Colonial First State

Market View – November 2016

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Summary

The Reserve Bank of Australia met on 1 November 2016 and, as widely expected, the cash rate was held unchanged at 1.5%.

The Australian dollar was mixed against most major currencies over November. The AUD was down 2.8% against the USD to $US0.7394 and also weaker against the sterling (-4.92%), but rose against the euro (+0.53%) and yen (+5.65%).

The S&P/ASX 200 Accumulation Index posted strong gains, rising 3.0%, with most sectors finishing the month in positive territory. Commodity prices, with the exception of precious metals, were mostly stronger. On 30 November, OPEC announced a 1.2m barrel cut to oil production to 32.5m barrel (roughly equal to production around the start of 2016).

The big event over the month was of course the US election. The election result led to some initial market volatility but has since been taken positively with the market focusing on the expansionary and likely inflationary aspects of a Trump presidency. The MSCI World Index was up 1.3% in US dollar terms and 4.2% in Australian dollar terms.

Australia

The Reserve Bank of Australia (RBA) Board met on 1 November 2016 and as widely expected, the cash rate was held unchanged at 1.5%.

The next meeting is scheduled for 6 December 2016; no change is expected by markets.

Over the month, RBA Governor Phil Lowe delivered an important speech at a Committee for Economic Development of Australia event. The Governor seems to have shifted the RBA to a 'neutral' bias on monetary policy – away from the previous easing bias.

Governor Lowe seems to be taking a more cautious/hawkish approach to Australia's debt levels, especially in the context of an already very low interest rate environment and the uncertainties and imbalances building up in the global economy.

The key line from the Governor's speech was "…it is unlikely to be in the public interest, given current projections for the economy, to encourage a noticeable rise in household indebtedness, even if doing so might encourage slightly faster consumption growth in the short term." This suggests the hurdle for another rate cut is significant and higher than previously anticipated.

The Q3 Capex survey released in early December was weaker than expected (-4% per quarter). The decline was mostly related to weaker construction of buildings and structures (-5.7% per quarter). Investment in Plant and Equipment also fell (-1.9% per quarter), reinforcing expectations of a weaker Q3 GDP outcome.

The October labour market report showed the unemployment rate stable at 5.6%, driven by continued weakness in participation which remained at a downwardly revised 64.4%, a 10 year low.

2016 has seen a marked slowing in employment growth to 4,300 per month, compared to an average of 24,800 per month over 2015 along with the loss of 90,000 full time jobs.

US

The big event over the month was of course the US Election. This was the second time in 2016 that the global geo-political landscape shifted dramatically, and traditional opinion polling has been shown to be severely lacking.

The election result led to some initial market volatility but has since been taken positively with the market focusing on the expansionary and likely inflationary aspects of a Trump Presidency, particularly the potential for tax cuts and infrastructure spending.

As mentioned last month, the US Federal Open Market Committee (FOMC) met on 1-2 November 2016 and as widely expected left the official Fed Funds target rate unchanged at 0.25%-0.5%.

The November meeting minutes, in addition to public statements from various Fed officials over the month, continue to reinforce the view that a 25bps rate hike is likely at the 13-14 December FOMC meeting. This has been further

strengthened by the supportive market reaction to the presidential election which was one of the major uncertainties, and market risks that could have derailed such a move.

Employment was slightly weaker than expected in October increasing by 161,000, compared to the 173,000 expected. The unemployment rate decreased 0.1% to 4.9%, from 5.0%, aided by a 0.1% decline in the participation rate to 62.8%.

Inflation continued to increase at a moderate pace with headline CPI up 0.4% in October and the annual rate increasing to 1.6%.

The Fed's preferred measure of underlying inflation, the Core Personal Consumption Expenditure, remained stable at 1.7% per year in October. This is around the level it has remained for most of 2016.

Durable goods orders, a key indicator for the industrial sector, were significantly stronger than expected in October, increasing 4.8% per month (compared to an estimate of +1.7% per month). While the headline numbers were boosted by a surge in aircraft orders, durable goods excluding transport were also stronger than expected rising 1% per month with an additional +0.7% of revisions to prior month data. This data suggests we are seeing a stabilisation, if not a recovery, in the industrial sector which has struggled with the fall in energy investment over the last two years.

Retail sales rose a higher than expected 0.8% in October, with an additional +0.3% in net revisions making for a significantly better than expected report and driving an increase in the annual rate to 4.3% from 3.2% per year in September. Strength was broad based with the largest contributions coming from autos (+1.1% per month), building materials (+1.1% per month), non-store retail (+1.5% per month) and miscellaneous (+2.4% per month).

Europe

The European Central Bank (ECB) did not meet over the month of November. The next meeting is scheduled for 8 December 2016. The ECB is widely expected to extend its asset purchase program, which is scheduled to end in March 2017, at the December meeting.

European data improved with the Markit Manufacturing and Services PMIs both increasing over November. The Manufacturing PMI increased to 53.7, the highest level since early 2014 and the Services PMI increased to 54.1, the highest since late 2015.

In France, François Fillon has unexpectedly won the Republican Party presidential primary. He is now expected to face off against the Front National's Marine Le Pen at the second round of the French presidential elections scheduled 7 May 2017. While current polling suggests that Fillon should win 67%-71% of the vote, this year has shown that it can be dangerous to put too much faith in opinion polls.

UK

The Bank of England Monetary Policy Committee (MPC) left monetary policy unchanged at its 3 November 2016 meeting.

The tone of the minutes were notably more hawkish than expected, noting a limited tolerance for above target inflation and stressing the ability of monetary policy to respond in either direction to changes in the outlook. The MPC made it clear that the bar for further easing is higher than previously thought and that the next move is just as likely to be up as down.

CPI data was a bit softer than expected with inflation increasing by 0.1% per month in October, below the 0.3% per month expected. The annual rate fell slightly to 0.9% per year from 1% per year. Core was also slightly weaker, down to 1.2% per year from 1.5% per year. The weaker than expected monthly print was driven by softer services and food prices. The fall in annual rates was largely driven by volatility in prices a year ago, particularly clothing inflation which fell to -0.7% per year from +1.1% per year in September.

NZ

The Reserve Bank of New Zealand met on 10 November 2016 and as largely anticipated, cut interest rates by 0.25% to a new all-time low of 1.75%.

Policy guidance in the accompanying statement was more neutral but did not completely discount the risk of further easing: "policy settings, including today's easing, will see growth strong enough to have inflation settle near the middle of the target range. Numerous uncertainties remain...and policy may need to adjust accordingly."

Canada

The Bank of Canada did not meet over the month. The next meeting is scheduled for 8 December 2016.

Employment data over the month showed unemployment steady at 7% and the participation rate up 0.1% to 65.8%, despite 44k new jobs.

Japan

Inflation picked up slightly over the month with the headline rate increasing to 0.1% per year from -0.5% per year; the first time it has been above 0% since February. Core CPI, excluding food and energy, also improved slightly increasing to 0.2% per year. Both measures still remain well below the Bank of Japan's 2% target.

China

Activity data was stable to slightly weaker over the month. Industrial production was stable at 6.1% per year while Fixed Asset Investment increased 0.1% to 8.3% per year. Retail sales were weaker, falling to 10% per year from 10.7% per year in September.

Inflation continued to increase in October, rising to 2.1% per year from 1.9% per year. Food price inflation continues to be the major driver of inflation, rising to 3.8% per year in October from 3.3% per year in September.

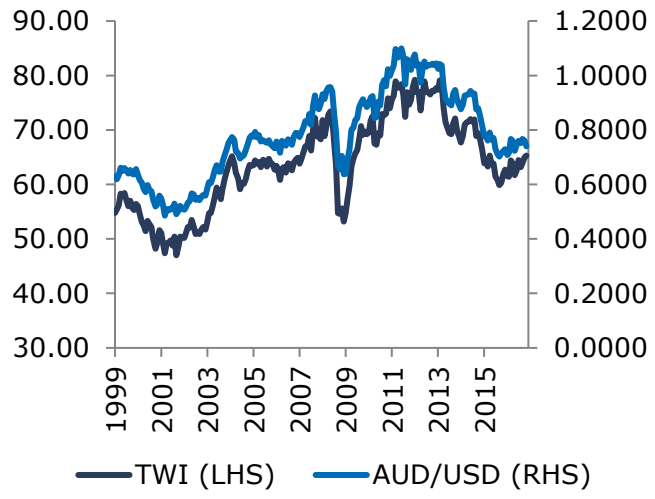
Chinese producer prices as measured by the PPI increase 1.2% per year in October, up from 0.1% per year in September and the highest level since December 2011.

Australian dollar

The Australian dollar was mixed against most major currencies over November. The AUD was down 2.8% against the USD to $US0.7394 and also weaker against the sterling (-4.92%) and NZ dollar (-1.87%), but rose against the Euro (+0.53%) and the Yen (+5.65%).

The positive dynamics of higher commodity prices were outweighed by USD strength to see the AUD weaker on the month.

USD STRENGTH TRUMPS INCREASING COMMODITY PRICES



Source: Bloomberg as at 30 November 2016

Commodities

Commodity prices, with the exception of precious metals, were mostly stronger over November, with significant moves in industrial metals following the election of Donald Trump and the expectation of increased infrastructure spending.

The price of West Texas Intermediate Crude finished the month at $US49.44 per barrel, up 5.5%, while the price of Brent was up 5.2% to $US51.84 per barrel. Oil prices weakened early in the month on scepticism around the potential for an OPEC deal, before increasing close to 10% on the last day of the month after the announcement of a production cut.

At OPEC's 30 November meeting in Vienna they announced a 1.2m barrel cut to oil production to 32.5m barrel (roughly equal to production around the start of 2016). As expected Nigeria, Libya and Iran will be exempt from cuts. The agreement will be in effect for six months, starting January 2017, with the option to extend a further 6 months.

While the market reacted positively to the news, there is still scepticism around the ability to enforce and monitor production levels and on the potential reaction of other producers to an increase in oil prices.

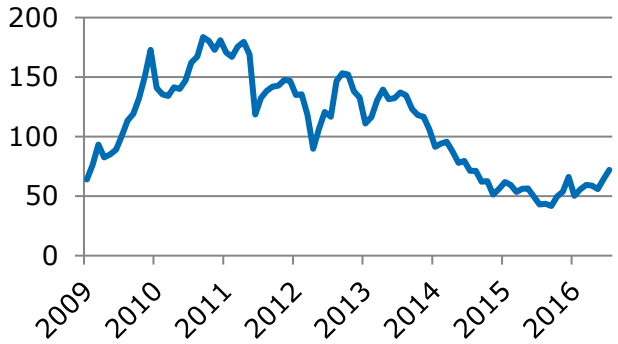
Gas prices were also stronger with the US Henry Hub spot price up 18% to $US3.295/MMBtu.

Iron ore prices were stronger over November on increased demand from China and the expectation of infrastructure spending in the US.

Prices were up 12.0% to $72.08 per metric tonne, as measured by the benchmark price of iron ore delivered to Qingdao China.

Copper (+17.6%), Zinc (+9.7%), Nickel (+5.8%) and Lead (+14.0%) rose over November while Aluminium (-0.7%) and Gold (-7.8%) were weaker.

IRON ORE RISES WITH INFRASTRUCTIRE EXPECTATIONS



Source: Bloomberg as at 30 November 2016

Australian shares

The S&P/ASX 200 Accumulation Index posted strong gains, rising 3.0%, with most sectors finishing the month in positive territory.

Rising commodity prices, particularly iron ore, supported Australia's Materials sector (+2.5%), with the large miners following the iron ore price higher. BlueScope Steel also posted strong gains after upgrading its 1H17 earnings outlook at its AGM.

Energy (+3.7%) was the best performing sector in the ASX 200, as oil-exposed companies, including Santos and Origin Energy, benefitted from a rising oil price.

Financials (+6.1%) outperformed, as sentiment continues to improve towards the sector. Rising interest rates will likely improve profitability for the large banks.

Bond proxy sectors, including A-REITs (+0.8%) and Utilities (+3.6%), steadied after three consecutive months of significant losses. Rising bond yields and a potential December rise in US interest rates now look to be fully priced in.

Health Care (-1.4%) also stabilised following a torrid October. Many companies in the sector, including CSL, Cochlear and ResMed, earn a significant proportion of their earnings from overseas, particularly in the US, so will benefit from a strengthening US dollar.

Listed property

The S&P ASX 200 A-REIT index fell during the first half of the month against a backdrop of turbulent financial markets, before recovering ground to finish November 0.8% higher.

Retail A-REIT Westfield Corporate (+2.5%) was amongst the top performers, after announcing positive sales growth at its third quarter update, and on the view that its development pipeline could support further earnings growth.

Charter Hall Group (-4.0%), which develops commercial, residential and industrial properties, underperformed despite announcing higher earnings guidance for its 2017 financial year.

Listed property markets offshore declined in November. The FTSE EPRA/NAREIT Developed Index (TR) fell by -2.7% in US dollar terms.

Global shares

Global developed equity markets were mostly stronger over November as "risk on" sentiment driven by the election of Donald Trump and the expectation of expansionary fiscal policy and tax cuts drove markets higher. The USD was also stronger on the month with the DXY index up 3.9%.

The MSCI World Index was up 1.3% in US dollar terms in the month of November and 4.2% in Australian dollar terms.

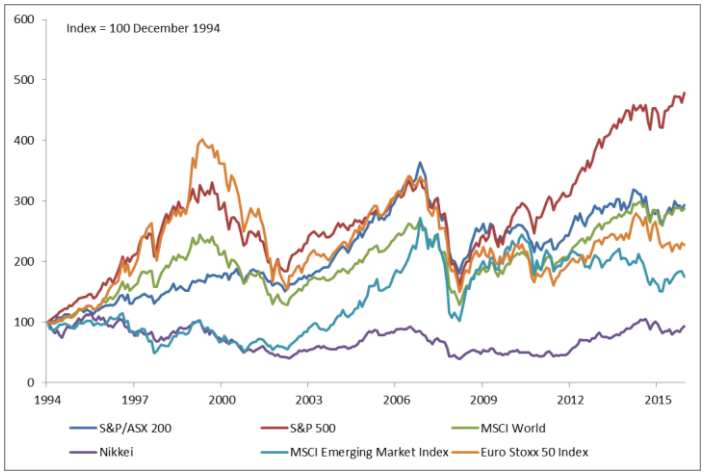
In the US, the S&P500 (+3.4%), the Dow Jones (+5.4%) and the NASDAQ (+2.6%) were all stronger, driven by the expectation of expansionary (and potentially inflationary) fiscal policy from President Elect Trump.

On a sector basis, MSCI Financials (+7.55%), Energy (+5.10%) and Industrials (+3.52%) were the best performers moving higher with rising yields, oil prices and expectations of fiscal expansion and infrastructure spending respectively. MSCI Utilities (-6.51%) and Consumer Staples (-5.26%) were the worst performers, impacted by rising yields and concerns around trade respectively.

Equity markets in Europe were slightly weaker over the month. The large cap Stoxx 50 Index was down 0.1%. Greece (+6.4%) and France (+1.5%) were stronger while Italy (-1.1%), Spain (-5.0%), the UK (-2.5%) and German (-0.2%) all fell. Political concerns around the election of Donald Trump and European elections next year along with the Italian referendum this Sunday impacted markets.

Asia markets were mixed with the Japanese Nikkei 225 up +5.1% as the Yen depreciated 8.7% against the USD and Singapore (+3.2%) higher as well while Taiwan (-0.5%) and Hong Kong's Hang Seng (-0.6%) fell, potentially related to trade concerns and emerging market weakness.

EQUITY MARKETS RALLY ON TRUMP WIN



Source: Bloomberg as at 30 November 2016

Global emerging markets

Emerging market equities were weaker over November in USD terms with the MSCI Emerging Market Index down 4.7%, underperforming DM equities.

USD strength, higher bond yields and concerns around US trade policy all weighed emerging markets, despite the continued strength in commodity prices.

MSCI EM Latin America was the worst performing region over the month falling 10.81% in USD terms, while MSCI EM Europe, Middle East and Africa (-4.98%) and MSCI EM Asia (-2.94%) were also down. The Shanghai Composite Index was stronger, up 4.8%.

Want more information?

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