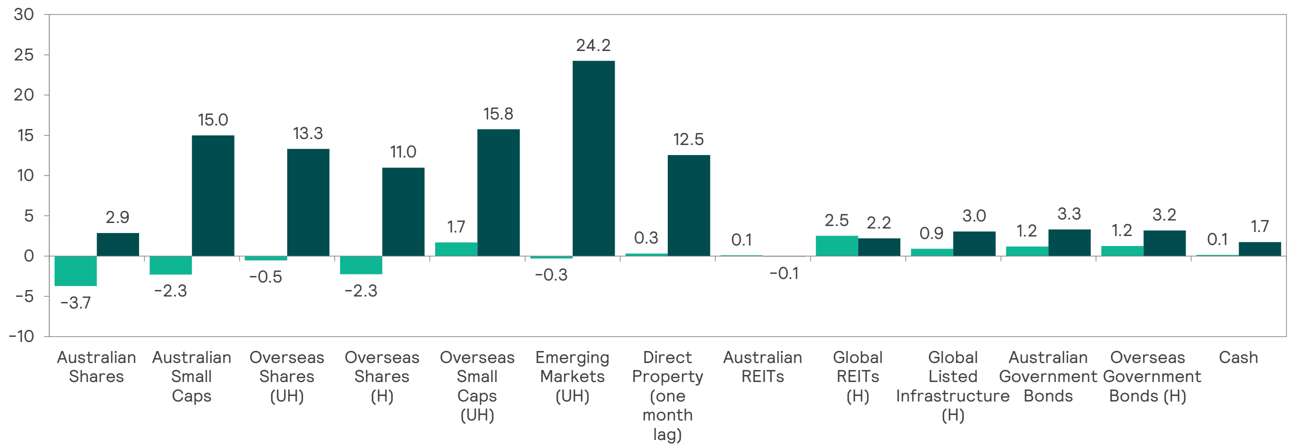
MARCH 2018

AUSTRALIAN MONTHLY MARKET REVIEW

SELECTED MARKET INDICATORS
COMMENTARY

ASSET CLASS RETURNS (%) AS AT 31 MARCH 2018



Data source: Thomson Financial Datastream; MSCI. Data provided 'as is'

President Trump's controversial announcement to impose trade tariffs in early March would end up directing the majority of market movements over the month. The 25% tariff on steel imports and 10% tariff on aluminium imports, to go into effect on March 23rd, sparked tension with major world traders China and Europe. Rhetoric of a potential 'trade war' impacted markets negatively as China and Europe began to consider retaliatory policies. Over March, the broad MSCI World ex Australia (NR) Index was down 2.3% in hedged terms while the MSCI Emerging Markets Index decreased 0.3% in unhedged terms. Major country equity indices were also down; notable movements were the S&P 500 Composite Index falling by 2.5%, FTSE 100 (United Kingdom) falling 2.0%, the DAX 30 (Germany) falling by 2.7% and in Asia, the Hang Seng (Hong Kong) (-2.3%) and the SSE Composite (China) (-2.8%) also falling. Another notable casualty of the trade tension was iron ore prices, falling 19.3% over March, also affected by fear of reductions in China's manufacturing and steel industry.

The Federal Reserve hiked interest rates as expected at their March meeting, increasing the rate interval by 25 basis points to 1.5-1.75%p.a. Two more hikes are expected over 2018, with potential for a third should economic conditions call for one. Fixed income returns were positive over the month, although inflationary pressures off of trade tension could hold back returns in the future.

Alongside the trade tension, notable technology firm Facebook was rocked by a privacy breach as the personal data of millions of users was utilised without permission by data analytics firm Cambridge Analytica. The event, which sparked a fall of 10% in Facebook's share value, brought into question further concerns about the stability and nature of the tech industry, with calls for improved regulation. Globally, the IT sector fell 2.1% following the revelations.

Domestically, Australian shares underperformed their hedged international counterpart index over March, with the S&P/ASX 300 Index decreasing 3.7%. Some effect can be attributed to the trade tension debacle with Australia's major trading partners, the US and China. Attention in Australia was also drawn to the Banking Royal Commission, with the first round of hearings commencing in March. This round focused on consumer lending practices, with some controversial findings on illegal practices in order to increase the number of loan approvals. The next round will follow the financial planning and wealth management industry practices, commencing in mid-April.

SIGNIFICANT DEVELOPMENTS

- The Reserve Bank of Australia (RBA) decided to leave the cash rate unchanged again in its early April meeting at 1.50%p.a, the cash rate has remained at this level since August 2016. RBA Governor, Philip Lowe, noted that economic growth in the global economy has strengthened over the past year, with above-trend growth experienced in most major economies. The Chinese economy continues to grow at a solid rate, proving support throughout the region, while Chinese authorities place more emphasis on sustainable growth. Oil and commodities prices have experienced a decline in recent times, contributing to the expected decline for Australia's terms of trade. A collection of major central banks have withdrawn monetary stimulus policies, this tightening has contributed to rising long and short term bond yields. US short term rates also increased higher than expected, influenced by factors outside the federal funds rate, spreading to rates in other economies. In Australia, the RBA has forecast the economy to grow at a quicker pace in 2018 than in 2017.
- Improvements in non-mining sectors and an influx of infrastructure projects support this outlook. On the other hand, low wage growth and rising household debt remain a concern, restraining household consumption. The Australian Prudential and Regulatory Authority (APRA) has addressed the threat of rising household debt through the new supervisory measures, and credit standards have been tightened to reduce the risk profile of borrowers. House price fluctuations have settled down in the past six months. Wage growth is expected to remain low for some time, but could improve with stronger conditions in the labour market. Australian employment growth was been strong over 2017. Underlying inflation is currently low, and expected to remain low as long as slow wage growth continues. With the gradual improvements in the economy and a view that low interest rates will continue to support the Australian economy, the RBA believed it was appropriate to leave the rate unchanged.
- Australian seasonally adjusted employment increased 17,500 in February, below expectations for a 20,000 rise while January figures were revised down to 12,500. The unemployment rate increased to 5.6% for February, above expectations to remain at 5.5%. The participation rate increased to 65.7%, above expectations to remain at 65.6%. Part time jobs decreased by 47,400 while full time jobs increased by 64,900.
- Australian building approvals decreased 6.2% month-on-month (MoM) to be down 3.1% for the year to February, compared to previous levels of +17.2% (revised) and +12.0% (revised) for respective periods ending January.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 59.3 in March, below consensus for 59.6, and below the 60.8 recorded in February. Of the 18 manufacturing industries, Fabricated Metal Products, Plastics & Rubber Products and Computer & Electronic Products were the top contributors while Apparel, Leather & Allied Products reported a contraction in growth during March. The ISM Non-Manufacturing Index recorded 58.8 in March, below consensus for 59, and below the 59.5 for February.

- The top performers were Mining, Transportation & Warehousing and Agriculture, Forestry, Fishing & Hunting with Educational Services and Information being the only industries to report contractions during February.
- US Non-Farm Payrolls increased by 103,000 in March, below the previous 336,000 increase (revised) for February. The unemployment rate was unchanged at 4.1% in March.
- US gross domestic product (GDP) estimate for Q4 2017 was revised to 2.9% quarter-on-quarter (QoQ) annualised, above expectations for 2.7%, and below the 3.2% growth estimate recorded for Q3 2017.
- The Caixin Manufacturing purchasing managers' index (PMI) in China recorded 51 in March, below expectations for 51.7. The indicator continues to show positive improvements in China's manufacturing industry, despite falling to a four month low.
- European Core consumer price index (CPI) estimate remained at 1.0% over the year to March, below expectations for a 1.1% rise. The unemployment rate decreased to 8.5% in February, while MoM CPI increased by 0.2% in February, following 0.9% decrease in January.
- The Eurozone composite PMI decreased to 55.2 in March, below expectations for 55.3, but maintained an expansionary signal for the fifty-seventh month in a row.
- Eurozone seasonally adjusted GDP remained in line with 2.7% for year-on-year, and also remained constant at 0.6% QoQ for Q4 2017.

AUSTRALIAN EQUITIES

The Australian equity market underperformed its hedged international developed counterpart index over the month, as the S&P/ASX 300 Index decreased 3.7%. The S&P/ASX Small Ordinaries was the strongest relative performer, decreasing 2.3%, while the S&P/ASX 50 was the weakest, decreasing 4.1% over the month.

The best performing sectors were Real Estate (-0.1%) and Utilities (-0.8%) while the weakest performing sectors were Telecom services (-6.2%) and Financials (-5.9%). The largest positive contributors to the return of the index were Brambles, Wesfarmers and Goodman Group, with absolute returns of 4.2%, 1.0% and 3.0% respectively. In contrast, the most significant detractors from performance were CBA, BHP and Westpac with absolute returns of -5.3%, -7.2% and -6.5% respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) Index was down 2.3% in hedged terms and 0.5% in unhedged terms over the month, as the Australian dollar (AUD) depreciated against the major currencies. The strongest performing sectors were Utilities (+5.7%) and Real Estate (+3.8%), while Financials (-2.5%) and Materials (-2.1%) were the worst performers. In AUD terms, the Global Small Cap sector was up 1.7% while Emerging Markets decreased by 0.3%.

Over March, the NASDAQ decreased 2.9%, the S&P 500 Composite Index decreased by 2.5% and the Dow Jones Industrial Average decreased by 3.6%, all in USD terms. In local currency terms, major European equity markets experienced negative returns as the FTSE 100 (United Kingdom (UK)) decreased 2.0%, the DAX 30 (Germany) decreased by 2.7% and the CAC 40 (France) decreased by 2.7%. In Asia, the Japanese TOPIX (-2.0%), Hang Seng (-2.3%), SSE Composite (-2.8%) and Indian S&P BSE 500 (-3.7%) all decreased over March.

REAL ASSETS

The Real Assets sector was broadly positive over March. The FTSE Global Core Infrastructure index increased 0.9% while Global REITs also increased 2.5% over the month (both in AUD hedged terms). Domestic REITs posted a mild increase of 0.1% over March, while Australian Direct Property (NAV) returned 0.3% on a one-month lagged basis.

FIXED INTEREST

Global bond markets were positive over March as yields generally fell across major regions. The Barclays Capital Global Aggregate Bond Index increased 0.8% while the Citigroup World Government Bond (ex-Australia) Index increased 1.2% over the month. Ten-year bond yields decreased in the US (-12bps to 2.75%), the UK (-15bps to 1.35%), Germany (-13bps to 0.50%) and Japan (-1bps to 0.04%). Two-year bond yields saw mixed movements over the month as US yields rose (+2bps to 2.27%) along with the UK (+4bps to 0.82%) and Japan (+3bps to -0.13%) while yields in Germany (-3bps to -0.64%) decreased.

Returns for existing domestic bond holders were mixed over March, as 10-year yields dropped (-21bps to 2.60%) and five-year yields dropped (-7bps to 2.31%) while two-year (+1bps to 2.02%) yields increased. Of the Bloomberg Ausbond indices, the Inflation and Treasury Indices produced the highest relative returns, both increasing 1.2% over the month, while the Australian Composite Bond Index return was 0.8% over the month.

CURRENCY MARKETS

The AUD depreciated against the major currencies over March, ultimately finishing with a lower Trade Weighted Index of 62.3 on 31 March 2018. The AUD depreciated against the USD (-1.6%), the Pound Sterling (-2.9%), the Euro (-2.5%) and the Yen (-2.3%). On a trade-weighted basis, the local currency decreased 2.0% over the month.

COMMODITIES

Iron Ore fell a significant 19.3% over March, finishing the month at $65 per metric tonne. The S&P GSCI Commodity Total Return Index rose 3.8% over the month. Gold prices finished the month at US$1,323.43 per ounce, increasing 0.3% over the period, while the oil price increased 6.7% to $70.1 per barrel over March..

CONTACT: Mercer >IS<

Tel: 1800 512 947

Email: merceris@mercer.com

IMPORTANT NOTICES