2019 CALENDAR YEAR

ECONOMIC AND MARKET COMMENTARY

Australia:

Key points:

- **Scott Morrison wins the 'unwinnable' Election.**
- **The Reserve Bank of Australia (RBA) cuts interest rates three times to an all-time low.**
- **Australian equities enjoyed a strong year.**
- **Residential property prices show signs of recovery.**

In Australia, Scott Morrison and the Coalition secured an unexpected election victory in May 2019. Australian equity markets responded positively to the election result, dismissing investors' concerns of the potential negative impacts of the Labor party's proposed tax policy changes to franking credits and negative gearing. Economic growth was down for the September quarter, growing at an annual rate of 1.7%, while the previous year's September quarter saw annual growth of 2.5%.

The Reserve Bank of Australia (RBA) cut the cash rate three times from 1.50% to an all-time low of 0.75% during 2019. The reduction in interest rates is intended to assist Australian labour markets (employment levels and income growth), support inflation, consistent with the medium-term target, and reduce the negative impact on the Australian economy due to the trend to lower interest rates globally.

The RBA, in its statement from the December 2019 Board meeting, noted that growth in Australia had continued at a moderate pace since the middle of the year although growth in household disposable income had been weak over recent years, in both nominal and real terms. It was also noted that globally, financial market conditions had been more positive, as market participants' concerns about downside risks had receded. The Board agreed that it would continue to assess the evidence of how the easing in monetary policy was affecting the economy and would reassess the economic outlook in February 2020, when the Bank would prepare updated forecasts.

The labour market was stable over the year, with the seasonally adjusted unemployment rate at 5.2% in November 2019 compared to 5.1% in November 2018. Inflation was 1.7% at September 2019, below the bottom of the 2%-3% target range.

The Australian share market had a strong year, with the ASX 300 Accumulation Index up 23.8%, but the Australian share market still underperformed relative to global shares (measured by the MSCI World ex-Australia index) which rose 26.8% in local currency terms and rose 28.0% in unhedged Australian dollar terms. The underperformance was largely driven by the Financial sector, representing approximately 28% of the ASX300, which was the worst performing sector over 2019, returning 13.6%. The Financials sector faced significant headwinds in 2019 because of the Royal Commission investigation, which was finalised in February, and the Westpac compliance breaches which were announced by AUSTRAC in November. The top performing sectors were Healthcare (44.9%) and Information Technology (37.4%) while Financials (13.6%) and Utilities (17.3%) were the worst performers.

Returns for period ending 31 December 2019	Month	1 Year
Australian Equities[1]	**-2.0%**	**23.8%**
Consumer Discretionary	*-2.2%*	*33.4%*
Consumer Staples	*-7.8%*	*21.0%*
Energy	*-1.4%*	*22.1%*
Financials, ex Property Trusts	*-1.6%*	*13.6%*
Health Care	*-2.7%*	*44.9%*
Industrials	*-3.1%*	*27.8%*
Information Technology	*-3.9%*	*37.4%*
Materials	*1.8%*	*27.2%*
Telecommunications Services	*-5.5%*	*26.4%*
Utilities	*0.8%*	*17.3%*

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

According to Corelogic data, residential property prices in Australian capital cities increased by 3% over the year, assisted by lower interest rates and easing of lending policies, reversing some of the decreases observed throughout 2018.

The Australian 10-year bond yield ended the year lower, falling from 2.32% to 1.37% over the year, after reaching a record low of 0.87% in August and October. This was in-line with global bond markets, which also experienced large reductions in long bond yields before a recovery in December. Australian fixed interest, as measured by the Bloomberg AusBond Composite Bond Index (All Maturities) returned 7.3% for the year, while global fixed interest, as measured by the Barclays Global Aggregate Index (hedged to AUD), returned 7.2%. Australian cash, as measured by the Bloomberg AusBond Bank Bill Index, returned 1.5% for the year.

The Aussie Dollar (AUD) was reasonably stable over the year, beginning the year at US$0.71, reaching a peak of US$0.73 at the end of January, a trough of US$0.67 at the beginning of October before recovering to US$0.70 by the end of the year. Over the calendar year the AUD was also stable against the currencies of Australia’s major trading partners depreciating by 0.7%, as measured by the Trade Weighted Index. The AUD appreciated by 0.7% and 1.2% against the yuan and euro respectively, while it depreciated by 2.2% and 4.0% against the yen and pound respectively over 2019.

International:

Key points:

- **Major markets experience the best returns in years amidst a backdrop of a messy Brexit and ongoing US – China trade war.**
- **Central Banks around the world cut rates out of concern that global economic growth is stagnating.**

The 2019 calendar year saw global equity markets hit record highs with all major markets experiencing very strong returns. Despite ongoing geopolitical tensions throughout 2019, especially the US – China trade war and Brexit, the MSCI World ex Australia Index (hedged to AUD) rose 26.8%. The first quarter saw equity markets rebound strongly following the drawdowns experienced in the final quarter of 2018. Equity returns were subdued in the second and third quarters, as global bond yields fell, and economic news focussed on heightened downside risks and subdued inflation. Central banks responded by cutting short term rates and equity markets reacted with a positive finish to the year.

Central Banks around the world dealt with uncertainty over the global economy and subdued inflation by easing monetary policy. The US Federal Reserve cut interest rates three times during 2019, finishing the year at 1.75%, following four increases the previous year. The impact and likelihood of negative interest rates, quantitative easing and fiscal stimulus were heavily discussed as central banks and governments faced the possibility of traditional monetary policy having less impact in the years ahead. Long yields responded by falling in most major economies. In the US, the 10-year government yield fell by more than 100 bps, to its lowest rate of 1.45% in September, and the yield curve inverted for the first time since just prior to the Global Financial Crisis (over a decade ago). However, as the Federal Reserve became more accommodative in the second half of the year yields rebounded by approximately 50 bps by December, finishing the year at 1.91%. Similarly, in Europe, the German 10-year yield reached an all-time low of -0.72% in late August before recovering to finish the year at -0.19%.

The US-China trade war will continue into 2020 as negotiations have proven difficult and progress throughout 2019 was restrained. Optimism following a meeting of President Trump and President Xi in March was short-lived as the US increased tariffs on Chinese goods from 10% to 25% in May, while China responded with further tariffs on US goods to commence in June. A mix of positive and negative news in the second half of 2019 created further uncertainty throughout the year as China and the US frequently switched between increasing and reducing tariffs against each other. Finally, in early January 2020, the US and China announced a “phase one” partial deal which includes provisions to curb intellectual property theft along with forced technology transfers. It also increases Chinese purchases of US products.

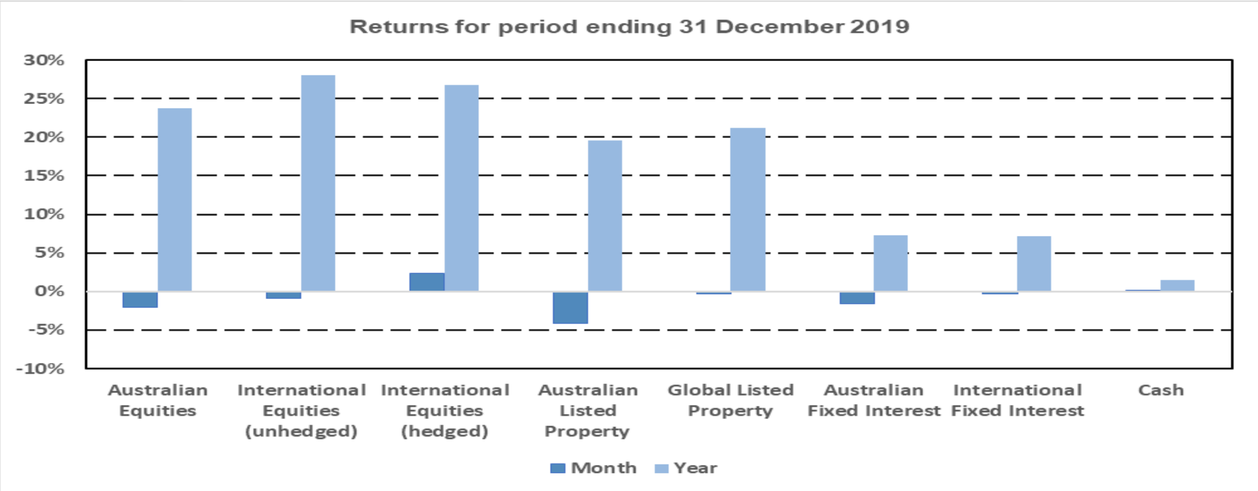
Annual US economic growth for the 1-year period to September 2019 decreased to 2.1%, down from 3.1% in September 2018. The unemployment rate continued to improve over the year falling from 4.0% in January to 3.5% in December. Annual core inflation increased from 1.6% in January 2019 to 2.1% in November 2019. Despite ongoing concerns regarding the US-China trade war, US stock markets experienced exceptional returns with the S&P 500 Index increasing by 28.9% for the year (in local currency terms). US 10-year government bond yields decreased by 78bps over the year from 2.69% to 1.91% but ended the year above the lowest recorded in 2019, of 1.46%, in September.

After the deadline for Brexit was delayed twice and following Parliament rejecting the proposed Brexit deal for a third time, Teresa May resigned as British Prime Minister. Boris Johnson took over as Prime Minister in July and the Conservative Party won an early election in December. The UK is now due to leave the EU on 31 January 2020, after Prime Minister Boris Johnson's Brexit deal was backed by MPs, with the remaining stages of the bill expected to be completed quickly in January. The FTSE All Share Index finished the year up 14.2% but underperformed the MSCI World Index on a total return basis.

European economic indicators were generally weak for the year, with Euro area annual GDP growth falling to 1.2% year-on-year in the third quarter of 2019, down from 1.6% in September 2018. The EU unemployment rate continued to improve over the year ending at 7.5% in November, down from 7.8% at the beginning of the year. However, year-on-year headline inflation in the Eurozone decreased from 1.5% in December 2018 to 1.3% in December 2019.

Unlike many other central banks, the Bank of Japan (BoJ) left its interest rate unchanged at -0.1% during 2019 and policymakers stuck to their target yield on 10-year Government bonds of 0%. Over 2019 Japan's annualised GDP growth rate increased from -0.3% for September 2018 quarter to 1.7% for the September 2019 quarter. Unemployment was lower at 2.2% in November 2019, down from 2.5% in January 2019, while inflation dropped to 0.5% in November 2019 from 0.8% the previous year.

The Shanghai Composite Index rose by 22.3% over the year, despite the continuing trade war between China and the US. Additionally, MSCI increased the weight of China A shares within the MSCI EM index over 2019, with the move expected to increase foreign capital inflows into China. Annual GDP growth has slowed to 6.0% in September 2019 from 6.5% one year prior. As a result, the People's Bank of China (PBOC) reduced the Loan Prime Rate (LPR) by 15bps over three separate rate cuts during the second half of 2019 to stimulate the slowing economy. The official unemployment rate decreased marginally to 3.6% in September 2019, down from 3.8% in September 2018.



Returns for period ending 31 December 2019	Month %	1 Year %
International Equities (unhedged) [1]	**-0.9%**	**28.0%**
North America	*-1.0%*	*30.9%*
UK	*1.3%*	*21.5%*
Europe (ex UK)	*-0.3%*	*25.3%*
Japan	*-1.8%*	*19.8%*
Asia Pacific (ex-Japan)	*2.6%*	*18.3%*
Emerging Markets	*3.4%*	*18.6%*
International Equities (hedged) [2]	**2.3%**	**26.8%**
Australian Listed Property	**-4.2%**	**19.6%**
Global Listed Property [3]	**-0.3%**	**21.2%**
Australian Fixed Interest [4]	**-1.6%**	**7.3%**
International Fixed Interest [5]	**-0.3%**	**7.2%**
Cash[6]	**0.1%**	**1.5%**

[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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