Australia Monthly Wrap I January 2015

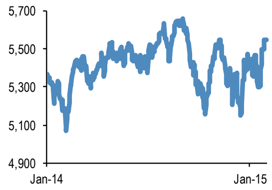
Draghi acts

Key market drivers. The ASX200 rose a respectable 3.3%, although a weaker AUD dragged the local index towards the back of the pack amongst global benchmarks in USD terms (-1.8%). European equities were the standout, as the ECB announced a QE program to begin in March; the Euro Stoxx 50 (+6.5%) posted its best monthly performance since June-12, a stronger USD weighed on the S&P500 (-3.1%), the Nikkei 225 rose 1.3% and Emerging Markets were roughly flat (MSCI Emerging Market Index, +0.6%). Domestically, the ex-resources index rose 4.2%, as lower long rates and a weaker AUD boosted the appeal of high yield and globally exposed companies. Among the sectors, Utilities (6.1%), Telcos (+8.3%) and REITs (+7.7%) rose firmly, while the Banks (+4.2%) and Consumer Discretionary (+6.2%) sectors also outperformed. The Energy (-6.5%) and mining heavy Materials (+0.8%) sectors continued to underperform, as oil and iron ore prices fell further.

Economic news. Expectations of rate cuts in Australia heightened following a weaker-than-expected fourth-quarter CPI print. January's FOMC statement reiterated that the Fed will be "patient" before raising interest rates. The ECB announced an open-ended sovereign QE program due to begin in March. China's fourth-quarter GDP rose 7.3% y/y, resulting in full-year growth finishing below the PBoC's stated 7.5% target. The Swiss National Bank announced it would end its three-year long policy to defend a EUR/CHF floor of 1.20. The left-wing Syriza party's leader, Alexis Tsipras, was sworn in as Prime Minister of Greece.

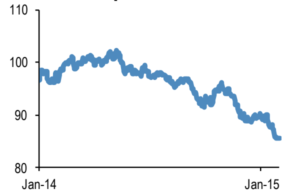
Major company news. Woodside and Oil Search provided CY15 production guidance. Arrium announced in its quarterly production report, it will mothball its high cost Southern Iron mine. ResMed posted a strong quarterly result with revenue from US flow generators rising 25% y/y. BHP reported Pilbara iron ore production of 248Mtpa at its December quarterly result, and RIO reported fourth-quarter iron ore shipments of 311Mtpa.

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	
Telco's	+8.3%	Telco's	+14.4%	Evolution Mining	+39.5%	Northern Star Res	+63.2%
A-REITs	+7.7%	A-REITs	+12.5%	Beadell Resources	+26.7%	Qantas Airways	+55.4%
Consumer Disc.	+6.2%	Health Care	+10.0%	Ainsworth Game	+25.0%	Evolution Mining	+50.0%
Utilities	+6.1%	Utilities	+6.9%	Newcrest Mining	+24.5%	Newcrest Mining	+45.5%
Banks	+4.2%	Industrials	+6.0%	Liquefied Nat Gas	+23.1%	Magellan Financial	+42.4%
Consumer Staples	+3.5%	Banks	+5.2%				
Health Care	+2.7%	Consumer Disc.	+1.6%	Bradken	-42.3%	UGL	-74.2%
Industrials	+1.3%	Technology	-3.2%	MMA Offshore	-35.5%	Sundance Energy Aus	-60.1%
Materials	+0.8%	Materials	-5.0%	Lynas Corp	-33.8%	Horizon Oil	-57.6%
Technology	-1.3%	Consumer Staples	-5.8%	Horizon Oil	-21.9%	MMA Offshore	-57.0%
Resources	-1.3%	Resources	-12.6%	Metcash	-21.3%	Bc Iron	-56.7%
Energy	-6.5%	Energy	-20.2%				

Source: Bloomberg, MSCI.

Equity review

Major Market Performance, January 2015

	Level	Change
DJ Industrials	17,165	-3.7%
S&P 500	1,995	-3.1%
NASDAQ	4,635	-2.1%
FTSE 100	6,749	+2.8%
Nikkei225	17,674	+1.3%
Euro Stoxx 50	3,351	+6.5%
ASX 200	**5,588**	**+3.3%**

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

US equity market

Despite better-than-expected Dec-14 quarter earnings, the S&P500 underperformed global benchmarks, posting a decline of 3.1%. Banks were the key laggard, with the sector falling 10.7%, while the Energy and Technology sectors also underperformed (-4.9% and -3.9% respectively). Defensive sectors including Healthcare (+1.2%), Utilities (2.3%) and Consumer Staples (-1.3%) outperformed the falling index.

As at Jan 28th, 120 companies in the S&P500 index had reported, with 73% of companies beating consensus estimates, and in aggregate, Dec Q earnings rose 4.1% y/y (blended actual & estimates).

Australian equity market

The ASX200 (+3.3% accumulation, +3.3% price) benefitted from falling bond yields and a weaker AUD. In particular, the REITs (+7.7% acc.), Telcos (+8.3% acc.) and Utilities (+6.1% acc.) sectors outperformed as the 10-year Australian benchmark yield fell to an all-time low. Similar to much of last year, the Materials (+0.8% acc.) and Energy (-6.5% acc.) sectors underperformed amid continued weakness in commodity prices. Banks also outperformed (+4.2% acc.), as did the Consumer Discretionary sector (+6.2%).

Highlights from quarterly production reports from resources companies included CY15 guidance updates from Woodside and Oil Search, and Arrium's decision to mothball its high cost Southern Iron mine. ResMed Inc. posted a strong quarterly result with revenue from US flow generators rising 25% y/y. BHP reported Pilbara iron ore production of 248Mtpa at its December quarterly result, while RIO reported 4Q14 iron ore shipments of 311Mtpa.

Other Financial Data, January 2015

	Level	Change
Aust RBA Cash rate	**2.50%**	**+0bp**
US 10 yr bond yield	1.64%	-53bp
AU 10 yr bond yield	2.44%	-30bp
Australian dollar/US$	0.7762	-5.3%
LME Metals Index	2,715	-6.8%

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

Bonds

In keeping with last year's theme, global developed market bond yields fell as tumbling oil prices eased the inflation outlook. The benchmark 10-year Australian government bond yield fell 30bp, remaining at all-time lows. The benchmark 10-year US government bond fell 53bps following Fed commentary stating inflation risk is to the down-side in the near term. The AUD OIS curve fell over the month, reflecting increased market expectations for RBA policy rate cuts this year. With the exception of Greece, bond markets of peripheral European countries brushed off fears that the Syriza election win in Greece will invoke similar action in other bailed-out countries; 10-year benchmark yields fell in Spain -19bps, Portugal -5bps and Italy -30bps, while Greek yields rose 140bps.

Currencies

The AUD fell 5.3% against the USD, moving closer to the 0.75c level Governor Glenn Stevens set as a target in an interview to the AFR last month. In trade-weighted terms, the AUD fell 3.9%, with the currency depreciating against Australia's largest trading partners (CNY -4.5%, JPY -6.8%, USD -5.3%, KRW -4.3%, SGD -3.0%). The USD, as measured by the ICE index, rose 5.0%, supported by the prospect of higher rates later in the year. The Swiss National Bank (SNB) announced it would end its policy of capping Swiss Franc appreciation against the euro by removing the EUR/CHF 1.20 floor it had defended for three-years – the Franc rallied 15.6% against the EUR.

Commodities

Spot **Brent crude slid** for a seventh consecutive month posting an 8.9 % decline. For the second time in the space of a month, S&P downgraded its oil price assumptions for 2015 by 30% to US$55 per barrel and c.23% in 2016 to US$65 per barrel, putting further pressure on credit ratings of oil and gas producers.

The benchmark spot **iron ore price** fell 12.7%, marking the largest fall in the commodity price since May-14.

Base metals, as measured by the LME index, fell 6.8%. Copper was particularly weak, plunging 13%. Zinc fell 2.2%, while aluminium (+1.6%), nickel (+0.2%) and lead (+0.1%) rose.

Revised global growth expectations from the World Bank (3.4% to 3.0%) and the Swiss National Bank's decision to remove the EURCHF peg underpinned an 8.3% surge in the **spot gold** price.

US Economy

January's **FOMC** statement reiterated that the Fed will be "patient" before raising interest rates. The message on factors that will determine the first rate hike were mixed - sounding more upbeat on the domestic economy but also noting that "international developments" will be a factor.

4Q14 GDP moderated to a 2.6% annual rate (exp. 3.0%). Consumer spending increased a strong 4.3%, while capital spending and exports slowed.

The Thomson Reuters/University of Michigan **consumer confidence** index increased 4.5pts to 98.1 (exp. 94.1), reaching the highest level since Jan-04. The **ISM manufacturing PMI** eased to 55.5 (exp. 57.5) from 58.7 last month. The **non-manufacturing survey** was also weaker-than-expected, reading 56.2 (exp. 58.0) compared to 59.3 last month.

Nonfarm payrolls increased 252k (exp. 240k) in December, and net revisions to the prior months brought 2014 job creation to a total of 2.952m. The **participation rate** reversed the prior two months' increase and sank to 62.7%, helping the **unemployment rate** fall 0.2%-points to 5.6% (exp. 5.7%).

Housing starts rose 4.4% m/m in December to a seasonally adjusted annual rate of 1.089m. **Housing permits** fell 1.9% m/m; the weakness was driven by multi-family permits falling 11.8%.

CPI inflation fell 0.4% m/m (exp. -0.4%) in December, while the ex food and energy measure was flat (exp. +0.1%).

China

The **HSBC manufacturing PMI** turned up modestly to 49.8 (exp. 49.5) from 49.6 in Dec-14.

4Q14 GDP rose 7.3% y/y (exp. 7.2%), unchanged from the increase in 3Q14. Annual growth for 2014 narrowly missed the stated growth target by 0.1%-points.

On average, national house prices declined 0.4% m/m in December, and 94.3% of cities in the NBS 70-city house price index registered m/m price declines.

December CPI met expectations coming in at 1.5% y/y. **PPI** deflation widened to -3.3% y/y (exp. -3.1%), and hit the lowest reading since October 2012.

M2 money supply eased slightly to 12.2% y/y in December (exp. 12.5%). **New loan creation** came in lower-than-expected at 697.3bn yuan (exp. 880bn), and **Total social financing** reached 1,690bn yuan (exp. 1,200bn), the highest figure since July 2014 (vs. 1,146.3bn in November and 1,232bn in December 2013).

Australian Economy and the RBA

As scheduled, there was no **RBA board meeting** in January. The outcome of the next meeting will be announced at 2:30pm on February 3.

The NAB **business confidence** index ticked up to +2 from +1in the November reading, while the **NAB business conditions** index fell 1 point to +4. The **Westpac-MI consumer confidence index** rose 2.4% to 93.2, after a 5.7% slump in December.

The economy added 37k **jobs** in December (exp. 5k), and the **unemployment rate** fell 0.1%-points to 6.1%. The **participation ratio** was roughly flat at 64.75%.

Retail sales rose 0.1% m/m (exp. +0.2%) in November. Food retailing and restaurants categories were strong, rising 0.6% and 0.8% respectively, while clothing declined 0.7%.

Building approvals rose 7.5% m/m (exp. +3.0%) in November, marking a monthly record high for the series at 18,245, driven by a 17.2% increase in the multi-family segment.

The volume of new **housing finance commitments** slipped 0.7% m/m in November (exp. +1.7%).

4Q CPI came in at 0.2% q/q (exp. 0.3%). As expected, the automotive fuel component was weak, trimming 0.25%-points off the headline figure.

Europe

The **ECB** announced an open-ended sovereign QE program at a pace of EUR60bn per month, starting in Mar-15 and continuing through at least Sep-16. The EUR60bn monthly pace now includes Euro Area government bonds in addition to the existing ABS and covered bond purchase programmes.

Alexis Tsipras was sworn in as Prime Minister of Greece following the Syriza party's victory at the general election in January. In an unusual arrangement, left-wing Syriza will form a coalition with the right-wing Independent Greeks party.

Eurozone CPI continued to fall with the preliminary print for January coming in at -0.6% y/y (exp. -0.5%).

Bank of Japan officials appeared to give up on the previously set 2% inflation target for FY15 as inflation expectations for FY15 were downgraded from 1.7% y/y to 1.0% y/y.