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Colonial First State
Global Asset Management

Hurricanes and missiles

Market Watch

September 2017

Australia

- As anticipated, the Reserve Bank of Australia left interest rates unchanged at 1.5%. The official rate has now been held steady at this level for more than a year.
- The economy expanded 0.8% in the June quarter of 2017, taking the annual pace of growth to 1.8%. The expansion was supported by strength in net exports as well as domestic demand. The figure was broadly in line with expectations, but represented a substantial improvement from the March quarter.
- In spite of more than 54,000 jobs being added in August, official statistics suggested that unemployment remained unchanged at 5.6%. The figure remains close to five-year lows.
- Lower unemployment appears to be having a favourable influence on consumer confidence, which improved markedly in September following a weaker reading in August.
- Business confidence is less positive, with the NAB Business Confidence Index falling to its lowest level this year. Companies appear to be concerned about demand, government policy, and input cost pressure from both energy and wage growth.

New Zealand

- The New Zealand economy also advanced 0.8% in the second quarter of 2017, again an improvement on the previous three-month period.
- The acceleration in the pace of growth reflected improvements in the services and manufacturing sectors and masked weakness in construction and mining activity.
- The Reserve Bank of New Zealand left interest rates unchanged at 1.75%, as anticipated.

US

- The Federal Reserve Board left official interest rates on hold at 1.25%, but, importantly, signalled that one more rate rise is likely in the remainder before the end of 2017.
- The US economy appears to remain in a reasonably healthy state, with GDP growth being upwardly revised to 3.1% yoy for the June quarter. This represented the quickest pace of annual growth since the first quarter of 2015.
- In spite of the buoyant conditions, some observers have suggested that the current storm season could affect economic activity and dampen further growth.
- The latest figures showed inflation running above expectations (1.9% yoy), appearing to strengthen the case for a further interest rate hike.
- Unemployment came in slightly above expectations, at 4.4%, suggesting companies remain cautious on the hiring front.

Europe

- Data released in September showed that the Eurozone economy expanded 2.3% in the year to 30 June 2017, slightly above the previous estimate of 2.2%.
- Among the largest economies in the region, GDP growth accelerated in Spain; was little changed in France and Italy; and slowed in Germany.
- In spite of the overall improvement, the European Central Bank held its benchmark refinancing rate at 0.0% and confirmed that it would likely persist with net asset purchases at the current rate of €60 billion per month until the end of December 2017.
- The Bank has suggested that significant monetary accommodation continues to be required, although raised its GDP growth forecast for 2017 to 2.2%. This would represent the quickest pace of annual growth since 2007.
- In the UK, the Bank of England's Monetary Policy Committee voted to leave interest rates unchanged at 0.25%.
- Data showed that UK inflation has accelerated to 2.9%, however, which appeared to increase the likelihood of an interest rate hike in the coming months.

Asia

- As ever, there was a fair degree of scrutiny among global investors on activity in China. In August, industrial production rose at an annual pace of 6.0%. This followed a 6.4% yoy increase in July and fell short of consensus expectations (6.6% yoy). In fact, August showed the weakest improvement in industrial production since late 2016.
- Industrial output increased at a slower-than-expected pace for mining, and electricity, gas and water production, although growth in the manufacturing sector appeared to remain robust.
- Meanwhile, authorities started to implement the first of a series of significant reductions in steel production, in an attempt to reduce pollution and to address overcapacity in the industry. This had an adverse influence on iron ore prices and, in turn, commodity-related shares globally.

Australian dollar

- Ongoing geopolitical tensions associated with North Korea's missile testing program resulted in further volatility in global foreign exchange markets.
- In spite of a strong start to the month, the Australian dollar weakened by 1.4% against the US dollar, closing a little above US$0.78.
- The Australian dollar also weakened against sterling, which tended to perform well against most currencies. UK inflation data suggested the Bank of England could consider increasing interest rates before the end of the year.

Commodities

- Most commodity prices moved lower. Iron ore, for example, fell almost 20% ahead of China's National People's Congress in October and on demand concerns given steel production cuts in China.
- Industrial metals took a breather following a strong run since the end of June. Nickel (-8.9%) recorded the largest monthly loss, followed by Copper (-4.5%) and Aluminium (-0.1%). Zinc (+2.5%) and Lead (+8.4%) both rose.
- Gold fell 2.6% to $1,282/oz on a rising US dollar and expectations that the Federal Reserve will increase US interest rates later this year. This offset 'safe haven' demand arising from escalating tensions between the US and North Korea.
- Markets turned more positive on oil consumption after the International Energy Agency upgraded demand estimates. Supply discipline also helped prices higher, with OPEC and other oil producers sidelining 16% more supply in August than previously agreed. As a result, the price of oil bucked the broader downward trend across most commodity prices, with WTI crude adding 9.4% to US$51.67 per barrel.

Australian equities

- Despite some volatility during the month, the S&P/ASX 200 Index finished flat (0.0%). The Index has added just 0.7% since the end of June, trading in a narrow range of -0.8% to +1.7%.
- Health Care (+2.2%) was the best performing sector, led by sector giant CSL. Fisher & Paykel and Japara Healthcare also posted gains. Energy (+1.2%) and Financials (+1.1%) also added value.
- The main drag on performance at a sector level was Telecoms (-4.6%). Telstra had another weak month, and has now lost almost 20% since mid-August 2017. Mid-cap telco TPG Telecom also fell sharply after posting lacklustre FY17 results.
- Utilities fell by 3.7%, led lower by AGL Energy, APA Group and Spark Infrastructure Group. AGL lost ground after the company announced its intention to close the Liddell Power Station by 2022; a move that has been challenged by the government on supply concerns.
- The Consumer Staples sector was led lower by Wesfarmers and Woolworths, both of which finished the month in negative territory. Amazon's launch of its Australian e-commerce offering is looming – possibly as soon as October or November.

Listed property

- The S&P/ASX 200 A-REIT Index was up a modest 0.5% in September, but still outperformed a flat S&P/ASX 200.
- A-REITs were up as much as 2.3% in mid-month, before losing ground as bond yields rose. Investors also appeared to become concerned that the Reserve Bank of Australia might follow central banks in the UK and Canada and start tightening monetary policy earlier than previously thought.
- Retail A-REITs (+2.7%) outperformed, with Westfield Corporation the strongest contributor (+5.5%). No material news was announced by the company, but a strengthening US dollar bodes well for earnings; almost 70% of its revenue is derived from the US. Industrial and Office A-REITs were down marginally (-0.6% and -0.5% respectively).
- Listed property markets were weaker outside of Australia, with the FTSE EPRA/NAREIT Developed Index (TR) falling -0.2% in USD terms. One of 2017's strongest performers, Singapore, was the worst performing property market in USD terms (-2.4%), with most other markets relatively flat, including the US (-0.0%). The UK was the strongest major market, up almost 2.0% in USD terms.

Global equities

- Global equity markets moved steadily higher over the month, with the MSCI World Index up 2.3% in USD terms.
- Markets rose despite concerns over North Korea's ongoing missile tests and the US Federal Reserve confirming it was going to start normalising its balance sheet from October. The Fed also reiterated its intention to lift rates for a third time this year, likely in December.
- The prospect of higher interest rates saw the US dollar strengthen against most currencies, boosting the returns from the MSCI World Index in Australian dollar terms to 3.4%.
- The S&P 500 Index largely tracked the MSCI World, rising 2.1% in local currency, while the German DAX was among the stronger performers, rising 6.4%.
- Emerging markets fared less well than their developed counterparts, falling -0.4% in USD terms. South Africa and Greece were the main laggards, down -6.4% and -14.0% respectively in USD. Both suffered from country-specific issues, external debt challenges (exacerbated by a stronger US dollar) and struggling economies.

Global and Australian Fixed Interest

- Despite continued geopolitical uncertainty surrounding North Korea's missile threats, global developed government bond yields managed to trade higher in the month, reversing the previous downward trend. The change in sentiment was driven by talk of continued monetary policy tightening, in particular in the US from Federal Reserve Chairman Yellen.
- As had been anticipated, the Fed announced a quantitative tightening program following its September meeting.
- Less expected was the retention of the target median forecast for 2017, meaning the Fed is still planning one more rate hike this year. This was a surprise to investors, in light of weak inflation prints and the recent hurricanes that have battered the US.
- Australian bond markets moved broadly in line with their global counterparts. Yields rose on the back of a more hawkish stance from the US Federal Reserve and positive developments on monetary reform, which is perceived to be positive for the global growth story. Australian 10-year government bond yields rose 13 bps, ending the month at 2.84%.

Global credit

- Global investment grade credit spreads reacted to the 'risk-on' market tone, tightening across the major global indices. Specifically, the Bloomberg Barclays Global Aggregate Corporate Index average spread moved 7 bps tighter, to 1.02%.
- US credit moved 8 bps wider, with the Bloomberg Barclays US Aggregate Corporate Index average spread closing at 0.96%.
- US high yield credit spreads moved notably tighter, with the Bank of America Merrill Lynch Global High Yield index (BB-B) in 26 bps to 2.75% by month end. The high yield market continues to be impacted by downgrades, particularly in the energy and mining sectors.
- In Europe, the spread on the Bloomberg Barclays European Aggregate Corporate Index tightened by 3 bps, to 0.96%.

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