ISSUE DATE: 11-01-2018

Month in Review

Market Moves — as at 31•12•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	1.81	7.64	8.37	11.80	8.63	10.23	4.14
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	3.20	13.69	18.70	20.02	14.38	7.39	-0.03
GLOBAL EQUITIES							
MSCI WORLD TR INDEX (AUD)	-1.60	5.95	8.72	13.94	11.55	18.80	6.86
S&P 500 TG INDEX (AUD)	-1.86	6.99	9.27	12.79	13.10	22.54	9.76
FTSE 100 TR INDEX (AUD)	1.87	6.23	9.22	13.47	6.09	11.68	2.86
MSCI EMERGING MARKETS NET TR INDEX (AUD)	0.54	7.78	13.68	27.09	10.76	10.43	2.87
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 300 A-REIT (SECTOR) ACCUMULATION INDEX	0.12	7.79	9.88	6.44	11.28	13.38	1.76
FTSE EPRA/NAREIT DEVELOPED NET TR INDEX (AUD HEDGED)	1.03	3.64	4.72	8.20	6.14	9.82	4.92
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	-0.52	1.44	1.37	3.66	3.05	4.15	6.19
BLOOMBERG AUSBOND BANK BILL INDEX	0.14	0.42	0.86	1.75	2.05	2.34	3.63
BARCLAYS GLOBAL AGGREGATE TR INDEX (AUD HEDGED)	0.24	0.90	1.79	3.68	4.09	4.94	7.12

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 1.8% in December, with the energy and materials sectors rallying in the final month of 2017. Driving the energy index was Beach Energy (+18.6%), which expanded its interests in offshore gas fields, along with Whitehaven Coal (+15.8%), as coal prices held their gains through December. Within the materials sector, gold producer St Barbara (+19.4%) topped the leaderboard, announcing record-low production costs and boosted by a higher gold price. BlueScope Steel (+12.9%) was another big gainer, trading higher after announcing a profit upgrade and benefiting from the US corporate tax cuts.

The telecommunications sector (+5.5%) had a positive month in December, led by TPG (+10.4%), which managed to recoup some of its losses through the year, and gains from Telstra (+5.8%), in the wake of a horror year for investors. Consumer discretionary shares (+3.9%) enjoyed a solid month, with gains from Ardent Leisure (+17.1%), which divested the last of its non-core assets in December, and Tabcorp Holdings (+15.1%), with shareholders voting to approve the long-anticipated merger with Tatts Group.

Global equities

In the US, the S&P 500 fell -1.6% in AUD terms but pushed to record highs through the month in both AUD and USD terms. The Dow Jones Index also rallied through December, breaking through 25,000 points in early January. Positive returns came from the telecommunications (+2.4%) and Energy (+1.5%) sectors, with gains from major carrier AT&T (+3.5%) and oil producers Halliburton (+13.7%) and Marathon (+10.5%). The rate sensitive utilities sector (-9.1%) was the hardest hit in December, with Edison International losing 24.0% and America's largest utility NextEra Energy down 4.3%.

Globally, the MSCI World TR Index fell 1.6% in AUD terms, driven by falls in US, Japanese and German markets. The broad-based Euro Stoxx 600 Index fell 1.5%, with gains coming predominately from the resources sector, including large gains from Glencore (+11.3%) and Anglo American (+10.5%). Utilities (-5.8%) were the hardest hit as yields on the European continent moved higher in response to Brexit negotiations, while the UK's FTSE 100 Index managed a gain of 1.9%.

In Asia, Japan's Nikkei fell 3.1%, China's Shenzhen CSI 300 Index was down 1.1% and Hong Kong's Hang Seng Index was down 0.8%. The MSCI Emerging Markets Index rose 0.5%, supported by Chinese and Indian markets. South Korea's KOSPI was down 1.9%, but still managing to hold firm in the face of a stressful few months on the peninsula.

REITs

The S&P/ASX 300 A-REIT Accumulation Index (which includes distributions) returned 0.12% in December. Westfield gained 13.3% as the Lowy family accepted a $32 billion takeover offer from European giant Unibail-Rodamco. Other gainers through December included Viva Energy (+3.7%) and Hotel Property Investments (+3.5%), while Arena REIT was the worst performer (-8.3%). Over the past year, property securities have returned 6.4%, including distributions, underperforming international property securities, which have returned 8.2%. However, A-REITs are still outperforming currency-hedged global REITs over three, five and seven years.

We strongly recommend that potential investors read the product disclosure statement or investment statement.
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Global REITs were able to extend November's gains in December, with the S&P Global REIT NTR Index up 0.6% (in AUD hedged terms), while the FTSE EPRA/NAREIT Developed NR Index managed a gain of 1.0%. US REITs moved higher, boosted by retail sales, in signs that malls are not completely dead. Mortgage REITs delivered a 19.8% total return over 2017, topping the REIT market. The infrastructure sector, whose largest companies are cell phone tower REITs, led the equity REIT market's performance with a 35.4% total return for the year.

Fixed income

Australian bonds returned -0.5% over December, with Australian government bonds returning -0.6%, and longer-term government bonds (ten years plus) returning -1.1%. The Australian 2-year government bond yield rose from 1.75% to 2.00%, while the 10-year yield rose from 2.50% to 2.63%, reaching a high of 2.71% mid-month. In the US, 10-year government yields were slightly lower, moving from 2.42% to 2.40%. The BofA Merrill Lynch US High Yield OAS narrowed in December from 3.61% to 3.63% and pushed to historic lows in early January, with volatility still all but absent from financial markets. The most recent cyclical high was 8.62% in February 2016.

Globally, the Bloomberg Barclays Global Aggregate Bond Index (A$ hedged) returned 0.2%, with yields in major developed markets flat or expanding. Japanese 10-year bond yields rose from 0.03% to 0.04%, still close to the Bank of Japan's zero yield target. The German 10-year yield rose from 0.37% to 0.42%, while 5-year yields rose from -0.31% to -0.21% and appear to be slowly moving back towards positive territory. The UK was the exception to rising yields in December, with the 10-year Gilt yield falling from 1.33% to 1.19% as uncertainty around Brexit negotiations and trade with the EU set in.

ASX 200 Share Movements

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

BEST PERFORMERS		WORST PERFORMERS	
ACONEX	49.51%	RETAIL FOOD GROUP	-45.23%
SIGMA HEALTHCARE	25.32%	G8 EDUCATION	-23.13%
ST BARBARA	19.38%	MYER HOLDINGS	-15.92%
BEACH ENERGY	18.57%	QANTAS AIRWAYS	-11.11%
ARDENT LEISURE GROUP	15.94%	APA GROUP	-10.81%

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

BEST PERFORMERS		WORST PERFORMERS	
A2 MILK CO LTD	261.27%	RETAIL FOOD GROUP LTD	-64.81%
SEVEN GROUP HOLDINGS LTD	95.28%	MYER HOLDINGS LTD	-52.17%
COSTA GROUP HOLDINGS LTD	91.86%	MAYNE PHARMA GROUP LTD	-48.33%
ST BARBARA LTD	87.25%	HT&E LTD	-33.80%
MINERAL RESOURCES LTD	74.42%	FLETCHER BUILDING LTD	-33.20%

Economic News

Australia

While there was no monetary policy meeting of the RBA in January, December's minutes revealed the board's continued ambivalence towards domestic conditions. Wages remain stable at a low rate, despite the 3.3% increase in awards and minimum wages in the September quarter. This appears to have impacted components of household spending, which has also moderated, reflected also in the retail sales figures. On the flip side, non-mining business investment has continued to rise, especially in the services sector.

The RBA has maintained the **cash rate** at 1.50% for well over a year, and appears content to wait and see how high other central banks go and how quickly. Although the September quarter GDP data showed growth of only 2.8% over the year with consumption spending flat, a range of other releases have provided some grounds for optimism. The RBA's growth forecast for 2017-18 according to its November Statement on Monetary Policy is 2.75%, rising to 3.5% in 2018-19, while Treasury's Mid-Year Economic and Fiscal Outlook (MYEFO) is more conservative, forecasting growth of 2.5% and 3.0% respectively. Both anticipate headline inflation to rise from 2.0% to 2.25%.

Australia's labour market continues to improve, with 61,600 seasonally adjusted jobs added in November, which included 41,900 full-time jobs and 19,700 part-time jobs. Total jobs added through 2017 was 383,000, representing growth of 3.2%. The **unemployment rate** remained steady in November at 5.4%, while the participation rate rose 0.3 points to 65.5%. The number of unemployed persons looking for full-time work

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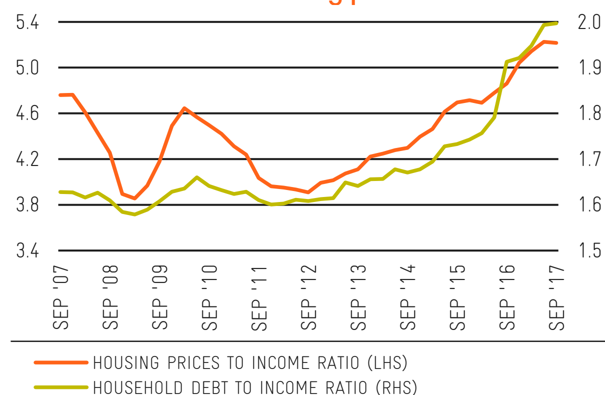
increased 2,500 to 489,900, and monthly hours worked rose 9.8 million to 1,740.9 million hours.

The **AIG Manufacturing Index** fell 1.1 points to 56.2 in December, indicating continued robust growth in the manufacturing economy but at a slightly slower pace. All seven sub-indices were in expansion in December, with modest growth in Production (+1.1 points to 57.7), Deliveries (+0.1 points to 57.4) and Stocks (+1.1 points to 55.5), and falls in New Orders (-3.5 points to 56.9), Employment (-2.0 points to 52.9), Sales (-3.6 points to 52.6) and Exports (-6.2 points to 51.4). The sector has been expanding in all but two months since July 2015.

Household debt and housing prices



Source: RBA, ABS

In a surprise turnaround, the Westpac Melbourne Institute **Index of Consumer Sentiment** rose 3.6% to 103.3 in December from 99.7 in November. Confidence in the domestic economy appears to be improving, with labour market strength adding to positivity despite low wages growth. Undoubtedly consumers are happy with the RBA's 'wait and see' approach, with fears of a rate hike in the immediate future waning.

Australia's **balance on goods and services** fell a seasonally adjusted $326 million in November, expanding the deficit to $628 million, which was well below the expected $800 million surplus. October's narrow $105 million surplus was also revised down to a $302 million deficit. Exports of general merchandise rose $418 million in November, non-rural goods added $394 million, and metals (excluding monetary gold) added $210 million. On the debits side, imports of general merchandise rose $483 million and consumption goods rose $213 million.

Global

The final estimate of **US Q3 GDP** indicated real growth of 3.2%, slightly lower than the second estimate reading of 3.3% but still growing at its fastest pace in more than two years. Growth in consumer spending, which accounts for more than two thirds of the economy, was revised down 0.1 points to 2.2%. Nowcast readings for Q4 range from the New York Fed's 3.9% and the St Louis Fed's 3.0%, while the Wall Street Journal's survey of economists in mid-December indicated it could be as low as 2.7%. President Trump's tax overhaul – seen as a significant legislative victory – will cut the corporate tax rate from 35% to 21% and is expected to provide a boost to growth. However, with the labour market at or near full capacity, there are concerns about potential overheating.

As was strongly anticipated by the market, the FOMC voted to raise the **funds rate** at its December meeting by 25bps to a target range of 1.25–1.50%. While it was noted that hurricane-related disruption had impacted the economy, the outlook has not been materially altered. Dissenting voices came from Charles Evans and Neel Kashkari, who preferred to maintain the pre-existing range, which in their view would better support a return to the 2% inflation target. The latest 'dot plot' shows that the Fed continues to expect to lift rates a further three times in 2018, to 2.25% and to 2.70% by end-2019. Market pricing, however, implies around 40 bps of tightening in 2018 and less than one hike in 2019, leaving the Fed funds rate at 2.00%.

The **ISM manufacturing PMI** rose in December from 58.2 to 59.7, indicating faster growth than the previous month. Major indices moved further into expansion, including New Orders (+5.4 to 69.4), Production (+1.9 to 65.8), Inventories (+1.5 to 48.5), Prices (+3.5 to 69.0) and New Export Orders (+2.5 to 58.5), while Employment (-2.7 to 57.0) and Customers' Inventories (-3.5 to 42.0) were lower. Businesses reported strong local and international conditions. Employment remains strong but shortages of qualified labour is creating bottlenecks in parts of the supply chain.

Non-farm payrolls rose 148,000 in December, building on November's gain of 228,000 but below the market's expected gain of 190,000. The unemployment rate was unchanged at 4.1%, and the number of persons employed part-time for economic reasons was essentially unchanged at 4.9 million. The largest employment gains came from healthcare (+31,000), construction (+30,000) and manufacturing (+25,000). The broader U-6 measure of unemployment, which includes discouraged workers and those marginally attached to the labour force, rose slightly in December from 8.0% to 8.1%.

US CPI rose 0.4% in November on a seasonally adjusted basis and 2.2% on an unadjusted y/y basis. Gasoline prices rose 7.3% in November, with y/y growth of 16.5%. All items less food and energy rose 1.7% y/y, driven predominately by shelter (+3.2%) and transportation services (+3.8%). The core PCE index – the Fed's preferred measure – moved slightly higher from 1.4% at 1.5% y/y, still below the headline rate of inflation and stubbornly at odds with overall growth and employment conditions.

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Turning to Europe, **euro area GDP** grew by 0.6% in Q3, bringing growth over the past 12 months to 2.6%. Growth across the 19 eurozone countries has improved steadily over the past year, and the recovery has also become more broad-based, both across different countries and sectors. In December the European Central Bank made a significant upgrade to its 2018 growth forecast for the euro area, lifting its expected annual growth rate from 1.8% to 2.3%, while the outlook for inflation also moved higher from 1.2% to 1.4%.

Political uncertainty, including the formation of a new German coalition and independence movements in Catalonia are having no discernible effect on business optimism. In the manufacturing sector the PMI suggests the best performance since the dot-com boom with greater demand leading to the strongest inflationary pressures in six years.

After a number of false starts, the **Brexit negotiations** between the EU and the UK have entered the second and decisive phase. By October 2018, both sides aim to have a divorce agreement in place, including an outline of future trade relations. Amid the summits and party conferences, Prime Minister May will need to navigate the pro- and anti-Brexit factions, as well as the Democratic Unionist Party (DUP), which is propping up her government.

Chinese data indicates a slight loss of momentum in recent months. Although **China's official PMI** picked up to 51.8 from 51.6, the Caixin PMI dropped to its lowest level in five months. Measures of industrial production and investment also appear to have softened. The focus of policy tightening has been on the property sector. Sales by value and by floor space are now declining the most since early 2015, while construction activity and prices are also easing. China's CPI was lower in November, posting 1.7% y/y, down from 1.9% in October and below the expected 1.8%.

In other **emerging markets**, Brazil's CPI rose from 2.7% to 2.8% in November, slightly below expectations and below the central bank's 4.5% target, providing room for further rate cuts. Brazil's economy is expected to grow at 1.1% in 2017 and 3.0% in 2018 following upward revisions from 0.5% and 2% previously. India's inflation rate rose in November from 3.6% to 4.9%, driven in part by rises in commodity prices. India's growth outlook remains around the 7.0% mark, with disruption from demonetisation and the introduction of a GST still causing some disruption. In Russia, inflation appears to have stabilised at 2.5%, falling from 5.5% at the start of 2017.

Commodities

After pulling back in November, metals resumed their rally in December. Copper, a bellwether for global manufacturing, slid early in December only to surge later in the month, rising 7.2% and adding to the wave of positive sentiment heading into 2018. Nickel (+14.9%) made an aggressive comeback in December, while other base metals were also higher, including Aluminium (+10.7%), Zinc (+5.16%), Tin (+2.1%), and Lead (+0.7%).

Gold was up 2.2% in December, rising from US $1,275/oz to $1,303. A weaker US dollar, which in 2017 experienced its largest annual fall since 2003, helped to lift gold by more than 13% through the year. The spot price of iron ore delivered to China (62% Fe) rose 3.0% from US $68.73/t to $70.78, pushing higher but still down on its recent August 2017 high of $78.91. In oil markets, the Brent spot price gained 5.0% from US $63.53/b to $66.73, while WTI rose 5.3% from $57.40 to $60.46, reaching the highest level since June 2015 and continuing to push higher through the new year.

Currencies

The AUD was down 2.0% in Q4 2017 in trade-weighted terms, with weaker commodity prices in November impacting export values. The AUD fell -0.3% against the USD, hitting a high of 0.7887 in October and a low of 0.7509 in December to end the year at 0.7809. The AUD was down against other major currencies including the EUR (-1.9%), JPY (-0.1) and GBP (-1.1%), and higher against the NZD (+1.4%).

The US Dollar Index was down 1.0% over Q4 2017, as a promising move higher in October was negated by renewed weakness in the final two months. The USD hit a high of 0.8634 against the EUR in November, but ended the year at 0.8330, down 1.6% over the quarter. The USD was down against the GBP (-0.8%) and up against the JPY (+0.2%) and CHF (+0.6%).

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