ISSUE DATE: 11-07-2016

Month in Review

Market Moves — as at 30•06•2016

RETURNS (%) P.A.	1 MTH	3 MTH	6 MTH	1 YR	3 YR	5 YR	10 YR
AUSTRALIAN EQUITIES							
S&P/ASX 200 ACCUMULATION INDEX	-2.45	3.94	1.09	0.56	7.66	7.40	4.86
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	-1.31	5.85	6.94	14.40	9.13	1.00	1.10
GLOBAL EQUITIES							
MSCI WORLD TR INDEX (AUD)	-3.75	4.56	-1.30	0.96	15.20	15.31	5.00
S&P 500 TG INDEX (AUD)	-2.45	5.85	1.46	7.34	19.61	20.54	7.40
FTSE 100 TR INDEX (AUD)	-6.42	2.37	-5.51	-8.93	8.18	9.54	1.53
MSCI EMERGING MARKETS NR INDEX (AUD)	1.18	3.99	3.98	-9.22	5.45	3.46	3.52
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 200 A-REIT ACCUMULATION INDEX	3.54	9.25	16.28	24.57	18.50	18.07	3.07
FTSE EPRA/NAREIT DEVELOPED NR INDEX (AUD HEDGED)	2.99	3.71	7.14	12.26	11.91	12.04	5.47
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	1.33	2.87	4.97	7.02	6.24	6.74	6.62
BLOOMBERG AUSBOND BANK BILL INDEX	0.16	0.56	1.14	2.24	2.51	3.10	4.35
BARCLAYS GLOBAL AGGREGATE TR INDEX (AUD HEDGED)	1.98	2.87	6.69	9.34	7.56	7.75	8.07

Data source: IRESS & 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

Australian shares took a dive in June as fallout from the Brexit referendum sent the S&P/ASX 200 Index to a low of 5051.00 points, 4.35% lower from the pre-Brexit close. Returns on Australian equities, as measured by the S&P/ASX 200 Accumulation Index, were -2.45% in June, with large falls in the Information Technology (-7.82%), Financial (-4.23%) and Consumer Staples (-4.08%) sectors. The Utilities sector was the best performing, returning 6.22% in June and 25.54% over 12 months.

The Financial sector saw large declines in shares with direct UK exposure, including Henderson Group (-31.20%), CYBG (-28.23%) and BT Investment Management (-21.44%), as well as QBE Insurance Group (-16.16) amid fears it would be forced to revise its business approach in the UK and Europe. Likewise, Information Technology sector shares Computershare (-14.62%) and IRESS (-12.67%) took the brunt of the post-Brexit blow. Australian small cap shares outperformed in June, with the S&P/ASX Small Ordinaries Accumulation Index returning -1.31%, continuing its run of outperformance over one- and three-year periods.

Global equities

Market drawdowns in the wake of the Brexit vote meant global TR index returns were significantly negative in June, with the UK market the hardest hit. Price return indices have, for the most part, already recovered, and the FTSE 100 Index even posted a positive return of 4.39% for the month, after falling -3.15% on the Friday following the vote, and a further -2.55% on the Monday. Funds with significant UK holdings were able to take advantage of recent strength in the GBP to partially hedge their exposure. However, the need to ensure adequate defence against a Brexit had to be balanced against the risks inherent in a remain vote, which would have given rise to further strength in risk assets. Funds overweight shares such as Royal Dutch Shell, BP, Anglo American and Rio Tinto were well placed to defend against losses, while the banks (RBS, Lloyds and Barclays) suffered, as did major property builders.

The S&P 500 TG Index returned -2.45%, while the MSCI Emerging Markets NR Index held firm, returning 1.18%, with any flow-on effects from Brexit so far contained to developed market economies. The German DAX, which measures the performance of Germany's top 30 listed shares, fell -6.82% on the day after the vote to close the month down -5.68%. In Asian markets, the Nikkei 225 Index fell -9.63% in June, while the Shenzhen CSI 300 Index was steady, falling -0.49%.

REITs

The S&P/ASX 200 A-REIT Accumulation Index returned 3.54% in June, with expected further easing from central banks likely to prop up the yield trade for some time yet. Concerns remain about excessive gearing and overpricing in some cases, driven by persistently low interest rates. In the UK, investors pulled money from open-ended property funds on fears that office values could plummet as a result of businesses leaving London. So far seven funds have moved to curb redemptions. Globally, REITs returned 4.02% in June (in AUD hedged terms), while the FTSE EPRA/NAREIT

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Developed NR Index gained 2.99%. In the US, REITs returned 6.15% (in USD terms) – clear Brexit winners.

Dividends remain high, especially in sectors such as health care, and are far outpacing yields on Treasuries. Globally, REITs are positioned to gain from Brexit, with 10-year yields forced down further as a result, and they are likely to continue to appeal to investors looking for cover as any effects on the global economy are felt.

Fixed interest

Australian bonds returned 1.33% in June, with Brexit pushing the Australian 10-year Treasury yield to a low of 1.98%, following a pre-Brexit close of 2.25%. Australian government bonds returned 1.54% during the month, while Australian corporate bonds were hampered by the flight to safety, returning only 0.73%. Globally, government bond yields underwent further compression in June, benefitting from a Brexit induced flight to quality. Bond markets are also anticipating more accommodative monetary policy from central banks. The US 10-year Treasury yield fell from 1.85% to 1.47%, while the German 10-year Bund yield was the latest to turn negative, falling from 0.14% to -0.13%.

Japanese yields moved further into negative territory, with the 10-year yield dropping from -0.12% to -0.22%. Global bonds, as measured by the Barclays Global Aggregate TR Index, returned 1.98% in June (in AUD hedged terms), while the return on global corporate investment grade bonds were 1.91%. Credit spreads were a casualty of the risk off behaviour in markets with the Bank of America Merrill Lynch US High Yield Option-Adjusted Spread widening from 5.97% to end the month at 6.21%.

A number of managers expressed their intention to extend the duration of their portfolios in the lead up to the Brexit referendum and took steps to hedge their positions, including through short positions in the GBP and long positions in UK Gilts. Based on reportable results, Australian Fixed Interest funds gained on the Friday as referendum results hit the newswires, while global Fixed Interest funds were steady, recording small positive gains on average, especially the more US-centric funds.

ASX 200 Share Movements

S&P/ASX 200 Share Performance for the Month of June

BEST PERFORMERS	
SARACEN MINERAL HOLDINGS	28.00%
WHITEHAVEN COAL	27.22%
MAYNE PHARMA GROUP	26.14%
ALS	20.74%
NEWCREST MINING	20.61%

WORST PERFORMERS	
HENDERSON GROUP	-31.20%
CYBG	-28.23%
BT INVESTMENT MANAGEMENT	-21.44%
ESTIA HEALTH	-20.52%
COVER-MORE GROUP	-20.13%

S&P/ASX 200 Share Performance for the Year to June

BEST PERFORMERS	
ST BARBARA	417.54%
SARACEN MINERAL HOLDINGS	234.88%
REGIS RESOURCES	216.67%
A2 MILK CO	173.44%
BELLAMY'S AUSTRALIA	133.64%

WORST PERFORMERS	
ORIGIN EBERGY	-45.09%
ORICA	-42.06%
BEACH ENERGY	-41.90%
PROGRAMMED MAINTENANCE SERVICES	-39.06%
SELECT HARVESTS	-38.73%

Economic News

Australia

Political uncertainty seems to be a recurring theme, with the double dissolution election held on 2 July producing no clear winner on the night. Australia's AAA rating remains intact, supported by high debt affordability, but S&P has placed Australia on negative watch, citing the threat of a hung parliament to budget consolidation, which could leave the economy vulnerable to global shocks. At its 5 July meeting, the RBA left the cash rate on hold at 1.75% as it takes time to assess the impact of the UK Brexit referendum on financial markets and the global economy. The Bank noted that markets have continued to function effectively, with low borrowing costs and accommodative monetary policy globally, but warned the global impact may be difficult to discern.

Inflation remains low, with the March quarter headline CPI recording an unexpected drop to 1.3%, and the underlying rate falling to 1.7% (still well below the 2–3% target). The Bank expects inflation to remain low for some time, given subdued labour costs both in Australia and globally. The unemployment rate remained steady at 5.7% in May, with the number of unemployed persons rising by 1,600 in seasonally adjusted terms. The participation rate also held firm at 64.8%, while monthly hours worked increased by 27.7 million hours.

Labour market conditions have generally been favourable, and in trend terms employment has

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increased by 1.9% over the past 12 months, which is above the average y/y growth for the past 20 years of 1.8%. However, indicators have been mixed in recent months, with falls in full-time employment.

Retail turnover rose 0.2% in May in seasonally adjusted terms, following a rise of 0.1% in the previous month. There were significant rises in food retailing (0.7%), representing 41% of Australia's retail turnover, as well as cafes, restaurants and takeaway food services (0.3%). Significant falls were recorded in household goods retailing (-1.1%), clothing, footwear and personal accessory retailing (-1.2%) and electrical and electronic goods retailing (-1.6%), while department store turnover was steady.

The Westpac Melbourne Institute Index of Consumer Sentiment dipped 1.0% in June from 103.2 in May to 102.2, following a surge of 8.5% in May. The small dip represents a slight consolidation, which is not surprising given the large bump in May, largely in response to the RBA's surprise rate cut. Interestingly, the 'news recall' questions revealed respondents were less focused on economic conditions and budget issues, despite the lead up to the election.

Australia's trade deficit expanded to $2.22 billion in May, an increase of $433 million on April's upwardly revised deficit figure of $1.79 billion. Imports of goods and services rose by $620 million, driven by merchandise goods (up $385 million), capital goods (up $182 million) and non-monetary gold (up $124 million). Exports were boosted by $188 million, supported by falls in the AUD and driven by increases in the value of non-rural goods (up $420 million).

Global

If you are tired of reading about Brexit, then the June Month in Review might not be for you. The issue has been at the front of fund managers' minds, although the odd few have displayed a heroic level of indifference. Despite the volatility heading into the referendum, markets appeared certain that the UK would vote to remain. While share markets were in free fall as the leave vote solidified, a more sustained impact has been felt in currencies, with the historic falls in sterling, as well as bonds, with the 10-year Gilt well below 1.00% at the end of June.

The knock-on effects for global GDP in the short and medium term will be difficult to assess. The main risks relate to contagion and the impact Brexit could have on the European growth situation, which is already very delicate. In the longer term, the UK economy is dynamic enough to weather the changes, but the risk of a recession is real, including the potential for a vicious cycle of economic stagnation, further weakening Europe's economies.

Moving through the Brexit issue, investors are still concerned about the growth situation in China. Chinese CPI fell to 2.0% y/y in May, below the expected 2.3%, while the official Chinese manufacturing PMI showed no expansion in manufacturing activity, with the index falling from 50.1 in May to a flat 50.0 in June.

Following the shock non-farm payrolls figures in May, the US outlook is looking more promising. US Q1 GDP was revised upwards in June from 0.8% to the 'third estimate' figure of 1.1%, slightly above expectations although still much reduced from the Q4 2015 growth rate of 1.4%. The revised GDP figure included upward revisions to exports and non-residential fixed investment (in particular intellectual property products and software), and downward revisions in consumer spending. While US growth has surprised on the upside, the overall subdued pace suggests that it remains vulnerable, with slowing consumer spending and the biggest fall in total business investment in six years.

The ISM Manufacturing PMI rose to 53.2 in June, up from May's reading of 51.3, beating expectations and representing the fourth consecutive month of expansion in the manufacturing economy. New orders again grew strongly, recording 57.0 in June, and there was faster growth in the production and supplier delivery indices, while employment moved from contraction to growth.

On 15 June, the FOMC decided to leave the federal funds rate at 0.25–0.5%. The decision came on the back of a shock non-farm payrolls result in May. The Committee noted that while the unemployment rate has declined, job gains have diminished, while inflation continues to run below target, partly reflecting earlier declines in energy prices. Following the Brexit decision, the Fed is likely to push back its tightening path, with no expectation for a rate hike in 2016. Vice Chair Stanley Fischer said the Fed will have to wait and see how things turn out, but did remind markets that there are other issues out there aside from Brexit.

US consumer prices rose 0.2% in May, representing a 12-month rise of 1.0% before seasonal adjustment, while core inflation (less food and energy) rose by 0.2%, which was in line with expectations. Energy prices were again a major contributor, rising 1.2%, while food items fell -0.2%.

US retail sales increased by 0.5% in May, following a rise of 1.3% in April, including growth from motor vehicles and parts dealers of 0.5%, as well as strong growth from gasoline stations of 2.1%. Drags on sales came from building material and garden equipment and supplies dealers (-1.8%) and department stores (-0.9).

GDP in the EU-28 grew by 0.5% in Q1 2016 – an improvement on previous quarters but still precariously low. Q1 growth for the UK is estimated at 0.4%, while growth for Germany was recorded at 0.7%. Euro area inflation fell by -0.1% in May and is estimated to grow by 0.1% in June. While there have been large falls in energy prices, even the underlying measures, which exclude energy and food, have grown at only 0.8%.

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German manufacturers reported their best performance since February 2015, with the Markit/BME Manufacturing PMI hitting a 28-month high of 54.4 in June. Positive contributions came from new orders, output and employment indices. While manufacturing has experienced strong expansion in recent months it remains below pre-2008 levels.

Unemployment in the euro area was reduced slightly from 10.2% in April to 10.1% in May, while EU-28 unemployment fell from 8.7% to 8.6%. While there have been steady falls, unemployment remains unacceptably high, especially in euro countries, while large dispersions persist between low unemployment members, including Germany (4.2%) and those with the highest unemployment rates, including Greece (24.1%) and Spain (19.8%).

In emerging markets, Brazil's economy contracted further in Q1 2016, with y/y growth recording -5.4%. Brazilian inflation grew at 9.3% y/y in May, reduced from its February high of 10.7%. Russian GDP fell in the first quarter by -1.2% y/y, an improvement on the large fall of -4.6% in September 2015. Russian inflation recorded 7.5% for May, down from a high of 16.9% in April 2015. Indian GDP growth remains robust according to official figures, accelerating to 7.9% in Q4 2015 (the highest since 2011).

Commodities

Energy prices were mixed in June, with the WTI crude oil spot price falling from US $49.10/b to US $48.33/b (-1.6%), while Brent crude rose slightly from US $48.31/b to US $48.42/b (0.2%). Brexit fears led to the steepest decline in crude prices in five months, with investors concerned about the impact on energy demand.

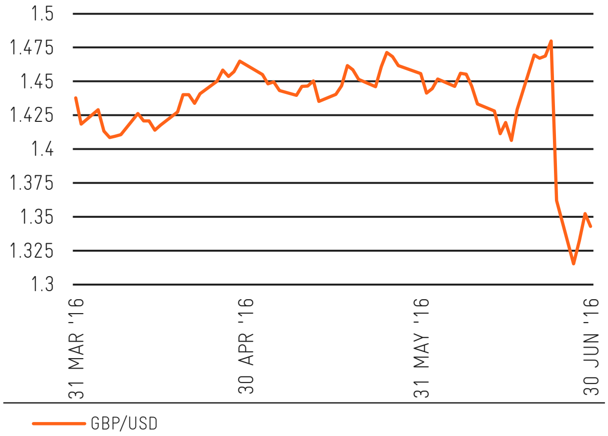
Metals were up in June, with Aluminium (6.0%), Copper (3.7%), Lead (5.2%), Nickel (12.0%), Tin (4.6%) and Zinc (9.4%) all gaining strongly. Gold was also up following the Brexit vote, finishing the month 8.8% higher at US $1321.90/oz.

Iron ore put a brake on its price slide, with the price of iron ore delivered to Qingdao in China rising from US $50.15 per tonne to $55.66 (11.2%), after shooting above $70 mid-way through April. The increase is positive for the Australian Budget, with Treasury having forecast a price for iron ore of US $55 over the 2016-17 period.

Currencies

The AUD appreciated against most currencies in June, rising from USD 0.7234 to end the month at USD 0.7447 (2.9%), after hitting an early low of USD 0.7227, and a high of USD 0.7594 just before the Brexit vote. In trade weighted terms the AUD rose 2.6%, gaining against EUR (3.5%) and GBP (12.6%), and falling against JPY (-4.1%) and NZD (-2.3%).

GBP/USD



Source: Bank of England

The real story was of course the record 31-year low reached by the GBP, which plunged from a pre-Brexit close of USD 1.4879 to end the month at USD 1.3311 (a fall of -10.5%). The US Dollar Index closed June slightly higher (0.3%), gaining against major currencies including EUR (0.6%), GBP (9.4%) and CHF (0.4%), while falling against the JPY (-6.8%), which served as a safe haven currency in the wake of Brexit.

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