Month in Review

Index returns at end February 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	0.36	1.72	7.52	10.10	5.07	8.01	5.40
S&P/ASX Small Ordinaries Accumulation Index	0.03	2.67	14.58	20.81	10.81	6.22	1.10
Global Equities							
MSCI World TR Index (AUD)	-0.35	-0.26	11.04	16.42	8.97	17.56	8.60
S&P 500 TG Index (AUD)	0.08	0.31	12.81	15.54	11.31	21.17	11.75
FTSE 100 TR Index (AUD)	-2.74	-1.36	7.53	13.00	1.62	10.37	4.11
MSCI Emerging Markets NTR Index (AUD)	-0.88	4.29	12.55	28.77	9.13	10.91	4.54
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	-3.15	-6.18	1.58	0.52	5.04	10.19	3.27
FTSE EPRA/NAREIT Dev. NTR Index (AUD Hgd)	-6.26	-6.55	-4.22	-2.60	1.40	6.92	4.93
Fixed Interest							
Bloomberg Ausbond Composite +Yr Index	0.29	-0.50	1.15	2.87	2.42	4.08	6.13
Bloomberg Ausbond Bank Bill Index	0.13	0.43	0.86	1.75	1.99	2.30	3.54
Barclays Global Aggregate TR Index (AUD Hgd)	-0.23	-0.68	-0.46	2.06	3.16	4.64	6.77

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

The S&P/ASX 200 Accumulation Index rose 0.4% in February, with losses during the start of the month fully regained on a total return basis. In price terms, the index hit a high of 6121 points early in February, bottoming at 5821 points (a fall of 4.9%), and then recovering to end the month at 6016 points (90% recovered from the start of the month). February's gains were driven by the health care sector (+7.0%), with CSL (+11.4%) the top performer on the back of record HY profit and a lift in its full-year guidance.

Consumer staples (+2.1%) shares were also higher, with strong gains from market darling A2 Milk Co (+47.5%) following a big earnings beat, while Woolworths (+2.5%) enjoyed a solid earnings performance, including a 3.8% rise in sales. The telecommunications sector (-6.2%) was the worst performing for the month, with Telstra (-4.4%) still out of favour since reducing its dividend, and Vocus Group (-18.1%) hit hard following a downgrade to its FY18 guidance and the departure of CEO Geoff Horth. The energy sector (-3.8%) also came under pressure, with Whitehaven Coal (-8.9%) battling higher-than-expected operating costs, albeit with the offset of a buoyant coal price.

Global equities

The MSCI World ex-Australia Index returned -0.6% in Australian dollar terms and -3.6% in local currency terms as global equity markets were rocked by volatility and a sharp correction early in the month. The US S&P 500 Index was down 3.9% over the month, hitting a low of 2581 points to end at 2714. The infamous VIX, a measure of implied volatility, spiked to a high of 37.3 to end the month at 19.9—still elevated compared to recent historic lows. IT was the only sector to gain (+0.1%), boosted by Apple (+6.8%) and Hewlett Packard (+13.4%). Energy (-10.8%) was the biggest losing sector, with oil giant Marathon falling 19.9%, while consumer staples (-7.8%) was not far behind, with popular defensive stocks like Walmart (-15.6%) and Kraft Heinz (-14.5%) failing to recover from the broader market correction. The US Dow Jones Index fell 4.3% but was still higher than at the end of 2017.

In Europe, the STOXX Euro 600 Index fell 4.0%, with falls in telecommunications (-5.1%) and utilities (-4.8%) shares. The German federal court paved the way for cities to ban or tax diesel cars, with the price of major auto shares reacting negatively, including Volkswagen (-9.0%) and Daimler (-4.4), whose Mercedes diesel SUVs may be impacted. In Asia, the Chinese CSI 300 Index was down 5.9%, Japan's Nikkei 225 Index fell 4.5%, and Hong Kong's Hang Seng dropped 6.2%. Global developed market shares fell 3.5% and emerging market shares fell 3.9% in local currency terms.

REITs

The S&P/ASX 300 A-REIT Accumulation Index fell 3.2% in February, with higher yields bringing the sector under pressure. Shopping centre giant Vicinity Centres (-7.8%) was hardest hit after reporting a fall in H1 profit amid challenging retail conditions. News from major tenant RFG (whose brands include Donut King, Gloria Jeans and Crust Gourmet Pizzas) that it would be forced to close between 160 and 200 stores did not help. After a frustrating few months, National Storage REIT (+2.0%) gained in February, announcing a 22% rise in storage

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revenue and a 152% rise in profit driven by fair value adjustments to its portfolio. Globally, the EPRA/NAREIT Developed Market Index (AUD hedged) fell 6.4% in February, highlighting the relative tenacity of domestic REITs. US REITs, measured by the MSCI US REIT Index, tumbled 7.9% as yields spiked.

Fixed income

Australian bonds returned 0.29% over February, with Australian government bonds returning 0.28% and longer-term government bonds (ten years plus) returning 0.17%. The Australian 10-year yield was flat over February at 2.81%, but jumped to a high of 2.94% early in the month. Globally, the Bloomberg Barclays Global Aggregate Bond Index (AUD hedged) returned -0.23% as global yields pushed higher. The five-year breakeven inflation rate—a market-derived gauge of expected inflation—reached its highest point in over five years, reflecting the market's focus on wages and consumer prices. The US 10-year treasury yield underwent significant expansion, rising from 2.72% to 2.86%. The Japanese 10-year yield fell from 0.09% to 0.05%, still hovering above the Bank of Japan's zero yield target. The German 10-year yield fell from 0.70% to 0.65%, while the 5-year yield fell from 0.10% to 0.02%, but still managing to hold above zero.

The BofA Merrill Lynch US High Yield OAS expanded slightly in February from 3.29% to 3.47%, with no sign of breaking out of its historic low range, even as volatility returned with a vengeance in early February. Investors are awaiting the next rate hike from the US Fed, which could come as early as March, with the market pricing in an 86% probability of 25 basis point rise.

ASX 200 share movements

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

Best performers		Worst performers	
A2 Milk Co	47.53%	IPH	-33.87%
Nine Entertainment Co Holdings	35.71%	Myer Holdings	-31.30%
Altium	32.83%	Platinum Asset Management	-22.86%
Corporate Travel Management	25.69%	Blackmores	-17.31%
Costa Group Holdings	19.34%	Domino's Pizza Enterprises	-16.80%

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

Best performers		Worst performers	
A2 Milk Co	453.39%	Retail Food Group	-62.60%
Altium	186.88%	Myer Holdings	-62.33%
WiseTech Global	185.69%	Mayne Pharma Group	-50.51%
Nine Entertainment Co Holdings	135.57%	Infigen Energy	-35.04%
Aconex	127.27%	Vocus Communications	-30.77%

Economic News

Australia

The outlook for Australia continues to improve, with unemployment expected to approach 5% over coming years and wages growth to pick up modestly. From a monetary policy perspective, this outlook suggests that while the next move in cash rates is likely to be up, there is little urgency.

The RBA is mindful that wages growth remains low, housing activity appears to be rolling over, and the Australian dollar is still close to 80 US cents, which is probably too high for the Bank's liking. In its March statement, the RBA had little to say about recent market turmoil, noting only that, "market volatility has increased from the very low levels of last year."

Business conditions are solid across all major industry groups, with construction the standout, but retail is the one exception—Australian retailers experienced a disappointing start to the year, with turnover rising a modest 0.1% in January, missing the expected 0.4% rebound. The Bank's central forecast for GDP growth is just above 3% over the next two years, supported by monetary policy conditions that remain expansionary, while the benefits of broad-based global growth and increased international trade are flowing through to the local economy. "Market volatility has increased from the very low levels of last year."

Australia's labour market continues to improve, with 16,000 seasonally adjusted jobs added in January. Full-time employment decreased 49,800, offset by a rise in part-time employment of 65,900. The **unemployment**

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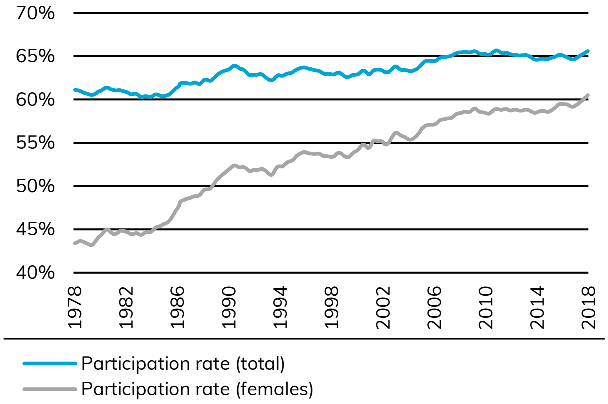
rate was steady at 5.5%. The number of unemployed persons looking for full-time work fell 4,500 to 497,800, while monthly hours worked fell 24.1 million to 1,708.2 million hours. The past 12 months have seen the participation rate grow steadily, from 64.8% to 65.6% in trend terms – close to an historical high and back to pre-GFC levels.

Participation rate



Source: ABS

The **AIG Manufacturing Index** fell 1.2 points to 57.5 in February, indicating continued robust growth in the manufacturing economy, but at a slightly slower pace. February marked the fourth consecutive month in which all seven activity sub-indexes expanded. Increases came from exports (+4.7 points to 56.5), employment (+5.7 points to 57.8), while other major indices eased, including production (-0.8 points to 61.9), new orders (-3.4 points to 55.4), sales (-2.6 points to 53.4), deliveries (-6.0 points to 56.0) and stocks (-1.8 points to 54.7).

The **Westpac Melbourne Institute Index of Consumer Sentiment** fell by 2.3% in February, from 105.1 to 102.7, with the survey period covering a week of volatility and a major correction in global share markets. While recent volatility needs to be taken into account, the index is still below levels historically associated with a robust consumer sector. The 'finances vs a year ago' sub-index fell by 4.5%, and the 'finances, next 12 months' sub-index fell by 3.1%. Not surprisingly the 'economic conditions, next 12 months' component fell sharply by 4.7%.

Australian retailers did not enjoy a strong start to the year, with **retail turnover** rising a modest 0.1% in January, missing the expected 0.4% rebound but clawing back some of December's 0.5% fall. Department stores continued to come under pressure, falling 0.6%, while clothing, footwear & personal accessory retailing fell 0.7%. Food retailing was flat while the major household goods retailing group gained a modest 0.1%.

Global

US **Q4 GDP** rose at an annual 2.5% according to the second estimate reading, which was in line with expectations but revised downward from the first estimate reading of 2.6%. The downward revision was caused mainly by inventories detracting more from growth than previously reported. Consumer spending, the biggest contributor to growth, was left unrevised at a 3.8% growth rate – an improvement on the previous quarter.

Along with cuts in the company tax rate, the second major plank of President Trump's economic plan is the renegotiation of major trade agreements, starting with the North American Free Trade Agreement (NAFTA). Trump alarmed NAFTA partners by explicitly tying steel and aluminium tariffs to a deal. The commerce department has flagged tariffs as high as 25% for steel and 10% for aluminium. While again raising the spectre of a trade war and potential inflation, markets are so far keeping their cool. Trump is also facing resistance from fellow Republicans in congress who believe tariffs would undermine efforts to boost growth.

The US manufacturing economy expanded in February, with the **ISM manufacturing PMI** rising from 59.1 to 60.8. New orders (-1.2 points to 64.2) and production (-2.5 points to 62.0) were down, but were offset by gains in other major sub-indices, including employment (+5.5 points to 59.7), deliveries (+2.0 points to 61.1), inventories (+4.4 points to 56.7) and prices (+1.5 points to 74.2). Customers' inventories (-1.9 to 43.7) was the only index in contraction.

US CPI rose 0.5% in January on a seasonally adjusted basis and 2.1% on an unadjusted year-on-year basis. Core inflation (which excludes food and energy) rose 0.3% during the month and 1.8% year-on-year, driven predominately by shelter (3.2% year-on-year) and transportation services (4.0% year-on-year). Gasoline prices rose 5.8% during the month after moderating in December and have risen 9.0% year-on-year. The core PCE index – the Fed's preferred measure – was steady at 1.5% year-on-year.

While core inflation may appear flat, it was earnings data that sparked February's market selloff, serving as an indication to investors that inflation may be just around the corner. **Average hourly earnings** were up 2.9% in January year-on-year, the biggest rise in more than eight years but still less than the 3.5–4.0% that is generally associated with strong growth. A state-by-state breakdown also saw more states recording faster wage growth, with no states recording wage declines.

Euro area **inflation** is expected to be 1.2% in February 2018, down from 1.3% in January. Core inflation (excluding energy, food, alcohol and tobacco) is estimated to be 1.0%, unchanged on the previous month and still very low. **Unemployment** in the eurozone fell

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to 8.6% in January, down from 8.7% in December and reaching the lowest rate recorded since October 2008. The lowest unemployment rates were recorded in the Czech Republic (2.4%), Malta (3.5%) and Germany (3.6%), while the highest rates were recorded in Greece (20.9% in November 2017) and Spain (16.3%).

China's February PMI readings were mixed, with the official index down to 50.3 from 51.3 and missing expectations, while the Caixin PMI moved slightly higher from 51.5 to 51.6. Industrial production growth in December was 6.2%, which narrowly beat consensus, while private investment was subdued at 7.2% and retail sales growth eased to 9.4% from 10.2%. Premier Li Keqiang announced a growth target of 6.5% for the coming year, which remains unchanged from 2017, despite the Chinese economy recording growth of 6.9%. Although credit growth slowed throughout 2017 as the authorities nudged up interest rates and tightened financial conditions in the shadow banking sector, new loans surged in January.

Commodities

The commodities rally paused for breath in February, with metals flat or falling and a dip in oil putting pressure on what has become a crowded futures trade. Most base metals fell through the month, including Lead (-4.2%), Aluminium (-3.9%), Zinc (-2.6%), Copper (-2.6%) and Tin (-0.7%), while Nickel (+1.4%) managed to gain. Gold fell 2.0% to finish at US $1,318.31/oz in what proved a volatile month. The spot price of iron ore delivered to China (62% Fe) rose 5.6% from US $71.61/t to $75.59, pushing towards its August 2017 high of $78.91. In oil markets, the Brent spot price fell 2.5% from US $67.78/b to $66.08, while WTI fell 5.2% from $64.82 to $61.43.

Currencies

The AUD was flat in trade-weighted terms over the three months to the end of February, with cooling commodity prices and reduced export volumes offsetting rises in the start of the year. The AUD rose 3.0% against the USD, hitting high of 0.8110 in late January to end February at 0.7792. The AUD was down against the JPY (-2.3%) and the NZD (-2.3%) and up against the EUR (+0.4%) and GBP (+1.0%).

The US Dollar Index fell 2.4% over the three months to February. The USD hit a high of 0.8634 against the EUR in November and a low of 0.8006 in January to end February at 0.8190 and flat over three months. The USD was down against the JPY (-5.8%) and flat against the EUR, GBP and CHF.

AUD weakness in February in part reflected a vanishing yield premium, with the US Fed expected to hike rates, possibly as early as March. The US Dollar Index rose 1.7% in February but still appears to be in a downward trend. Concerns over the rising US budget and current account deficits may have contributed to US dollar falls over recent months.

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