Month in Review

Index returns at end December 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	-0.12	-8.24	-6.83	-2.84	6.69	5.63	9.00
S&P/ASX Small Ordinaries Accumulation Index	-4.18	-13.70	-12.75	-8.67	7.45	5.62	6.87
Global Equities							
MSCI World TR Index (AUD)	-4.12	-10.91	-4.38	1.99	8.09	10.30	10.18
S&P 500 TG Index (AUD)	-5.64	-11.12	-2.24	6.23	10.46	13.82	13.01
FTSE 100 TR Index (AUD)	-0.08	-9.30	-9.13	-4.54	2.80	3.40	6.86
MSCI Emerging Markets NR Index (AUD)	0.97	-4.91	-3.96	-5.10	10.45	6.64	7.92
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	1.73	-1.71	0.24	3.27	7.55	12.53	10.66
FTSE EPRA/NAREIT Dev. NR Index (AUD Hgd)	-6.03	-5.76	-5.48	-3.95	3.28	7.06	11.69
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	1.50	2.24	2.80	4.54	3.70	4.67	5.19
Bloomberg Ausbond Bank Bill Index	0.15	0.48	0.99	1.92	1.91	2.15	3.07
Barclays Global Aggregate TR Index (AUD Hgd)	1.43	1.66	1.59	1.65	3.51	4.82	6.35

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 -0.1% through December, rebounding in the first week of January 2019 as Wall Street recovered slightly from a horror end to 2018. The ASX outperformed global shares, holding up well compared to other major markets. Volatility, measured by the ASX 200 VIX Index, remained elevated through December, rising above 20.0 before easing slightly into the new year. Materials (+5.3%) was the best performing sector in December, with BHP (+11.5%) rising on the back of news that it will pay a special dividend of US $1.02 per share (A $1.42) following the completion of its US $5.2 billion share buyback, while Rio Tinto (+7.1%) ended the month higher after confirming the sale of its Grasberg mine interest in Indonesia.

Gains in the Health Care sector (+2.9%) were led by pharmacy distribution business Sigma Healthcare (+16.3%) following a merger proposal from rival Australian Pharmaceutical Industries (-5.8%), the owner of pharmacies Priceline and Soul Pattinson. Within the Communications sector (-5.1%) it was a tough month for media, with Nine Entertainment (-21.4%) still struggling after its high-profile acquisition of Fairfax, while telcos were also in negative territory as the ACCC voiced concerns over the proposed merger between TPG (-10.4%) and Vodafone.

Global equities

Global shares fell 4.4% in Australian dollar terms in December as major developed markets plummeted on fears of slowing global economic growth and the prospect of an escalation in trade conflict. The US S&P 500 Index fell 9.0% in December, dropping to a low of 2351 points (its lowest level since April 2017) and recovering to above 2500 in the new year. Trade tensions between the US and China continued to impact markets, while a standoff between the Trump White House and Congress over immigration and the funding of a border wall has created additional uncertainty, resulting in a partial shutdown of some government departments.

The start of the new year greeted Apple (-11.7%) investors with lower guidance for its first quarter, which pointed to a significant drop in operating income on the previous year. Higher prices for the iPhone has been offset by weaker demand, most obviously in China. The STOXX Europe 600 Index fell 5.6% in local currency terms, with the Retail (-8.0%), Bank (-7.7%) and Auto (-7.2%) sectors hardest hit. In Asia, Japan's Nikkei 225 Index fell 10.3% in local currency terms and China's CSI 300 Index dropped 5.1%.

REITs

The S&P/ASX 200 A-REIT Index returned 1.7% in December as the outlook for interest rate rises softened and bond market yields fell. Shopping centres came under pressure in December, with falls from Shopping Centres Australasia (-3.4%) and Vicinity Centres (-2.6%), but overall the sector has maintained its high occupancy rates in the face of the online onslaught. On the other side of the equation, industrial property manager Goodman Group (+3.7%), whose biggest tenant is Amazon, saw a 26.2% rise in its share price over 2018. Viva Energy REIT (+8.7%) was the top performer in December, with investors attracted to its relatively high

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yield and low levels of leverage that allow for some debt-funded growth. December saw the completion of Oxford Properties' $3.4 billion all-cash acquisition of the Investa Office Fund, consisting of investment grade office buildings in Australia's CBDs. While Australian REITs were able to stand their ground in December, the fate of global listed property was tied to the deep falls in equity markets, which saw developed market REITs outside of Australia fall 6.3% in hedged terms. US REITs were no exception, falling 8.5%, with the biggest falls coming from Hotels (-13.4%), Offices (-11.7%) and Malls (-11.0%).

Fixed income

Global bonds measured by the Barclays Global Aggregate Index returned 5.8% in December in Australian dollar unhedged terms and 1.4% in hedged terms as yields in major developed markets fell through December and early January. The end of the ECB's quantitative easing was expected to put upward pressure on European yields, even in Germany where there is a relative scarcity of safe government Bunds, but so far there are few signs of this happening. The US 10-year Treasury yield fell from 2.99% to 2.69% in December, before dropping as low as 2.55% in early January 2019. Similarly, the Australian 10-year Treasury yield fell from 2.59% to end 2018 at 2.32% before falling further to 2.18% in the new year. Germany's 10-year Bund yield fell from 0.31% to 0.24% in December, while the 5-year yield fell further into negative territory from -0.27% to -0.32%.

Japan's 10-year government bond yield also dipped into negative territory, falling from 0.087% at the start of December to -0.045% in early January 2019. In December yields on US 2-year government bonds rose above those for 3 and 5 years for the first time since 2008, while the spread between the 10- and 2-year Treasury yield narrowed to below 11 basis points, raising fears of a potential economic recession.

ASX 200 share movements

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

Best performers		Worst performers	
GrainCorp	25.62%	Pilbara Minerals	-25.60%
Resolute Mining	21.58%	Orocobre	-25.23%
Saracen Mineral Holdings	18.62%	IOOF Holdings	-25.07%
Evolution Mining	17.52%	Lynas Corp	-24.52%
WiseTech Global	16.51%	Emeco Holdings	-21.62%

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

Best performers		Worst performers	
Bravura Solutions	113.87%	Syrah Resources	-66.63%
Afterpay Touch Group	107.71%	Automotive Holdings Group	-57.14%
Saracen Mineral Holdings	73.37%	Orocobre	-53.47%
Altium	63.40%	AMP	-52.79%
IDP Education	60.49%	Ausdrill	-52.63%

Economic News

Australia

The RBA's December minutes revealed that members were wrongfooted by the September quarter GDP release, which came in lower than expected at 2.8% year-on-year compared to an expected figure of over 3.0%. Members noted that the outlook for household consumption is uncertain due to low income growth and relatively high levels of household debt, together with declining property prices. However, the bank still expects steady growth in consumption supported by robust labour market conditions and a gradual pickup in wage growth. Australian **house prices** fell 4.8% in 2018 according to CoreLogic, driven by sharp falls in the Sydney (-8.9%) and Melbourne (-7.0%) markets. Sydney house prices fell 1.8% in December and 3.9% during the quarter, while the fall across all capital cities was 1.3% and 2.8% respectively. According to the ABS, price falls are now also evident in the middle and lower segments of the market, while auction clearance rates and volumes are trending lower. Treasurer Josh Frydenberg called on the banks to keep their books open to "ensure affordable, accessible and timely loans".

Labour force data for November showed employment rose 37,000 in seasonally adjusted terms, driven by a rise in part-time employment of 43,400, which was offset by a fall in full-time employment of 6,400. In trend terms there are still signs of momentum within the labour market, with 171,500 full-time jobs added through 2018

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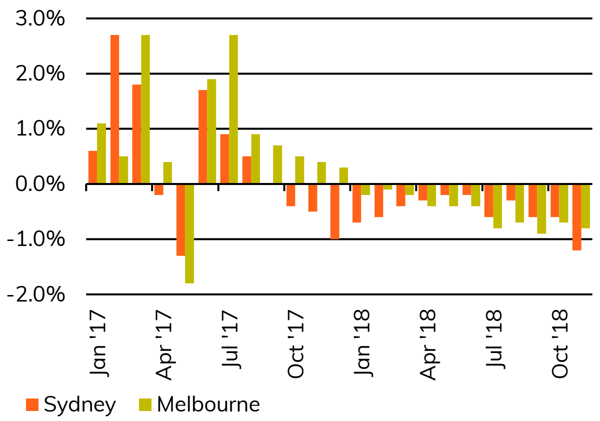
to the end of November, including strong growth in the second half of the year despite November's weakness. The **unemployment rate** rose 0.1 points in November to 5.1%, pushed higher by a rise in the participation rate of 0.2 points to 65.7%, which in trend terms is the highest on record. Monthly hours worked in all jobs fell 3.3 million to 1,759.5 million hours.

The **AIG Manufacturing Index** dropped 1.8 points to 49.5 in December to finish 2018 in a state of mild contraction. Weaker conditions were seen across most indices, including Production (-2.4 points to 48.4), Employment (-1.5 points to 47.9), Exports (-3.7 points to 47.1) and Sales (-2.3 points to 50.3), while New Orders were steady (+0.3 points to 49.0) but still in contraction. Input Prices (+1.3 to 76.3) remained elevated, especially for energy-intensive sectors, while the Selling Prices index (-6.3 points to 44.1) fell into contraction in December, meaning tighter margins for businesses.

Monthly change in median house price (Sydney and Melbourne)



Source: CoreLogic, Lonsec

The Westpac Melbourne Institute **Index of Consumer Sentiment** edged higher in December from 104.3 to 104.4, indicating a positive end to 2018 despite the negative headlines around falls in home prices and the share market. Confidence among mortgagees actually improved, hinting that concerns about rising interest rates may be fading, while labour market strength has led to greater security and recent falls in petrol prices have given consumers some extra cash in their pockets. However, other sub-indices remain subdued, including the 'finances vs a year ago' and 'finances, next 12 months', which both declined in December but remain comfortably above their earlier 2018 lows.

Australia's **balance on goods and services** narrowed in November from $2,013 million to $1,925 million (a drop of 4.4%). Exports of general merchandise fell $206 million and non-rural goods fell $173 million, offset by exports of non-monetary gold of $681 million. On the debits side, imports of general merchandise rose $613 million and consumption goods rose $202 million. The resilience of fuel exports surprised on the upside despite a fall in global energy prices, rising $90 million to $5.4 billion, while fuel and lubricant imports fell $145 million.

Global

The US Fed lifted the target funds rate to a range of 2.25–2.50% as markets had long anticipated, but the move was not entirely without doubt given recent market volatility and concerns over slower economic growth. The Fed lowered its forecast for 2018 GDP growth from 3.1% to 3.0% and reduced its 2019 forecast from 2.5% to 2.3%. While 2018 saw the three rate hikes markets expected at the start of the year, the FOMC is now more dovish in its outlook, reflected in Fed Chairman Jay Powell's comment that "it is more likely the economy will grow in a way that calls for two rate increases next year."

US **September quarter GDP** grew by an annualised 3.4%, revised down 0.1 points from the previous estimate, with consumer spending growth marked down from 3.6% to 3.5% and fixed investment down from 1.4% to 1.1%. While fiscal stimulus measures have supported growth, there are signs that the economy is losing momentum amid a widening trade deficit, sluggish business spending and housing market weakness which is likely to put pressure on households. However, the economy remains on track to meet the Trump administration's target of 3.0% growth in 2018. The Atlanta Fed's GDPNow estimate of growth for the December quarter was 2.6% in early January.

The **ISM manufacturing PMI** fell 5.2 points to 54.1 in December reflecting a softening in demand and a slowing in employment and production. New Orders (-11.0 points to 51.1) registered a sharp slowdown, retreating to recent lows, while Production (-6.3 points to 54.3) continues to grow but at a slower pace. Prices (-5.8 points to 54.9) continue to rise but at a significantly lower rate compared to previous months, reflecting falls in prices for metals (steel and aluminium).

Eurozone GDP growth continues to disappoint, rising 0.2% in the September quarter according to December's estimate. In Germany, the growth picture continues to be clouded by developments in the auto industry, with major car manufacturers having problems certifying vehicles in accordance with the new exhaust and consumption standards.

The IHS Markit Europe Sector PMI showed further falls in output for autos, driven by a drop in new orders, while purchasing of inputs contracted at the sharpest rate since March 2013. Meanwhile, PMI data point to continued slowing in the European economy, with the IHS Markit Eurozone Composite PMI recording the slowest growth in over four years, falling from 52.7 to 51.1 in December. The slowdown in part reflects the ongoing protests in France, which have impacted industrial production and services.

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At its December meeting the Governing Council of the ECB decided to bring an end to its asset purchase programme, which has been in place since March 2015 and has resulted in the purchase of around €2.6 trillion worth of debt (predominately government bonds). The market reacted nervously to the removal of monetary support, with concerns focused on Italy, which would experience the most pain should interest rates rise given its high debt-to-GDP ratio of over 130%, with some analysts predicting it could rise to nearly 180% by 2020.

China's official manufacturing PMI fell from a flat 50.0 to 49.4 in December, marking the first month of contraction since July 2016, driven by the domestic economic slowdown and the ongoing trade dispute between Beijing and Washington DC. New export orders contracted for the seventh month in row. At the start of December, Chinese President Xi Jinping and US President Trump were able to negotiate a 90-day delay to the implementation of tariffs due to be introduced on 1 January 2019. Trade talks resumed at the start of January, with the world watching closely to see if any breakthrough can be made, or if the US will make good on its threat to impose tariffs on a further US $200 billion worth of Chinese exports.

The People's Bank of China cut the reserve requirements for the country's commercial banks, effectively injecting US $117 billion of liquidity into the banking system, while also urging them to lend to small- and medium-sized businesses. The authorities are also beginning to ramp up stimulus spending, approving a US $125 billion rail project, which will add 6,800 km of track (a 40% increase on the distance added in 2018). Markets might be hoping for full-blown stimulus measures like those seen in 2009 and 2015 which supported global demand, but this seems like wishful thinking. Chinese officials have stated that the economy is still likely to reach its 2018 growth target of 6.5%.

Commodities

Oil prices continued their slide through December, with the Brent crude price falling from US $57.71 per barrel to $50.57 and the WTI crude price falling from $50.78 to $45.15, rebounding in early January 2019 as government data showed US crude stocks fell less than expected. Metals were mixed through December, with Aluminium (-5.7%), Nickel (-4.6%), Copper (-3.8%) and Zinc (-3.0%) down and Tin (+5.8%) and Lead (+2.5%) rising. Gold rose 5.0% to end the month at US $1281.58/oz, rising above $1300 early in the new year.

Currencies

The Australian dollar resumed its fall in December, reaching a 10-year low of US $0.6715 in early January 2019 as the Chinese economic picture weakened, only to bounce back above $0.71 on hopes that progress can be made towards a trade settlement between the US and China. Over 2018 the Australian dollar fell 9.8% against the US dollar driven by the interest rate differential between the two countries.

The Australian dollar fell 4.1% in trade-weighted terms through December, falling against the US dollar (-3.6% to 0.70), British pound (-3.6% to 0.55), euro (-4.7% to 0.62) and Japanese yen (-6.9% to 60.70). Over the December quarter the Australian dollar fell 2.5% against the US dollar, 0.33% against the British pound, 1.2% against the euro, 5.6% against the Japanese yen and was down 2.4% in trade-weighted terms.

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