Market Watch

More of the same

First Sentier Investors

End-November 2019

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Economics overview

- **US:** The US economy is growing faster than expected with the second estimate of the annualised QoQ GDP growth rate coming in at 2.1% for Q3 versus the advance estimate last month of 1.9% and 2.0% for the prior quarter.
- Durable goods orders were also above expectations, rising 0.6% in October having fallen -1.4% in September. Most encouraging was the 1.2% jump in non-defence capital goods excluding aircraft. This is seen as a proxy for business spending and it was the largest gain since January.
- The US housing sector is showing signs of recovery with both housing starts and existing home sales posting solid improvements in October.
- The above data reads, along with stronger than expected improvements in US manufacturing and services activity over November, helped allay fears over the US/China trade war's impact on the health of the US economy.
- There were also encouraging signs of trade détente with Trump's top economic adviser, Larry Kudlow, observing that the "phase one" trade agreement negotiations were "coming down to the short strokes." In addition, there were signs that China is more willing to respect and protect intellectual property rights – addressing another stumbling block in negotiations.
- In spite of improving signs of economic growth, inflation remains subdued. The core personal consumption expenditures (PCE) index, the Federal Reserve's preferred inflation gauge, was up only 1.6% YoY in October. That was marginally down from the 1.7% growth seen in the previous month. This confirmed expectations that any interest rate rises were unlikely in the foreseeable future.

- **Australia:** The economic outlook in Australia is looking less positive. Surprisingly, net employment in Australia declined by -19,000 jobs over October as the unemployment rate rose back to 5.3%
- Increasing capacity in the labour market saw subdued Q3 wage growth – slowing to 2.3% (YoY) from 2.2% last quarter.
- Private sector credit rose only 2.5% (seasonally adjusted) over the year to October 2019. This is the lowest annual rate of credit growth since April 2010, which does not augur well for any near-term bounce in consumption or business investment. Indeed, both third quarter capex and fourth quarter business spending intentions came in below expectations.
- Further dismal news came from the CommBank Purchasing Managers Index (PMI), which showed that economic malaise is spreading with both the manufacturing and services sectors in Australia deteriorating in November for the first time since the inception of the CommBank PMIs in 2016
- These disappointing economic updates are particularly worrying in light of the 75 basis points of rate cuts from the Reserve Bank of Australia (RBA) and the tax cuts provided by the Coalition Government since the start of the fiscal year.
- This has prompted speculation that the RBA may need to consider unconventional monetary policy in order to stimulate growth. Late in the month, the RBA Governor dampened those expectations saying, "… that QE becomes an option to be considered at a cash rate of 0.25%, but not before that."

- **New Zealand:** At its November meeting The Reserve Bank of New Zealand decided to keep the Official Cash Rate at 1.0%. The RBNZ noted, "Economic developments since the August Statement do not warrant a change to the already stimulatory monetary setting at this time."
- Median house prices across New Zealand increased by 8.2% in October to a new record high of $607,500; breaking the $600k barrier for the first time.

- **Europe**: The EU parliament approved incoming Commission President Ursula von der Leyen's new team by a large majority. However, there is no UK commissioner after Prime Minister Boris Johnson's government opted not to nominate a candidate. The EU subsequently launched legal action against the UK.
- The 19 countries in the Eurozone reported sluggish growth of 0.2% in the three months to end-September. Slow growth in the region is likely to put more pressure on the region's stronger performers to stimulate their economies.
- The ECB's account of its September monetary policy meeting reported, "A plea was made for patience to allow the measures taken in September to work through the economy, supporting a 'wait and see' posture at the current juncture." In addition, a strong call was made for unity of the Governing Council after several members opposed September's stimulus package.
- In country-specific developments, Germany narrowly avoided a technical recession, with 0.1% growth in the third quarter. The Germany's Economy Minister described economic development in the region as 'fragile'.
- In the UK, attention was focused on the general election as party campaigns entered their fourth week. Voters go to the polls on December 12 in the UK's fourth election in five years.
- Opinion polls show the Conservative Party in the lead over Labour although, as ex-PM Harold Wilson once noted, a week is a long time in politics. MPs are set to vote on Johnson's Brexit deal before Christmas if the Conservatives win a majority, which would all but guarantee the Bill being approved.

- **Asia/EM:** China's annual inflation rose to 3.8 percent in October 2019 - the highest inflation rate since January 2012. The rise was primarily due to soaring pork prices following an outbreak of African swine fever, which has resulted in around 40% - or 100 million - of Chinese pigs culled.
- In Hong Kong, voters turned out in record numbers for district elections, which gave pro-democracy candidates a landslide win following months of demonstrations. Hong Kong's pro-Beijing Chief Executive, Carrie Lam, said the government would "listen to the opinions of members of the public humbly and seriously reflect".
- The unemployment rate in Japan edged 2bps higher from near 30-year lows to 2.4%.

Australian dollar

- October's strength in the Aussie dollar was reversed during November, as the AUD fell from three month highs at the start of the month to finish 1.8% lower at 67.6 cents. The Aussie dollar also fell slightly against the British pound to finish at 52.4 pence; a level not seen since mid-2016.

Commodities

- It was a mixed month for commodity prices. Aluminium (+0.1%), copper (+0.3%) and Tin (+0.1%) were little changed, while zinc (-10.9%), lead (-11.4%), and nickel (-18.9%) posted sizeable losses. Nickel fell as shortfall concerns eased around Indonesia's proposed export ban from 2020.
- Precious metals were mostly lower. Gold (-4.6%) lost some 'safe haven' support, while silver (-6.0%) and platinum (-5.7%) also fell.
- Iron ore prices tracked lower in the first half of the month as Vale continued to bring production back online, before prices staged a recovery into month end as Chinese steelmakers looked to increase production before restrictions are introduced.
- Oil (Brent -0.6%) tracked higher over the month on US/China trade optimism, before posting some sharp falls at month end as Saudi Arabia looked to boost output.

Australian equities

- Despite increasing evidence of a deteriorating local economy and a weak month for banks, Australian shares moved steadily higher over November as the S&P/ASX 100 Accumulation Index established a new all-time high on the second last day of the month. Barring a sell-down exceeding -5% in December, 2019 will also be the strongest year for Australian shares since the recovery from the GFC in 2009. Share investors appear to be focussed more on the benefits of lower interest rates than the potential threat to earnings from weaker economic growth.
- Although stronger earners reaped high rewards over the month. Cloud based software developer, Xero, announced revenue up 32% over the prior half as last year's subscriber numbers surged 30%. Its 17.8% share price jump helped drive Information Technology (+11.1%) to top the sector placings for November. Similarly, market heavyweight, CSL helped propel Health Care (+9.6%) to second place with a 10.7% jump in share price as the biotech company reaffirmed 2019-20 profit guidance. Growth stocks are set to enjoy their strongest relative returns since the GFC with the MSCI Australia Growth Index jumping 35.6% calendar year to date versus its value equivalent's rise of 18.4%.
- Westpac's 15% fall in full-year profit at the start of the month followed up with a $2.5bn equity raise and then news that it faced allegations of money laundering rules saw its share price slump -10.5%. This contributed to Financials (-2.3%) being the worst performing sector over November.
- Small companies run of underperformance continued with the S&P/ASX Small Ordinaries Accumulation Index managing only +1.6% for the month and is underperforming the S&P/ASX 100 equivalent by more than 5% over the 11 months to end November. Gold stocks, as a whole, struggled (-7.5%) as the yellow metal dipped more than -3% in USD terms given the reduced demand for haven assets.

Listed property

- Global listed property was flat in November as the risk-on mood that permeated global markets saw defensive sectors trail the wider equity market. The FTSE EPRA/NAREIT Developed Index returned 0.0% in local currency terms and 0.7% in AUD terms, reflecting a weaker Australian dollar.
- Europe was the best performing region (+2.6%), with key contributors including Sweden (+6.4%) and the UK (+2.4%). In the run up to the British election on December 12, opinion polls have generally pointed to a Conservative majority government, which investors have welcomed as a more business friendly outcome than a potential Jeremy Corbyn led Labour government.
- The weakest performing market was Hong Kong (-3.6%) with the ongoing political turmoil in the territory.
- In Australia, AREITs returned 2.3% for the month, with the industrial (+3.0%) and diversified (+2.6%) sub-sectors leading the way. Notable outperformers included Mirvac (+5.0), Charter Hall Retail (+4.3%) and Unibail-Rodamco-Westfield CDI (+4.2%).

Global equities

- Global equities also reset all-time highs on improved prospects of a "phase one" trade deal being negotiated prior to year-end. US shares led the charge on this optimistic outlook with the S&P500 also setting new highs as they surged towards month end to finish November up 3.6% in USD terms. A weaker AUD also contributed to stronger global share returns to Australian investors as the MSCI World Index jumped 4.7% in AUD terms over the month.
- UK shares again struggled given the election and Brexit uncertainty, even though recent polls are now suggesting a strong majority for the Conservative Party. The FTSE 100 only managed 1.8% in local currency terms over the month and is in a race to the bottom with the Japanese Nikkei for worst performing major market in 2019. Both indices are up a respectable 14.1% over the last 11 months, but that is well below the MSCI World Index, which is up an impressive 25.2% in local currency terms.
- Emerging markets again underperformed developed markets in November as the MSCI Emerging Markets Index could only manage a 1.7% return for the month in AUD. This will bring up a calendar year to date underperformance of -14.6% versus developed markets and 2019 may be the worst relative performance since 2013 if emerging markets underperform by more than -1.5% in December. South Africa (-2.7%) was the worst performer in November and looks certain to be the worst performer over 2019 as well given a weak economy, political upheaval and, since early September, a steadily falling gold price.

Global and Australian Fixed Income

- Most government bond markets saw yields rise for a third straight month, resulting in negative returns across fixed income markets.
- The notable exception was Australia where yields fell as economic data continued to soften while expectations of further RBA easing were further priced in by markets. Ten-year Australian government bond yields closed October 11 bps lower, at 1.03%, resulting in positive total returns.
- Global manufacturing survey results improved during November, albeit from previous contractionary territory. The US for example saw its ISM manufacturing index beat expectations after printing at 52.2 during the month (over 50 is expansionary). This improvement in data along with continued optimism of a US/China trade deal saw yields continue to push higher.
- Bond market participants appear to be thinking that we have likely already seen most of the likely interest rate cuts worldwide and that further moves could be some time away.
- In the US, 10-year Treasury yields closed the month 9 bps higher, at 1.78%. Similarly, yields rose 7 bps and 5 bps in the UK and Germany and by 6 bps in Japan.

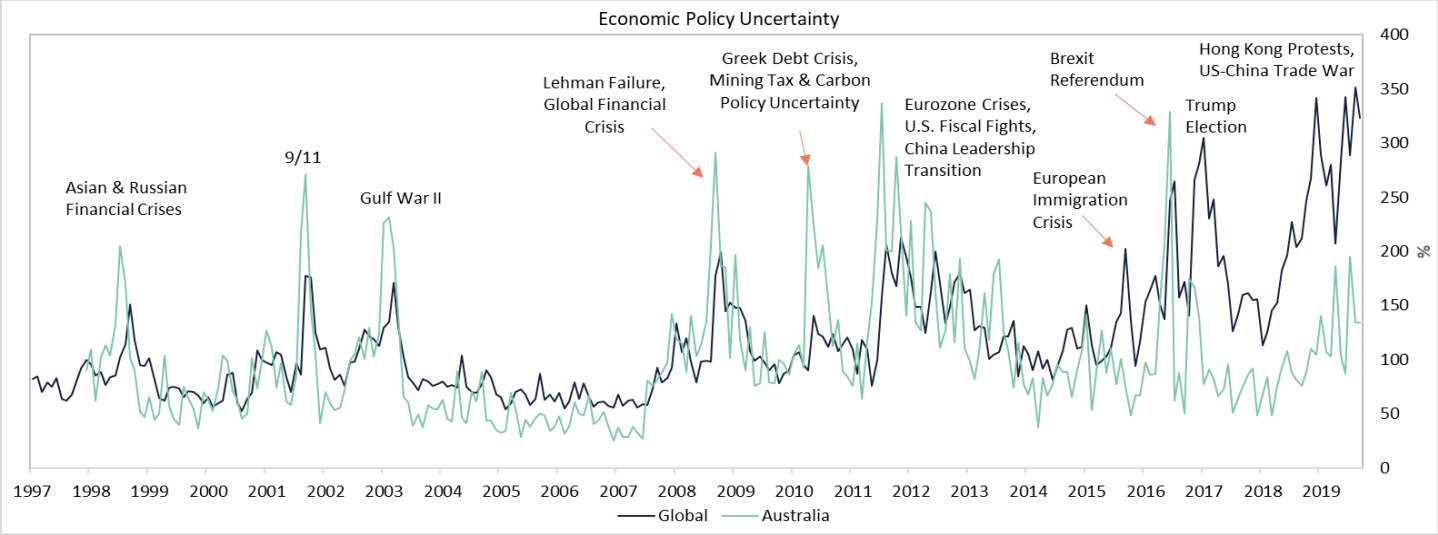
Global credit

- Corporate bonds delivered positive returns in November in line with other risk assets such as equities.
- An ongoing positive technical picture (i.e. more demand than supply) saw credit spreads steadily contract to near cycle lows.
- Earnings season ended fairly positive in the US with 76% reporting a positive earnings surprise although only 61% saw a top line (revenue) surprise.
- November's top performing sectors included Finance, Insurance, Communications, and Consumer Non-Cyclicals.
- Despite a continued supportive macroeconomic backdrop and low rates, investors remain worried about a material increase in defaults. Although default rates remain well below long-term averages, there has been a slight uptick from recent lows.
- Manufacturing-related businesses continue to face headwinds. Investors are closely monitoring the impact to service-oriented companies to see if weakness is spreading to other sectors, but for now consumer activity in most developed markets continues to expand, albeit slowly.

Chart of the Month
Economic policy uncertainty reaches peak levels

In these bulletins, we aim to share interesting observations from global investment markets. This month we highlight a chart that looks at uncertainty surrounding economic policy across the globe.

Global uncertainty has reached all-time highs; in fact, it is towering over the levels that followed 9/11, the second Gulf War and the Global Financial Crisis of the previous decade. As economic conditions continue to be fraught with unpredictability, the global and country-specific Economic Policy Uncertainty ('EPU') indices endeavour to track the overall state of the economy. They respond to events like financial crises as well as theatrical geopolitical tensions. The indices, both global and for individual economies, are constructed using content from national newspaper publications that include prescribed keywords. The global index is a GDP-weighted average of national economic policy uncertainty indices across 20 countries, including Australia. As per the chart below, the EPU data for the Global and Australian index tend to be highly correlated.



Source: Economic Policy Uncertainty - Baker, Bloom and Davis (2019)

As China, the US and the Eurozone are some of the largest constituents of the global EPU, they have unsurprisingly moved the index to high levels. Trade tensions between the US and China have placed the market on edge over the last 18 months, contributing to austere conditions in the Eurozone and uneasiness around the rest of the world. Earlier in the year, Americans faced great uncertainty after the US Government shutdown, which sent the index soaring upwards. Since then, focus has been on the trade talks with market participants eagerly waiting to see where this could lead ahead of the 2020 US Presidential Election. Over in the UK, Brexit continues to dominate the political landscape with the prospective outcomes changing almost weekly. UK Prime Minister Boris Johnson has led Britons to a ballot that could lead the UK out of the EU but the possibility of a new referendum is still on the cards.

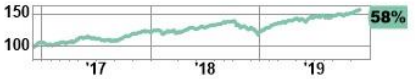
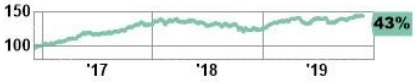
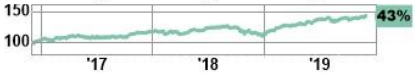
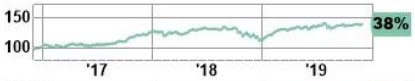
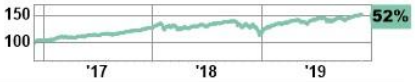
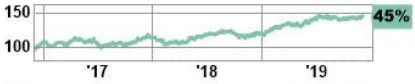
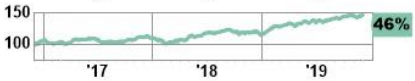
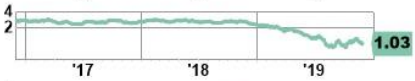
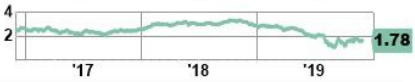
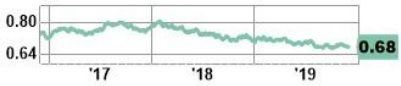
While melodramatic geopolitical tensions can make for great headlines, they do not augur well for economic growth, evident in the reduction in global expansion and diminishing sentiment. The Atlanta Federal Reserve advised that 12% of businesses surveyed had cut or delayed spending and capital investment due to concerns about the precarious economic environment. A US Presidential Election set for late 2020 could provide further uncertainty, encouraging US businesses to remain conservative. On top of trade conflict, China is also juggling issues with the Semi-Autonomous Region of Hong Kong where pro-democratic protests have taken centre-stage this year. As of 30 November 2019, the Hang Seng Index has underperformed MSCI World by 17.6% since demonstrations began late March. The unrest has led to retail sales and tourist arrivals also plunging.

After the recent district council elections saw pro-democracy candidates raking in about 85% of seats, the autonomous state may be heading for more disorder. Accordingly, central banks globally have been responding to the bipolar economic climate with monetary policy changes. Europe and Japan have even gone as far as negative interest rates. Meanwhile, bond yields have been falling and equities have been generally moving higher. These movements lately have been predominantly more reactive to political changes rather than hard economic data, which has been dismal.

Australia, likewise, is facing its own issues. While the June quarter recorded the first current account surplus in 44 years, GDP growth has fallen to its slowest pace since 2009, posting a meagre return of 0.5% for the quarter. Inflation remains low while business investment and household consumption is still subdued. The Reserve Bank of Australia ('RBA') however are among optimists whom believe that the effects on activity from the recent rate cuts and Canberra's tax relief package may be yet to come. Consensus predicts a 21.0% probability of a rate cut by the RBA in December with this number tripling for the first six months of the New Year.

As we can see, uncertainty is climbing and in our globalised world, no one is immune. While times may seem ominous, it looks like we might almost be moving in the right direction for a US-China trade deal. Promisingly, there have been talks of tariff delays, even if negotiations spill into 2020. While Brexit may seem to have an unlimited number of extensions available, an end in 2020 seems to be consensus. The Eurozone however might still need to weather another storm before things improve. For the rest of the world feeling the effects from the side lines, uncertainty just might be the new norm.

MARKET WATCH DATA SHEET

		1 Month Return/Change	3 Month Return/Change	12 Month Return/Change	3 Year Annualised Return/Change	3 Year Chart
EQUITIES						
MSCI World (Gross of withholding tax, in AUD)	3,795.40	4.74%	7.35%	24.36%	16.35%	
MSCI Emerging Markets (AUD)	1,110.16	1.72%	5.70%	16.27%	12.69%	
ASX 200	6,846.00	3.28%	4.80%	25.98%	12.66%	
ASX Small Ordinaries	2,915.90	1.56%	3.68%	16.62%	11.39%	
S&P 500 (USD)	3,140.98	3.63%	7.86%	16.11%	14.88%	
REITs						
ASX 200 A-REIT	1,667.40	2.31%	0.75%	26.97%	13.21%	
FTSE EPRA/NAREIT Developed (AUD)	3,936.25	0.66%	3.42%	24.88%	13.47%	
CASH and FIXED INCOME						
Official Cash Rate Australia	0.75%	0.00%	-0.25%	-0.75%	-	
10-year yield Australia	1.03%	-0.11%	+0.15%	-1.56%	-	
10-year yield US	1.78%	+0.08%	+0.28%	-1.21%	-	
Foreign Exchange						
AUD/USD	0.676	-1.82%	0.39%	-7.37%	-2.90%	

Source: Factset and Bloomberg, at 30 November 2019