Month in Review

ISSUE DATE: 9-01-2017

Market Moves — as at 31•12•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	4.38	5.18	10.59	11.80	6.59	11.85	4.53
S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX	3.61	-2.45	5.84	13.18	6.24	4.87	-0.28
GLOBAL EQUITIES							
MSCI WORLD TR INDEX (AUD)	4.52	7.77	10.10	8.67	12.01	19.04	5.30
S&P 500 TG INDEX (AUD)	4.05	9.72	10.88	12.49	16.82	22.92	7.86
FTSE 100 TR INDEX (AUD)	6.33	4.87	6.15	0.30	2.95	11.70	1.37
MSCI EMERGING MARKETS NET TR INDEX (AUD)	2.26	1.28	7.44	11.72	4.56	8.57	2.71
REAL ESTATE INVESTMENT TRUSTS (REITS)							
S&P/ASX 300 A-REIT (SECTOR) ACCUMULATION INDEX	6.75	-0.73	-2.60	13.18	17.96	18.51	0.25
FTSE EPRA/NAREIT DEVELOPED NET TR INDEX (AUD HEDGED)	3.58	-2.36	-1.07	5.99	10.60	14.11	3.05
FIXED INTEREST							
BLOOMBERG AUSBOND COMPOSITE 0+ YR INDEX	-0.17	-2.86	-1.96	2.92	5.05	4.95	6.17
BLOOMBERG AUSBOND BANK BILL INDEX	0.15	0.44	0.92	2.07	2.37	2.78	4.13
BARCLAYS GLOBAL AGGREGATE TR INDEX (AUD HEDGED)	0.36	-2.17	-1.36	5.24	6.28	6.13	7.42

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

The Australian market ended 2016 on a high note, with the Santa rally in full swing. The S&P/ASX 200 Accumulation Index rose 4.38% on the back of November's 2.99% increase. All sectors enjoyed positive returns, with strong gains from the Utilities (8.70%) and Energy (6.09%) sectors, while Consumer Staples (1.79%) and Health Care (0.89%) managed only modest returns following large declines in November.

Galaxy Resources (22.09%) continued its late-year surge as it announced it had agreed to sell 120,000 tonnes of lithium at USD 905/t, while auto parts supplier Bapcor gained 10.11% as it edged closer to gaining control of NZ's Hellaby. Small cap shares came under pressure in December, weighed down by losses from Consumer Staples such as Bega Cheese (-14.34%) and A2 Milk Co (-14.29%), which have tried to differentiate themselves from the troubled Bellamy's. Small miners such as Perseus Mining (-42.74%) and Dacian Gold (-30.64%) felt the pain as the price of gold fell. The S&P/ASX Small Ordinaries Accumulation Index managed a return of 3.61% in December, underperforming ASX 20 shares, which returned 4.39%.

Global equities

The US market still appears unbreakable, with the S&P 500 TG Index adding 4.05% in December. Valuations, while not at egregious highs, are making investors wary. The US market is second only to Denmark as the most expensive in the world on both a 10-year cyclically adjusted price-to-earnings (CAPE) and price-to-book value basis. Quality growth shares have been dominant in recent years, but some managers are now anticipating a shift in the cycle that could favour value.

The US Utilities sector, which sold off in the wake of the presidential election, regained ground in December, moving 4.94% higher in USD terms, with the strongest gains from energy-related shares. A potential shift in energy policy under the incoming Trump administration is seen as slightly positive by investors, but so far has not been enough to completely undo the sector's November losses. Telecommunications also gained (8.12%), led by major carriers AT&T and Verizon.

The commodities rally has delivered a major boost to European share markets, especially the Oil and Gas and Resources sectors. Europe's miners have returned 66.11% in EUR terms over the 12 months to December 2016, compared to a 2.30% return across the entire Euro Stoxx 600 Index. The FTSE 100 TR Index gained 6.33% in AUD terms, while in Asian markets the Nikkei 225 Index rose 4.40% in local currency terms while the Shenzhen CSI 300 Index lost -6.44%. As Japan's deflation continues, companies have hoarded cash, and have built some USD 3.2 trillion in cash reserves, which has impacted both yields and growth.

REITs

The S&P/ASX 300 A-REIT Accumulation Index gained 6.75% in December after managing a small positive return in November. The index suffered significant losses over the three months to the end of October, dragged down by rising bond yields and losing 14.04%. December showed the continued resilience of Australian listed property, which is still seen by investors as having solid fundamentals. While rising yields will put pressure on A-RIET values, the sector may continue to be a source of stability, especially if equity market volatility persists through 2017.

We strongly recommend that potential investors read the product disclosure statement or investment statement.
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Month in Review

Globally, REITs recovered in December, with the S&P Global REIT NTR Index returning 4.50% (in AUD hedged terms), and the FTSE EPRA/NAREIT Developed NR Index gaining 3.58%. In a rising rate environment, REITs will face additional pressure on cap rates and leasing spreads, but many investors still anticipate that rates will be 'lower for longer', meaning demand for yield-producing asset classes like REITs may be able to withstand current market movements.

Fixed income

Yields continued to undergo further expansion through December, after being propelled higher in November on the back of anticipated inflation and a rotation into equities. The US 10-year Treasury yield rose from 2.38% to 2.45%, reaching an early high of 2.60% following the Federal Reserve's decision to raise the target rate range by 25 bps. The return on US corporate investment grade bonds was 0.67% in December, while US high yield debt returned 1.82%, benefiting from a risk-on environment.

Credit spreads were further compressed in December, with the BofA Merrill Lynch US High Yield OAS falling from 4.67% to 4.22%, the narrowest it has been since September 2014. Global bonds, measured by the Barclays Global Aggregate TR Index, returned -0.32% in December (in AUD hedged terms). Returns on Australian corporate bonds were -0.17% while government bonds returned -0.15%, with the yield on Australian 10-year Treasuries rising from 2.72% to 2.77%.

The UK 10-year Gilt yield fell from 1.42% to 1.24%, retracing part of its post-Brexit recovery and now slightly lower than its July high of 1.37%. The German 10-year Bund yield turned positive in October, moving higher in November but falling through December from 0.27% to 0.20%. The 5-year Bund remains in negative territory, falling from -0.43% to -0.54%. Japanese 10-year yields turned positive in November and continued to rise in December from 0.02% to 0.04%.

ASX 200 Share Movements

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

BEST PERFORMERS		WORST PERFORMERS	
GALAXY RESOURCES	11.09%	SIRTEX MEDICAL	-48.70%
BAPCOR	10.11%	BELLAMY'S AUSTRALIA	-45.69%
ILUKA RESOURCES	18.79%	MAYNE PHARMACEUTICAL GROUP	-15.67%
SEVEN WEST MEDIA	17.52%	BEGA CHEESE	-14.34%
JAPARA HEALTHCARE	16.49%	A2 MILK CO	-14.29%

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

BEST PERFORMERS		WORST PERFORMERS	
RESOLUTE MINING	420.00%	SIRTEX MEDICAL	-64.62%
GALAXY RESOURCES	356.52%	ESTIA HEALTH	-62.24%
WHITEHAVEN COAL	272.86%	BLACKMORES	-52.58%
FORTESCUE METALS	214.97%	BELLAMY'S AUSTRALIA	-50.92%
MINERAL RESOURCES	202.24%	VOCUS COMMUNICATIONS	-47.94%

Economic News

Australia

With a paucity of local data over the Christmas break and no RBA meeting in January, investors were allowed a short reprieve from the flow of economic releases, giving them time to get their heads around 2017. Minutes from the RBA's December rate decision revealed that labour market underutilisation remains a key concern for the board, as well as the slower than expected pace of wage growth. The contribution of dwelling investment to growth is likely to decline over the forecast period with falls in construction and approvals.

The Bank noted that some slowing in the year-end growth rate is likely, which was confirmed by the last GDP release, which showed negative growth in the September quarter. The CPI grew 0.7% in Q3, bringing the year-end change to 1.3%, but the board believes that headline inflation may have increased recently, supported by higher commodity prices and an improvement in the terms of trade.

The number of unemployed persons rose by 39,100 in November in seasonally adjusted terms, with the unemployment rate rising 0.1 pts to 5.7%. The participation rate rose slightly by 0.2 pts to 64.6. However, full-time employment increased by 39,300 while part-time employment fell by 200, defying the shift from full-time to part-time work that has taken place throughout 2016. Adding to the good news was a significant drop in the underemployment measure, which fell to 8.3% from the record high 8.7% reported in August.

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Following a convincing rise in November of 3.3 pts, the AIG Manufacturing Index extended by a further 1.2 pts to 55.4 to finish 2016 with a solid rate of expansion. The month saw continued strong growth in new orders (60.6) and sales (58.8), while exports surged ahead (68.5). The employment index slipped in December (47.4), falling into contraction and below the 12-month average.

The Westpac Melbourne Institute Index of Consumer Sentiment fell by 3.9% in December from 101.3 to 97.3. While the index has traded within a narrow range over the past six months, December's figure shows this run of stability may be starting to shake. While the share market rallied, sentiment was negatively affected by local economic conditions (the most recalled news item), including the negative GDP print in Q3 and a softer labour market.

Australia's balance on goods and services recorded a surplus of $1.243b in November, representing a turnaround of $2.362b on October's deficit. Exports of metal ores, coal, general merchandise and non-rural goods contributed to an 8.4% rise in goods and services credits and Australia's first surplus in almost three years. The figures show Australia may avoid a technical recession, and comes at a crucial time for the government, with the May budget now on the horizon.

Global

The third estimate for US Q3 GDP growth was an annualised 3.5%, higher on the second estimate reading of 3.2% and beating the expected 3.3%. Consumer spending – the main engine room of US growth – grew at 3.0%, up from the 2.8% previously estimated. The largest contributor to the change in non-residential fixed investment was an upward revision to intellectual property products, reflecting updated R&D expense data.

The higher than expected growth provided further support to the Federal Reserve's rate hike in early December, with the board voting unanimously to lift the funds rate by 25 bps to a target range of 0.5–0.75%. The decision was taken in view of current and expected labour market conditions, which continue to improve.

The 'dot chart' shows all board members believe the appropriate target range or level should move higher in 2017 compared to its current setting, with the median assessment being a range of 1.25–1.50%, with the full range of members' assessments lying between 0.75% and 2.25%. Most participants see the target level normalising in the longer term at 2.75% or 3.00%.

Fed board projections of growth were not substantially changed, with the 2017 growth rate estimated to be 2.1% (up from the 2.0% estimate in September), with the long-run projection steady at 1.8%. Similarly, the estimate for unemployment in 2017 was revised down 0.1 pts to 4.5%, while the estimate for inflation remains unchanged at 1.9%, moving to 2.0% in 2018.

The ISM manufacturing PMI climbed to 54.7 in December, beating the expected 53.6 and reaching the highest level since February 2015. New orders rose 7.2 pts to 60.2 and production 4.3 pts to 56.0. Businesses drew down on their stock of raw materials in the final month, with the inventories index falling 2.0 pts to 47.0.

December's non-farm payrolls grew by a reasonable 156,000 versus the expected 178,000, but revisions added a net 19,000 to the two prior months. The big story in the announcement was the 0.4% rise in average hourly earnings, which pushed year-on-year wages growth to a cycle high of 2.9%. A broader measure of unemployment that counts discouraged workers and those working part-time for economic reasons edged to 9.2%, a fresh 2016 low and the best since April 2008.

US prices rose by an annual unadjusted rate of 1.7% in November, still below the Fed's inflation target but building steadily in recent months. Increases in shelter and gasoline prices were again the largest contributors to the all-items increase. The gasoline price index rose 2.7% in November, following a 7.0% rise in October, with rising energy prices translating into higher prices at the pump.

Europe enters a new year of major national parliamentary and presidential elections, kicking off with the Netherlands in March, followed by France in April and May, and Germany in September or October. Austria's second round of voting for the presidential election took place in December, with left-leaning independent Alexander Van der Bellen defeating Freedom Party candidate Norbert Hofer. Following the defeat of the constitutional reform package and the resignation of the prime minster, Italy may bring forward its parliamentary election to 2017.

Euro area inflation jumped to 1.1% in December, up from 0.6% in November, representing the fastest growth in consumer prices in over three years. However, core inflation (excluding energy, food, alcohol and tobacco) remains at only 0.9% and has remained stubbornly low since the GFC. Germany's inflation rate rocketed to 1.7% in December, following November's figure of 0.7%, primarily as a result of higher oil prices. While there has been some expansion in yields, they have failed to match inflation, and the issue of negative real yields remains a key political as well as economic issue for Germany's savers.

China's official PMI survey showed Chinese manufacturing still in expansion, but down slightly from 51.7 in November to 51.4 and below the expected 51.5. The Caixin PMI, based on a survey of smaller manufacturers, rose from 50.9 to 51.9, representing the fastest improvement since January 2013. China's November CPI was an annualised 2.3%, reaching a seven-month high, with the immutable China Daily reporting that it will likely remain at a similar rate for December.

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In other emerging markets, Brazil's unemployment rate remained steady at 11.9% in December, while November CPI fell 0.1 points to 7.0% y/y. India's CPI fell to a two-year low of 3.6% y/y following Prime Minister Modi's sudden move to replace 500 and 1000 rupee banknotes, and is now well below the central bank's 5.0% target. Russian Q3 GDP showed a contraction of -0.4%, while December inflation was 5.4% y/y.

Commodities

The price of iron ore delivered to Qingdao in China rose 9.4% in December, from USD 72.08/t to end the month at 78.87/t, after hitting a new high of USD 83.58/t mid-month. Metals experienced significant falls, with lead (-14.7%) and nickel (-11.1%) moving back down to their October levels. Aluminium (-2.3%), copper (-5.0%) and zinc (-4.7%) fell, while tin gained 0.4%. Gold has fallen since the US election, dropping a further -2.2% in December from USD 1,173.2/oz to 1,147.5/oz and out of favour with further interest rate rises on the horizon.

Oil prices continued to surge through December ahead of the OPEC and non-OPEC agreement, which came into force on 1 January 2017 and involves a cut of approximately 1.8 million barrels per day. The Brent crude oil spot price rose from USD 47.95/b to 54.96/b (14.6%) while WTI rose from USD 49.41/b to 53.75/b (8.8%). If you got a lump of coal for Christmas, you probably have little to complain about, with the price of premium hard coking coal still above USD 230/t, but falling significantly from its high of around USD 300/t at the start of December.

Currencies

The AUD finished December down -2.1% in trade weighted terms, dropping from USD 0.7385 to 0.7208 (-2.4%). The AUD fell against other major currencies including the EUR (-1.9%), JPY (-0.3%), GBP (-1.1%) and NZD (-0.1%).

The US Dollar Index closed 0.7% higher at the end of the month, gaining against the EUR (0.7%), JPY (2.2%), GBP (1.3%) and CHF (0.2%). The Mexican Peso (MXN) fell -0.8% against the USD, steady but still retaining its heavy losses since the election. The rising US currency has been felt in metals (especially precious metals), and a sustained lift could place pressure on some emerging markets.

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