.97%
Australian Dollar Trade-Weighted Index		60.7	-1.46%	-4.56%

* Closing index values are based on price indices. Index returns are expressed as total returns in local currency.
** All foreign exchange rates rounded to two decimal places.
Past performance is not a reliable indicator of future performance.

Global economies

Backtracking from central banks and a move away from a tightening bias has given markets a reprieve, along with positive developments in trade negotiations between the US and China. However, the recent rally in shares has been in contrast to softer economic data and downgrades in growth and inflation forecasts, pointing to a loss of momentum in global economies.

US

An apparent 180-degree shift in the Fed's thinking since the end of 2018 has markets believing that the Fed is done hiking rates for this cycle and that the next move is likely to be down. GDP growth appears to have moderated, with the initial estimate for the December quarter (released a month late due to the government shutdown) recording an annualised 2.6%, down from the 3.4% outcome in the September quarter. The extremely weak retail sales data for December (also released late and most likely also impacted by the uncertainty) dragged down overall growth estimates. Initial claims for unemployment insurance also lifted to their highest level since early 2018, with most of the deterioration occurring since September. This is often a good leading indicator for unemployment and equity returns relative to bonds, although the December quarter downturn may well be seen as a temporary blip. The ISM Manufacturing PMI indicates slowing growth in the manufacturing economy over December and the early part of 2019, with the new orders component falling from 58.2 to 55.5 in February, and production falling from 60.5 to 54.8. After strongly beating expectations in January, February's non-farm payroll data showed employment growth grind to a halt during the month, with only 20,000 jobs added compared to an anticipated 181,000.

Europe

Eurozone GDP grew 1.1% year-on-year in the December quarter according to revised data, down from 1.6% in the September quarter, and has fallen from its recent peak of 2.8% over the year to September 2017. Contractions were observed in Greece and Italy (both -0.1%) while German growth was static through the year. The ECB has warned that the slowdown—thought to be temporary—appears to be persisting due to global trade tensions, uncertainty surrounding Brexit, and recent financial market volatility. The German government cut its growth forecast for 2019 from 1.8% to just 1.0%, and there are calls for the government to adopt policies to counteract the slowdown with tax incentives and a speeding up of planning procedures for infrastructure projects. The UK economy grew 1.3% year-on-year in the December quarter but contracted 0.4% in the month of December. The Bank of England has predicted a further slowdown, with a 25% chance of the economy falling into recession by mid-year. Labour leader Jeremy Corbyn has thrown his support behind a second referendum, but the likely outcomes remain either a 'hard' Brexit, with the concomitant risk of disruption to the economy, or some variant of Prime Minister May's compromise plan, which would need to be approved by the parliament before the 29 March deadline.

China

The rate of Chinese growth, already at a 28-year low, continued to slow in the early part of 2019. China's Premier Li Keqiang announced a cut to the country's economic growth target for 2019 to 6.0–6.5%, down on 2018's target of 6.6% and the slowest pace since 1990. From the equity market's perspective, however, much bad news had already been priced in. Some data series seem to have stabilised at lower levels, although data for January and February is difficult to interpret given the impact of the Chinese New Year period. China's official manufacturing PMI fell further in February from 49.5 to 49.2 and remains below 50, while the Caixin PMI improved slightly from 48.5 to 49.9, but again markets appear to have largely anticipated this decline. New bank loans totalled 3.23 trillion yuan in January—perhaps a sign that credit growth is beginning to lift in response to recent monetary policy easing. The challenge for China is that it is attempting to wean itself off its reliance on credit-fuelled investment spending while also targeting a healthy rate of growth. While nowhere near the scale seen in response to the 2015-16 deflation scare, China has begun to step up its stimulus efforts. There have been five reductions in the bank reserve requirement ratio this cycle, as well as tax cuts for households and some industries.

Asia region

Japan's GDP growth for the December quarter was 0.5%, or an annualised 1.9%, better than the initial estimate had suggested and allowing Japan to avoid a technical recession following a contraction of 0.7% in the previous quarter. A landmark trade deal between the EU and Japan came into effect in February, removing almost all tariffs covering around one third of the world's output, and has likely been a determining factor in the decisions of Nissan and Honda to bring production back to Japan. Inflation in the Tokyo region was slightly higher in February, rising from 0.4% in January to 0.6%, while core inflation, excluding food and energy, remained unchanged year-on-year at 1.1%. While beating expectations for the month, price pressures remain weak and are showing little sign of lifting, forcing the Bank of Japan to cut its forecast for core inflation over 2019 to a range of 1.0–1.3%, down from 1.5–1.7%. India's GDP growth for the December quarter was 6.6%—lower than the anticipated 6.8% and down on the 7.0% rate achieved in the September quarter—confirming fears that the economy is losing momentum. While the Reserve Bank of India was comfortable to cut rates in early February ahead of the election, it has been reluctant to revise its optimistic growth forecasts for the economy, with FY19 growth still pegged at 7.4%.

Australia

The most significant development in Australia over the past month has been the RBA's shift in its policy bias from tightening to a neutral stance. Underpinning the change was a downgrade to the RBA's growth forecasts, with GDP growth revised down to 3.0% in 2019 and 2.75% in 2020, while inflation is projected to be 2.0% for 2019 (down from 2.25%) before moving to 2.25% in 2020. These forecasts would not generally imply a need for the RBA to cut rates, but the bank acknowledges risks to the downside, reflecting weakness in China, the downturn in global growth, and the impact of the downturn in housing. After having been relatively optimistic on housing over recent years, the RBA is now more focused on the risks faced by the household sector, particularly the potential for a negative wealth effect on consumption and a downgrade in residential investment growth. Markets, however, have gone one step further and are now fully pricing in a cut in the cash rate by November 2019. The 22% decline in dwelling approvals over the past year is consistent with a 10% fall in the overall dwelling investment component of GDP, with a lag of around nine months. At more than 6.0% of GDP, this type of decline in dwelling investment would make it extremely difficult to achieve trend growth.

EQUITY MARKETS

- The S&P/ASX 200 Index rose 6.0% in February and by early March was fully recovered from the sell-off in the December quarter.
- The US S&P 500 Index rose 3.2% in US dollar terms as markets took comfort from a more dovish Fed.
- Europe's broad STOXX Europe 600 Index gained 3.4% in February, with the German DAX rising 3.1% and the French CAC 40 Index up 5.0%.
- In Asia, Japan's Nikkei 225 Index rose 3.0% and China's CSI 300 Index rose 14.6% as trade fears faded.
- Global developed market shares outside Australia rose 5.5% in Australian dollar terms while emerging market shares gained 2.8%.

Australian equities

Equity	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 200 Acc. Index	5.98%	7.05%	12.96%	7.30%	10.18%
	S&P/ASX 50 Acc. Index	6.06%	8.28%	12.58%	6.57%	10.23%
	S&P/ASX Small Ordinaries Acc.Index	6.78%	3.48%	13.77%	7.73%	4.70%

Australian shares have been marching higher since the end of 2018, with the S&P/ASX 200 Index returning 10.1% over January and February, and in price terms now fully recovered since the start of the sell-off in October 2018. February's gain of 6.0% was extended through the first week of March, with the Energy (+7.9%) and Information Technology (+7.6%) sectors once again performing strongly over the month. But it was the Financials sector (+9.1%) that was the real driver of returns, with the recovery in banks and insurance providers also offering a boost to asset managers. February's earnings season was mixed but generally beat expectations. There are signs that falling house prices and ongoing low wages growth are affecting retail businesses, with Coles Group (-9.4%) under pressure after reporting a 14% fall in half-year profit (despite the initial success of its Little Shop campaign in the first half). Blackmores (-27.7%) was the hardest hit in the Consumer Staples sector (-1.5%), with investors clearly disappointed by the flat NPAT result, which was affected by Chinese market weakness. Meanwhile, Australia's tech darlings have continued their inexorable rise, with Appen (+46.7%) thoroughly beating its earnings guidance and Afterpay Touch Group (+15.9%) likely to be largely unaffected by the Senate's inquiry into the 'buy now, pay later' sector.

Investment Index/ Benchmark returns*

S&P/ASX 200 Index

Sector	1 Month	3 Months	1 Year
Financials ex-Property	9.10%	5.49%	-1.65%
Energy	7.91%	17.93%	14.92%
Information Technology	7.59%	12.89%	22.08%
Consumer Discretionary	6.56%	9.21%	4.38%
Materials	6.33%	19.85%	14.74%
Industrials	6.32%	9.43%	12.40%
Communications	4.31%	6.81%	-2.59%
Utilities	3.93%	13.34%	11.41%
Property	1.75%	9.86%	18.86%
Health Care	1.01%	7.95%	13.28%
Consumer Staples	-1.53%	2.73%	3.84%

*Total returns based on GICS sector classification

BIG MOVERS THIS MONTH

Going up

⇑ Financials ex-Property 9.1%

⇑ Energy 7.9%

⇑ Information Technology 7.6%

Going down

⇓ Consumer Staples -1.5%

Global Equities

Equity	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Global	MSCI World Ex Australia Index (AUD)	5.51%	10.28%	12.57%	11.65%	15.96%
	MSCI World Ex Australia Index (LCL)	3.27%	2.42%	12.27%	8.09%	10.57%
	MSCI World Ex Australia Small Cap Index (AUD)	6.28%	8.96%	13.76%	11.08%	16.63%
Emerging	MSCI Emerging Markets Index (AUD)	2.67%	-1.10%	15.17%	9.01%	8.46%
	MSCI AC Far East Index (AUD)	3.73%	-0.44%	12.63%	10.77%	12.46%

The global market rally continued apace in February and has extended into March, with the risk-on environment supported by a shift in central bank bias away from further tightening. While volatility remains elevated, it has eased significantly since December's spike. China's CSI 300 Index rose 14.6% in February on the back of stimulus efforts and an easing in trade tensions. While China was forced to cut its economic growth target, this did not come as a great shock to the market, although hopes still hinge on the efficacy of China's stimulus measures. The US S&P 500 Index rose 3.2% in February, with the biggest gains coming from the Information Technology (+6.6%) and Industrials (+6.1%) sectors. While there are still some areas of contention, including the treatment of intellectual property, progress appears to be made on a trade deal between the US and China, which has supported equities markets. However, German auto manufacturers are now the ones in the firing line, with President Trump threatening tariffs of up to 25% on German car imports. The UK's FTSE 100 Index rose 2.3% in February but ended the month on shakier ground as uncertainty surrounding the Brexit outcome intensified ahead of the March deadline, with a number of moving parts making it difficult for markets to track the likely success of any new deal brought before parliament.

Property

Property	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 200 A-REIT Acc. Index	1.75%	18.86%	8.38%	13.00%	14.45%
Global	FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)	0.30%	15.31%	9.06%	9.08%	11.07%

The S&P/ASX 200 A-REIT Index returned 1.75% in February, building on January's gains but underperforming most other ASX sectors. Amazon continues to be a boon for industrial REIT Goodman Group (+9.8%)—Amazon's biggest landlord in Australia, Asia and Europe—which delivered stronger than expected earnings and lifted its full-year EPS guidance 9.5% to 51.1 cents per share. Themes such as a weaker housing sector, ongoing low wages growth, and the rise of Amazon continue to affect retail-exposed A-REITs, including Vicinity Centres (-5.8%) and Scentre Group (-2.5%), which both fell after releasing earnings in February. Globally, REITs returned 15.3% in Australian dollar hedged terms over 2018, but in US dollar terms they were down 5.6%. The sector delivered modest gains as global growth and reflation expectations unwound through 2018 and investors sought defensive assets with resilient income streams. For US investors, global REITs are attractive given that they have been strongly negatively correlated with tech stocks, offering some protection from those feeling over-exposed.

February was a mixed month for US REITs—the Bloomberg US REITs Index returned 0.3% in US dollar terms, with gains from Hotels (+3.9%) and Manufactured Homes (+2.8%) and falls from Healthcare (-3.5%) and Self-Storage (-1.1%).

Fixed Interest

Fixed Interest	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	Bloomberg AusBond Composite 0+ Yr Index	0.94%	6.16%	3.47%	4.70%	4.95%
	Bloomberg AusBond Bank Bill	0.17%	1.99%	1.91%	2.14%	2.46%
Global	Bloomberg Barclays Global Aggregate Index (AUD)	1.90%	8.91%	2.27%	5.50%	7.03%
	Bloomberg Barclays Global Aggregate Index (AUD Hedged)	0.07%	3.65%	3.00%	4.54%	4.98%

Even as equities have rallied, money has still flowed steadily into bond markets, with yields further compressed through February and early March. This is in contrast to the market dynamic at the end of 2018, in which growth shocks and fears over Fed tightening led to a flight to safety, with investors favouring defensive shares and bonds. Globally, bonds gained 1.9% in February in Australian dollar terms, while Australian bonds returned 0.9%. In Australia, the RBA's more neutral stance saw markets price in a 25bp cut in the cash rate by November 2019. The Australian 10-year Treasury yield jumped to 2.19% ahead of the RBA's March meeting before resuming its downward path and remains considerably lower compared to its November peak of 2.76%. Similarly, a more dovish US Fed has resulted in yields trending down—the US 10-year Treasury yield rose from 2.72% to 2.63% in February but continued falling through March. Greece marked a milestone in early March as part of its long road to recovery, selling 10-year debt for the first time since March 2010. Japan's 10-year yield fell to -0.05% in late February before rising back above zero in early March, while Germany's 10-year Bund yield rose from 0.15% to 0.18% before heading south in March as caution set in ahead of the ECB's meeting.

Australian dollar

For the Australian dollar, the outlook is complicated by the conflicting moves in interest rate differentials and commodity prices. With the Fed pausing its interest rate cycle, one might have expected the US dollar to weaken further, however this has been offset by the shift in RBA policy bias. In the meantime, Australia's bulk commodity prices and the terms of trade have strengthened, partly due to one-off factors but also due to the ongoing global expansion and improved supply conditions. From a valuation perspective, the Australian dollar is around its PPP level and on a real effective exchange rate basis is sitting near its long-term average.

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