SEPTEMBER 2019 QUARTERLY COMMENTARY

Australia:

Key points:

- **The Reserve Bank of Australia (RBA) cut interest rates by 25bps in July to 1.00% followed by an additional cut to a new record low of 0.75% in early October**
- **Inflation remains below the RBA's 2-3% target range, with heightened concerns of an economic slowdown**
- **The Australian Dollar depreciated over the third quarter against the US Dollar by 3.8%, closing at 67.50 US cents at the end of September**

The Australian economy remained weak, as annual GDP growth slowed to its lowest rate since 2009. The economy grew just 1.4% over the year to June with domestic demand largely supported by government rather than private sector spending. Inflation picked up a little, rising to 1.6% in the June quarter from a low of 1.3% in the previous period, but remains below the Reserve Bank's target range. The RBA currently expects inflation to remain slightly below 2% in 2020 and pick up to over 2% in 2021. It is this expectation that led the RBA to cut rates in July and again in October, resulting in a new record low cash rate of 0.75%. Consumer sentiment, as measured by the Westpac Melbourne Institute Consumer Sentiment Index, declined to 98.2 in September from 100.7 in June (a result above 100 reflects a higher number of optimists relative to pessimists). Despite weak economic data, housing market conditions steadied over the quarter with reported housing prices in Sydney and Melbourne rising noticeably. This is consistent with an increase in auction clearance rates at a time when volumes remain low.

Australian equity markets posted modest gains over the quarter with the S&P/ASX300 returning 2.6%, resulting in a calendar year-to-date return of 22.9%. Defensives, such as Consumer Staples, performed well over the quarter, returning 11.6%. The worst performing sectors were Materials and Telecommunication Services posting negative returns of -3.5% and -3.4% respectively. The Australian listed property sector continued its upward trajectory, although to a lesser extent, returning 1.1% for the September quarter.

Returns for period ending 30 September 2019	Quarter %	1 Year %
Australian Equities[1]	**2.6%**	**12.6%**
Consumer Discretionary	*8.9%*	*11.7%*
Consumer Staples	*11.6%*	*16.0%*
Energy	*0.1%*	*-9.8%*
Financials, ex Property Trusts	*3.3%*	*12.0%*
Health Care	*7.2%*	*16.7%*
Industrials	*0.6%*	*15.7%*
Information Technology	*5.9%*	*14.7%*
Materials	*-3.5%*	*15.6%*
Telecommunications Services	*-3.4%*	*7.6%*
Utilities	*1.6%*	*12.0%*

[1] S&P/ASX 300. Below are sub-sectors.

The Australian Dollar (AUD) continued to depreciate against the US Dollar, beginning the second quarter at 70.20 US cents and falling to 67.50 US cents by quarter end. The AUD also depreciated against other major currencies including the Chinese yuan, British pound and the Japanese yen while remaining flat against the euro. Overall the AUD fell against a basket of major currencies over the third quarter.

The Australian Manufacturing PMI (Purchasing Managers Index) increased over the September quarter from 49.4 to 54.7 (a reading above 50 indicates an expansion of the manufacturing sector and a reading below 50 a contraction, compared with the previous month). Business confidence, as measured by the NAB Business Confidence survey, fell back to 0 in September, down from a high of 7 in May. The result suggests concerns about slowing economic growth and the near-term outlook have not been outweighed by recent RBA rate cuts.

Domestic bond yields continued to decline amidst concerns over the economic outlook. The Australian Government 10-year bond yield fell sharply in August to 0.89% but ended the quarter at 1.02%, down 30bps from the end of June. Australia's 10-year government bond yield remains significantly lower than that of the US (1.66%). The Bloomberg AusBond Composite Index returned 2.0% for the quarter.

International:

Key points:

- **The US Federal Reserve cut the federal funds rate twice this quarter, and is now targeting a range of 1.75% to 2.00%**
- **UK Prime Minister, Boris Johnson, suspended parliament until October 14 which was subsequently ruled unlawful**
- **Consumer confidence continued to decline over the quarter with global equity markets delivering broadly flat returns**

The September quarter was characterised by heightened volatility as markets responded to escalated trade war tension, rate cuts in the US, a drone attack in Saudi Arabia and mass protesting in Hong Kong. China announced tariffs of 5 – 10% on around $75bn of imports from the US, causing US equities to pull back 1.7% in August as measured by the S&P 500 Composite (in local currency terms). The US responded by increasing the tariffs scheduled for September and December from 10% to 15% and the current 25% tariff on $250bn of Chinese imports to 30%. Investors gained some relief after China later agreed to remove some products from the list and the US delayed its tariff increase to mid-October. Despite heightened trade tension, the S&P 500 delivered a broadly flat result for the quarter of 1.5% (in local currency terms).

The US Federal Reserve cut interest rates in July and September, pointing to heightened downside risks, as well as subdued inflation pressures. The federal funds target range now sits at 1.75% - 2.00% down from 2.25% - 2.50% at the end of the June quarter. US GDP grew by 2.0% in the second quarter, down from the 3.1% expansion in the first quarter of 2019.

The National Association of Home Builders/Wells Fargo Housing Market Index (HMI) increased to 68 over the September quarter, from 64 at the end of June (a number over 50 indicates more builders view sales conditions as good than poor). Activity in the US manufacturing sector, as measured by the US Markit Manufacturing PMI, was revised slightly higher over the quarter, closing at 51.1, up from 50.6 in June. This signalled a modest improvement in manufacturing sector conditions. Consumer sentiment, as measured by the University of Michigan Consumer Sentiment Index, fell to 93.2 in September from 98.2 in June. US headline year-on-year inflation increased slightly over the third quarter to 1.7% from 1.6% in June. Annual core US inflation rose to 2.4% in September, its highest in a year.

In Europe, UK Prime Minister Theresa May was replaced by Boris Johnson in July. His first act of business was to commit to leave the EU on October 31, with or without a deal. Parliament was less supportive of a potential no-deal Brexit, passing legislation that forces the government to ask for an extension if it cannot come to an agreement with the EU. In an attempt to push past these concerns, Boris Johnson suspended parliament until October 14, two weeks before the Brexit date. The suspension was subsequently ruled unlawful. An election is now the most likely outcome if a deal cannot be reached by October 31. Amidst the ongoing uncertainty, UK equities delivered broadly flat returns of 0.7% over the quarter, as measured by the MSCI UK (in local currency terms).

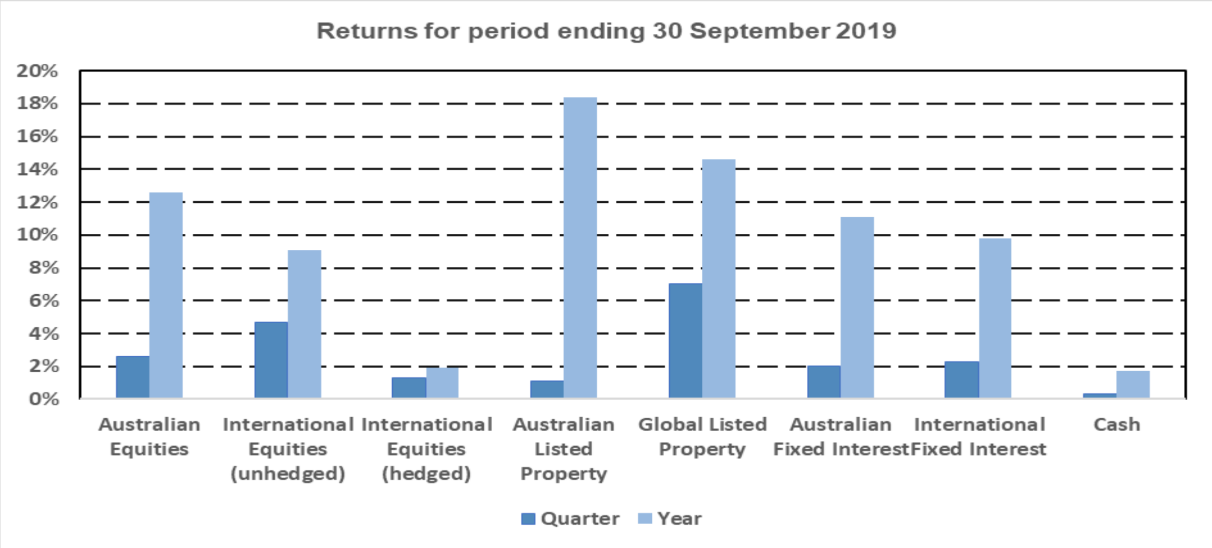
European equities posted a positive return for the June quarter of 2.8%. The European Central Bank (ECB) cut interest rates by 10bps in September to -0.5%, sending rates further into negative territory. In addition, the ECB announced the quantitative easing program would recommence as of 1 November, buying €20 billion worth of bonds per month, indefinitely. Contraction in the manufacturing sector continued in September, as observed through the Markit Eurozone Manufacturing PMI closing at 45.7 compared to 47.6 in June. The Euro Area unemployment rate continued to decline to 7.4% in August, its lowest level since May 2008. The Euro area's headline year-on-year inflation is expected to ease to 0.9% in September from 1.3% in June. European core inflation (which excludes prices of volatile items such as food and energy) increased 1.0% in September over the same month in the previous year.

Chinese quarterly GDP expanded 1.6% in the three months to June, up from the 1.4% growth recorded in the previous quarter. The China Caixin Manufacturing PMI unexpectedly rose to 51.4 in September from its low of 49.4 in June. Amidst the ongoing trade war, Chinese equities performed poorly over the quarter returning -2.5% (measured by the Shanghai Composite Index).

As widely expected, the Bank of Japan (BoJ) left its interest rate unchanged at -0.1% for another quarter at its September meeting. Policymakers stuck to their target yield on 10-year government bonds of 0%, noting they would review economic and price developments more thoroughly at the next policy meeting. The BoJ reiterated that the economy will likely continue to expand through to 2021 despite the global slowdown and weakness in exports. Japanese year on year CPI inflation fell from its May reading of 0.7% to 0.3% in August, increasing the likelihood of further stimulus. Over the September quarter, the Japanese unemployment rate remained broadly flat at 2.2%. A fall in the Markit/Nikkei Final Japan Manufacturing PMI from 49.3 in June to 48.9 in September signalled a sharper deterioration in manufacturing conditions. Despite weaker economic data, Japanese equities posted positive returns over the quarter, as measured by the MSCI Japan, returning 3.5% for the period (in local currency terms).

Bond yields fell globally over the September quarter against the backdrop of looser monetary policy around the world. The US 10-year government bond yield fell by 34 bps to 1.66%, the UK 10-year government bond yield fell by 35 bps to 0.49% and the 10-year German government bond yield delved further into negative territory, falling 24 bps to end the quarter at -0.57%.

Global listed property outperformed global equities for the September quarter with a 7.0% return, as measured by the FTSE EPRA/NAREIT Developed ex-Australia Rental Index (AUD hedged).



Returns for period ending 30 September 2019	Quarter %	1 Year %
International Equities (unhedged) [1]	**4.7%**	**9.1%**
North America	*5.3%*	*11.0%*
UK	*1.3%*	*4.1%*
Europe (ex UK)	*2.3%*	*7.2%*
Japan	*7.2%*	*2.2%*
Asia Pacific (ex-Japan)	*-0.8%*	*3.5%*
Emerging Markets	*-0.5%*	*5.1%*
International Equities (hedged) [2]	**1.3%**	**1.9%**
Australian Listed Property	**1.1%**	**18.4%**
Global Listed Property [3]	**7.0%**	**14.6%**
Australian Fixed Interest [4]	**2.0%**	**11.1%**
International Fixed Interest [5]	**2.3%**	**9.8%**
Cash[6]	**0.3%**	**1.7%**

[1] MSCI World ex-Australia Index (with net dividends reinvested in AUD)

[2] MSCI World ex-Australia Index (with net dividends reinvested hedged in AUD)

[3] FTSE EPRA/NAREIT Developed Ex Aus Rental Index (Net TRI Hedged in AUD)

[4] Bloomberg AusBond Composite Index

[5] Barclays Global Aggregate Hedged in AUD Index

[6] Bloomberg AusBond Bank Bill Index

All returns are based on accumulation indices.

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