ISSUE DATE: 9-08-2017

Month in Review

Market Moves — as at 31•07•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	-0.01	-2.59	3.97	7.33	5.11	10.88	3.83
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	0.34	0.24	4.00	-1.09	5.55	5.77	-1.75
GLOBAL EQUITIES							
MSCI WORLD TR INDEX (AUD)	-1.59	-1.52	5.55	11.17	12.83	18.63	5.79
S&P 500 TG INDEX (AUD)	-1.94	-2.45	4.14	10.48	16.65	21.30	8.50
FTSE 100 TR INDEX (AUD)	-1.65	-1.45	5.81	7.77	3.75	11.83	1.63
MSCI EMERGING MARKETS NET TR INDEX (AUD)	1.81	3.22	13.14	18.85	7.72	10.71	2.70
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 300 A-REIT (SECTOR) ACCUMULATION INDEX	-0.15	-5.61	1.51	-10.58	10.37	12.98	0.38
FTSE EPRA/NAREIT DEVELOPED NET TR INDEX (AUD HEDGED)	0.88	1.91	4.77	-1.69	7.64	10.88	4.10
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	0.25	0.51	1.88	-0.24	4.24	4.30	6.18
BLOOMBERG AUSBOND BANK BILL INDEX	0.15	0.44	0.87	1.79	2.19	2.49	3.85
BARCLAYS GLOBAL AGGREGATE TR INDEX (AUD HEDGED)	0.37	0.79	2.49	0.14	5.05	5.25	7.44

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 had another flat month in July, down 0.01%, with gains from the Materials (+3.57%) and Financials (+1.25%) sectors propping up the index. Within the Financials sector, big four Westpac (+4.29%) and ANZ (+3.17%) enjoyed positive gains, while non-bank lenders FlexiGroup (+5.75%) and recently listed Eclipx Group (+3.92%) rose after reaffirming earnings guidance for FY17. Gold miner Saracen Mineral Holdings (+14.96%) led the gains for the Materials sector, announcing strong drilling results at its Carouse Dam and Thunderbox mines.

Healthcare, which added 23.48% in H1 2017, was down in July, falling 7.47%. Mayne Pharma (-11.52%) was the hardest hit, with further underperformance of its $900m generic portfolio acquisition from Teva Pharmaceutical Industries. Bucking the trend was Sigma Healthcare (+7.26%), which reached a negotiated settlement with Chemist Warehouse Group over a disputed supply agreement. Australian small shares managed a small positive gain, with the S&P/ASX Small Ordinaries Accumulation Index returning 0.34%.

Global equities

The S&P 500 gained 1.93% in USD terms and pushed to a new record high, but fell 1.94% in AUD terms as the USD weakened. Telecommunications (+2.34%) and Information Technology (+0.39%) were the only sectors to gain in AUD terms. Heavyweight Verizon Communications posted 5.66%, while Facebook A-shares rose 7.86% and GPU manufacturer NVIDIA gained 8.16%. The Dow Jones Industrial Average pushed above 22,000 points for the first time, with no small thanks to Apple, which jumped 3.27% in USD terms before hitting a new record high in early August.

Reinforcing the aura of invincibility for US shares, the VIX, otherwise known as the ‘fear index’, closed at its lowest level ever in July at 9.36, and even hit an intraday reading of 8.84 (the first time the VIX has ever fallen below 9).

Globally, the MSCI World Index lost 1.59% in AUD terms, with the Japanese and German markets the main drags. The Euro Stoxx 600 Index fell 0.77%, with gains from the Resources (+7.74%) and Insurance (+2.89%) sectors helping to stem the tide. The DAX fell 3.90% as a crisis erupted in Germany’s automotive industry, with the big five (Audi, BMW, Daimler, Porsche and VW) threatened with multi-billion euro fines for cartel behaviour by the European and German competition authorities. The French CAC 40 eased 0.95%, while in the UK the FTSE 100 Index fell a further 1.65% after dropping 4.73% in June. In Asian markets, the Nikkei 225 Index fell 2.62% while the Shenzhen CSI 300 Index was down 1.33%. The MSCI Emerging Markets Index rose 1.81%, supported by Chinese and Indian shares.

REITs

The S&P/ASX 300 A-REIT Accumulation Index had another tough month in July, losing 0.15% with a rise in bond yields placing some pressure on the sector. Retail-focused REITs were mixed, with Westfield Corporation (-4.63%) down while Vicinity Centres (+7.00%) and Scentre Group (1.98%) were able to shake off the Amazon blues. Australia’s largest residential developer Stockland lost 4.11%, with cap rates on recent major deals tightening. The best performing A-REIT in July was popular dividend share Rural Funds Group (+8.13%), with diversified farmland property and attractive rental agreements. A-REITs are offering a current-year distribution yield of around 4.9%.

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Global REITs were slightly higher in July, with the S&P Global REIT NTR Index returning 1.00% (in AUD hedged terms), while the FTSE EPRA/NAREIT Developed NR Index managed a more modest gain of 0.88%. Stronger than expected earnings across the US REIT sector supported gains, including from the beaten-down retail space, helped along by weaker earnings from Amazon. Halfway through earnings season, apartment, shopping centre, industrial and data centre REITs have been the clear winners. Volumes from office and retail REITs remain low due to slow employment growth from offices taking up leases.

Fixed income

Global yields were mixed in July, with long-term yields in Europe generally rising and spreads narrowing, while in the US and UK yields were down slightly. The US 10-year Treasury yield fell from 2.31% to 2.30% after rising to an early high of 2.39%. The return on US corporate investment grade bonds was 0.76% in July, with the index reaching a new record high, while US high-yield debt returned 1.15%, with the index similarly near record high levels.

The BofA Merrill Lynch US High Yield OAS narrowed slightly in June from 3.77% to 3.61% and reached a high of 3.85%. Global bonds, measured by the Barclays Global Aggregate TR Index, returned 0.37% in July (in AUD hedged terms), with a number of developed market indices pushing to new record highs. Returns on Australian corporate bonds were 0.17% while government bonds returned 0.55%. The Australian 10-year Treasury yield rose from 2.66% to 2.68%, hitting a three-month high of 2.75%. The UK 10-year Gilt yield rose from 1.26% to 1.23% in July. In contrast, the German 10-year Bund yield rose from 0.46% to 0.54%.

Japanese bond prices stabilised in July following the successful auction of 5- and 10-year notes. The BOJ responded to recent falls in the bond market by offering to buy unlimited amounts of 10-year debt at 0.11%, effectively setting a floor on yields and providing an anchor for 20-year bonds. The JGB market also drew relief after the BOJ announced that it will keep unchanged the value of bonds it plans to buy through its operations in August. Japan's 10-year yield rose from 0.01% to 0.08%.

ASX 200 Share Movements

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

BEST PERFORMERS		WORST PERFORMERS	
BEACH ENERGY LTD	18.26%	AVEO GROUP	-12.59%
PLATINUM ASSET MANAGEMENT LTD	18.14%	NUFARM LTD/AUSTRALIA	-12.15%
SARACEN MINERAL HOLDINGS LTD	14.96%	MAYNE PHARMA GROUP LTD	-11.52%
HARVEY NORMAN HOLDINGS LTD	14.40%	AUSTRALIAN AGRICULTURAL CO LTD	-10.78%
AUTOMOTIVE HOLDINGS GROUP LTD	14.33%	COCA-COLA AMATIL LTD	-10.73%

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

BEST PERFORMERS		WORST PERFORMERS	
A2 MILK CO LTD	121.39%	VOCUS COMMUNICATIONS LTD	-59.91%
SIMS METAL MANAGEMENT LTD	89.82%	TPG TELECOM LTD	-54.50%
SEVEN GROUP HOLDINGS LTD	82.44%	MAYNE PHARMA GROUP LTD	-52.71%
WHITEHAVEN COAL LTD	76.26%	ACONEX LTD	-52.49%
QANTAS AIRWAYS LTD	75.08%	SIRTEX MEDICAL LTD	-48.39%

Economic News

Australia

The Australian economy appears well positioned with an improving employment situation, strong manufacturing growth, and a robust retail sector. However, the improved employment outlook contrasts with the lack of growth in wages, which remains at a record low. WPI growth in the March quarter was an annual 1.9% (1.8% for the private sector) – the lowest since the series began in 1997. The low growth in wages appears to be a universal phenomenon in developed markets. In Australia's case, weak income growth, together with household debt reaching 190% of income, has undermined confidence and spending power.

At its August meeting the RBA left the **cash rate** on hold at 1.50%, where it has remained since the most recent downward move in rates one year ago. The RBA noted that inflation continues to run below the 2% target, with higher prices for electricity and tobacco expected to boost CPI in coming months. However, working in the other direction is increased competition from new retail entrants – a reference no doubt to Amazon's imminent arrival on Australian shores.

The **unemployment** figures for June showed further tightening in the labour market, with an increase in employed persons of 14,000 in seasonally adjusted terms, including full-time employment growth of

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62,000. Over the first half of 2017, 143,000 full-time jobs have been added, with nearly 80% of these added in the last two months. The unemployment rate was steady at 5.6% while monthly hours worked in all jobs rose 0.5% to 1,703.5 million hours.

The **AIG Manufacturing Index** rose 1.0 points in July to 56.0, with six of the seven sub-indexes in expansion. July was the tenth consecutive month of expansion for Australian manufacturing, consistent with ABS data showing a recovery in manufacturing employment. The production index increased 1.7 points to 59.0, while employment bounced 8.4 points higher to 57.4, having contracted in the previous month. New orders fell 3.7 points 55.8, indicating a slower rate of expansion. Exports rose 0.7 points to 53.9, deliveries fell 3.4 points to 54.0, and stocks rose 4.7 points to 49.0, indicating a slower pace of contraction.

Retail turnover rose 0.3% in June in seasonally adjusted terms, following growth of 0.6% in May and 1.0% in April. June witnessed further growth from household goods retailing (+0.9% on May) and the clothing, footwear and personal accessory retailing segment (+0.8%). Department stores (-0.3%) continued to fall and food retailing was relatively unchanged. The value of nominal sales was the highest on record at $26.15 billion.

While all appears well in the world of retail, **consumer sentiment** remains a weakness. The Westpac Melbourne Institute Index of Consumer Sentiment rose 0.4% from 96.2 in June to 96.6 in July, but pessimists still outnumber optimists, which does not bode well for consumer spending. Despite banks increasing rates on interest-only mortgages, confidence among mortgagees actually rose 4.8%. Conditions in the housing market appear to be stabilising, at least for the time being. The 'time to buy a dwelling' index lifted by 3.1% in the month – the first significant increase this year.

Australia's **trade balance** was a surplus of $856m in June, down $409m on May's balance of $1,168m. General merchandise – Australia's largest export segment – fell $714m, while non-rural goods fell $740m and metal ores and minerals fell $470m, dragged down by falling iron ore prices and volumes. These falls in resources goods were offset by a rise of $406m in the volatile non-monetary gold segment. While higher commodity prices are expected to boost July's surplus, a rising Australian dollar will be a drag.

Global

The first estimate for **US Q2 GDP** showed real growth of 2.6%, in line with expectations and higher than the 1.2% growth for Q1 (revised down from 1.4%). While based on incomplete data, the result is promising and, together with an unemployment rate at a 16-year low, paints a healthy picture of the US economy. Private Consumption Expenditure (PCE) rose 2.8% and was the biggest contributor to growth, while business investment, net exports and state and local government spending were drags. Missing from this idyllic picture of economic health is inflation, with the Fed's preferred inflation metric, core PCE, falling from 1.8% in Q1 to 0.9%, after reaching 2% in the first half of 2016.

In July **US Fed** members voted unanimously to keep the target funds rate on hold at 1–1.25%, noting that core inflation was running below 2% with measures of inflation expectations little changed over 12 months. The Fed expects to begin normalising its balance sheet "relatively soon", assuming growth and inflation play out as expected. On balance, the market still anticipates a rise in the target rate before the end of 2017, with a 47% probability of one hike and a 3.4% probability of two hikes.

The **ISM manufacturing PMI** showed slower expansion than the previous month, recording 56.3 versus an expected 56.5 and June's 57.8. Most sub-indices fell on the previous month, but all remain convincingly in expansion, with the exception of Inventories at 50.0 (+1.0 points) and Customers' Inventories (-1.5 points). The New Orders index registered 60.4, a decrease of 3.1 points from June's reading of 63.5. Production registered 60.6 (-1.8 points) and Employment came in at 55.5 (-2.0 points). The Prices index jumped 7.0 points 62.0 in line with higher commodity prices.

July's **non-farm payrolls** delivered another upside surprise, recording 209,000 versus the expected 183,000 and following June's positive 231,000 figure. The unemployment rate was little changed at 4.3%. The number of long-term unemployed (those jobless for 27 weeks or more) was slightly higher at 1.8 million, and accounted for 25.9% of unemployed. Food services was the biggest gaining segment in July, adding 53,000 jobs, followed by professional and business services (49,000) and healthcare (39,000 in July and 327,000 over the past year). The broader U-6 measure of unemployment, which includes discouraged workers and those marginally attached to the labour force, was steady at 8.6%.

US CPI figures showed zero growth across the month to June and annual unadjusted growth of only 1.6%, falling from 1.9% in May. The index for all items less food and energy rose 0.1% and remains steady at an annual or 1.7% over 12 months. The energy index fell 1.6% in June, with gasoline prices dropping 2.7% following a 6.4% drop in May. The core PCE index – the Fed's preferred measure – fell to an annual 1.4% in May, down from 1.5% in May. The index for used cars and trucks fell 0.7%, its sixth consecutive decline. The index for wireless telephone services also continued to fall, decreasing 0.8% in June.

After the trials and tribulations of the French and UK elections, Europe's political calendar is looking relatively sparse. The **German federal election** on 24 September is the final major political event of the year, and polls point to the return of Angela Merkel as Chancellor. Within the Bundestag, the 'grand coalition'

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between Merkel's CDU and the centre-left SPD will likely be renewed, although there is a chance the CDU could form a government with the free-market FDP and Greens. The latest Forsa poll shows the CDU on 40%, the SPD on 22%, and the Greens, FDP and anti-immigration AfD each on 8%.

Euro area GDP grew by 0.6% in Q2 2017, higher on Q1 growth of 0.5% and providing further support to Europe's recovery story. The ECB's Governing Council left the key rates on hold in July, absent any convincing sign of a sustained pickup in inflation. President Draghi stated that rates are expected to remain at current levels "for an extended period of time, and well past the horizon of the net asset purchases". The Bank remains averse to upsetting what remains a delicate applecart with a mistimed hike.

Euro area inflation is expected to be 1.3% p.a. in July, steady on June and now significantly lower than April's promising 1.9% and February's high of 2.0%. Core inflation (excluding energy, food, alcohol and tobacco) rose from 1.1% to 1.2% suggesting that underlying growth is still present in the euro economy. The energy component was higher on June at 2.2% but remains below recent results. **Euro area unemployment** moved down from 9.2% in May to 9.1% in June – the lowest recorded since February 2009. Dispersion in unemployment rates is still present among members, with the lowest rates present in the Czech Republic (2.9%) and Germany (3.8%), in contrast to high rates in Greece (21.7%) and Spain (17.1%). In Greece, despite some recent signs of economic recovery, the unemployment rate for the 25-32 age group is still very high at 27.6%.

China's GDP recorded growth of 6.9% in Q2 2017, which proved enough to ward off fears of a slowdown, as well as satisfying officials that efforts to tighten lending have not been detrimental to the economy. Factory output and retail sales came in well ahead of expectations at 7.6% and 11.0% respectively. **China's official PMI** survey showed manufacturing still in expansion mode at 51.4 but down on June's 51.7 and below the expected 51.6. The Caixin PMI, which surveys smaller, private manufacturers, beat expectations at 51.1, up from the previous month's 50.4.

In other **emerging markets**, Brazil's unemployment rate continued to edge downwards in July, falling to 13.0% from 13.3% in June. Unemployment in Brazil climbed rapidly from 6.9% at the start of 2016 to a high of 13.8% in April 2017, and has since eased in line with improving output and sentiment survey data. Russia's CPI fell in July from 4.4% to 3.9%, significantly lower than the expected 4.3%, while unemployment continues to fall, moving from 5.2% to 5.2%. India's CPI fell from 2.2% in June to 1.5% in July – well below RBI staff projections of over 4.0%. RBI meeting minutes should make for some interesting reading this month.

Commodities

Commodities rallied through July, with sharp moves higher in copper (+7.3%) and Nickel (+8.8%). Tin (+3.4%) built steadily through the month, while Lead (+1.8%) and Zinc (+1.3%) were flatter but still posting gains. Aluminium (-0.1%) finished the month slightly down despite a late rise. Gold (+2.2%) finished higher at US $1,269.44/oz after hitting a low of $1,212.46. The price of iron ore delivered to Qingdao in China rose a further 13.5% in July after shooting 13.9% in June, finishing the month at US $73.70/t, but still below its February high of $94.86.

Oil ended the month on a high with US inventories falling by 10.2m bbl in the final week, Saudi Arabia's energy minister announcing a cap on exports, and US energy companies announcing capex reductions. The Brent crude oil spot price rose from US $47.01/b to $51.99 (+10.4%) through the month, and similarly WTI increased from US $46.02/b to $50.21.

Currencies

The AUD rose 3.8% against the USD in July, from 0.7689 to 0.7980, reaching its highest level since May 2015. In trade-weighted terms, the AUD was lifted 2.8%, boosted by a rise in trade and commodity prices. The AUD ended the month higher against major currencies, including the GBP (+2.5%), JPY (+2.0%), NZD (+1.5%) and EUR (+0.5%).

The US Dollar Index closed the month 2.9% lower, reaching its lowest level since January 2015. The USD fell against major currencies including the EUR (-3.2%), JPY (-1.8%) and GBP (-1.3%), and gaining modestly against the CHF (+0.9%). The USD has been falling since the start of 2017, and was hit hard heading into the non-farm payrolls release by reports that a grand jury had been empanelled to investigate the Trump campaign's ties with Russia. Luckily, the NFP print held up and disaster was averted. Meanwhile, the EUR has had an impressive winning streak through the year to date, associated with continued signs of economic recovery on the continent.

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