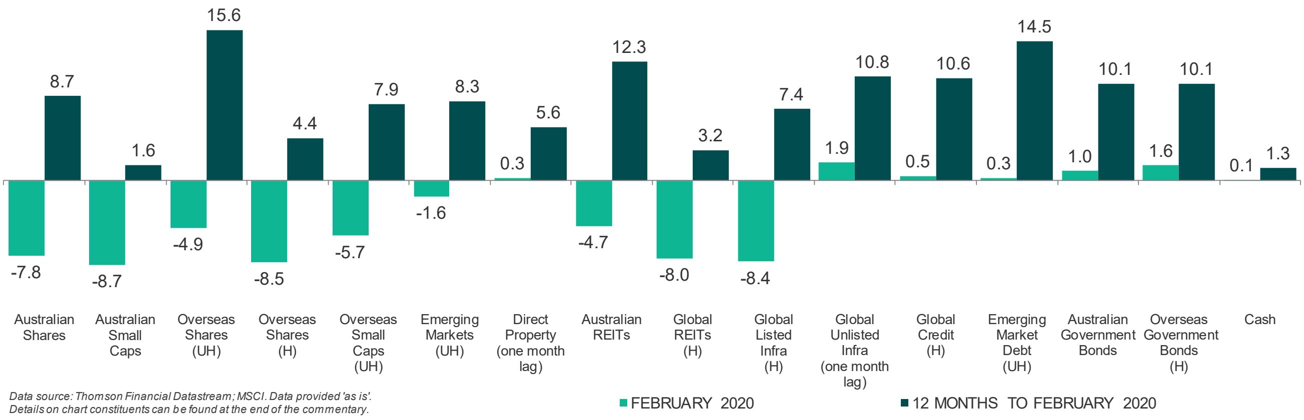
FEBRUARY 2020

AUSTRALIAN MONTHLY MARKET REVIEW

SELECTED MARKET INDICATORS COMMENTARY

ASSET CLASS RETURNS (%) AS AT 29 FEBRUARY 2020



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

Coronavirus fears drove losses across equity markets and sparked a flight to defensive assets over February. Global equity markets reached fresh highs in mid February, then sold off sharply alongside other risky assets shortly thereafter. The sell-off in markets stem from investor concerns regarding the spread of COVID-19, with an acceleration in reported cases outside mainland China, specifically in Italy, Iran and South Korea and the ramifications on global economic growth. Unhedged Overseas Developed Shares (-4.9%) fared better than their Hedged counterpart (-8.5%), as the depreciation of the Australian dollar benefited unhedged investors. Given the large sell-off experienced across markets and in anticipation of the economic growth fallout, the OECD revised its 2020 economic growth forecast downward from 2.9% to 2.4%.

Given market sentiment deteriorated quite rapidly and a general panic has been displayed by investors, it is no surprise that equity and bond market volatility surged, particularly towards the end of the month. Whilst slightly negative over February, the S&P GSCI Gold Index has gained 6.4% over the past three months. The price of gold rose rapidly in December and again in mid-February, before a sharp fall in the last week of February.

As a whole, emerging markets held up relatively well over the month, with unhedged emerging market shares falling 1.6% over the month. China was the only emerging market that gained over the month, aided by their substantial stimulus effort, whilst Brazil and Russia suffered large losses from falling oil prices. The oil price continued to tumble with prices dropping 13.2% over the month of February alone.

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With current media attention largely being devoted to Coronavirus, geopolitical risks have lessened with US and China trade risks now moving into the background. Nonetheless, unrest in Iran, Venezuela and Libya, along with trade negotiations between the UK and European Union (EU) remain concerns. The US election season also got underway over the month, with Bernie Sanders and Joe Biden emerging as top contenders for the Democratic party.

Alongside China, many other emerging market central banks, including Argentina, Brazil and Russia cut benchmark rates over February. The US Fed has continued to expand its balance sheet and cut rates by 50bps and the Reserve Bank of Australian cut its official interest rate by 25bps in early March. Whilst growth assets clearly underperformed over February Australian and global government bonds rallied, with the Bloomberg Ausbond Treasury Index rising 1.0% and the FTSE WGBI Non Australia Index rising 1.6% over February. Total negative yielding debt rose from 20% to 25% as at end of February, but below the high of 35% reached in August 2019.

The Australian share market followed the direction of overseas shares over February, with the S&P/ASX300 returning -7.8%, outperforming its hedged international counterpart by 0.7%. Domestic small caps also displayed negative performance and underperformed domestic large caps, returning -8.7%. Utilities (-4.0%) and Healthcare (-4.0%) were the top performing sectors, whilst Energy was once again the bottom performing sector, returning -17.4%.

Mercer's most recent views and commentary regarding the Coronavirus can be found through the following link: Coronavirus Outbreak Investment Implications Update.

SIGNIFICANT DEVELOPMENTS

- The Reserve Bank of Australia (RBA) has decided to lower the cash rate by 25 basis points to 0.50% per annum (pa). The decision was made against the backdrop of the global coronavirus outbreak. Governor, Philip Lowe, noted that the coronavirus has clouded the near-term outlook for the global economy, which means that global growth in the first half of 2020 will be lower than expected. It is too early to tell the magnitude of the effect of the outbreak and at what point the global economy will return to improving path, but policy measures have been announced to support growth. Long-term government bond yields have fallen to record lows in many countries, including Australia. The Australian dollar has also depreciated further and is at its lowest level for many years. The unemployment rate increased in January to 5.3% and has been around 5.25% since April last year. Wage growth remains subdued and is not expected to pick up for some time. Inflation pressures remain subdued with the global outbreak of the coronavirus expected to delay Australia's progress towards full employment and the inflation target. There are further signs of a pick-up in established housing markets, with prices rising in most markets, in some cases quite strongly. Mortgage rates are at record lows and there is strong competition for borrowers of high credit quality. Credit conditions for small and medium-sized businesses remain tight. The Board therefore judged that it was appropriate to ease monetary policy further to provide additional support to employment and economic activity. It will continue to monitor developments closely and to assess the implications of the coronavirus for the economy. The Board is prepared to ease monetary policy further to support the Australian economy.
- Australian seasonally adjusted employment increased by 13,500 in January, above expectations for a 10,000 rise, while December figures were revised to an increase of 28,700. The unemployment rate increased to 5.3% for January, above expectations for 5.2%. The participation rate increased to 66.1%, above expectations for 66.0%. Part time jobs decreased by 32,700 and full time jobs increased by 46,200.
- Australian building approvals decreased 15.3% month-on-month and decreased 11.3% for the year to January, compared to previous levels of 3.9% (revised) and 7.2% (revised) for respective periods ending December.
- The Institute for Supply Management (ISM) Manufacturing Index recorded 50.1 in February, below consensus for 50.5, and below the 50.9 recorded in January. Of the 18 manufacturing industries, Wood Products and Furniture & Related Products were the top contributors, whilst Petroleum & Coal Products and Transportation Equipment were the largest detractors over the month.

The ISM Non-Manufacturing Index recorded 57.3 in February, above consensus for 54.8 and above the 55.5 recorded in January. Of the 18 non-manufacturing industries, the top performers in February were Accommodation & Food Services and Management of Companies & Support Services, while Arts and Entertainment & Recreation and Agriculture, Forestry, Fishing & Hunting were the two industries, which reported decreases over the month.

- US Non-Farm Payrolls increased by 273,000 in February, in line with the 273,000 increase (revised) recorded for January. The unemployment rate decreased to 3.5% over February.
- US gross domestic product (GDP) second estimate for Q4 2019 is 2.1% quarter on quarter (QoQ) annualised, in line with expectations.
- The Caixin Manufacturing PMI in China recorded 40.3 in February, below expectations for 46.0. China's production levels declined at record pace over February, as factories shutdown due to Coronavirus.
- A preliminary estimate of the European Core Consumer Price Index (CPI) recorded 1.2% over the year to February, in line with expectations for 1.2%.
- The Eurozone composite PMI increased to 51.6 in February, in line with expectations for 51.6.
- The final estimate recorded for Q4 2019 Eurozone seasonally adjusted GDP is 1.0% for year-on-year (YoY) and 0.1% QoQ.

AUSTRALIAN EQUITIES

The Australian share market outperformed its hedged overseas counterpart index over the month, as the S&P/ASX 300 Index returned -7.8%. The S&P/ASX 50 was the strongest relative performer, decreasing 7.3%, while the S&P/ASX mid 50 was the weakest, returning -9.7% over the month.

The best performing sectors were Healthcare (-4.0%) and Utilities (-4.0%), while the weakest performing sectors were Energy (-17.4%) and Information Technology (-16.3%). The largest positive stock contributors to the index return were CSL, CBA and NAB with absolute returns of -0.8%, -1.9% and -2.4% respectively. In contrast, the most significant detractors were BHP, Woodside Petroleum and Santos with absolute returns of -14.4%, -19.3% and -20.6%, respectively.

GLOBAL EQUITIES

The broad MSCI World ex Australia (NR) Index decreased 4.9% in unhedged terms and decreased 8.5% in hedged terms over the month, as the Australian dollar (AUD) depreciated against most major currencies. The strongest performing sectors were Communication Services (-2.9%) and Healthcare (-3.3%), while Energy (-10.7%) and Materials (-6.5%) were the worst performers. In AUD terms, the Global Small Cap index was down -5.7% and Emerging Market index was down 1.6% over February.

Over February, the NASDAQ decreased 6.4%, the S&P 500 Composite Index decreased 8.2% and the Dow Jones Industrial Average decreased 9.8%, all in USD terms. In local currency terms, major European share markets experienced negative returns as the CAC 40 (France) decreased 8.6%, the DAX 30 (Germany) decreased 8.4% and the FTSE 100 (UK) decreased 9.0%. Returns were also negative in Asia, as the Japanese TOPIX (-10.3%), the Indian S&P BSE 500 (-6.5%), Hang Seng (-0.4%) and the Chinese SSE Composite (-3.2%) all decreased over February.

REAL ASSETS

The Real Assets sector experienced negative returns over February. The FTSE Global Core Infrastructure Index returned -8.4% and the Global Real Estate Investment Trusts (REITs) Index decreased by 8.0% over the month (both in AUD hedged terms). Domestic REITs decreased 4.7% over February, while Australian Direct Property (NAV) returned 0.3% on a one-month lagged basis.

FIXED INTEREST

Global bond markets were broadly positive over February as yields decreased across most major regions. The Barclays Capital Global Aggregate Bond Index (Hedged) increased 1.2% over the month and the FTSE World Government Bond (ex-Australia) Index (Hedged) increased 1.6%. Ten-year bond yields decreased in the US (-37bps to 1.15%), Japan (-9bps to -0.15%), Germany (-16bps to -0.63%) and the UK (-10bps to 0.42%). Two-year bond yields also experienced negative movements over the month with German (-10bps to -0.78%), Japanese (-10bps to -0.25%), US (-44bps to 0.91%) and UK (-20bps to 0.32%) bond yields decreasing.

Returns for domestic bondholders were positive over February, with 10-year yields (-15bps to 0.81%), five-year yields (-14bps to 0.57%) and two-year yields (-10bps to 0.57%) all decreasing. Of the Bloomberg Ausbond indices, the Treasury index produced the highest return, increasing 1.0% over the month.

CURRENCY MARKETS

The AUD Trade Weighted Index decreased to 57.0 over February, down by 1.9% from the previous month. The AUD depreciated against most major currencies, including the Euro (-2.7%), Japanese Yen (-3.1%), US dollar (-3.7%) and Pound Sterling (-1.4%).

COMMODITIES

Iron Ore decreased 12.4% over February, finishing the month at US$84.5 per metric tonne. The S&P GSCI Commodity Total Return Index decreased 4.9% over the month. Gold prices finished the month at US$1,586.71 per ounce, returning flat over the period and the oil price decreased 13.2% to US$50.52 per barrel over February.

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 Unlisted Infrastructure (one month lag)	Mercer Global Unlisted Infrastructure Fund	Gross 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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