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WEALTH PARTNERS

RESEARCH UPDATE

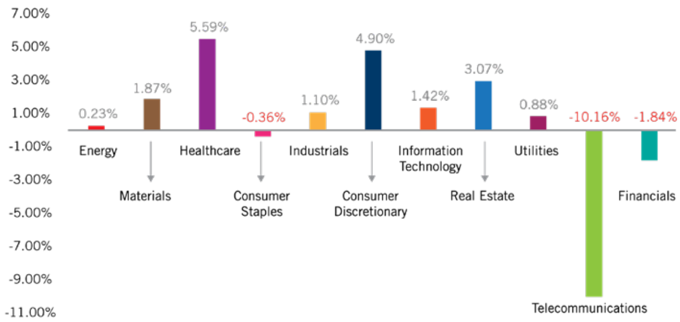
Market Watch - June ‘18

Global markets rallied in May, shrugging off political uncertainty in Italy and increased trade tensions between the US and its biggest trading partners. The S&P 500 Index rose 2.16% to close at 2,705 points and the Nasdaq, which is dominated by the largest US technology companies, rallied 5.32% to close at 7,554 points.

The S&P/ASX 200 Index (ASX 200) underperformed global indices despite a strong rally early in the month, rising 0.48% to close at 6,012 points.

S&P/ASX 200 Sector Performance

Data source: Bell Potter, 4 June 2018



Sector Performance

Telecommunications was the worst performing sector declining 10.16%, predominantly driven by Telstra which declined 13.6% following a credit rating downgrade from rating house Standard and Poor’s and updated profit guidance, which disappointed the market.

The Financials Index declined 1.84% as Westpac Corporation, ANZ Banking Group and National Australia Bank all traded ex-dividend. The Royal Commission into the banking sector continued with the focus shifting to the treatment of small business owners, which continued to impact sentiment in the sector.

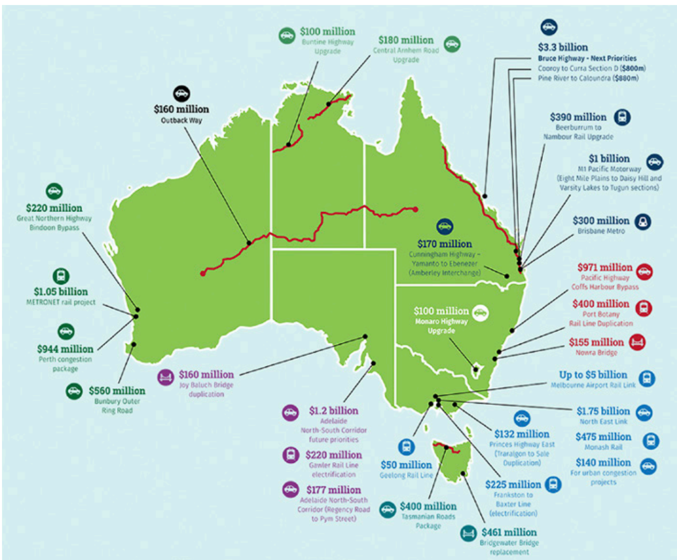
The Consumer Staples sector declined 0.36%, despite Wesfarmers rallying 4.1% after it announced it is exiting its UK and Ireland hardware operations, which has cost shareholders over $1.7 billion over the past 36 months.

The Energy sector was broadly flat, rising 0.23% as Santos ceased takeover discussions with US private equity firm Harbor Energy, which resulted in the share price falling 4.56%. The correction in the oil price tempered gains in the rest of the sector, as Saudi Arabia and Russia raised the prospect of increased production.

Healthcare was the best performing sector rising 5.5% as CSL, which comprises over 30% of the Healthcare Index, continued to rally following their half year report.

Economic Highlights

Australia: The Reserve Bank of Australia kept cash rates on hold at 1.50%, noting low wage inflation and an unemployment rate of 5.6%, which is little changed over the past year. This is a sharp contrast to the US where unemployment is at record lows and interest rates are already rising. The housing markets in Sydney and Melbourne continued to slow in May following the strong gains experienced over the last 5 years. However, nationwide the housing market has been largely flat over the past 6 months.



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Economic Highlights cont.

The Federal Budget was released with a key feature being a 10-year $24 billion national infrastructure program. Many of the large projects are centred on the East Coast which should soften the impact of the slowdown in the housing market, but does raise concerns about additional fiscal stimulus this late in the economic cycle. The image on the previous page shows the size and location of the proposed projects.

United States: The US unemployment rate fell to 3.8% in May, the lowest rate since April 2000. A tight labour market in both skilled and unskilled labour is increasing the pressure on wages. The Federal Open Market Committee (FOMC) kept rates on hold at 1.5%-1.75% but indicated that signs of inflation are beginning to pick up and they remain concerned about the impact of low interest rates on asset valuations. The FOMC indicated they will continue to gradually increase rates with the view that inflation will approach the 2% target over the medium term.

Eurozone: The European Central Bank confirmed, they remain open to continuing the €30 billion bond purchase program beyond the current September end date until they can see consistent signs of inflation. Political uncertainty following the March election in Italy dominated headlines with a return to the polls a possibility which may lead to Italy leaving the European Union (EU) causing further disruption and delaying the recovery in Europe.

What to watch for

Global trade tensions continued to escalate as US President Donald Trump threatened to impose 25% tariffs on car and truck imports and announced further steel and aluminium tariffs on Canada, Mexico and the EU. Mexico and the EU have threatened retaliatory taxes and Canada has imposed tariffs, between 10% and 25% on a range of US imports. Further escalations will contribute to market volatility and negatively impact global economic growth long term.

The recent Italian election reignited fears that Italy may exit the EU as it continues to struggle with nearly €2.3 trillion in public debt, close to 135% of GDP. Italy is the third largest economy in the EU and is currently the second largest debt issuer in Europe. Italian bond yields have widened significantly as investors fret that if Italy leaves the EU they will be repaid in a devalued Italian currency or that they may default on their debt obligations. The interconnectedness of global markets means this has the possibility to cause significant contagion in the European bond market.

The Organization of the Petroleum Exporting Countries is due to meet on 22 June, where a decision will be made on oil output levels. The oil price has been rallying since the lows in 2015 and with global reserves now dwindling, an increase in output is likely. Oil is still an important input in a number of industries and a sustained price would feed into price inflation as costs are eventually passed on to consumers.

Conclusion

- Volatility is likely to continue after the relative calm experienced in 2017.
- Rising national protectionism and high debt levels in many countries could produce further shocks.
- Global markets are continuing to rally, however, now look fully valued and are vulnerable to sharp corrections on any negative news.

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