Month in Review

Index returns at end August 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	1.42	6.19	7.33	15.40	11.46	8.94	6.77
S&P/ASX Small Ordinaries Accumulation Index	2.49	2.53	6.75	22.32	16.90	9.19	3.12
Global Equities							
MSCI World TR Index (AUD)	4.11	9.29	12.32	24.71	11.81	15.56	9.64
S&P 500 TG Index (AUD)	6.14	12.74	16.33	31.24	15.35	19.39	12.82
FTSE 100 TR Index (AUD)	-1.50	0.11	7.13	15.20	3.92	7.73	5.04
MSCI Emerging Markets NTR Index (AUD)	0.01	-0.29	-3.22	8.93	10.68	9.51	5.27
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	2.61	5.94	13.89	15.68	10.77	13.15	5.97
FTSE EPRA/NAREIT Dev. NTR Index (AUD Hgd)	1.23	4.25	12.24	7.50	8.25	9.94	6.74
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	0.81	1.45	2.65	3.84	3.08	4.48	5.78
Bloomberg Ausbond Bank Bill Index	0.17	0.51	0.99	1.85	1.95	2.20	3.24
Barclays Global Aggregate TR Index (AUD Hgd)	0.29	0.48	1.30	0.83	3.54	4.92	6.65

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 Index returned 1.4% in August, with the Telecommunications (+13.1%), Information Technology (+12.9%) and Health Care (+10.7%) sectors among the top gainers. TPG (+50.0%) and Vodafone announced a merger that will provide a major third challenger to Telstra (+9.2%) and Optus, with a combined enterprise value of $15 billion. The merger is positive news for markets as it should result in stabilising Average Revenue Per User (ARPU) but could raise competition concerns.

Earnings season saw a flurry of buying in the IT sector on the back of positive earnings results, led by language and search data services company Appen (+41.2%), which announced revenue growth of 106% in H1 2018 driven by both organic growth and its Leapforce acquisition. Energy stocks (-1.3%) were down, due predominantly to major gentailer Origin Energy (-18.6%), with its Energy Markets division bolstered by higher wholesale electricity prices but underlying earnings impacted by competition and higher-than-expected currency hedging costs. Both Origin and AGL (-5.5%) are also subject to regulatory uncertainty with the scrapping of the National Energy Guarantee (NEG). The Materials sector (-4.8%) took a hit in August as commodity prices tumbled and the US dollar rose on fears of emerging market contagion and trade tensions between major economies.

Global equities

Global developed market shares, measured by the MSCI World Ex Australia Index, returned 4.1% in Australian dollar terms, driven by US share performance and a rising US dollar. The US S&P 500 Index returned 3.2% in local terms, with Information Technology (+6.7%) the top performing sector, followed by Consumer Discretionary (+5.0%) and Health Care (+4.2%). Apple (+19.6%) continued its inexorable rise through August, reporting revenue growth of 17% over the year, strong demand for the iPhone X and robust growth in services like Apply Pay and Apple TV. Amazon (+13.2%) drove gains in the consumer discretionary sector, becoming the second stock after Apple to reach a US $1 trillion market cap.

European shares, measured by the broad STOXX Euro 600 Index, were down 1.8% in August, with falls from Banks (-8.1%), Telecommunications (-7.1%) and Basic Resources (-6.8%). The MSCI Emerging Markets Index was steady in August in Australian dollar terms, but certain emerging market indices were hit hard in local currency terms, including China's CSI 300 Index (-5.0%) and Turkey's Borsa Istanbul 100 Index (-4.4%). Recent emerging market volatility began in Turkey as the result of the country's weakening fiscal position, a strengthening US dollar, and a potential trade war with the US. However, investors fear these issues may become systemic within the emerging markets sector.

REITs

The S&P/ASX 200 A-REIT Index returned 2.7% in August led by industrial property manager and Amazon landlord Goodman Group (+11.1%), which announced better-than-expected operating profit for FY 2018. The retail sector continues to drag due to both structural and cyclical headwinds, with income growth among shopping centre portfolios lagging office and

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industrial. BWP Trust (-2.4%), whose core tenant is Wesfarmers-owned Bunnings Warehouse, came under pressure in August due to flat results and concerns that the transitioning of some Bunnings stores to alternative uses may result in rent-free periods. Scentre Group (-3.3%), the manager of Westfield, was lower in August despite announcing a 3% rise in funds from operations, with leasing spreads (the difference in rental terms between new and existing leases) falling from -2.5% to -6.6% over the past year. Globally, developed market property rose 1.1% on a hedged basis in August. US REITs had a solid month, with the Bloomberg US REIT Index up 2.2%, with gains from the Health Care (+6.4%), Single Tenant (+3.7%) and Mall (+3.1%) sectors.

Fixed income

The Barclays Global Aggregate Index returned 0.3% in AUD hedged terms, with developed market yields largely holding firm on the back of positive economic data, while yields in some emerging markets fell sharply. The US 10-year Treasury yield held below 3.00% throughout August, falling as low as 2.82% before rising above 2.90% in early September following strong jobs numbers. The 2-year yield finished August at 2.63% before climbing to 2.71% in early September—its highest level in more than 10 years.

The latest growth and inflation data leave the US Fed in tightening mode, with a 25 basis point hike expected in September and a strong likelihood of another move in December. Markets are concerned that central banks in Turkey, Argentina and other emerging markets may need to draw down heavily on foreign exchange reserves, including US Treasuries, to stem pressure on their currencies. Locally, Australian bonds returned 0.8% in August, with Australian corporate debt returning 0.8% and government debt returning 0.9%, while long-term government bonds (with a maturity of ten years or more) returned 1.5%.

ASX 200 share movements

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

Best performers		Worst performers	
TPG Telecom	50.00%	SpeedCast International	-31.61%
Appen	41.16%	Sims Metal Management	-26.76%
WiseTech Global	40.07%	Pact Group Holdings	-23.84%
Altium	37.40%	Iluka Resources	-18.95%
Afterpay Touch Group	27.86%	Western Areas	-18.83%

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

Best performers		Worst performers	
Afterpay Touch Group	380.90%	G8 Education	-46.63%
Appen	226.87%	Fortescue Metals Group	-36.11%
Beach Energy	194.25%	AMP	-34.51%
Altium	181.14%	Sigma Healthcare	-33.33%
WiseTech Global	167.33%	Greencross	-31.05%

Economic News

Australia

Australia's GDP growth was a stronger-than-expected 0.9% for the June quarter and 3.4% year-on-year—the fastest growth since 2012 during the height of the mining boom. Growth was boosted by a 0.7% rise in consumer spending, despite households struggling with low wage growth and falling house prices. The June figures compare favourably to the 2.9% growth for the 2017-18 financial year, as well as the RBA's estimate of just over 3.0% for 2018 and 2019.

However, while headline growth is strong, wage growth remains modest and spending growth is being supported by a falling savings ratio. Gross operating surplus for all industries increased 7.2% year-on-year with the mining industry the main contributor, driven by both higher production and continued strength in commodity prices. It is no surprise that the RBA has kept rates unchanged at current low levels. Inflation and wage growth are not consistent with higher rates, while declining house prices combined with tighter credit conditions mean the RBA will be carefully monitoring developments over the coming quarters. June quarter data showed private sector wages grew by a slightly stronger 0.6% for the quarter but only 2.0% for the year, essentially flat in real terms.

Australia's labour market remains in a tightening trend, but recent growth in employment is showing signs of losing momentum. Full-time employment rose by a seasonally adjusted 19,300 in July, offset by a fall in part-time employment of 23,200. The **unemployment rate**

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edged lower from 5.4% to 5.3%, reaching its lowest level since 2012 but driven predominately by a fall in the number of part-time job seekers. The participation rate fell 0.1 points to 65.5% while monthly hours worked rose a modest 4 million (+0.2%) to 1,750 million hours.

The **AIG Manufacturing Index** rose 4.7 points to 56.7 in August, recovering from July's sudden drop in momentum and firmly pointing to expansion. After a typically volatile end to the financial year, the sales index (+15.2 points to 60.7) returned to expansion, while new orders (+8.5 points to 59.6) recovered strongly and exports (+8.5 points to 58.4) were boosted by a lower Australian dollar through August. Other indices moved higher, including production (+6.9 points to 57.2), employment (+3.0 points to 53.3) and deliveries (+1.3 points to 58.3), while the stocks index (-3.6 points to 51.1) slowed.

Following a wave of positivity in June and July, the mood of consumers was decidedly less cheery in August. The Westpac Melbourne Institute **Index of Consumer Sentiment** fell 2.3% in August from 106.1 to 103.6 as consumers seemed to forget about the tax cuts that were passed into law in June, while negative news stories from overseas, especially around trade, put a dampener on confidence. The survey period did not cover the leadership crisis in Canberra, but it is clear that economic uncertainty has risen, with the 'economic outlook, next 12 months' sub-index down 4.9% and views on employment softening.

Retail turnover was flat in July, putting a halt to the steady but subdued pace of sales growth through 2018. Pain for department stores continued, with a fall in turnover of 1.9% in July coinciding with David Jones' write-down of goodwill to the tune of $713 million. Clothing and accessory retailing dropped 2.0% and the household goods retailing group saw a fall of 1.2%. The major food retailing group managed a rise of 0.3% and cafes and restaurants added 0.6%.

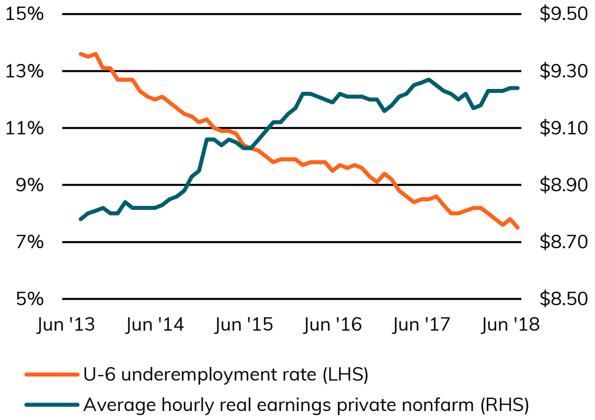
Australia's **balance on goods and services** narrowed in July from $1,937 million to $1,551 million. Exports of non-rural goods fell $138 million, including a fall in exports of metal ores and minerals of $367 million. Exports of general merchandise fell $214 million and non-monetary gold fell $189 million. On the debit side, imports of fuels and lubricants grew $712 million and intermediate and other merchandise goods rose $605 million.

Global

The US economy is growing at a solid rate and employment continues to build, but inflation expectations are still largely unchanged and wage growth, while showing some promising signs, remains stubbornly low despite labour market tightness. Currency markets have been volatile, in part due to the trade issue. Emerging markets have been severely impacted but US shares continued their rise in August on the back of positive company earnings results.

US June quarter GDP was an annualised 4.2% according to the second estimate reading, revised upwards from the initial 4.1% estimate. The Atlanta Fed's latest GDPNow estimate for September quarter growth jumped as high as 4.7% at the start of September following positive manufacturing data, moderating to 4.4% based on incoming trade and auto sales data. Growth remains at its highest in nearly four years, with the economy on track to reach the Trump administration's 3.0% annual growth target.

US underemployment and hourly earnings



Source: BLS

Minutes from the US Fed's July/August meeting revealed the Fed is generally upbeat about economic growth, employment, and trade, although the committee noted a potential slowdown in goods exports in June. However, measures of long-term inflation expectations have barely changed, while wage growth measures have risen only modestly. Markets fully expect a rate rise at the Fed's next policy meeting on 25-26 September and a further hike in December.

The **ISM manufacturing PMI** rose 3.2 points to 61.3 in August, with strong demand reflected in a higher rate of expansion in new orders (+4.9 points to 65.1). Production (+4.8 points to 63.3) and employment (+2.0 points to 56.5) both grew at a faster rate on the previous month. Inputs (expressed as supplier deliveries, inventories and imports) continued to expand, partly due to continuing supply chain inefficiencies and a slight easing of imports. While the impact of tariffs is yet to how up strongly in demand or input costs, manufacturers are finding it difficult to budget for future uncertainty.

US consumer price inflation was steady at a year-on-year rate of 2.9% in July, while the core CPI, which excludes food and energy, rose from 2.3% to 2.4%. The core PCE index—the Fed's preferred measure—rose to

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2.0% year-on-year in July after pulling back to 1.9% in June, bolstering the case for a September rate hike. Employment continues to grow, with August's non-farm payroll release revealing an impressive 201,000 jobs were added during the month, beating the expected 191,000.

In Europe, economic growth is maintaining momentum but is largely disappointing in absolute terms, while inflation remains weak and is forecast to remain below target over the next three years. June quarter economic growth for euro member countries was 2.2% year-on-year, and while the ECB expected growth to slow from its peak of 2.5% in 2017, it has slowed earlier than expected, reflecting weaker export performance. ECB President Mario Draghi has played down concerns about an economic slowdown, making it clear that the ECB remains on track to cease bond purchases after December.

Euroarea inflation fell in August from 2.1% to 2.0% year-on-year, with a 9.2% rise in energy price inflation the only thing sustaining the headline CPI figure. Underlying inflation (excluding energy, food, alcohol and tobacco) was down from 1.1% to 1.0%. The UK economy continues to add jobs, with unemployment at 4.0% and possibly set to move lower in September. On the Brexit front, the biggest stumbling blocks remain the Irish border plan and the UK's post-exit trade relationship with the EU. The next big event is the Conservative Party conference on 30 September, with Prime Minister May needing to satisfy the party's grassroots before any real concessions can be made to EU negotiators.

China's headline GDP for the June quarter showed a steady growth rate at 6.7%, but growth in the first half of the year has moderated to 6.4%, with a decline in investment spending being the driving force. China's debt-to-GDP ratio appears to have stabilised, albeit at very high levels, while the shift in debt growth from the shadow banking sector to the more regulated bank sector is also a welcome development. Investment spending growth eased back to 5.5% in July—the slowest pace in decades—with investment in utilities and the transport sector turning down sharply after years of rapid growth.

Measures of manufacturing activity show industrial production growth relatively steady at around 6.0%, while PMI readings eased further in August. The People's Bank of China has improved liquidity by lowering reserve requirements for banks, but this has contributed to lower market interest rates and a lower yuan. The Chinese currency has lost 8.0% against the US dollar since the end of March due to domestic easing measures, US Fed tightening, and concerns over a possible trade war.

Commodities

The commodities sector gave markets a non-too-subtle sign in August that trade tensions are a danger to the global economy. Given Australia's economic fortunes are tied to commodities, investors watched the diagnosis of Dr Copper with interest, and it seems the patient could be in better shape. Base metals took a tumble in August, with falls from Nickel (-8.8%), Zinc (-6.4%), Tin (-5.4%), Copper (-5.2%) and Lead (-3.6%), with Aluminium (+2.1%) gaining. Gold fell 1.8% to end the month at US $1200.12/oz, down from its April high of $1358.31. Oil prices were mixed in August, with Brent oil rising 3.8% to US $76.94/barrel while WTI crude was flat.

Currencies

Strong US growth relative to other major developed economies has seen the US dollar gain 6.2% against the euro and more than 8.2% against the pound since the end of March. The rise in the US dollar has been even more pronounced against many emerging market currencies, particularly those with large current account deficits and external debt positions. The Australian dollar fell against major currencies in August, including the US dollar (-3.3% to 0.72), British pound (-2.1% to 0.55), euro (-2.5% to 0.62) and Japanese yen (-4.0% to 79.82).

Over the three months to August, the Australian dollar has fallen 5.0% against the US dollar, reaching a high of 0.7666 in June to finish August at a six-month low of 0.7189. On a trade-weighted basis, the Australian dollar has depreciated 1.0% over the past three months, losing value against the EUR (-4.4%), JPY (-3.0%) and GBP (-2.5%), and gaining against the NZD (-0.5%).

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