Colonial First State

Market View – April 2017

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Summary

The Reserve Bank of Australia (RBA) Board met on 4 April and as widely expected, left the official cash rate on hold at 1.5%. At the time of writing, the RBA also left the official cash rate on hold at its 2 May 2017 meeting.

The housing market saw more moderate gains in April, with month end figures from CoreLogic showing capital city home prices rose 0.1% per quarter and 11.2% per year.

The S&P/ASX 200 Accumulation Index rose by 1.0% during April. Against the US dollar, the Australian dollar fell 1.8% to $US0.7488.

The US Federal Reserve Open Market Committee (FOMC) did not meet in April, with the next meeting scheduled for 2-3 May 2017.

Global developed equity markets began the month cautiously with no shortage of geopolitical risks including the French elections, North Korea, Syria and the unwinding of optimism around President Trump's policy timeline. However the outcome of the French election towards the end of month saw gains in most global developed equity markets.

Australia

The Reserve Bank of Australia (RBA) Board met on 4 April and as widely expected, left the official cash rate on hold at 1.5%. At the time of writing, the RBA also left the official cash rate on hold at its 2 May 2017 meeting. There has been no change in the official cash rate since August 2016.

The RBA continues to balance three key risks in the economy for their monetary policy deliberations: the outlook for inflation, the strength or otherwise of the labour market and household financial stability.

In the May statement accompanying the "on hold" decision, it was clear that the RBA is not contemplating moving interest rates again soon in either direction.

Q1 17 inflation data was released in the month, and rose by 0.5% per quarter, a touch below consensus expectations of 0.6%, and the same increase as seen in Q4 16. This took the annual rate of inflation up to 2.1% per year from 1.5% per year in Q4 16. This sees the rate of headline inflation move into the RBA's 2%-3% target range for the first time since Q3 14.

The main price pressures in Q1 17 came from automotive fuels (+5.7% per quarter), medical and hospital services (+1.6% per quarter) and new dwelling costs (+1.0% per quarter). These price rises were partially offset by falls in furniture and household equipment/services (-1.0% per quarter) and recreation & culture (-0.7% per quarter).

The housing market saw more moderate gains in April, with month end figures from CoreLogic showing capital city home prices rose 0.1% per quarter and 11.2% per year. Prices for detached houses were stronger in Sydney (+0.2% per quarter) and Melbourne (+0.5% per quarter) while unit prices were weaker in Brisbane. Perth prices fell 1.0% per quarter and continued their run of recent weakness. Overall house prices did show more moderate gains in April versus recent months, post the step-up in macro prudential measures announced in March and recent increases in investor mortgage rates.

The March labour market report showed the unemployment rate hold steady at 5.9%

US

The US Federal Reserve Open Market Committee (FOMC) did not meet in April, with the next meeting scheduled for 2-3 May 2017. No change in the Federal Funds rate is expected at this meeting after the FOMC lifted the Fed Funds rate at its March meeting. An interest rate hike in June is priced in at around 70% by markets.

The news flow in April centred on President Trump's plan for tax reform, and the need for Congress to pass a spending bill to keep the government funded till 30 September 2017.

On 26 April 2017, President Trump through economic adviser Gary Cohn and Treasury Secretary Steven Mnuchin, announced a list of objectives for tax reform. The main objectives included: cutting the federal income tax rate to

15% for corporations, small businesses and partnerships of all sizes; a one-time repatriation tax of 10% on corporate earnings currently offshore, lowering the top individual tax rate from 39.5% to 35%; and the potential for the removal of several high income taxes such as estate taxes and the alternative minimum tax. However, there were limited details on how these tax changes would be funded and the timetable for legislation around tax reform.

Congress were also required to pass a spending bill to fund the government until 30 September 2017. However only a stopgap bill was passed that gave Congress one week to agree to a spending bill. On 1 May, there were reports that a deal had been reached to fund the government through the remainder of the US fiscal year, with President Trump indicating he would sign the bill despite it providing no provision for a number of his key policy initiatives, such as the border wall with Mexico.

Employment was weaker than expected in March, with just 98k payrolls added, compared to 219k in February. Bad weather likely impacted the result, with a severe winter storm driving a higher than normal impact on the inability to work over the month. The unemployment rate fell from 4.7% to 4.5%.

Inflation data for March was weaker than expected falling 0.3% per quarter, taking the headline inflation rate down from 2.7% to 2.4% per year. This was the first monthly fall since February 2016, and was largely due to a one-off fall in wireless phone services, and weakness in apparel prices.

Europe

The European Central Bank (ECB) met on 27 April 2017 with no change to policy. The Governing Council continues to expect the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of net asset purchases.

As of April, the ECB will be purchasing €60bn of securities per month until the end of December 2017, or beyond if necessary.

The ECB made little changes to its overall view, with expectations that this will be updated in June when new staff forecasts will be available. Risks to the economic outlook were seen to have further diminished, but remain to the downside.

In April, the estimate for headline CPI was 1.9%, up from 1.5% in March. Core CPI also rose, now at 1.2%, up from 0.7% per year.

The focus in Europe in April were on the first round of the French Presidential elections. Consistent with pre-election opinion polls, the first round of the French Presidential election saw the centre-left independent candidate Emmanuel Macron, and the far-right Marine Le Pen, win the two largest shares of the vote. This included a higher-than-expected voter participation rate of around 77%.

Macron and Le Pen will now fight it out in the second round vote, scheduled for Sunday 7 May. Significantly, this will be the first time in modern French political history that neither of the two major traditional political parties in France (ie. the Socialist Party and the Republican Party) will be represented in the second round of the Presidential election.

UK

The Bank of England (BoE) did not meet in April. The next meeting will be held on 11 May.

A speech by board member Michael Saunders during the month suggested he was more optimistic on economic growth.

Prime Minister Theresa May called a surprise snap election for 8 June, well ahead of the scheduled end of her term in 2020 and despite an earlier promise not to call an early election. This should help strengthen and shore up support for her Brexit plan.

Late in the month, the European Council published a set of guidelines to govern the EU's Brexit negotiations with the UK. In short, the principle to the strategy is "a non-member of the Union that does not live up to the same obligations as a member, cannot have the same rights and enjoy the same benefits as a member".

NZ

The Reserve Bank of New Zealand (RBNZ) did not meet in April, with the next meeting scheduled for 11 May.

Q1 17 CPI data was released, with inflation rising 1.0% per quarter, compared to a consensus of 0.8%. Annual inflation rose to 2.2% per year, compared to a consensus of 2.0%. Much of this lift is due to volatility in fuel and food, returning inflation to within the RBNZ's target band.

Japan

The Bank of Japan (BoJ) met on 27 April 2017 and as was widely expected, left its policies intact, with the Policy Balance Rate on hold at 0% and 10-year yield target at -0.10%.

The BoJ in updated forecasts expects to achieve the price stability target of 2% in the middle of the projection period – around fiscal 2018.

April inflation data showed headline inflation at 0.2% per year and underlying inflation (ex fresh food and energy) at -0.1% per year.

China

Q1 17 GDP data was released with growth of 6.9% per year recorded, slightly ahead of expectations and Q4 16's reading of 6.8%. Improved global demand, domestic infrastructure spending and strength in the property market helped the higher than expected reading.

Other economic data also showed upside surprises, with Industrial Production (+7.6% per year), Retail Sales (+10.9% per year) and Fixed Asset Investment (+9.2% per year).

Inflation data released for March continued to show an easing of pressure that had built up at the start of the year. Inflation for the year to March was 0.9% per year, up from 0.8% in February, but down from 2.5% in January.

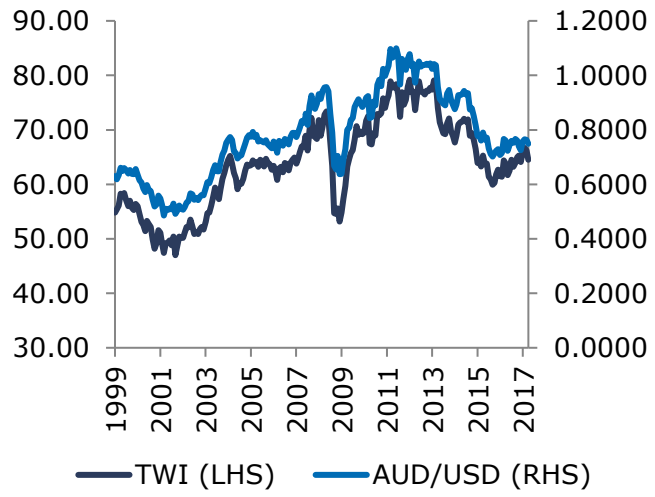
Australian dollar

The Australian dollar was weaker over the month, with falls in bulk commodity prices, particularly iron ore leading to the falls. There was also a shift lower in geopolitical risks, with the election in the UK and outcome of the first round of the French election leading to the Australian dollar to fall 3.1% against the GBP and 4.0% against the EUR.

Against the US dollar, the Australian dollar fell 1.8% to $US0.7488.

The AUD was also weaker against the Yen (-1.7%) but rose 0.2% against the New Zealand dollar.

AUD WEAKENS WITH COMMODITIES PRICES



Source: Bloomberg as at 30 April 2017

Commodities

Commodity prices were predominantly lower in April led by metal prices, while some energy prices including coal and US gas prices were higher.

The price of West Texas Intermediate (WTI) Crude oil finished the month at $US49.3 per barrel, down 2.5% per quarter, while the price of Brent Crude oil was down 3.2% to $US52.1 per barrel. The main catalyst was strong imports into the US supporting oil inventory levels.

Gas prices were higher, with the US natural gas Henry Hub futures price up 2.2% to $US3.16 per one million British Thermal Units, after a sharp gain of 23% in March.

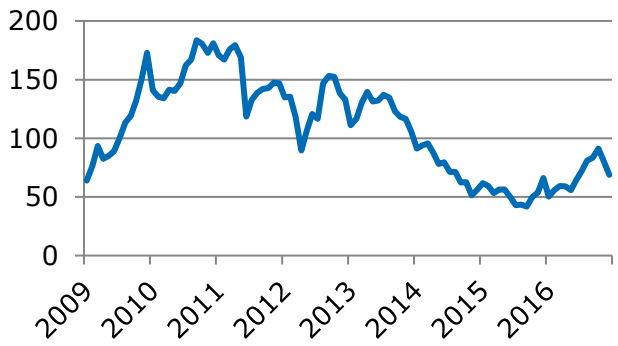
Iron ore prices continued to retreat in the month, with the spot iron ore contract (Qingdao 62% Fe fines) down by 14.4% to $US68.8 per tonne in April, down from the recent peak of $US94.9 in February. The recent volatility in the iron ore price is largely due to speculation and trading rather than fundamentals.

Coal prices rose in April, with the price of coal at the Newcastle Coal terminal rising 3.5%, largely as a result of weather impact from Cyclone Debbie in Queensland.

Base metals were mixed, with the London Metals Exchange (LME) Index down by 2.7%. Nickel (-5.7%), aluminium (-2.6%), zinc (-5.3%), lead (-3.9%) and tin (-1.4%) all fell. Copper was also weaker, down 1.7%.

The spot gold price rose 1.5% to US$1,268.3/oz.

IRON ORE DECLINES ON CHINA CONCERNS



Source: Bloomberg as at 30 April 2017

Australian shares

The S&P/ASX 200 Accumulation Index rose by 1.0% during April. The strongest performers were Industrials (+4.3%), IT (+4.1%), Health Care (+3.2%), Utilities (+3.1%), Property Trusts (+2.6%) and Financials (+1.9%).

The worst performer by some margin was Telcos (-9.9%), which was led lower by Telstra, TPG Telecom and Vocus Communications. Energy (-0.6%) and Materials (-0.2%) edged lower, as weakness in commodity prices, especially iron ore, continued.

Listed property

The S&P ASX 200 A-REIT index rose by 2.6% in April in AUD terms. Diversified A-REITs led the gains and climbed 3.4%, helped by robust performance from residential business segments.

The best performing A-REITs included industrial A-REIT Goodman Group (+4.8%) and diversified A-REIT Stockland (+4.5%). Goodman Group continues to see keen demand for its high quality logistics facilities, driven by the growing popularity of e-commerce. This is consistent with lacklustre recent sales figures reported by retail A-REITs. Stockland gained as investors focussed on strong results from its residential business, including a 24% increase in net deposits for the first nine months of this financial year, compared to the same period a year ago.

The worst performers included Cromwell Property Group (-1.6%) which made an indicative, non-binding proposal to acquire Investa Office Fund for A$4.85.

Listed property markets offshore also gained in April. The FTSE EPRA/NAREIT Developed Index (TR) climbed by 1.1% in US dollar terms. The UK was the best performing market, with a gain of 8.5%. The worst performing market, Japan, finished the month 0.4% higher.

Global shares

Global developed equity markets began the month cautiously with no shortage of geopolitical risks including the French elections, North Korea, Syria and the unwinding of optimism around President Trump's policy timeline. However the outcome of the French election towards the end of month saw gains in most global developed equity markets.

The International Monetary Fund (IMF) upgraded its global economic growth forecasts. Global growth of 3.5% is expected in 2017 and 3.6% in 2018. This compares to 3.1% in 2016. The upgrades are broad based amongst advanced and developing economies, and through trade and manufacturing.

The MSCI World Index was up 1.3% in US dollar terms in the month and 3.6% in Australian dollar terms.

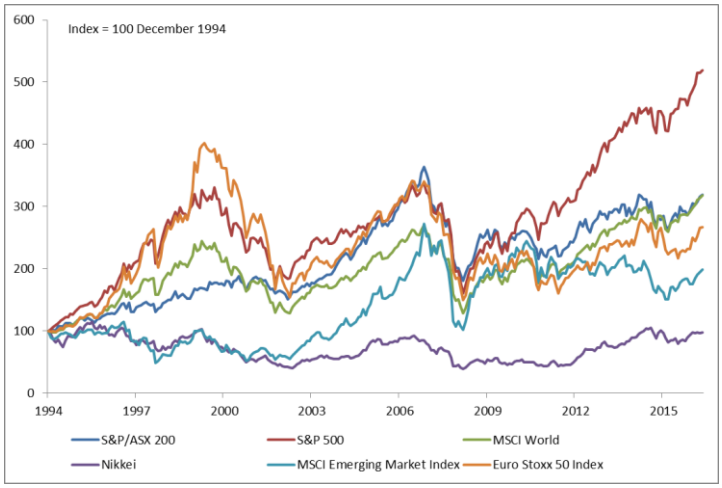
The VIX Index, a market estimate of future volatility of the S&P500 Index finished the month at 10.82 yet moved in a wider range given the geopolitical risks in the month, it peaked at 15.96 on 13 April before falling into month end.

In the US, the S&P500 (+0.9%), the Dow Jones (+1.3%) and the NASDAQ (+2.3%) all rose. The NASDAQ continues its outperformance, driven by the technology sector, particularly Google which rose 9.0% in the month.

Equity markets in Europe performed well as geopolitical risks eased in the month. The large cap Euro Stoxx 50 Index rose +1.7%. Italy (+0.6%), France (+2.8%) and Germany (+2.4%) all rose. The FTSE100 fell 1.6% with the snap election called in the month. The pound rose sharply on the announcement, with it finishing 3.1% higher against the US dollar in April.

Asia markets were stronger, with the Japanese Nikkei 225 up 1.5%. The other major markets also moved higher; Hong Kong (+2.1%) while Korea surprisingly rose 2.1% despite rising geopolitical tensions with North Korea.

EQUITY MARKETS IGNORE RISING RISKS AND MOVE HIGHER



Source: Bloomberg as at 30 April 2017

Global emerging markets

Emerging market equities had another positive month on improved global growth and falling concerns around President Trump's more controversial trade policies. The MSCI Emerging Market Index was up 2.0% in USD terms and 4.3% in AUD terms.

MSCI EM Latin America (-0.4%) was weaker with lower commodity prices. While MSCI EM Asia ex Japan gained 2.1% over the month. Meanwhile the Shanghai Composite Index was down 2.1%, despite better economic data.

The MSCI EM Europe, Middle East and Africa rose 3.9%, with strong gains in Turkey post the referendum that increased the powers of President Erdogan.

Global and Australian developed market fixed interest

Monetary policy and US political uncertainty took a back seat in April as geopolitical risks and the first round of the French election were front and centre in the month. Rising tensions between the US and North Korea over missile testing and the US retaliation on Syria's chemical weapons dominated headlines. The uncertainty largely led to a risk-off tone in markets early in the month before receding after the French election result.

Against this backdrop, bond yields in Europe traded in a wide range but moved little month on month with the 10-year German bunds down 1 bps to 0.32%. US yields traded in a similarly large range given the geopolitical conflicts and 10-year yields ultimately fell 11 bps in the month to 2.58%. UK 10-year gilts were down 5 bps to 1.09%. Japanese bond yields fell 6 bps in the month to 0.018%.

Early in the month the spread between US and Australian 10-year yields compressed to a 16-year low of 19bps. This was short-lived and Australian 10-year bond yields soon rose with global yields, finishing the month at 2.58%, down 13bps

Global credit

Global investment grade credit spreads reverted back to mild tightening in the month with the majority of this coming after the French election results.

The broader risk-on tone given the lack of volatility priced in to markets saw Investment Grade credit continue to provide an opportunity for investors. There was robust supply in the month accordingly.

Specifically the Bloomberg Barclays Global Aggregate Corporate Index average spread moved 3 bps tighter to 1.17%. US credit moved 2 bps tighter, with the Bloomberg Barclays US Aggregate Corporate Index average spread closing at 1.10%. In Europe, the spread on the Bloomberg Barclays European Aggregate Corporate Index was 7 bps narrower to 1.11% on the back of the French election results.

US high yield credit spreads reacted notably to the change in sentiment following the French election results with the spread on the Bank of America Merrill Lynch Global High Yield index (BB-B) tightening from a high of 3.27% mid-month to 2.99% by month end, down 13 bps on the month. In addition, the high yield market continues to be impacted by downgrades particularly in the energy and mining sectors.

Australian credit spreads moved a little tighter in the month largely ignoring the volatility in outright yields and the widening of global credits spreads witnessed last month. Specifically the average spread on the Bloomberg Australian Corporate Index moved 4 bps tighter to 101 bps.

Want more information?

Please speak with your financial adviser or visit our website at **colonialfirststate.com.au**. Alternatively, you can call us on 13 13 36.