Market Update

JANUARY 2020

- Both the US and China are optimistic that a 'phase one' trade deal will be reached, but subsequent negotiations will likely prove more difficult.
- Tension between the US and Iran following the US assassination of Iranian general Soleimani has left markets on edge.
- The devastation from the Australian bushfires will have a significant impact on economic growth and may prompt further action by the RBA.
- A Conservative Party victory in the UK general election has allowed the government to move ahead with its EU withdrawal bill, paving the way for Brexit on 31 January 2020.
- Recent positive economic news from China has given markets confidence that an economic recovery may be possible.

December market performance

Equity Markets – Index Return*	Index	At Close 31/12/2019	% Return 1 Month	% Return 12 Months
Australia	S&P/ASX 200 Index	6684.10	-2.17%	23.40%
United States	S&P 500 Index	3230.78	3.02%	31.49%
Japan	Nikkei 225 Index	23656.62	1.73%	20.72%
Hong Kong	Hang Seng Index	28189.75	7.02%	13.04%
China	CSI 300 Index	4096.58	7.01%	39.19%
United Kingdom	FTSE 100 Index	7542.44	2.78%	17.32%
Germany	DAX 30 Index	13249.01	0.10%	25.48%
Europe	FTSE Eurotop 100 Index	3151.68	1.83%	26.65%

Property – Index Returns*	Index	At Close 31/12/2019	% Return 1 Month	% Return 12 Months
Listed Property	S&P/ASX 200 A-REITS Index	1568.00	-4.41%	19.36%

Interest Rates	At Close 31/12/2019	At Close 31/11/2019	At Close 31/12/2018
Australian 90 day Bank Bills	0.91%	0.89%	2.09%
Australian 10 year Bonds	1.37%	1.03%	2.32%
US 90 day T Bill	1.54%	1.57%	2.35%
US 10 year Bonds	1.92%	1.78%	2.69%

Currency**		At Close 31/12/2019	% Change 1 Month	% Change 12 Months
US dollar	AUD/USD	0.70	3.86%	-0.27%
British pound	AUD/GBP	0.53	1.25%	-4.15%
Euro	AUD/EUR	0.63	1.92%	1.71%
Japanese yen	AUD/JPY	76.28	3.02%	-1.24%
Australian Dollar Trade-weighted Index		60.3	2.20%	-0.66%

* Closing index values are based on price indices. Index returns are expressed as total returns in local currency.
** All foreign exchange rates rounded to two decimal places.
Past performance is not a reliable indicator of future performance.

Global economies

There remains a great deal of geopolitical uncertainty, but markets are more upbeat about the economy than they were in August 2019 when the yield curve inverted. However, while an economic recovery is possible, earnings per share (EPS) growth is muted, tax cuts in the US have not had a sustained impact on spending, and China's stimulus measures remain relatively modest.

Market Update

US

By the end of 2019 markets were optimistic that a 'phase one' trade deal could be reached between the US and China, which would see a lowering of tariffs. A Chinese delegation is set to arrive in Washington DC on 13 January to sign the agreement. According to the statement from the United States Trade Representative's Office, the agreement would require China to make structural reforms and change its trade practices in the areas of intellectual property, technology transfer, agriculture, financial services and currency. However, subsequent phases dealing with discriminatory treatment of foreign investors and the massive subsides provided to state-owned companies may prove more problematic. Meanwhile, the US assassination of Iranian general Soleimani added to an already highly uncertain geopolitical environment. On the economic data front, the news was slightly more positive. September quarter GDP growth for the US was revised up to 2.1% from 1.9%. The record expansion is now 41 quarters long, although the compound annual growth rate of 2.3% p.a. is the slowest expansion of the post-war period. The US payrolls data for November was better than expected, with 266,000 jobs added (versus an expected 190,000), which saw the unemployment rate drop to 3.5%. Wages growth for the private sector eased back to 3.1%, although for non-supervisory production workers wages growth is now running at 3.7%.

Europe

Europe's manufacturing sector continues its decline. In Germany it is contracting at its fastest rate since the GFC and only in France and Greece is the sector seeing any growth. The services sector, while it is expanding, is growing slowly while inflation remains well below target at an annualised 1.3% across the eurozone. The most recent data show industrial production fell 2.2% over the year to October 2019, driven by a large fall in German output of 6.3% over the period. The German car industry has been in a slump since the diesel scandal and is now facing falling sales while having to meet the cost of investing in electric vehicles. Calls for a boost in government spending have come from a range of sources including Christine Lagarde, the new president of the ECB, as well as the OECD and, surprisingly, the Bundesbank. In the UK, the Conservative Party won the election in a landslide with 365 seats to Labour's 202. The Conservatives now have a commanding majority of 80 seats in Parliament. In Scotland the picture was radically different as the Scottish National Party (SNP) won 56 out of 59 seats and renewed the push for national independence. The result allows the government to pass its European Union withdrawal bill, which would activate a transition period lasting until the end of 2020.

China

Recent economic news out of China has been more upbeat. A range of better-than-expected data releases and, of course, the expectation of a 'phase one' trade deal with the US, supported the view that a more significant downturn in Chinese growth could be averted (at least for now). These positive developments also mitigate the immediate need for additional stimulus to support growth targets. The official manufacturing PMI was steady in December at 50.2 after edging back into expansion the previous month. Meanwhile, the Caixin PMI, which is more focused on the private sector, fell to 51.5 from 51.8 the previous month. The improved PMI data was reinforced by better-than-expected outcomes for industrial production and retail sales. Investment spending, however, continues to languish, up only 5.2% over the year to November 2019. The easing measures undertaken over the past 12 months appear to have alleviated fears of a major downturn. Growth has been boosted by cuts to the bank reserve requirement ratio, while the government has brought forward 1 trillion yuan of the 2020 local government special bonds quota used to finance infrastructure projects. Inflation in China rose to 4.5% in November, driven by a 110% surge in pork prices as African swine fever swept through China's hog herds.

Asia region

Japan's September quarter GDP was revised up to an annualised 1.8% from 0.2%, thanks to business investment growing by a higher-than-expected 7.3%. Consumption contributed 1.2 percentage points, investment 1.1 and the public sector 0.7 percentage points. Offsetting this was 0.7% from both net exports and inventories. However, the November Jibun Bank Japan PMIs present a more disappointing view of the economy. The composite index suggests a further contraction in growth in November, albeit at a lesser rate than in October. A stronger rebound in November was expected after the distortion following October's sales tax rise. The services sector staged a weak recovery in November, suggesting that demand in the sector had weakened in the December quarter, while in the manufacturing sector orders from China were lower. Exports are down 7.9% year-on-year to November over the year to October, down from a recent yearly growth rate of 15.0% in May 2017. In India, the outlook has deteriorated over the past six months, forcing the government to revise its estimate for 2019-20 GDP growth from 7.0% to 5.0%. Private consumption, the main engine of growth, is lower than expected and business investment is expected to grow at only 1.0%, down from 10.0% on the previous year.

Australia

The Australian economy enters 2020 growing well below potential growth rates, with excess capacity in the labour market and inflation slightly under 1.0%, below the target rate. This suggests the RBA maintains a bias to cutting cash rates further. Indeed, RBA Governor Lowe signalled that the "effective lower band" for the cash rate was 0.25%, and against a background of weak capex, wages and GDP data, markets moved to factor in further policy easing towards this level by mid- to late-2020. September quarter inflation data showed core inflation of 1.5%, with little sign of upward pressure. Despite the weak growth trends, Australia is on track to achieve a budget surplus in 2019-20, although the Mid-Year Economic and Fiscal Outlook (MYEFO) revealed that the forecast budget surplus was cut from $7.1 billion to $5 billion, and included a downgraded forecast for economic growth from 2.75% to 2.25%. It's not yet clear what the full economic impact of the extreme bushfires is, but they have likely created significant disruption to supply chains and infrastructure, as well as directly harming industries such as tourism and farming. Prime Minister Morrison announced that the government will invest $2 billion in the new National Bushfire Recovery Agency (NBRA), which involves a joint effort between states, territories and local governments.

Market Update

EQUITY MARKETS

- The S&P/ASX 200 Index was down in December but showed signs of regaining momentum early in 2020 after posting a 23.4% gain for 2019.
- The US S&P 500 Index finished 2019 strong with a gain of 3.0% in December, bringing the calendar year return to 31.5% in US dollar terms.
- The STOXX Europe 600 Index rose 4.0% in December while the German DAX 30 Index was mostly flat but regaining momentum in the new year.
- In Asia, China's CSI 300 Index rose 7.0% in December and 39.2% over 2019, and Japan's Nikkei 225 Index rose 1.7% in December and 20.7% over 2019.
- Global developed market shares rose 28.1% over 2019 in Australian dollar terms and emerging markets rose 18.7%.

Australian equities

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 200 Acc. Index	-2.17%	23.40%	10.26%	8.97%	10.01%
	S&P/ASX 50 Acc. Index	-2.36%	24.43%	10.29%	8.47%	9.85%
	S&P/ASX Small Ordinaries Acc. Index	-0.29%	21.36%	9.98%	10.64%	6.78%

Australian shares sold off in December, ending 2019 on a sour note for what was otherwise a stellar year for equities. The S&P/ASX 200 Index returned 23.4% over 2019, with the strongest performance coming from the Health Care sector (+43.5%), including large gains from CSL (+48.9%) and Resmed (+37.6%). Although it represents a smaller proportion of the index, the IT sector (+33.5%) also had a very strong 2019. AfterPay (+136.1%) was one of the highest returning shares of the year, while Xero (+90.4%) and Appen (+75.1%) also thrived in the 'risk on' environment. Meanwhile, the Consumer Discretionary sector (+32.4%) pushed back against the 'retail is dead' narrative, exemplified by JB Hi-Fi (+70.1%), which reported 3.5% growth in sales in its September annual report, defying its short sellers and proving that in-store and online experiences are both valuable for consumers. In December, the Materials sector (+1.6%) produced the only meaningful gain, while the defensive Utilities sector (+0.8%) was flat. Every other sector was in the red, with the largest fall coming from Consumer Staples (-8.1%), dragged down by Metcash (-14.3%) and Treasury Wine Estates (-13.2%). Communications (-5.8%) was also hit hard due to falls from telcos and a 13.5% drop in Southern Cross Media Group.

Investment Index/Benchmark returns*

S&P/ ASX 200 Index

Sector	1 Month	3 Months	1 Year
Materials	1.55%	4.34%	27.22%
Utilities	0.78%	1.57%	16.21%
Energy	-1.50%	6.36%	22.93%
Financials ex-Property	-1.62%	-6.35%	13.53%
Consumer Discretionary	-2.53%	3.13%	32.43%
Health Care	-2.67%	14.00%	43.47%
Industrials	-2.98%	3.98%	27.09%
Property	-4.41%	-0.99%	19.36%
Information Technology	-4.60%	1.69%	33.47%
Communications	-5.80%	-0.24%	27.29%
Consumer Staples	-8.05%	-2.66%	20.98%

*Total returns based on GICS sector classification

Market Update

BIG MOVERS THIS MONTH

Going up

⇑	Materials	+1.6%
⇑	Utilities	+0.8%

Going down

⇓	Consumer Staples	-8.1%
⇓	Communications	-5.8%
⇓	Information Technology	-4.6%

Global Equities

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Global	MSCI World Ex Australia Index (AUD)	-0.78%	28.13%	13.68%	12.15%	17.14%
	MSCI World Ex Australia Index (LCL)	2.39%	27.43%	11.84%	9.24%	11.99%
	MSCI World Ex Australia Small Cap Index (AUD)	-0.36%	26.68%	11.10%	11.77%	17.18%
Emerging	MSCI Emerging Markets Index (AUD)	3.48%	18.74%	12.59%	8.83%	9.18%
	MSCI AC Far East Index (AUD)	1.07%	19.91%	12.00%	10.54%	13.24%

Global share markets had a strong finish to 2019, at least in local currency terms, with developed markets returning 2.4% in December and 27.4% over the year. The US S&P 500 Index posted 31.5% for the year—its best annual return since 2013. Perhaps unsurprisingly, 23 of the top 50 performing shares over 2019 were from the Information Technology sector, including Apple (+9.9%), which ended the year with market cap of US$1.3 trillion. Interestingly, the Health Care sector, which is the second-largest sector in the S&P 500 after Technology, did not produce a single top-50 performer. Markets watched trade developments between the US and China closely and appeared optimistic that a 'phase one' deal would be successful. European markets entered the new year with some early gains as the German DAX 30 Index prepared to push past its previous all-time high of 13,560 at the start of 2018. Markets were rattled by the US assassination of Iran's top military general, which resulted in retaliatory strikes from Iran, but so far equity markets have contained their anxiety over the possibility of a broader gulf conflict. Asian markets delivered impressive results over 2019, with China finishing the year strong with a 7.0% return from the CSI 300 Index in December and 39.2% over the year. Japan's Nikkei 225 Index returned 1.7% in December, bringing the year-end return to 20.7%.

Property

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 200 A-REIT Acc. Index	-4.41%	19.36%	9.10%	10.93%	12.53%
Global	FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)	0.00%	22.40%	8.94%	7.57%	10.02%

The S&P/ASX 200 A-REIT Index lost 4.4% in December in a horrid month for listed property, taking the shine off an impressive 2019 marked by the success of large diversified managers. Topping the leader board for 2019, however, was Ingenia Communities, which was only brought into the ASX 200 in the December rebalance and gained 65.9% over the year. While two of its resident owned homes have been affected by the bushfires, and tourism revenue is anticipated to be negatively impacted, results are still expected to be within the guidance range. Dwelling approvals rose in November by 11.8%, bouncing back from October's sharp fall of 7.9%. Total approvals are down 3.8% over the past 12 months but are now up 3.3% on a rolling three-month basis, the first positive gain since April 2019. While this is broadly consistent with the improvement in the property market witnessed in the second half of 2019, the sector is fairly volatile, mostly due to the high-rise segment. In the US, housing data continues to improve, reflecting lower mortgage rates and reasonable income growth. The NAHB builder sentiment index rose to a 20-year high while housing permits surged to the highest level since 2007.

Fixed Interest

	Index/Benchmark (% pa)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	Bloomberg AusBond Composite 0+ Yr Index	-1.64%	7.26%	5.14%	4.18%	4.65%
	Bloomberg AusBond Bank Bill Index	0.07%	1.50%	1.72%	1.91%	2.16%
Global	Bloomberg Barclays Global Aggregate Index (AUD)	-3.22%	7.00%	5.31%	5.46%	7.15%
	Bloomberg Barclays Global Aggregate Index (AUD Hedged)	-0.28%	7.19%	4.15%	4.20%	4.78%

Through 2019 the yield on the Australian 10-year Treasury fell from 2.32% to 1.37%, reflecting weakening economic conditions and a reversal in monetary policy as the RBA shifted into an easing cycle with three rate cuts. However, it remains above its recent low of 0.89% in October. Australian government bonds returned -1.9% in December but were up 7.6% through 2019, compared to 7.1% from corporate bonds. In the US, the bond market reacted nervously to the US administration's assassination of Iran's military general Soleimani, reflected by a nine basis-point drop in the US 10-year Treasury yield. On the monetary policy front, the US Fed kept the funds rate steady at 1.50–1.75% in December while the latest FOMC dot plot shows the Fed has downgraded its projections for the funds rate, which is now expected to remain on hold through 2020 and to rise to 1.90% at the end of 2021. Yields were generally higher in December. The UK Gilt 10-year yield rose from 0.69% to 0.82% over the month as the general election results produced a sizeable Conservative majority, while the yield on 10-year German Bunds rose to -0.17%, the highest rate in seven months. The yield on the five-year Bund rose just above zero for the first time since July 2019. The Japanese 10-year yield rose from -0.08% to -0.02%, moving above zero briefly towards the end of the month.

Australian dollar

The Australian dollar moved higher in December from US$0.68 to $0.70, responding to positive trade news, but faded at the start of 2020 as the bushfires gave rise to the possibility of an RBA rate cut as early as February. Drought- and fire-stricken farmers will be hoping for a lower dollar to help boost the value of agricultural products overseas.