# Australia Monthly Wrap I April 2016

## April economic wrap

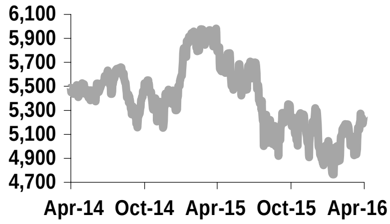
Why is everyone so tired on April 1st? Because they've just finished a long, 31 day march. April saw lower performance compared to March. The S&P/ASX 200 returned +3.3% for the month, due to a bounce in the mining sector. The S&P/ASX 200 exceeded most of its developed market peers. Iron ore enjoyed one of its largest single monthly gains of +23.4%, it is up 46.3% in the Year-to-date (April). The iron ore price rise combined with other commodity price increases saw the Materials sector rise +14.2%, this was one of the largest moves in April. The Prime Minister, Malcolm Turnbull confirmed that, the Australian Building and Construction Commission (ABCC) reforms, twice rejected by the Senate, will trigger a double dissolution election in Australia on 2 July. Inflation fell in the March quarter, with the Consumer Price Index falling to 1.3%yoy a 15 year low, well below the Reserve Bank of Australia's (RBA) target band (2-3%). Spilling into May we saw the RBA lower the cash rate to 1.75%.

In global markets the MSCI World Index rose by 1.3% in April. The FTSE 100 rose by +1.1%, the Euro Stoxx 50 rose by +0.8% and the S&P 500 rose by +0.3%. Most markets managed to post positive returns with the exception of the NASDAQ down -1.9% and the Nikkei 225 down -0.6%.

**Key economic news** – The RBA kept the cash rate unchanged in April at a historical low of 2.0%. The RBA hinted towards a future rate cut due to concerns over the recent Australia Dollar (AUD) strength and diminishing inflationary pressures. Unexpectedly weak consumer price index (CPI) data shocked the market as headline inflation for Q1 recorded -0.2% (consensus: +0.2% QoQ). As a result, cash rate futures put the probability of a rate cut in May at approximately 50%. The AUD continued its uptrend throughout April but dropped below US76c immediately following the release of the weak inflation data. The European Central Bank (ECB) left quantitative easing on hold due to improvements in loan supply conditions and expectations of an economic recovery. The US Federal Reserve (Fed) left monetary policy unchanged following stronger labour market conditions.

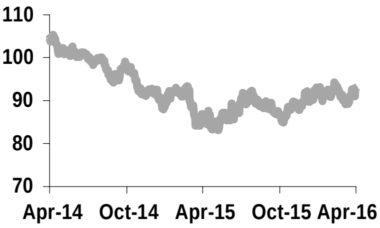
**Key company news –** Through April we saw Ferrovial declare its takeover offer for Broadspectrum unconditional following the Board's unanimous recommendation that shareholders accept the $1.50 cash offer. Ferrovial's voting power in Broadspectrum increased to over 50% after Papua New Guinea ruled that the Manus Island detention centre was illegal and unconstitutional. Westpac followed rivals ANZ and CBA in restricting lending to foreign property investors. The decision followed pressure from regulators as concerns grow over the big banks exposure to property. The Federal government also announced an increase to the levy that banks pay to fund ASIC by $121 million. Dexus' $2.5 billion takeover proposal for Investa Office Fund was rejected in April and sparked a reshuffle of the executive team.

**S&P/ASX 200 Price Index**




Source: Bloomberg, IOOF

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




Source: Bloomberg, IOOF

## 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 | -1.65 | Consumer Discretionary | 0.05 | Monthly | | | |
| ▲ | Consumer Staples | 1.34 | Consumer Staples | -2.25 | Fortescue Metals Group | +33.7% | Nine Entertainment Holding | -27.6% |
| ▲ | Energy | 7.65 | Energy | 11.91 | Worleyparsons Ltd | +29.9% | Qantas Airways Ltd | -20.9% |
| ▲ | Financials ex Property | 1.40 | Financials ex Property | -0.65 | Evolution Mining Ltd | +29.0% | Mantra Group Ltd | -18.3% |
| ▲ | Financials | 1.65 | Financials | 0.69 | Broadspectrum Ltd | +24.9% | Mesoblast Ltd | -14.8% |
| ▲ | Health Care | 3.28 | Health Care | 3.40 | Mineral Resources Ltd | +23.3% | Myer Holdings Ltd | -11.9% |
| ▲ | Industrials | 1.48 | Industrials | 9.12 | Quarterly | | | |
| ▲ | IT | 3.00 | IT | 2.27 | Worleyparsons Ltd | +106.2% | Nine Entertainment Holding | -31.5% |
| ▲ | Materials | 14.18 | Materials | 30.30 | Mineral Resources Ltd | +99.7% | Ozforex Group Ltd | -30.8% |
| ▲ | Property Trusts | 2.80 | Property Trusts | 7.33 | Beach Energy Ltd | +97.3% | Cover-More Group Ltd | -29.1% |
| ▲ | Telecommunications | 0.47 | Telecommunications | -3.31 | Fortescue Metals Group | +97.1% | Bellamy's Australia Ltd | -27.1% |
| ▼ | Utilities | -0.39 | Utilities | 0.73 | Whitehaven Coal Ltd | +87.8% | Programmed Maintenance | -27.1% |

Source: Bloomberg, IOOF

# Equity review

## Major Market Performance, April 2016

| | Australian Indices | Mth | %∆ | Qrt | %∆ |
|---|---|---|---|---|---|
| ▲ | S&P/ASX 200 | 5252 | 3.33 | 5006 | 4.93 |
| ▲ | All Ordinaries | 5316 | 3.19 | 5057 | 5.13 |
| ▲ | Small Ordinaries | 2235 | 2.93 | 2063 | 8.33 |
| | **US Indices** | | | | |
| ▲ | S&P 500 | 2065 | 0.27 | 1940 | 6.45 |
| ▲ | Dow Jones | 17774 | 0.50 | 16466 | 7.94 |
| ▼ | Nasdaq | 4775 | -1.94 | 4614 | 3.50 |
| | **Asia Pacific Indices** | | | | |
| ▲ | Hang Seng | 21067 | 1.40 | 19683 | 7.03 |
| ▼ | Nikkei 225 | 16666 | -0.55 | 17518 | -4.86 |
| | **UK & Europe Indices** | | | | |
| ▲ | FTSE 100 | 6242 | 1.08 | 6084 | 2.60 |
| ▲ | CAC40 | 4429 | 1.00 | 4417 | 0.27 |
| ▲ | Dax Index | 10039 | 0.74 | 9798 | 2.46 |

Source: Bloomberg, IOOF

### US equity market

The S&P 500 was up +0.27%. Performance came mostly from Energy up +8.7%, Banks up +6.8% and Materials up +4.9%. Other sectors with positive performance were Financials up +3.3%, Healthcare up +2.9% and Industrials up +0.8%. Defensive sectors underperformed over the month with Telco's down -3.1%, Utilities down -2.4% and Consumer Staples down -1.5%.

The first quarter company earnings results were reported in April, with around 60% of companies listed in the S&P 500 posting a positive result.

### Australian equity market

The S&P/ASX200 index finished the month up +3.3%. Sector performance was similar to that of the US. We saw cyclical sectors of Materials down -9.5%, Resources down -9.2%, and Banks down -9.1% lead the declines. Defensive sectors lead the charge and managed to return positive performance, A-REITS up +1%, Utilities up 0.7% and Telco's up +0.7%

# Fixed Income

| | Fixed Income | Mth | +/- | Qrt | +/- |
|---|---|---|---|---|---|
| | Aussie Cash Rate | 2.00 | -- | 2.00 | -- |
| ▲ | Aust 10-year Bond Rate | 2.52 | 0.03 | 2.64 | -0.12 |
| ▼ | Aust 3-year Bond Rate | 1.86 | -0.05 | 1.88 | -0.02 |
| ▼ | 90 Day Bank Accepted Bills SFE-Day | 2.15 | -0.12 | 2.26 | -0.11 |
| ▲ | US 10-year Bond Rate | 1.83 | 0.06 | 1.92 | -0.09 |
| ▲ | US 3-year Bond Rate | 0.93 | 0.08 | 0.97 | -0.03 |

Source: Bloomberg, IOOF

Over the month the Australian yield curve remained mostly unchanged due to the uncertainty in the lead up to the May RBA meeting. The Australian 3year fell (-5bps) while the 10year bond yields rose (+3bps) over the course of the month, the US 3year (+8bps) and 10year (+6bps) bond yields both rose over the month.

# Currencies

| | Currencies | Mth | %∆ | Qrt | %∆ |
|---|---|---|---|---|---|
| ▼ | $A vs $US | 76.03 | -0.71 | 70.84 | 7.33 |
| ▼ | $A vs GBP | 52.03 | -2.42 | 49.73 | 4.61 |
| ▼ | $A vs YEN | 80.97 | -6.06 | 85.82 | -5.65 |
| ▼ | $A vs EUR | 66.40 | -1.32 | 65.41 | 1.51 |
| ▼ | $A vs $NZ | 109.00 | -1.65 | 109.27 | -0.25 |
| ▼ | $US vs EUR | 87.33 | -0.61 | 92.33 | -5.42 |
| ▼ | $US vs GBP | 68.44 | -1.71 | 70.20 | -2.51 |
| ▼ | $US vs CHF | 95.99 | -0.20 | 102.31 | -6.18 |

Source: Bloomberg, IOOF

The AUD ended the month weaker against the USD after the latest Australian inflation figures reversed initial AUD strength. Commodity price support saw the AUD break through the US78c mark in mid-April but disappointing inflation figures triggered a plunge to below US76c. We also saw the AUD depreciate against most other global partners. The big story of the month was the Japanese Yen which soared over 5% against the USD after the Bank of Japan left asset purchases and interest rates on hold. The Yen has had the best start to the year in two decades as a result of the Bank of Japan's failed effort to weaken the currency by adopting negative interest rates. The fading prospect of a US interest rate rise in 2016 weighed on the USD.

# Commodities

| | Commodities | Mth | %∆ | Qrt | %∆ |
|---|---|---|---|---|---|
| ▲ | Aluminium | 1674 | 10.66 | 1522 | 9.97 |
| ▲ | Copper | 228 | 4.22 | 208 | 10.00 |
| ▲ | Nickel | 9417 | 11.19 | 8628 | 9.14 |
| ▲ | Gold | 1291 | 4.44 | 1117 | 15.55 |
| ▲ | Silver | 18 | 14.95 | 14 | 24.69 |
| ▲ | Crude Oil - Brent | 48 | 21.54 | 35 | 38.54 |
| ▲ | Lead | 1802 | 5.94 | 1719 | 4.83 |
| ▲ | Zinc | 1934 | 6.72 | 1625 | 19.00 |
| ▲ | Iron Ore | 59.58 | 7.31 | 41.17 | 44.72 |

Source: Bloomberg, IOOF

Commodities continued to rally in April as markets hinted that the worst was over for the commodity rout. This idea is being supported by signs of stabilisation in China and falling US oil supply as shale oil producers continue to be priced out of the market.

Precious metals soared on a weaker USD and uncertain policy action with gold up 4.4% and silver up 15% over the month. Base metals were also supported by a weaker USD and ended the month higher. Brent crude oil finished the month up 21.5% due to falling output in the US whilst oil inventories climbed to their highest level in 80 years. The OPEC meeting in Doha failed to produce a deal on an oil production freeze. The crude oil price dropped immediately following the decision but rebounded on news of supply disruptions in Kuwait and Mexico.

## Australian Economy and the RBA

In April we saw the RBA leave the cash rate on hold at a historical low of 2.0%. The RBA noted that recent AUD strength could complicate the progress in rebalancing from a mining to a services driven economy. Disappointing CPI data released in April indicated that headline inflation for Q1 was -0.2%QoQ and 1.3%YoY. This data will be an important catalyst in a decision to lower the cash rate in May because inflation is currently well below the RBA's medium term target zone of 2-3%.

Cash rate futures put the probability of a rate cut in May at approximately 50%. Mixed economic data and the uncertainty regarding a May rate cut drove volatility in the AUD towards the end of the month and pushed the currency as high as US77c. The combination of weak inflation and an appreciating AUD provides a strong argument for the RBA to judge it prudent to reduce the cash rate in May. Doing so would improve the prospects for growth and inflation going forward.

Residential building approvals for March beat forecasts by rising to 3.7%MoM, suggesting that the recent downtrend may be flattening out. Employment growth for March rose by a solid 26.1k, whilst employment growth fell marginally to 2.0%YoY. The unemployment rate fell to 5.7%, putting pressure on the RBA to cut rates in May. Retail sales for March beat expectations and rose 0.4%MoM, but consumer spending still appears to be on the cautious side.

## US Economy

The Fed maintained the federal funds rate in the target range of 0.25 - 0.50% in the month of April. Growth in economic activity slowed in the US and was reason enough to keep rates on hold even though a range of recent indicators were positive including stronger labour market conditions in the form of strong job gains. Future adjustments to interest rates will depend on employment and inflation data which continue to run below the Fed's target in part due to weaker energy prices. The Fed has indicated that there will be gradual adjustments in the stance of monetary policy, but we can expect lower rates for longer until inflation rises closer to 2% and the downside risk to global economic conditions softens.

The ISM manufacturing index for April expanded for the second consecutive month registering 50.8. This is a decrease of 1 percentage point on the March reading and indicates growth following a period of sub-50 readings. The ISM non-manufacturing index for April rose to 55.7 providing further evidence that the non-manufacturing sector is growing and that the economy is on the track to recovery. The Markit Services PMI was also encouraging, rising to 52.8 in April, highlighting the rebound in business activity.

The advance estimate of GDP growth for Q1 2016 was 0.5%, reflecting negative contributions from non-residential fixed investment, private inventory investment and exports. This estimate is down from Q4 2015 GDP of 1.4% and indicates that the economy is growing slower than expected.

## China

The Chinese equity market in the month of April was lower compared to March, with the Shanghai Composite posting a -2.2% return. The month overall started weak due to the factors concerning the Peoples Bank of China's (PBoC) willingness to continue its stimulus in the economy.

Overall manufacturing and non-manufacturing numbers rose over the month signalling to the market that the Chinese economy is still in good condition going forward. This positive sentiment was translated in the market with stocks rising through to mid-month, the continuing positive numbers in exports also beat expectations rising to 18.7%. The positivity was short lived with the market falling for the rest of the month. Imports fell -4.8% for the quarter which was worse than what was anticipated. Overall there seems to be growing uncertainty over China's future economic prospects which most investors are worried about going forward.

## Europe

The ECB decided to focus on the implementation of additional policy measures in April, maintaining the current level of monthly asset purchases at €80 billion and the deposit rate at -0.4%. The ECB expects to maintain low interest rates for an extended period of time and well past the horizon of its asset purchase program in order to support the economic recovery in Europe.

The Markit Eurozone Composite PMI fell 0.1 points in April to 53.0, with similar falls in Manufacturing (-0.1 to 51.5), whilst a rise was recorded for Services (+0.1 to 53.2). New orders improved to a 3-month high, albeit below the average seen over the past year which still indicates sluggish growth. The annual inflation rate for April is expected to be -0.2%, down from the March reading of 0.0%. Europe is still struggling with deflationary pressures despite the adoption of negative interest rates in June 2014. The ECB maintains that without the monetary policy measures enacted in March, inflation would be negative this year and about half a percentage point less over the coming two years. Structural policies are essential to boost job creation and it appears that the recovery is being supported by improvements in loan supply conditions for enterprises due to low interest rates.

A lot of the focus in Europe is still centred on the June 23 referendum regarding the UK's potential withdrawal from the EU. Opinion polls continue to show that the position between the 'remain' and 'leave' vote is close. This comes after Barrack Obama announced that the UK would be "at the back of the queue" for a trade deal with the US if the exit eventuates. The uncertainty regarding the outcome is driving volatility in Europe and the potential spill over effects are adding pressure to global economies already struggling with growth.