Month in Review

ISSUE DATE: 8-08-2016

Market Moves — as at 31•07•2016

RETURNS (%) P.A.	1 MTH	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR
AUSTRALIAN EQUITIES							
S&P/ASX 200 ACCUMULATION INDEX	6.29	6.88	13.67	2.37	8.03	9.60	5.49
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	8.57	11.52	22.34	22.29	8.72	2.38	1.98
GLOBAL EQUITIES							
MSCI WORLD TR INDEX (AUD)	2.13	4.23	4.22	-3.25	13.29	16.82	5.48
S&P 500 TG INDEX (AUD)	1.58	6.25	5.43	2.04	17.49	22.05	7.84
FTSE 100 TR INDEX (AUD)	0.65	-1.12	-1.49	-14.11	5.45	10.23	1.65
MSCI EMERGING MARKETS NET TR INDEX (AUD)	2.90	5.58	11.23	-4.11	5.39	4.69	3.99
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 200 A-REIT ACCUMULATION INDEX	5.42	12.03	21.29	24.22	20.92	20.96	3.34
FTSE EPRA/NAREIT DEVELOPED NET TR INDEX (AUD HEDGED)	4.89	9.60	16.60	12.63	13.29	13.08	5.63
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	0.74	3.35	4.47	6.42	6.20	6.54	6.69
BLOOMBERG AUSBOND BANK BILL INDEX	0.17	0.53	1.11	2.23	2.48	3.05	4.32
BARCLAYS GLOBAL AGGREGATE TR INDEX (AUD HEDGED)	0.70	3.27	5.69	8.79	7.59	7.58	8.01

Data source: IRESS & Financial Express. Returns greater than one year are annualised.
Commentary regarding equity indices below references performance without including the effects of currency (unless specifically stated).

Australian equities

The Australian market enjoyed a post-Brexit rally in July, with the S&P/ASX 200 Index moving up to 5562.36 points, the highest level since August 2015. Returns on Australian equities, as measured by the S&P/ASX 200 Accumulation Index, were a solid 6.29%, with all sectors gaining. The largest gains came from the Consumer Discretionary (8.84%), Consumer Staples (8.52%) and Materials (7.78%) sectors, with upside earnings from Myer and Bluescope, while mining services company Monadelphous has almost doubled in value since February following a three-year slump. The Energy sector managed only a modest gain of 0.15%, although the exception was Whitehaven Coal, which gained 56.74% after announcing record coal production.

Small cap returns, as measured by the S&P/ASX Small Ordinaries Accumulation Index, was 8.57% in July, with small shares remaining the strong outperformers over 12 months, returning 22.29%. Earnings season is upon us, with aggregate EPS for FY 2016 expected to fall by -9.0%, which will mean the second of negative EPS in a row. However, aggregate figures are misleading given the resources sector continues to weigh on the market, and EPS growth ex-resources is a respectable 5.0%.

Global equities

Global markets have entered a period of calm in July following the June Brexit storm, with a series of global events – including terror attacks in Europe, a failed coup in Turkey, and China's South Sea intervention – failing to produce any real anxiety in global share markets. Indeed, the CBOE Volatility Index (VIX) hit a two-year low during the month – a remarkable 54% drop from the 24 June spike.

The S&P 500 TG Index returned 1.58% in July, while the FTSE 100 TR Index returned 0.65%, after a month of intense volatility in June both leading up to and following the Brexit referendum. The MSCI Emerging Markets Net TR Index returned 2.90%, with no evidence of Brexit contagion, while the German DAX recovered from its June stumble, gaining 6.79%. In Asian markets, the Nikkei 225 Index gained 6.38% in July, while the Shenzhen CSI 300 Index rose 1.59%.

The first morsels of UK and European data post-Brexit have come in the form of July PMI figures, which have painted a diverging picture. Eurozone service and manufacturing PMIs both indicate expansion, with index values around where they were in June. In contrast, the UK services PMI has fallen from 52.3 to 47.4, while the manufacturing PMI has fallen from 52.1 to 48.2. While only one measure of economic activity, this is certainly not an ideal sign.

REITs

The S&P/ASX 200 A-REIT Accumulation Index returned 5.42% in July, with the RBA's August rate cut likely to drive returns, and expected further easing from central banks is likely to prop up the yield trade for some time yet. Concerns remain about excessive gearing and overpricing in some cases, driven by persistently low interest rates. The RBA has indicated that it believes the housing market will slow, especially as the new supply of apartments impacts the major cities. For now, though, with interest rates low and potentially moving lower, the A-REIT market remains in rude health.

Globally, REITs returned 1.72% in July (in AUD hedged terms), while the FTSE EPRA/NAREIT Developed NR Index gained 4.89%.

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In the US, REITs returned 4.20% (in USD terms), with the market under no immediate threat from an interest rate hike and fundamentals largely positive, with supply still relatively constrained and vacancy rates for commercial real estate at significant lows. In August, real estate will become the S&P 500's eleventh sector, which is expected to create some forced buying from funds currently underweight REITs, as well as interest from investors looking to exploit this move. Dividends remain high, especially in sectors such as health care, and are far outpacing yields on Treasuries, and REITs have benefited from recent Brexit-induced volatility.

Fixed interest

Australian bonds returned 0.74% in July, with the Australian 10-year Treasury yield pushing down from 1.98% to 1.87%, after hitting a new record low of 1.82%. Australian government bonds returned 0.78% during the month, while Australian corporate bonds remained hampered by the flight to safety, returning only 0.57%. Globally, government bond yields underwent further compression in July, benefitting from a Brexit induced flight to quality.

Bond markets are also anticipating more accommodative monetary policy from central banks. The US 10-year Treasury yield fell from 1.47% to 1.45%, while the German 10-year Bund rose modestly from -0.13% to -0.12%. The German government issued 10-year Bunds with a zero percent coupon for the first time in history, raising EUR 4.038 billion at a yield of -0.05%. The New York Fed's William Dudley warned against caution in any funds rate hike, citing "sluggish" GDP growth figures, although no policy tightening in 2016 has been ruled out.

The Japanese 10-year yield came back from an unprecedented low of -0.295% to close the month at -0.195% and rising as market calm returned. Global bonds, as measured by the Barclays Global Aggregate TR Index, returned 0.70% in July (in AUD hedged terms). The return on US corporate investment grade bonds was 1.54% in July, while US high yield debt returned 2.62% as yields moderated. Credit spreads continued to narrow following a brief Brexit spike, with the Bank of America Merrill Lynch US High Yield Option-Adjusted Spread narrowing from 6.21% to end the month at 5.69%, much reduced from its February high of 8.87%.

ASX 200 Share Movements

S&P/ASX 200 Share Performance for the Month of July

BEST PERFORMERS		WORST PERFORMERS	
WHITEHAVEN COAL	56.74%	ASALEO CARE	-35.24%
MONADELPHOUS GROUP	41.15%	SYRAH RESOURCES	-23.62%
BLUESCOPE STEEL	32.65%	CIMIC GROUP	-18.21%
WESTERN AREAS	26.98%	ISENTIA GROUP	-9.51%
FORTESCUE METALS	26.57%	BEACH ENERGY	-9.02%

S&P/ASX 200 Share Performance for the Year to July

BEST PERFORMERS		WORST PERFORMERS	
ST BARBARA	496.04%	LIQUEFIED NATURAL GAS	-100.00%
SARACEN MINERAL HOLDINGS	345.45%	MESOBLAST	-71.57%
REGIS RESOURCES	210.00%	ORIGIN ENERGY	-44.56%
EVOLUTION MINING	182.00%	BEACH ENERGY	-43.08%
APN OUTDOOR GROUP	160.84%	COVER-MORE GROUP	-42.30%

Economic News

Australia

At its 2 August meeting, the RBA decided to lower the cash rate by 25 bps to 1.50%, marking yet another record low. Since it began its cutting cycle in November 2011, the RBA has brought the cash rate down from 4.75%, and has kept it below 3.00% for 38 consecutive months (3.00% was the lowest level rates hit during the 'emergency lows' of the GFC). Weak inflation figures and emerging downside risks in the global economy led to the decision, with the Bank noting that labour costs remain very subdued, while the underlying pace of China's growth continues to moderate.

The CPI figure for the June quarter recorded 1.0% y/y across all groups, and reinforcing the RBA's concerns about weak price growth following the March quarter figure of 1.3%. Given that the underlying rate, which removes the impact of volatile items, is also very low at 1.6% (well below the 2–3% target), along with the low cost pressures globally, the RBA would appear justified in its determination to provide support to prices. The unemployment rate increased slightly in June to 5.8%, up from 5.7% in May, with the number of unemployed persons rising by 9,900 in seasonally adjusted terms, although there was an encouraging gain in full-time employment of 38,400.

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The participation rate rose only marginally to 64.9%, while monthly hours worked decreased by 4.3 million hours. While labour market conditions have generally been reflective of expansion over the near term, indicators have been mixed in recent months, including falls in full-time employment.

Retail turnover rose 0.1% in June in seasonally adjusted terms, following a rise of 0.2% in May and weaker than the anticipated 0.3% gain. There was a large increase in the clothing group (3.5%) and a significant bump in department stores (0.7%), but this was offset by falls in the major food retailing group (-0.6%). The retail sector has showed little momentum heading into the new financial year, adding to concerns that June quarter GDP will show a significant weakening.

The Westpac Melbourne Institute Index of Consumer Sentiment fell by 3.0% in July from 102.2 in June to 99.1 in July, driven predominantly by global uncertainty, including Brexit, despite financial markets becoming more settled at the time of the survey. The August rate cut will likely see a bounce back in sentiment, with the May cut resulting in a surge in the index of 8.5%.

Australia's trade deficit blew out to $3.195 billion in June, far above the market's estimate of a non-trivial $2 billion. Boosts in consumption and capital goods imports might be seen as a positive sign for the economy, but the recent persistence in large trade deficits may raise some concern for investors, with the current account to GDP ratio hitting -4.6%.

Global

The United States is still showing signs of sustained growth, but the question remains how long the US consumer can keep the economy going. Non-farm payrolls recorded an additional 255,000 jobs in July, well in excess of the expected 180,000 and putting to bed any question of an abrupt slowdown in the labour market. Despite weaker GDP growth, the manufacturing economy remains in expansion, and the Fed remains in an accommodative frame of mind.

US Q2 GDP grew at an annual rate of 1.2%, according to the BEA's advance estimate, below the market's expectation of 2.6%. Q1 GDP, estimated at 1.1%, was revised down to 0.8%. The Q2 figure reflected strong growth in personal consumption expenditure as well as a boost in exports, offset by negative contributions from private inventory and fixed investment, and state and local government spending. While the US consumer appears in rude health, weakness from other components is making for a cloudy outlook.

The ISM Manufacturing PMI fell to 52.6 in July, down from June's reading of 53.2 and falling short of expectations. However, manufacturing remains in the fifth consecutive month of expansion, with new orders and production still growing strongly, and hope that the gradual improvement in the manufacturing economy will allow the US to emerge from a weak first half.

On 27 July the FOMC again decided to leave the federal funds rate within the 0.25–0.5% range. The labour market outlook has firmed since the shock payrolls result in May, and indicators point to greater labour utilisation. Household spending continues to grow strongly, but there are still concerns about persistent weakness in fixed business investment. While there is no expectation of a rate hike in 2016, the Fed has not ruled it out, with some members split on the timing of future increases.

US inflation continues to run below target, with consumer prices rising at an annual rate of 1.0% in June, which remains steady on the previous month. Energy prices continue to rise steadily following large declines at the start of the year, especially in the price of gasoline. The Board expects that consumer prices will move back in line with the 2% target over the medium term. US retail sales grew a healthy 0.6% in June, with consumers continuing to push the economy forward. Large gains in building material as well as gasoline stations were offset by falls in clothing and food services.

GDP in the euro area grew at an annual rate of 1.6% in Q2, according to the preliminary estimate, with growth failing to take hold following the end of the European recession in 2013. The UK economy grew by an annual rate of 2.2% in Q2 ahead of the Brexit vote, helped by the biggest pickup in industrial production since 1999. However, the construction industry saw a significant loss of momentum in July following the referendum, with the Markit/CIPS PMI Index falling to 45.9.

Euro area inflation is expected to reach an annual rate of 0.2% in July, with June inflation recording 0.1% (0.9% excluding energy). Unemployment in the euro area was steady in June at 10.1%, down from 11.0% on the previous year. The slow pace of employment growth, as well as the very low rates of inflation recorded across the continent, have been a source of much consternation for policy makers.

China's July PMI surveys saw mixed results, with the official gauge slipping unexpectedly into negative territory for the first time since March, while the Caixin figure, which tracks smaller-scale private firms, rose to 50.6, compared to an anticipated 48.7 – the first time the indicator has pointed to expansion since February 2015. July also saw the release of Chinese Q2 GDP, which remains steady at an annual rate of 6.7%, compared to an expected fall to 6.6%.

In other emerging markets, Brazilian inflation fell from an annual rate of 9.3% to 8.8% in June, reduced from its February high of 10.7%. Unemployment remains high, rising slightly from 11.2% to 11.3%. Russian inflation grew at an annual 7.2% in July, down from 7.5% in June, while unemployment fell from 5.6% to 5.4%. Indian data was sparse in July, with inflation growing at an annual rate of 5.8% in June.

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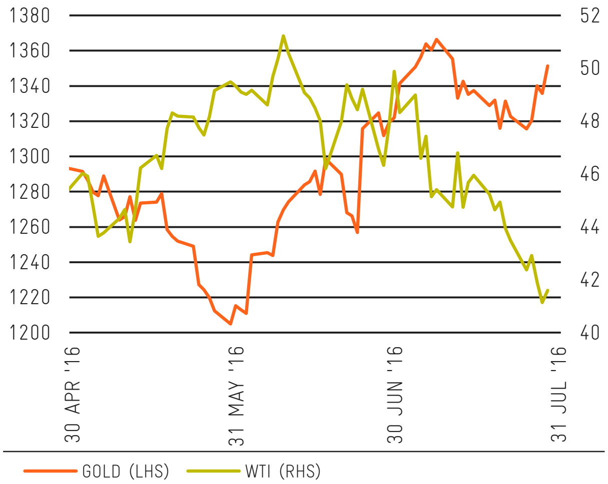
Commodities

July saw mixed results from commodities, with oil falling on supply concerns, including a rising rig count in North America, Nigeria and Libya. Gold, on the other hand, rallied on longer-term structural and political concerns, as well as the risk of devaluation in key currencies (EUR, JPY and CHY), hitting a three-year high.

Gold versus WTI crude oil (USD)



Source: Bloomberg

The Brent crude oil spot price plunged from US $48.42/b to US $41.01/b (-15.3%) while WTI crude fell from US $48.33/b to US $41.60/b (-13.9%). Metals were up strongly in July, with Copper (1.7%), Lead (2.0%), Nickel (12.6%), Tin (4.7%) and Zinc (6.6%) all gaining strongly, while Aluminium was down slightly (-0.3%). Gold continued its rally following the Brexit vote, finishing July 2.2% higher at US $1351.28/oz.

Iron ore rose after a weak month in June, with the price of iron ore delivered to Qingdao in China rising from US $55.66 to US $59.37 (6.7%), still much reduced from its April speculative high of $70.46. Iron ore rallied again following the boom-bust of April and May, with Chinese mills hitting record daily rates of steel production that have produced a tighter market.

Currencies

The AUD rose 1.3% in July in trade weighted terms, gaining 2.0% against USD, but falling against other major currencies, including EUR (-1.3%), JPY (-0.8%), GBP (-2.5%) and NZD (-1.0%). The AUD lifted against the USD early in the month as US sentiment eased, but pulled back following more bullish data and higher expectations of a Fed rate hike.

The US Dollar Index closed July slightly lower (-0.6%), gaining against GBP (0.6%) but down against other major currencies, including EUR (-0.6%), JPY (-1.1%) and CHF (-0.7%). Following a collapse in the GBP of -13.2% against the USD after the Brexit vote, the Sterling found some stable ground around USD 1.31.

China broke its pledge to maintain a stable exchange rate, embarking once again on a systematic devaluation of the CNY, despite criticism from within the Chinese government that economic fundamentals are strong, including steady GDP growth of 6.7%. China's devaluation has reignited concerns that a depreciating Chinese currency could see deflation exported to other markets.

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