Australia Monthly Wrap I August 2015

An awful August

Volatility struck back in August, with markets around the world falling as concerns grew about slowing economic activity in China, the Federal Reserve interest rate lift-off and financial imbalances across emerging markets.

Against that backdrop, the S&P/ASX 200 Index delivered its worst monthly performance since the GFC struck in October 2008, with a fall of 7.8% in accumulation terms and 8.6% in price terms. All sectors landed in the red for the month, with negative performance driven by energy, down 13.8%; banks, down 11.7%; and resources, down 7.2%.

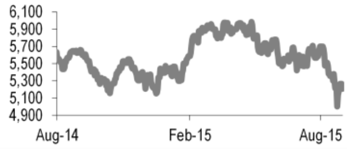
Overall, the domestic index's decline was more pronounced than global developed market peers – the MSCI Developed market index dropped 6.8%.

Among the regions, Europe, as measured by the Euro Stoxx 50 index, led declines with a 9.0% fall, along with the Nikkei 225, down 8.2%, while the FTSE 100, down 6.7%, and the S&P500, down 5.5%, outperformed on a relative basis.

Economic news – Domestically, the Reserve Bank of Australia (RBA) kept its cash rate on hold, with commentary from the board suggesting that current policy is well positioned given emerging positives on the economic front and a better-than-expected labour market. The People's Bank of China (PBOC) announced policy adjustments aimed at stimulating growth in China. The measures included a 25 basis points cut to benchmark interest rates and reductions of the required reserve ratio, which will free up capital for financial institutions to lend. The prospect of the US Federal Reserve starting its rising cycle was rarely out of the headlines through the month, with Fed vice-chairman's Stanley Fischer's comments at Jackson Hole leaving the door open for a move this month.

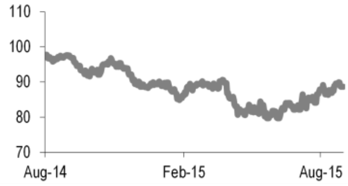
Major company news – Capital management was again a prominent theme during reporting season with Rio Tinto (RIO), CSL (CSL), Fairfax Media (FXJ) and Ansell (ANN) all announcing share buybacks. Capital raisings from ANZ Bank (ANZ) of $3 billion and Commonwealth Bank (CBA) of $5 billion followed on from the National Australia Bank (NAB) capital raising of $5.5 billion in May. On the M&A front, Asciano (AIO) agreed to an $8.9 billion takeover offer from international infrastructure investment group Brookfield, comprising $6.94 in cash and 0.0387 Brookfield Infrastructure units per Asciano share.

ASX 200 Price Index



Source: Bloomberg

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



Source: Bloomberg

Sector and stock returns%

Ranked sector returns				Top and bottom ASX200 universe stocks			
One month		Three months		One month		Three months	
Utilities	-0.2%	Utilities	-1.0%	**Top five stocks**			
A-REITs	-4.1%	Health Care	-2.7%	Pacific Brands	+41.7%	Pacific Brands	+43.4%
Consumer Staples	-4.1%	A-REITs	-2.8%	Sims Metal Management	+21.4%	Sirtex Medical	+30.0%
Consumer Disc.	-4.2%	Telco's	-4.5%	Bluescope Steel	+18.7%	Asciano	+25.6%
Industrials	-4.9%	Consumer Staples	-4.9%	Ozforex	+16.5%	Regis Resources	+23.3%
Materials	-5.2%	Industrials	-6.8%	Spark New Zealand	+13.0%	Bluescope Steel	+22.8%
Health Care	-5.8%	Consumer Disc.	-9.5%	**Bottom five stocks**			
S&P/ASX 200	-7.8%	Banks	-10.0%	Senex Energy	-36.2%	Senex Energy	-61.5%
Telco's	-8.3%	Materials	-14.0%	Beach Energy	-31.3%	Drillsearch Energy	-49.2%
Banks	-11.7%	Technology	-16.8%	Santos	-30.7%	Bradken	-46.8%
Energy	-13.8%	Resources	-17.1%	Drillsearch Energy	-29.4%	Slater & Gordon	-45.8%
Technology	-15.1%	Energy	-20.0%	Apn News & Media Limited	-29.4%	Mineral Resources	-42.7%

Source: Bloomberg, MSCI.

Equity review

Major Market Performance, August 2015

	Level	Change
DJ Industrials	16,643	-5.9%
S&P 500	1,989	-5.5%
NASDAQ	4,828	-5.8%
FTSE 100	6,248	-6.7%
Nikkei225	18,890	-8.2%
Euro Stoxx 50	3,276	-9.0%
ASX 200	5,207	-8.6%

Source: Bloomberg. Note: Index levels are as at close of business, 31 August 2015.

US equity market

The S&P 500 followed global equity markets south, dropping to a low on August 25th before rebounding more than 100 points to finish the month down -5.5%, its worst month since May-12. Banks led the declines (-7.5%) while Healthcare (-6.3%) and Consumer Discretionary (-5.9%) also underperformed the broader index. Utilities offered the best defense in the volatile market (-2.4%) as well as Telcos (-3.1%). The VIX volatility index jumped sharply toward the end of the month, increasing to 40.74 on August 24th, the highest level seen since Oct-11, before decreasing to 28.43 at the end of the month.

With 90% of S&P 500 companies having reported 2Q15 results, earnings were above expectations. On their count, 68% of companies beat estimates, although the quality of beats was poor with only 47% of companies beating on revenue (vs. 54% average over the last four quarters). Since the start of earnings season, S&P500 2Q15 EPS has been revised up by 4.6%.

Australian equity market

The ASX200 delivered its worst monthly return since the GFC in Oct-08, with a -7.8% accumulation return (-8.6% price). All sectors were in the red, with negative performance driven by Energy (-13.8%), Banks (-11.7%) and Resources (-7.2%).

The Aug-15 reporting season had a number of mixed results. According to Bloomberg, 50% of companies beat analyst expectations, with 48.7% missing expectations and 1.3% being in line. Despite this, aggregate earnings surprises were 3% below expectations, dragged down by Oil & Gas (-14.62%) and Materials (-9.70%). EPS growth for the ASX200 index implied by consensus estimates for FY15 finished reporting season at-1.8% y/y, down from the 0.8% growth rate implied prior to reporting season.

Other Financial Data, August 2015

	Level	Change
Aust RBA Cash rate	2.00%	+0bp
US 10 yr bond yield	2.16%	-2bp
AU 10 yr bond yield	2.66%	-9bp
Australian dollar/US$	0.7133	-2.4%
LME Metals Index	2,378	-2.5%

Source: Bloomberg. Note: Index levels are as at close of business, 31 August 2015.

Bonds

Domestically, the ten-year benchmark yield decreased by -9bps over the month. Despite neutral commentary coming from the August RBA Board minutes regarding policy-stance, the yield curve is in backwardation out to 3-years, presenting a gloomy outlook for the domestic economy. In the US, the 10-year benchmark yield remained largely unchanged, decreasing slightly by -2bps. In Europe, movement in long rates was mixed; 10-year benchmark yields rose in Germany (+15bps), the UK (+8bps), France (+22bps) Italy (+19bps) and Spain (+27bps), while yields in Sweden (-4bps) and Switzerland (-6bps) fell. Bondholders looked favourably upon negotiations between Greece and its creditors, with the 10-year Greek benchmark yield falling -271ps.

Currencies

The soft outlook for the Australian economy and uncertainty in the global economy, particularly surrounding China saw the AUD fall against most of the other major global currencies. The Aussie fell against the USD (-2.4%), the Euro (-4.3%), the Pound (-1.1%) and the Yen (-4.4%). More broadly, the AUD trade weighted index decreased marginally against its largest trading partners (-0.8%). The USD index (ICE Index), fell -1.4% during the month.

Commodities

Spot **Brent crude** bucked its downward trend; after bottoming at US$40.74 on August 24th the contract rebounded sharply to close up 1.4% to US$51.28/barrel, with prices continuing to surge in to early September trading. A request by Venezuela for an emergency meeting of OPEC countries to stem the oil-price rout spurred this spike and was supported by production figures in the US being revised downwards for 1H. The Baker Hughes number of active US oil-drilling rigs increased by 1 over the month to 675, this is down 900 compared to the same time last year.

The benchmark spot **iron ore** price dropped sharply during the last week of the month before rebounding just as quickly to finish up 5.2% for the month at US$56.21/t. The PBOC cut rates during the month and introduced other policy measures in an effort to shore up the slowing economy.

Base metals as measured by the LME index declined 2.5% in August. Of the six primary index members, Lead (+1.7%) and Aluminium (+0.4%) were the metals to post a gain, while Copper (-1.4%), Zinc (-5.5%), Nickel (-8.7%) and Tin (-12.1%) lost ground.

Spot gold rose 3.3% over August, bottoming at a more than 5-year low on August 8 before increasing again to close the month in positive territory.

US Economy

NY Fed President Dudley acknowledged in an address on August 26 that the case for a September liftoff for interest rates were "less compelling" than it was a few weeks ago. The message conveyed was that, while a September liftoff was not ruled out, the onus is on the data to remain strong and for markets to calm in order for that to happen.

Since the remarks did not rule out September, it seems that part of the message was simply one of reassurance that the Fed is monitoring developments and is on top of the situation. The main reasons for Dudley's ratcheting down of September odds were the prospects for slower global growth and potentially tighter financial conditions.

The Thomson Reuters/University of Michigan **consumer confidence index** was revised down from 92.9 to 91.9 (exp. 93.5) between the preliminary and final August reports. Retail sales increased in line with expectations by 0.6% m/m in July and showed increases across all of the main retail sales categories with the exceptions of general merchandise stores and electronics and appliance stores. The **ISM manufacturing PMI** fell by 0.8 to 52.7 in July (exp. 53.5), while the non-manufacturing survey surprised by rising to 60.3(exp. 56.5) from 56.0 in June. This is the highest level reached for the **non-manufacturing survey** since August 2005.

Nonfarm payrolls rose 215k in July (exp. 240k) and job growth for the previous two **releases** was revised up by a combined 14k. The **participation rate** was unchanged at 62.6% leaving the **unemployment rate** also unmoved at 5.3% (exp. 5.6%), both were in line with expectations.

July **housing starts** were stronger than expected, rising 0.2%% m/m to a seasonally adjusted annual rate (saar) of 1.21m (exp. 1.03m). Meanwhile, **housing permits** fell 16.3% m/m to 1.12m saar (exp. 1.11m).

July CPI measures were slightly below expectations. The headline figure increased 0.1% y/y (exp. +0.2%), and the core measure (ex. food and energy) also rose 0.1% m/m (exp. +0.2%).

The government revised up **2Q15 real GDP** growth to 3.7% q/q saar (from +2.3%), with most of the revision coming from final sales, which were revised up from 2.4% to 3.5% with upward revisions to most categories of aggregate expenditure.

China

On August 25, the **PBOC** announced it will cut benchmark **interest rates** by 25bp effective from August 26, with the one-year benchmark deposit rate now at 1.75% (from 2.00%) and one-year benchmark lending rate at 4.60% (from 4.85%).The PBOC also announced to remove the 50% upper-bound limit for deposits exceeding one year, and only keep the 50% maximum premium limit above the benchmark deposit rates for 1-year deposits and shorter-maturity. **Also announced was a universal RRR cut of 50bp**, effective September 6 2014 which will inject CNY670bn into the banking system. This was the fifth policy rate cut, and third universal RRR cut by the PBOC since last November.

The **HSBC flash manufacturing PMI** fell by a further 0.7 points to 47.8 in July (exp. 48.1).

41.4% of Chinese cities registered m/m house price declines in July compared to 48.6% in June. On average, national house prices rose 0.2%m/m in July, which is the fourth consecutive month of increases.

July **CPI** inflation moved up to 1.6% y/y (exp. +1.3%), compared to 1.4% y/y in June. **PPI** deflation intensified to -5.4% y/y (exp. -4.9%) compared to -4.8% y/y in June.

M2 money supply growth picked up further to 13.3% y/y (exp. +11.9%) in July, compared to 11.8% y/y in June. **New loan creation** came in at 1,480bn yuan (exp. 760bn), compared to 1280bn yuan in June, while **total social financing** rose 720bn yuan, compared to 1860bn yuan in June and 280bn yuan in Jul-14.

Australian Economy and the RBA

The **RBA** kept rates on hold at 2.0% in August. The Board acknowledged that domestically “economic activity had generally been more positive in recent months” and that in the labour market “conditions had been better than expected”. The tone of the RBA minutes reflects the Board’s conviction that the policy stance is currently well-positioned, although the September commentary will be more informative on how the Board views recent China developments.

The NAB **business confidence** index declined 4-points to +4 following an impressive surge in June, while the NAB business conditions index also slid four points to +6. The **Westpac-MI consumer confidence index** rose 7.8% m/m, with the index reaching above the pivotal 100 point level, however this remains historically low and firmly entrenched in the range of the past 18 months. Among the sub-indexes, perceptions of family finances over the next 12 months are up a strong 10%oya, while outlook for gains the economy over the next one year has sunk 9%oya.

The economy added a much stronger than expected 38.5k **jobs** in July (exp. +5.0k), but the **participation rate** jumped 0.3% higher than expectations to a new high of 69.3%. This pushed the **unemployment rate** up 0.1% to 5.9% (exp. 5.6%).

Retail sales rose 0.7% m/m (exp. +0.4%). Ex-food sales were particularly impressive, jumping 1.2%m/m and continuing the trend in discretionary spending increases.

Investment spending dropped another 4% in 2Q for private businesses, which represents the fourth straight quarterly decline. Firms in mining became even gloomier than they were previously, but there was a surprise jump in spending intentions by manufacturers. Across all sectors, firms plan to trim investment spending by about 23% in the year ended Jun-16.

The volume of **construction work** done during the June quarter rose 1.5%q/q (exp. 0%q/q). This was underpinned by a rebound in engineering work done which rose 5% q/q, although this was offset by residential works decrease 3%q/q although this is following a large increase of +7.4% q/q in 1Q15.

Europe

The ECB's QE program has been calibrated to ensure that inflation moves back to the central bank's objective by 2018. Recent comments indicate that the central bank is willing to recalibrate this program if there is a meaningful risk of failing to achieve that objective.

Forecasts for Euro area GDP growth for the June quarter were upgraded to 1.6% from 1.3%. Inflation was also upgraded to 0.3% for the quarter from 0.1%. Bank Lending in the Euro area to the real economy picked up further in July, lending to households rising €14bn while lending to nonfinancial corporates rose €15bn. The sum of both was the largest monthly gain in 4 years.

PMI rose 0.2 to 54.1 in August, with solid gains in German manufacturing and further acceleration in the periphery. The European Commission Survey of economic sentiment increased by 0.2 to 104.2 (exp. 104.4) and was driven by both business and consumer confidence.

Company news

Reporting season wrap-up

The Aug-15 reporting season had a number of mixed results. According to Bloomberg, 50% of companies beat analyst expectations, with 48.7% missing expectations and 1.3% being in line. Despite this, aggregate earnings surprises were 3% below expectations, dragged down by Oil & Gas (-14.62%) and Materials (-9.70%). EPS growth for the ASX200 index implied by consensus estimates for FY15 finished reporting season at-1.8% y/y, down from the 0.8% growth rate implied prior to reporting season.

Major company June-15 full-year results

AGL (+1.3%): AGL reported Underlying NPAT of $630m, at the upper end of $575m to $635m guidance. FY15 EBIT increased by 12.2% to $1,126m, reflecting the first time contribution of MacGen. Stripping out the impact of MacGen, the result was basically flat (2% higher) compared to FY14 at $1,657. FY16 earnings guidance to be given at the September AGM will give first insights into what we can expect for electricity margins given the step change in NSW network costs and the high level of discounting in the market.

AMC (-4.8%): On a constant currency basis, NPAT for the Group was up 7.2%. However, the translation of non-US earnings into reported US incurred a $47m currency impact. The result largely confirmed the slowing of growth in Emerging Markets, with management indicating growth had declined from 8% in 1H15 to 4% in 2H15. The outlook points to a similar thematic playing out in FY16 in particular with only 'moderate organic growth' expected for the Flexibles division.

AZJ (-6.4%): AZJ reported normalized FY15 NPAT of $604m, up 15.6% on the pcp, an operating margin of 74.3% was the key driver of the result, and management announced that it expects further efficiencies moving forward. Management commented that the capex required for the West Pilbara Iron Ore Project could be $1.5bn lower than the original $6bn estimate, whilst increasing throughput by 33%.

BHP (-4.8%): BHP Reported EBITDA of US$21.8bn from continuing operations (ex-S32) and NPAT of US$6.4bn. Net debt stood at US$24.4bn, down from US$24.9bn at Dec-14. BHP has lowered capex & exploration guidance for FY16 US$500m to US$8.5bn.

BXB (-9.6%): BXB reported FY15 normalized NPAT of US$632.8m, up 8.3% on the pcp. Revenue was up 12% in constant currency terms driven by a 15% increase in the number of RPCs in circulation. Pallets Americas opex was up 5%: This led to margins in the division of 26.6%, down from 27.9% in FY14 BXB intends to spend US$1.5bn by FY19 on growth projects.

CBA (-13.9%): CBA FY15 cash earnings of $9,137m and was broadly in line with consensus. NIM of 2.07% for 2H15 5bps lower than the 1H15 result of 2.12%. A slightly higher-than-expected provisioning charge relative of $548m was driven by higher unsecured arrears in the retail bank and weakness relating to NZ Agri related exposures. The big news accompany the result was CBA's $5bn pro rated renounceable entitlement offer, at an offer price of $71.50 per new share.

CSL (-7.2%): CSL reported FY15 NPAT of $1,434 up 9.7% on a constant currency basis. FY16 guidance changes gears somewhat with 5% CC NPAT growth which is more like 7.5% underlying growth. Despite the temporary hiatus in FY16, the outlook for FY17 and beyond is extremely encouraging with Hizentra (CIDP), rFIX, SC(Berinert) and rFVIIa underpinning strong growth. Management also announced another ~$950m share buyback.

IAG (-13.9%): IAG reported an FY15 result hit by well-flagged adverse perils claims (reported margin at 10.7%, at the low end of latest guidance of 10.5-12.5%). FY15 NPAT was $728 compared to $1,233 in FY14. Underlying margins fell to 13.1% in FY15, down from 14.2% in FY14.

ORG (-27.2%): FY15 NPAT decreased by 4.3% compared to the pcp to $682m. In conjunction with the result, management also announced further cost-out measures, which are set to contribute an operating improvement of

$200m from FY17, which is in addition to the $100m already announced in May. ORG now expects to inject $1.8bn into the APLNG JV, which is an increase of $550m compared to guidance provided at the 1H result.

QAN (-10.4%): QAN reported FY15 underlying PBT of $975m, which was up from a loss of $646m in the pcp. QAN is targeting $450m of further cost initiatives in FY16 ($894m was achieved in FY15 taking the total to $1,098m). A capital return of $505m, equivalent to 23 cents per share, is proposed to be paid to shareholders in early November 2015. The return will be accompanied by a share consolidation (roughly 6% of shares) which makes the capital return similar to a buyback.

S32 (-14.8%): S32's first result as a stand-alone entity delivered FY15 EBITDA of US$1.849bn which was a 3% beat vs OMLf, although underlying earnings were lower than we expected on the back of higher finance charges. Cost out guidance of US$350m by FY18, or ~US$117m/yr was announced on US$4.6bn of controllable costs. The management team noted US$650m per year sustaining capex guidance. which is circa US$100m lower than consensus forecasts.

SUN (-10.1%): Reported profit for FY15 came in at $1,133, representing an increase of 55% compared to the pcp. Reported margins in 2H15 were 11.4%, underlying as SUN calculates they remained very strong at 14.7% for FY15, up from 14.3% in FY14. The surplus CET1 capital as calculated by SUN after excluding the dividend to be paid is $570m above operating targets down from $831m in Jun-14.

TCL (-2.9%): EBITDA of $1,289 led to a margin of 74.7%, representing a 220bps decrease compared to the pcp while FCF increased by 7.1% to $40.2m. Despite FFO/Debt at 7.9% slipping slightly below the 8-12% range, CFO Adam Watson noted that the metric was in line with expectations for FY15, and that he remains comfortable with the funding equation at the moment.

TLS (-11.1%): TLS' FY15 EBITDA was in line with consensus ($10,745m actual vs $10,758m consensus) which represented 2% EBITDA growth on FY14. TLS guided for FY16E mid single digit income growth and low single digit EBITDA growth. There was a small increase in dividend, 30.5cps in FY15 vs 29.5 cps in FY14 - TLS management reiterated their focus on a sustainable increase in the dividend, with more meaningful dividend increases more likely as NBN roll out reaches critical mass.

WES (-4.2%): NPAT (continuing operations ex significant items) increased 8.3% to $2.44bn. At a divisional level the key Coles and Home Improvement divisions were slightly above expectations, as was Target, while Industrial & Safety, Kmart and Officeworks were in-line with forecasts.

WOW (-7.7%): WOW reported a FY15 NPAT of $2.45bn in-line with its flat guidance. Australian Food, Liquor & Petrol and New Zealand Supermarkets EBIT was in-line with expectations, with Home Improvement, Hotels and Big W worse than expected with NPAT assisted by lower quality drivers (lower Central Overheads and Net Interest Expense). Food & Liquor LFL sales growth declined 0.9% in the first 8 weeks of FY16, while General Merchandise LFL declined 8.9%.

Performance attribution for the ASX 200 sectors and best/worst stocks for August 2015

Sector	% chg	Points	Best Performer	% chg	Points	Worst performer	% chg	Points
Materials	-0.7	-44.2	Sims Metal Management	+21.4	+1.4	Syrah Resources Ltd	-18.0	-0.4
Consumer Discretionary	-0.2	-11.5	Pacific Brands Ltd	+41.7	+0.7	APN News & Media Ltd	-29.4	-0.8
Energy	-0.7	-44.1	Whitehaven Coal Ltd	-2.9	-0.1	Senex Energy Ltd	-36.2	-0.3
Industrials	-0.4	-22.0	GWA Group Ltd	+9.1	+0.3	Downer EDI Ltd	-20.4	-1.6
FinancialsxREITS	-4.4	-270.3	OzForex Group Ltd	+16.5	+0.3	Genworth Insurance	-25.1	-0.9
Information Technology	-0.1	-6.9	IRESS Ltd	-9.0	-0.5	Computershare Ltd	-19.9	-5.1
Health Care	-0.4	-21.6	Sirtex Medical Ltd	+12.5	+0.9	Mesoblast Ltd	-15.7	-0.5
Telecoms	-0.5	-37.8	Spark New Zealand Ltd	+13.0	+0.3	M2 Group Ltd	-17.0	-1.4
Utilities	0.0	-0.8	Spark Infrastructure	+2.8	+0.4	AusNet Services	-6.1	-0.6
Consumer Staples	-0.3	-21.5	Asaleo Care Ltd	+5.6	+0.2	Coca-Cola Amatil Ltd	-9.5	-1.9
REITS	-0.3	-20.2	Abacus Property Group	-1.3	-0.0	Cromwell Property	-8.1	-0.5
Starting Index Level[1]		5,699.2						
Ending Index Level		5,207.0						
Price Change	-8.64%	-492.9						

Source: Analyst Quant. [1]Starting index level is close of 31 July 2015, ending index level is close of 31 August 2015, performance of stocks is based on chg, point chg of sectors is calculated using starting index value and don't sum to points chg of index.