Month in Review

ISSUE DATE: 10-07-2017

Market Moves — as at 30•06•2017

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	0.17	-1.58	3.16	14.09	6.63	11.81	3.61
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	1.99	-0.35	1.11	7.01	7.13	5.66	-1.88
GLOBAL EQUITIES							
MSCI WORLD TR INDEX (AUD)	-2.54	3.64	4.80	15.38	13.41	18.70	5.62
S&P 500 TG INDEX (AUD)	-2.34	2.52	3.22	14.45	17.46	21.47	8.27
FTSE 100 TR INDEX (AUD)	-4.73	4.34	3.89	10.28	4.37	11.86	1.44
MSCI EMERGING MARKETS NET TR INDEX (AUD)	-1.97	5.69	11.80	20.12	8.31	10.16	2.95
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 300 A-REIT (SECTOR) ACCUMULATION INDEX	-4.51	-3.05	-3.12	-5.64	12.22	14.24	-0.08
FTSE EPRA/NAREIT DEVELOPED NET TR INDEX (AUD HEDGED)	0.49	2.08	3.33	2.22	7.76	11.42	3.40
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	-0.90	1.01	2.25	0.25	4.26	4.32	6.23
BLOOMBERG AUSBOND BANK BILL INDEX	0.14	0.44	0.89	1.82	2.22	2.52	3.89
BARCLAYS GLOBAL AGGREGATE TR INDEX (AUD HEDGED)	-0.22	1.17	1.86	0.47	5.08	5.51	7.52

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 was stuck in neutral through June as local investors experienced an anti-climactic end to what has been an otherwise thrilling financial year. The ASX 200 Accumulation Index managed a meagre 0.17%, led by the Healthcare (+6.11%) and Financial (+1.63%) sectors. Materials, despite being the leader over 12 months (+26.94%) has been trending downwards since the end of January. Sirtex Medical, which had a very forgettable 12 months, was the highest performer in June (+35.53) as investors reacted positively to cost-cutting and a write-off of previous R&D expenditure. Financial sector returns came predominately from non-bank shares, with Magellan Financial Group (+14.54%) and Platinum Asset Management (+8.94%) the top performers.

Over the year to June the Australian market returned 14.09%, underperforming the global index and losing momentum in the final quarter. Australian small cap shares returned 1.99% in June and have under-performed over the year, delivering only 7.01%. The start of 2017 saw a large moderation in small cap resources shares as the outlook for key commodities softened and some exuberance was depressurised.

Global equities

The unstoppable US market finally showed signs of slowing in June. The S&P 500 gained 0.48% in USD terms and pushed to a new record high, but fell 2.34% in AUD terms, with a Fed rate hike unable to stave off US dollar weakness later in the month. Gains came from the Financial (+3.07%) and Healthcare (+1.32%) sectors, with leading student loan servicer Navient (+11.75%) boosted by a rate increase despite a steady rise in delinquent loans, while investment bank JP Morgan (+7.75%) and wealth manager Northern Trust (+7.67%) were also lifted higher. Telecommunications were hit the hardest, with major carriers Verizon (-7.26%) and AT&T (-5.16%) down as key defensive shares sold off.

Globally, the MSCI World Index lost 2.54% in AUD terms, dragged lower by European markets. The Euro Stoxx 600 Index fell 4.31% with the largest falls coming from the Oil and Gas (-7.21%) and Retail (-7.17%) sectors, including losses from major department stores Sainsbury (-12.46%), Marks & Spencer (-12.14%) and Tesco (-10.19%). The German DAX fell 3.90% but remains just off its recent record highs, while the French CAC 40 eased 4.67% during the month following parliamentary elections. In the UK, the FTSE 100 Index fell 4.73% in AUD terms as investors assessed the fallout from the snap general election. In Asian markets, the Nikkei 225 Index fell 2.74% while the Shenzhen CSI 300 Index finished positive at 2.46%. The MSCI Emerging Markets Index fell 1.97%, supported by Chinese and Brazilian shares but pulled down by the Indian market.

REITs

The S&P/ASX 300 A-REIT Accumulation Index had another tough month in June, losing 4.51%. The retail-focused REITs again felt the heat, with Westfield Corporation (-5.31%) and Scentre Group (-4.93%) down, but sharing in in the pain were diversified property groups Abacus (-7.43%), Dexus (-6.33%) and GPT (-6.33%). The best performing A-REITs in June were the higher-yielding units like National Storage Trust (+6.90%), which continues to benefit from rising property prices, Rural Funds Group (+4.55%), which has contracted rental increases of 2.5% or CPI for most of its tenants, and Arena REIT (+3.64%), which is currently providing a yield around 5.45%.

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Global REITs held steady in June, with the S&P Global REIT NTR Index returning 0.63% (in AUD hedged terms), while the FTSE EPRA/NAREIT Developed NR Index managed a modest gain of 0.49% as developed market yields moved higher late in the month. With the Fed now emboldened and the market pricing in one final rate hike for 2017, cap rates and leasing spreads may continue to come under pressure. However, if the tightening path remains on the dovish side, yield-producing asset classes like REITs may continue to be in demand.

Fixed income

Global yields managed to push higher in June, but whether this heralds a resumption of the tightening cycle remains to be seen. The US 10-year Treasury yield rose from 2.20% to 2.31%, shooting higher late in the month. While recent CPI releases in both Europe and the US have been promising, the numbers have moderated in recent months, and core inflation remains below central bank targets. The return on US corporate investment grade bonds was 0.28% in June with the index reaching a new record high, while US high-yield debt returned a very modest 0.04%. The BofA Merrill Lynch US High Yield OAS expanded slightly in June from 3.74% to 3.77% and reaching a high of 3.87% but has been predominately flat since the start of 2017.

Global bonds, measured by the Barclays Global Aggregate TR Index, returned -0.22% in June (in AUD hedged terms) although a number of developed market indices have pushed to record highs. Returns on Australian corporate bonds were -0.54% while government bonds returned -0.70%. The Australian 10-year Treasury yield rose from 2.45% to 2.66% after rocketing 25bps late in the month. The UK 10-year Gilt yield rose from 1.05% to 1.26% in June in the wake of the snap general election. The German 10-year Bund yield rose from 0.30% to 0.47%, while the Japanese 10-year yield rose from 0.01% to 0.08%.

ASX 200 Share Movements

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

BEST PERFORMERS	
SIRTEX MEDICAL	35.53%
ISENTIA GROUP	22.16%
VOCUS COMMUNICATIONS	19.50%
A2 MILK CO	18.24%
METCASH	17.07%

WORST PERFORMERS	
GALAXY RESOURCES	-27.41%
INFIGEN ENERGY	-16.57%
TASSAL GROUP	-15.33%
ACONEX	-12.65%
AVEO GROUP	-12.48%

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

BEST PERFORMERS	
WHITEHAVEN COAL	166.98%
A2 MILK CO	114.86%
QANTAS AIRWAYS	110.94%
BLUESCOPE STEEL	108.79%
SIMS METAL MANAGEMENT	99.88%

WORST PERFORMERS	
VOCUS COMMUNICATIONS	-58.95%
SYRAH RESOURCES	-53.60%
TPG TELECOM	-50.16%
ACONEX	-46.79%
MAYNE PHARMA GROUP	-43.05%

Economic News

Australia

At its July meeting the RBA left the cash rate on hold at 1.50% for the tenth month in a row, with a string of inactivity following the most recent drop in August 2016. With only two moves in the past two years – both of them down – the RBA has been waiting for the right moment to begin lifting. The Bank reiterated its concerns about high levels of Chinese debt, low core inflation and mixed labour market conditions, while upping its warning on low wage growth and high levels of household debt, which remain key long-term issues.

Headline inflation has moved higher over the past year, reflecting lower oil prices, while wages and core inflation remain low. While financial market volatility degree of uncertainty globally. March quarter GDP growth was soft, partly reflecting temporary factors. End of easing cycle in major economies. Australian growth for Q1 2017 slowed to 0.3% for the quarter and 1.7% through the year, compared to the 2.4% growth in Q4 2016. The trade sector was the biggest drag, with exports down 2.6% for the quarter, driven by falls in iron ore and coal shipments.

The unemployment figures for May showed an increase in employed persons of 42,000 in seasonally adjusted terms, with full-time employment growing by 52,100. These numbers provide further support to the build-up in full-time work since the start of the year. The unemployment rate fell 0.2 pts to 5.5%, while monthly hours worked in all jobs rose 1.87% to 1,695.3 million hours and measures of labour underutilisation also

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narrowed. Unemployment fell in all states except NSW, where the unemployment remains the lowest nation-wide at 4.8%, and Tasmania, which increased by 0.2 pts to 6.1%.

The AIG Manufacturing Index inched 0.2 pts higher in June to 55.0, putting a halt to the slowing pace of expansion in the previous month. New orders (59.5) moved further into expansion territory, while sales (60.9) surged higher and remains well above its 12-month average. Deliveries (57.4), production (57.3) and exports (54.6) also increased, while employment (49.0) and stocks (44.3) contracted. Large construction projects are buoying activity, including in transport, defence and commercial construction, while stronger activity in agriculture and renewable energy is creating other opportunities.

Retail turnover rose 0.6% in May in seasonally adjusted terms, on the back of April's 1.0% increase. Growth was well spread across each industry group, with the biggest bumps came from household good retailing (2.2%) and clothing, footwear and personal accessory retailing (1.3%), while department stores (-0.7%) were down and still feeling the heat ahead of Amazon's imminent arrival in Australia.

The Westpac Melbourne Institute Index of Consumer Sentiment fell 1.8% from 98.0 in May to 96.2 in June. The index is now the weakest since the RBA's August 2016 rate cut. Confidence around the wider economy fell sharply in June, with the weak GDP print certainly not helping. The 'economic conditions, next 12 months' sub-index down 4.8% and the 'economic conditions, next 5 years' subindex down 8.3%. Despite an improving labour market, consumers remain uneasy about job security, with the unemployment expectations index rising 3.5% from 135.5 to 140.3 (a lower read means fewer consumers expect unemployment to rise over the next year).

Australia's balance on goods and services grew from \$90m in April to \$2.47b in May. Exports of coal, coke and briquettes surged 62% to \$5.04b, while metal ores and minerals fell 7% to \$7.47b. The largest contributors on the credits ledger were general merchandise (\$2.45b) and non-rural goods (\$2.33b).

Global

The third estimate for US Q1 GDP showed real growth of 1.4%, beating the expected 1.2%. More detailed data showed things were not quite as bad as indicated by the advance estimate of 0.9%. During the first quarter of the year, consumer spending grew at faster pace than earlier GDP estimates suggested. Spending on housing, healthcare and financial services rose much higher than previously estimated. According to the Atlanta Fed's GDPNow, the most recent forecast for Q2 2017 is 3.0%, revised upwards from 2.7% at the end of June.

In June the US Fed hiked for the second time this year and the third time in six months, raising the target funds rate by 25bps to 1–1.25%. The decision came despite weaker May inflation figures, which suggested a softening in domestic demand. The committee voted 8—1 in favour of the rise, with lone dove Neel Kashkari of the Minneapolis Fed the only member to dissent.

The ISM manufacturing PMI show stronger expansion in June, recording 57.8 versus 54.9 in May. Several sub-indices saw significant expansion, including the New Orders Index, which registered 63.4, up 2.9 pts from the May reading of 54.9, and the Production Index, which rose 5.3 pts to 62.4. Employment also rose, from 53.5 in May to 57.2 in June, while Inventories fell 2.5 pts to 49.0 and Prices fell -5.5 pts to 55.0, with inflationary pressures starting to move through the supply chain as the commodities prices soften.

Non-farm payrolls recorded 222,000 new jobs in June, higher than the anticipated 179,000 and up on May's disappointing 152,000 figure. The number of long-term unemployed (those jobless for 27 weeks or more) was unchanged at 1.7 million in June and accounted for 24.3% of unemployed. Healthcare employment continued to grow in June, rising by 37,000, while social assistance employment increased by 23,000 and financial services added 17,000. The broader U-6 measure of unemployment that includes discouraged workers and those marginally attached to the labour force grew from 8.4% to 8.6% in June.

US consumer prices fell 0.1% in May in seasonally adjusted terms, with unadjusted 12-month growth falling to 1.9% from the more promising 2.2% in April. The index for all items less food and energy rose 0.1%, or 1.7% over 12 months (down from 1.9% in April). The energy index fell 2.7% in May, with the largest fall coming from gasoline prices, which dropped 6.4%. The core PCE index – the Fed's preferred measure – fell to an annual 1.4% in May, down from 1.5% in May. Worryingly, the PCE index has fallen in three consecutive months after reaching 1.8% in February, prompting fears from policymakers that recent weak inflation is not as temporary as they hoped.

With the UK election over, the Brexit forecast has turned softer with Prime Minister Theresa May's mandate badly damaged after the Conservatives failed to gain an outright majority, winning only 42.4% of the vote share versus Labour's 40.0%. However, two complicating factors remain – firstly, Labour leader Jeremy Corbyn's commitment to leaving the single market, and secondly the behaviour of the Democratic Unionist Party, which has joined with the Conservatives to form government. Both of these mean a hard Brexit remains in the deck. Turning to Germany, after pulling ahead of Merkel's CDU party in March, Martin Schulz's SPD has again fallen behind. A recent Infratest poll showing the CDU at 39% and the SPD at 23%, while the right-wing AfD party is now on 9% after hitting 15% in January.

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GDP in the Euro area grew by 0.6% in Q1 2017, higher than the previously expected 0.5%, providing further support to Europe's recovery story. Spain is leading the pack with GDP growth estimated to be up 1% over the quarter followed by France and Germany at 0.7% and Italy growing at 0.5%. The ECB has upped its growth forecasts to 1.9% over 2017 (from 1.8%) and 1.8% in 2018 (from 1.7%). ECB President Draghi changed his tune, describing the growth outlook from "tilted to the downside" to "broadly balanced" but said a "very substantial degree" of stimulus was still needed to support stronger inflation.

Headline euro area annual inflation continued to slide in June as a result of declining energy prices, falling to an estimated 1.3%, down from 1.4% in May and the 2.0% high reached in February. Promisingly, core inflation (excluding energy, food, alcohol and tobacco) rose 1.1% versus 0.9% in May, suggesting that underlying growth is still present in the euro economy. The energy component was significantly lower in June at only 1.9% versus 4.5% in May and 7.6% in April. The euro area unemployment rate was stable at 9.3% in May and down from 10.2% in May 2016. Dispersion in unemployment rates is still present among members, with the lowest rates present in the Czech Republic (3.0%) and Germany (3.9%), in contrast to high rates in Greece (22.5%) and Spain (17.7%).

China's official PMI survey showed manufacturing still in expansion mode at 51.7 versus the expected 51.0. The Caixin PMI, which surveys smaller, private manufacturers, came in at 50.4, above the expected 49.5. Chinese inflation grew at an annual 1.5% in May, higher than the 1.2% in April and in line with expectations. Encouraged by a stabilisation in growth over the past year the People's Bank of China (PBOC) has been steadily tightening financial conditions. The PBOC has kept cash conditions relatively tight in recent months to support the government's efforts to reduce risk and leverage within the financial system.

In other emerging markets, Brazil's unemployment rate continued to fall modestly in June, down to 13.3% from 13.6% in May. Russia's CPI rose in June for the first time since July 2016, moving from an annual 4.1% in May to 4.4%. The unemployment rate fell modestly from 5.3% to 5.2% in May. India's inflation rate fell from 3.0% in April to 2.2% in May slipping further from the Reserve Bank of India's medium-term target of 4%. Guidance from the RBI that it will stick to the 4% target, rather than tolerate a looser band of 2–6%, may mean interest rates rise sooner than the market anticipates.

Commodities

Base metals had a late surge in June after moving lower through the month and generally tracking lower since the start of 2017. Lead (+8.1%), which had fallen since April, moved back to its March level, while Nickel (+4.7%) also ran up but is still nowhere near February and March levels. Copper (+4.5%) has been tracking higher over the past two months, while Tin (-1.7%) took a big fall early in June and was unable to recover, and Aluminium (-0.5%) was down despite a late push higher.

The price of iron ore delivered to Qingdao in China recovered 13.9% in June, rising to US $64.95/t after falling 17.1% in May and 14.4% in April, but is still a far cry from its February high of $94.86. Gold (-2.2%) was softer in June, having rallied in fits and starts through the first half of 2017, reaching a high of US $1,294.39/oz early in the month before closing at $1,241.60. The Brent crude oil spot price fell from US $49.40/b to $47.08 (-4.7%) and WTI fell from US $48.29/b to US $46.02 (-4.7%).

Currencies

The AUD rose 3.5% against the USD in June, from 0.7430 to 0.7689, and 2.7% in trade-weighted terms, boosted by a jump in trade and commodity prices, as well as a realisation that the US Fed may not be the only game in town when it comes to higher rates. The AUD ended the month higher against other currencies, including the EUR (1.8%), JPY (5.0%), GBP (2.4%) and was flat against the NZD.

The US Dollar Index closed the month 1.3% lower, falling against major currencies including EUR (-1.6%), GBP (-1.0%) and CHF (-1.0%) and gaining against JPY (1.5%). June saw a sharp reversal in market expectations for further depreciation in the Chinese yuan (CNY) and capital outflows, after the PBOC moved to flush out speculative bets against the currency and allowed it to jump sharply against the dollar. The yuan is now up 2.3% so far in 2017, after tumbling 6.5%. China's FX reserves have also stabilised this year.

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