Month in Review

Index returns at end September 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	-1.26	1.53	10.13	13.97	12.11	8.19	7.75
S&P/ASX Small Ordinaries Accumulation Index	-0.35	1.10	8.86	20.32	16.97	8.75	4.78
Global Equities							
MSCI World TR Index (AUD)	0.55	7.32	13.57	21.29	13.05	15.67	10.12
S&P 500 TG Index (AUD)	0.52	9.99	18.11	27.87	16.15	19.94	12.94
FTSE 100 TR Index (AUD)	1.47	0.20	7.28	11.82	5.28	7.92	5.96
MSCI Emerging Markets NTR Index (AUD)	-0.58	1.00	-3.49	7.56	11.25	9.07	6.32
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	-1.55	1.98	12.00	13.25	10.30	12.59	6.46
FTSE EPRA/NAREIT Dev. NTR Index (AUD Hgd)	-1.84	0.30	7.63	5.63	7.09	8.55	7.50
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	-0.42	0.54	1.36	3.72	2.85	4.28	5.60
Bloomberg Ausbond Bank Bill Index	0.16	0.52	1.01	1.87	1.94	2.19	3.19
Barclays Global Aggregate TR Index (AUD Hgd)	-0.38	-0.07	0.08	0.89	3.15	4.64	6.68

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 -1.3% in September as the benchmark was dragged down by Financials (-2.2%) and the Health Care sector (-7.7%), including a major dip in pharmaceuticals giant CSL (-11.5%) which is coming off record highs following August's earnings season. The Federal Government's announcement of a royal commission into the aged care sector also impacted care providers Estia Health (-22.3%) and Fisher & Paykel Healthcare (-8.1%), which will begin engaging on the terms of reference of the inquiry. Meanwhile, the Royal Commission into Financial Services weighed on major insurance providers in September, with falls from Suncorp (-6.7%) and Insurance Australia Group (-5.2%).

The Energy sector (+4.3%) was the top gainer in September, recovering from August's falls, led by oil and gas explorer Beach Energy (+10.3%). Materials (+4.2%) also bounced back, with Rio Tinto (+8.3%) announcing a US$3.2 billion share buyback. In September the S&P/ASX 200 Communications Services Index was formed, merging telecommunications, media and online advertisers. September performance was split across the new sector, with telcos Vocus Group (+15.1%) and Telstra Corporation (+2.9%) gaining, while Carsales.com (-6.7%) and Southern Cross Media Group (-6.7%) were the biggest losers.

Global equities

Divergence between developed and emerging market shares has been a key theme in global markets, and it awaits to be seen if September's recovery in emerging market shares will be sustained. Global developed market shares, measured by the MSCI World Ex Australia Index, saw modest gains in local currency terms, bolstered by gains from the US and Japanese markets. The Dow Jones Industrial Index hit a record high in early October, pushing above 28,600 points, and the Japanese Nikkei 225 returned 6.2%, powering to a 27-year high following the final negotiation of a trade deal between the US, Mexico and Canada (USMCA).

Leading US sector returns was the newly created Communications sector (+4.3%), which was boosted by traditional media and telco stocks including Viacom (+15.3%) and AT&T (5.1%), while 'new' media stocks Twitter (-19.1%) and Facebook (-6.4%) were down. The MSCI Emerging Markets Index was down 0.6% in September in Australian dollar terms but rose 1.8% in US dollar terms. Emerging market equities recovered partially through September, with the Turkish market rising 16.3% in US dollar terms and the Argentinian index rising 7.0%. Selling in emerging market currencies showed signs of reversing in September, only to continue to slide through the start of October.

REITs

The S&P/ASX 200 A-REIT Index returned -1.8% in September as rising yields brought the sector under pressure. Shopping centres tracked downwards, with Vicinity Centres (-5.4%) sliding through the month before announcing the selloff of 11 centres for $631 million, and Scentre Group (-3.4%) feeling the pinch as department stores battle falling revenue. Over the past year, the ASX 200 A-REIT Index has delivered broadly in line with the ASX 200 Index, and has outperformed Australian shares over five and seven years. While

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rising long-term bond yields are generally negative for REITs, especially those with higher leverage, the sector is proving relatively robust, indicating that investors are still looking for exposure to sustainable income and high-quality property. Labour's plan to eliminate most cash refunds for excess franking credits may also result in a shift away from high-dividend paying and franked shares in preference of REITs and infrastructure. Globally, developed market property returned -1.8% on a hedged basis in September. US REITs hit a roadblock in September, with the Bloomberg US REIT Index down 3.1%, with falls in Health Care (-4.8%), Office (-4.3%) and Malls (-3.2%).

Fixed income

Global bonds, measured by the Barclays Global Aggregate Index, returned -0.4% in September in AUD hedged terms as yields in both developed and emerging markets pushed higher. The US 10-year Treasury yield rose to a seven-year high in early October, pushing above 3.20% on the back of positive employment data, while markets focused on the potential for higher inflation and the impact of rising interest rates on equity markets.

Following the Fed's September rate hike, markets are still strongly anticipating a further increase in the funds rate in December, which would bring the target range to 2.25–2.50% by the end of 2018. Another three hikes are currently projected for 2019, which would move the funds rate above the 'neutral' rate. The Australian 10-year Treasury yield rose in September from 2.52% to 2.67%. The Australian dollar has been closely tracking the continued erosion of Australia's interest rate spread, with the difference between the Australian 2-year Treasury yield moving just below 90 basis points in early October. Government yields in Turkey and Argentina, both of which have been on the front line of recent market turmoil, eased through September.

ASX 200 share movements

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

Best performers		Worst performers	
Vocus Communications	15.09%	Lynas Corp	-27.17%
South32	12.64%	Estia Health	-22.30%
Monadelphous Group	12.06%	Blackmores	-19.43%
Pilbara Minerals	11.80%	Resolute Mining	-14.23%
Sigma Healthcare	10.53%	Aveo Group	-14.04%

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

Best performers		Worst performers	
Afterpay Touch Group	329.43%	G8 Education	-50.86%
Appen	168.14%	Eclipx Group	-36.54%
WiseTech Global	153.91%	AMP	-33.95%
Altium	152.91%	Automotive Holdings Group	-33.43%
Mayne Pharma Group	96.97%	Syrah Resources	-33.14%

Economic News

Australia

The Australian economy continues to outpace expectations. For the first half of 2018, Australia's GDP expanded at an annualised pace of 4.0%, challenging the US economy for the strongest rate of growth in the developed world. Recent growth outcomes are broadly in line with the RBA's and Treasury's optimistic projections, while the household sector has maintained solid consumer spending in the face of very subdued wage growth.

However, while overall employment and hours worked have contributed to 4.6% growth in total labour 'compensation', the per head calculation was up only 1.6% over the year. In other words, wage growth remains anaemic and growth in overall income has been driven by population and employment growth.

Employment rebounded strongly in August, with 44,000 seasonally adjusted jobs added in August, including gains in both full-time (+33,700) and part-time (+10,200) workers. The result allayed fears of a slowdown in employment growth, while the data also showed a fall in the underemployment rate of 0.3 points to 8.1%. While still relatively high in historical terms, it shows that Australia's labour market is continuing its tightening trend. The **unemployment rate** was unchanged at 5.3% due to a rise in the participation rate of 0.2 points to 65.7% Monthly hours worked in all jobs edged higher by a modest 0.6 million to 1,750.9 million hours.

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The **AIG Manufacturing Index** climbed 2.3 points to 59.0 in September, bringing up two years of uninterrupted expansion in the manufacturing economy. All seven measures of activity indicated growth over the month, with new orders (+3.0 points to 62.6), exports (+0.5 points to 58.9), production (+1.5 points to 58.7), employment (+4.8 points to 58.1) and stocks (+2.6 points to 53.7) showing stronger growth on the previous month, while sales (-3.1 points to 57.6) and deliveries (-1.1 points to 57.2) were slower but still firmly in expansion.

The mood of consumers appears to have taken a dark turn in recent months, with the Westpac Melbourne Institute **Index of Consumer Sentiment** falling 3.1 points to 100.5 in September, following a 2.5 point drop in August. Out-of-cycle mortgage rate hikes from the major banks appear to be the main culprit, while political instability, soft wage growth and falling home prices have also contributed to the gloomier outlook, while strong labour market conditions remain the bright spot. Consumer views around family finances were notably weaker in September, with the 'finances vs a year ago' and 'finances, next 12 months' sub-indexes both recording 3.6% falls.

Retail turnover rose 0.3% in August, rebounding modestly following a flat month in July and broadly in line with expectations. Department stores enjoyed a 0.9% rise, while clothing gained 0.8%, indicating August's 2.1% drop might have been partly due to weather. Spending in discretionary areas were higher, offsetting flat month for the major food retailing group and providing evidence of robustness in the household sector.

Australia's **balance on goods and services** grew from a surplus of $1,595 million in July to $1,716 million in August, beating economists' expectations despite falling revenue from mining and metals. The value of goods exports rose $139 million, but included a fall in non-rural goods of $222 million and was supported by a rise in exports of non-monetary gold of $228 million. Exports of metal ores and minerals fell $239 million, reflecting lower metals prices through September.

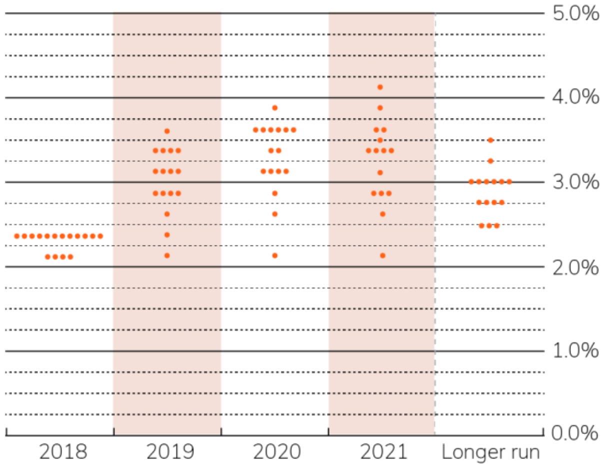
Global

The US economy is powering along, and the September quarter is likely to see a repeat of June's solid growth rate. However, there are concerns that tax cuts and the imposition of tariffs have led to some short-term effects, as manufacturers and purchasers ramp up inventory ahead of further possible tariff increases. A rising US dollar and slowing housing market activity may also be a handbrake on strong GDP growth.

At its September meeting the **Federal Reserve** voted to raise the funds rate for the third time in 2018, hiking by 25 basis points to a target range of 2.00–2.25%. Based on a backdrop of strong jobs growth, as well as robust consumer spending and business investment, the increase was taken more or less as a given by the market. The Fed's forecast for GDP growth for 2018 is 3.1% (up from June's forecast of 2.8%) and 2.5% over 2019 (up from 2.4%). The forecast for PCE inflation remains at 2.1% for 2018, but has been revised down for 2019 from 2.1% to 2.0%.

September's non-farm payrolls release was below expectations, showing jobs growth of 134,000, but the unemployment rate is now at its lowest level since 1969. Focus remains on US-China trade relations, with the Trump administration imposing tariffs on US $200 billion of Chinese goods and threatening a further US $267 billion—in effect covering the entire US trade balance with China.

FOMC dot plot



Source: FOMC

The **ISM manufacturing PMI** fell 1.3 points in September to 59.8, indicating a mild slowdown in growth but still firmly in expansion. The new orders index (-3.3 points to 61.8) showed a noticeable dip in September but remains above 60 points, indicating strong demand. Supplier deliveries (-3.4 point to 61.1), inventories (-2.1 points to 53.3) and prices (-5.2 points to 66.9) were also down, while production (+0.6 points to 63.9), employment (+0.3 points to 58.8) and new export orders (+0.8 points to 56.0) pushed higher. However, manufacturers are predominantly concerned about tariffs, with a number of factories reporting higher input costs and reduced export opportunities.

US consumer price inflation for all items fell in August from an annualised 2.9% to 2.7%, while core CPI, which excludes food and energy, fell from 2.4% to 2.2%. The core PCE index—the Fed's preferred measure—was steady at 2.0% year-on-year, paving the way for September's rate hike. Higher oil prices and continued strength in consumer confidence and other economic indicators have led to concerns about inflation, but so far long-run expectations remain muted. Fed Chair

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Jerome Powell said early in October that the economy could expand for "quite some time", which markets took as a hint to expect further tightening.

Recent **economic data across the EU** has been relatively soft with Italian, French and Spanish CPIs all missing estimates, and Spain's June quarter GDP revised lower. Growth across the eurozone was 0.4% in the June quarter and 2.1% over the year. GDP growth in Germany was 0.5% in the June quarter, up from 0.4%, buoyed by strong increases in consumer and government spending, while France, Italy and Spain saw subdued growth in private consumption. There is some evidence that the German economy is starting to rebalance, with most of the growth in GDP coming from government spending and retail demand on the back of rising wages.

ECB President Mario Draghi backed up previous hawkish statements, describing eurozone inflation as "relatively vigorous", although this was not entirely corroborated by September's inflation release. While headline inflation rose in September from 2.0% to 2.1% year-on-year, **core inflation** was softer, falling from 1.0% to 0.9%. The Italian government spooked investors with a deficit target of 2.4% of GDP, which was significantly higher than the 1.6–1.9% previously indicted by Italy's finance minister.

The news out of **China** has been mixed over the past month. The crackdown on credit growth in the shadow banking sector has been a significant factor behind the weakness in investment spending, although modest fiscal stimulus and easier liquidity conditions in the traditional banking market has supported growth. Stimulus may be needed to offset export growth, with the US imposing tariffs on US $200 billion of Chinese exports in September, which is estimated to wipe 0.5 percentage points off Chinese GDP growth.

September's official **manufacturing PMI** showed a fall from 51.3 to 50.8, while the private sector PMI dipped to a flat 50.0 reading, indicating no expansion. Industrial production growth was 6.1% while retail sales rose modestly to 9.0%. The easing in policy has contributed to lower market interest rates and a lower yuan. The currency has lost more than 9.0% against the surging US dollar since late March on the back of domestic easing measures, US Fed tightening, and concerns over a possible trade war with the US.

Commodities

Commodities were mostly higher in September, with a recovery in Copper (+4.7%) and iron ore and steel prices resilient despite ongoing trade tensions. In the metals market, Zinc (+6.3%) was also higher, but Aluminium (-3.0%), Lead (-2.0%), Nickel (-1.6%) and Tin (-0.6%) were down. Gold fell 0.6% to end the month at US $1192.52/oz, down from its April high of $1358.31. Oil prices were higher in September, with Brent crude rising from US $76.94 per barrel to $82.72—its highest price in over four years—and WTI rising from $69.84 to $73.16.

Currencies

The Australian dollar has been among the worst-performing G10 currencies in 2018, despite prices for key commodities including iron ore and coal proving resilient despite a slowing Chinese economy. The Australian dollar has fallen by more than 11% since its February high, pushing against the 70 US cent threshold. A key factor to Australian dollar weakness is the widening spread between Australian and US interest rates, which may become more pronounced as the Fed continues to tighten.

The Australian dollar was flat in trade-weighted terms through September, gaining again the USD (+0.5% to 0.72), EUR (+0.4% to 0.62) and JPY (+2.9% to 82.13) and falling against the GBP (-0.1% to 0.55). Over the three months to the end of September, the Australian dollar has depreciated 2.4% against the US dollar, falling from 0.7405 to a low of 0.7105 in September to end the month at 0.7224. On a trade-weighted basis, the Australian dollar has depreciated 0.6% over the past three months, losing value against the EUR (-1.8%), GBP (-1.1%) and NZD (-0.2%) and gaining against the JPY (+0.2%).

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