Market Watch

First Sentier Investors

Relief as the US and China agree a trade truce

End-December 2019

For adviser use only

Economics overview

- **US**: Arguably the most significant development of the month was the agreement of a 'phase one' trade deal between the US and China.
- Exact details have not been released, but US negotiators had reportedly offered to significantly reduce existing tariffs on ~A$500 billion worth of imports from China. In return, China pledged to buy large quantities of agricultural produce from the US and boost the protection of US intellectual property rights.
- In economic news, employment trends remained encouraging. 266,000 jobs were created in the US in November – the highest monthly number since January 2019. Estimates for the prior month were also increased. As a result, the official unemployment rate ticked down to just 3.5%.
- Most US workers also enjoyed reasonable pay rises in 2019. On average, wages are growing at an annual pace of more than 3%, easily outpacing gains in Australia.
- Stronger employment data was inconsistent with other indicators. Surveys of activity levels in the manufacturing and non-manufacturing sectors, for example, both indicated further weakness.
- The pace of growth in the world's largest economy is undoubtedly tailing off. It will be interesting to see whether further interest rate cuts are required this year. The Federal Funds rate was unchanged in December, but at least one more rate cut is anticipated during 2020.

- **Australia**: GDP data for the September quarter confirmed that growth remains subdued and below long-term averages.
- The Australian economy expanded just 0.4% during the period, which was slightly below expectations.
- October retail sales were worryingly weak too, despite many consumers having additional disposable income following tax cuts and lower mortgage costs. Anecdotal evidence suggests November and December retail sales were subdued as well, though the next official data will not be released until 9 January.
- The job market improved in November from a poor October, with nearly 40,000 new jobs created. Only around one in ten of these roles was full time, however. Employers appear unwilling to increase their full time workforce, perhaps due to the uncertain economic outlook.
- House prices continued to rise – most notably in Sydney and Melbourne – which could help support sentiment in 2020.

- **New Zealand:** Consumer confidence improved quite markedly, rising to its highest level since early 2018.
- According to the latest survey, increasing numbers of households believe they will be better off in the next year. This likely reflects lower mortgage costs and a resurgence in the residential property market.
- The brighter mood has been reflected in consumer behaviour – credit card spending increased 4.5% in the year ending 30 November, supporting retailers and other services companies.
- Business confidence has also improved, to its highest levels since the 2017 general election. Buoyant conditions in the manufacturing sector are prompting employers to consider increasing employment, according to the latest survey.

- **Europe**: The major development came in the UK, where a resounding victory for incumbent Prime Minister Johnson in the general election effectively gave a green light for Brexit to be completed before the revised 31 January deadline.
- Johnson had campaigned with a '*Get Brexit Done*' message, which appeared to resonate with the electorate. The election resulted in the biggest majority in Parliament for more than 30 years.
- The proposed Withdrawal Agreement passed easily with new MPs following the election and is expected to be formally ratified in January.
- Policymakers can then try and address the economic slowdown in the UK. The economy did not grow at all in the three months ending 31 October and industrial production is below levels from a year ago.
- Construction output has also fallen over the past year and inflation is running below target.
- Markets are suggesting there is a ~40% probability that UK interest rates are lowered this year to try and lift activity levels.
- Conditions also remain challenging in Continental Europe. German industrial production is running ~5% below 2018 levels and consumer confidence is at its most subdued in three years.
- In France, consumer spending remains sluggish and inflation is well below target.
- The European Central Bank's asset repurchase program is continuing – at €20 billion per month – to provide support to the ailing economy.

- **Asia/EM:** Like elsewhere, attention was dominated by the 'phase one' trade deal reportedly agreed between Chinese and US officials.
- The hope is that a reduction in tariffs will see export volumes to the US improve – for now, Chinese exports are below levels from a year ago. This has translated into a slowdown in the manufacturing-led economy. Chinese GDP growth has slowed to a 30-year low.
- Domestic demand in China is holding up rather better. Retail sales growth is increasing at an annual pace of 8%, providing important support to overall growth.
- Industrial production also remains subdued in Japan and exports are well down on 2018 levels.
- Elsewhere, Kim Jong-Un, Supreme Leader of the Democratic People's Republic of Korea, hinted the country would step up its missile testing program in 2020.
- The country continues to suffer through severe economic sanctions, but appears determined to develop a nuclear arsenal that the leader believes will force the US to compromise on its hard-line stance.

Australian dollar

- The Australian dollar strengthened quite substantially in December. The currency added 3.8% against the US dollar, 3.0% against the Japanese yen and 2.2% against a trade-weighted basket of international currencies.
- The 'Aussie' is now back around the US$0.70 level, ending the year almost exactly where it started it.

Commodities

- Most commodities finished in positive territory following completion of ‘phase one’ of the US-China trade deal.
- Iron ore (+9.5%) performed well, as Chinese policymakers said they would maintain economic growth in a ‘reasonable range’ in 2020, suggesting policy easing measures and infrastructure spending are likely.
- Oil (Brent +9.2%) tracked higher over the month on US/China trade optimism and falling US stockpiles.
- Precious metals were mostly higher. Gold (+3.7%) found some ‘safe haven’ support, while silver (+6.4%) and platinum (+7.9%) also rose.
- Aluminium (-0.6%), lead (-1.2%) and zinc (-0.8%) were little changed, while copper (+5.2%) posted stronger gains.

Australian equities

- Australian equity markets experienced a near 4% drop in the first week of December as a disappointing third-quarter GDP result and volatile geopolitical news flow saw investors move into ‘risk-off’ mode.
- Subsequent data releases, growing expectations of additional interest rate cuts and progress in trade discussions drove an improvement in sentiment as the month progressed. The S&P/ASX 100 Accumulation Index recovered somewhat to end the month -2.2% lower.
- Rising commodities prices helped push the Materials sector +1.4% higher. Whilst the higher gold price aided Northern Star Resources’ +17.9% rally, it was the announced purchase of Kalgoorlie Lake View, owner of a 50% share in various mines including the ‘Super Pit’ in Kalgoorlie, and positive production news from the Alaska-based Pogo mine that excited investors.
- The Consumer Staples sector was at the other end of the spectrum, declining -8.6% as all constituents dropped lower.
- Winemaker Treasury Wine Estates tumbled -13.2% as data trends indicated that sales continue to lag in the US market, despite higher promotional activity. The continued run of weak wine import data from China placed additional downward pressure on the share price.
- Small companies broke their run of underperformance compared to their large cap peers, with the S&P/ASX Small Ordinaries Accumulation Index falling a modest -0.3%. Small mining companies provided the best returns, with both Syrah Resources and Perseus Mining both surging more than 30%.

Listed property

- Property shares lost ground in the final month of the year, with the S&P/ASX 200 A-REIT Index closing -4.4% lower.
- Returns were behind the broader Australian market in both December and in the full year, but 2019 was nonetheless a pleasing year for investors in the sector. Listed property stocks returned +19.5% over the full 12 months.
- Performance during December was hampered by the disappointing performance of Goodman Group. The stock slumped more than -8% over the month, declining to its lowest level since May and dragging down returns from the Industrial sub-sector.
- The month saw a reasonable amount of transactions and equity raisings – Scentre Group and Charter Hall were among several REITs to make new acquisitions over the month.
- Overseas property stocks eked out modest gains in local currency terms, but returns were negative for Australian investors due to Australian dollar strength.
- Hong Kong was among the best performing international markets, following a few months of subdued performance where social unrest had eroded sentiment.

Global equities

- Global equities established new all-time highs, in local currency terms, towards the end of December as data reads gave increased hope that the global economy might have bottomed and as speculation mounted that a ‘phase one’ trade deal between the US and China was imminent.
- However, the associated rally in the Australian dollar (AUD) more than offset share market gains for local investors; the MSCI World Index dipped -0.9% in AUD terms over the month.
- The US market once again led other bourses in December – with the S&P 500 (+3.0%) just pipping the UK’s FTSE 100 (+2.8%) over the final days in local currency terms. Post-election euphoria in Britain gave way to concerns over the complexities ahead in negotiating a trading relationship with the EU post Brexit and the implications of that uncertainty on the UK economy.
- The Australian market was one of the only developed markets to suffer a negative return over the month. The German market only narrowly missed a similar fate – eking out a meagre +0.1% in local currency terms.
- Having been persistent underperformers for most of 2019, emerging markets came back in the final month of the year with the MSCI Emerging Markets Index rising +3.5% in AUD terms, extending gains to +19.1% in the calendar year.
- Korean stocks enjoyed the strongest bounce in December, with the MSCI Korean index jumping +8.1% in Korean Won – largely on the rising hopes of a US/China trade deal. This helped it to draw away from the single figure laggards of Mexico and South Africa, which only managed +7.2% and +7.6% respectively in local currency terms for the year. Both countries are plagued with a combination of economic and political difficulties.

Global and Australian Fixed Income

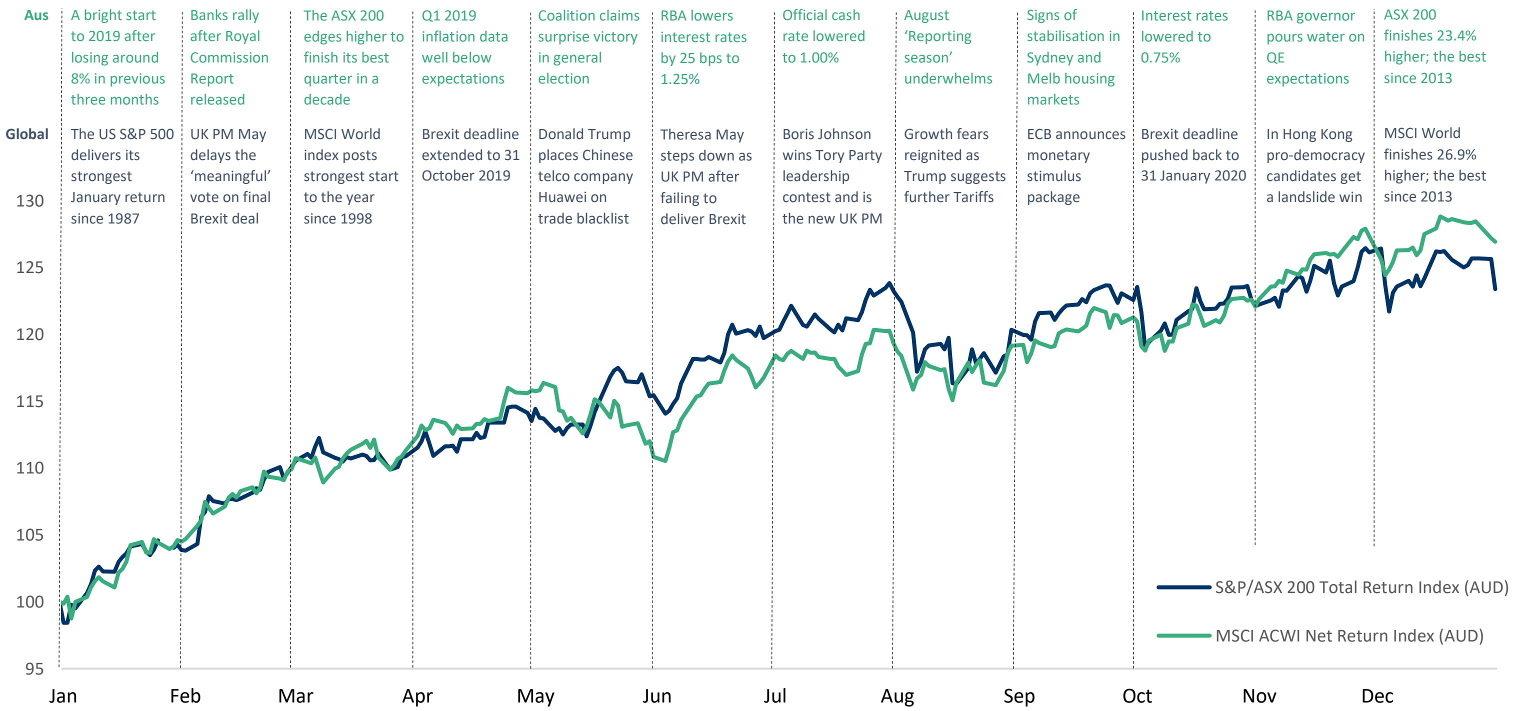
- Government bond yields rose globally, which resulted in negative returns from fixed income securities.
- Among major markets, the moves were most extreme in Australia and Germany – benchmark 10-year yields rose more than 30 basis points in both countries.
- There were no particularly surprising economic data or developments over the month. Instead, sentiment was dominated by the perceived reduction in geopolitical risk.
- Most significantly, the agreement of a trade truce between the US and China could potentially remove – or at least moderate – a meaningful headwind to global growth in 2020.
- An improvement in economic activity levels in the world’s two largest economies would lift global growth forecasts and reduce the likelihood of further interest rate cuts in the year ahead.
- At the same time in Europe, victory for the ruling Conservative Party in the UK general election greatly increased the probability of the Brexit process being completed in early 2020. Again, this would remove an important source of uncertainty for global markets and, potentially, reduce the appeal of global bonds as a relatively stable, defensive asset class.

Global credit

- The general improvement in risk appetite globally was reflected in credit markets.
- Corporate bond spreads narrowed in both the investment grade and high yield sectors, as investors suggested the reduction in geopolitical risk globally would support corporate earnings and help mitigate the risk of defaults.
- Investment grade spreads closed the year below 1%, at their lowest levels for nearly two years. High yield spreads also closed December at their lowest levels for the year.
- Strong performance was seen across the board, with issuers in the US, Europe and Asia all well supported over the month.

Chart of the Month – Saving the best 'til last: local equity market returns in 2019 were the strongest in the past decade

In these bulletins, we aim to share interesting observations from global investment markets. This month we review the year that was for the Australian and international share markets.



Source: Bloomberg, 31 December 2018 to 31 December 2019. Rebased to factor 100 at 31 December 2018.

2019 proved to be a particularly pleasing year for equity investors. Those invested in balanced or multi-sector products benefited too, as these vehicles typically maintain sizeable allocations to Australian and global shares. This was a welcome development, particularly as both Australian and global shares had performed poorly in late 2018.

The prospect of dividend income – and associated franking credits for some local investors – as well as the possibility of capital growth from shares became increasingly attractive as potential income from alternative asset classes decreased. Bond yields declined in almost all major regions during 2019 and reductions to official interest rates meant deposit rates fell too.

In Australia, the S&P/ASX 200 Index climbed more than 18% over the year, hitting all-time record highs during November. The resilience of company profitability meant Australian listed companies were able to maintain reasonable dividend payments to investors. The receipt of these dividend payments boosted the total return from Australian shares to 23.4% over the year, the highest since 2009.

The market paused for breath in May, partly reflecting political uncertainty. There appeared to be some consternation among investors about a possible change in government and potential policy changes that could affect listed companies. In the event, the ruling Coalition claimed a surprise victory in the general election, helping the local share market to resume its upward trajectory.

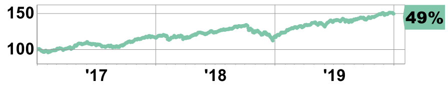
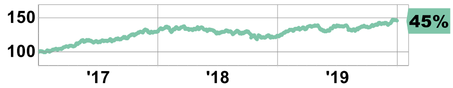
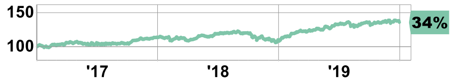
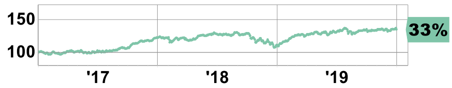
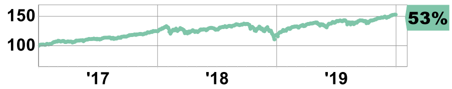
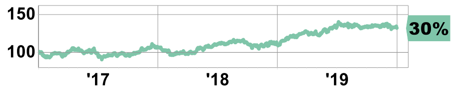
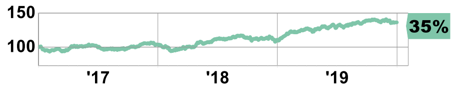
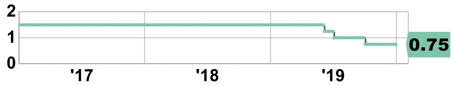
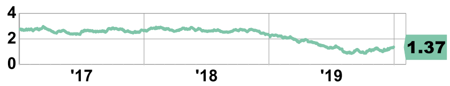
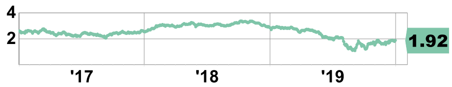
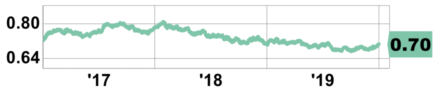
There was a second modest correction during August, when most ASX-listed companies reported their earnings for the 2018/19 financial year ending 30 June. Overall results were lacklustre. In fact, this was the worst August reporting season since 2012 with respect to the extent that both earnings and dividend downgrades outnumbered upgrades. Again though, investors quickly shrugged off the news and continued to support Australian shares for the remainder of the year.

Overseas share markets performed even more strongly in 2019. The MSCI AC World Index – a good gauge of the performance of global equites – added 24.4% in Australian dollar terms over the year. Global shares did not reward investors with quite such generous dividend payments, but distributions nonetheless boosted total returns to 26.9%. This was the strongest annual return since 2013, when a sharp decline in the Australian dollar significantly boosted returns from global shares for local investors.

All major equity regions fared well over the year, though the heavyweight US market outperformed others. Sentiment towards US stocks was buoyed by the release of generally strong corporate earnings. Consumer spending in the US is benefiting from falling mortgage costs, rising wages and record low unemployment. This is supporting profitability for companies in services sectors, which account for around three quarters of the US economy.

Keep an eye on our website during January, as several of our investment teams will be outlining their expectations for the year ahead.

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)	3,757.53	-0.86%	4.27%	28.59%	14.33%	
MSCI Emerging Markets (AUD)	1,144.87	3.47%	7.39%	19.06%	13.10%	
ASX 200	6,684.10	-2.17%	0.68%	23.40%	10.26%	
ASX Small Ordinaries	2,897.70	-0.29%	0.76%	21.36%	9.98%	
S&P 500 (USD)	3,230.78	3.02%	9.07%	31.49%	15.27%	
REITs						
ASX 200 A-REIT	1,568.00	-4.41%	-0.99%	19.36%	9.10%	
FTSE EPRA/NAREIT Developed (AUD)	3,793.71	-3.18%	-2.17%	23.25%	10.40%	
CASH and FIXED INCOME						
Official Cash Rate Australia	0.75%	0.00%	-0.25%	-0.75%	-	
10-year yield Australia	1.37%	+0.34%	+0.35%	-0.95%	-	
10-year yield US	1.92%	+0.14%	+0.26%	-0.76%	-	
Foreign Exchange						
AUD/USD	0.703	3.93%	4.23%	-0.15%	-0.98%	

Source: Factset and Bloomberg, at 31 December 2019

This material has been prepared and issued by First Sentier Investors (Australia) IM Ltd (ABN 89 114 194 311, AFSL 289017) (Author). The Author forms part of First Sentier Investors, a global asset management business. First Sentier Investors is ultimately owned by Mitsubishi UFJ Financial Group, Inc (MUFG), a global financial group.

This material is directed at persons who are professional, sophisticated or 'wholesale clients' (as defined under the Corporations Act 2001 (Cth) (Corporations Act)) and has not been prepared for and is not intended for persons who are 'retail clients' (as defined under the Corporations Act). This material contains general information only. It is not intended to provide you with financial product advice and does not take into account your objectives, financial situation or needs. Before making an investment decision you should consider, with a financial advisor, whether this information is appropriate in light of your investment needs, objectives and financial situation. Any opinions expressed in this material are the opinions of the Author only and are subject to change without notice. Such opinions are not a recommendation to hold, purchase or sell a particular financial product and may not include all of the information needed to make an investment decision in relation to such a financial product.

The product disclosure statement (PDS) and Information Memorandum (IM) for the Colonial First State Wholesale Geared Share Fund, ARSN 087 563 924 (Fund) issued by Colonial First State Investments Limited (ABN 98 002 348 352, AFSL 232468) (CFSIL) should be considered before making an investment decision. The PDS / IM are available on the First Sentier Investors website.

CFSIL is a subsidiary of the Commonwealth Bank of Australia (Bank). First Sentier Investors was acquired by MUFG on 2 August 2019 and is now financially and legally independent from the Bank. The Author, MUFG, the Bank and their respective affiliates do not guarantee the performance of the Fund(s) or the repayment of capital by the Fund(s). Investments in the Fund(s) are not deposits or other liabilities of MUFG, the Bank nor their respective affiliates and investment-type products are subject to investment risk including loss of income and capital invested.

To the extent permitted by law, no liability is accepted by MUFG, the Author, the Bank nor their affiliates for any loss or damage as a result of any reliance on this material. This material contains, or is based upon, information that the Author believes to be accurate and reliable, however neither the Author, MUFG, the Bank nor their respective affiliates offer any warranty that it contains no factual errors. No part of this material may be reproduced or transmitted in any form or by any means without the prior written consent of the Author.