Month in Review

Index returns at end May 2019 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	1.71	4.88	15.32	11.08	10.60	7.74	10.05
S&P/ASX Small Ordinaries Accumulation Index	-1.25	2.69	10.91	2.06	9.84	8.82	6.53
Global Equities							
MSCI World TR Index (AUD)	-4.18	1.73	7.24	9.51	11.26	12.68	12.18
S&P 500 TG Index (AUD)	-4.87	2.00	6.17	13.34	13.39	16.33	15.60
FTSE 100 TR Index (AUD)	-4.60	-0.11	9.35	0.82	5.60	5.18	7.88
MSCI Emerging Markets NR Index (AUD)	-5.78	-1.95	6.80	-0.29	11.52	7.97	6.55
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	2.30	6.00	16.31	17.22	8.22	13.63	14.11
FTSE EPRA/NAREIT Dev. NR Index (AUD Hgd)	-0.26	2.39	6.17	8.97	6.16	7.52	12.80
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	1.70	3.85	7.08	8.96	4.33	5.01	5.80
Bloomberg Ausbond Bank Bill Index	0.15	0.48	0.99	1.99	1.87	2.10	3.00
Barclays Global Aggregate TR Index (AUD Hgd)	1.38	3.14	5.70	6.04	3.38	4.69	6.61

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 1.7% in May, with the price index rising above 6,500 points to end the month at just under 6,400 as global pressures, including the re-emerging US-China trade dispute, added to uncertainty over the month. Despite the weakness, Australian large cap shares held up well compared to global indices, with the top 50 stocks rising 2.6%. The top performing sectors in May were Communications (+7.3%), boosted by gains from Nine Entertainment (+18.9%), which is making inroads outside of broadcasting with its online streaming business Stan and online property portal Domain. Telstra (+8.0%) has benefited from the ACCC's decision to block the TPG-Vodafone merger and has regained favour from the market after horrifying investors with a dividend cut in 2018.

The Health Care sector (+3.3%) was led by Resmed (+11.3%) and Ramsay Health Care (+6.9%), while the Materials sector saw large gains from mid-tier miners and solid advances from the likes of Newcrest (+8.8%) and Rio Tinto (+5.2%), whose price hit an 11-year high on the ASX. Dragging on performance in May was the Consumer Staples sector (-4.2%), which continues to be impacted by soft retail sales and a struggling household sector. Agribusiness Costa Group (-30.3%) was hardest hit, affected by low-yielding raspberries and high water costs.

Global equities

Global shares retreated in May as the re-emergence of trade fears and the adjustment of market expectations with respect to rate cuts dampened the outlook. Developed market shares, measured by the MSCI World Ex Australia Index, lost 4.3% in Australian dollar terms while emerging market shares fell 5.7%, buffeted by a rise in the US dollar. The US S&P 500 Index lost 6.4% in May, with falls from all sectors excluding property, including significant falls from the Energy (-11.7%) and Information Technology (-8.9%) sectors. IT saw large falls from equipment manufacturers such as Qualcomm (-22.4%), while Apple (-12.8%) and Facebook (-8.2%) were hit by the risk-off wave. Volatility crept back into play with the CBOE Volatility Index rising from April's low of 12.0 points to a high of 20.6 in May.

Europe was unable to avoid the pain, with the broad STOXX Europe 600 Index falling 5.3%. Auto sector shares (-13.7%) are still exposed to potential disruptive trade negotiations with the US and the integrated nature of the global value chain means almost no participant is left unscathed. Meanwhile the sharp fall in yields has put pressure on Europe's major banks (-11.6%), forcing some to multi-year lows. Asian markets were also hit by trade fears, with falls in Japan's Nikkei Index (-7.4%), China's CSI 300 Index (-6.9%) and Hong Kong's Hang Seng Index (-8.4%).

REITs

Australian listed property had a positive month in May, returning 2.5% as a drop in fixed income yields drove prices higher in what tends to be a rate-sensitive sector. Stockland (+17.5%) was the standout performer, boosted by the dissipation of some negative sentiment following the Coalition's election win, which spelled the end for any changes to negative gearing. Mirvac Group (+7.1%) and Charter Hall Group (+5.4%)—both holders of residential developments—also gained, with Mirvac

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also luring investors with a 5% lift in its FY19 dividend. Shopping centres continue to struggle in the face of softer retail activity and a cautious household sector, with Shopping Centres Australasia (-1.2%) and Scentre Group (-0.5%) down in May. While Labor's negative gearing proposals were thought to favour developers by limiting tax concessions to new stock, the improvement in sentiment has so far had a greater impact on the sector. Globally, developed market REITs fell 0.3% in Australian dollar hedged terms. In the US, REITs were flat in May in US dollar terms, with gains from Public and Self-Storage (+5.9%), Healthcare (+5.1%) and Manufactured Homes (+3.2%) and falls from Regional Malls (-7.1%), Hotels (-6.9%) and Warehouse and Industrial (-2.7%) REITs.

Fixed income

The bond market is still expecting the Fed to ease policy through to 2020, while the US administration is showing it is prepared to keep the trade dispute with China running, and possibly even attempt to renegotiate deals with Mexico and Europe. While recent Fed comments suggest an extended period of steady rates, markets clearly see a rolling trade dispute as a key factor in favour of additional monetary support. In Europe, yields have fallen steeply, reflecting a deterioration in the economic outlook. The ECB made no changes to its key rates in June, but President Mario Draghi stated it is "determined to act in case of adverse contingencies."

The German 10-year Bund yield hit record lows, falling from 0.01% to -0.20% in May, signifying declining confidence in the growth outlook. French yields moved from 0.37% to 0.21% and UK yields dropped 30 basis points from 1.18% to 0.89%. The fall in yields led to positive performance from bond indices, with the Bloomberg Barclays Global Aggregate Index (AUD Hedged) returning 1.4%. Markets remain spooked by the inverted US yield curve, which is a potential indicator of recession, with the spread of 10-year over 2-year Treasury yields narrowing in May from 24 to 19 basis points.

ASX 200 share movements

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

Best performers		Worst performers	
Lynas Corp	54.04%	Costa Group Holdings	-30.34%
Domain Holdings Australia	21.85%	Reliance Worldwide Corp	-24.80%
Evolution Mining	21.32%	Nufarm	-22.13%
Syrah Resources	19.37%	BlueScope Steel	-21.64%
nib holdings	19.13%	Link Administration Holdings	-21.45%

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

Best performers		Worst performers	
nearmap	274.59%	Eclipx Group	-67.44%
Afterpay Touch Group	208.82%	Pact Group Holdings	-59.89%
Appen	154.95%	Syrah Resources	-57.94%
Vocus Communications	90.46%	Nufarm	-57.80%
Magellan Financial Group	88.09%	Galaxy Resources	-55.01%

Economic News

Australia

Market expectations for a cut in interest rates were satisfied in June as the RBA decided to lower the cash rate by 25 basis points to a record low 1.25%. The outlook remains broadly unchanged with the Australian economy expected to grow by 2.75% in both 2019 and 2020, but the RBA noted its intention is to provide additional support to the labour market and ensure that inflation expectations can be sustained. The move follows the very low inflation reading for the March quarter, which pointed to a significant downshift in growth over the second half of 2018, driven by falls in dwelling approvals and weakness in household spending, which has not been reflected in labour market indicators. The Coalition was the upset winner in the federal election, and this appeared to unwind some pessimism in the housing market, although the Australian dollar came under renewed pressure as trade fears pushed the US dollar higher.

While jobs growth has been robust, with a further 28,400 jobs added in April, a rise in the participation rate has seen the unemployment rate rise to 5.2%, up from 5.1% in March and 4.9% in February. The unemployment rate in NSW has risen from 3.9% to 4.5% in the space of four months, while in Victoria it has risen from a low of 4.2% in December to 4.9%. While these monthly readings can

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be volatile, the trend is difficult to ignore in the major eastern states.

The **AIG Manufacturing Index** fell 2.1 points in May to 52.7, remaining in expansion but growing at a slower rate. Respondents reported lower demand during the month, while higher electricity costs are still impacting the industry, especially the metals and machinery & equipment sectors. After heading higher in the previous month, key sub-indices were lower in May, with falls in Production (-6.9 points to 51.2), New Orders (-3.3 points to 52.3), Exports (-3.6 points to 50.3) and Sales (-2.3 points to 51.6). Only Employment (+4.1 points to 55.6) and Finished Stocks (+2.9 points to 50.8) grew at a faster pace.

The Westpac Melbourne Institute **Index of Consumer Sentiment** rose 0.6% to 101.3 points in May, indicating a modest improvement in the mood of consumers following the April federal budget and in the leadup to the election. Interestingly, the post-Budget period Index reading was 104.3, indicating that the Budget was well received but that sentiment subsequently eased by around 3%. While the RBA stayed on the sidelines in May, consumers were clearly anticipating June's rate cut, with the 'family finances vs a year ago' index improving by 6.3%.

Retail activity softened in April with turnover falling 0.1% over the month compared to a 0.3% rise in March. The major food retailing group rose 0.2% and has so far experienced solid growth through 2019, while other sectors have been mixed. Turnover in the household goods retailing group fell 0.9%, indicating consumers were holding off on some key purchases, while clothing and restaurants saw falls of 1.2% and 0.7% respectively. Department stores have been volatile so far in 2019, falling 1.5% in March but bouncing back 1.8% in April. NSW felt the drop more acutely, with sales dropping 0.4%—the largest fall in more than seven years.

Australia's **balance on goods and services** showed a trade surplus of a seasonally adjusted $4,871 million in April, narrowing slightly on the previous month but still holding up near record highs due to a strong commodities market, including rises in iron ore prices due to supply problems in Brazil and weaker Chinese output. Exports of metal ores and minerals added $1,375 million (a 16% rise on the previous month) while general merchandise fell a net $366 million.

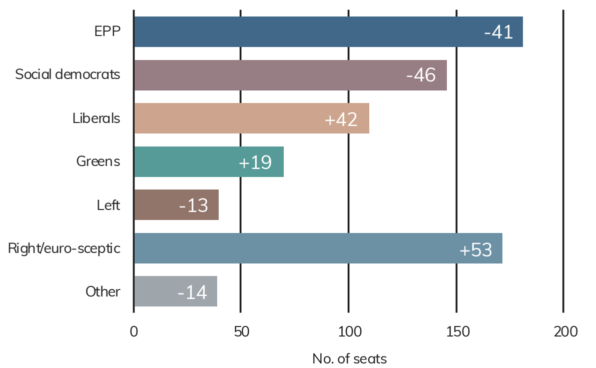
Global

The breakdown in trade negotiations between the US and China has rattled markets, while the growing threat of protectionism has dampened the economic outlook. Central banks have dispensed with further tightening, but markets clearly see a case for easing given the current geopolitical risks, low inflation, and the fear of an economic downturn.

The US economy seems to have settled back towards a more sustainable growth path. The **March quarter GDP** result of 3.1% overstates the underlying position of the economy, but the Atlanta Fed's GDPNow of just 1.2% growth for the June quarter likely understates the true picture. In any case, the US is on track to record its longest post-war economic expansion come June when it matches the 120-month expansion of the 1990s. Interestingly, the growth rate across this expansion has been just 2.3% per annum, well below that of previous expansions, including the 3.6% per annum rate recorded in the 1990s.

Fed chairman Jerome Powell stated that some of the recent weakness in inflation data may be transitory, which is in contrast to the more dovish comments made since the equity market rout in December 2018, but markets see the trade war as a key factor in support of easing. Job creation stalled in May with **non-farm payrolls** rising only 75,000 compared to an expected gain of 185,000. The labour market remains relatively tight with the unemployment rate unchanged at a record low of 3.6%, while average hourly earnings were down one point to 3.1% year-on-year. The **ISM Manufacturing Index** came in below expectations at 52.1, down from 52.8 in the previous month.

European election provisional results by grouping



Source: European Parliament

Europe is battling low inflation and falls in manufacturing activity, with some small signs of improvement overshadowed by trade fears and a tense Europe-wide election. The eurozone grew 0.4% in the March quarter according to Eurostat's flash estimate, following growth of 0.2% in the December quarter. The European Commission forecasts **German GDP** to grow by 0.5% through 2019, lower than the 1.4% expected for France and the 1.2% expected for the euro area.

It has been suggested that a move to a more expansionary fiscal policy in the three major economies in the zone, together with a pickup in Chinese growth, could boost GDP growth a full percentage point by the end of 2019. However, sentiment remains weak, with the German **IFO Institute's business climate indicator**

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falling from 99.2 to 97.9 in May, while yields on 10-year German Bunds fell from 0.01% to -0.20%, reflecting a deterioration in the outlook.

Annual **inflation in the eurozone** picked up to 1.7% in April before slumping back to 1.2% in May, while core inflation is stuck at around 1.0%. The European election results revealed the extent of the political divide across the UK and the continent, with both the major centre right and social democrat groupings losing 87 seats, which flowed to euro-sceptic, liberal and green groupings.

In China, recent economic data has broadly undershot expectations, with the May **manufacturing PMI** slipping from 50.1 to 49.4 (lower than the expected 50.0) and April industrial production easing to 5.4% after spiking to 8.5% in March. Meanwhile **retail sales** for April slowed from 8.7% to 7.2% and investment spending also slowed slightly from 6.3% to 6.1%. The major news is the escalation in the trade war with the US, with the Trump administration accusing the Chinese of backing away from earlier agreed positions, creating a case for further hikes in duties from 10% to 25% on US $200 billion of Chinese imports, accompanied with the threat to extend tariffs to another US $300 billion of goods.

China subsequently responded, saying it would levy duties on US $60 billion of goods. The Chinese economy appeared to be responding to stimulus measures put in place over the past year, with March quarter GDP growth of 6.4%, which was in line with the previous quarter and above expectations. However, recent data points to a weaker situation, raising concerns that current levels of stimulus may not be enough, especially if the trade dispute is not resolved. The authorities have one eye fixed on financial stability and one on achieving a minimum growth rate of around 6.0%.

Commodities

Oil experienced an end to recent bullishness in May as rising geopolitical uncertainty and a deceleration in demand for crude put pressure on prices. The Brent spot price fell 1.7% to US $66.78/b while WTI crude fell 11.1% to $53.49. Metals continued to drop, with falls in Zinc (-9.6%), Copper (-8.9%), Lead (-8.3%), Tin (-4.8%), Nickel (-3.2%) and Aluminium (-1.8%). Gold rose 2.1% to US $1,305.58/oz, surging higher in the early part of June and breaking away from its year-to-date lows as talk of Mexican tariffs spurred further buying.

Currencies

The Australian dollar appeared to benefit from a surprise Coalition election victory with some unwinding of pessimism around the housing market, but a rising US dollar and expectations of an RBA rate cut pulled the currency in the other direction. The Australian dollar fell 0.8% in trade-weighted terms in May, depreciating against the US dollar (-1.6% to 0.69), euro (-1.2% to 0.62) and Japanese yen (-4.3% to 75.12), and rising against the British pound (+1.6% to 0.55).

Over the three months to the end of May 2019 the Australian dollar has fallen 1.2% in trade-weighted terms, depreciating against the US dollar (-2.3%), euro (-0.4%) and Japanese yen (-4.9%) and rising against the British pound (+2.7%).

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