Month in Review

Index returns at end March 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	-3.77	-3.86	3.48	2.54	3.76	7.66	5.35
S&P/ASX Small Ordinaries Accumulation Index	-2.29	-2.79	10.52	14.99	10.67	6.45	1.36
Global Equities							
MSCI World TR Index (AUD)	-0.56	0.79	6.80	13.58	8.43	17.30	8.38
S&P 500 TG Index (AUD)	-0.99	1.19	8.26	13.37	10.63	20.48	11.42
FTSE 100 TR Index (AUD)	1.33	-1.89	4.23	11.81	3.29	10.77	4.23
MSCI Emerging Markets NTR Index (AUD)	-0.30	3.41	11.46	24.25	8.66	11.63	4.83
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	0.11	-6.19	1.12	-0.07	5.78	10.79	3.29
FTSE EPRA/NAREIT Dev. NTR Index (AUD Hgd)	2.37	-5.30	-1.85	1.23	1.92	6.89	5.18
Fixed Interest							
Bloomberg Ausbond Composite +Yr Index	0.84	0.87	2.32	3.28	2.45	4.30	6.05
Bloomberg Ausbond Bank Bill Index	0.14	0.43	0.85	1.73	1.97	2.28	3.49
Barclays Global Aggregate TR Index (AUD Hgd)	0.84	-0.09	0.81	2.89	3.18	4.66	6.82

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 Accumulation Index fell 3.8% in March, topping off the worst Q1 performance since the GFC despite a mostly positive earnings season in February. Potential inflation is still a concern for investors, and the market is steeling itself for the next rate hike from the RBA, which, when it finally comes, will be the first increase since November 2010. All sectors aside from property were down over the month, with defensive utilities shares (-0.8%) able to stem losses, and industrials (-0.9%) supported by gains from Brambles (+4.0%).

Telecommunications (-6.2%) was the worst performing sector, with Telstra (-6.3%) falling to its lowest price since 2011 and still finding its way in a very different marketplace since the arrival of the NBN. Financials (-5.9%) took a hit through the month, with major lenders coming under pressure as the financial services royal commission began testimony, while investment managers suffered from further market falls. Materials (-4.2%) continued its slide since the start of 2018, with Fortescue Metals (-14.1%) following the iron ore price down and Rio Tinto (-10.4%) lower despite announcing the sale of its last remaining coal asset.

Global equities

The MSCI World ex-Australia Index returned -2.3% in both Australian dollar and local currency terms as global equity markets continued to slide through March. While underlying economic data is broadly positive, markets remain concerned about the prospect of inflation as well as the potential for a trade war between the US and China. The US S&P 500 Index was down 2.7% on the back of February's 3.9% fall, reaching a high of 2787 points to finish the month at 2641. The VIX settled early in the month at 14.6 before jumping higher to 24.9—still elevated compared to the historic lows of 2017. Financials (-4.5%) were hardest hit, with big falls from Citigroup (-10.6%) and Wells Fargo (-10.3%). Information Technology (-4.0%) was another sector under pressure in the wake of Facebook's data crisis, with Facebook A shares down 10.4% and Alphabet A shares dropping 6.1%.

In Europe, the STOXX Euro 600 Index fell 2.3%, with banks also suffering, led by the beleaguered Deutsche Bank (-14.2%), which took action to replace CEO John Cryan after reporting its third annual loss in a row. Resources shares (-4.5%) also took a hit down, including Glencore (-8.4%) and Anglo American (-6.7%). In Asia, the Chinese CSI 300 Index was down 3.1%, Japan's Nikkei 225 Index fell 2.8%, and Hong Kong's Hang Seng dropped 2.4%.

REITs

The S&P/ASX 300 A-REIT Accumulation Index rose 1.1% in March, with lower yields and a flight to defensive asset classes supporting the sector. A-REITs may also have been positively impacted by Labor's plan to remove franking credit refunds, which will impact high yielding shares like Telstra but not the A-REIT sector, which does not generate franking credits. Global diversified investor Cromwell Property Group (+6.5%) led the gains, with FY18 guidance pointing to a yield of 8.9%. Shopping centres came under pressure, with Vicinity Centres (-2.8%) and Westfield (-2.7%) down amid store closures from struggling retailers. Globally,

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the EPRA/NAREIT Developed Market Index (AUD hedged) rose 2.4% in March, with US REITs gaining 3.7%, dragged down once again by malls (-2.6%) and boosted by healthcare (+8.8%), data centres (+7.5%) and hotels (+7.0%).

Fixed income

The US Fed voted to raise the funds rate in March by 25 basis points to a target range of 1.50–1.75%, but this was not enough to prevent yields from heading down. Australian bonds returned 0.84% over March, with Australian government bonds returning 0.99% and longer-term government bonds (ten years plus) returning 2.60%. The Australian 10-year yield fell from 2.81% to 2.60% and the spread over 2-year bonds narrowed. Globally, the Bloomberg Barclays Global Aggregate Bond Index (AUD hedged) returned 2.67% as global yields pushed lower. Despite a 25 basis point rate hike from the Federal Reserve, developed market yields contracted as investors rotated into fixed income assets, and credit spreads widened. The US 10-year treasury yield underwent significant contraction, falling from 2.86% to 2.74%. The ICE BofAML US High Yield Option-Adjusted Spread (a measure of the performance of high yield corporate debt) rose from 3.47% to 3.72%.

The Japanese 10-year yield fell from 0.05% to 0.04%, still hovering above the Bank of Japan's zero yield target. The German 10-year yield fell from 0.65% to 0.49%, while the 5-year yield fell back into negative territory, falling from 0.02% to -0.11%.

ASX 200 share movements

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

Best performers		Worst performers	
Lynas Corp	15.49%	Galaxy Resources	-15.43%
APN Outdoor Group	11.05%	Bank of Queensland	-13.22%
Chorus	10.83%	Fortescue Metals Group	-12.18%
Bellamy's Australia	9.80%	Mineral Resources	-10.63%
Iron Mountain	9.21%	Fairfax Media	-10.59%

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

Best performers		Worst performers	
Bellamy's Australia	382.21%	Retail Food Group	-100.00%
a2 Milk Co	318.25%	Mayne Pharma Group	-48.07%
Lynas Corp	167.39%	Vocus Communications	-45.54%
Altium	166.66%	Infigen Energy	-40.58%
Orocobre	113.83%	G8 Education	-30.82%

Economic News

Australia

Despite leaving the **cash rate** on hold at its March meeting, the RBA continues to expect labour markets to tighten globally, and for central banks to get on the front foot by withdrawing stimulus. In its statement, the RBA mentioned the market's concerns about US trade policy and the contribution it has made to heightened volatility. The expectation is for CPI inflation to be a bit above 2% in 2018, but central banks have already done a great deal of expecting.

The RBA and Treasury both expect GDP growth to be in excess of 3% over the next two years, but monetary policy is still extremely accommodative. The paradox is best explained by ongoing consumer caution, and the concern of policymakers over the impact of any interest rate rise on the household sector, especially given current low wages growth and high levels of household debt. The RBA is inclined to be patient, ensuring the household sector is better positioned before embarking on the policy normalisation process. Current low inflation provides the RBA cover to sit on its hands.

Inflation remains below the target range, as it has been since 2015, suggesting there has been a structural downturn in inflation and inflation expectations. Ordinarily this would warrant further policy easing, but strong business conditions and fear of stoking another outbreak in house prices has prevented any action.

Australia's labour market continues to tighten, with 17,500 seasonally adjusted jobs added in February. Full-time employment rose 64,900, offset by a fall in part-time employment of 47,400. The **unemployment rate** was unchanged at 5.5% in February, and has been steady for the past six months. The number of unemployed persons looking for full-time work rose 13,600 to 734,100, while monthly hours worked rose 21.2 million hours to 1,734.1 million hours, while the participation rate rose slightly from 65.6% to 65.7%.

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Measures of underemployment and underutilisation have been steadily falling since the start of 2015.

The **AIG Manufacturing Index** jumped 5.6 points to a record high of 63.1 in March (the second-highest was 62.1 in May 2002). New orders (+11.2 points to a record 66.6), supplier deliveries (+10.6 points to 66.6), and sales (+10.5 points to 63.9) saw large month-on-month increases. Gains also coming from production (+0.3 points to 62.2), employment (+2.2 points to 60.0), inventories (+1.3 points to 56.0), and exports (+2.4 points to 58.9).

Australian retail recovered slightly after a very lacklustre start to the year, with **retail turnover** rising 0.6% in February, soundly beating the consensus 0.3%. Department stores led the pack, adding 1.5% on the previous month, followed by household goods retailing, which rose 1.1% after a very disappointing Christmas period, and clothing, footwear and personal accessory retailing, which was up 1.1%. The major food retailing component added 0.3% and cafes, restaurants and takeaway food services was up 0.7%.

Australia's balance on goods and services fell a seasonally adjusted $127 million in February, narrowing the surplus to $825 million, higher than the anticipated $680 million. Exports of general merchandise rose $463 million, rural goods added $552 million, and metals (excluding monetary gold) added $200 million. On the debits side, imports of consumption goods rose $547 million, non-industrial transport equipment rose $386 million and general merchandise rose $51 million.

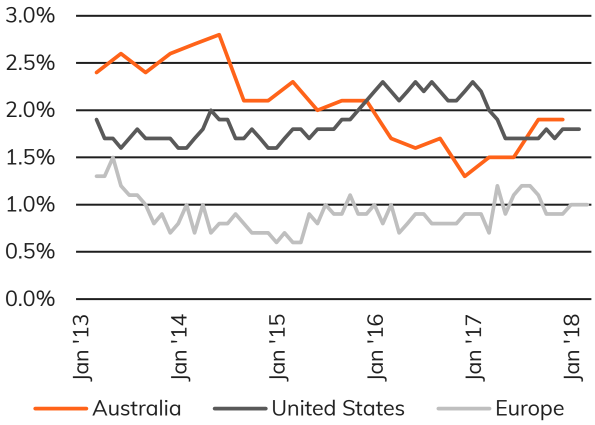
Global

According to the third estimate reading for Q4 growth, US GDP rose at an annual 2.9%, which was higher than the expected 2.7% and up on the second estimate reading of 2.5%. While the prospect of a trade war has been the cause of some consternation for markets, there is debate about the economic impact of tariffs, including China's retaliatory 25% levy on a range of US products, including soybeans, cars and whiskey. While US steel and aluminium hardly represent the new economy, it is the response from US trade partners that poses the greatest uncertainty.

The US manufacturing economy expanded at a slightly slower pace in March, but with the PMI above 55 for the past ten months, the manufacturing economy still appears in good health. Manufacturers reported concerns about the impact of tariffs across the supply chain, but so far demand appears to be holding firm. The **ISM manufacturing PMI** fell modestly from 60.8 to 59.3, but remains firmly in expansion. Major sub-indices including new orders (-2.3 points to 61.9) and production (-1.0 points to 61.0), employment (-2.4 points to 57.3), supplier deliveries (-0.5 points to 60.6) and inventories (-1.2 points to 55.5) were all down. Prices (+3.9 points to 78.1) was the only sub-index to gain.

Inflation was a key focus for markets on the back of February's wage data, but came in largely as expected. **US CPI** rose 0.2% in February on a seasonally adjusted basis and 2.2% on an unadjusted year-on-year basis. Core inflation (which excludes food and energy) was unchanged on January, rising 0.2% during the month and 1.8% year-on-year, gradually picking up in line with the Fed's expectations but without any major acceleration. Gasoline prices fell 0.9% in February but have risen 12.6% year-on-year. The core PCE index – the Fed's preferred measure – rose from 1.5% to 1.6% year-on-year.

Core inflation (% year-on-year)



Source: RBA, BLS, Eurostat

Non-farm payrolls edged up by 103,000 in March, versus the expected 193,000, leaving the unemployment rate unchanged at 4.1%. While a significant miss, the labour market is already tight, with unemployment at a 17-year low. Growth in average hourly earnings, while slightly higher at an annualised 2.7%, is still not conclusive evidence of a sustained pickup in wages.

Despite stronger than expected growth throughout the eurozone, the ECB kept its key interest rates on hold in March, although notably dropping its usual commitment to increase the size of quantitative easing if the situation deteriorates. Euro area **inflation** is expected to be 1.4% in March 2018, up from 1.1% in February, but still well below the ECB's target. Core inflation (excluding energy, food, alcohol and tobacco) was estimated to be flat at 1.0% and has refused to budge over the last six months.

Euro area **unemployment** in fell to 8.5% in February, down from 8.6% in January, and reaching the lowest rate recorded since September 2008. The lowest unemployment rates were recorded in the Czech Republic (2.4%) and Germany (3.5%), while the highest rates are still evident in Greece (20.8% in December 2017) and Spain (16.1%), which are very gradually moving down.

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Economic data for **China** has been mixed, with manufacturing PMIs failing to break out of the low 50s, while exports, industrial production and retail spending data have surprised on the upside. Producer prices continue to outpace consumer prices, although the annual rate has dropped back to 3.7% year-on-year, while the CPI lifted to 2.9% year-on-year in February. The strength of the global economy is benefiting China, however the lift in interest rates and the slowdown in credit growth to the shadow banking sector are likely to mean slower growth over coming quarters.

Commodities

The nascent commodities recovery took a hit in March with fears of a tariff war taking its toll on metals. Base metals fell through the month, with Aluminium (-6.0%), Zinc (-5.2%), Lead (-4.3%), Nickel (-3.6%), Copper (-3.1%) and Tin (-2.0%) all down. Gold rose 0.5% to end the month at US $1325.48/oz following a volatile February. The spot price of iron ore delivered to China (62% Fe) fell 18.7% from US $75.59/t to $61.49. In oil markets, the Brent spot price rose 4.5% from US $66.08/b to $69.02 and WTI rose 5.6% from $61.43 to $64.87, shaking off trade fears but still softer since the start of February.

Currencies

The AUD was down 4.0% in trade-weighted terms over the March quarter, with cooling commodity prices and fears of a trade war weighing on the currency. The AUD fell 1.7% against the USD, hitting a high of 0.8110 in late January to end the quarter at 0.7679. The AUD was down against the EUR (-4.2%), JPY (-7.3%), GBP (-1.7%) and NZD (-3.6%). The US Dollar Index fell 2.3% over the March quarter, down against major currencies including the EUR (-2.6%), JPY (-5.7%), GBP (-3.7%) and CHF (-2.3%).

For the AUD, the situation is complicated. Australian rates are now below US rates across the yield curve, and this may be amplified as the Fed continues to tighten policy. This may place downward pressure on the AUD, although the USD itself is soft, undermined by growing ‘twin deficits’ (both the budget and current account).

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