Month in Review

ISSUE DATE: 8-11-2016

Market Moves — as at 31•10•2016

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	-2.15	-3.20	3.46	6.11	3.87	9.17	4.39
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	-4.72	-4.77	6.20	14.90	4.42	2.69	0.27
GLOBAL EQUITIES							
MSCI WORLD TR INDEX (AUD)	-1.36	-1.33	2.85	-4.56	12.30	17.18	4.66
S&P 500 TG INDEX (AUD)	-1.27	-1.78	4.36	-2.01	17.07	21.37	6.88
FTSE 100 TR INDEX (AUD)	-4.51	-3.96	-5.03	-15.71	2.98	9.79	0.70
MSCI EMERGING MARKETS NET TR INDEX (AUD)	0.80	3.93	9.73	2.45	5.36	7.46	3.66
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 300 A-REIT (SECTOR) ACCUMULATION INDEX	-7.70	-14.04	-3.73	6.39	13.59	16.81	0.74
FTSE EPRA/NAREIT DEVELOPED NET TR INDEX (AUD HEDGED)	-4.49	-7.75	1.11	3.11	9.10	12.92	3.58
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	-1.28	-1.08	2.23	4.03	5.77	5.82	6.39
BLOOMBERG AUSBOND BANK BILL INDEX	0.15	0.46	0.99	2.14	2.41	2.89	4.20
BARCLAYS GLOBAL AGGREGATE TR INDEX (AUD HEDGED)	-0.90	-0.78	2.47	6.71	6.63	6.76	7.61

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 sold off in October, with the S&P/ASX 200 following US indices down to end the month at 5,229.00 pts. All sectors suffered, with the exception of Materials, which was able to add to large gains over the past five months, returning 1.29% in October, while the Financials sector produced a small positive return of 0.76%, with modest gains from the big four.

The largest monthly gain came from Infigen Energy, which returned 24.84% as investors reacted favourably to the removal of uncertainty over changes to the renewable energy target. Whitehaven continued its bull run, riding the coal price recovery and gaining 23.67%. The hardest hit sector was Health (-8.26%), led by falls in Healthscope, which issued a profit warning based on weak hospital volumes, falling 28.01%. Ardent Leisure fell 27.08% during the month following the tragedy at its Dreamworld theme park.

Small cap returns, measured by the S&P/ASX Small Ordinaries Accumulation Index, returned -4.72% in October, underperforming large cap shares, with the 12-month return moving down to 14.90%.

Global equities

Global shares were down in October, with a gradual sell-off in the US and renewed pressure on the UK market. Europe's largest shares managed to bounce back from recent falls, allowing the European index to finish in positive territory. Global shares, measured by the MSCI World TR Index, returned -1.36% in AUD terms, while the S&P 500 TG Index returned -1.27%, with some pre-election nerves making themselves felt throughout the month.

The US election now replaces Brexit as the geopolitical event to watch. Despite the media frenzy, markets were remarkably stable in October. The VIX did tick upwards at the end of the month, but remained below the September peak, and well below the July Brexit spike. Recent earnings from the US have generally come in ahead of expectations, including from the banking sector, where the prospect of a Fed rate hike is viewed as positive. In October, America's largest telco AT&T agreed to buy Time Warner for USD 85.4 billion, with Time Warner shares climbing 11.78% during the month.

In Europe, the Euro Stoxx 50 Index was up 1.77% in EUR terms, led by a strong recovery in banks and insurers. Following a horrid September, Deutsche Bank shares gained 13.70% as talks with the US Department of Justice neared a settlement. The UK's FTSE 100 held up well in local currency terms, but saw a drop of -4.51% in AUD terms. In Asian markets, the Shenzhen CSI 300 gained 2.55%, while Hong Kong's Hang Seng dropped -1.56%.

REITs

The S&P/ASX 300 A-REIT Accumulation Index entered a third month in the red, returning -7.70% following September's return of -4.31%, taking the index to its lowest point since April 2016. With investors anticipating that the interest rate cycle has reached the bottom, both in Australia and overseas, yield shares such as A-REITs have taken large hits. Nevertheless, stable and attractive yields from income producing trusts appear well supported by property fundamentals, while investor demand remains strong. In October, Centuria announced it was in discussions with 360 Capital about a potential acquisition, following approaches from Cromwell earlier in the year.

Month in Review

After pulling back in September, Global REITs took a harder fall in October, with the S&P Global REIT NTR Index returning -5.22% (in AUD hedged terms), and the FTSE EPRA/NAREIT Developed NR Index losing -4.49%. REIT yields remain a selling point, even with bond yields pushing upwards. In a rising rate environment, REITs will face additional pressure on cap rates and leasing spreads, although there have been plenty of buying opportunities since the Fed's December 2015 rate hike.

Fixed interest

Global bonds, measured by the Barclays Global Aggregate TR Index, returned -0.90% in October (in AUD hedged terms). Yields have begun to climb from their record lows, prompting investors to ask if the tuning point has finally arrived. Developed market yields saw some real expansion in October, building steadily through the month. The US 10-year Treasury yield rose from 1.60% to 1.86% as bonds sold off. The US Fed has soft-pedalled its guidance for months now, and may be fearful of another 'Taper Tantrum', but solid jobs growth in October will bolster the case for a December hike.

The return on US corporate investment grade bonds was -0.90% in October, while US high yield debt returned 0.41%, continuing to benefit from ultra-low rates. Remarkably, credit spreads were further compressed following a small Brexit spike in June, with the Bank of America Merrill Lynch US High Yield OAS falling slightly from 4.97% to 4.91%. Historically, US presidential elections have had little direct impact on fixed income markets, but investors will have to wait and see exactly how the bond market reacts.

Australian bonds returned -1.28% in October. Returns on Australian corporate bonds were -0.56% while government bonds returned -1.49% as the 10-year yield broke out from 1.91% to 2.35%. In early October, the Australian government issued its first 30-year bond, maturing in March 2047 with a yield of 3.27%. Strong interest from international investors saw the auction oversubscribed by some AUD 13 billion.

The UK 10-year Gilt yield recovered strongly from its post-Brexit lows, moving from 0.75% to 1.24% and closing in on its pre-Brexit high of 1.37%. The German 10-year Bund yield turned positive in early October, moving from -0.12% to 0.16% through the month.

ASX 200 Share Movements

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

BEST PERFORMERS	
INFIGEN ENERGY	24.84%
WHITEHAVEN COAL	23.68%
GENWORTH MORTGAGE INSURANCE	13.76%
TATTS GROUP	11.23%
FORTESCUE METALS GROUP	11.11%

WORST PERFORMERS	
HEALTHSCOPE	-28.01%
ARDENT LEISURE GROUP	-27.08%
BEGA CHEESE	-25.75%
RESOLUTE MINING	-23.60%
SARACEN MINERAL HOLDINGS	-22.57%

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

BEST PERFORMERS	
GALAXY RESOURCES	354.55%
RESOLUTE MINING	304.82%
WHITEHAVEN COAL	197.07%
MINERAL RESOURCES	179.40%
FORTESCUE METALS GROUP	172.71%

WORST PERFORMERS	
ESTIA HEALTH	-61.76%
SPOTLESS GROUP HOLDINGS	-49.96%
OZFOREX GROUP	-44.09%
NINE ENTERTAINMENT CO HOLDINGS	-39.46%
HENDERSON GROUP	-37.11%

Economic News

Australia

At its meeting on 1 November, the RBA decided to leave the cash rate unchanged at 1.50%. Financial markets had all but priced out the chance of a cut, anticipating that the board would hold tight following its two cuts in May and August. With September's inflation figure slightly higher than expected, and economic growth relatively robust, the case to hold was strong. RBA watchers may have found the Melbourne Cup a more compelling proposition, but of course even November is never always surprise-free.

The RBA noted the recent stabilisation in China, underpinned by construction activity, as well as a lift in commodity prices, which is supportive of Australia's terms of trade. The Bank still appears relatively relaxed about the housing market, noting the slowdown in lending growth and turnover. The CPI grew 0.7% in the September quarter, bringing the year-end change to 1.3% across all groups. Underlying inflation, which excludes volatile items, was 1.7%, still well below the RBA's 2–3% target range. The probability of a November rate hike, as implied by cash rate futures, moved to 4%, down from 14% prior to the CPI release.

Month in Review

The unemployment rate fell slightly in September from 5.7% to 5.6%, with the number of unemployed persons falling 12,500 in seasonally adjusted terms. The participation rate fell by 0.2 pts to 64.5%, while monthly hours worked increased 4.0 million to 1,660.0 million hours. In trend terms, employment growth is down from its September 2015 peak, and the shift to part-time employment has continued, with the number of part-time workers rising by 11,800 in September 2016, offset by a fall in full-time workers of 7,900.

After a sharp drop in August, the AIG Manufacturing Index has edged back into expansion, increasing 1.1 pts to 50.9. The shift to mildly expansionary conditions was driven by stronger growth in exports (56.0 pts), as well as sales (55.0 pts) and new orders (54.7 pts), while employment (47.7 pts) remains in contraction and inventories (45.9 pts) were run down during the month.

Retail turnover was higher in September, rising 0.6% – the highest rate of growth since August 2015. Growth was well balanced across industry groups, with a large increase in household goods retailing (2.3%) and cafes and restaurants (1.0%), as well as continued growth in department stores (0.5%) and the major food retailing group (0.2%).

The Westpac Melbourne Institute Index of Consumer Sentiment increased by 1.1% in October, from 101.4 to 102.4. The index has had a remarkable run of stability over the past six months, holding within a relatively tight range. This is despite two rate cuts from the RBA, uncertainty around budgetary and superannuation policy, and international events such as Brexit and the upcoming US presidential election. The largest boost has come from the economic outlook component, which has lifted 13.1% on the previous year.

The trade deficit was lower than expected in September, falling to $1.227 billion from August's revised deficit figure of $1.894 billion. Higher commodity prices have generally been supportive of Australia's terms of trade, with increases in exports of coal (12.1%), metals (13.8%) and rural goods (5.1%), while imports of fuels were also up (14.2%).

Global

Despite sell-offs in some equity markets, October was generally a good month for economic news. Continued improvements in business confidence, as well as upside surprises in US and UK growth, were tempered by some consumer jitters ahead of the US presidential election.

In the US, the advance estimate of Q3 GDP growth came in at an annual rate of 2.9%, higher than the expected 2.5%, and up on the Q2 increase of 1.4%. While the US recovery appears to be gaining steam, there is still some cause for concern, with consumption spending up just 2.1% versus the 4.3% gain in Q2, and overall growth was boosted by agricultural exports and inventories, which may prove transitory.

Job creation missed expectations in October, with non-farm payroll employment rising by 161,000, below the expected 175,000 gain and down on September's 191,000. The unemployment rate was little changed at 4.9%. While slightly below the consensus, jobs growth is still solid, and growth in wages will bolster the case for a December rate hike.

The CB Consumer Confidence Index declined in October, moving from 103.5 in September to 98.6. Consumers' assessment of current business and employment conditions softened, with expectations that the economy will continue to expand in the near-term, but at a moderate pace. The fall was larger than expected, and a sign that the US presidential election may be starting to weigh on consumers' minds.

US inflation continues to run below target, with the CPI rising at an annual unadjusted rate of 1.5% in September, up from 1.1% in August. Increases in shelter and gasoline prices were the largest contributors, with gasoline prices rising 5.8% in September and representing more than half of the all items increase, with rising oil prices translating into higher prices at the pump.

The UK economy grew by a larger than expected 0.5% in Q3, with the annual change in GDP recording 2.3%. This is the first GDP release covering a full quarter of data following the EU referendum, with the Office for National Statistics noting that the pattern of growth appears broadly unaffected by the result so far, with strong performance in services industries offsetting falls in other industrial groups, including construction (-1.4%) and manufacturing (-1.0%).

But of course, it's not over yet. Even as the Kingdom was beginning to reconcile itself to the reality of Brexit, the UK High Court has ruled that parliamentary approval is required for the government to trigger Article 50. The government will appeal the decision in the Supreme Court, and may even resort to royal prerogative, depending on the Opposition's demands. Wherever it leads, it means yet more uncertainty for the UK and Europe.

German business confidence remained buoyant in October, with the Ifo Institute business climate index climbing to 110.5 pts, up from 109.5 pts in September. Similarly, the Markit/BME Germany Manufacturing PMI rose to a 33-month high of 55.0, up from 54.3 in September, with the strongest rate of job creation in over five years.

Growth in Europe remains fragile, with Q3 GDP for the euro area countries unchanged on the previous quarter at 0.3% and 1.6% on the previous year. Euro area inflation was estimated to reach an annual rate of 0.5% at the end of October, up from 0.4% in September. Growth in the price of services remains promising at 1.1%, but growth in non-energy industrial goods prices is still very weak at 0.3%.

Month in Review

Chinese GDP has remained remarkably steady since Q1 this year, holding at 6.7%. Economists may be starting to look askance at these figures, but quick to reassure markets was state media agency Xinhua, which said Beijing was not “data smoothing” its numbers. China’s October PMI surveys exceeded expectations, with both the official measure and the Caixin PMI figure hitting 51.2, showing large pickups in the output and new orders components, underpinned by a resurgence in domestic demand.

In other emerging markets, Brazil’s unemployment rate fell from 12.0% to 11.8% in September, while the CPI fell from 8.6% to 8.5%. South America’s largest economy has contracted significantly, and the IMF estimates that growth will fall by 3.3% in 2016. Russia’s economy appears to be showing signs of recovery from the recent oil price shock, with GDP forecast to contract by 0.8% in 2016. Unemployment remained steady in September at 5.2%, and inflation fell from 6.2% to 6.1%. Indian inflation fell from 4.8% to 4.3% in September, and the Bank of India left its benchmark repo rate at 6.25%, following a surprise cut early in October.

Commodities

It has been a wild ride for commodities this year. Iron ore found renewed vigour in the second half, and has risen 47.8% since the start of 2016. The price of iron ore delivered to Qingdao in China surged from USD 55.86 to 64.38 (15.3%) in October, delivering a potential windfall to the federal budget should prices hold up. This was more than matched by gains in coal – Australia’s second largest export behind iron ore, with the price of premium hard coking coal rising from USD 210.63/t to 252.41 (19.8%).

The Brent crude oil spot price fell from USD 48.24/b to 46.20 (-4.2%). WTI fell from USD 47.72/b to 46.83 (-1.9%).

Metals were mixed through October but generally rallied at the end of the month. Tin (3.4%), Zinc (3.6%) and Aluminium (3.7%) all gained strongly, while copper (-0.3%), lead (-2.8%) and nickel (-1.0%) failed to retrace their mid-month falls. Gold fell from USD 1315.87/oz to finish the month at 1277.21, reaching the lowest level since the Brexit vote, beaten down by rising expectations of a Fed rate hike.

Currencies

The AUD rose 1.7% in October in trade weighted terms, moving from its early low of USD 0.7539 to reach a mid-month high of 0.7722, ending weaker at 0.7609 (-0.7%). The AUD gained against most other major currencies, including EUR (1.7%), GBP (5.3%), JPY (2.8%) and NZD (1.2%).

The US Dollar Index closed September slightly lower (-0.6%), with the USD falling against major currencies, including EUR (-0.7%), JPY (-2.01%) and CHF (-1.3%), but gaining against GBP (1.2%) as the sterling continued its horror run since the Brexit vote, struggling to breach the USD 1.30 level.

Month in Review