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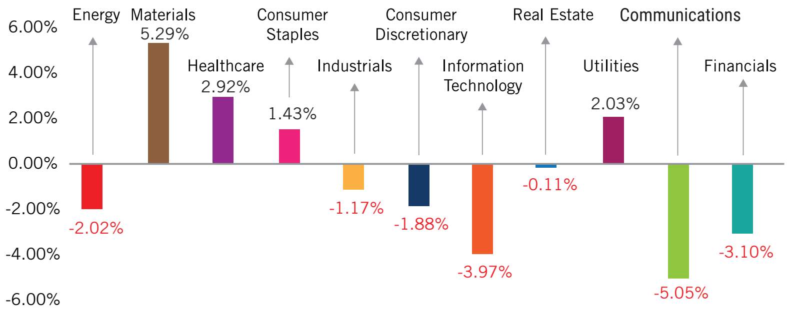
RESEARCH UPDATE

Market Watch - January 2019

International markets accelerated their decline in December, with the S&P500 Index falling 9.18% to close at 2,506 points and the Nasdaq declining 8.91% to close at 6,329 points. The S&P/ASX 200 Index (ASX 200) declined 0.37% to close at 5,646 points.

S&P/ASX 200 Sector Performance

Data source: Bell Potter, 3 December 2018



Sector Performance

The ASX 200 saw mixed sector performance, with the Materials sector the strongest performer rising 5.29%. The increase was primarily driven by BHP Group which rose 11.53% after the completion of an off-market share buyback and the announcement of a US$1.02 per share special dividend.

Healthcare was the second best performing sector rising 2.92%, despite Mayne Pharma Limited which fell 20.92% following its Annual General Meeting. Sonic HealthCare Limited declined 3.03% after it announced a capital raising to fund the acquisition of a US pathology provider.

The Utilities sector increased 2.03%, driven by AGL Energy Limited which rose 9.52% after announcing the appointment of a new Chief Executive Officer.

Consumer Staples increased 1.43%, as investors looked to gain exposure to more defensive companies as market volatility increased. Coca-Cola Amatil Limited fell 5.21% after it announced it had been impacted by the introduction of container deposit schemes in NSW, ACT and QLD, poor market conditions in Indonesia as well as operational issues in Papua New Guinea and the SPC fruit-canning division.

Financials declined 3.10%, primarily driven by the listed funds managers with Platinum Asset Management, Magellan Financial Group and Pendal Group declining by 10.17%, 9.77% and 5.79% respectively.

The Communications Sector was the worst performer, declining 5.05% driven by TPG Telecom Limited, which fell 10.43% as the Australian Competition and Consumer Commission released an announcement that it had concerns around the proposed merger with Vodafone Hutchison Telecommunications.

Economic Highlights

Australia: The economy grew at 0.3% in the 2018 September quarter, which was below market expectations and the weakest quarterly growth in two years. The main drivers were slowing growth in household disposable income and a fall in discretionary spending, which offset increased food, rent and transport spend. The infrastructure, health care and social assistance sectors continued to experience strong growth, supported by ongoing government expenditure.

The Reserve Bank of Australia (RBA) left the interest rates on hold at 1.5% in December, with the last official move 28 months ago in August 2016. RBA Governor, Phillip Lowe, pointed to increased uncertainty on household consumption due to concerns around the impact of declining asset prices, high debt levels and the drought conditions in outback Australia.

The current account deficit decreased by $1.37 billion to $10.7 billion in the September quarter, driven by an increase in goods and services exports, predominantly mineral fuels and natural gas exports, which was partially offset by a rise in the import of goods and services.

According to the Australian Bureau of Statistics, the fertility rate of Australian women aged 35 years and over continues to rise with most other age groups declining. In the past 30

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years, the fertility rate of women aged 35 to 39 has more than doubled, and for women aged 40 to 44, it has tripled. Australia recorded a total fertility rate of 1.74 babies per woman in 2018, the lowest level since 2001 and below the replacement level of 2.

The Clean Energy Council reported continued growth in large-scale renewable energy projects in 2018, despite the uncertainty around Federal Government policy. State and Territory governments continue to invest large amounts in new projects to reach their individual renewable energy targets. The strong growth has created a number of industry problems, with large contractor RCR Tomlinson experiencing cost blowouts on a number of large projects, which led to it entering administration in December. Solar energy retailers also reported a shortage of qualified electricians and installers, as demand for household rooftop solar continues to rise. Globally, clean energy investment reached US$333.5 billion in 2018, driven by China and the US, which spent US$136.2 billion and US$56.9 billion, respectively. This offset a fall in Europe, driven by uncertain sound policy support.

Source: Clean Energy Australia 2018 Report, Clean Energy Council, December 2018.

US: The Federal Open Market Committee raised the Federal Funds Rate to 2.25 - 2.50%, as the low unemployment rate and strong economic growth continued. Household spending grew strongly, which offset slowing growth in business fixed investment.

China: Leading American technology company, Apple Inc, reported a sharp decline in iPhone sales. The decline was attributed almost entirely to China sparking fears with the slowdown in China's economy being more severe than expected. The likely cause was the impact of the ongoing trade tensions between China and the United States.

What to watch out for

CommSec reported that December new car sales totalled 87,528, a decline of 14.9% on the prior corresponding period. The decline has been attributed to tightening credit conditions and the negative wealth effect created by the decline in Sydney and Melbourne house prices. The wealth effect is where households increase or decrease their spending in response to fluctuation in asset prices. The wealth effect may begin to impact other sectors, especially those that are more exposed to discretionary spending.

The UK Parliament is due to vote on the proposed conditions surrounding the exit of the UK from the European Union (EU) on 15th January. The UK is scheduled to leave the EU on 29th March 2019, with investors concerned that the failure to reach an agreement will lead to a disorderly exit.

The US Government is currently in 'shutdown' over a dispute between the two political parties around funding for the border wall with Mexico. The shutdown means several US Federal Government departments do not have funding which is impacting services and the payment of employee wages. If the shutdown continues for an extended period, it may begin to impact the wider US economy.

Conclusion

Financial markets are continuing to experience increased volatility, as global interest rates rise, and concerns are raised around a slowdown in global economic growth. The key concerns for the market are the US Government shutdown, Britain's exit from the European Union, the ongoing US-China trade war, and the slowing housing market in Australia. These issues are likely to continue for some time, leading to large fluctuations in asset prices.

Sydney • Melbourne • Geelong
1800 801 277
aptwealth.com.au
info@aptwealth.com.au