MARKET WATCH

September 2016

Market and economic overview

Australia

- The Reserve Bank of Australia (RBA) Board meet on 4 October 2016, for their first time with Dr Phil Lowe as Governor. As widely expected, the cash rate was held unchanged at 1.5%.
- Also as expected, Governor Lowe has taken the opportunity to re-write some aspects of the statement. Although, critically, the words describing both the inflation and policy outlook are unchanged.
- On inflation: "Inflation remains quite low. Given very subdued growth in labour costs and very low cost pressures elsewhere in the world, this is expected to remain the case for some time."
- In terms of policy guidance, there was very little, with the RBA repeating the view that "having eased monetary policy at its May and August meetings, the Board judged that holding the stance of policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time."
- The Q2 2016 GDP report for Australia came in largely in-line with expectations and marks the 25th consecutive year of economic growth.
- Quarterly GDP came in at slightly below expectation 0.5%/qtr vs 0.6%/qtr while the annual rate increased to 3.3%/yr, from 3.1%/yr in Q1 2016, in line with market expectations and a 4 year high. One of the most positive signs from the report is the increase in real gross domestic income to 1.9%/yr from 0.4%/yr, largely driven by a 0.95%/qtr increase in Q2 2016 and the improvement in the terms of trade.
- The biggest contributions to growth came from; Public investment (+0.7%), Government consumption (+0.3%) and Inventories (+0.3%) while Non-residential building (-0.8%) and Net exports (-0.2%) were the largest detractors.
- The August labour market report showed the unemployment rate decreased by 0.1% to 5.6%, driven by a 0.2% fall in the participation rate to 64.7%. The number of people employed fell by 4k below the 15K expected. The decrease was entirely driven by part time employment (-15.4k) while full time employment rose (+11.5k) reversing some of last month's move.
- Retail sales in August were up +0.4%/mth, above the +0.2/mth expected. The largest increase was in department store sales (+3.5%/mth) following a 5.8%/mth fall in July. Cafes and Restaurant were also stronger up 1.2%/mth.
- Consumer confidence increased over the month with the index up 0.3%/mth to 101.4. Gains were seen in the current conditions (+3.5%) and year ago family finances (+3.5%) components, while one year ahead expectations for finances (-2.3%) and the economy (-4.6%) declined.

US

- The US Federal Open Market Committee (FOMC) meet on 20-21 September 2016 and as widely expected left the official Fed Funds target rate unchanged at 0.25%-0.5%.
- In detailing the policy decision, the Fed "judges that the case for an increase in the federal funds rate has strengthened but decided for the time being to wait for further evidence of continued progress towards its objectives".
- The Fed's statement noted that "near-term risks to the economic outlook appear roughly balanced" and that they will continue "to closely monitor inflation indicators and global economic and financial developments".
- In addition the committee noted that "the labor market has continued to strengthen and growth of economic activity has picked up from the modest pace seen in the first half of this year… job gains have been solid, on average… household spending has been growing strongly but business fixed investment has remained soft".
- Interestingly the FOMC decision was not unanimous with three members of the committee, Esther George, Loretta Mester and Eric Rosengren, dissenting and calling for a 0.25% increase in the federal funds rate. All three members have recently spoke out publically in favour of increasing rates in 2016 and so there dissent was not a surprise to us or the market but further reinforces the case for an increase in December.
- The FOMC maintained their forecast for 2017 and 2018 growth at 2%/yr and added 2019 to their forecasts, where they see growth at 1.8%/yr.
- The majority of the FOMC members now believe there will be just one rate hike this year (down from two), two in 2017 and three in each 2018 and 2019. The expected long-term rate was also lowered from 3% to 2.9%.

- As mentioned is last month's Market Watch employment increased by 151k/mth in August weaker than the 180k/mth expected. Despite this, the unemployment rate was stable at 4.9%, where it has remained for the past 3 months.
- Inflation remains subdued. Headline CPI was up 0.2%/mth in August with the annual rate increasing to 1.1%/yr. Core CPI increased 0.3%/mth with the annual rate increasing 0.1% to 2.3%/yr. Inflation continues to be driven by Rents (+3.8%/yr) and medical costs (+1%/mth) which had their largest one month increase in 32 years.
- The Fed's preferred measure of underlying inflation, the Core Personal Consumption Expenditure, increased to 1.7%/yr in August, the cyclical high it last reached in February 2016.
- Consumer confidence increased in more than expected in September to 104.1, a 7 year high. The large increase was driven by increasing optimism about the labour market and present economic conditions.
- Manufacturing sentiment measured by the ISM Manufacturing PMI also increased more than expected to 51.5 in September from 49.4 in August. The increase was driven by pick-ups in the orders and production indices and likely aided by the gradual increase in US rig counts over recent weeks.

Europe

- The European Central Bank (ECB) meet on 8 September 2016 and left monetary policy unchanged while the market expected an extension of the ECB's QE program due to end in March 2017.
- The only concrete thing that came from the meeting was to task "the relevant committees to evaluate the options that ensure a smooth implementation of our purchase programme." During the Q&A ECB President Draghi said that the committees have a full mandate to redesign the programme and look at all policy options including QE, interest rates and TLTROs. While no timeframe was given any decisions seem likely only at the December meeting. This is likely a response to the constraints the ECB is nearing in the implementation of its QE program.
- In addressing questions of why policy was not changed, Draghi answered that the March package was working very well and that the forecast had simply not changed enough since June. Despite acknowledging that it would take a bit longer to get back to price stability and that risks were still on the downside.
- The first estimates of CPI for the euro area in September showed an increase of 0.4%/yr, the fastest since 2014. Core CPI was stable at 0.8%/yr still well below the ECB's 2% target. Inflation was driven by the increase in oil prices over the month with energy prices down -3%/yr in September compared to -5.6%/yr in August.

UK

- As largely expected the Bank of England (BoE) Monetary Policy Committee (MPC) left policy unchanged at their 15 September meeting.
- On the economy the MPC noted that the outlook had improved for 2H16 with "less of a slowing" now expected compared to their August forecast and near term momentum "slightly to the upside".
- On their longer term outlook, the MPC stated that it was still too early to draw inferences for 2017 and beyond and that the "contours" of the economic outlook following the Brexit vote had not changed.
- On the outlook for monetary policy the committee maintained the language from the August meeting that "a majority of members expect to support a further cut in Bank Rate to its effective lower bound at one of the MPC's forthcoming meetings during the course of this year" to a level that is "close to, but a little above, zero".
- Timing of the UK's exit from the EU has been firmed up with PM May confirming that Article 50 will be invoked before the end of March 2017, starting the 2-year negotiation process. PM May also offered more details on the likely deal, confirming that the UK would seek to take back control of immigration even at the cost of access to the single market.

NZ

- The Reserve Bank of New Zealand (RBNZ) left the OCR on hold at 2% on the 22 September 2016, as largely expected by markets. In the accompanying statement the RBNZ maintained their easing bias, stating that that "further policy easing will be required".
- Q2 16 GDP was slightly weaker than expected at 0.9%/qtr, however annual growth at 3.6%/yr is still above the level the RBNZ expected in August. Construction activity and exports remain the key drivers of growth.

Canada

- The Bank of Canada (BoC) left rates unchaged at 0.5% at their 8 September 2016 meeting.
- GDP was stronger than expected increasing to 1.3%/yr in July after the wildfire-induced slump in May. The improvement in growth was driven by strong gains in Energy as production returned and prices improved.

Japan

- The Bank of Japan's (BoJ) meet on 21 September 2016 and released its promised "comprehensive reassessment" of their monetary policy easing program – known as Quantitative and Qualitative Easing with Negative Interest Rates (QQE-NIR).
- They concluded that in order to achieve the "price stability target of 2% at the earliest possible time"

the BoJ would "introduce QQE with Yield Curve Control" by strengthening the QQE-NIR program.

- The BoJ is now aiming to undertake "yield curve control", by controlling both short-term and long-term interest rates. The short-term rate will remain at -0.1% and 10yr JGB yields will now be targeted at around 0%.
- The BoJ has also made an "inflation-overshooting commitment" in which the BoJ "commits itself to expanding the monetary base until the year-on-year rate of increase in the observed consumer price index (CPI) exceeds the price stability target of 2% and stays above the target in a stable manner."

China

- The People's Bank of China (PBoC) left monetary policy unchanged during the month with no rate cuts or reserve requirement ratio easing.
- Over the month Chinese data showed stabilisation and improvement as the impact of fiscal easing continues to flow through. Over August Industrial Production increased 6.3%/yr (from 6.0%/yr in July), Retail Sales was up 10.6%/yr (from 10.2%/yr in July) and Fixed Asset investment was stable at 8.1%/yr.
- Inflation continued its decline, falling to 1.3%/yr from 1.8%/yr in August. Food price inflation remains a major driver, falling from 3.3%/yr to 1.3%/yr August.

Australian dollar

- The Australian dollar strengthened against most major currencies over September. The AUD finished up 1.9% against the USD to $US0.7664, driven by better than expected growth and improving terms of trade.
- The Australian dollar rose against the euro (+1.07%), the sterling (+3.12%), and NZ dollar (+1.48%), but fell against the yen (-0.08%) over September.

Commodities

- Commodity prices were stronger over September with oil and most metals up.
- The price of West Texas Intermediate Crude finished the month at $US48.24/bbl, up 7.9%, while the price of Brent was up 6.2% to $US50.19/bbl. Oil prices moved higher after OPEC announced a preliminary agreement to reduce production by up to 750k bpd at their meeting in Algeria. While the deal has been announced, cuts will not occur till the 30 November OPEC meeting were individual quotas and supply cuts will be decided. Given the pressure on OPEC budgets and desire to increase supply by several members (including Iraq, Iran, Nigeria, Venezuela and Algeria) a sustainable agreement to reduce production seems unlikely.
- Gas prices were mixed with the US Henry Hub spot price down 3.5% to $US2.84/MMBtu while the UK natural gas price was up 17% over August.
- Iron ore prices were slightly weaker in September, down 5.3% to $55.86/metric tonne, as measured by the benchmark price of iron ore delivered to Qingdao China.
- Nickel (+8.3%) was one of the best performing metals over the month after news of several mine closures (due to environmental violations) in the Philippines, the largest producer, drove prices higher.
- Zinc (+2.9%) and Lead (+11.5%), Gold (+0.7%), Copper (+5.4%) and Aluminium (+3.7%) all rose over September.

Australian equities

- The ASX/S&P ASX 200 Accumulation Index returned 0.5% during September. Despite some weakness during the first half of the month, the Index recovered to finish in positive territory.
- The Materials sector was the standout performer during the month, returning 5.6%. Large diversified miners BHP Billiton (10.6%) and Rio Tinto (8.4%) both posted strong gains.
- Consumer Staples (1.7%) and IT (0.8%) also finished the month higher.
- Bond proxy sectors fell during the month as the market reacted to rising bond yields. REITs and Utilities fell by 4.3% and 3.3% respectively. Telecommunications fell by 4.0%, dragged lower by TPG Telecom (-29.3%) which was sold off on the back of disappointing FY17 guidance.

Listed property

- The S&P ASX 200 A-REIT index declined by -4.3% in September. Property securities fell sharply early in the month on profit taking, before recovering some ground in the second half of the month as supportive valuations rekindled investor demand.
- The best performing A-REIT was Growthpoint Properties Australia (+6.9%), which rallied as its long-running takeover of GPT Metro Office Fund drew close to completion.
- Charter Hall Group (-12.6%) fell after the sale of a large stake in the company by an institutional investor weighed on its share price. Dexus Property (-5.9%) also underperformed, following a run of strong performance from this office-focussed A-REIT.
- Listed property markets offshore generated mixed returns in September. The FTSE EPRA/NAREIT Developed Index (TR) fell by -0.9% in US dollar terms. Hong Kong (+4.0%) was the strongest performing region for a second consecutive month, followed by Singapore (+2.8%). Property securities in Australian and the UK lagged.

Global developed market equities

- Volatility returned to Global equity markets over September after an unusually quite August and July.
- Markets reacted to uncertainty around central bank policy as Fed speakers attempted to talk up the likelihood of rate increases later this year and the BoE, ECB, BoJ and Fed all met.
- The MSCI World Index was up 0.4% in US dollar terms in the month of September but down -1.5% in Australian dollar terms.
- In the US, the S&P500 (-0.1%), the Dow Jones (-0.5%) were weaker while the NASDAQ (+1.9%) rose, driven by strong performance in the technology sector.
- MSCI Energy (+2.66%) was the best performer as the rebound in oil prices and the news of the OPEC deal buoyed energy markets, MSCI Information Technology (+2.50%) also performed, driven by Apple's early September product launch event. MSCI Financials (-1.40%) was the worst performer as news of Deutsche Bank's US$14bn fine from the Department of Justice and concerns around the bank's solvency rattled financial markets.
- Equity markets in Europe were mixed over the month. The UK FTSE100 (+1.7%), Spain (+0.7%) and France (+0.2%) rose while The German DAX (-0.8), Italy (-3.2%) and the large cap Stoxx 50 Index (-0.7%) all fell.
- Asia markets were mostly stronger with Singapore (+1.7%), Taiwan (+1.1%) and Honk Kong Hang Seng (1.4%) all up while the Japanese Nikkei 225 (-2.6%) fell.

Global emerging markets

- Emerging market equities were up in September with the MSCI Emerging Market Index up 1.1% in US dollars.
- With a weaker USD and stronger commodity prices EM equities continued to perform over September.
- MSCI EM Europe, Middle East and Africa was the best performing region over the month rising 2.54% in USD terms with Strength in Eastern European and some African markets.
- Asia also performed with the MSCI EM Asia Index up 1.42% with gains in Pakistan (+2.10%), Indonesia (+1.69%), Vietnam (+1.67%) and other EM Asia markets. The Shanghai Composite Index was weaker, down 2.6%. MSCI EM Latin America was also down 0.87%.

Global and Australian developed market fixed interest

- Markets continued to be moved by the actions of central banks in the month. Most notably was the curve steepening led by the BoJ change to its monetary policy easing program. The market reaction to this announcement was somewhat muted, following the sharp rise in 10 year Japanese government bond yields in early August when the focus on the curve was first announced.
- Later in the month saw long-dated yields in the US and elsewhere rise, as a number of US Fed speakers moved the expectations of a rate hike in the US higher (albeit from a very low starting point).
- Domestically the Australian Office of Finance Management (AOMF) announced that it will issue its first 30 year bond before the end of October 2016. The announcement caused a steepening at the very back end of the Australian curve.
- Overall the general rise and fall in government bond yields outlined above saw mixed results, with the biggest moves in ten-year yields in the UK (+10 bps) and Australia (+8 bps). More muted movements were seen in the US (+1 bps), Japan (-2 bps) and Germany (-5 bps). The relatively range bound nature to markets indicates that they remain resilient to the continued uncertainty around monetary policy and geopolitical events.

Global credit

- Global credit spreads moved marginally wider in the month as shocks in the market were felt mid-month as the pricing of a US rate hike increased and news of the large fine imposed by the US Department of Justice for Deutsche Bank saw financial credits impacted. Combined with oscillations in oil prices, this saw volatility return to synthetic credit indices following a previous lull.
- Physical credit was less impacted with the Barclays Global Aggregate Corporate Index average spread moving 4 bps wider to 1.34%, while the Barclays US Aggregate Corporate Index average spread moved 2 bps wider to 1.31%. The Barclays European Aggregate Corporate Index widened a larger 7 bps to 1.15%, reflecting the increased focus on the Deutsche Bank litigation.
- US high yield credit spreads moved notably intra month with the Bank of America Merrill Lynch Global High Yield index (BB-B) spread as high at 4.16%. But the risk-on attitude later in the month saw the spread narrow to where it started the month, closing at 3.98%. The high yield market continues to be impacted by increased downgrades particularly in the energy and mining sectors.
- Australian credit spreads played catch up to the global compression seen in July, with the average spread of the Bloomberg AusBond Credit Index to bond down 10 bps to 107 bps. The compression in swap spreads at the front of the curve contributed around half of the move.
- Issuance in Australian credit was stronger at the start of the month but tailed off from mid-month with no notable issuance in the second half. With historically low cash rates and views that accommodative monetary policy is here to stay, the search for additional yield continues to drive demand.

Asia was the best performing region with the MSCI EM Asia Index up 3.85% with gains in China and the Shanghai Composite Index (+3.6%) driving the performance. Thailand (+1.6%) and Indonesia (+1.6%) and India (+1.4%) all rose while the Philippines (-2.5%) was down.

MSCI EM Latin America was up 0.43%, driven by strength in Mexico (+1.9%) and Brazil (+1.0%) while Argentina (-0.4%) fell.

MSCI EM Europe, Middle East and Africa reversed some of last month's gains closing down 2.72% in US dollar terms, led by weakness in Saudi Arabia (-3.5%) and Czech Rupublic (-2.6%).

HEADING FORWARD
FINANCIAL PLANNING