Month in Review

Index returns at end June 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	3.27	8.47	4.29	13.01	9.04	9.98	6.40
S&P/ASX Small Ordinaries Accumulation Index	1.06	7.67	4.67	24.25	15.01	11.56	2.59
Global Equities							
MSCI World TR Index (AUD)	2.40	5.82	6.66	15.96	10.54	15.39	9.69
S&P 500 TG Index (AUD)	3.04	7.38	8.66	18.74	13.41	18.39	13.09
FTSE 100 TR Index (AUD)	1.38	7.07	5.05	14.73	4.84	9.88	5.50
MSCI Emerging Markets NTR Index (AUD)	-1.85	-4.45	-1.19	12.33	7.00	9.61	4.97
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	2.27	9.82	3.02	13.20	9.99	12.18	6.07
FTSE EPRA/NAREIT Dev. NTR Index (AUD Hgd)	2.03	7.31	1.62	6.42	6.88	8.80	6.77
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	0.48	0.82	1.69	3.09	3.41	4.38	6.09
Bloomberg Ausbond Bank Bill Index	0.15	0.49	0.92	1.78	1.95	2.22	3.34
Barclays Global Aggregate TR Index (AUD Hgd)	0.17	0.15	0.06	1.85	3.82	4.95	6.90

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 3.3% in June, led by the Energy (+7.8%) and IT (+6.3%) sectors. A late rally in oil prices saw oil refiner Caltex (+10.6%) gain, solidified by the announcement of a long-term wholesale food supply agreement with Woolworths (+7.2%). Machine learning tech provider Appen (+31.0%) saw the biggest price gain in June, and has surged 235.1% over the past 12 months, with investors seeing a potential wave of demand from global tech giants for artificial intelligence data.

Over the past year to June, the ASX 200 has returned 13.0%, with Australia's top 20 largest shares proving the laggards, returning 11.3%. Meanwhile, the S&P/ASX Small Ordinaries Index, the benchmark for small-cap shares, has returned a remarkable 24.3%, with themes such as technological disruption, Chinese demand, and the commodity rally driving valuations higher. Growth shares continued their winning streak through the first half of 2018 and are currently the main drivers of market returns, among them consumer staples shares like a2 Milk Co (+5.9% in June and +179.8% over 12 months), as well as big names like CSL (+3.6% in June and +39.5% over 12 months).

Global equities

Global developed market shares, measured by the MSCI World Ex Australia Index, returned 2.3% in Australian dollar terms and 0.3% in local currency terms, reflecting lacklustre US performance, ongoing European weakness, and a softer Australian dollar. The US S&P 500 Index returned 0.6%, with the Consumer Staples (+4.2%) and Consumer Discretionary (+3.5%) sectors the biggest gainers. Twenty-First Century Fox A shares (+28.9%) jumped during the month as Disney (+5.4%) bested Comcast (+5.2%) in a tense bidding war for the Murdoch owned entertainment conglomerate, offering US$71.3 billion in cash and shares. Industrials (-3.4%) was the worst performing US sector in June, dragged down by American Airlines Group (-12.8%) and Caterpillar (-10.7%).

In Europe, the STOXX Euro 600 Index fell 0.6%, with trade uncertainty weighing on major auto stocks like Volkswagen (-11.6%) and Daimler (-10.6%). Other trade-sensitive sectors took a hit during the month, including the pan-European basic resources (-3.8%) sector, while retailers (+1.9%) managed to keep their heads above water. In Asia, Japan's Nikkei 225 Index rose 0.7%, Hong Kong's Hang Seng fell 4.5%, and China's CSI 300 Index fell 7.0%. Emerging market shares fell 1.8% in Australian dollar terms, while small caps remain the superior performers over one year, returning 19.2%.

REITs

The S&P/ASX 200 A-REIT Accumulation Index rose 2.2% in June as yield contraction lifted the sector during the month. Viva Energy REIT (+9.8%) was the top gainer, with parent company Viva Energy Group announcing its long-awaited IPO. Shopping centre leasing giant Scentre Group (+5.0%) continued to push higher, supported by favourable conditions in the retail market. High-yielding shares like National Storage REIT (+3.8%) also gained, providing an attractive income alternative to banks and telcos. Meanwhile, the prospect of falling house prices did nothing to help home and apartment builders Mirvac Group (-5.7%) and Stockland (-4.3%).

Month in Review

Globally, developed market property rose 2.0% on a hedged basis in June. In the US, REITs enjoyed their fourth consecutive month of gains after suffering a sharp correction earlier in 2018. The Bloomberg US REIT Index rose 4.0%, led by shopping centres (+7.3%) and self-storage (+6.2%), while hotels (-2.8%) were down.

Fixed income

Australian bonds returned just under 0.5% in June, with Australian corporate debt returning 0.3% and government debt returning just over 0.5%. Long-term government bonds (with a maturity of ten years or more) returned 1.1%. Globally, the Bloomberg Barclays Global Aggregate Bond Index (AUD hedged) returned 0.2% as geopolitical tensions forced yields lower.

In the US, the flat shape of the yield curve continues to worry investors (a negative-sloping curve is historically a predictor of future recessions). The spread of 2-year over 10-year treasury yields converged to around 290 basis points during the month, threatening to invert for the first time since 2007. At the same time, the US Fed is gradually raising the funds rate while the government is bringing ever more short-term debt to the market to finance its tax reform package, which has helped to raise the shorter end of the yield curve.

In Europe, Germany's safe-haven Bunds underwent further yield compression, with the 10-year yield falling from 0.34% to 0.30%, while the 5-year yield pushed further into negative territory, from -0.28% to -0.31%.

ASX 200 share movements

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

Best performers		Worst performers	
GUD Holdings	32.40%	AusNet Services	-27.47%
ARB Corp	30.95%	McMillan Shakespeare	-13.37%
APA Group	25.46%	Healthscope	-13.18%
APN Outdoor Group	19.57%	Burson Group	-12.20%
Newcrest Mining	18.80%	Ramsay Health Care	-11.98%

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

Best performers		Worst performers	
ARB Corp	238.21%	Telstra Corp	-34.36%
Breville Group	217.11%	Amcor Ltd/Australia	-27.44%
APN Outdoor Group	216.95%	Ramsay Health Care	-25.08%
a2 Milk Co	179.79%	Technology One	-24.63%
ALS	167.50%	Galaxy Resources	-23.46%

Economic News

Australia

Australian economic growth is on a firm footing, supported by a bounce in global growth, a rallying commodities sector, and improved business and public sector investment. However, while there has been a surge in employment and hours worked over the past year, momentum has slowed from 2017's pace, and wages growth remains subdued at around 2.0%. Employment growth for the six months to May was an annualised 1.6%, down from a high of 4.0% in 2017. Prudential controls and tighter bank lending practices, partly in response to the Royal Commission into Financial Services, have already underpinned a marked slowdown in household credit.

While momentum has slowed, Australia's labour market continues to tighten, with 12,000 jobs added in May. Part-time jobs rose 32,600 although this was offset by a fall in full-time jobs of 20,600. The **unemployment rate** fell by 0.2 points to 5.4% in seasonally adjusted terms, while the participation rate fell 0.2 points to 65.5%. Monthly hours worked fell by 24.2 million hours (-1.4%) to 1,738.8 million hours. The quarterly labour underemployment rate, which measures those willing and able to work more hours, rose by 0.1 points to 8.5%. Since its recent high of 6.3% in July 2015, the unemployment rate has fallen 0.9 points to May 2018, while the underemployment rate has been stuck in the mid-8% range.

The **AIG Manufacturing Index** eased 0.1 points to 57.4 in June, indicating a slightly slower but still buoyant rate of expansion. The sales sub-index rose +10.8 points to 61.2 after dropping 12.1 points in May to 50.4, which appears to have been a temporary disruption to sales growth. Production (+3.2 points to 58.9), employment (+2.0 points to 58.1), stocks (+3.5 points to 50.5) and exports (+0.4 points to 52.9) also gained in June, while

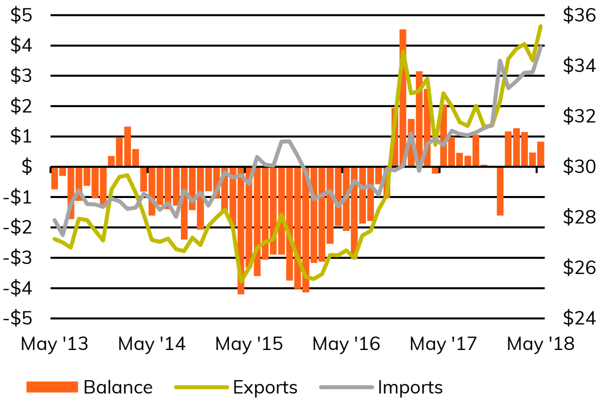
Month in Review

deliveries (-1.2 points to 58.0) and new orders (-4.8 points to 52.9) fell.

The Westpac Melbourne Institute **Index of Consumer Sentiment** rose 0.3% in June from 101.8 to 102.1, capping off the financial year on a positive note. A clear shift in consumers' view of the economy has been reflected in the gradual uplift in sentiment over the past 12 months, although this has failed to substantially impact the household finances gauge. The 'finances vs a year ago' sub-index rose 4.5%, recovering most of last month's surprisingly sharp 6.5% fall.

In a further sign that consumers may have their mojo back, **retail turnover** lifted 0.4% in May, beating expectations and coming on the back of a 0.5% rise in April. Department stores (+3.9%) had their best month since March 2015, following negative results in the previous two months. The major food retailing group (+0.3%) also rose, along with household goods (+0.1%) and clothing (+2.2%) retailers, while cafes and restaurants (-1.0%) were down.

Australia's trade balance ($ billion)



Source: ABS, Bloomberg

Australia's **trade surplus** rose in May from $472 million to $827 million, falling short of expectations. Exports grew 0.4% during the month, but are unlikely to provide the same tailwind to GDP as they did through the start of 2018. Exports rose by $1,353 million, offset by a rise in imports of $998 million. Although the surplus was narrower than expected, global conditions are boosting trade volume, with both exports and imports hitting their highest value on record.

Global

US March quarter GDP was lower than previously estimated, weighed down by the weakest consumer spending in almost five years. June's third estimate reading showed GDP growth was revised down 0.2 points to an annual rate of 2.0%, with economists expecting it to remain unchanged. While Trump's $1.5 trillion tax cuts are expected to provide a boost to consumer spending in the June quarter, the tit-for-tat tariff war with major trading partners, including China, Canada, Mexico and the EU, could prove a drag on growth, putting pressure on supply chains and possibly undercutting business investment.

As expected, the **US Fed** lifted the funds rate at its June meeting by 25 basis points to a range of 1.75–2.00%, the seventh hike in this cycle. The Fed is now projecting an additional two hikes in 2018, which would bring the range to 2.25–2.50%. It then expects a further three hikes in 2019, before reaching a peak of 3.40% in 2020, which would place it above the longer-term projection of 2.90%.

The **ISM manufacturing PMI** rose 1.5 points in June to 60.2, with a shortage of skilled labour and materials failing to put a dent in production. Sub-indices recording faster rates of expansion in June included production (+0.8 points to 62.3), supplier deliveries (+6.2 points to 68.2), and inventories (+0.6 points to 50.8). New orders (-0.2 points to 63.5) fell modestly but remains firmly in expansion, reflecting strong demand. Employment (-0.3 points to 56.0) was softer but still growing, while prices (-2.7 points to 76.8) are still showing sustained input price pressure, which is expected to flow through to consumer goods.

The **US CPI** rose 0.2% in May on a seasonally adjusted basis, with the year-on-year rate rising from 2.5% to 2.8% (the quickest rate in six years). Core inflation, which excludes food and energy, rose 0.2% over the month, rising from 2.1% to 2.2% year-on-year. In further evidence of inflation taking hold, the core PCE index—the Fed's preferred measure—rose from 1.8% to 2.0%, and is sitting at the Fed's inflation target for the first time since April 2012. Labour conditions remain tight, but jobs growth continues to surprise, with June's **non-farm payroll** release showing a greater than expected 213,000 jobs added in June.

In the ongoing trade saga, the US has threatened to hike tariffs on European automakers, with President Trump accusing the EU of imposing higher tariffs on American cars than the US imposes on European models. German Chancellor Angela Merkel signalled her willingness to lower tariffs on American cars, contingent on agreement from Germany's 'big five'. Meanwhile, the IMF has issued its own warning for the German economy. While it expects growth will continue apace at 2.2% in 2018 and 2.1% in 2019, a trade war or a banking crisis would strike a severe blow to confidence.

Euroarea inflation rose to 2.0% in June from 1.9% in May, driven by an 8.0% rise in energy prices. The core rate, which excludes volatile items including food and energy, fell from 1.1% to 1.0%, with policymakers hoping for a sustained move higher. Although oil prices are bolstering the headline rate, services inflation plunged from 1.6% to 1.3% and, while this is likely to be a one-off, there is little sign of underlying improvement.

Month in Review

Unemployment in the eurozone was 8.4% in May, stable compared to April and down from 9.2% over the past 12 months. Three years since the Greeks held a referendum on whether to accept the EU's bailout conditions, the Greek unemployment rate is sitting at 20.1%, with the government expecting it to fall to 18.4% by the end of 2018 based on budget estimates. In Italy, the governing coalition of right-wing parties has solidified its economic program, putting both tax cuts and universal basic income in its first budget, proving to voters and markets it is not backing down from its agenda. These fiscal measures, along with an expected slowdown in growth, will likely reduce the pace of budget deficit reduction.

China's economy continues to show signs of fatigue, with slowing credit growth and infrastructure spending pointing to softer economic growth for the June quarter. June's **official PMI** figure showed a further slowing in the manufacturing economy, falling from 51.6 to 51.5, while industrial production also slowed, falling from 6.9% to 6.8% year-on-year. Chinese firms have been feeling the pinch from the government's measures to curb risky lending, which has resulted in higher borrowing costs and reduced access to funds for smaller companies. The **People's Bank of China** (PBOC) responded by cutting reserve requirements for the major state-owned banks—the third such move in 2018.

On 6 July, US tariffs on US$34 billion worth of Chinese goods came into effect, with China responding in kind with tariffs on American soybeans, pork and electric vehicles. The major fear for markets is that this is merely the first of many tariff rounds in an escalating trade conflict. PBOC Governor Yi Gang said China will "keep the yuan exchange rate basically stable at a reasonable and balanced level", and said recent weakness was the result of market fluctuations and not central bank guidance.

Commodities

Commodities were mixed in June, with oil prices continuing their rally, which has been ongoing since mid-2017, while metal prices slumped on global trade fears. The spot price of Brent oil rose 1.3% to US$77.44 per barrel and over the past year has rallied 64.5% from a price of $47.08. The WTI oil price rose 10.7% in June to $74.13, converging on the Brent price. Base metals took a tumble in June, with Zinc (-7.9%) the biggest loser, followed by Aluminium (-6.9%), Tin (-4.1%), Copper (-3.3%), Nickel (-2.1%) and Lead (-2.0%). Gold continued to fall through June, dropping 3.5% from US$1,298.51/oz to $1,252.60. The price of iron ore delivered to China (62% Fe) fell from US$61.57/t to $60.44, reduced from its most recent high of $76.88 in February.

Currencies

The Australian dollar lost ground against the US dollar in June as a more hawkish Fed drove the US currency higher. With the Fed expected to lift rates by 50 basis points before the end of 2018, further downside in the AUD is to be expected. The Australian dollar fell 0.3% in trade-weighted terms in June, losing against the GBP (-1.5%), EUR (-2.3%) and JPY (-0.3%).

Over the three months to June, the Australian dollar has fallen -3.6% against the US dollar, reaching a high of 0.7786 in April and a low of 0.7355 near the end of June. On a trade-weighted basis, the Australian dollar has risen modestly by 0.5%, gaining against the GBP (+2.3%), EUR (+1.6%), JPY (+0.5%) and NZD (+2.3%).

Month in Review