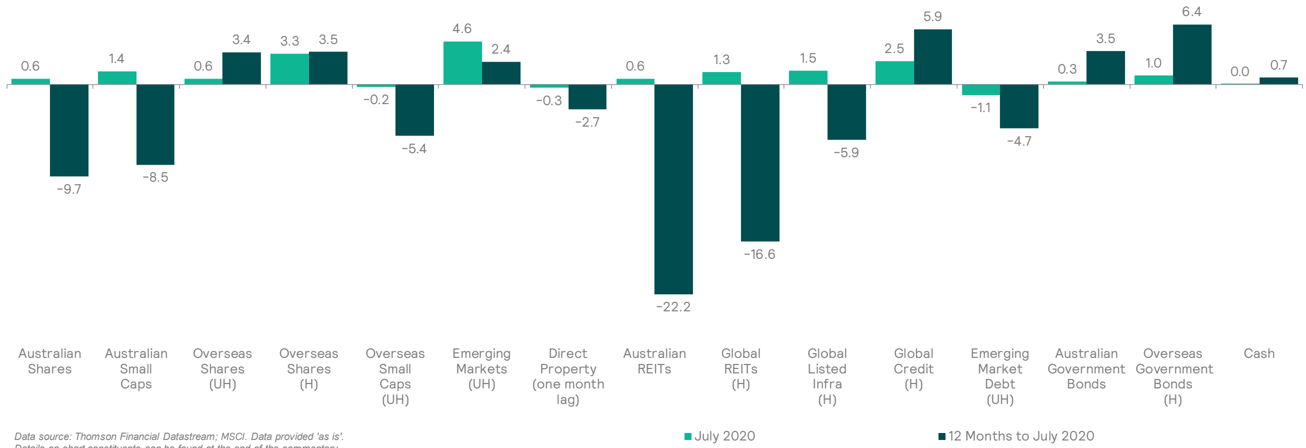
JULY 2020

AUSTRALIAN MONTHLY MARKET REVIEW

SELECTED MARKET INDICATORS COMMENTARY

ASSET CLASS RETURNS (%) AS AT 31 JULY 2020



Data source: Thomson Financial Datastream; MSCI. Data provided 'as is'. Details on chart constituents can be found at the end of the commentary.

The month of July generally saw positive returns across asset classes, as growth assets continue to gain. Emerging Markets were the strongest performing market in equities, with the MSCI EM Index (UH) returning 4.6% over the month. On the domestic front, Australian small caps outperformed large caps and overseas hedged investors realised greater gains from the appreciation of the Australian dollar. Investors were encouraged by positive economic data, as US non-farm payrolls showed strong results and global purchasing manager indices (PMI) showed a recovery in both manufacturing and services. However, there has also been some negative indicators from the structural damage of lockdowns and social distancing measures, including large lay-offs of workers and bankruptcies across the retail sector.

COVID-19 remains uncontained with the US still the epicentre of the pandemic as case growth increased significantly over the past month. Consequently, the US dollar experienced its worst month in almost a decade. Questions around a sustainable global recovery beyond the pandemic continue to remain at the forefront.

Political tensions also materialised over the month. The US, UK, Australia and the EU took decisive actions against China in response to their treatment of Hong Kong, including sanctions, bans on Huawei's involvement in 5G networks and suspension of extradition treaties. Despite this, China saw large gains in mainland shares after state media encouraged retail investors to buy.

MERCER

Monetary and fiscal support remains highly accommodative. In addition to keeping the benchmark interest rate unchanged, the Federal Reserve extended seven emergency lending programs and reiterated its pledge to maintain aggressive measures to support the economy for the near future. Similarly, the Reserve Bank of Australia (RBA) left rates on hold at 0.25% and maintained its stance that it will not raise rates again until it can see progress in domestic inflation and employment levels. Australian and global government bonds remained relatively stable over the month, with the Hedged FTSE World Government Bond (ex-Australia) Index returning 1.0% over July and 6.4% over the past 12 months to 31 July 2020. Across asset classes, this yearly return is amongst the strongest and illustrates the volatility and severity of the drawdown experienced earlier in the year. In terms of credit assets, spreads continued to tighten for investment grade, high yield and emerging market debt, driving positive performance, though currency movements meant the latter ended up in negative territory.

The Australian share market has continued its positive run, with the S&P/ASX300 returning 0.6% over July but lagged its hedged overseas counterpart. Materials (+5.9%) and IT (+4.8%) were the top performing sectors, whilst Energy was the bottom performing sector, returning -6.3%.

SIGNIFICANT DEVELOPMENTS

- During its early August meeting, the RBA decided to maintain its current policy settings, including maintaining the target cash rate at 0.25% per annum and the targeted 0.25% yield on 3-year Australian Government bonds. Governor Philip Lowe noted that the global economy is experiencing a severe contraction as countries seek to contain the coronavirus. Even though the worst of this contraction has now passed, the outlook remains uncertain. The recovery is expected to be gradual and its shape is dependent on containment of the virus. While infection rates have declined in some countries, they are still very high and rising in others. International trade remains weak, although there has been a strong recovery in industrial activity in China over recent months.

  The Bank's mid-March support package for the Australian economy is working as expected. There is a very high level of liquidity in the Australian financial system and borrowing rates are at historical lows. Authorised deposit-taking institutions are continuing to draw on the Term Funding Facility, with total drawings to date of around $29bn. Further use of this facility is expected over coming months. The downturn is not as severe as earlier expected and a recovery is now underway in most of Australia. However, this recovery is likely to be uneven and bumpy, with the coronavirus outbreak in Victoria having a major effect on the Victorian economy. In the most recent quarter, CPI inflation fell to −0.3% in year-ended terms, reflecting lower oil prices and the effects of various policy measures. Inflation is expected to return to positive territory in the current quarter. The Board has stated that it will not increase the cash rate target until progress is made towards full employment, and it is confident that inflation will be sustainably within the 2–3% target band.

- Australian seasonally adjusted employment increased by 210,800 in June, above the expectations for 100,000, while May figures were revised to a decrease of 264,100. The unemployment rate increased to 7.4% for June, above expectations for 7.3%. The participation rate increased to 64.0%, above expectations for 63.3%. Part time jobs increased by 249,000 and full time jobs decreased by 38, 200.

- Australian building approvals decreased 4.9% month-on-month to June, compared to the previous level of -15.8% (revised) for period ending May.

- The Institute for Supply Management (ISM) Manufacturing Index recorded 54.2 in July, above consensus for 53.6, and above the 52.6 recorded in June. Of the 18 manufacturing industries, Wood Products and Furniture & Related Products were the industries that reported the highest growth. Transportation Equipment and Machinery were the largest detractors over the month. The ISM Non-Manufacturing Index recorded 58.1 in July, above consensus for 55.0 and above the 57.1 recorded in June. Of the 18 non-manufacturing industries, the top performers in July were Arts, Entertainment & Recreation, Health Care & Social Assistance and Retail Trade. Mining and Other Services were the two industries, which reported the largest decreases over the month.

- US Non-Farm Payrolls increased by 1,763,000 in July, below the 4,791,000 increase (revised) recorded for June. The unemployment rate decreased to 10.2% over July, below expectations for 10.6%.
- US gross domestic product (GDP) advanced estimate for Q2 2020 is -32.9% quarter on quarter (QoQ) annualised, above expectations for -34.5%.
- The Caixin Manufacturing PMI in China recorded 52.8 in July, above expectations for 51.1, as solid improvement in the health of China's manufacturing sector continues.
- A preliminary estimate of the European Core Consumer Price Index (CPI) recorded 1.2% over the year to July, above expectations for 0.8%.
- The Eurozone composite PMI increased to 54.9 in July, above expectations for 54.8. Eurozone operating conditions have improved considerably from the month prior.
- The advanced estimate recorded for Q2 2020 Eurozone seasonally adjusted GDP is -12.1% quarter-on-quarter (QoQ) and -15.0% year-on-year (YoY).

AUSTRALIAN EQUITIES

The Australian share market underperformed its hedged overseas counterpart over the month, as the S&P/ASX 300 Index returned 0.6%. The S&P/ASX Mid 50 was the strongest relative performer, increasing 2.0%, while the S&P/ASX 50 was the weakest, returning 0.2% over the month.

The best performing sectors were Materials (+5.9%) and Information Technology (+4.8%), while the weakest performing sectors were Energy (-6.3%) and Healthcare (-3.8%). The largest positive stock contributors to the index return were Fortescue Metals, Goodman Group and Newcrest Mining with absolute returns of 26.4%, 14.2% and 11.7% respectively. In contrast, the most significant detractors were CSL, Westpac and ANZ with absolute returns of -5.8%, -4.4% and -2.9%, respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) Index increased 3.3% in hedged terms and 0.6% in unhedged terms over the month, as the Australian dollar (AUD) appreciated 4.2% against the USD.

In AUD terms, the strongest performing sectors were Materials (+3.0%) and Consumer Discretionary (+2.9%), while Energy (-7.6%) and Financials (-1.8%) were the worst performers. In AUD terms, the Global Small Cap index was down 0.2% and Emerging Markets index was up 4.6% over July.

Over July, the NASDAQ increased 6.8%, the S&P 500 Composite Index increased 5.6% and the Dow Jones Industrial Average increased 2.5%, all in USD terms. In local currency terms, major European share markets experienced negative returns as the CAC 40 (France) decreased -2.6% and FTSE 100 (UK) decreased -4.2%, while the DAX 30 (Germany) remained flat. Returns were mostly positive in Asia, as the Indian S&P BSE 500 (+6.8%), Hong Kong Hang Seng (+1.5%) and Chinese SSE Composite (+10.9%) all increased, whilst the Japanese TOPIX (-4.0%) decreased over July.

REAL ASSETS

The Real Assets sector achieved broadly positive returns over July. The FTSE Global Core Infrastructure 50/50 Index returned 1.5% and the Global Real Estate Investment Trusts (REITs) Index increased by 1.3% over the month (both in AUD hedged terms). Domestic REITs increased 0.6% over July, while Australian Direct Property (NAV) returned -0.3% on a one-month lagged basis.

FIXED INTEREST

Global bond markets were broadly positive over July. Both the Barclays Capital Global Aggregate Bond Index (Hedged) and the FTSE World Government Bond (ex-Australia) Index (Hedged) returned 1.0% over the month. Ten-year bond yields decreased in most markets including the US (-12bps to 0.54%), Japan (-1bp to 0.02%), Germany (-7bps to -0.56%) and the UK (-6bps to 0.07%). Two-year bond yields were mixed over the month, decreasing in the US (-5bps to 0.12%) and Germany (-2bps to -0.71%), whilst increasing in the UK (+1bp to -0.07%) and remaining flat in Japan (-0.14%).

Returns for Australian bondholders were mixed over July, with 10-year yields decreasing (-6bps to 0.82%), five-year yields remaining flat (0.41%) and two-year yields increasing (+1bp to 0.28%). Of the Bloomberg Ausbond indices, the Inflation Index produced the highest return, increasing 3.1% over the month.

CURRENCY MARKETS

The AUD Trade Weighted Index increased to 61.9 over July, up by 3.2% from June. The AUD appreciated against the US Dollar (+4.2%) and Japanese Yen (+1.8%), but depreciated against the Pound Sterling (-1.6%) and the Euro (-0.7%).

COMMODITIES

Iron Ore increased by 7.9%, finishing the month at US$109.5 per metric tonne. The S&P GSCI Commodity Total Return Index decreased 0.3% over the month. Gold prices significantly increased from June finishing the month at US$1,975.1 per ounce and the oil price increased 4.6% to US$43.1 per barrel over July.

CHART CONSTITUENTS

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Net Index: Total Return (Net Dividends Reinvested).*
- *Total Return: Total Return Index with Gross Dividends.*
- *Where a lag exists, the performance period start and end dates are shifted accordingly.*

ASSET CLASS	BENCHMARK	DATA TYPE
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
Overseas Shares (UH)	MSCI World ex Australia	Net Index
Overseas Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
Overseas Small Caps (UH)	MSCI World Small Cap	Total Return
Emerging Markets (UH)	MSCI Emerging Markets	Net Index
Direct Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian REITs	S&P/ASX 300: Industry Group: A-REIT	Total Return
Global REITs (H)	FTSE EPRA/NAREIT Developed Hedged	Total Return
Global Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Total Return
Global Credit (H)	Bloomberg Barclays Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
Overseas Government Bonds (H)	FTSE WGBI Non Australia	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

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