

**Read the latest market update from the Economic and Market Research team at Colonial First State Global Asset Management.**

## Market and economic overview

### Australia

- The Reserve Bank of Australia (RBA) left the official cash rate on hold at 2% in February and again on 1 March 2016 - where it has remained since May 2015. The next RBA Board meeting is 5 April 2016.
- The RBA statement remained relatively upbeat on the domestic economy "the Board judged that there were reasonable prospects for continued growth in the economy", while maintaining a cautious easing bias. The RBA notes that "continued low inflation may provide scope for easier policy, should that be appropriate to lend support to demand."
- The RBA released its quarterly Statement on Monetary Policy (SOMP) on 5 February 2016 and made relatively minor changes to their economic forecasts.
- GDP growth was revised up to 2.5% from 2.25% for 2015. While the range of GDP growth expected for 2017 was lowered slightly to 2.5% to 3.5% down from 3% to 4%. The first look at GDP growth for June 2018 is at 3% to 4%.
- Inflation forecasts were also revised - the June 2016 CPI inflation forecast has been cut to 1.5% per year from 1.5% to 2.5% per year previously and headline inflation is forecast at 2% to 3% from December 2016 onwards. Underlying inflation is forecast at the bottom-end of the 2% to 3% target range as at June 2016 and then within that range out to June 2018.
- House prices continued to increase in February, albeit at a slower pace, rising 0.5% per month and 7.6% per year according to

RPData-Rismark. House price gains remained the strongest in Sydney (+9.5% per year) and Melbourne (+11.1% per year).

- Q4 2015 GDP data (released 2 March) rose 0.6% per quarter, increasing the annual pace to 3.0% per year, the fastest pace of growth since Q1 2014. Growth was driven by household consumption (+0.4%/pts), public investment and inventories (each up 0.2%/pts), while trade was flat and non-residential building was the largest drag (-0.5%).
- The income side of the Australian economy remains weak (+0.3% per year), driven by the continued decline in the Terms of Trade (-12.1% per year) and anaemic wages growth (+2.2% per year).
- Labour market data surprised on the downside, although there are some data quality issues related to sample rotations. The official seasonally-adjusted data showed 7,900 jobs were lost in January, below the +13,000 the market expected after a revised loss of 800 jobs in December.
- The unemployment rate increased to 6.0% in January, still well below its most recent peak of 6.4% in January 2015 and below the RBA's 2H15 forecast.
- Business conditions and confidence, as measured by NAB, remain constructive despite small declines (Confidence -1 to 2 and Conditions -2 to 5). Consumer confidence, as measured by Westpac, remains volatile, increasing 4.2% in February after a 3.5% fall in January.

### US

- The Federal Open Market Committee (FOMC) of the US Federal Reserve Board did not meet in February, with the next meeting scheduled for 15 to 16 March 2016.
- FOMC Chair Yellen did provide the semi-annual monetary policy report to the Congress, where she was cautious in not

capitulating on the idea that the Fed is in the early stages of a gradual tightening cycle while recognising the downside risks created by recent financial market volatility and global growth concerns.

- Chair Yellen remained upbeat on the domestic economy and the continued improvement in the labour market noting that the ongoing employment gains and faster wages growth should support consumer spending.
- Chair Yellen was also very careful not to pre-commit the Fed to any specific outcome at the March FOMC meeting. As always, she was clear that monetary policy in the US was on no pre-set course and would be data dependent. She clearly noted that the sharp increase in (global) financial market volatility was a concern – but that the impact of this volatility was yet to show up in any US economic data.
- The second estimate of Q4 2015 GDP showed growth was 1.0% on a seasonally-adjusted-annualised-rate, compared to the first estimate of 0.7%. The upgrade was due to a larger gain in inventories than previously expected and came despite small downgrades to consumption, investment, exports and government spending.
- For all of 2015, growth in the US was 1.9%, compared to 2.5% in 2014.
- The US labour market continued to improve. A total of 151,000 jobs were added in January, although this was less than the 190,000 the market expected. The unemployment rate decreased to 4.9% despite a 0.1% increase in the participation rate to 62.7%. Average hourly earnings increased by 0.5%, more than expected, keeping the annual gains at 2.5% per year.
- The manufacturing sector remains weak, with the ISM Manufacturing Index in contractionary territory at 49.5, while the Manufacturing PMI decreased to 51.3 from 52.4 in January.
- Despite the continued decline in the oil price and the strong US dollar inflation printed flat for the month, while the base effects increased headline inflation to 1.4% per year in January, up from 0.7% per year in December 2015. The Fed's preferred measure of inflation – Core Personal Consumption

Expenditure Price Index – was up 0.3% in January, taking annual gains to 1.7%, the highest since November 2012.

## Europe

- The European Central Bank (ECB) did not meet in February, its next meeting is scheduled for 10 March 2016.
- Minutes of the January ECB meeting were released and pointed to a healthy debate on what action should be taken in order to bring inflation closer toward the 2% target. It also noted amplified risks against a backdrop of increased volatility and weakness in emerging markets (specifically China). This lends weight to the view that the ECB will announce additional stimulus to the economy at its March meeting.
- GDP data was released for the euro area, increasing at 0.3% per quarter, lowering the annual growth to 1.5%, from 1.6% per year. Germany grew by 0.3% per quarter, while Spain (+1.2% per quarter), Portugal (+0.2% per quarter) and France (+0.3% per quarter) all recorded growth. Greece (-0.6% per quarter) recorded negative growth.
- The first estimate of February CPI for the euro area was recorded at -0.2% per year, a decrease from the +0.3% per year in January. A renewed decline in the price of oil and continued soft food prices led to the decline. Core inflation was 0.7% per year, down on January's figure of 1.0% per year.

## UK

- The Bank of England (BoE) left policy unchanged when it announced its decision on 4 February 2016, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn. For the first time in six months it was a unanimous decision from the nine member board.
- The BoE's medium-term inflation forecasts were little changed even though forecasts for growth were revised down slightly. The BoE continues to judge that it is "...more likely than not that Bank Rate will need to increase over the forecast period to ensure inflation remains likely to return to the target in a sustainable fashion".
- Q4 2015 GDP increased 0.5% per quarter keeping the annual rate at 1.9% per year.

Growth continues to be driven by strong consumer spending (+0.7% per quarter) which helped counter the decline in exports and business investment.

- CPI data showed inflation decreased by 0.8% in January, dragged down by the continued fall in energy prices. The annual rate of inflation increased to 0.3% per year from 0.2% per year while core inflation decreased from 1.4% per year to 1.2% per year.
- During the month UK Prime Minister David Cameron formally announced a referendum on the UK's EU membership, scheduled for 23 June 2016.
- After the announcement several high profile Conservative politicians including the Mayor of London Boris Johnson and Justice Secretary Michael Gove threw their support behind the 'leave' vote.
- Current polling suggests a close race with a significant proportion of undecided voters still to be won.

## NZ

- The Reserve Bank of New Zealand (RBNZ) did not meet in February, its next meeting is 10 March 2016.
- Quarterly labour market data was released, with the unemployment rate falling to 5.3% from 6.0% for Q4 2015. Strong employment growth, which rose 0.9% per quarter, was assisted by a fall in the participation rate. The participation rate fell to 68.4% down from 68.6%.

## Canada

- The Bank of Canada (BoC) did not meet in February, with the next meeting on 10 March 2016.
- The unemployment rate increased to 7.2% for January with 5,700 jobs lost over the month. Inflation rose, up 0.2% per month, taking the annual rate to 2% from 1.6% in December.

## Japan

- The Bank of Japan's (BoJ) policy board did not meet in February, the next meeting is 15 March 2016.
- Q4 2015 GDP data was released, with the Japanese economy contracting by 0.4% per

quarter, annualising at -1.4% per year. This was a deterioration on Q3 2015, with growth 0.3% per quarter and annualising at 1.3%.

- Headline CPI was flat over January while the core measure excluding food and energy decreased 0.1% to 0.7% per year, both well below the BoJ's 2% target.

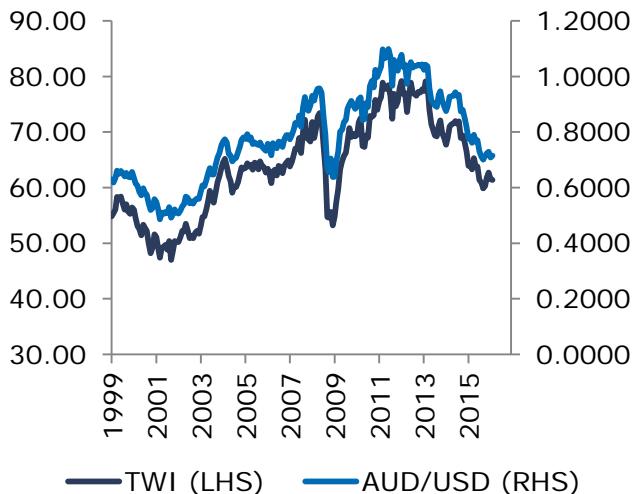
## China

- The People's Bank of China (PBOC) cut the Reserve Requirement Ratio on 29 February by 50bps to 17.0%. The PBOC left benchmark interest rates unchanged and halted the depreciation of the yuan against the USD, publicly stating that the current level was appropriate when compared against a basket of currencies.
- Higher frequency economic data releases point towards slow manufacturing growth and a softer but still positive services sector. In early March the Caixin PMI Manufacturing Index fell to 48.0 from 48.4 while the Caixin PMI Services Index fell to 51.2 from 52.4.
- Inflation increased slightly, rising to 1.8% per year for January, up from 1.6% per year in December. The increase was led by food costs ahead of the week-long Lunar New Year Holiday.

## Australian dollar

- The Australian dollar was mixed against the major currencies in February. The AUD finished up 0.9% against the USD to \$US0.7150. These gains occurred partly due to reduced expectations of the US Federal Reserve continuing to raise interest rates in 2016.
- The Australian dollar rose against the euro (0.5%) and sterling (+3.3%) but fell against the yen (-5.9%) and NZ dollar (-0.8%) over the month of February.

## AUSTRALIAN DOLLAR MIXED IN FEBRUARY



Source: Bloomberg as at 29 February 2016

## Commodities

- Commodity prices were stronger in February, driven by signs of excess supply leaving the market and a fall in the US dollar.
- The price of West Texas Intermediate Crude finished the month at \$US33.8/bbl, up 0.4%, while the price of Brent was down 0.7% to \$US36.6/bbl. On 16 February 2016 Saudi Arabia and Russia agreed to freeze oil output at near-record levels conditional on the agreement of other OPEC members. While the deal is preliminary and does entail any production cuts it is the first sign of cooperation between OPEC and non-OPEC producers in 15 years and was seen as a significant development by the market.
- Gas prices were volatile with the US Henry Hub spot price down 28.2% to \$US1.62/MMBtu while the UK natural gas price was up 5.3% over February.
- Iron ore prices were stronger in February, up 18.9% to \$49.6/metric tonne, as measured by the benchmark price of iron ore delivered to Qingdao China – 62% Ferrous Content.
- Nickel (-1.2%) fell in January, while Gold (+10.3%), Aluminium (+3.6%), Zinc (+8.7%) Copper (+2.9%) and Lead (+2.0%) made gains.

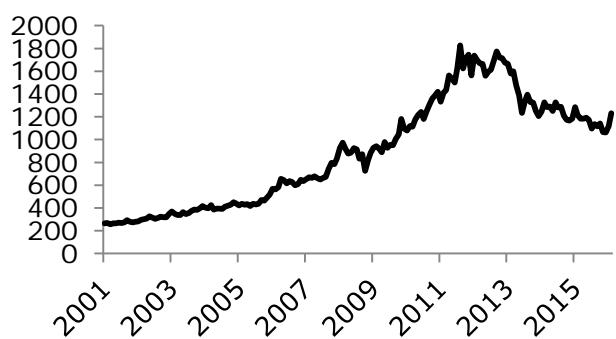
## IRON ORE UP IN FEBRUARY



Source: Bloomberg as at 29 February 2016

## STRONG START TO THE YEAR FOR GOLD

### Gold (\$US per Troy Ounce)



Source: Bloomberg as at 29 February 2016

## Australian equities

- January's weakness in the Australian sharemarket persisted during February, with the S&P/ASX 200 Accumulation Index declining a further 1.8%.
- The market was dragged lower by weakness in the Financials sector, which accounts for more than 45% of the Index. Widening credit spreads and increased funding costs prompted investors to become concerned about margins and profitability in the sector.
- On the positive side, several stocks in the Materials sector performed relatively well. This partly reflected a rebound in some commodity prices from low levels – the iron ore price increased during the month, for example.
- Following a long period of subdued commodity prices, most mining companies have been focusing on cost-out initiatives and capital expenditure cuts. Progress on both

fronts was outlined during February, when most companies announced their latest financial results. In some cases, cost savings enabled mining companies to exceed consensus earnings expectations and helped stocks in this area of the market to outperform.

- In other sectors, the tone of earnings releases was less bad than the market had been anticipating. Around 40% of companies beat consensus revenue expectations, which augurs well for the Australian economy going forward. In spite of these encouraging indicators, consensus earnings growth expectations for both FY16 and FY17 declined modestly during February.

## Listed property

- The 'reporting season' was generally favourable for listed property securities. A number of stocks including Stockland (+2.0%) and Vicinity Centres (+6.9%) upgraded earnings guidance for the full year, helping to support investor sentiment towards the sector.
- The S&P/ASX 200 Property Accumulation Index rose 2.9% in February, extending gains in the 2016 year to date to more than 4%. The relatively stable, income-producing characteristics of property stocks have clearly appealed to investors during a period where the broader Australian sharemarket has fallen around 7%.
- The Industrial sub-sector was the standout performer during the month, aided by solid returns from Goodman Group (+6.7%). The company's 9% improvement in interim profit exceeded consensus expectations and management lifted full year earnings growth forecasts from +6% to +7.5%.
- Overseas property securities also gained ground, with the FTSE EPRA/NAREIT Global Developed Index adding 0.5% in US dollar terms. Asian markets including Japan and Singapore performed particularly well. UK property stocks continued to underperform, however, as speculation that Britain could exit the European Union weighed on investor sentiment.

## Global developed market equities

- Global financial markets continued their volatile start to 2016, with most equity markets recording losses in early February before recovering somewhat by end of month. Falls continued at the start of the month with concerns over weaker economic growth and the continued slide in commodity prices. These were exacerbated early in the month with doubts around the effectiveness of negative interest rates in improving growth and inflation and their potentially negative impact on bank profitability.
- Financials in particular were down during the month over concerns on banks' abilities to repay interest on their riskier debt obligations and the impact of regulation and negative rates on profitability, before recovering into month end.
- With large volatility in equity markets and signs of downside risks to global growth, there was renewed speculation over central bank policy announcements with further easing measures expected and doubts over the US Federal Reserve's ability to raise rates.
- The MSCI World Index fell by 1.0% in US dollar terms in the month of February, and 1.9% lower in Australian dollar terms.
- In the US, the S&P500 (-0.4%), and the NASDAQ (-1.2%) fell in January while the Dow Jones (+0.3%) rose slightly. MSCI Financials (-3.7%) was the worst performer, while MSCI Materials (+6.0%) was the best performer.
- Equity markets in Europe were also weaker. The German DAX (-3.1%), Italy (-5.5%), Spain (-4.0%) and France (-1.4%) all fell. The UK FTSE 100 was up 0.2%.
- In Asia, the Japanese Nikkei 225 (-8.5%) and Honk Kong Hang Seng (-2.9%) fell while Singapore (+1.4%) and Taiwan (+3.3%) rose.

## ANOTHER VOLATILE MONTH FOR EQUITY MARKETS IN FEBRUARY



Source: Bloomberg as at 29 February 2016

### Global emerging markets

- Emerging market equities were mixed in February, with the MSCI Emerging Market Index down 0.3% in US dollars and 1.3% in AUD terms. Concerns around weaker global growth and trade contributed to these losses with the Asian region recording the largest falls. MSCI Asia Ex Japan was down 1.0%, with weakness in the Shanghai Composite Index (-1.8%) and MSCI India (-6.7%) over February. MSCI EM Latin America rose 3.4% and MSCI EM Europe, Middle East and Africa was up 1.8% in US dollar terms.

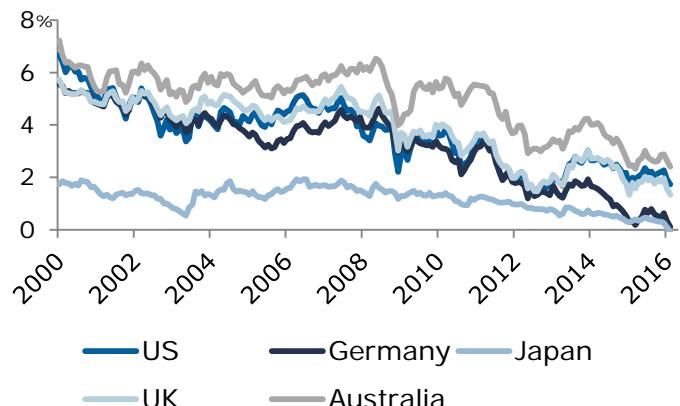
### Global and Australian developed market fixed interest

- The future for monetary policy, whilst cloudy in the short term, is ultimately likely be a divergent one with some central banks tightening whilst others continue to ease. However, a new divergence appears to be evolving – that between what the data is telling us central banks should do and what the market appears to think it should do.
- The market seems divorced from the fundamentals and this is driving an overly bearish, risk-off tone in markets. This again washed through to bond markets with yields lower globally in February. Liquidity in global bond markets remained challenging in the month and also contributed to the falls in yields which broke through the bottom of recent ranges. 10-year government bond

yields in the major markets fell between 16 and 24 basis points (bps).

- Largely due to the market continuing to price out imminent rate hikes from the Fed, 10-year US Government yields were down 19 bps ending the month at 1.73%.
- In Europe, German 10-year bund yields fell 22 bps in the month, to 0.11%, the lowest level since April 2015.
- In the UK, the yield on the 10-year gilt fell by 22 bps to 1.34%.
- In Japan, the 10-year Japanese Government Bond yield fell 16 bps in the month, falling into negative territory at -0.07%.
- In Australia, the 10-year government bond yield followed global yields and fell 24 bps to 2.40%.

### BOND YIELDS LOWER IN FEBRUARY ON ANTICIPATED CENTRAL BANK ACTION



Source: Bloomberg as at 29 February 2016

### Global credit

- Over the month, global credit spreads traded marginally wider. However for the latter part of the month there was a downward trend as spreads contracted from mid-month wides. Overall, the Barclays Global Aggregate Corporate Index average spread was 5 bps wider in the month, closing at 1.88%. The Barclays US Aggregate Corporate Index average spread finished the month at 1.84%, widening by only 3 bps and the Barclays European Aggregate Corporate Index widened by 6 bps to 1.56%.
- Volatility continued in the US high yield credit market. After widening early in the months spreads contracted notably in the second half

of the month and ultimately finished the month tighter. The Bank of America Merrill Lynch Global High Yield index (BB-B) spread moved 16 bps tighter to 6.03%. In Asia, credit markets followed the global widening trend with the JPMorgan Asia Credit Index (JACI Composite) average spread out by 9 bps to 3.19%.

- Australian credit spreads widened marginally in the month. Activity was lumpy in the month as the first half saw investors concerned with falling oil prices and banking

sector issues. However, activity returned with big issues from NAB and Rabobank, overall total issuance in the month was around A\$5bn. However, appetite remains cautious with continued concerns over China's growth outlook, ongoing market volatility and dollar depreciation. The average spread of the Bloomberg AusBond Credit Index relative to swap increased from 118 bps to 124 bps.

## Index return

	Index Level in Base Currency	1 month	12 month
<b>S&amp;P/ ASX200 Index</b>	<b>4,881</b>	<b>-2.5%</b>	<b>-17.7%</b>
<b>S&amp;P / ASX 200 Accumulation Index</b>	<b>44,893</b>	<b>-1.8%</b>	<b>-13.7%</b>
<b>MSCI World Net Index (AUD)</b>		<b>-1.7%</b>	<b>-2.5%</b>
<b>MSCI World Net Index AUD Hedged</b>		<b>-1.4%</b>	<b>-8.3%</b>
<b>Dow Jones Index</b>	<b>16,517</b>	<b>0.3%</b>	<b>-8.9%</b>
<b>UK FTSE 100</b>	<b>6,097</b>	<b>0.2%</b>	<b>-12.2%</b>
<b>German DAX Index</b>	<b>9,495</b>	<b>-3.1%</b>	<b>-16.7%</b>
<b>France CAC Index</b>	<b>4,354</b>	<b>-1.4%</b>	<b>-12.1%</b>
<b>Japan - Nikkei</b>	<b>16,027</b>	<b>-8.5%</b>	<b>-14.7%</b>
<b>Hong Kong – Hang Seng</b>	<b>19,112</b>	<b>-2.9%</b>	<b>-23.0%</b>
<b>MSCI Emerging Markets Net Index (AUD)</b>		<b>-1.1%</b>	<b>-16.1%</b>
<b>US 10 year bond yield</b>	<b>1.73%</b>	<b>-19bps</b>	<b>-26bps</b>
<b>Australia 10 year bond yield</b>	<b>2.40%</b>	<b>-24bps</b>	<b>-6bps</b>
<b>UBS All Maturities Composite Bond Index</b>	<b>8,755</b>	<b>1.0%</b>	<b>3.0%</b>
<b>90 Day Bank Bill Index</b>	<b>2.29%</b>	<b>0bps</b>	<b>-4bps</b>
<b>Bloomberg AusBond Bank Bill Index</b>	<b>8,396</b>	<b>0.2%</b>	<b>2.2%</b>
<b>S&amp;P / ASX 200 - A-REIT Accumulation Index</b>	<b>41,005</b>	<b>2.9%</b>	<b>6.4%</b>
<b>AUD/USD (end of month)</b>	<b>0.7141</b>	<b>0.8%</b>	<b>-8.5%</b>
<b>Oil price</b>	<b>\$US33.75/barrel</b>	<b>0.4%</b>	<b>-32.2%</b>
<b>Gold price</b>	<b>\$US1238.74/ounce</b>	<b>10.8%</b>	<b>2.1%</b>

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