# Market Watch

## ANZ Wealth Chief Investment Office

AUGUST 2016

## Market Highlights

- Share markets moved higher as complacency rose
- Bond yields moved higher but central bank liquidity limited the rise
- Slowdown in Chinese industrial growth points to risks for commodity prices

### Searching for growth

Share markets may be starting to run out of puff against a backdrop of rising complacency and low volatility. The market has priced an improvement in earnings following the bounce in commodity prices, but will growth be sufficient to sustain momentum in prices for the remainder of the year?

In the US, economic data softened in the month as regional industrial surveys pointed to a slowdown in manufacturing activity. That said, consumer spending remains on track for a strong contribution towards GDP in the September quarter as the labour market continues to chug along with strong employment growth.

Late in the month, comments from US Federal Reserve (Fed) Chair Janet Yellen that the case was building for another rate rise weighed on markets. Despite this, the Fed is likely to wait until concrete signs of inflation emerge before tightening policy rates further.

**Share market complacency remains high**

In Europe, growth drivers continued to show a pace of gradual expansion as consumer sentiment remains strong and industrial production improves. In the UK, the Bank of England cut rates and raised bond purchases in a bid to shore up business confidence. Across in Japan, speculation continued that the Bank of Japan will announce further measures to stimulate growth.

In China, the dataflow was poor as broad based measures of investment and spending signalled a slowdown in growth. So far, investment has mainly been driven by the public sector as private sentiment declines. Credit growth has also recently slowed as authorities try to clamp down on excessive borrowing. Given this backdrop commodity prices may be at risk, especially at a time when the government looks to reduce overcapacity in steel, coal and industrial goods production.

**Soft Chinese data momentum points to risk for commodities**


Sources: Bloomberg, ANZ Wealth.

In Australia, an interest rate cut by the Reserve Bank (RBA) in August provided a further boost to the housing market with property prices and auction clearance rates in major capital cities on the rise. Dwelling approvals also improved as low interest rates stimulate housing construction. Meanwhile, the labour market remained firm as the transition towards non-resources growth gathered momentum with tourism, health care and services performing strongly.

### Shares

Share markets rose moderately after the strong increase in July. Global developed share markets were up 0.6% in August in hedged Australian dollar (AUD) terms. European shares were up 1.2% in local currency terms as consumer sentiment remained strong given easy monetary conditions. That said, concerns over the undercapitalised Italian and Portuguese banking sectors still highlight some risk factors in the region.

The UK market (FTSE index) rose by 0.8% as a lower British Pound (GBP) favoured companies with offshore earnings. This offset concern of a domestic slowdown which weighed on the outlook. In the US the share market remained flat as most of the pickup in earnings had already been reflected.

The Australian share market underperformed major developed markets, down 1.6% in the month, due to weaker financial and industrial sectors where earnings growth and dividends are most at risk from undershooting expectations.

Emerging market shares outperformed developed markets, up 2.3% in US dollar (USD) terms. This was due to an increase in portfolio flows into the region on the back of reduced Fed rate hike expectations and a softer USD. Commodity producing countries like Russia, Brazil and South Africa continued to benefit from higher bulk commodity and oil prices.

## Bonds

Bond yields remained low despite moving slightly higher in the month. US 10-year bond yields rose 0.12% with a similar increase observed for European and Japanese bonds. This resulted in a return of 0.1% in the month for international fixed income. Australian fixed income outperformed international fixed income as expectations of further monetary easing by the RBA provided support.

Across credit markets, spreads have continued to decline as central bank liquidity encourages the search for yield. Also, higher commodity prices helped to ease concerns of distress across the high yield market where energy companies make up almost 20% of issuance.

## Currencies

Currency markets also reflected the benign environment of low volatility. The USD softened against major currencies as expectations for US rate hikes were pushed out. However, the AUD fell by 1.1% due to expectations of a further narrowing of the interest rate differential to the US as prospects for further RBA cuts set in. This helped unhedged investments in the month. The New Zealand dollar was up 1.9% following a bounce in milk prices and stronger investment inflows.

## Implications

Share market valuations have continued to rise against a backdrop of low volatility as investor complacency returns. This comes at a time when risks remain high in an environment of uncertainty. Our investment strategy favours caution in the near term as share market pricing is not commensurate with the environment of somewhat softer economic growth and ultimately tepid corporate earnings generation.

While central bank support via monetary stimulus and low interest rates can support the market it becomes increasingly difficult to identify catalysts for further market appreciation.

Within defensive assets, our preference is to hold a neutral position in Australian bonds as further RBA easing looks likely in the wake of softening inflationary pressures. We hold an underweight position in international bonds given how low bond yields are, even with a delayed risk of Fed tightening. We hold an overweight position to cash.

## Major asset class performance as at 31 August 2016 (%)

| Sector | 1 month | 3 months | 12 months | 5 Years |
|---|---|---|---|---|
| **Australian Shares** | -1.6 | 2.2 | 9.7 | 9.5 |
| **Global Shares (hedged)** | 0.6 | 3.6 | 7.7 | 14.4 |
| **Global Shares (unhedged)** | 1.3 | -0.6 | 0.5 | 17.8 |
| **Global Emerging Markets (unhedged)** | 3.6 | 7.9 | 5.5 | 6.9 |
| **Global Small Companies (unhedged)** | 1.3 | -0.2 | 1.3 | 18.9 |
| **Global Listed Property** | -2.5 | 6.2 | 21.2 | 14.4 |
| **Cash** | 0.2 | 0.5 | 2.2 | 3.0 |
| **Australian Fixed Income** | 0.4 | 2.5 | 6.2 | 6.2 |
| **International Fixed Income** | 0.1 | 2.8 | 8.9 | 7.2 |

Source: JP Morgan & ANZ Wealth

Indexes: Australian Shares - S&P / ASX300 Accumulation, Global Shares (hedged/unhedged) - MSCI World ex Australia, Global Emerging Markets - MSCI Emerging Free Net in AUD (unhedged), Global Small Companies (unhedged) - MSCI World Small Cap exAustralia, Global Listed Property - FTSE EPRA/NAREIT Developed Rental Index exAustralia (hedged), Cash - Bloomberg Bank Bill, Australian Fixed Income - Bloomberg Composite Bond All Maturities, International Fixed Income - Barclays Global Aggregate Bond Index (hedged).

Please note: Past performance is not indicative of future performance