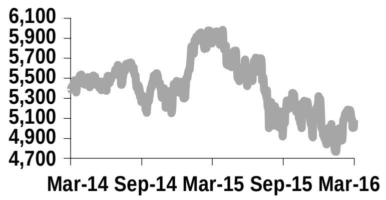
Australian Monthly/Quarterly Wrap I March 2016

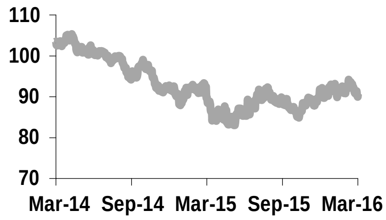
March Economic Wrap

S&P/ASX 200 Price Index



Source: Bloomberg, IOOF

MSCI Australia relative to MSCI Asia Pacific ex Japan, US$ terms



Source: Bloomberg, IOOF

Positive March marches onwards, the overall performance for the month was positive, equity investors benefited as the S&P/ASX 200 rose by +4.1%. Another positive result was with the S&P/ASX 200 Resources index which posted its second consecutive positive month up +5.8%. The MSCI World index also performed positively enjoying a rise of +6.5%.

Emerging markets saw a rally over the month as fears of a China hard landing loomed over the market. The MSCI EM index rose by +13.0% which was the strongest monthly rise since May 2009.

Over the quarter we saw negative performance across most markets with the S&P/ASX 200 returning -4.0%. The theme of rebounding commodities from technically oversold levels saw the oil price return 6.2% over the quarter, spurred by the upcoming Doha meeting regarding an oil production freeze. We remain sceptical about a freeze in oil production because Iran is adamant in regaining market share by lifting production whilst Saudi Arabia has indicated that it would only agree if all producers followed suit. An output freeze will boost market sentiment but it could prove meaningless because it is a deal that more or less reflects existing conditions. There is no spare production capacity outside Saudi Arabia and Iran within OPEC, though a formal output freeze would be helpful for sentiment and may prevent further damage to the oil price and the knock-on effects to global markets.

Key economic news – In Australia, we saw the reserve bank of Australia leave the cash rate at 2%. The federal government announced that the budget would be brought forward to the 3rd May, this increases the possibility of a double dissolution election in July. The Australian dollar has continued its upward approach over the month due mostly to a dovish announcement from the US Fed. In the UK, British exit from the European Union (Brexit) opinion polls showed the position between the 'remain' and 'leave' vote is relatively close for the British exit from the European Union. The central case is that UK remains in the EU.

Key company news – Australian companies reported their half year financial results during the quarter, exceeding expectations against a backdrop of significant global headwinds. Stocks leveraged to housing and the consumer market fared best, reinforcing the moderating concerns associated with the property market. Through March we saw TPG Telecom, which is in the process of acquiring rival iiNet, upgrade its earnings guidance to $480-$483 million. Asciano Limited announced that it entered into binding documentation with the Brookfield and Qube Consortium's in relation to the joint scheme to acquire Asciano for $9.15 per share. ANZ increased their bad debt charges to at least $900 million for the first half due to commodities related exposures, while Westpac admitted they may need to increase bad debt provisions.

Sector and stock returns%

	ASX/S&P200 Sectors (GICS)				Best and Worst S&P/ASX200 Performers			
	Monthly	%Δ	Quarterly	%Δ	Top five stocks		Bottom five stocks	
▲	Consumer Discretionary	4.14	Consumer Discretionary	-0.38	Monthly			
▲	Consumer Staples	2.29	Consumer Staples	-3.70	Mesoblast Ltd	+33.9%	Evolution Mining Ltd	-13.1%
▲	Energy	5.27	Energy	-2.51	Sims Metal Mgmt Ltd	+28.6%	Liquefied Natural Gas Ltd	-12.4%
▲	Financials ex Property	6.33	Financials ex Property	-10.81	Premier Investments Ltd	+28.4%	Northern Star Resources	-12.1%
▲	Financials	5.61	Financials	-8.30	Worleyparsons Ltd	+28.1%	Sirtex Medical Ltd	-9.6%
▼	Health Care	-0.52	Health Care	-2.37	Sigma Pharmaceuticals Ltd	+27.7%	Syrah Resources Ltd	-8.4%
▲	Industrials	1.68	Industrials	4.74	Quarterly			
▲	IT	5.30	IT	-6.41	Cimic Group Ltd	+43.1%	Cover-More Group Ltd	-29.9%
▲	Materials	5.47	Materials	3.27	Bluescope Steel Ltd	+39.7%	Bendigo & Adelaide Bank	-25.8%
▲	Property Trusts	2.37	Property Trusts	5.48	Mesoblast Ltd	+38.9%	Bt Investment Mgmt Ltd	-24.6%
▲	Telecommunications	1.86	Telecommunications	-3.06	Beach Energy Ltd	+33.7%	Bellamy'S Australia Ltd	-24.0%
▲	Utilities	0.53	Utilities	1.88	Sims Metal Mgmt Ltd	+19.3%	Bega Cheese Ltd	-20.3%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, March 2016

	Australian Indices	Mth	%∆	Qrt	%∆
▲	S&P/ASX 200	5083	4.14	5296	-4.02
▲	All Ordinaries	5152	4.12	5345	-3.61
▲	Small Ordinaries	2171	4.46	2175	-0.18
	US Indices				
▲	S&P 500	2060	6.60	2044	0.77
▲	Dow Jones	17685	7.08	17425	1.49
▲	Nasdaq	4870	6.84	5007	-2.75
	Asia Pacific Indices				
▲	Hang Seng	20777	8.71	21914	-5.19
▲	Nikkei 225	16759	4.57	19034	-11.95
	UK & Europe Indices				
▲	FTSE 100	6175	1.28	6242	-1.08
▲	CAC40	4385	0.72	4637	-5.43
▲	Dax Index	9966	4.95	10743	-7.24

Source: Bloomberg, IOOF

US equity market

Over the month the S&P500 was up +6.6%. Performance came mostly from Energy up +9.9%, Technology up +9.2%, and Materials up +8.0%. Other sectors which outperformed the index were Financials up +7.5%, Industrials up +7.1%, and Utilities up +7.1%. The sectors which fared worse were Consumer Stapes up +4.7% and Healthcare up +2.8%.

For the first quarter the S&P500 was slightly positive, up +0.8% this was attributed to a strong second half rally over the quarter. The defensive sectors fared the best (Telco's up +15.1%), while the worst performance came from Banks (down -13.3%) and Financials (down -5.9%).

Australian equity market

The S&P/ASX200 index finished the month up+4.1% Sector performance came from Financials ex property up +6.33%, followed by Resources and Materials up +5.5%. All sectors performed positively over the month, Healthcare was the only exception down -0.52%. Over the quarter the S&P/ASX200 ended in negative territory down -4.0%. This was driven by negative performance from most sectors, Financials ex property down -10.8% was the worst.

Australian companies reported their half year financial results during the quarter which exceeded expectation against a backdrop of significant global headwinds.

Fixed Income

	Fixed Income	Mth	+/-	Qrt	+/-
	Aussie Cash Rate	2.00	--	2.00	--
▲	Aust 10-year Bond Rate	2.49	0.09	2.88	-0.39
▲	Aust 3-year Bond Rate	1.90	0.17	2.02	-0.12
▼	90 Day Bank Accepted Bills SFE-Day	2.27	-0.01	2.33	-0.06
▲	US 10-year Bond Rate	1.77	0.03	2.27	-0.50
▼	US 3-year Bond Rate	0.85	-0.04	1.31	-0.45

Source: Bloomberg, IOOF

Over the month the Australian yield curve rose. The Australian 3year bond yield was up +17bps and the 10year bond yield was up +9bps, bond yields rose over the course of the month, the same did not occur for the US, its 3year bond yield was down -4bps and its 10year bond yield was up only +3bps.

The stronger Australian dollar seems to be the determining factor for the way the yield has moved due to its firm relationship with the bond curve. The declines in yields from the US was mostly brought on by the Fed's hunt for lower real short-term yields as well as its lenience for higher inflation.

Currencies

	Currencies	Mth	%∆	Qrt	%∆
▲	$A vs $US	76.57	7.23	72.86	5.09
▲	$A vs GBP	53.32	3.90	49.45	7.83
▲	$A vs YEN	86.20	7.10	87.60	-1.60
▲	$A vs EUR	67.29	2.45	67.11	0.27
▲	$A vs $NZ	110.83	2.28	106.63	3.94
▼	$US vs EUR	87.87	-4.46	92.10	-4.59
▼	$US vs GBP	69.63	-3.09	67.86	2.61
▼	$US vs CHF	96.18	-3.67	100.21	-4.02

Source: Bloomberg, IOOF

The Australian dollar appreciated 7.23% against the USD, aided by the rising iron ore price. We also saw the dollar appreciate among most global partners supported by stronger Australian economic data. Emerging market currencies had the best month in 18 years as the Federal Reserve signalled a gradual and cautious approach to raising rates, easing pressure on indebted emerging market companies.

Commodities

	Commodities	Mth	%∆	Qrt	%∆
▼	Aluminium	1509	-4.24	1510	-0.07
▲	Copper	218	2.37	214	1.94
▼	Nickel	8457	-0.56	8826	-4.18
▲	Gold	1236	0.04	1062	16.40
▲	Silver	15	3.66	14	11.78
▲	Crude Oil - Brent	40	10.09	37	6.22
▼	Lead	1699	-3.05	1794	-5.32
▲	Zinc	1811	2.84	1613	12.28
▲	Iron Ore	55.52	19.84	39.58	40.27

Source: Bloomberg, IOOF

Commodities continued to rally from their initial bounce back from technically oversold levels in February. The highlight in commodities during the month was the 19.8% surge in the iron ore price, possibly aided by China's comments regarding increasing fiscal spending to boost growth. Gold closed flat amidst U.S. economic and policy uncertainty. Base metal prices were mixed, with Copper and Zinc the standout. Brent crude oil recovered throughout the month to end up 10.1% as the number of active oil rigs in the U.S. fell to the lowest level in 6 years. Investors remain sceptical about a freeze in oil production because Iran is adamant in regaining market share by lifting production now that nuclear related sanctions have been lifted.

Australian Economy and the RBA

In March we saw the Reserve Bank of Australia leave the cash rate on hold at a historical low of 2.0%. The RBA's themes remain unchanged with focus on the capital expenditure drag, domestic business conditions and the AUD. The RBA noted that the expansion in the non-mining parts of the economy improved labour market conditions, however, monetary policy would need to be accommodative to support weaker growth. We expect the RBA to hold rates going forward but diminishing inflationary pressures and concerns that the recent AUD strength could hamper the economic recovery may give rise to a rate cut in the second half of 2016.

Residential building approvals for February continued a downward trend coming in at 3.1%mom, although improving on January's fall of 7.5%. Employment growth for February rose by a paltry 0.3k, whilst employment growth fell to 2.1%yoy. The unemployment rate unexpectedly fell to 5.8% putting pressure on the chances of an RBA rate cut. Retail sales for February remained flat at 0%mom, casting doubt over whether household spending can boost economic growth in 2016.

The Australian economy continued to show signs of responding to commodity price weakness by rebalancing to the services sector and activity driven by domestic demand. The commodity price appreciation over the quarter has cushioned this transition, but we expect further commodity price weakness in 2016.

The latest capital expenditure survey highlighted mixed data, although total year on year new capital expenditure retraced to -16% from -20%, indicating tentative signs of stabilisation. Capital expenditure in non-mining sectors will be required to support activity and jobs to counteract the sharp fall in mining investment. While these indicators suggest that there is significant downside risk in 2016/17, a pick-up in capital expenditure during the second half of the period is expected as business lending increases and downside risk to the AUD eventuates.

US Economy

In March Janet Yellen signalled caution in raising interest rates given the headwinds facing global economies. Expectations regarding the number of rate hikes for the year dropped to two as Yellen stated that the Federal Reserve's employment and inflation targets "will likely require a somewhat lower path for the federal funds rate than was anticipated". The AUD broke through the US77c mark as investors pared back expectations for U.S. monetary policy tightening.

The ISM manufacturing index for March rose to 51.8, breaking the five month contractionary trend of sub-50 readings. The ISM non-manufacturing index for March rose to 54.5 providing further evidence that the economy is on track to recovery. The Markit services PMI was also encouraging, rising to 51.3 after a worrying February reading of 49.8.

Real GDP growth for Q415 was revised up to a 1.4% coming in at 2.0% yoy, reflecting the increase in consumer spending and residential investment. However, investment in structures declined because lower oil prices have contracted oil related investment. U.S. crude oil production continued its decline throughout the March quarter as low oil prices continue to hurt higher cost U.S. shale oil producers.

The economy is showing signs of improvement but the backdrop of slower global economic growth continues to hamper sentiment. Despite encouraging U.S. data, in particular a solid March jobs report, the deterioration in global financial conditions poses ongoing downside risk and will continue to weigh on the economy.

China

China continued extraordinary monetary easing and expansionary fiscal policy in an attempt to bolster growth. Risky asset markets were given some reprieve as the Chinese Yuan stabilised over the quarter. The improved market sentiment for risky assets is likely to be short lived though as recessionary pressures and macro headwinds give rise to volatility in Chinese Yuan denominated assets.

Economic fundamentals are not helping deflate market concerns as China's growth continued to slow whilst being over-reliant on credit. Standard and Poor's cut its credit rating outlook for China in March to negative in response to the country's rising debt levels and reliance on credit growth to meet economic targets.

The official manufacturing PMI for March jumped to 50.2 as some signs of stabilisation appeared, breaking the trend of seven sub 50 readings in a row. Exports for February however fell a much worse than expected 25.4%yoy, their sharpest drop in seven years. GDP for Q415 grew at a weaker than expected 6.8%yoy. GDP for CY15 came in at 6.9%yoy which marked the weakest calendar year growth in 25 years.

The latest trade figures have raised concern over whether China can maintain economic growth whilst implementing reforms and trying to shift towards more services and domestic spending. It is anticipated that economic rebalancing is likely to proceed slower than anticipated as risks to China's debt burden increase. This may limit the government's policy options and their effectiveness. Nevertheless, China still has room to increase credit funded spending and investment to boost the economy and increase growth.

Europe

Over the month of March we saw European equity markets remain positive. The ECB still continues to focus on expansion and pace as QE increased from 20 billion Euros of asset purchases to 80 billion Euros, the universe was also widened to include non-bank corporate bonds. Rates also were cut over the month.

ECB also announced a new TLTRO program called TLTRO II (targeted long-term refinancing operations). The program aims to offer attractive long-term funding conditions to banks to help ease further the private sector credit conditions. The ECB also hopes this program will stimulate credit creation and reinforce the monetary policy the ECB is conducting.

Brexit was also on the cards over the month, as the vote to remain in the European Union nears. Significant downside risk to the UK economy from uncertainty of the vote. Long run risks from an EU exit would depend on post EU relationship. A relationship that restricts trade, the financial sector, or impeded free movement of labour could have large negative consequences.

Over the quarter we did not see any major changes, most European equity markets finished in the red. A current trending theme was with the European commission consumer confidence indicator which fell from -5.7 to -9.7, this continues to be a thorn blocking European recovery. The other major themes are still geopolitical in nature.

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