

Month in Review

Index returns at end July 2019 (%)

	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
Australian Equities							
S&P/ASX 200 Accumulation Index	2.94	8.58	18.66	13.26	11.68	8.55	9.56
S&P/ASX Small Ordinaries Accumulation Index	4.51	4.15	15.65	7.61	9.27	9.18	5.86
Global Equities							
MSCI World TR Index (AUD)	2.35	3.24	15.77	12.40	14.71	14.30	12.58
S&P 500 TG Index (AUD)	3.28	3.84	17.77	16.47	17.11	18.20	16.19
FTSE 100 TR Index (AUD)	0.14	-0.98	9.91	2.97	9.07	6.10	7.88
MSCI Emerging Markets NR Index (AUD)	0.57	-0.61	6.25	5.51	12.01	8.13	6.54
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	2.61	9.35	15.33	21.34	7.49	13.30	14.06
FTSE EPRA/NAREIT Dev. NR Index (AUD Hgd)	1.01	1.63	4.68	7.82	4.11	7.44	12.00
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	0.95	3.73	6.92	10.44	4.30	5.20	6.04
Bloomberg Ausbond Bank Bill Index	0.12	0.40	0.91	1.90	1.84	2.06	2.97
Barclays Global Aggregate TR Index (AUD Hgd)	0.69	3.39	5.26	7.95	3.14	4.90	6.54

Data source: Bloomberg & 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

Australian shares lifted in July on the back of improving global sentiment as trade negotiations between the US and China appeared to be heading in a positive direction and central banks stepped in to offer support to address the ongoing uncertainty. This narrative quickly fell apart at the start of August as trade negotiations again broke down, sending the ASX tumbling -4.3% over the first week. Consumer Staples (+9.8%) led the gains in July, with the China-exposed A2 Milk Co (+23.6%) and Bellamy's (+21.5%) the major beneficiaries, although these gains were partly reversed in the first week of August with falls of -7.7% and -10.0% respectively.

Health Care (+5.9%) was another top performer, with gains from Resmed (+10.7%) and biotech giant CSL. Expectations for aggregate FY19e EPS growth have continued to drift lower over the course of this calendar year and there has also been a stark contrast between super sector earnings outlooks with a positive pulse seen in Resources, declines off low bases for Banks, and sharper deceleration for Industrials. Uncertainty and volatility are expected to remain in global markets, with ramifications for Australian shares, as central banks continue to drive speculation surrounding additional global monetary policy support.

Global equities

Global shares finished modestly higher in July but positive signs from trade negotiations and the strong expectations of rate cuts could not sustain the previous month's momentum. The MSCI World Ex Australia Index rose 2.4% in Australian dollar terms and 1.2% in

local currency terms but this was quickly reversed through early August with news that the US and China had again walked away from negotiations. In the US, the S&P 500 Index was lifted to an all-time high of 3,025 points late in the month, only to be undone by the subsequent falls in global markets. Chinese equities made only modest headway in July and remain under pressure as the US's trade actions take their toll. Meanwhile there are reports of US corporates rejigging their supply chains to avoid the tariffs on Chinese goods, with Vietnam emerging as a potential early winner.

The US market remains the bright spot for global investors, with July seeing further gains in the key Information Technology (+3.2%) and Communications (+3.0%) sectors, although there are still concerns that valuations are stretched. Europe remains mired in disappointing economic data and persists as a deep value play. The ECB's willingness to dole out stimulus might provide a cushion and support shares, but volatility should be expected with Brexit negotiations set to ramp up once again under Britain's new prime minister Boris Johnson.

REITs

Listed property is benefiting from the hunt for yield spurred by the low rate environment, with the S&P/ASX 200 A-REIT Index gaining 2.6% in July, adding to its stellar performance over the past 12 months. Despite a beaten down retail sector there were solid gains from shopping centres, with Stockland (+9.6%) topping the leaderboard, followed by Vicinity Centres (+4.5%) and Scentre Group (+3.9%). Real asset sectors globally have

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Month in Review

benefited in calendar 2019 with expectations swinging around to lower interest rates, and in Australia the RBA having cut the official rate twice (from 1.50% to 1.00%). In this environment, the sector continues to attract capital, which is underpinning high valuations and reflecting lower yields. Nonetheless, fundamentals are supportive, with rental and earnings growth continuing in most sectors across the globe.

In Australia, there has been a surge in wholesale money looking to redeem from retail property funds and listed property funds are also putting non-core retail assets on the market. Meanwhile Australia's residential housing market looks to be past the worst as prices rose nationally for the first time in June. Rising auction clearance rates and low cash rates are starting to reverse buyer sentiment, but with low supply and lending still questionable, a strong rebound in prices may be too much to hope for.

Fixed income

The rise in bonds continued through July in stark defiance of investors who called a fade to the rally in late 2018 when the US Fed appeared determined to

continue along its tightening path. The US 10-year Treasury yield has dropped from a rate of 3.24% in November 2018 to 1.71% at the time of writing, while the 30-year yield has seen a similar decline, amounting to an almost 40% rise in the value of long-duration Treasury bonds. The bond market continues to track a deterioration in global growth, but so far there are few signs that more aggressive action is required by the Fed. In Australia, the 10-year Treasury yield fell from 1.32% to 1.19% over July.

Looking forward, low inflation remains a key issue, as does spare capacity in the labour market. Domestic bonds have rallied significantly in recent months on the back of two RBA cuts and weakening economic data. Credit remains popular with active managers still favouring a bias to corporate bonds within portfolios, albeit bell-ended with more defensive positioning in sovereign bonds or cash-like assets. Emerging markets are an attractive option for investors seeking yields well beyond what is on offer in other developed markets, with many active managers choosing to utilise a portion of their risk budget in these types of assets.

ASX 200 share movements

S&P/ASX 200 share performance for the month to July

Best performers	
Resolute Mining	32.96%
St Barbara	25.85%
a2 Milk Co	23.61%
Bellamy's Australia	21.54%
Magellan Financial Group	21.33%

Worst performers	
SpeedCast International	-45.83%
CIMIC Group	-18.05%
AMP	-15.57%
Pilbara Minerals	-13.76%
Adelaide Brighton	-12.38%

S&P/ASX 200 share performance for the year to July

Best performers	
Appen	182.78%
Clinuvel Pharmaceuticals	163.24%
Magellan Financial Group	150.73%
Austal	136.84%
nearmap	124.67%

Worst performers	
SpeedCast International	-69.60%
Galaxy Resources	-55.09%
Eclipx Group	-52.77%
Costa Group Holdings	-49.56%
CYBG	-48.84%

Economic News

Australia

The minutes from the RBA's July meeting noted that low wages growth and spare capacity in the labour market meant there was room for the bank to cut rates. The underemployment rate in May was 8.6%, barely below the level seen in 2014 when the unemployment rate was more than 1.0% higher at 6.5%. The participation rate is now at a record 66.0%, up from 64.5% in 2014. Perhaps the RBA has been too focused on the employment growth data, which has surpassed

expectations over recent years, and has risen 2.6% in trend terms over the past year to June. Meanwhile, GDP growth is just 1.8% p.a., suggesting productivity growth is negative. Indeed, GDP per capita has been negative for the past three quarters, in what could be described as a GDP per capita recession. On the positive side, Australia's commodity prices remain firm and the mining sector is experiencing a 'mini-boom'. Iron ore moved to above US\$120 per tonne, and with export volumes strong, China accounted for over 40% of Australia's exports of goods. The 2019-20 federal budget assumed a US\$88 per tonne iron ore price, below

Month in Review

current prices with every US\$10 above forecast adding around \$4 billion to the budget surplus.

Employment growth was flat in June but in trend terms remains robust, growing 2.6% over the financial year, although the growth has come predominately from part-time jobs. The participation rate held at 66.0% in June while the unemployment rate was steady at 5.2% and monthly hours worked saw a small decline. With the unemployment rate stabilised, the RBA may hold off on further cuts for now.

The **AIG Manufacturing Index** edged back into expansion in July, rising 1.9 points to 51.3. Local demand for Australian manufactured products remains weak but overseas demand remains strong, particularly for consumable manufacturing products. New orders (+3.2 points to 53.0) and employment (+3.1 points to 53.2) both bounced back, while production (-3.6 points to 48.3) fell into contraction and sales (-8.1 points to 42.7) suffered a large pull-back.

The Westpac Melbourne Institute **Index of Consumer Sentiment** fell 4.1% to 96.5 in July, moving below the 100 level and indicating that pessimists now outnumber optimists, even as interest rates fall and the government's tax cuts are legislated. Not even a pause in trade hostilities and signs that the property market may be stabilising were enough to lift consumers' spirits. The survey noted that increasing concern about the economy is undermining consumers' sense of job security, with confidence in the labour market deteriorating sharply in July.

Retail activity grew 0.4% in June in seasonally adjusted terms, driven by large rise in clothing (+2.0%) and solid growth from cafes and restaurants (+0.5%), household goods (+0.2%) and food retailing (+0.1%). Despite a promising end to the financial year, this was worst annual result for the retail sector since the 1991 recession, with growth of only 0.2%.

Australia's **balance on goods and services** added \$1,863 million in June, bringing the surplus to \$8,036 million, helped by an upward revision to the previous month's result. Net exports of general merchandise delivered a \$2 billion windfall, while exports of metal ores and minerals added \$554 million, boosted by the rise in commodity prices.

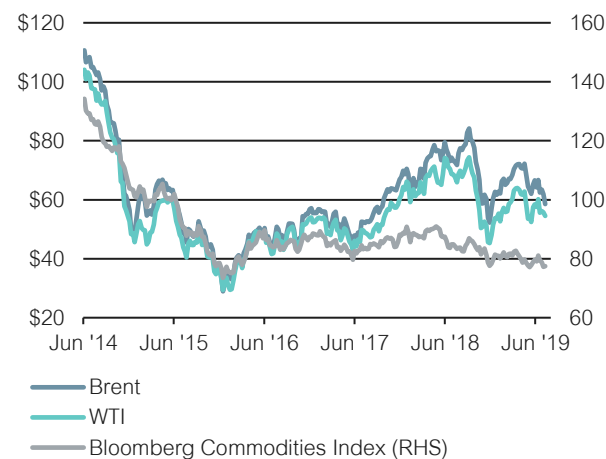
Global

Markets enjoyed a short-lived reprieve from the US-China trade conflict in July, but economic data points to a further slowing in the global economy. The **US Federal Reserve's** recent rate cut appears justified given the re-emergence of trade tensions, with the US administration threatening 10% tariffs on the remaining \$300 billion of Chinese goods. The US Fed has finally completed one of the most significant policy reversals in recent history.

After lifting the funds rate towards 2.50% in late 2018 and signalling that there was some way to go with tightening (the FOMC dot plot pointed to a peak of 3.40% in 2021), July's FOMC meeting saw members vote to lower the funds rate to a range of 2.00–2.25%. The pivot in policy over the past six to nine months has been in response to a combination of a slowing US economy, weaker global growth, uncertainties associated with the ongoing trade war, and consistent undershooting in inflation.

In terms of data, the **US ISM manufacturing index** declined to 51.2 in July from 51.7—the lowest reading since August 2016—while the new orders component rose only modestly to 50.8 from a flat 50.0, while the service sector ISM also declined to 53.7 from 55.1. CEO confidence levels have declined for the past five quarters while capex intentions have dropped to their lowest level since early 2017, although these are from elevated levels. Core CPI inflation ticked up a little to an annual 2.1% but the core PCE price index is only 1.6%, and the trimmed mean measures from the Dallas Fed are around 2.0%.

The oil rally has come under pressure



Source: Bloomberg

In Europe, the **IFO Institute's** leading index showed that the mood among managers has weakened to its lowest level in nearly five years. The **IHS Markit Global Business Outlook** fell to its lowest level since 2012 in June, with new orders weakening sharply and business optimism at the lowest level on record. French 10-year bonds joined German bonds to yield a negative rate of return, reflecting expectations of slowing growth and prompting ECB president Draghi to reiterate that the central bank had "considerable headroom" to seek to stimulate the economy in the face of threats to growth, which include tensions over global trade.

Month in Review

Core inflation in the Eurozone fell to 0.9% year-on-year in July from 1.1% and remains in the 0.8–1.2% range that has prevailed since early 2017. The Markit surveys suggest it is more likely to ease than rise, at least in the near term. **Unemployment** in the euro area continues to fall, dropping to 7.5% in June from 7.6%. The rate in each of the main economies is falling on a sustained basis in Germany unemployment is at its lowest level since 1990. In the UK Boris Johnson was handed the prime ministership by his party and will begin negotiations with the EU, calling on Brussels to drop the controversial Irish backstop from the withdrawal agreement.

Chinese data over the past month has been mixed but generally in line with expectations. **GDP growth** in the June quarter slowed to 6.2%—the lowest level since 1992— and the July manufacturing PMI readings are both holding below the critical 50 level, while the service sector PMI fell to 53.7 from 54.2. Industrial production lifted to 6.3% year-on-year in June from 5.0%, and retail sales growth jumped to 9.8% from 8.6%.

A surge in auto sales ahead of a change to emission standards underpinned the improvement. Indeed, consumption spending and the service sector is becoming an increasingly important driver of Chinese growth. From less than half of GDP in 2011, consumption spending is now 54% of GDP while accounting for almost two thirds of growth in 2018 and tax cuts earlier in the year have helped shield the economy from the impact of the trade war.

Chinese exports recorded growth of 3.3% year-on-year in July, firmly beating expectations for a contraction, giving investors hope that the economy may prove resilient to the trade conflict. Money supply growth and the level of outstanding loans and total social financing (total credit) suggests the authorities have attempted to support the economy through monetary stimulus but not anywhere near the scale of previous stimulus phases.

Commodities

The oil rally proved fragile through July, with prices volatile due to growing geopolitical risks including sanctions as well as slowing demand growth and inventory drawdowns. The **Brent spot price** fell -5.1% from US\$67.52 per barrel to \$64.07 while WTI was steady over July at \$58.53. A flare up in trade tensions at the start of August saw oil prices head down. **Metals** were mixed over July, with a large gain in Nickel (+14.2%) and further gains in Lead (+4.0%) while other metals were down including Tin (-8.0%), Zinc (-2.0%), Copper (-1.1%) and Aluminium (-0.1%). Gold continued its climb, rising 1.1% from US\$1409.6/oz to \$1424.6 over July.

Currencies

Despite a rise in commodity prices the **Australian dollar** is under pressure from the narrowing interest rate differential with the US, falling 2.0% in July against the US dollar before hitting a 10-year low of US\$0.667 in early August. The Australian dollar fell 1.0% in trade-weighted terms, losing value against the Japanese yen (-1.3% to 74.72) and gaining against the British pound (+1.9% to 0.56) and euro (+0.2% to 0.62).

Over the three months to the end of July 2019 the Australian dollar has fallen 1.7% in trade-weighted terms, depreciating against the US dollar (-2.4%), euro (-1.6%) and Japanese yen (-4.8%) and risen against the British pound (+4.2%).

Month in Review

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