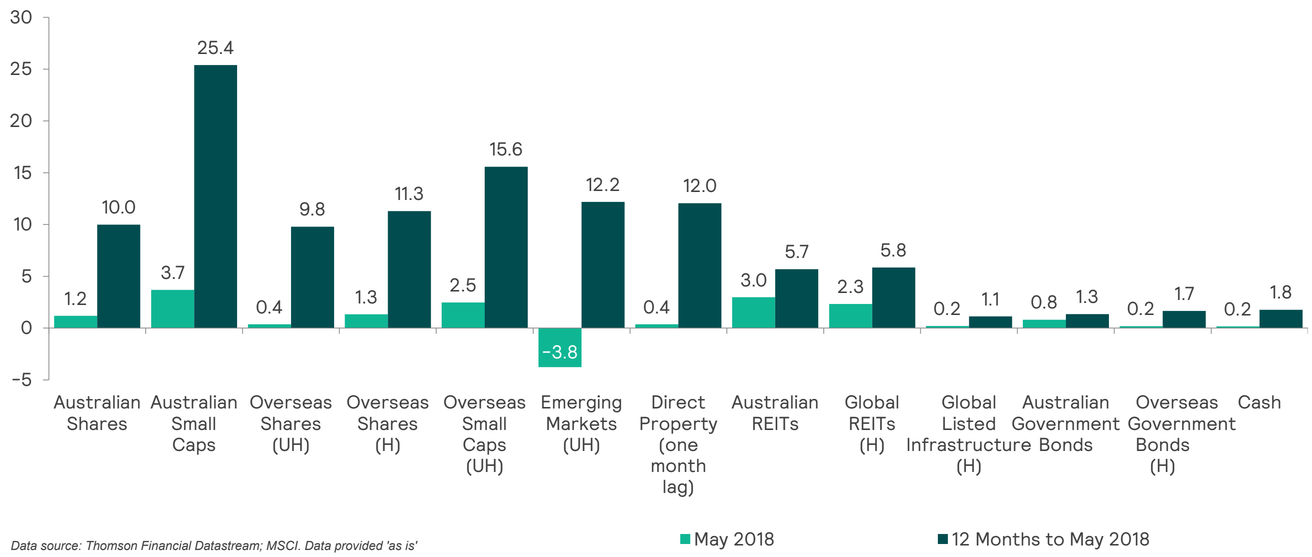
MAY 2018

AUSTRALIAN MONTHLY MARKET REVIEW

SELECTED MARKET INDICATORS
COMMENTARY

ASSET CLASS RETURNS (%) AS AT 31 MAY 2018



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

Continued trade tensions between the United States (US) and a host of major global trading partners as well as political instability in Europe dominated market news over May 2018. Major developed equity indices rose over the month, carrying momentum over from April, due to strong first quarter earnings and positive economic data results in the US. The MSCI World ex Australia (NR) Index was up 1.3% in hedged terms, with Information Technology (+6%) and Energy (+1.5%) providing the best performance of the sectors.

The NASDAQ (+5.3%) and the S&P 500 Composite (+2.4%) also experienced positive performance, with small cap and technology stocks providing strong returns.

However, a risk off attitude and a stronger US dollar (USD) saw the MSCI Emerging Markets Index fall by 3.8% in Australian dollar (AUD) terms. This attitude was influenced, in part, by the continued tension over trade deals, following the decision by the US to pull out of the Iran nuclear deal and North American Free Trade Agreement (NAFTA).

The continued back and forth on whether the US will take part in the North Korea Summit and talks of a trade war following the recent tariff implementation on iron and steel imports by the US on major trading partners including China, Japan and most of Europe also led to this tension. There was also heightened risk in the Eurozone following political crisis in Italy after Five Star Movement leader Giuseppe Conte resigned following rejection of his party's favoured candidate for finance minister, Paolo Savona, by current president, Sergio Mattarella, due to fear of the candidate's anti-European agenda. The event sparked a sell-off frenzy which saw Italian 10-year bond yields surge 70 basis points (bps) overnight. Spain also contributed to the political instability, with a corruption scheme causing a vote of no confidence and ousting of the prime minster, Mariano Rajoy.

Domestically, Australian shares slightly underperformed their hedged international counterpart index over May, with the S&P/ASX 300 Index increasing 1.2%. The best performing sectors were Healthcare (+5.5%) and Consumer Discretionary (+5.3%) which both benefitted from upgrades to earnings figures over the month.

SIGNIFICANT DEVELOPMENTS

- The Reserve Bank of Australia (RBA) decided to leave the cash rate unchanged again in its early June meeting at 1.50% per annum (pa), 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. However, more recently, political tension in Europe as well as trade tension between global major trading partners has heightened volatility. Conditions in USD short-term money markets have tightened over the first quarter of 2018, with USD short-term interest rates increasing for reasons other than an increase in the federal funds rate. This movement has flowed through to high short-term interest rates in other countries, including Australia. The price of oil and some base metals have also experienced a recent increase in prices. The RBA's central forecast for the Australian economy remains for growth to pick up and average just above 3.0% across 2018 and 2019. Employment growth, whilst being quite strong over the past year, has experienced a slowdown over recent months. On a trade-weighted basis, the AUD remains within the range that it has been in over the past two years. 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 22,600 in April, above expectations for a 20,000 rise while March figures were revised to a decrease of 700. The unemployment rate increased to 5.6% for April, above expectations to remain at 5.5%. The participation rate remained at 65.5%, in line with expectations. Part time jobs decreased by 10,000 while full time jobs increased by 32,700.
- Australian building approvals decreased 5.0% month-on-month (MoM) to be up 1.9% for the year to April, compared to previous levels of -6.0% (revised) and -0.8% (revised) for respective periods ending March.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 58.7 in May, above consensus for 58.2, and above the 57.3 recorded in April. Of the 18 manufacturing industries, Textile Mills, Non-metallic Mineral Products and Electrical Equipment were the top contributors while Transportation Equipment, Paper Products and Primary Metals recorded the lowest growth for the month. The ISM Non-Manufacturing Index recorded 58.6 in May, above consensus for 57.7, and above the 56.8 for April. Of the 14 non-manufacturing industries, the top performers in May were Wholesale Trade, Mining and Real Estate and the industries recording the lowest growth were Utilities and other services while Information was the only industry to report contraction over the month.

- US Non-Farm Payrolls increased by 223,000 in May, above the previous 159,000 increase (revised) for April. The unemployment rate decreased to 3.8% in May.
- US gross domestic product (GDP) revised estimate for Q1 2018 is 2.2% quarter-on-quarter (QoQ) annualised, below expectations for 2.3%, and below the 2.9% growth estimate recorded for Q4 2017.
- The Caixin Manufacturing purchasing managers' index (PMI) in China recorded 51.1 again in May, below expectations for 51.2. The indicator signals a marginal improvement in operating conditions across China's manufacturing sector.
- European Core consumer price index (CPI) estimate increased to 1.1% over the year to May, above expectations for 1.0%.
- The Eurozone composite PMI decreased to 54.1 in May, below 55.1 for April, but maintained an expansionary signal for the fifty-ninth month in a row.
- The final figures released for Q1 2018 Eurozone seasonally adjusted GDP remained at 2.5% for year-on-year and 0.4% QoQ.

AUSTRALIAN EQUITIES

The Australian equity market slightly underperformed its hedged international developed counterpart index over the month, as the S&P/ASX 300 Index increased 1.2%. The S&P/ASX Small Ordinaries Index was the strongest relative performer, increasing 3.7%, while the S&P/ASX Mid 50 was the weakest, increasing 0.1% over the month.

The best performing sectors were Healthcare (+5.5%) and Consumer Discretionary (+5.3%) while the weakest performing sectors were Telecom Services (-10.1%) and Financials (-0.1%). The largest positive contributors to the return of the index were CSL, BHP and Wesfarmers, with absolute returns of 9.2%, 6.3% and 4.6% respectively. In contrast, the most significant detractors from performance were NAB, CBA and Telstra with absolute returns of -6.8%, -3.5% and -11.4% respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) Index increased 1.3% in hedged terms and 0.4% in unhedged terms over the month, as the AUD appreciated against most major currencies. The strongest performing sectors were IT (+6.0%) and Energy (+1.5%), while Telecom (-5.6%) and Financials (-3.6%) were the worst performers. In AUD terms, the Global Small Cap sector was up 2.5% and Emerging Markets decreased by 3.8%.

Over May, the NASDAQ increased 5.3%, the S&P 500 Composite Index increased by 2.4% and the Dow Jones Industrial Average increased by 1.4%, all in USD terms. In local currency terms, major European equity markets experienced mixed returns as the FTSE 100 (United Kingdom (UK)) increased 2.8% while the DAX 30 (Germany) decreased by 0.1% and the CAC 40 (France) decreased by 0.5%. In Asia, the Japanese TOPIX (-1.7%), Hang Seng (-0.4%) and Indian S&P BSE 500 (-1.9%) all decreased while the Chinese SSE Composite (+0.4%) increased over May.

REAL ASSETS

The Real Assets sector was positive over May. The FTSE Global Core Infrastructure index increased 0.2% while Global REITs also increased 2.3% over the month (both in AUD hedged terms). Domestic REITs posted an increase of 3.0% over May, while Australian Direct Property (NAV) returned 0.4% on a one-month lagged basis.

FIXED INTEREST

Global bond markets were broadly negative over May as yields generally fell across major regions. The Barclays Capital Global Aggregate Bond Index rose 0.4% and the Citigroup World Government Bond (ex-Australia) Index rose 0.2% over the month. Ten-year bond yields decreased in the US (7bps to 2.86%), the United Kingdom (19bps to 1.23%), Germany (22bps to 0.34%) and Japan (2bps to 0.04%). Two-year bond yields also experienced negative movements over the month as US yields fell (-6bps to 2.42%) along with Germany (-9bps to -0.72%), the UK (-17bps to 0.61%) and Japan (-1bp to -0.14%).

Returns for existing domestic bond holders were positive over May, as 10-year yields (-9bps to 2.67%), five-year yields (-11bps to 2.32%), and two-year (-8bps to 1.98%) yields all fell. Of the Bloomberg Ausbond indices, the Treasury and Inflation Indices produced the highest return, increasing 0.8% over the month, while the Australian Bank Bill Index return was 0.2% over the month.

CURRENCY MARKETS

The AUD appreciated against the USD over May, ultimately finishing with a higher Trade Weighted Index of 62.8 on 31 May 2018. The AUD depreciated against the Yen (-0.4%) but appreciated against the Pound Sterling (+3.5%), the Euro (+3.8%) and USD (+0.2%). On a trade-weighted basis, the local currency increased 1.1% over the month.

COMMODITIES

Iron Ore fell 2.2% over May, finishing the month at $65.5 per metric tonne. The S&P GSCI Commodity Total Return Index rose 1.2% over the month. Gold prices finished the month at US$1301.83 per ounce, falling 0.86% over the period, while the oil price increased 3.5% to $77.7 per barrel over May.

CONTACT: Mercer >IS<

Tel: 1800 512 947

Email: merceris@mercer.com

IMPORTANT NOTICES