ATCHISON
CONSULTANTS

Market Review – September 2019

Australian Economy

The direction of the Australian economy rests, to an extent, with the Reserve Bank of Australia (RBA) Governor Philip Lowe's regular speeches. In September the RBA Governor's "An Economic Update" speech left the door wide open for more rate cuts. Governor Lowe remains optimistic that the Australian economy has seen a "gentle turning point" but his comments around increasing downside risks to global growth, weaker than expected GDP growth, spare capacity in the labour market, a stalling in the pick-up in wages growth, it being "not unreasonable" to expect further easing and that markets should be surprised if the RBA didn't "act consistent with our mandate" are all very dovish.

Both skilled job vacancies and the ABS measure of economy wide job vacancies fell (led by NSW and Victoria) pointing to slower jobs growth ahead and a further rise in unemployment. What's more, ABS employment data by industry shows that all of the jobs growth in Australia over the last year has come from the public sector – which perhaps explains why jobs growth has been so strong relative to weak GDP growth. The CBA's business conditions PMIs rose in September, but they tend to be a bit volatile and they are still well down from 2017 highs.

The pick-up in auction clearance rates that has occurred in Sydney and Melbourne this year is now being accompanied by higher listings and sales suggesting that it has legs. Key to watch for now will be whether clearance rates continue to hold up as the spring selling season heats up and whether housing finance commitments continue to rise. many commentators forecast that after a further bounce, price gains will be constrained through next year, due to still tighter lending standards, unit supply, slow growth and rising unemployment.

Cash and bank deposits are likely to provide poor returns as there is a strong possibility that the RBA cuts the official cash rate to 0.5% by early next year.

The A$ is likely to fall further to around US$0.65 as the RBA cuts rates further. Excessive A$ short positions, still high iron ore prices and the US Fed easing will provide some support though with occasional bounces and may avoid a sudden fall in the A$.

Global Economy

Global equity markets ended September in positive territory as investors weighed the latest turns in the trade war between the world's two largest economies.

Meanwhile, a significant rotation swept through financial markets globally. It was the biggest rotation out of relatively expensive stocks exhibiting low corporate earnings volatility and strong share price momentum and into cheaper, unloved sectors offering attractive valuations versus history since the financial crisis.

Investors sold out of defensive low volatility stocks and higher growth technology companies which have propelled the decade-long bull market in the US. They opted instead for value stocks, which includes energy and financial stocks that have underperformed the broader market in recent years.

Of course, political risks loomed large, from the US Congressional investigation into President Trump's dealings with Ukraine to Brexit. Indeed, the Brexit deadlock continued, and UK Prime Minster, Boris Johnson's prorogation of Parliament was ruled unlawful by the UK Supreme Court.

UK and European equity markets provided a positive return during September as investors adopted a more 'risk-on' stance. Mario Draghi, leader of the European Central Bank (ECB), announced a fresh wave of stimulus measures to help shore up the economy.

While interest rate cuts in the eurozone and the US attracted global headlines, central banks in Latin America were also active with Brazil, Mexico and Chile reducing interest rates by 0.50%, 0.25% and 0.50% respectively.

September was a more challenging month for fixed income markets with many sectors recording their first negative monthly return of the year so far. In large part, this reflected movement in government bond yields, which increased from the record lows reached in August. The rise in government bond yields was driven by signs that the global economy may be stronger than had previously been anticipated and a potential thawing of trade tensions.

UK: Politics continued to dominate the domestic agenda during September. Boris Johnson's prorogation of Parliament was ruled unlawful by the UK Supreme Court and the Brexit deadlock continued. The value of Sterling versus international currencies strengthened in the first half of the month but fell lower once again as we moved closer to the 31 October 2019 deadline.

US: Equity market ended September in positive territory amid easing fears over a trade war escalation and a cut in interest rates by the US Federal Reserve (Fed). The Fed said that the cut was aimed at shoring up the US economy, amid "uncertainties" about future economic growth.

Political risks continued to loom large after it was reported that House Speaker Nancy Pelosi would announce a formal impeachment inquiry of President Donald Trump. Economic indicators also muddied the picture. A key gauge of US business investment unexpectedly fell in August and consumer spending slowed, signalling the US economy cooled in the third quarter. consumer spending, which accounts for the bulk of US gross domestic output, climbed just 0.1% month on month — its weakest showing in six months. Spending slowed even as personal incomes rose 0.4 per cent, in line with expectations.

The US economy added 130,000 jobs last month, slowing more than expected, the latest official figures have shown. Economists polled by Reuters had expected an increase of 158,000. The unemployment rate was unchanged at 3.7%, though, while average hourly earnings growth rose 3.2% from last year.

China: Chinese equities underperformed regional peers despite an earlier easing in US-China trade tensions. Talks are set to recommence in October following President Trump's raising of tariffs on Chinese goods in August. China retaliated with its own set of tariffs on US imports but had since released a number of exemptions as a "goodwill gesture".

Domestically, the People's Bank of China cut reserve requirements for all banks by 0.50%, stating that it will maintain a prudent monetary policy, maintaining reasonable and abundant liquidity.

Europe: European markets rallied strongly in September as investors adopted a more 'risk on' stance following some easing of US-China trade war rhetoric. The month also witnessed a sharp sector and style rotation as stocks with more cyclical characteristics (linked closely with economic activity) showed signs of coming back into favour, having significantly underperformed year to date.

European Central Bank announced a fresh wave of stimulus measures to help shore up the economy. The Central Bank said it would; reduce the deposit interest rate by 0.10%; restart quantitative easing (asset purchase programme); provide more favourable TLTRO bank funding (long-term loans to banks to incentivise lending to businesses and consumers); introduce deposit tiering (to reduce the impact of negative interest rates on banks' profitability).

Emerging Markets: Equity markets advanced higher in September with all the regions registering gains. Latin America was the best performer, followed by Asia. From a country perspective, Turkey, Pakistan and Argentina came top with the best sector returns coming from technology, energy and industrials. While interest rate cuts in the eurozone and the US attracted global headlines, central banks in Latin America were also active with Brazil, Mexico and Chile reducing interest rates by 0.50%, 0.25% and 0.50% respectively. To bolster a sluggish economy and steer inflation back up towards the target, interest rates in Brazil were reduced to 5%, a record.

In conclusion: Markets to remain volatile in the months ahead due to several unresolved issues; US trade war with China (and now Europe), friction with Iran, impeachment noise and weak global economic data. However, all is not gloom, valuations remain attractive, particularly against low bond yields, global growth indicators are expected to improve next year, and monetary and fiscal policy are becoming more supportive.

Table 1: Market Performance – Periods to 30 September 2019

Sector	1 Month %	3 Months %	1 Year %	3 Years % pa	5 Years % pa
Australian Shares	1.8	2.4	12.5	11.9	9.5
Australian Shares Small Cap	2.6	3.1	3.9	8.8	9.6
International Shares Ex-Aus (Unhedged)	2.0	4.6	9.1	15.0	13.0
International Shares Ex-Aus (Hedged)	2.3	1.5	2.6	10.8	8.3
Emerging Markets (Hedged)	1.5	-2.1	-0.2	7.6	5.5
Emerging Markets (Unhedged)	1.8	-0.4	5.1	10.5	7.8
Australian Listed Property	-2.7	0.9	18.3	9.2	13.6
International Listed Property ($A)	2.6	9.6	17.9	9.8	12.6
Australian Direct Property	0.1	2.0	7.9	11.1	11.7
Australian Fixed Interest	-0.5	2.0	11.1	5.5	4.8
International Fixed Interest (Hedged)	-0.6	2.3	9.8	3.7	5.0
Cash (BAUBIL)	0.1	0.3	1.7	1.8	2.0
		Change over the month			
Australian Govt. 10 yr Bond Yield	1.01%	12 bps			
AUD/USD	$0.67	-$0			

*as at 30 June 2019

Australian Shares (S&P/ASX 200 Accumulation Index)

The S&P/ASX 200 Accumulation Index bounced back in September returning +1.8%, masking a volatile quarter, further accentuated by a fairly lack-lustre FY19 reporting season. Earnings growth remains elusive in many sectors with many companies cutting costs to support margins and most companies giving mixed earnings guidance.

On sector basis Energy (+4.7%), Financials (+4.1%) and Small Industrials (+3.3%) were the standout performers. Whilst Telecom (-4.2%), A-REITs (-2.7%), Health Care (-2.5%) were the largest detractors.

Companies with strong franchises that continue to derive scale advantages continued to grow well; CSL, Sonic Healthcare, Coles, Woolworths, IAG and Steadfast. Resource companies bounced around at the whim of changing commodity prices but companies such as BHP (+5.8%), RIO (+4.3%) and South32 (+0.8%) managed to provide solid returns for the month.

The index finished trading at a P/BV of 2.1x and a P/E Ratio of 18.0x and equity yield (dividend) of 4.1%.

The VIX was at 14.04 (the average since 01.10.2010 is 16.4) indicating below average level of market volatility.

Australian Shares Small Cap (S&P/ASX Small Ordinaries Index)

As a collective, Australian small caps (stocks 101-300 in the ASX) benefit from low interest rates, a low currency and availability of equity capital. Add a modest improvement in demand (high employment and some wage inflation) and there is reason to expect some growth.

The Small Ords Accumulation index had a strong month returning +2.6% in September outperforming the broader index by +0.8%.

Companies such as Codan, Baby Bunting Group, Smartgroup Corporation, and EML Payments produced stellar returns.

Trailing P/E Ratio was at 20.0x at the end of the month, P/BV is at 2.1x and equity yield (dividend) of 3.0%.

International Shares (MSCI World ex Australia Index, Net AUD and the MSCI World ex Australia Index, Net LCL)

The MSCI World ex Australia Index (Unhedged) +2.0% for September whilst the MSCI World ex Australia Index (Hedged) returned +2.3%.

US equity market: US equity market rose by +1.7% over the month despite ongoing growth concerns and uncertainty surrounding US-China trade. The Fed acted as expected by cutting rates by 25 basis points both in July and in September but has not committed verbally to a more extended easing cycle.

Less economically sensitive areas of the market generally performed more strongly. Utilities, real estate and consumer staples were amongst the quarter's better performers. Energy and Materials were weaker areas of the market, given expectations of a more challenging demand environment. Healthcare remains a matter of heated debate in the run-up to the 2020 US presidential election, and the political sensitivity caused the sector to lag the market.

UK and European markets: UK equities recorded modest gains amid concerns about the world economic outlook, many investors favoured assets perceived to have defensive qualities. These included so-called "quality growth" companies which are characterised by their superior and defensible earnings growth.

Eurozone shares made gains, the best-performing sectors included Utilities, Real Estate and Consumer Staples. Underperformers were Energy and Consumer Discretionary. The market saw a rotation in September with Financials, which had previously been out of favour this year, leading the gains.

Chinese market: China underperformed by a more modest margin. The US announced 10% trade tariffs on $300 billion of goods imported from China, some of which took effect in September. Following the announcement, the renminbi weakened beyond the symbolic seven-per-dollar threshold, and in response the US Treasury labelled the country a currency manipulator. The US also announced plans to increase existing tariffs of $250 billion of Chinese goods from 25% to 30% in October. China responded by announcing tariffs on $75 billion of US goods.

The long-awaited reversal from growth to value may have commenced. For the month of September, the MSCI World ex Australia Growth Index (Hedged) returned +0.7% versus the equivalent Value index (Hedged) of +4.1%.

At the country level, US stocks in September were up +1.7% (Hedged) Other major share markets provided solid returns, reversing last month loses. On a hedged basis; Japan (+5.9%), China (+0.6%) and Europe (+3.1%).

The index finished trading at a P/BV of 2.3x and a P/E Ratio of 18.3x and equity yield (dividend) 2.4%.

Emerging Markets Shares (MSCI Emerging Markets Index, Net AUD)

Emerging market equities recovered in September, +1.8% (Unhedged) even though there was an escalation in US-China trade tensions and concerns over global growth continued to mount.

All the regions registering gains. Latin America was the best performer, followed by Asia. From a country perspective, Turkey, Pakistan and Argentina came top with the best sector returns coming from Technology, Energy and Industrials.

The index ended trading at a forward P/E Ratio of 12.7x and P/BV of 1.6x and equity yield (dividend) 3.0%.

Australian Listed Property (S&P/ASX 200 A-REIT Accumulation Index)

The ASX 200 AREIT index experienced a negative month in September -2.7% underperforming the market by 4.5%. S&P/ASX Retail AREITS returned -1.2% in September, S&P/ASX Industrial AREITS returned -2.3%, S&P/ASX Diversified AREITS returned -3.1% and S&P/ASX Office AREITS returned -5.2%. Key outperformers were URW (+6.0%), CMW (+4.8%) and BWP (+1.3%).

At the end of September, the index was trading on a dividend yield of 4.4% with a P/BV 1.2x and a P/E Ratio 14.2x.

International Listed Property (FTSE EPRA/NAREIT Developed ex-Australia Index, AUD)

Globally REITs ended their solid run returning -2.7% for the month. In UDS terms, United Kingdom was the top-performing region (+7.7%). The worst-performing region over the month was Australia (-2.0%).

At the end of September, the index was trading on a dividend yield of 3.8% with a P/B 1.8x and a P/E Ratio 20.9x.

Australian Direct Property (Atchison Consultants Unlisted Property Funds Index)

Australian direct property posted a return of +2.0% over the June 2019 quarter. Capitalisation rates across property sectors continued to trend downwards. Cap rates across office, industrial and retail properties range are 5.2%, 5.8% and 5.2% respectively.

Australian Fixed Interest (Bloomberg AusBond Composite Bond Index)

Australian fixed interest fell by 0.487% over the month. Australian government 10-year bond yields increased by 12bps to 1.01% while 3-year single A corporate credit spreads tightened from 0.873% to 0.855%.

International Fixed Interest (Barclays Global Aggregate TR Bond Index, Hedged to AUD)

International fixed interest returned -0.58% over the month (Barclays). The 10-year US government bond yield increased by 17bps to 1.68% while the US corporate investment-grade credit spread tightened from 1.612% to 1.560%.

Contact Details

To obtain further information, please contact Atchison Consultants.

Jake Jodlowski
Principal
Atchison Consultants
Phone: +61 3 9642 3835
Email: jake.jodlowski@atchison.com.au

Alex Wong
Senior Investment Analyst
Atchison Consultants
Phone: +61 3 9642 3835
Email: alex.wong@atchison.com.au