Month in Review

Index returns at end July 2018 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	1.36	5.81	6.18	14.56	7.97	9.16	7.05
S&P/ASX Small Ordinaries Accumulation Index	-1.01	3.74	4.19	22.58	14.03	9.27	3.07
Global Equities							
MSCI World TR Index (AUD)	2.52	5.48	7.50	20.80	9.12	14.32	10.02
S&P 500 TG Index (AUD)	3.09	8.52	9.69	24.83	12.06	17.47	13.30
FTSE 100 TR Index (AUD)	0.24	0.68	5.78	16.94	2.68	8.12	5.76
MSCI Emerging Markets NTR Index (AUD)	1.57	-4.06	-4.09	12.07	8.50	9.29	5.32
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	0.95	6.32	7.49	14.45	8.33	12.56	6.71
FTSE EPRA/NAREIT Dev. NTR Index (AUD Hgd)	0.93	5.28	3.93	6.46	5.64	8.76	6.67
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	0.16	1.33	2.13	2.99	3.02	4.24	5.92
Bloomberg Ausbond Bank Bill Index	0.19	0.52	0.95	1.83	1.95	2.21	3.29
Barclays Global Aggregate TR Index (AUD Hgd)	0.02	0.55	0.77	1.50	3.41	4.83	6.77

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 1.4% in July, with gains from the Industrials (+3.5%), Health Care (+2.1%) and Financials (+2.1%) sectors. The Telecommunications sector (+7.9%), which is dominated by Telstra (+8.4%), appeared to recover as attention turned to the much-anticipated 5G spectrum auction, putting a halt to a seven-month slide. Brambles (+11.3%) built on positive sentiment ahead of its full-year earnings release in August, despite its US operations continuing to drag.

The Consumer Discretionary sector (+2.1%) saw mixed results in July, with headlines dominated by Nine's $4 billion takeover of Fairfax. Shares in Fairfax Media (+8.0%) jumped on the news, while Nine Entertainment (-9.7%) fell as a result, which is not unusual for a company launching a major deal but nevertheless reflects some market scepticism. The deal will need to be approved by Nine shareholders in November. Major energy suppliers AGL Energy (-2.2%) and Origin Energy (-2.2%) came under pressure following the ACCC's release of recommendations aimed at improving access for new entrants. Australian small cap performance, measured by the S&P/ASX Small Ordinaries Index, returned -1.0% in July but is still beating its large-cap peers over a 12-month period.

Global equities

Global developed market shares, measured by the MSCI World Ex Australia Index, returned 2.6% in Australian dollar terms and 2.7% in local currency terms, driven predominately by US and European performance. US indices were higher on the back of a broadly positive earnings round, with Apple (+2.8%) rising modestly in July before surging to an historic $1 trillion market cap after announcing higher than expected revenue and EPS growth. But it was a very different story for Facebook (-11.2%), which plummeted after a revenue miss and lower than expected growth in Daily Active Users (DAUs), forcing the stock to retreat to its May market cap.

The US S&P 500 Index returned 3.7% in July, led by Industrials (+7.3%), Health Care (+6.5%) and Financials (+5.2%). US banks had mixed earnings results, with JP Morgan Chase (+10.2%) beating estimates, while Citigroup (+7.4%) and Wells Fargo (+3.3%) missed.In Europe, the broad STOXX Euro 600 Index rose 3.1%, led by Health Care (+6.3%) and Banks (+4.3%), while Basic Resources (-1.6%) were down. In Asia, Japan's Nikkei 225 Index returned 1.1%, Hong Kong's Hang Seng fell 0.5%, and China's CSI 300 Index rose a modest 1.0% after falling 7.0% in the previous month.

REITs

The S&P/ASX 200 A-REIT Index returned 1.0% in July as the inflationary outlook in the US eased and bond yields were steady. The retail A-REIT sector, which dominates the broader A-REIT market, has underperformed over the past year, with the woes of large retail anchor tenants such as Myer and Target having a negative impact on sentiment. However, these concerns have started to alleviate, with the sector bouncing back from its previously oversold position in recent months. Some delays in the rollout of Amazon in Australia have also provided some support. Mirvac Group (+5.1%) and Stockland (+4.5%) were the top performers in July, recording strong settlements despite concerns about a

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weakening housing sector. Globally, developed market property rose 0.9% on a hedged basis in July. US REITs underperformed global markets, with the Bloomberg US REIT Index up 0.7%, led by the Regional Mall (+3.6%), Single Tenant (+2.6%) and Apartment (1.8%) sectors.

Fixed income

Bond markets were relatively muted through July as central banks left rates on hold and trade-related fears were put to one side as investors focused on earnings and positive economic data. Globally, the Barclays Global Aggregate Index was flat in AUD hedged terms, with US 10-year yields holding below 3.0%. Despite anticipation leading up to the US auction of US$26 billion of treasury bonds in August, yields were only slightly impacted. Concerns remain about yield curve flatness, with the spread between US 2-year and 10-year Treasury yields narrowing to 24 basis points in July—the tightest it has been since 2007. Some observers, including former Fed chairman Ben Bernanke, suggest the yield curve is a less reliable indicator than it once was, with the signal distorted by central bank balance sheets and quantitative easing measures still in place in Europe and Japan. Locally, Australian bonds returned 0.2% in July, with Australian corporate debt returning 0.2% and government debt returning just over 0.1%, while long-term government bonds (with a maturity of ten years or more) returned less than 0.1%.

After keeping monetary policy settings on hold at its meeting at the end of July, the Bank of Japan reinforced its commitment to extremely low interest rates, as well as its yield curve control measures, which are so far holding the 10-year yield at just above zero.

ASX 200 share movements

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

Best performers		Worst performers	
Afterpay Touch Group	51.66%	Sigma Healthcare	-39.51%
Technology One	16.24%	Bellamy's Australia	-29.21%
CIMIC Group	14.26%	Evolution Mining	-20.51%
Super Retail Group	14.07%	Sandfire Resources	-19.43%
Credit Corp Group	13.89%	Nufarm	-19.30%

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

Best performers		Worst performers	
Afterpay Touch Group	357.42%	Sigma Healthcare	-48.96%
Beach Energy	185.46%	AMP	-36.92%
Appen	160.43%	G8 Education	-34.30%
Altium	133.14%	Vocus Communications	-30.95%
a2 Milk Co	131.88%	Telstra Corp	-30.73%

Economic News

Australia

Given the risks within the household sector, the RBA is happy to sit on the bench, holding rates at 1.50% at its August meeting. While household debt and sluggish wage growth remain a concern, the business sector is enjoying favourable conditions, especially in the manufacturing, construction and business services industries. Perhaps the biggest surprise has been the strength in public sector investment and infrastructure, with public sector capex amounting to around $90 billion over the past year, around 5.5% of the economy and almost as large as the dwelling investment sector.

Downside risks remain, with a tightening in lending conditions, partly in response to the Royal Commission into Financial Services, constraining households and the possibility of a sharp decline in house prices posing a challenge to the prudential system. House prices have been falling for the past nine months in Sydney and auction clearance rates remain in the low-60% range.

Australia's labour market continues to tighten, with 50,900 jobs added in June, which included a solid rise in full-time jobs of 41,200 and an increase in part-time jobs of 9,700. Over the past 12 months, full-time jobs have grown 2.5% and part-time jobs have grown at 5.2%, reflecting the broader trend of increasing part-time employment share. The **unemployment rate** was steady at 5.4%, which in trend terms is its lowest rate in five years. The participation rate rose 0.2 points to 65.7% while monthly hours worked rose 10.7 million (+0.6%) to 1,750.7 million hours.

The **AIG Manufacturing Index** fell 5.4 points to 52.0 in July, indicating a significant slowdown in growth. The biggest change came from the sales sub-index (-15.7 points to 45.5), which tends to be volatile around the

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end of the financial year. Production (-8.6 points to 50.3), new orders (-6.5 points to 51.1) and employment (-7.8 points to 50.3) were lower but still expanding, while exports (-3.0 to 49.9) fell into contraction. Stocks (+4.2 points to 54.7) was the only index to move higher. The input prices sub-index (-2.2 points to 68.1) remains elevated, reflecting high input costs for energy.

In a clear shift in mood, the Westpac Melbourne Institute **Index of Consumer Sentiment** rose 3.9% in July from 102.1 to 106.1. This is the most positive result since November 2013 and compares favourably to results since the GFC. The positivity is clearly gathering around the economy, with the 'economic outlook, next 5yrs' sub-index surging 9.8% in July to be up nearly 20% on a year ago. Exactly what is driving this sentiment is unclear, but it may relate to income tax cuts, which would benefit middle-income earners, as well as positive economic news stories globally.

Providing further backing to the confidence story was the 0.4% lift in **retail turnover** in June, following a similar rise in May. Over the year to June, total retail turnover has grown at a relatively subdued rate of 2.9%, but gathered momentum in the June quarter and is holding up well in the face of low wage growth. Clothing was up 1.7% in June and 5.3% over the year, while department stores were down -1.2%. Cafes (+0.9%) had a solid month while household goods (+0.4%) has recovered from a disappointing 2017.

Australia's **trade surplus** expanded by a massive $1,148 million in June, vastly exceeding expectations. Exports rose $914 million, while the value of imports fell $233 million. Non-rural goods exports rose $542 million, including a $118 million boost in metal ores and minerals, while net exports of general merchandise grew by $936 million. Exports of rural and non-monetary gold also increased by $181 million and $104 million respectively, while services exports also gained, adding $87 million on May.

Global

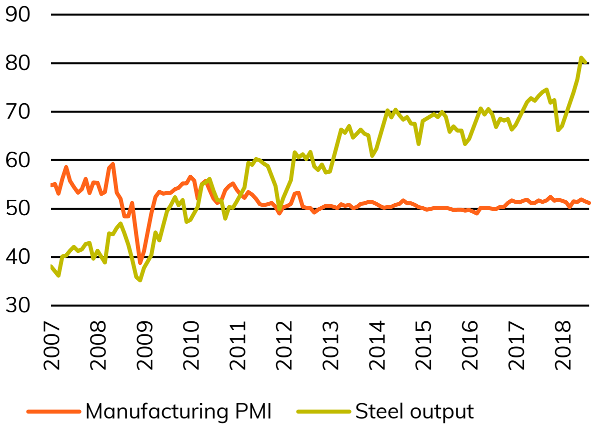
US June quarter GDP shot to an annualised 4.1% according to the first estimate reading, which was in line with expectations but based on factors that could prove temporary, including the impact of income and company tax cuts. This was the fastest the US economy has grown since the September quarter 2014, with consumer spending rising at a solid 4.0% and business investment maintaining strong momentum 7.3%. The Atlanta Fed's GDPNow estimate for September quarter growth is 4.4%, although this appears optimistic compared to the market's assessment, which expects growth to pull back to around 3.0%.

The **US Fed** left the funds rate unchanged at its July/August meeting, noting that the labour market is strengthening and economic activity is rising at a "strong rate", with signs that the household sector is regaining confidence. While President Trump announced he was not "thrilled" the Fed was raising rates, the market is expecting the next hike to come in September and one further hike before the end of 2018, which would bring the range to 2.25–2.50%.

The **ISM manufacturing PMI** fell 2.1 points to 58.1 in July, but production and employment continued to expand at a solid pace despite labour and material shortages. New orders (-3.3 points to 60.2) slowed but are still growing at a substantial rate, with the impact of tariffs still not significantly denting demand, although surveyed manufacturers expressed concern about the impact of reciprocal tariff moves among US trading partners.

The **US CPI** rose to a year-on-year rate of 2.9% in June from 2.8% in May, while the core CPI, which excludes food and energy, rose to 2.3% from 2.2%. The core PCE index—the Fed's preferred measure—pulled back to 1.9% year-on-year after hitting 2.0% in May. Overall, the data still points to a sustained but gradual rise in inflation, giving support to the Fed's tightening path. Employment continues to grow, with July's **non-farm payroll** release showing an additional 157,000 jobs were added during the month, missing against the expected 193,000 but still enough to keep markets buoyed.

China Manufacturing PMI and steel output



Source: Bloomberg

In Europe, economic growth across the euro member countries was 0.3% in the June quarter according to the preliminary estimate, or 2.1% year-on-year. Despite improved labour market flexibility and ongoing structural reform, the eurozone economy is yet to show signs of sustained growth. Growth is down from 2.5% in the previous quarter and continues to pull back from the higher rates of growth seen in 2017, which were underpinned by strong export performance.

The European Central Bank left rates on hold at its July meeting, and the very clear guidance from President Draghi is that they will stay that way until mid-2019 at the very earliest. The Bank is still on track on reduce monthly asset purchases in September from €30 billion to €15 billion before ending the program in December.

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Euroarea inflation rose to 2.1% in July from 2.0% in June, driven by a 9.4% rise in energy prices. The core rate, which excludes volatile items including food and energy, pushed slightly higher from 0.9% to 1.1%. After five years of economic recovery, workers are finally seeing signs of meaningful wage growth, with official data showing a 2.0% rise in the March quarter, with a promising lift in the negotiated wage component.

The latest round of Chinese data provides evidence of a further slowing in manufacturing activity while the services sector lifts its contribution to growth. The June quarter GDP data showed growth easing back to 6.7%, with the services sector growing by 7.6%, highlighting the evolution of the Chinese economy. The clampdown on shadow banking credit, the closure of inefficient capacity, and a focus on pollution are proving to be a headwind in some parts of the economy, while rising incomes and living standards are boosting demand for consumer goods and services.

July's **official PMI** showed China's manufacturing economy grew at its slowest pace in eight months, but more concerning was the marked contraction in new export orders, which dropped from 49.8 to 48.4. The downturn is likely partly related to the announcement of tariffs, but may also reflect the slowdown in global trade already in place. The yuan continued to weaken through July and has fallen more than 5% against the US dollar since early April, raising fears of a 2015-style panic. The Chinese central bank has denied 'weaponising' the yuan as part of the broader trade conflict with the United States, but there are fears that China will guide its currency lower to stimulate exports.

Commodities

Commodities came under pressure in July with the rally in oil prices disrupted by trade fears while base metals continued to slide. The spot price of Brent oil fell 4.2% to US$74.16 per barrel while the Brent oil price was down 5.7% to $69.88. Base metals fell, with Lead (-10.6%) the biggest loser, followed by Zinc (-8.0%), Nickel (-5.8%), Copper (-4.9%) and Aluminium (-2.4%), while Tin (+1.7%) held firm. Gold continued to slide through July, falling 2.1% from US$1,252.60/oz to $1226.10. The price of iron ore (62% Fe, CFR China) rose from US$64.60/t to $67.67.

Currencies

The Australian dollar rose against major currencies in July, including the US dollar (+0.4% to 0.74), British pound (+1.1% to 0.57), euro (+0.3% to 0.64) and Japanese yen (+1.4% to 83.15). Strong relative growth and rising interest rate differentials have supported the US dollar in recent months, but the US dollar index was mostly flat in July, with core inflation measures steady and the Fed holding fire on rates. With the Fed expected to lift rates by 50 basis points before the end of 2018, further downside in the AUD is to be expected.

Over the three months to July, the Australian dollar has fallen 1.5% against the US dollar, reaching a high of 0.7666 in June and a low of 0.7312 in early July. On a trade-weighted basis, the Australian dollar has risen 2.3% over the past three months, gaining against the GBP (+3.3%), EUR (+1.9%), JPY (+1.0%) and NZD (+2.0%).

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