Month in Review

Index returns at end May 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	1.09	1.08	2.81	9.63	5.94	8.76	5.24
S&P/ASX Small Ordinaries Accumulation Index	3.70	4.11	6.89	25.40	11.55	9.69	1.26
Global Equities							
MSCI World TR Index (AUD)	0.48	2.77	2.50	10.37	8.68	15.35	8.46
S&P 500 TG Index (AUD)	2.15	3.17	3.11	12.42	11.39	18.47	11.71
FTSE 100 TR Index (AUD)	-0.98	6.84	5.28	7.76	2.91	9.40	4.63
MSCI Emerging Markets NTR Index (AUD)	-3.77	-2.94	1.22	12.19	6.58	9.59	3.99
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	2.98	7.50	0.86	5.69	7.71	11.46	4.57
FTSE EPRA/NAREIT Dev. NTR Index (AUD Hgd)	2.23	7.66	0.61	4.81	4.59	7.82	5.25
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	0.69	1.18	0.68	1.67	2.93	4.07	6.07
Bloomberg Ausbond Bank Bill Index	0.17	0.48	0.91	1.78	1.96	2.24	3.39
Barclays Global Aggregate TR Index (AUD Hgd)	0.33	0.05	-0.99	1.10	3.92	5.00	7.64

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 1.1% in May, with the biggest gains coming from the Health Care (+5.6%) and Consumer Discretionary (+5.1%) sectors. Australia's leading biotechnology business CSL (+9.1%) advanced to its highest price since listing in 1994 after announcing its second profit upgrade in 2018, including better than expected sales. Seven West Media (+47.8%) jumped early in the month after acquiring the free-to-air broadcast rights from Cricket Australia, taking them off channels Nine and Ten.

The Materials sector (+2.0%) was higher in line with a rise in base metal prices, with gains from major miners BHP Billiton (+6.0%) and Oz Minerals (6.4%). Telecommunications (-10.2%) was the worst performing sector, with Telstra (-12.0%) hitting seven-year lows in the wake of multiple network outages during May and ongoing concerns about competition from the NBN. Australia's large cap shares (measured by the S&P/ASX 50 Accumulation Index) rose 1.0% in May, compared to a 3.7% gain from its small cap peers. Over the past 12 months to the end of May, small caps have outperformed large caps by 17.9%, while large cap shares are lagging the ASX 200 Index over short and medium terms.

Global equities

Global developed market shares, measured by the MSCI World Ex Australia Index, returned 0.5% through May in AUD terms, bolstered predominately by gains from the United States and United Kingdom. The US S&P 500 Index rose 2.4% in USD terms, with the Information Technology sector (+7.1%) the best performer, contributing 77% of the S&P 500's gains in May. Facebook (+11.5%) bounced back despite continued fallout from the Cambridge Analytica scandal, while Apple (+13.1%) moved closer to becoming the first stock to reach a market capitalisation of US $1 trillion.

In Europe, the STOXX Euro 600 Index rose a modest 0.5%, weighed down by Europe's banks (-9.0%), including major falls from Italian banks like Unicredit (-21.4%), which were most impacted by uncertainty surrounding Italy's election outcome and the possibility of an 'Italexit'. In Asia, Japan's Nikkei 225 Index fell -1.2%, Hong Kong's Hang Seng fell -0.4%, and China's CSI 300 Index gained 1.5%. Global emerging market shares, measured by the MSCI Emerging Markets Index, fell -3.8% in AUD terms, but have still outperformed developed market shares over the past 12 months.

REITs

The S&P/ASX 200 A-REIT Accumulation Index rose 3.1% in May as modest falls in short-term yields lifted the sector during the month. Almost all major A-REITs gained, led by Investa Office Fund (+15.0%), which received a $3.1 billion bid from US fund manager Blackstone. Shopping centres had another positive month, with gains from Vicinity Centres (+9.4%), which will sell $1 billion of 'non-core' sub-regional centres to focus on premium malls, and Scentre Group (+3.7%), which may be one of the beneficiaries of the sale of Westfield if former shareholders feel the need to reinvest their cash payout in shopping centre stocks.

Diversified property managers Abacus (+6.1%) and GPT Group (+3.9%) also had a solid month. Globally, the FTSE EPRA/NAREIT Developed Ex Australia Index (AUD hedged) rose 2.2% in May. In the US, the REIT

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recovery gathered more steam in what was the best month for REITs so far in 2018. Mall REITs, which have suffered in recent quarters from tenant bankruptcies, continued their turnaround, returning 9.4% in May, while hotels returned 10.9% and health care facilities 7.4%.

Fixed income

Australian bonds returned 0.7% in May, with Australian government bonds returning 0.8% and longer-term government bonds (with a maturity of ten years or more) returning 1.3%. Globally, the Bloomberg Barclays Global Aggregate Bond Index (AUD hedged) returned 0.4% as geopolitical tensions pushed safe haven yields lower. After briefly moving into positive territory mid-month, Germany's 5-year Bund yield ended May at -0.27% as the prospect of a eurosceptic coalition in Italy solidified.

After hitting 3.1% earlier in the month, the US 10-year Treasury yield finished the month just above 2.8%, with the spread between 10-year and 2-year yields narrowing to 43 basis points. While the market is concerned about the flatness of the yield curve (a negatively sloping yield curve is correlated with recessions), there is some debate about whether central bank policies globally are creating a false signal. The Japanese 10-year yield fell from 0.06% to 0.04%, still hovering above the Bank of Japan's zero yield target, which the Bank hinted could be scrapped even before inflation reaches the 2% target.

ASX 200 share movements

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

Best performers	
Seven West Media	47.75%
Wisetech Global	46.41%
Blackmores	29.26%
IDP Education	26.04%
Reliance Worldwide	25.35%

Worst performers	
Metcash	-19.44%
Automotive Holdings Group	-17.75%
Link Administration Holdings	-17.35%
Greencross	-15.25%
MYOB Group	-13.54%

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

Best performers	
Bellamy's Australia	248.14%
A2 Milk Co	212.26%
Lynas Corp	184.71%
Beach Energy	164.56%
Altium	147.28%

Worst performers	
Retail Food Group	-84.05%
Telstra Corp	-36.36%
Mayne Pharma Group	-28.57%
Perpetual	-27.77%
QBE Insurance Group	-26.51%

Economic News

Australia

The Reserve Bank of Australia (RBA) left the **cash rate** anchored at 1.5% at its June meeting, and judging by the most recent Statement on Monetary Policy, it is unlikely to change course any time soon. Ongoing low wages growth, uncertainty over the extent and impact of the recent tightening in home lending conditions, and inflation barely in the bottom of the RBA's target range suggest that it would be premature to begin exiting current accommodative policy settings. However, the broader economic picture remains robust, with **March quarter GDP** recording annual growth of 3.1%, and labour and business conditions pointing to solid fundamentals.

Australia's labour market continues to add jobs, with seasonally adjusted employment rising by 22,600 persons in April. Full-time jobs continued to rise, with 32,700 added in April, and a total of 72,600 added since the start of 2018, offsetting a fall in part-time employment of 11,400. The **unemployment rate** rose by 0.1 points to 5.6%, driven by more people looking for work and a rise in the participation rate, which in trend terms rose to a record high of 65.7% in April. The number of unemployed persons looking for full-time work fell 17,100 to 506,100 and those looking for part-time work rose 27,600 to 234,900. Monthly hours worked rose 19.4 million to 1,764.0 million.

The **AIG Manufacturing Index** eased by 0.8 points to 57.5 in May, indicating a slightly slower but still buoyant rate of expansion. May marked the twentieth month of growth for the manufacturing economy, and the longest run of expanding or stable conditions since the 50 continuous positive months between July 2001 and July 2005. A number of major sub-indices saw increased growth in May, including deliveries (+5.4 points to 59.2), exports (+4.5% to 52.5) and new orders

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(+0.8 points to 62.4). Falls came from sales (-12.1 points to 50.4), production (-6.4 points to 55.7) and stocks (-2.8 points to 47.0). Employment held steady at 56.1.

The Westpac Melbourne Institute **Index of Consumer Sentiment** fell in April from 103.0 to 102.4, remaining in optimistic territory but still well below the 105-115 levels typically associated with a strong consumer-led economy. The sub-index tracking views on finances over the next 12 months posted a sharp fall of 5.8%, while the economic outlook over the next five years rose 2.9%, unwinding part of March's 4.4% drop, which was likely due to the escalating tariff war.

Retail turnover lifted 0.4% in April, beating what were admittedly fairly low expectations. Contributing to the rise was the major food retailing group (+0.3%), household goods retailing (+0.7%) and restaurants (+1.3%), while department stores (-0.9%) were lower. Company gross operating profit for the March quarter jumped 5.9%, nearly twice what the market expected. Mining profit led the way, rising 11.0%, but non-mining profit was also solid at 3.4% (versus an expected rise of only 0.5%), led by construction, manufacturing and retail.

Australia's **balance of payments** figures for the March quarter showed a narrower current account deficit of $10,469 million, improving on December's deficit of $14,661 million. The balance on goods and services rose $5,105 million over the quarter from a deficit of $1,022 million to a surplus of $4,083 million. Total goods credits rose $1,903 million in seasonally adjusted chain volume terms. Resource goods credits added $1,707 million and general merchandise added $1,062 million, while rural goods fell $554 million.

Global

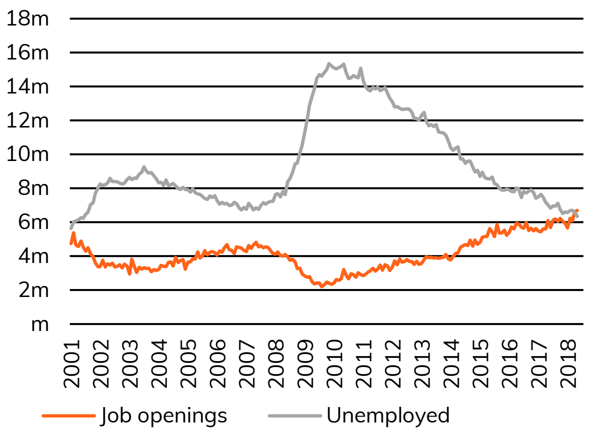
US March quarter GDP was revised down 0.1 points to an annualised 2.2% according to May's second estimate reading, missing against the expected reading of 2.3%. Despite the slower-than-expected growth, there are signs of a stronger June quarter, including improved consumer spending and business investment, while January's income tax cuts are expected to start flowing through to the household and business sectors.

On the trade front, the White House announced that it is determined to move ahead with tariffs on US $50 billion worth of Chinese goods, in what China's Commerce Ministry described as a "violation of the consensus" reached between the two countries only days earlier. Meanwhile, across the Atlantic, the European Union is preparing for its own retaliatory tariffs against a list of key US exports.

The **ISM manufacturing PMI** rose 1.4 points in May to 58.7. The index has recorded results over 55 for the past year, reflecting strong demand, although some manufacturers have expressed concern about the potential impact of tariffs on the price of Chinese-sourced inputs. Major sub-indices recorded an increased rate of expansion in May, including production (+4.3 points to 61.5), new orders (+2.5 points to 63.7) and employment (+2.1 points to 56.3). Other indices slowed but remained in expansion, including inventories (-2.7 points to 50.2) and new export orders (-2.1 points to 63.5). Prices rose modestly by 0.2 points but remain at a six-year high, hitting 79.5 points in May.

The **US CPI** rose 0.2% in April on a seasonally adjusted basis, reaching an unadjusted year-on-year rate of 2.5%. Core inflation, which excludes food and energy, rose 0.1% over the month to remain steady at 2.1% year-on-year, which is just above the Fed's 2% target. The core PCE index—the Fed's preferred measure—eased from 1.9% to 1.8%, after jumping from 1.6% in March. Real consumer spending rose 0.4% in April in a sign that economic growth is regaining momentum.

US job openings and employment



Source: Bureau of Labor Statistics

Non-farm payrolls rose by 223,000 in May, beating expected growth of 189,000. Job openings at the end of April hit a record high of 6.7 million, and revised data showed March was the first time since records began in 2000 that openings exceeded the number of unemployed. The unemployment rate dropped further from 3.9% to 3.8%.

Concerns over slowing world trade growth and rising geopolitical tensions, together with extreme weather conditions, have combined to undermine economic activity across the European continent. The spectre of a trade war with the US also places major European economies in an uncertain position, with Germany particularly vulnerable given its large trade surplus in manufactured goods, including automobiles. While the pace of Europe's economic growth is moderating, there is no sign yet of a turning point—May data showed **euro area GDP** growth was 2.5% in the March quarter, down on December quarter growth of 2.8%.

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Inflation in the euro area made a surprise comeback in May, jumping from 1.2% to 1.9% and smashing the consensus rate of 1.6%. Energy prices were the key drivers of the move, rising 6.1% in May. Core inflation, which excludes energy, food, alcohol and tobacco, rose from 0.7% in April to 1.1%.

In May the ECB celebrated its 20th birthday, with the past four of those years seeing non-conventional monetary policy become the market norm. The question of what monetary policy should look like over the next four years is a debate unlikely to be resolved in the immediate present. While inflation has shown signs of moving higher, it is still below target, and even if net asset purchases were to end, monetary policy would remain extraordinarily accommodative.

In Italy, the political impasse was finally broken, with a coalition government formed between the two popular right parties, Lega Nord and the Five Star Movement. The new government has announced it will tackle Italy's high levels of debt, but has ruled out an exit from the euro (much to the relief of markets).

While **China's March quarter GDP** growth was a promising 6.8% year-on-year, indicators of manufacturing output growth and business investment remain subdued. China's **official manufacturing PMI** rose in May from 51.4 to 51.9, indicating a modest improvement in growth, however the unofficial Caixin PMI, which measures output from smaller firms, was steady at 51.1.A key focus for President Xi Jinping's government is financial risk control. China's courts have begun handing down harsh sentences for fraudulent financing practices, while a slowing in credit creation, especially within the shadow banking sector, has created a more restrictive lending environment.

May data showed investment spending growth slowed to just 7.0% year-on-year in April—a far cry from the mid-20% range experienced through 2010-11—and infrastructure investment growth for the January to April period slowed 0.6 points to 12.4% year-on-year. Real estate investment has also softened, and property sales by floor area dropped 4.1% year-on-year to April. China's exports have maintained solid growth in 2018 in line with broad strength among Asia's big exporters, although this may be threatened by US tariffs, which would make Chinese goods more expensive in the country's biggest export market.

Commodities

Commodities built on April's gains through May, with global demand ostensibly unaffected by tariff fears. Nickel was the biggest gainer, rising 11.5%, and other base metals also rose, including lead (+5.6%), aluminium (+1.6%) and copper (+0.7%), while tin (-2.7%) and zinc (-0.9%) were down. Gold continued to fall through May, dropping -1.3% to US $1,298.51/oz. The price of iron ore delivered to China (62% Fe) fell from US $63.32/t to $61.57. Oil prices were mixed in May, with WTI falling 2.3% to US $67.0/b while Brent rose by 0.7% to $76.5.

Currencies

The Australian dollar rose 0.3% against the US dollar in May and 1.1% on a trade-weighted basis, helped by strengthening metals prices and a transitory cooling in US-China trade talks. The Australian dollar finished the month at USD 0.7566, and made even stronger gains against the euro (+3.9% to end the month at EUR 0.6483) and the British pound (+3.8% to end the month at GBP 0.5691). With the Fed expected to lift rates to at least 2.75% over the coming 18 months (and Australian rates likely to remain steady), further downside in the AUD is to be expected.

Over the three months to May, the AUD has fallen -2.9% against the USD from its high of 0.7786 in April, but has been flat in trade-weighted terms, falling against the JPY (-1.1%) and gaining against the EUR (1.6%), GBP (0.7%) and NZD (+0.1%).

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