Month in Review

Index returns at end January 2020 (%)

Australian Equities	1 mth	3 mth	6 mth	1 yr	3 yr	5 yr	10 yr
S&P/ASX 200 Accumulation Index	4.98	6.08	5.11	24.72	12.36	9.33	9.08
S&P/ASX Small Ordinaries Accumulation Index	3.38	4.69	2.76	18.84	12.12	11.18	5.28
Global Equities							
MSCI World TR Index (AUD)	5.53	9.59	12.61	30.37	17.30	13.23	13.78
S&P 500 TG Index (AUD)	4.96	9.82	12.54	32.54	19.44	15.82	17.25
FTSE 100 TR Index (AUD)	0.98	6.02	8.65	19.41	11.45	6.20	8.42
MSCI Emerging Markets NR Index (AUD)	0.93	6.15	7.29	13.99	12.80	7.87	6.85
Real Estate Investment Trusts (REITs)							
S&P/ASX 300 A-REIT Accumulation Index	6.30	4.10	4.00	19.95	13.60	10.98	12.65
FTSE EPRA/NAREIT Dev. NR Index (AUD Hgd)	1.31	0.13	6.61	11.60	8.64	5.76	11.48
Fixed Interest							
Bloomberg Ausbond Composite 0+ Yr Index	2.33	1.47	2.00	9.06	5.73	4.32	5.85
Bloomberg Ausbond Bank Bill Index	0.08	0.24	0.49	1.40	1.70	1.88	2.84
Barclays Global Aggregate TR Index (AUD Hgd)	1.81	1.32	2.69	8.09	4.86	4.13	6.32

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

Following a very strong performance in 2019, the Australian equity market started 2020 in the same manner. It's possible that markets were factoring in some optimism on economic growth and earnings, although there is scant evidence of what RBA Governor Philip Lowe described as a "gentle turning point" in the economy. Highlighting the precariousness of markets was the volatility caused by the outbreak of the coronavirus, which saw shares decline in late January and early February.

Over January, the S&P/ASX 200 Index returned 5.0%, led by large cap shares. The Health Care sector (+12.0%) continued its remarkable run, building to a rolling 12-month return of 54.8%. CSL rose 13.1% over the month and continues to build momentum, underpinned by a strong earnings outlook through its commercial pipeline of new applications and treatments. The 12-month forward P/E for the Australian equity market stood at 17.4 times in January, nearing its highest level since 2001, with earnings growth for FY20 coming in at a moderate 5.0%. This signifies a relatively expensive market, which makes it vulnerable to shocks like the coronavirus, but investors need to be cognisant of the continuation of ultra-low interest rate settings providing a meaningful valuation support for equities.

Global equities

After surging in the final quarter of 2019, US equities were flat in January, while the coronavirus outbreak added to global uncertainty and saw markets tumble at the end of the month. The services sector has remained relatively resilient, driven mostly by the robust US consumer sector, which has enjoyed healthy balance sheets, steady employment, wage growth, and low interest rates. The MSCI World Ex-Australia Index rose 4.2% in January in Australian dollar terms, but most major indices were down in local currencies.

News of the virus's spread had a pronounced effect on markets, with investors concerned about the flow-on effects to the real economy. Chinese tourists are the highest-spending in the world (in 2018 they spent US$277 billion), so the effects of travel restrictions and quarantine will have an impact on all markets, with the tourism and travel sectors directly impacted. In the UK the FTSE 100 Index finished 3.5% lower in January on the back of weaker economic data, as well as lingering uncertainty around Brexit arrangements and the form of a trade deal with the EU. Globally, valuations across most regions remain above their long-term average from a PE standpoint, but remain relatively attractive in terms of yield.

Property

Australian listed property rose 6.4% in January as the sector bounced back from a tough month in December, while globally property was a popular safe haven for investors. Charter Hall Group (+16.1%) rebounded strongly in January, returning to its September 2019 level, while Goodman Group (+11.4%) reaffirmed its FY20 forecast for operating earnings. In the residential market, house prices rose by 4.0% nationally in the December quarter although they remain 3.1% below peak levels. House prices in Melbourne and Sydney rose 5.3% in 2019 according to CoreLogic data. In the US, REITs gained 1.1% as the domestic-focused residential

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and commercial real estate sectors were the bright spots amid broader market weakness.

REITs and housing are among the best-performing sectors over 12 months. Meanwhile, the NAHB builder sentiment index ended 2019 at its highest level since 1998-99 and housing starts surged 17.0% in December to their highest level in 13 years. Lower mortgage rates and low unemployment have generally supported the domestic housing sector, powering the US homeownership rate to its highest level since 2013 at 65.1%.

Fixed income

While the RBA expects inflation to gradually increase (as it did for its most recent print in January), subdued wages growth and restrained levels of consumer spending remain the key threats to this scenario. The bank maintained the official cash rate at an historic low of 0.75% at its February meeting, where it has remained since the 25 basis point cut in October, as members assessed the economic fallout from the bushfires and the likely impact of the coronavirus outbreak. The market continues to expect at least one further rate cut this financial year, with a high probability priced in that the official rate falls as low as 0.25%.

Yields remain low across both government and corporate sectors, however the search for yield remains strong. Yields were down over January, with the Australian 10-year Treasury yield falling from 1.37% to 0.95% and the US 10-year Treasury yield falling from 1.92% to 1.51%. The UK 10-year Gilt yield fell from 0.82% to 0.52% as markets contemplated the form of a future trade deal with the EU, while the German 10-year Bund yield moved deeper into the red, falling from -0.19% to -0.44%. Japan's 10-year Treasury yield fell from -0.02% to -0.07%, only briefly switching into positive territory over the month.

ASX 200 share movements

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

Best performers		Worst performers	
PolyNovo Ltd	42.13%	nearmap Ltd	-33.27%
Afterpay Touch Group Ltd	31.66%	Treasury Wine Estates Ltd	-19.77%
Silver Lake Resources Ltd	21.27%	Western Areas Ltd	-15.18%
Saracen Mineral Holdings Ltd	19.34%	nib holdings Ltd/Australia	-13.72%
Vocus Communications Ltd	18.53%	Corporate Travel Management Ltd	-13.12%

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

Best performers		Worst performers	
Avita Medical Ltd	400.00%	Pilbara Minerals Ltd	-54.62%
PolyNovo Ltd	311.76%	New Hope Corp Ltd	-49.88%
Emerchants Ltd	271.08%	Costa Group Holdings Ltd	-45.13%
Silver Lake Resources Ltd	187.61%	Mayne Pharma Group Ltd	-43.47%
Magellan Financial Group Ltd	146.35%	St Barbara Ltd	-42.49%

Economic News

Australia

The Australian economy grew at 1.7% in the September quarter and most likely less than 2.0% in the December quarter, well below the growth rate required to lift wages and inflation and to keep unemployment from rising. The RBA has indicated that if it drifts further away from achieving its inflation and unemployment targets, rates will be cut. The **unemployment rate** currently sits at 5.1%, up slightly from 5.0% a year ago.

Leading indicators of unemployment still paint a picture of subdued jobs growth, contrary to the 43,400 jobs added in the December quarter. **ANZ job ads** dropped an alarming 6.7% in December and fell 18.8% over the year, although part of the monthly result may have been impacted by the bushfires. After strong Black Friday sales in November, **retail sales** pulled back more than expected in December.

As noted previously, the bushfires over recent months, particularly in NSW and Victoria, will have an impact on growth, reflecting direct loss of output, lost tourism, lower consumer and business confidence, and supply chain disruptions. However, insurance payouts and government support packages will likely provide an offsetting boost in the quarters ahead. For the RBA, the bias is still towards lower cash rates. We may see a "gentle turning point" in the economy, but escape velocity is not assured at this stage.

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December's **employment figures** showed 28,900 jobs added, although full-time employment fell by 300. Over 2019, 152,700 full-time jobs were added, compared to 162,400 in 2018, although this has been offset by a rise in the participation rate to produce a slightly higher rate of unemployment. While the RBA still expects some upward pressure on wages as the labour market tightens, this will likely be limited.

It's been a tough start to the year for Australia's manufacturing sector. The **AIG Manufacturing Index** fell a further 2.9 points to 45.4 in January, the lowest result since 2015, pointing to a deeper contraction impacted in part by drought and bushfire disruptions, although some manufacturers reported a rise in new orders due to the bushfire response. Overall, though, new orders were down 5.1 points to 43.7 and production was down 3.5 points to 45.2. Every sub-index is in contraction except for input prices, which rose 3.0 points to 61.9.

After a disappointing Christmas season for retailers, the start of the new year hasn't done anything to improve the disposition of Australian consumers. The **Westpac Melbourne Institute Index of Consumer Sentiment** fell further in January from 95.1 to 93.4, due in no small part to the effect of the bushfires, especially in NSW and Victoria. The 'economy, next five years' sub-index fell 3.7% in January and the 'economy, next 12 months' sub-index fell 5.4%, and both are down sharply on a year ago (–8.9% and –11.9% respectively).

Global

Markets have been affected by risk events like the coronavirus and geopolitical unrest, which are creating uncertainty for investors and policymakers. Some indicators that were recently trending down, such as manufacturing activity, seem to have stabilised and consumer spending is still holding up. However, evidence suggests that we are in the later stages of the current economic cycle.

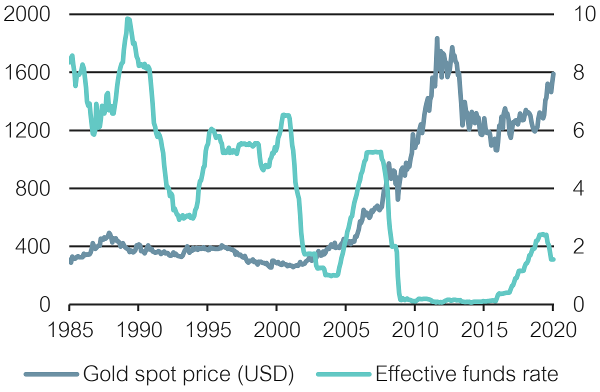
The risk of a further escalation in the **trade war** has been averted for now, but a full resolution remains unlikely until at least 2021. Removal of existing tariffs is conditional on achieving the targeted increase in US imports over 2020-21, meaning trade tensions are unlikely to disappear anytime soon. The US economy has already been impacted by the trade war, as evidenced by the weaker manufacturing sector. While the **ISM manufacturing index** rose back into expansion territory in January, it remains in a precarious state after contracting since July 2019.

Orders for capital goods dropped 0.9% in December, suggesting that business investment was a drag on growth in the December quarter. There's a risk that the malaise in manufacturing could spread to the services sector if lower business confidence flows on to lower investment spending and employment.

The bright spot was again the labour market, with a greater-than-expected rise in **non-farm payrolls**, indicating that hiring may be speeding up again. From a monetary policy perspective, the slowdown in growth suggests the chances of a further cut in the Fed funds rate is still relatively high. The **FOMC dot-plot** in December indicated that the funds rate would be on hold at 1.50–1.75% in 2020, although markets currently imply one further cut to 1.40% by the end of 2020.

The German statistics office reported that GDP grew by only 0.6% in 2019, down from 1.5% in 2018 and 2.5% in 2017. The government expects growth to pick up to 1.0% in 2020 having cut its forecast from 1.5% in October. The **IHS Markit Eurozone PMIs** show manufacturing weakness is most severe in Germany, but a pickup in the service sector points to flat overall activity at the end of 2019. Germany is particularly sensitive to disruptions in global trade, and hence to the US-China trade war and Brexit.

The Gold price has been rising since 2018



Source: Bloomberg

In France, the composite index points to sustained growth, with the service sector assisted by small but positive growth in manufacturing activity. In the UK, GDP contracted 0.3% in November ahead of the general election after growing by 0.1% in the previous two months. **UK inflation** fell to 1.3% over the year to December 2019, the lowest level since November 2016 and well below the Bank of England's 2.0% target.

Pleasingly, the worst appears to be over for the eurozone, with the Brexit bill now passed by the UK parliament, possible fiscal support on the way from the German government, and the largest increase in exports in two years helped by the weaker euro. Markets expect earnings growth to increase by 1.3% in the December quarter after falling in three consecutive quarters.

The outbreak of the coronavirus in Wuhan and its spread to 27 other countries has resulted in travel restrictions and quarantine measures to prevent a

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pandemic. Australians flown home from Wuhan will be quarantined on Christmas Island for two weeks, while Americans will be "temporarily housed" at an air base in California.

Containing the virus has been made more challenging given that the outbreak coincided with the Lunar New Year, which typically involves extensive worldwide travel by Chinese citizens. The easing measures undertaken over the past 12 months appear to have stabilised the Chinese economy, however the direct economic effect from the coronavirus is likely to be significant and may warrant further measures.

The other major development over the month was the signing of the phase one trade deal. While existing tariffs largely remain in place, China has agreed to buy an additional US$200 billion in US agricultural, manufacturing, energy and services exports over the next two years. China will provide US firms greater access to a number of sectors and will strengthen intellectual property protection. The US has refrained from adopting the December tariff hike and will halve tariffs on US$120 billion of Chinese imports. At this point, the trade deal is more about avoiding an escalation than a complete scaling back of tariffs.

Commodities

Commodities took a tumble in January with base metals down, including Copper (-9.8%), Nickel (-8.4%), Aluminium (-4.9%), Tin (-4.7%) and Zinc (-3.2%). Gold bucked the trend, rising 4.4% over the month to US $1589 per ounce. In oil markets, the Brent crude spot price fell 14.8% to US $57.8 per barrel and WTI crude dropped 15.6% to $51.6.

Currencies

For the RBA, the bias is still towards lower cash rates. A "gentle turning point" in the economy may materialise, but escape velocity is not assured at this stage. The currency failed to break through the US $0.70 barrier in December and finished January at $0.67. A move through the upper end of the recent 0.70–0.67 range requires more evidence of stronger domestic growth or a weaker US dollar. Over the three months to the end of January 2020 the Australian dollar fell 4.7% against the US dollar, 3.6% against the euro, 4.9% against the Japanese yen and 4.3% against the British pound.

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