Month in Review

Index returns at end January 2019 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	3.87	1.45	-4.55	1.37	10.09	7.10	9.96
S&P/ASX Small Ordinaries Accumulation Index	5.56	0.78	-6.95	-3.06	11.34	7.37	7.97
Global Equities							
MSCI World TR Index (AUD)	4.10	-1.98	-2.91	4.37	10.76	11.47	10.61
S&P 500 TG Index (AUD)	4.29	-2.54	-1.10	8.48	12.87	15.01	13.44
FTSE 100 TR Index (AUD)	3.35	-1.52	-6.31	-0.89	5.17	4.45	6.90
MSCI Emerging Markets NR Index (AUD)	5.02	7.15	-0.70	-4.76	13.74	8.60	8.17
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	5.96	7.50	5.21	13.10	9.30	13.74	12.43
FTSE EPRA/NAREIT Dev. NR Index (AUD Hgd)	9.98	7.04	3.00	7.04	7.92	9.09	14.22
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	0.64	2.40	3.29	5.49	3.50	4.58	5.11
Bloomberg Ausbond Bank Bill Index	0.18	0.49	0.98	1.95	1.91	2.14	3.05
Barclays Global Aggregate TR Index (AUD Hgd)	0.97	2.87	2.55	3.34	3.28	4.67	6.52

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 3.9% in January as stocks recovered from a global selloff in December. In early February markets were able to digest the recommendations of the Royal Commission report into financial services misconduct, which provided a measured response to the system's failings. Major financial services shares moved higher, but overall the sector remains beaten down having fallen 14.8% over the course of 2018. Energy (+11.5%) was the top performing sector in January, with large gains from Beach Energy (+33.8%), whose December quarter results held up well given seasonally low gas demand, and Worley Parsons (+21.5%), which inched closer to completing its $3.3 billion acquisition of US group Jacobs Engineering.

The Information Technology sector (+9.3%) swiftly recouped losses sustained through the December quarter, driven by the major 'WAAAX' stocks including AfterPay Touch (28.3%), Appen (+24.4%) and Wisetech Global (+20.4%), which managed to claw back their already dizzying valuations. Communications (+7.9%) posted solid gains, with Telstra (+9.1%) attracting interest despite the risk of a further de-rating if its dividend is cut to 16c per share. The ASX 200 VIX, which measures implied volatility, fell from its recent high of 20.6 in December to end January at 14.1.

Global equities

Global shares staged a comeback in January with hopes raised for a positive US earnings season and some backtracking from the Federal Reserve on its more hawkish comments. The US S&P 500 Index rallied 8.0% over January in Australian dollar terms and hit a five-day winning streak in the first week of February. In local currency terms the biggest gains came from Industrials (+11.4%), led by General Electric (+34.2%) and supported by a recovery in major airline shares, which have benefited from concerns over an oversupply of crude oil. Information Technology (+6.9%) shares managed to claw back December's losses, with Facebook (+26.4%) beating revenue and earnings expectations for the quarter, while Apple (+5.5%) saw modest gains as investors looked beyond declining iPhone sales to strong growth in Apple services and other devices.

Markets were mostly muted as President Trump delivered his State of the Union address, while signs of positive developments in the trade negotiations between the US and China helped bring some stability. The UK's FTSE 100 Index rose 3.6% in January and continued to recover in February as investors remained hopeful that an exit deal will be made in time. Japan's Nikkei 225 Index rose 3.8% in local currency terms and China's CSI 300 Index gained 6.3% as Chinese authorities announced further monetary and fiscal stimulus to combat softer GDP.

REITs

The S&P/ASX 200 A-REIT Index returned 6.2% in January as the outlook for interest rate rises softened and bond market yields fell. While Australia offers one of the highest REIT market dividend yields of 5.1%, the spread over 10-year bonds is slipping in comparison to other developed markets. Nevertheless, the 10% fall in the Australian dollar over calendar year 2018 has made

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prices considerably cheaper to foreign investors. The slowdown in residential markets has been driven in large part by the curtailment of bank lending, while the prospect of a change of federal government (and changes to property and tax regulations) is adding to the uncertainty.

In terms of January's performance, shopping centres were again the laggards, with Shopping Centres Australasia (-2.4%) down ahead of its half-year results, which came in largely as expected, while Vicinity Centres (+0.4%) was flat. Globally, the positive outlook is being underpinned by consistent demand, relatively low vacancy rates, and rental growth that is supporting earnings and dividends. US REITs rebounded from December's falls, with the biggest gains coming from Warehouses (+15.2%), Shopping Centres (+14.2%) and Offices (+13.9%).

Fixed income

Fears of a 'breakout' in interest rates were allayed in January as slower global growth and softer inflation saw a resurgence in bond values and compression of yields.

Global bonds measured by the Barclays Global Aggregate Index returned -2.0% in January in Australian dollar unhedged terms and 1.0% in hedged terms. Major developed market yields have been on a downward path since the end of the September quarter, largely driven by a flight to quality as equity volatility spooked markets and disappointing global data.

The impact of the political landscape cannot be ignored either, with continuing tensions around trade policies and the US government shutdown adding to the angst in markets. The US 10-year Treasury yield fell from 2.69% to 2.63% in January, down from its recent highs of over 3.20% in November 2018 as the US Fed sought to reassure markets that it was not blindly committed to its tightening path. Money markets have pared back expectations on the number of rate rises and now expect the Fed to hit the pause button in 2019. Weak inflation figures in Europe saw the German 10-year Bund yield fall from 0.24% to 0.15% while the 5-year yield held at -0.32%. In Australia, the 10-year yield fell from 2.32% to 2.24%, down from its recent high of 2.76% in November.

ASX 200 share movements

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

Best performers		Worst performers	
Fortescue Metals	34.84%	Costa Group Holdings	-25.47%
Beach Energy	33.82%	Challenger	-23.71%
Afterpay Touch Group	28.31%	ResMed	-17.90%
Appen	24.40%	Elders	-11.33%
WorleyParsons	21.54%	Australian Pharmaceutical Industries	-8.70%

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

Best performers		Worst performers	
Saracen Mineral Holdings	126.18%	Syrah Resources	-60.38%
Afterpay Touch Group	116.17%	AMP	-54.45%
Bravura Solutions	114.34%	Automotive Holdings Group	-54.07%
IDP Education	91.18%	Orocobre	-53.62%
Appen	82.34%	IOOF Holdings	-51.68%

Economic News

Australia

Confidence in the Australian economy has taken a hit from the correction in house prices and a slowdown in global growth, both of which have led the Reserve Bank to reassess downside risks. Consumer spending has remained relatively robust despite the negative wealth effects of falling property prices, but this has been partly driven by a fall in the savings rate. Overall, GDP growth slightly above the trend rate of 2.75% has seen the unemployment rate decline from 5.5% at the start of 2018 to 5.0% in January 2019, but excess capacity remains, partly evidenced by the lack of any meaningful pick up in wage growth and inflation (indeed core inflation measures remain below the RBA's target range).

Together with extremely accommodative monetary policy settings and a currency no longer constraining growth, these conditions would typically be associated with a favourable equity market backdrop. Of course, this ignores the risks posed by the excesses of the past decade and Australia's sensitivity to China, which is undergoing both a structural and a cyclical downturn.

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Employment growth remains strong, with 21,600 jobs added in December and 251,000 added over 2018, while job ads are consistent with reasonable growth going forward. Full-time employment was again soft, falling by 3,000, while part-time jobs added 24,600. In trend terms there are still signs of momentum within the labour market, although recent growth has been driven by part-time employment. The **unemployment rate** dropped 0.1 points to 5.0%, helped by a small drop in the participation rate, which remains very high in historic terms. Monthly hours worked in all jobs rose 1.3 million hours to 1,758.9 million hours.

The **AIG Manufacturing Index** rose 2.5 points to 52.5 in January, recovering from December's fall, with revised figures showing the manufacturing sector avoided a contraction but was flat at 50.0 points. New Orders (+2.8 points to 52.3) rebounded in the new year but remains below the 12-month average of 56.3, while Production (+4.9 points to 54.0) moved back into expansion. The survey noted manufacturers' concerns regarding energy costs as well as an ongoing skills shortage. The Input Prices sub-index (-2.9 points to 70.3) softened in January but cost pressures are still evident, reflecting prices for gas and electricity.

The Westpac Melbourne Institute **Index of Consumer Sentiment** dropped from 104.4 to 99.6 in January as pessimists got the upper hand during an eventful month. While equity markets recovered, talk of trade wars, slowing growth and the continued slide in house prices made if hard for consumers to keep their chins up. The 'economic outlook, next 12 months' sub-index dropped 7.8%, the biggest fall since September 2015 when sentiment was hit by a sharp sell-off in financial markets. While a strong labour market is adding to security, consumer views on family finances also recorded a poor start to the year, with the 'finances vs a year ago' sub-index posted a sharp 5.9% decline.

Australia's **balance on goods and services** expanded in December from a surplus of $2,256 million to $3,681 million (a 63% increase). Total goods credits fell $650 million but this was mostly due to a significant fall of $1,034 million of non-monetary gold exports. General merchandise exports rose $385 million and rural goods rose $353 million, while exports of metal ores and minerals fell $181 million. On the debits side, imports of general merchandise dropped $2,440 million and imports of capital goods fell $1,070 million.

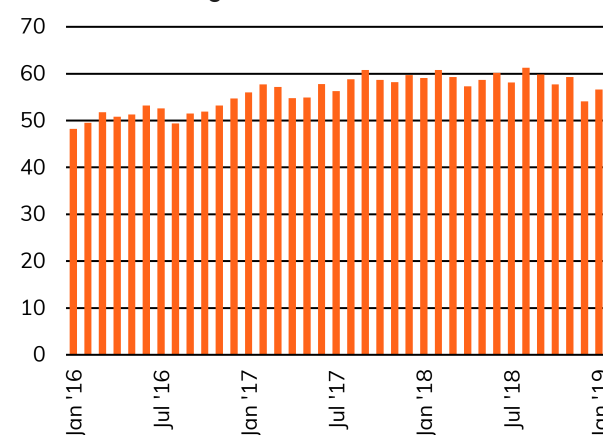
Global

The **US Fed** began the new year struggling to regain its balance after being wrongfooted by markets as it attempted to address concerns surrounding its current tightening path. At the mid-December FOMC meeting the Fed lifted rates as expected to 2.50% and, although Fed officials have since backtracked from their more hawkish comments, there are signs that the US economy has slowed from annual growth figures of 4.2% in the June quarter and 3.5% for the September quarter of 2018. However, talk of a possible recession would appear to be overblown—the Atlanta Fed's GDPNow projection for the December quarter growth was 2.7% in early February, while commercial loans have lifted and January's payrolls data were well ahead of expectations.

December's CPI dropped 0.1 points to leave the annual rate at 1.9%, while wage growth slowed in January but still represents a 3.2% gain over the year. The standoff over congressional funding for a border wall continues, with President Trump and Congress agreeing to short-term arrangements to keep the government running, but an agreement is needed to secure funding past 15 February to avoid another shutdown.

The **ISM manufacturing PMI** rose 2.3 points to 56.6 in January, with a large uptick in New Orders (+6.9 points to 58.2) and strong momentum in Production (+6.4 points to 60.5). The results were welcomed by investors who feared December's slowdown could continue into the new year. Inputs continue to be a drag on expansion, reflected in a declining Prices index (-5.3 points to 49.6), which contracted for the first time in nearly three years. Manufacturers have experienced some price turbulence, especially the price of steel, which the survey notes has generally returned to more normal, pre-tariff levels.

ISM Manufacturing PMI



Source: Institute of Supply Management

Growth appeared to slow across Europe in December as political uncertainty and a confluence of one-off factors took their toll. German car makers continue to struggle to adjust to new emissions regulations, while France's political system is being disrupted by the rolling gilets jaunes (yellow vest) protests. The IHS Markit Eurozone PMIs are consistent with GDP growth of 0.3% for the December quarter, which would be an improvement on September quarter growth of 0.2%, but the data point to a slowdown in activity in December.

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Growth is falling due to a range of factors, including the US-China trade war, Brexit, financial market volatility and slower global growth. The IFO Institute's economic climate index for the first quarter of 2019 plunged in early February from 6.6 to -11.1 points, falling below zero for the first time since 2014. The Brexit issue was again thrown into a state of flux following the UK parliament's rejection of Prime Minister May's deal.

May is forced to renegotiate with the EU to an reintroduce a revised deal as soon as possible, raising the stakes and the possibility of the UK falling out of the EU without a deal. Meanwhile, the Italian government and the EU have reached a deal on the 2019 budget, which would leave Italy with a budget deficit of 2.0% of GDP in 2020 (down from the 2.4% in its original plans) to be achieved by delaying some spending measures.

China is attempting to wean itself off its reliance on credit-fuelled investment spending, and with good reason given debt levels approaching 300% of GDP. However, given the additional threat of a trade war with the US and an increasingly cautious household sector, China appears to have reached the point where additional stimulus measures are required. In January Chinese authorities announced the fifth cut in the bank reserve requirement ratio for this cycle, freeing up potentially US $200 billion while also committing to a stimulus package centered on tax cuts for select industries. These measures follow tax cut for households and the planned record-high rail investment worth US $125 billion.

The reason for the step up in policy is the ongoing weakness in activity, with January's PMI numbers failing to recover after moving below the 50-point mark in December, indicating a contraction in activity and a sign that the trade war may finally be entering the data. The truce reached between China and the US at January's G20 summit in Argentina was a welcome development, and negotiations since appear to indicate a reasonable chance of a deal, which is important for both countries as other sources of growth come under pressure.

Commodities

Concerns of an oversupply of oil receded in January as signs of tightening appeared despite relatively large US exports. The Brent crude price rebounded from US $53.23 to $62.46 per barrel and WTI crude rose from $46.92 to $53.84, reversing price falls through December. Metals also rallied strongly through January, with Nickel (+16.7%), Zinc (+10.2%), Tin (+7.1%), Lead (+4.5%), Aluminium (+3.5%) and Copper (+3.4%) all gaining. Gold rose 3.2% to US $1,322.06/oz, moving closer to its highs at the start of 2018.

Currencies

The Australian dollar rose 3.3% in January against the US dollar and 1.5% in trade-weighted terms but came under pressure in February as the RBA cut its GDP growth forecasts, which markets already considered to be overly optimistic. Australia's bulk commodity prices and the terms of trade have held up reasonably well, notwithstanding the uncertainty over global demand, while on a simple PPP basis, the Australian dollar is not far from its long-term average level. If the US Fed is forced to resume tightening in response to continued US growth momentum and wage growth, the Australian dollar will likely continue its downward path.

Over the three months to the end of January 2019 the Australian dollar has fallen 0.5% in trade-weighted terms, losing value against the British pound (-0.1%) and the Japanese yen (-1.0%) and gaining against the US dollar (+2.8%) and euro (+1.5%).

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