



RESEARCH UPDATE

Market Watch - July 2019

The S&P/ASX 200 Index rose for the sixth straight month, up 3.4% to close at 6,619 points in June. The increase in the Australian equity market follows the Reserve Bank of Australia's (RBA) decision to cut interest rates by 0.25% to a new record low of 1.25%, the first change in the RBA's policy setting since August 2016.

The theme of lower interest rates flowed through in the US, with market forecasts expecting the Federal Reserve's next move will be to cut to US interest rates given slowing growth. The S&P 500 Index, Dow Jones Industrial Average, and Nasdaq Composite Index all posted positive returns, with the S&P 500 Index rising 6.9%, the best June performance since 1955.

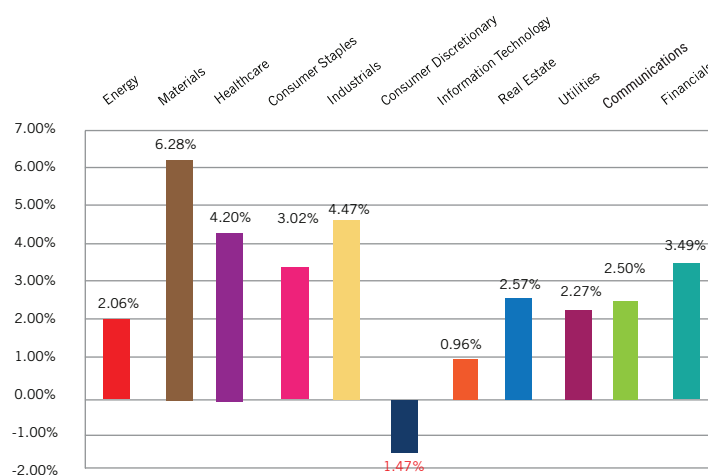
Sector Performance

All sectors posted positive results during June with the exception of Consumer Discretionary, which was the worst performing sector, down 1.47% for the month. The underperformance of the Consumer Discretionary sector was driven by disappointing earnings updates from Wesfarmers (-2.4%), which has been impacted by its Kmart and Target businesses, and Star Entertainment Group (-8.3%), which has been impacted by continued weakness in international VIP spending.

Materials was the best performing sector, increasing 6.3%, driven by gold stocks, (Northern Star +20.0%, Newcrest Mining +17.4% and Evolution Mining +12.7%), as investors hedged against the continued trade conflict between the US and China and further potential central bank easing.

Industrials was the second-best performer, rising 4.5%, driven by 'bond proxy' stocks as Australian 10-year bond yields continued to decline from 1.48% to 1.34%. Transport infrastructure stocks led the outperformance, with Atlas Arteria Group increasing 10.8%, Sydney Airport rising 8.5% and Transurban Group up 5.8%.

Graph 1: S&P/ASX 200 Sector Performance



Data Source: Bell Potter, 1 July 2019.

Healthcare also outperformed, up 4.2%. Nanosonics share price rose 24.9% due to a change in its distribution with GE Healthcare, which is expected to result in a significant uplift in earnings, and the announcement that a new product will be released in mid-2020.

Financials slightly outperformed during the month, up 3.5%, as investors continued to search for yield following the RBA's decision to cut interest rates. However, not all Financial stocks benefited from the cut. Challenger's share price declined 17.7% after downgrading its net profit before tax guidance for the 2020 financial year by 8-9%.

The downgrade was driven by a change in its annuity assumptions as the long-term growth rate for equities was reduced and the disruption to the sale of annuities through its primary financial adviser distribution channels following the Royal Commission.

Consumer Staples increased 3.02% driven by Coca-Cola Amatil (+7.24%), Coles Group (7.23%) and Woolworths Group Limited (WOW). Coca-Cola Amatil announced that the SPC fruit and vegetable processing business will be sold for \$40 million. Coles Group held its annual investor day, announcing a \$1 billion cost out program and reiterating that it will maintain the dividend payout ratio of 80-90%.

Woolworths announced that it has formed a five-year strategic partnership with Marley Spoon, a global subscription-based meal kit provider, and Woolworths will own approximately 9% of Marley Spoon.

Communications and Utilities underperformed the overall market, up 2.5% and 2.3%, respectively. The Communications sector was impacted by Vocus Group Limited, which declined 29.4% after the takeover bid from AGL Energy disappeared.



Photo from Marley Spoon

Highlights

Australia: The Reserve Bank of Australia (RBA) reduced the cash rate by 25 basis points to 1.25% in order to support employment growth and increase confidence to stimulate inflation. The market is expecting further interest rate cuts in the second half of 2019.

The South Australian (SA) Government has marketed a \$500 million bond offering priced off the 'RBA Interbank Overnight Cash Rate' instead of the standard 'Bank Bill Swap Rate'. If successful, this will be a change and possibly more cost-effective funding option for Australian State Governments.

The SA energy and mining minister has announced it is expected SA will be 'net' 100% renewable energy by 2030. This is despite the switch from a Labor to Liberal Government in the recent election.

The Federal Court of Australia has issued an order for Telstra, Optus, TPG Telecom, Vodafone Hutchison and Vocus Group to block 76 website domains that are associated with piracy and copywrite infringement. The order was a result of a court case bought by Village Roadshow.

Oil: Volatility in the oil price continued after Iran was accused of sabotaging another two oil tankers by both Saudi Arabia and the US. The sabotage is believed to have followed retaliation for US sanctions imposed on Iran after the US unilaterally exited a 2015 nuclear deal and imposed new sanctions on Iranian exports, which crippled Iran's economy.



Photo from Japan Times

Norway: The world's largest sovereign wealth fund, Norway's US\$1 trillion 'Government Pension Fund' will divest more of its investments that are involved in coal and oil exploration or production following a Norway Parliamentary ruling. The holdings are expected to be worth US\$1 billion and include Australian companies BHP Group, South32 and AGL Energy.

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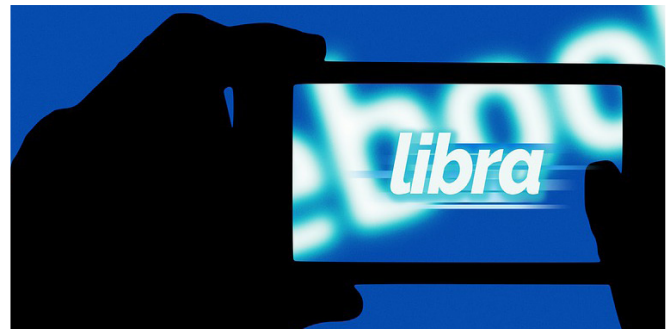
Trade War: India has imposed higher customs duties on 28 US products, including chickpeas, phosphoric acid, apples, almonds and walnuts as a retaliation against US President Donald Trump's decision to end trade concessions of US\$5.7 billion on goods India ships to the US.

Spain: The Spanish football league, 'La Liga', used its mobile app to listen to fans through the mobile's microphone to identify bars illegally streaming games. Spain's data protection agency fined the league €250,000 for violating EU data privacy and transparency laws, despite the application 'terms of service' allowing the app to use the phone to detect fraudulent behaviour like pirated games. The league intends to appeal the decision.

New Technology: British life insurance software company, 'UnderwriteMe', is disrupting the life insurance and actuary market. The software has enabled financial advisers to complete pre-assessment, prepare quotes and complete applications in less than 30 minutes. The software is used by most of the market in Britain and has launched in Australia and has already won five new clients including MLC, CommInsure and NEOS.

Podcasts are simply digital audio files that consumers can download or stream. The increasing popularity has been driven by new technologies, such as internet connected cars, smart phones, smart cars and Bluetooth headphones, which have improved accessibility. The increased usage is attracting investment as the content medium matures and disrupts both the traditional music and media industries.

Facebook will launch a new cryptocurrency called 'Libra.' Libra will be launched with the intention to create a viable, trusted and stable digital currency. The 'Libra Tokens' will be backed by capital stable 'real assets' including bank deposits, short-term government securities and currencies from trusted Central Banks, such as Japan and America.



What to watch out for

Speculation that the US Federal Reserve will cut interest rates in the second half of 2019 has increased, as the ongoing trade war begins to impact the economy and economic growth begins to slow.

The iron ore price has been rallying as the world's third largest producer, Vale, suspended operations in several mines after a dam collapse. Vale has announced it will now restart operations, which will increase supply and reduce prices. The high iron ore price has benefited Australian companies BHP Group, Rio Tinto and Fortescue Metals Group, as well as the Federal Budget, as it is Australia's largest export.

Conclusion

Markets have rallied strongly in 2019 and have recovered most of the losses incurred at the end of 2018. Global growth appears to be slowing, which is causing Central Banks to reassess the rate of interest rate increases and consider stimulatory measures if the slow down accelerates. The Federal Budget and the Federal Election will likely dominate headlines in Australia.

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