



RESEARCH UPDATE

Market Watch - June 2019

The Australian Federal Election sparked a mid-month rally in May with the S&P/ASX 200 Index rising 1.13% to close at 6,396 points, outperforming international markets. The S&P 500 (US), Nasdaq Composite (US), and the Shanghai Composite (China), fell by 6.58%, 7.93% and 6.08% respectively as trade war concerns escalated.

Sector Performance

Communications was the best performing sector, increasing by 7.32% driven by Telstra Corporation, which rallied 7.99% after it announced it would bring forward a \$200 million restructuring charge which will reduce ongoing operating costs. The Australian Competition and Consumer Commission (ACCC) blocked the merger of TPG Telecom (-6.68%) and Hutchison Telecommunications (-23.53%) on competition concerns. Both companies will appeal the decision in the Federal Court.

Healthcare was the second-best performing sector increasing by 3.27%. InvoCare Limited increased by 2.09% after it announced that the number of deaths appeared to be returning to trend after two abnormal years.

The Materials sector increased by 3.10% driven by rare-earth mining company, Lynas Corporation, which rallied 54.04% after the media reported that China has plans to restrict rare earths exports to the US if the trade war escalates.

The Consumer Discretionary sector rallied 1.78% as Wesfarmers Limited increased 2.89% after announcing that, subject to shareholder approval, it would acquire lithium miner Kidman Resources (+24.17%) for \$776 million.

Financials increased 0.85% as Australia and New Zealand Banking Group (+2.50%), Westpac Banking Corporation (-0.25%) and National Australia Bank (+4.50%) traded ex-dividend. AMP Limited fell 4.41% as the NSW Supreme Court announced only one of five pending class actions for the 'fees for no service scandal' would proceed after law firms Slater & Gordon and Maurice Blackburn agreed to consolidate their claim.

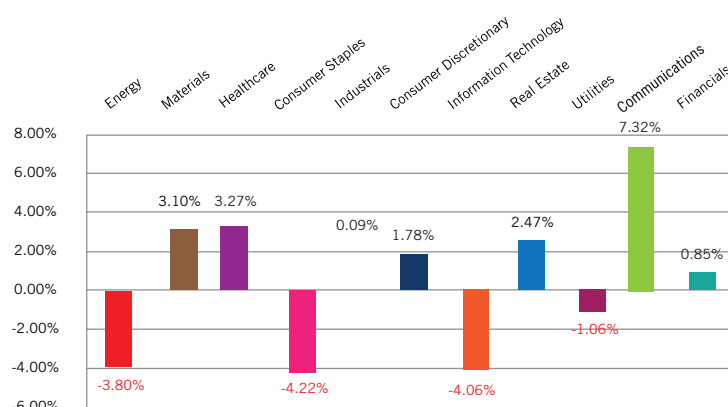
Health insurers Medibank Private and NIB Holdings rallied 15.73% and 19.13% respectively after the election of the Liberal-National Coalition government which removed the near-term possibility of a cap on private health insurance premium increases.

The Industrials sector was flat for the month. At a strategy day Qantas Airways (-1.07%) said it had begun preparing for new ultra-long-range aircrafts that would enable direct flights from Sydney to London and New York. Sydney Airport declined 2.76% after announcing there had been a year on year decline in passenger numbers and that it had issued a \$1.4 billion 'sustainability linked loans' whereby the interest margin will fluctuate depending on whether sustainability performance targets are met.

Utilities decreased 1.06% driven by AGL Energy which fell 7.56% despite announcing it had entered into a new Gas Supply Agreement with BHP Group for the supply of an additional 78 petajoules of gas for Victorian and New South Wales gas customers.

Consumer Staples was the worst performing sector decreasing by 4.22% driven by Costa Group which fell 30.34% after it downgraded previous earnings guidance.

Graph 1: S&P/ASX 200 Sector Performance



Data Source: Bell Potter, 3 June 2019.

Highlights

Australia: The Australian Bureau of Statistics (ABS) reported that the April unemployment rate remained at 5.1%. Reserve Bank (RBA) Governor, Philip Lowe, stated that the RBA board had reached an agreement that inflation would not rise back to the 2%-3% target range unless unemployment fell. This statement and the reported ABS unemployment data has raised economist expectations that the RBA will cut interest rates by 0.25% in June followed by a second and possibly third cut later in the calendar year.

The Australian Prudential Regulation Authority (APRA) has proposed removing a regulation that required lenders to assess borrowers at a minimum 7% serviceability threshold. Instead, lenders would be able to set their own serviceability requirements with a suggested buffer of 2.5% above the rate offered to the borrower.

The re-election of the Liberal-National Coalition government has removed the prospects of near-term alterations to the current Capital Gains Tax, negative gearing and franking credit policies.



Online fashion retailer 'The Iconic' has received an \$18 million capital injection from its European parent, Global Fashion Group, after reporting losses of \$18.3 million in 2018. It is aiming to breakeven at the EBITDA level in 2019 after doubling its market share and taking sales from traditional retailers such as Myer, David Jones and Premier Investments. The Iconic has accumulated losses of \$170.8 million since establishing in Australia 8 years ago and is expanding its private-label sales and developing technology to personalise offers for customers.

The ACCC has alleged misleading conduct by online retailer Kogan.com Limited for offering 'false discounts' in June 2018 where it raised retail prices by 10% a few days before marketing a 10% limited time sale to consumers.

United Kingdom (UK): The UK appears no closer to achieving an orderly exit from the European Union after Prime Minister Theresa May announced she would resign on June 7. After recent negotiations, the UK is now expected to leave the European Union on 31 October 2019 unless a further extension is negotiated.

Trade War: The US has raised tariffs on \$200 billion of Chinese imports with China quickly retaliating by increasing tariffs from 4% to 25% on \$US60 billion worth of US imports. The US has also prepared a US\$20 billion aid package for farmers to offset US farmer losses from the trade war.

The US has also raised sanctions on Chinese technology company, Huawei Technologies, which has resulted in US technology company Google blocking access to further Android operating system updates and computer chip manufacturers Intel, Qualcomm, Xilinx and Broadcom stopping any further supply. The US is pressuring partner intelligence countries, including Australia, to ban the use of Huawei technology in their 5G telecommunication upgrades over security concerns. Observers say Chinese countermeasures could include encouraging consumer boycott of US goods, such as Apple and Microsoft products.

New Zealand: Major supermarkets have announced they will phase out the sale of caged eggs by 2027. This will force the industry to transition to barn and free-range eggs that has led some in the industry to predict a shortage of eggs for consumers.

US Technology Companies: Amazon has announced it will pay its US part-time and full-time employees US\$10,000 and 3-months' salary to leave Amazon and establish their own package delivery business. Amazon will provide access to technology, training and discounts including Amazon branded vans, uniforms and insurance as Amazon looks to continue to develop delivery capabilities as ecommerce continues to grow. Amazon also announced investments in Aurora a self-driving start-up, Rivian an electric vehicle manufacturer, as well as leading a \$575 million investment in UK food delivery company Deliveroo.

Google employees claim search engine data analytics signalled a Liberal Government win on the morning of the Australian Federal Elections after search results for the Liberal government outstripped Labor by 20%. This was consistent with overseas elections as back testing showed it predicted every US president since 2004 and Australian elections since 2010. The claim was in response to local opinion polling leading into the Election which predicted a landslide Labor Government win.

Facebook paid US\$19 billion for popular messaging service WhatsApp in 2014 and has announced they will now begin monetising the service by offering in-app advertising.



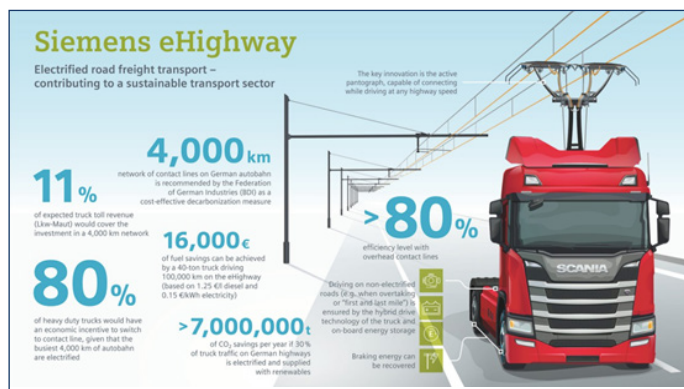
Ride sharing company Uber Technologies has launched a submarine service in Queensland called scUber which offers a Great Barrier Reef experience for \$3,000. Customers order through the Uber app and the experience includes pickup and drop off, a helicopter ride and a one-hour scUber submarine and half-day snorkel and tour of the Great Barrier Reef.

US online real estate company Zillow Group Inc, which offers a similar service to realestate.com.au and domain.com.au in Australia, has begun offering 'iBuying.' iBuying is where a company purchases the property from the vendor for a discounted upfront payment.

The offer price is determined by internal data analytics from the platform. The property is then listed, marketed and sold through the website. If successful a similar service could be introduced in Australia.

National Australia Bank announced it will become the third major bank to offer Apple's mobile payment service 'Apple Pay' after Commonwealth Bank of Australia earlier in the year and Australia and New Zealand Banking Group in 2016.

Germany: The German government has partnered with German automation company, Siemens, to electrify a 6 mile stretch of highway at a cost of €14 million. The German Government has also invested €7 million developing a truck with Scania and Volkswagen which is able to recharge the onboard electric battery whilst driving and is one of the first government infrastructure projects to prepare for transport electrification. The truck is expected to have lower operating costs and reduced carbon emissions with the trial scheduled to run until 2022.



Data Source: 'eHighway – electrification of road freight transport', Products and Services, Siemens, 3 June 2019

A second case against German company, Bayer, involving the glyphosate-based product Roundup has resulted in a Californian court awarding US\$2 billion to a US couple. The jury found Roundup had been defectively designed and that the company failed to warn consumers of the herbicide's cancer risk and that the company acted negligently.



Bayer faces more than 13,400 US lawsuits over the herbicide's alleged cancer risk. Roundup has been used in Australia for a number of decades and is distributed by Australian company Nufarm Limited.

What to watch out for

Australian residential property price declines could slow or reverse with the removal of the possibility of changes to negative gearing, Capital Gains Tax and the introduction of a new First Home Buyer Scheme. Expected interest rate cuts and, APRA's repeal of caps on investor loans, as well as personal income tax cuts, should also improve borrower loan serviceability.

The oil price is being driven by both supply and demand factors. Supply concerns have arisen as the US government did not extend sanction exemptions for 8 countries for the import of Iranian oil after Iran was alleged to have sabotaged two oil tankers transporting Saudi Arabian oil. This is being offset by concerns around slowing global economic growth which is expected to impact demand.

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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