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WEALTH PARTNERS

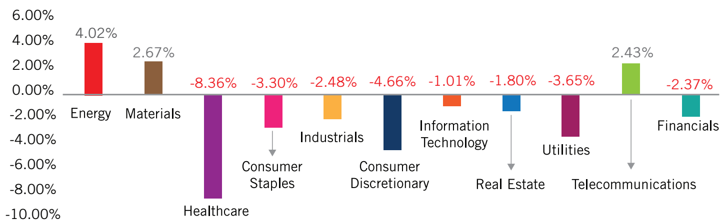
RESEARCH UPDATE

Market Watch - October '18

In September, the S&P500 Index increased 0.43% to close at 2,914 points, surpassing the previous high set in January 2018. The Shanghai 100 Composite recovered some of this year's losses rallying 3.53% to close at 2,821 points, whilst the Japanese Nikkei 225 was the region's best performer, increasing 5.49% to close at 24,120 points. The S&P/ASX 200 Index underperformed global indices declining 1.77% to close at 6,207 points.

S&P/ASX 200 Sector Performance

Data source: Bell Potter, 2 October 2018



Sector Performance

Energy was the best performing sector, rising 4.02% driven by a Santos Limited which increased 7.08% after it announced it would double annual production to 100 million barrels of oil equivalent by 2025.

The Materials sector rose 2.67% driven by Rio Tinto Limited which rallied 8.28% after it announced a $3.2 billion share buyback programme. BHP Billiton rose 4.28% after it stated it intended to return to shareholders the US$10.8 billion it received from the sale of US shale oil assets.

Financials declined 2.37% as investors considered the impact the Royal Commission into the Financial Services Industry would have on the sector following the release of the interim report.

The Real Estate sector declined 1.80% despite the ongoing bidding war from two overseas buyers for Investa Office Fund which saw its unit price increase 3.56%.

Industrials decreased 2.84% driven by Transurban Group which declined 6.97% after it completed a capital raising to fund the acquisition of Sydney's WestConnex.

Consumer Discretionary was the second worst performing sector, declining 3.30%. Harvey Norman declined 2.22% after it announced a capital raising to reduce outstanding debt and G8 Education declined 2.91% after announcing earnings would be impacted by an oversupply of child care centres and recent regulatory changes.

Healthcare was the worst performing sector declining 8.36% as profit taking saw CSL Limited and Cochlear Limited decrease by 11.53% and 7.03% respectively.

Economic Highlights

Australia: The Australian Federal Treasury released the Final Budget Outcome 2017-18 which saw a budget deficit of $10.1 billion for the 2017/18 Financial Year, better than the $18.2 billion deficit forecast in the May 2018 Budget. The better than expected numbers was a result of higher than anticipated tax receipts from income taxes, superannuation taxes and lower aged pension payments, NDIS payments and the delay in funding State led infrastructure projects. The budget also benefited from higher than anticipated commodity prices and a strong labour market which resulted in lower social security payments. Total government debt stood at $342 billion at the end of June 2018, equivalent to 18.6% of Australia's Gross Domestic Product (GDP).

According to the Australian Bureau of Statistics (ABS) Australia's unemployment rate decreased 0.1% on the prior month to 5.3% in August. Job vacancies also increased to

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240,900 in August 2018, the highest on record, largely driven by the private sector which saw vacancies increase 20.3% on the prior corresponding period. This will likely lead to further falls in the unemployment rate and wage growth in future periods.

The House of Representatives’ Standing Committee on Economics will conduct an inquiry into the implications of removing refundable franking credits. The inquiry follows the Labor Party’s proposal to remove the cash rebate for excess dividend imputation credits for some investors if they form government at the next Federal election.

Rider Levett Bucknall (RLB) released the RLB Crane Index for third quarter 2018 which saw the number of cranes across Australia reach a record high of 735 driven largely by the State and Federal infrastructure projects. The number of cranes is used as a proxy for the level of construction activity in Australia, a key driver of economic growth. Regionally Melbourne saw the largest increase of 35 and Sydney saw the largest decrease of 21 on the prior quarter. The number of cranes reached a peak in Sydney in 3Q 2017 and has been steadily declining since. By sector, the largest increase by absolute number was in the residential, health and civil sectors, whilst the hotel sector saw the largest decrease.

CRANE ACTIVITY – AUSTRALIA BY KEY CITIES

	OPENING COUNT		MOVEMENT			CLOSING COUNT	
	Q2 2018	%	+	-	NET	Q3 2018	%
ADELAIDE	15	2.2%	6	-5	1	16	2.2%
BRISBANE	67	9.8%	47	-42	5	72	9.8%
CANBERRA	17	2.5%	14	-8	6	23	3.1%
CENTRAL COAST	3	0.4%	16	-1	15	18	2.4%
DARWIN	0	0.0%	0	0	0	0	0.0%
GOLD COAST	23	3.4%	9	-8	1	24	3.3%
HOBART	5	0.7%	0	-1	-1	4	0.5%
MELBOURNE	157	23.0%	125	-90	35	192	26.1%
NEWCASTLE	11	1.6%	3	-2	1	12	1.6%
PERTH	33	4.8%	15	-11	4	37	5.0%
SUNSHINE COAST	10	1.5%	11	-5	6	16	2.2%
SYDNEY	342	50.1%	191	-212	-21	321	43.7%
TOTAL	**683**	**100.0%**	**437**	**-385**	**52**	**735**	**100.0%**

CRANE ACTIVITY – AUSTRALIA BY SECTOR

	OPENING COUNT		MOVEMENT			CLOSING COUNT	
	Q2 2018	%	+	-	NET	Q3 2018	%
CIVIC	3	0.4%	2	0	2	5	0.7%
CIVIL	15	2.2%	19	-9	10	25	3.4%
COMMERCIAL	54	7.9%	25	-19	6	60	8.2%
EDUCATION	14	2.0%	6	-8	-2	12	1.6%
HEALTH	14	2.0%	14	-5	9	23	3.1%
HOTEL	30	4.4%	7	-23	-16	14	1.9%
MIXED USE	39	5.7%	28	-22	6	45	6.1%
RECREATION	6	0.9%	2	-2	0	6	0.8%
RESIDENTIAL	491	71.9%	327	-290	37	528	71.8%
RETAIL	17	2.5%	7	-7	0	17	2.3%
TOTAL	**683**	**100.0%**	**437**	**-385**	**52**	**735**	**100.0%**


Photo by PhotoMIX Ltd

The Banking Royal Commission interim report was released with four key issues identified.

1. **Access:** do all Australians have adequate and appropriate access to banking services?
2. **Intermediaries:** for whom do the different intermediaries (mortgage brokers/aggregators, introducers, financial advisers) act and who are they responsible to?
3. **Responsible Lending:** should the regulation around lending be changed?
4. **Regulation and the Regulators:** has the regulators identification and response to misconduct been appropriate?

The final report which will provide recommendations to address these issues will be released in February 2019.

US: The Federal Open Market Committee (FOMC) raised interest rates by 0.25%, to a target benchmark between 2% and 2.25% citing continued strength in the labour market, rising economy activity and inflation (exclusive of food and energy) near 2%. The FOMC is likely to continue tightening monetary policy with quarterly 0.25% increases expected through the remainder of 2018 and 2019. Australian banks fund a large portion of their lending with wholesale funding which is sourced from the US. As US interest rates rise, this will increase the cost of wholesale funding and may lead to further out of cycle mortgage rate increases in Australia.


Photo by Michael Vadon

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Trade war: The US implemented a 10% tariff on $200 billion of Chinese products on 24 September 2018 which is set to increase to 25% on January 1, 2019. This is in addition to the 25% tariff on $50 billion of goods implemented in July. A de-escalation appears some way off with China rejecting an invitation from the US to restart trade negotiations. China appears to be responding by softening its stance on trade with other countries/regions with the current focus on the European Union, whilst the US has entered into a new free trade agreement with Mexico and Canada.

Emerging Markets: Emerging markets such as Argentina, Turkey and Brazil have high levels of foreign debt predominantly denominated in US dollars. Rising US interest rates and an appreciating US dollar has made it costlier to service debt which has impacted local economies.

What to watch out for

Oil prices have continued to rally as strong demand and falling inventory levels created concerns around global supply. The reintroduction of US economic sanctions on Iran, a major oil producer, and the refusal of the US to tap into their Strategies Petroleum Reserve has also supported higher prices. This is impacting Asian and Emerging Market economies, in particular as they have also seen a steep depreciation in their currencies. The affects are also being felt in Australia with retail petrol prices hitting multi-year highs.

The next generation mobile network, '5G' is expected to be rolled out in 2019. This is likely to have a transformative impact on a number of businesses as an increasing number of machines and appliances become internet enabled. An example is wireless software updates for cars, which will become increasingly important as driverless cars become readily available.

The major political parties are beginning to release polices as we head into the Federal Election which is due to be called before May 2019. This may impact individual sectors with the recent announcement of a Royal Commission into the aged care sector resulting in large share price decreases for ASX listed operators. Areas such as international technology companies operating in Australia such as Google and Facebook as well as the energy and healthcare sectors are also likely targets.

Conclusion

Emerging markets have been impacted by the high oil price, ongoing trade disputes, rising global interest rates and an appreciating US dollar. In developed markets, Central Banks continue to tighten monetary policy as inflation approaches target ranges and economic growth improves. In the short term, the Australian financial services sector following the release of the Royal Commission's interim report and political policy leading into the next Federal Election are likely to be the key areas of focus for the local market.

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