Colonial First State

Market Watch

November 2015

Read the latest market update from the Economic and Market Research team at Colonial First State Global Asset Management.

Market and economic overview

Economics overview

Australia

- The Reserve Bank of Australia (RBA) left the official cash rate on hold at 2% at its meeting on 3 November 2015 and again on 2 December 2015 - where it has remained since May this year.
- In announcing the on hold decision in December, the RBA reiterated its view from November that "the prospects for an improvement in economic conditions had firmed a little over recent months and that leaving the cash rate unchanged was appropriate. Members also observed that the outlook for inflation may afford scope for further easing of policy, should that be appropriate to lend support to demand."
- On the global economy the RBA noted it is "expanding at a moderate pace, with some softening in conditions in the Asian region, continuing US growth and a recovery in Europe."
- On Australia, a "moderate expansion in the economy continues in the face of a large decline in capital spending in the mining sector." There is some hope as "business surveys suggest a gradual improvement in conditions in non-mining sectors over the past year."
- On the housing market the RBA notes that "the pace of growth in dwelling prices has moderated in Melbourne and Sydney over recent months and has remained mostly subdued in other cities." While "growth in lending to investors in the housing market has eased. Supervisory measures are helping to contain risks that may arise from the housing market."
- Australian Gross Domestic Product Data (GDP) data was released in early December for Q3 2015 and showed stronger than expected growth of 0.9% per quarter and 2.5% per year. This compares to a revised 1.9% per year in Q2 2015.
- Growth on the quarter was driven by a strong 1.5% points contribution from net exports, while final consumption spending contributed a solid 0.5% points. These increases were partly offset by a fall in capital investment (gross fixed capital formation) with a negative contribution to growth of -1.0% points.
- Including the impact of a further 2.4% per quarter fall in the Terms of Trade in Q3 2015, real gross domestic income rose by 0.3% per quarter, to be up just 0.2% per year. Income growth in the Australian economy remains substantially below production growth.
- The unemployment rate fell to 5.9% in the month of October, with 58,600 jobs added in the month. Over the past 12 months 315,000 jobs have been added.
- There continues to be signs of softening in the housing market. Building approval numbers appear to have peaked, albeit at an elevated level, with around 230,000 approvals over the past 12 months to October 2015.
- CoreLogic RP Data for November showed house prices fell 1.5% per month nationally, compared to a gain of 0.2% per month in October. This took annual gains to 8.7% per year with house prices now up 20.5% from the peak in November 2010.

- On a capital city basis, both Sydney (-1.4% per month) and Melbourne (-3.5% per month) fell while Brisbane (+0.5% per month), Adelaide (+0.7% per month) and Perth (+0.4% per month) all rose.

US

- The US Federal Open Market Committee (FOMC) did not meet during November. The next meeting is scheduled for 15-16 December where it is widely expected the FOMC will lift the Fed Funds rate by 25 basis points, in what will be the first rate hike since 2006.
- Expectations over the FOMC lifting interest rates in December escalated over the month with the release of a strong employment report for October. A total of 271,000 jobs were added in the month, compared to market expectations of just 185,000 and a gain of 137,000 in September. This was the strongest monthly job gain since December 2014 with the unemployment rate falling to 5.0%, the lowest rate since March 2008.
- One other strong aspect from the report was an increase in wages growth, a stronger-than-expected 0.4% per month, taking annual wage gains to 2.5%, the first sign of upward wage pressure this cycle.
- As a result the market is now pricing in around a 70% chance the Federal Reserve lifts interest rates in December.
- The minutes from the October meeting of the FOMC released on 18 November, hinted at the desire to lift interest rates at the December meeting with the minutes noting "most participants anticipated that, based on their assessment of the current economic situation and their outlook for economic activity, the labor market, and inflation, these conditions could well be met by the time of the next meeting."
- The minutes also highlighted that a decision to defer lifting rates could indicate undue pessimism by the FOMC on the outlook for the US economy and could have negative implications for the Fed's credibility.
- The second estimate of Q3 2015 GDP was revised up to 2.1% on a seasonally-adjusted-annualised-rate, up from the first estimate of 1.5%, still down from the 3.9% rate recorded in Q2 2015. The consumer continues to be one of the main sources of growth in the US, helped by low gasoline prices with household consumption growing at 3% on a seasonally-adjusted-annualised-rate. Total auto sales were over 18 million on an annualised basis for the third month in a row.
- House prices continue to show signs of growth, with the FHFA House Price Index rose 0.8% per month in September, taking annual growth to 6.1% per year, the strongest since March 2014. Other housing market indicators have been more volatile with new home sales up 10.7% per month of October, existing home sales down 3.4% per month in October and housing starts down 11.0% per month.

Europe

- The European Central Bank (ECB) did not meet in November with the next meeting scheduled for 3 December 2015.
- Over the month of November expectations of an aggressive package of easing measures to be announced at the December meeting rose substantially.
- Possible easing measures include; extending the timeframe of the asset purchase program (APP) beyond September 2016, cutting the deposit rate and / or the main refinancing rate, removing the deposit rate as the yield cut off point for buying securities in the APP, increasing the size of monthly purchases in the APP from €60bn and / or increasing the type of assets bought in the APP.
- Continued fears over deflation and the potential for spill overs from a slowdown in Emerging Marking economies led to the heightened speculation with ECB President, Mario Draghi hinting that all must be down to raise inflation as quickly as possible.
- During the month, Draghi noted "if we decide that the current trajectory of our policy is not sufficient to achieve that objective, we will do what we must to raise inflation as quickly as possible" and also went on to note "in making our assessment of the risks to price stability, we will not ignore the fact that inflation has already been low for some time."
- The estimate for CPI inflation in November was 0.1% per year for headline and 0.9% per

year for core inflation, with the later down from 1.1% per year in October.

- Despite weak inflation, Q3 2015 GDP data continued to show signs of improvement, with growth of 0.3% per quarter and 1.6% per year, up from 1.5% per year for Q2 2015.

UK

- The Bank of England (BoE) left policy unchanged when it announced its decision on 5 November 2015, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn. There was one dissent on the nine member board, the fourth meeting in a row. Ian McCafferty preferred to increase the Bank Rate by 25 basis points based on a view that domestic cost pressures was more likely to lead to inflation exceeding the target in the medium term than the Committee's collective November projections.
- Employment data continued to improve with 177,000 jobs added in the three months to September 2015, more than expected. The unemployment rate fell to 5.3% and wages ex bonuses grew at 2.5% per year.

NZ

- The Reserve Bank of New Zealand (RBNZ) did not meet in November with the next meeting scheduled for 10 December 2015.
- While there was no RBNZ meeting over the month, commentary from the central bank's semi-annual Financial Stability Report was focussed on risks in the Auckland housing market and risks from falling dairy prices.
- On 1 November the RBNZ tightened lending rules for Auckland residential property investors, requiring them to have a deposit of at least 30% for a mortgage. Changes were also made to capital gains on holding properties for less than two-years. These changes are in response to an estimated 27% gain in Auckland property prices in the 12 months to September 2015.

Canada

- The Bank of Canada (BoC) did not meet in November with the central bank meeting on 2 December 2015 where the overnight rate was left on hold at 0.5%.
- In its decision the BoC noted that risks to inflation are 'roughly balanced' and rate sensitive, non-resource exports are picking up while vulnerabilities in the household sector are edging higher.

Japan

- The Bank of Japan's (BoJ) policy board convened on 19 November 2015 and left its qualitative and quantitative easing (QQE) program at an annual increase of ¥80trillion to its monetary base.
- The decision was made after GDP data confirmed that the Japanese economy had re-entered recession. GDP contracted 0.8% per quarter in Q3 2015 following a 0.7% per quarter contraction in Q2 2015. Weak business investment was the main contributor to negative growth, with back-to-back declines for the first time since 2011. This is despite relatively healthy corporate profitability numbers.
- There does remain some expectation for further stimulus by the BoJ in 2016 with the goal of returning inflation to 2% now delayed 6 months till March 2017.

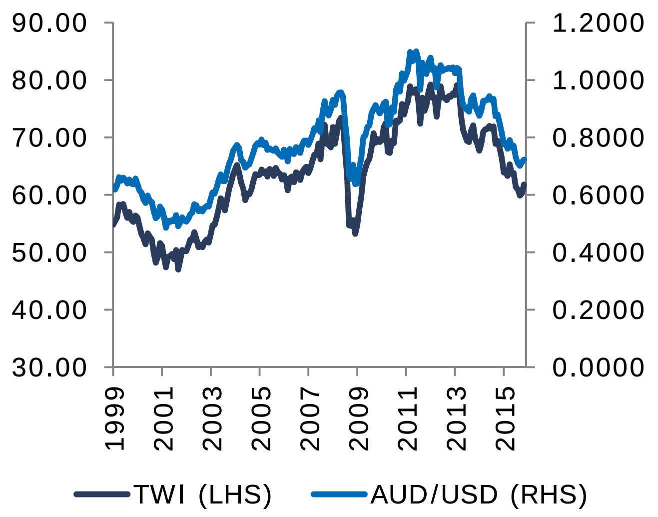
China

- It was announced on 30 November that the Renminbi (RMB) will be included in the International Monetary Fund's Special Drawing Rights basket as of 1 October 2016. This is a clear step forward for the RMB becoming an international reserve currency.
- The RMB will join the US dollar, Euro, Japanese yen and British sterling in the basket and should prompt further depreciation of the RMB and capital account liberalisation.
- The initial weight for the RMB was set at 10.92%, while the remaining weights are; US dollar (41.73%), Euro (30.93%), Yen (8.33%) and Sterling (8.09%).
- The outcome from the government's fifth plenum confirmed the aim to double the nations GDP and per capita income by 2020, from 2010. This equates to a GDP rate of around 6.5% per annum.

Australian dollar

- The Australian dollar was stronger against the major cross currencies over the month. The AUD finished up 1.2% against the USD in November to $US0.7227. These gains occurred despite growing expectations of the US Federal Reserve lifting interest rates at its December meeting, and were partly driven by reduced expectations of further rate cuts by the RBA given better domestic economic data.
- The Australian dollar also moved higher against the Euro, up 5.5% as prospects for further ECB easing appeared more certain. The AUD rose against the Japanese yen (+3.3%), was up 3.8% against the sterling and 3.9% against the NZ dollar.

AUSTRALIAN DOLLAR HIGHER IN NOVEMBER

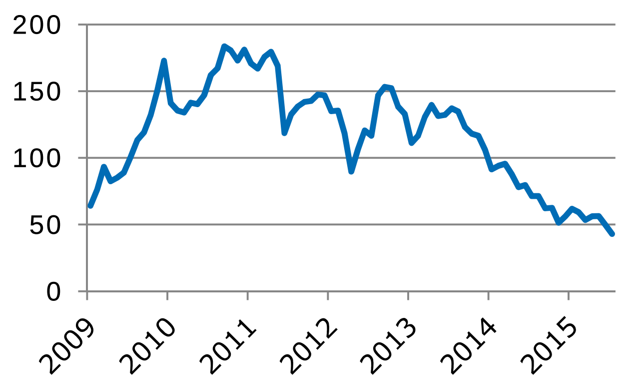


Source: Bloomberg as at 31 November 2015

Commodities

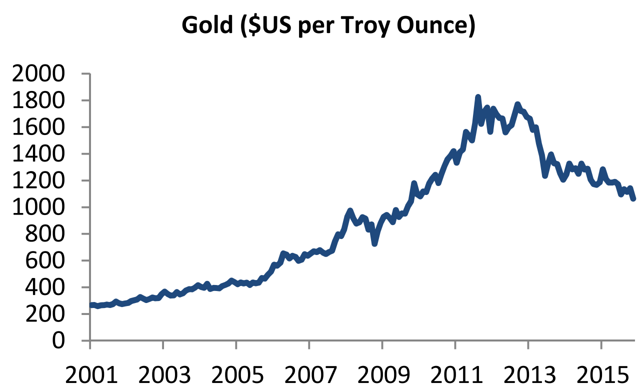
- Commodity prices were weaker across the board in November, largely led by oil and metals.
- Iron ore prices fell 13.8% over the month, as measured by the benchmark price of iron ore delivered to Qingdao China – 62% Ferrous Content. The price ended at $43 / metric tonne at end of November around decade lows, driven by weaker import volumes from China.
- Nickel (-11.5%) and copper (-10.3%) were the weakest performers, while zinc (-8.6%), lead (-2.8%) and aluminium (-2.2%) also fell. Tin was the rare exception, rising 0.4% in the month.
- The oil price also recorded large falls, down 10.6% in the month despite a rise in geopolitical risk and events over November. Further gains in the US dollar, rising US inventories and expectations that OPEC will not cut production at its 4 December meeting led to the falls. The price of West Texas Intermediate Crude finishing the month at $US41.65.

IRON ORE DOWN SHARPLY



Source: Bloomberg as at 31 November 2015

GOLD UP SLIGHTLY



Source: Bloomberg as at 31 November 2015

Australian equities

- October's sharemarket rally ran out of steam in November, with the S&P/ASX 200 Accumulation Index closing the month 0.7% lower. Many of the issues that have affected investor sentiment recently remained unresolved. Macroeconomic issues such as uncertainty surrounding the pace of Chinese economic growth and the timing of potential interest rate increases in the US continued to affect sentiment.

- The Materials sector was particularly weak, dragged lower by sector heavyweight BHP Billiton (-21.4%). A serious incident in Brazil at a mine operated by Samarco – a 50/50 joint venture between BHP Billiton and Brazilian iron ore miner Vale – exerted significant downward pressure on the share price. The market capitalisation of BHP Billiton has declined by more than $25 billion since the incident in early November. As well as the financial impact of any fines and penalties, investors appear to be increasingly concerned about the outlook for BHP's cash flows, earnings and the sustainability of the dividend given current commodity prices. The iron ore price, for example, has sunk to new multi-year lows reflecting increased supply and speculation that mills in China are cutting back on steel production.
- Share prices were more stable in the Financials sector, with all four of the major banking stocks registering gains. Recent increases to home loan rates are expected to support margins for lenders.

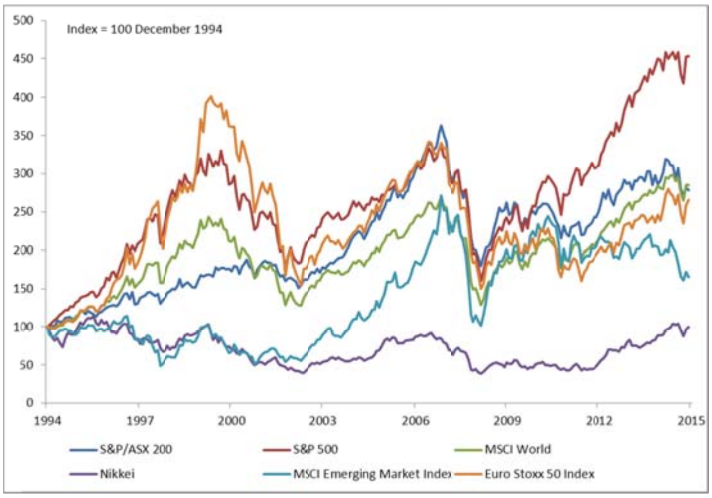
Listed property

- Listed property securities gave back some of their gains from the past year in November, with the S&P/ASX 200 Property Accumulation Index declining 2.9%.
- Stocks in the retail sub-sector, which have been performing relatively well of late, were among the weakest performers. Vicinity Centres (-6.9%) and Westfield Corporation (-6.3%), for example, underperformed peers.
- On the positive side, Mirvac Group (+3.3%) was a notable outperformer following its AGM where management suggested it is exploring options to unlock value in the business.
- Overseas REITs also lost momentum, with the FTSE EPRA/NAREIT Global Developed Index closing 2.2% lower in USD terms. As ever, there was a fair degree of performance variance between global regions. US REITs, for example, were little changed overall while stocks in the UK declined in value by more than 5%.

Global developed market equities

- After recording gains of close to 8% in October, the broad developed equity market, as measured by the MSCI World Index fell by 0.7% in US dollar terms in the month of November, and 1.9% lower in Australian dollar terms.
- Geopolitical risks, weak commodity prices and heightened expectation of an interest rate hike by the US Federal Reserve after strong employment numbers weighed on the market.
- These overall falls hide mixed losses and gains globally, with markets in Europe outperforming as expectations increased of aggressive easing measures to be introduced by the ECB. US markets were up marginally while Asia was broadly weaker.
- In the US, the S&P500 (+0.1%), the Dow Jones (+0.3%) and the NASDAQ (+1.1%) all rose. The MSCI Energy sector fell 1.6%, Utilities fell 4.0% while IT was the top performer, rising 0.8%.
- Equity markets in Europe were also stronger despite the tragic events in Paris. The German DAX (+4.9%), France (+1.2%), Spain (+0.3%) and Italy (+1.2%) all rose. Much of the gains were in reaction to expected easing measures by the ECB at its 3 December meeting. The UK FTSE 100 was down 0.1%.
- In Asia, the Japanese Nikkei 225 rose 3.5%, after strong gains in October. Singapore (-4.7%) fell on economic concerns with weak external demand and tight financial conditions impacting the economy while Hong Kong (-2.8%) fell.

EQUITY MARKETS MIXED IN NOVEMBER



Source: Bloomberg as at 31 November 2015. Past performance is not an indication of future performance.

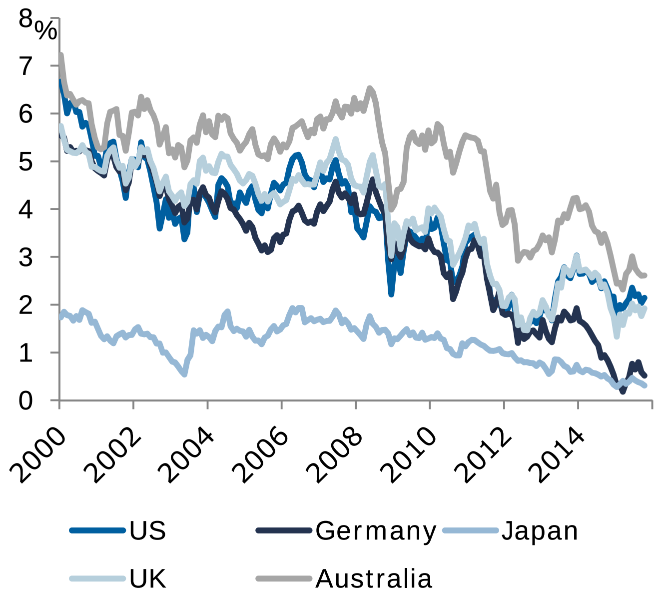
Global emerging markets

- Emerging market equities performed poorly in November with the MSCI Emerging Market Index down 4.0% in US dollars and 5.1% in AUD terms. All regions recorded falls, led by Europe, Middle East and Africa, with the weaker oil price contributing to these losses. MSCI EM Latin America fell 4.4% while MSCI EM Asia was down 3.3% in US dollar terms.
- The Shanghai Composite rose 1.9%, although lost ground late in the month on investigation into major brokerage firms.

Global and Australian developed market fixed interest

- Over the month, global bond markets continued to be driven by speculation of central bank action. Following strong payrolls data from the US, the market is now significantly pricing in commencement of policy normalisation in the US at the next meeting of the FOMC of the US Federal Reserve, as a result bond yields were up in the month.
- In comparison, comments from the European Central Bank (ECB) have markets speculating a range of easing measures will be announced at their December meeting. The horrific terror attacks in Paris during the month had an immediate short term impact on markets, but eventually markets managed to stay relatively calm.
- The positive economic backdrop saw bond yields rise in the US. 10-year US government yields were up 6 basis points (bps) ending the month at 2.21%.
- In Europe, short-dated Eurozone yields dropped to record lows in November with the 2-year and 5-year bund yields falling to -0.42% and -0.18% respectively by the end of the month. The price action was caused by a stampede to buy bonds ahead of what's largely anticipated to be an extensive package of changes to the ECB's bond buying program. 10-year bund yields were relatively more stable, falling only 4bps to end November at 0.47%.
- In the UK, the yield on the 10-year gilt fell by 10 bps to 1.83%.
- In Japan, the 10-year Japanese Government Bond (JGB) yield was flat in the month at 0.30%, continuing to trade in a relatively narrow range of 5bps.
- In Australia the 10-year government bond yield rose 25bps to end the month at 2.86%. The sell-off in bonds was a result of the Reserve Bank of Australia's (RBA) November meeting decision and commentary, and some stronger economic data.

BOND YIELDS MOVES MIXED IN NOVEMBER



Global credit

- Over the month, global credit spreads provided mixed results as heightened expectations for Fed policy normalisation in December moved the US dollar higher and commodity prices lower. The result was a marginal narrowing in US credit with the Barclays US Aggregate Corporate Index average spread finished the month at 1.47%, coming in 3bps.
- The highly expected additional easing from the ECB to occur in December saw the average spread on the Barclays European Aggregate Corporate Index narrow by 3bps to 1.30%. Overall, the Barclays Global Aggregate Corporate Index average spread came in 4bps in the month, closing at 1.51%.
- Volatility spiked in the US high yield credit market and continued weakness from the Energy and Materials sector resulted in a widening in spreads in the month, with the Bank of America Merrill Lynch Global High

Yield index (BB-B) spread 28 bps wider at 5.09 %. In Asia, credit markets strengthened slightly, with the JPMorgan Asia Credit Index (JACI Composite) average spread narrowing by 5 bps to 2.79%. Australian credit spreads widened only slightly in the month, as investor sentiment was more positive on global events, aided by the pricing in of normalisation from the US Fed.

However, activity remained cautious as numerous factors keep investors on the fence including the outlook on China's growth, domestic growth concerns and dollar depreciation. The average spread of the Bloomberg AusBond Credit Index relative to swap increased from 111 bps to 114 bps.

Index return

	Index Level in Base Currency	1 month	12 month
S&P/ ASX200 Index	5,167	-1.4%	-2.8%
S&P / ASX 200 Accumulation Index	47,063	-0.7%	1.9%
MSCI WORLD (AUD)		-2.0%	16.9%
MSCI World Net Index AUD Hedged		0.8%	5.2%
Dow Jones Index	17,720	0.3%	-0.6%
UK FTSE 100	6,356	-0.1%	-5.5%
German DAX Index	11,382	4.9%	14.0%
France CAC Index	4,958	1.2%	12.9%
Japan - Nikkei	19,747	3.5%	13.1%
Hong Kong – Hang Seng	21,996	-2.8%	-8.3%
MSCI EM (EMERGING MARKETS) (AUD)		-5.4%	-2.2%
US 10 year bond yield	2.21%	6bps	4bps
Australia 10 year bond yield	2.86%	25bps	-17bps
UBS All Maturities Composite Bond Index	8,533	-0.9%	4.0%
90 Day Bank Bill Index	2.27%	17bps	-48bps
Bloomberg AusBond Bank Bill Index	8,349	0.2%	2.4%
S&P / ASX 200 - A-REIT Accumulation Index	37,932	-2.9%	14.9%
UBS Global Real Estate Investors Index (Net TR) AUD Hedged	0.7138	1.7%	-18.9%
AUD/USD (end of month)	0.7227	1.2%	-15.0%
Oil price	$US41.65/barrel	-10.6%	-37.0%
Gold price	$US1064.77/ounce	-6.8%	-8.8%

The Economic and Market Research team

Stephen Halmarick
Head of Economic and Market Research

Belinda Allen
Senior Analyst Economic and Market Research

James White
Senior Analyst Economic and Market Research

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