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Monthly Market Insights January 2020

Australia

The Australian economy grew at 1.7% in the September quarter and most likely less than 2.0% in the December quarter, well below the growth rate required to lift wages and inflation and to keep unemployment from rising. The RBA has indicated that if it drifts further away from achieving its inflation and unemployment targets, rates will be cut again.

The bushfires over recent months, particularly in NSW and Victoria, will have an impact on growth, reflecting direct loss of output, lost tourism, lower consumer and business confidence, and supply chain disruptions. However, insurance payouts and government support packages will likely provide an offsetting boost in the quarters ahead.

The unemployment rate currently sits at 5.1%, up slightly from 5.0% a year ago. Over 2019, 152,700 full-time jobs were added, although this has been offset by a rise in the participation rate to produce a slightly higher rate of unemployment. Leading indicators of unemployment still paint a picture of subdued jobs growth.

It's been a tough start to the year for Australia's manufacturing sector. The AIG Manufacturing Index fell a further 2.9 points to 45.4 in January, the lowest result since 2015, pointing to a deeper contraction impacted in part by drought and bushfire disruptions, although some manufacturers reported a rise in new orders due to the bushfire response.

After a disappointing Christmas season for retailers, the start of the new year hasn't done anything to improve the disposition of Australian consumers. The Westpac Melbourne Institute Index of Consumer Sentiment fell further in January, due in no small part to the effect of the bushfires.

Global

Markets have been affected by risk events like the coronavirus and geopolitical unrest, which are creating uncertainty for investors and policymakers. Some indicators that were recently trending down, such as manufacturing activity, seem to have stabilised and consumer spending is still holding up. However, evidence suggests that we are in the later stages of the current economic cycle.

In the US, orders for capital goods dropped in December, suggesting that business investment was a drag on growth in the December quarter. The bright spot was again the labour market, with a greater-than-expected rise in non-farm payrolls, indicating that hiring may be speeding up again. From a monetary policy perspective, the slowdown in growth suggests the chances of a further cut in the Fed funds rate is still relatively high.

German GDP grew by only 0.6% in 2019, down from 1.5% in 2018 and 2.5% in 2017. The government expects growth to pick up to 1.0% in 2020 having cut its forecast from 1.5% in October. Germany is particularly sensitive to disruptions in global trade, and hence to the US-China trade war and Brexit.

Pleasingly, the worst appears to be over for the eurozone, with the Brexit bill now passed by the UK parliament, possible fiscal support on the way from the German government, and the largest increase in exports in two years helped by the weaker euro. Markets expect earnings growth to increase by 1.3% in the December quarter after falling in three consecutive quarters.

The outbreak of the coronavirus in Wuhan and its spread to 27 other countries has resulted in travel restrictions and quarantine measures to prevent a pandemic. Containing the virus has been made more challenging given that the outbreak coincided with the Lunar New Year, which typically involves extensive worldwide travel by Chinese citizens. The easing measures undertaken over the past 12 months appear to have stabilised the Chinese economy, however the direct economic effect from the coronavirus is likely to be significant and may warrant further measures.

The other major development over the month was the signing of the phase one trade deal between the US and China. The risk of a further escalation in the trade war has been averted for now, but a full resolution remains unlikely until at least 2021. Removal of existing tariffs is conditional on achieving the targeted increase in US imports over 2020-21, meaning trade tensions are unlikely to disappear anytime soon. The US economy has already been impacted by the trade war, as evidenced by the weaker manufacturing sector. At this point, the trade deal is more about avoiding an escalation than a complete scaling back of tariffs.

Commodities

Commodities took a tumble in January with base metals down. Gold bucked the trend, rising 4.4% over the month to US while oil dropped to $58.16.

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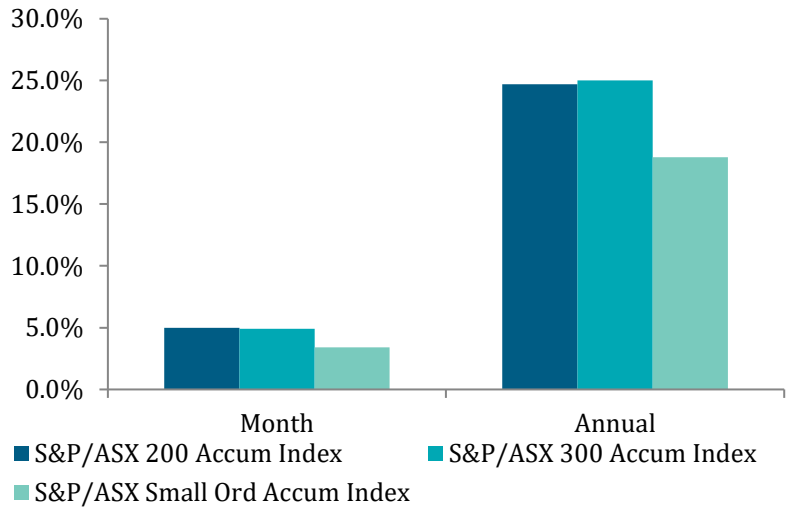
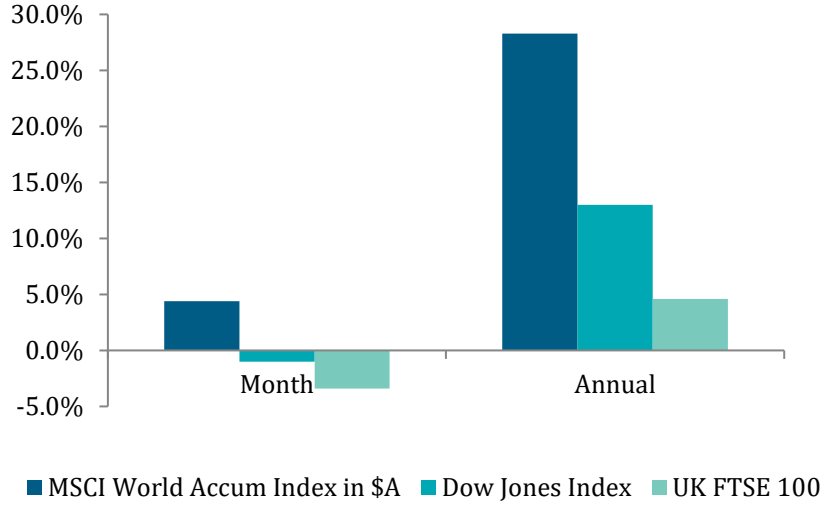
Australian Shares



Following a very strong performance in 2019, the Australian equity market started 2020 in the same manner.

Over January, the S&P/ASX 200 Index returned 5.0%, led by large cap shares. The 12-month forward Price/Earnings ratio for the Australian equity market stood at 17.4 times in January, nearing its highest level since 2001. This signifies a relatively expensive market, which makes it vulnerable to shocks like the coronavirus, but investors need to be cognisant of the continuation of ultra-low interest rate settings providing a meaningful valuation support for equities.

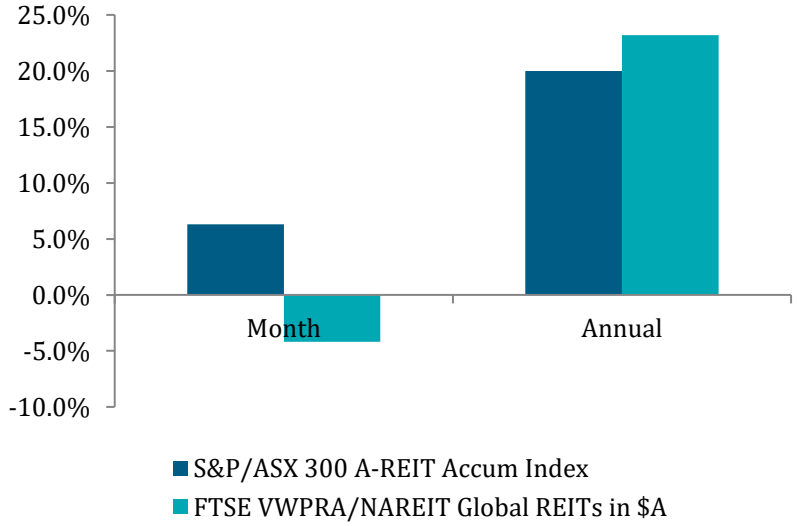
International Shares



After surging in the final quarter of 2019, US equities were flat in January, while the coronavirus outbreak added to global uncertainty and saw markets tumble at the end of the month. The MSCI World Ex-Australia Index rose 4.2% in January in Australian dollar terms, but most major indices were down in local currencies.

News of the virus's spread had a pronounced effect on markets, with investors concerned about the flow-on effects to the real economy. Globally, valuations across most regions remain above their longer average from a Price/Earnings ratio standpoint.

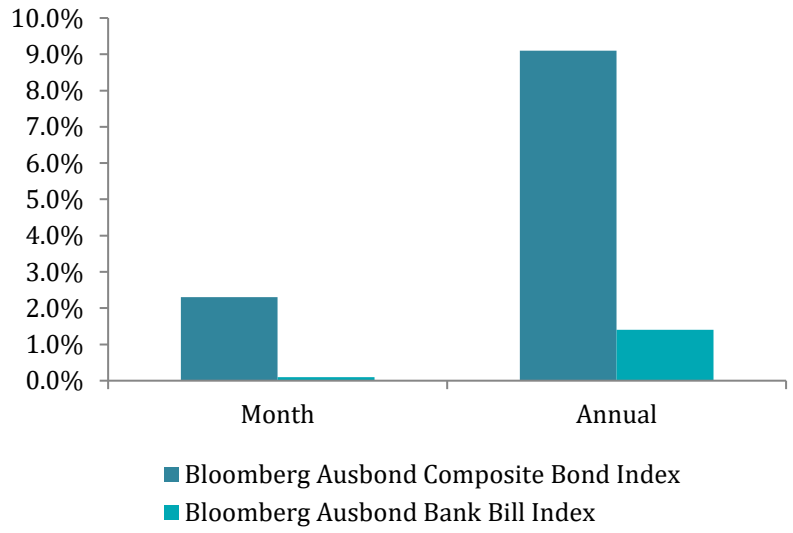
Property



Australian listed property rose 6.4% in January as the sector bounced back from a tough month in December, while globally, property was a popular safe-haven for investors.

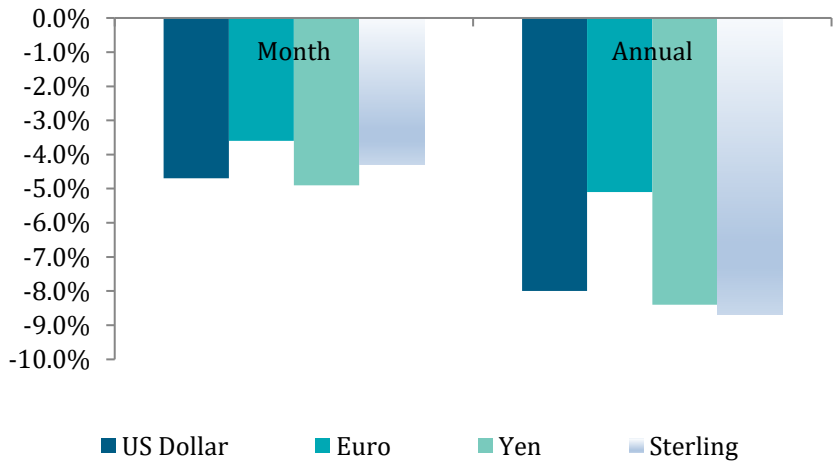
In the residential market, house prices rose by 4.0% nationally in the December quarter although they remain 3.1% below peak levels. House prices in Melbourne and Sydney rose 5.3% in 2019 according to CoreLogic data.

Fixed Interest



While the RBA expects inflation to gradually increase, subdued wages growth and restrained levels of consumer spending remain the key threats to this scenario. The bank maintained the official cash rate at an historic low of 0.75% at its February meeting, where it has remained since the 25 basis point cut last October, as members assessed the economic fallout from the bushfires and the likely impact of the coronavirus outbreak. The market continues to expect at least one further rate cut this financial year, with a high probability priced in that the official rate falls as low as 0.25%.

Australian Dollar



For the RBA, the bias is still towards lower cash rates. A "gentle turning point" in the economy may materialise, but escape velocity is not assured at this stage. The currency failed to break through the US $0.70 barrier in December and finished January at $0.67. A move through the upper end of the recent 0.70–0.67 range requires more evidence of stronger domestic growth or a weaker US dollar.

Over the three months to the end of January 2020 the Australian dollar fell against the US dollar, the euro, the Japanese yen and the British pound.

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Key Investment Indices

As at 31 January 2020		1 month	3 months	6 months	1 year	5 years
Australian Shares		%	%	%	%	%
S&P/ASX 200 Accumulation Index		5.0	6.1	5.1	24.7	9.3
S&P/ASX 300 Accumulation Index		4.9	6.0	5.2	25.0	9.4
S&P/ASX Small Ordinaries Accumulation Index		3.4	4.7	2.8	18.8	11.2
S&P/ASX 300 Industrials Index		6.0	5.8	6.4	27.3	8.8
S&P/ASX 300 Resources Index		0.7	7.1	0.5	16.7	12.1
International Shares	**Value**	%	%	%	%	%
MSCI World Accumulation Index in $A		4.4	8.4	11.3	28.3	12.4
MSCI World Accumulation Index ($A hedged)		-0.4	5.1	7.3	17.9	10.1
MSCI Emerging Markets Index in $A		0.1	5.3	6.4	13.1	7.7
Dow Jones Index in $US		-1.0	4.5	5.2	13.0	10.5
S&P 500 Index in $US		-0.2	6.2	8.2	19.3	10.1
FTSE 100 Index in £		-3.4	0.5	-4.0	4.6	1.5
Deutsche Boerse Index in €		-2.0	0.9	6.5	16.2	4.0
Nikkei 225 Index in ¥		-1.9	1.2	7.8	11.7	5.6
Hang Seng Index in HKD		-6.7	-2.2	-5.3	-5.8	1.4
Shanghai Shenzhen CSI 300 Index in RMB		-2.3	3.0	4.4	25.1	3.1
Property		%	%	%	%	%
S&P/ASX 200 A-REIT Accumulation Index		6.4	4.0	3.6	19.6	10.7
S&P/ASX 300 A-REIT Accumulation Index		6.3	4.1	4.0	20.0	11.0
FTSE EPRA/NAREIT Global REITs in $A		5.8	2.0	9.8	21.6	7.6
Fixed Interest		%	%	%	%	%
Bloomberg Ausbond Bank Bill Index		0.1	0.2	0.5	1.4	1.9
Bloomberg Ausbond Composite Bond Index		2.3	1.5	2.0	9.1	4.3
Barclays Global Aggregate Index ($A Hedged)		1.8	1.3	2.7	8.1	4.1
Inflation		%	%	%	%	%
Australia CPI		0.2	0.6	1.2	2.0	1.8
Currencies (relative to $A)	**Value**	%	%	%	%	%
$US	0.6692	-4.7	-2.9	-2.2	-8.0	-2.9
Japanese ¥	72.5080	-4.9	-2.7	-2.6	-8.4	-4.5
Euro €	0.6030	-3.6	-2.5	-2.4	-5.1	-2.6
Sterling £	0.5068	-4.3	-4.9	-10.0	-8.7	-0.4
Chinese Yuan		-5.5	-4.5	-2.3	-5.4	-1.0
Commodities	**Value**	%	%	%	%	%
S&P Goldman Sachs Commodity Index ($US)		-10.9	-4.6	-8.0	-4.7	-0.1
Oil ($US/barrel)	58.16	-15.6	-4.9	-12.0	-4.2	1.3
Gold ($US/ounce)	1,589.16	4.7	5.0	12.4	20.3	4.4
Iron Ore ($US/tonne)	81.35					

Sources: Lonsec, Atchison Consulting