



## RESEARCH UPDATE Market Watch - August '18

Global markets resumed their uptrend in July as the S&P 500 Index increased 3.60% to close at 2,816 points. The Nasdaq rose 2.15% to close at 7,671 points despite giving back early gains following a broad sell off in technology stocks. The S&P/ASX 200 Index (ASX 200) rallied 1.38% to close at 6,280 points.

### S&P/ASX 200 Sector Performance



### Sector Performance

The ASX 200 had mixed sector performance, with Telecommunications the best performing sector rising 7.90% as Telstra Corporation increased 8.40%, recovering some of last month's decline.

The Financials sector rose 2.05% as Westpac Corporation announced they would stop lending to Self-Managed Super Funds and Commonwealth Bank announced it had entered an Enforceable Undertaking with the Australians Securities and Investment Commission regarding the provision of personal advice whilst selling their Essential Super product.

HealthCare was the third best performing sector rising 2.08% with the share price of both Cochlear Limited and CSL Limited breaking through \$200 per share.

The Energy sector rallied 0.87% as Caltex Australia signed a new 15-year fuel supply deal with major supermarket, Woolworths. The decline in the oil price tempered gains in the rest of the sector as new supply from Libya and Saudi Arabia entered the global market.

The Materials sector declined 0.10% as implications of the global trade war on the Chinese economy depressed commodity prices. BHP Billiton Limited rallied 2.80% as it announced the sale of its onshore US oil and gas assets for US\$10.8 billion.

Information Technology declined 1.18% as investor sentiment towards technology stocks began to turn.

The Utilities sector was the worst performing sector declining 1.44% as the Australian Competition and Consumer Commission released draft recommendations to bring down electricity prices, which resulted in AGL Energy Limited declining 2.18%.

### Economic Highlights

**Australia:** Inflation, as measured by the Consumer Price Index (CPI), grew at an annualised rate of 2.1%, the highest rate since the September 2014 quarter. The increase was predominantly driven by the price of automotive fuel (+6.9%), medical and hospital services (+3.1%), and tobacco (+2.8%). The Reserve Bank of Australia (RBA) is targeting a 2-3% inflation range and as it approaches the top of this range the RBA may consider raising interest rates.

The Australian Bureau of Statistics (ABS) released immigration numbers for 2016-17 showing that a record high of 539,000 migrants arrived in Australia, 377,000 people moved interstate and 276,000 moved overseas. Migrants are a key contributor to long-term economic growth in Australia. The table below shows the net migration figures for each State and Territory.

#### Net Overseas Migration - 2016-17(a)

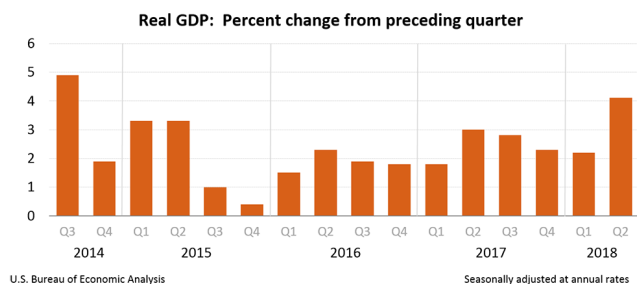
State or Territory	no.	%
NSW	104 478	39.8
VIC	90 009	34.3
QLD	35 199	13.4
SA	11 668	4.4
WA	13 384	5.1
TAS	2 029	0.8
NT	1 748	0.7
ACT	3 964	1.5
<b>Australia(b)</b>	<b>262 489</b>	<b>100.0</b>

(a) Estimates are preliminary  
(b) Includes Other Territories.

Source: ABS – Australia's dynamic population, 2016-17  
Released 27 July 2018.

## Economic Highlights cont.

**United States:** The U.S. Bureau of Economic Analysis reported the American economy grew at an annual rate of 4.1% in the second quarter of 2018, the fastest pace in nearly four years. The increase was predominantly driven by an increase in consumer spending, exports and government spending. The surge in exports has been attributed to farmers rushing shipments of soybeans and other agricultural goods to China before China's trade tariffs took effect on 6 July.



Source: U.S. Bureau of Economic Analysis released 27 July 2018.

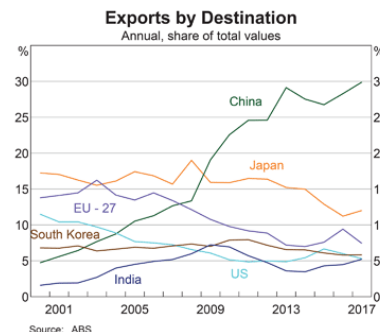
US technology stocks that have been driving the US share market came under selling pressure in July with Facebook, Twitter and Netflix declining 11.2%, 27.0% and 13.8% respectively. On 26 July, Facebook shares posted the largest one-day fall in market value in US stock market history, losing US\$119 billion as the company reported lower than expected sales growth.

**Credit spreads:** Credit spreads on US bonds have begun to widen, which is traditionally an early indicator of an upcoming recession. A 'credit spread' is the difference in yield for bonds with the same maturity but varying quality. When credit spreads tighten, yields on lower quality 'junk bonds' begin to approach that of higher quality 'AAA' bonds. In effect, investors demand less return for the extra risk they are taking on. As part of the expansionary monetary policies following the Global Financial Crisis, many global Central Banks became indiscriminate buyers of bonds, resulting in the tightening of credit spreads. Central Banks are now beginning to wind down these measures which is causing credit spreads to widen.

**China:** China's economic growth slowed in the second quarter of 2018 to 6.7% p.a., the slowest pace in two years. The People's Bank of China injected 50 billion Renminbi into the banking system through a 'Medium-term Lending Facility' which was established in 2014 to provide loans to commercial banks for three or twelve-month periods. The measure is intended to soften the impact of the trade war with the US and follows other previously announced

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stimulatory measures, including the reduction in reserve requirements for major banks. The strength of China's economy is vital to Australia's economic growth as it is the recipient of 30% of Australia's exports.



Source: RBA – Balance of Payments and External Position Chart Pack released 4 July 2018.

### What to watch out for

US President, Donald Trump, tweeted that both China and Europe have been manipulating their currencies as both the Renminbi and Euro have declined significantly against the US dollar since the beginning of the 2018 calendar year. This has raised market concerns that the current trade war may expand into currencies.

Farmers in Australia are beginning to feel the effects of the El Nino weather pattern which has resulted in drought conditions across outback Queensland, South Australia and New South Wales. This is resulting in lower forecast grain and livestock production. The agricultural sector is important to the performance of the Australian economy with beef and wheat together accounting for 3.5% of Australia's total exports in 2017.

We are heading into company earnings season in Australia. Many companies are currently trading on high earnings multiples, especially technology stocks. If results do not meet market expectation, we may see sharp share price corrections.

### Conclusion:

The global trade war continues to dominate headlines but barring any major escalations, market attention is likely to shift to individual company performance in the short term, as we enter reporting season. Strong economic growth, tightening labour markets and high commodity prices are beginning to feed through into inflation. This has increased the chance of the RBA lifting interest rates, which continues to be a major risk to both the economy and asset prices over the longer term.