Our view

Researchupdate

Economic Wrap

August 2019

Summary

- Signs of weakness in leading indicators and now, to an extent, official economic data support slowing growth for this year in the US with the latest GDP showing 2.3% growth year-on-year. Slowing growth is a consistent theme globally bar a few exceptions.
- Tariff measures reappeared with the Trump Administration triggering a Chinese response at the start of September as well as during the month of August. The PBOC allowing the Chinese yuan to rise above the symbolic 7 per USD$1 sparked market volatility to start August as well. Since then it has remained above this point without decoupling more sharply.
- The Markit Global Manufacturing PMI remained in contractionary territory. Slowing but positive growth in the US has been insufficient to offset weakness in Europe, notably in Germany, and in China. Services sectors continue to hold up comparably well seeing overall economic growth in positive territory.

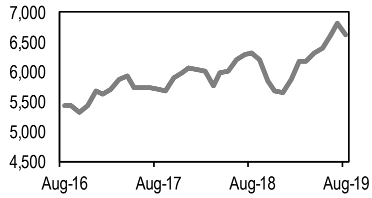
Markets – The “everything rally” faltered in August with most equity markets down during the month with the bid for “risk off” asset classes remaining strong.

- Small and micro caps and, emerging markets continued to lag developed market large caps with weak performance during the month (see p11)
- Unhedged exposures to global REITs and global infrastructure were the best performers benefitting from falling bond yields and a falling Australian Dollar.
- Australian equities underperformed vs international peers (see chart 2) and investors continue to bid up growth stocks (see chart 3) as yields fell.
- Emerging market weakness has continued to persist (see chart 4) with the Hong Kong Hang Seng softer in the month as social unrest and an uptick in trade tensions weighed on the Chinese market.

Key economic news – The Reserve Bank of Australia left rates on hold in both August and September at 1%. In line with our expectations Australian GDP growth disappointed driven by weakness in investment and consumer spending. RBA communications have solidified expectations of further interest rate cuts by up to 0.5% over the next two years. News of global trade talks have deferred a possible second rate cut later into 2020 while a rate cut is still expected by December this year.

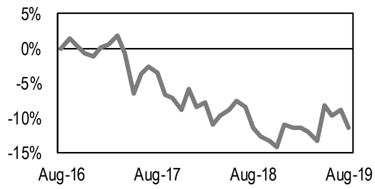
Key company news – Earnings season was the major highlight of company returns during August as the reception versus expectations drove price performance of many companies. New addition to the S&P/ASX200 Pro Medicus (ASX: PME) and fellow healthcare firm Nanosonics (ASX: NAN) saw their results and outlook well received.

1. S&P/ASX 200 Price Index



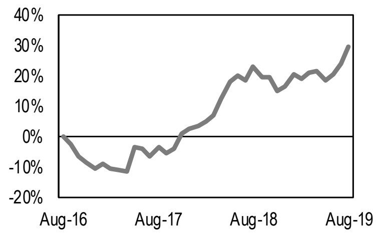
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



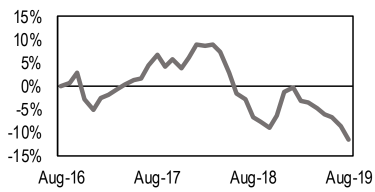
Source: Bloomberg, IOOF

3. MSCI Australia Growth relative to MSCI Australia Value



Source: Bloomberg, IOOF

4. Emerging markets vs Developed Markets, US$ terms



Sources: Bloomberg, MSCI, S&P, IOOF

Sector and stock returns

	ASX/S&P 200 Sectors (GICS)				Best and Worst S&P/ASX 200 Performers			
	Monthly	%∆	Quarterly	%∆	Top five stocks		Bottom five stocks	
▼	Consumer Discretionary	-1.06	Consumer Discretionary	2.22	Monthly			
▼	Consumer Staples	-0.48	Consumer Staples	12.49	Nanosonics Ltd	+21.1%	Speedcast Intl Ltd	-58.9%
▼	Energy	-6.41	Energy	-2.84	Pro Medicus Ltd	+19.7%	Ooh!Media Ltd	-31.3%
▼	Financials ex Property	-3.60	Financials ex Property	1.49	Smartgroup Corp Ltd	+18.7%	Bellamy's Australia Ltd	-25.7%
▼	Financials	-3.60	Financials	1.49	Lendlease Group	+17.3%	Iluka Resources Ltd	-25.7%
▲	Health Care	3.53	Health Care	14.27	Afterpay Touch Group Ltd	+15.9%	Pilbara Minerals Ltd	-25.5%
▼	Industrials	-2.70	Industrials	5.10	Quarterly			
▼	IT	-0.02	IT	5.94	Pro Medicus Ltd	+62.0%	Speedcast Intl Ltd	-79.4%
▼	Materials	-7.92	Materials	-1.18	Wisetech Global Ltd	+51.6%	Pilbara Minerals Ltd	-51.4%
▲	Property Trusts	0.70	Property Trusts	5.82	Resolute Mining Ltd	+49.1%	CIMIC Group Ltd	-31.4%
▼	Telecommunications	-4.53	Telecommunications	0.74	Nanosonics Ltd	+48.2%	Vocus Group Ltd	-29.4%
▼	Utilities	-4.23	Utilities	-0.16	Austal Ltd	+44.0%	Ooh!Media Ltd	-27.4%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, August 2019

	Australian Indices	Aug-19 Price	1M return (%)	May-19 Price	3M return (%)
▼	S&P/ASX 200	6604	-3.06	6397	3.24
▼	All Ordinaries	6698	-2.88	6492	3.18
▼	Small Ordinaries	2837	-4.19	2817	0.73
	US Indices				
▼	S&P 500	2926	-1.81	2752	6.34
▼	Dow Jones	26403	-1.72	24815	6.40
▼	Nasdaq	7963	-2.60	7453	6.84
	Asia Pacific Indices				
▼	Hang Seng	25725	-7.39	26901	-4.37
▼	Nikkei 225	20704	-3.80	20601	0.50
	UK & Europe Indices				
▼	FTSE 100	7207	-5.00	7162	0.63
▼	CAC40	5480	-0.70	5208	5.24
▼	DAX Index	11939	-2.05	11727	1.81

Sources: Bloomberg, MSCI, FTSE, S&P, IOOF

Note: return is reported on a price basis and in local currency terms e.g. S&P500 performance is in US dollars and excluding dividends.

Global equity markets

The S&P 500 index finished August down 1.8%, ahead of the tech-heavy NASDAQ which was down 2.6%. The market performance was negative across most sectors with only three of the eleven up in August. The sectors who led for the month were Utilities (up 4.7%), Real Estate (up 4.6%) and Consumer Staples (Up 1.6%). Energy continued to falter (down 8.7%) followed by financials (down 5.1%) and the Materials sector (down 3.1%). Risk aversion was a key driver with bond proxies such as Utilities benefitting from the prospect of further US interest rate cuts following tariff escalation by the Trump administration. More subdued global growth with disappointing PMIs and weaker economic data out of Europe saw the Energy sector continue to struggle.

Globally most markets fell during August led by weakness in China and the UK. The FTSE 100 fell 5% driven by increased "no deal" Brexit fears (the prospect of an economically damaging British exit from the EU). Chinese equities remained weak driving emerging market equities lower still (see chart 4 above). Key to the weakness in China was the further escalation of US tariffs following a lack of negotiation progress. President Trump signalled the implementation of new tariffs in early September with a portion targeting consumer goods delayed until mid-December. This continues to weigh on investor sentiment towards the Chinese market.

Australian equity market

The S&P/ASX 200 index finished August down 3.1%. Most sectors were in negative territory with Health care (up 3.5%) and Property (up 0.7%) the notable exceptions. Mirroring the US experience Energy was amongst the worst performers (down 6.4%) as was the Materials sector (down 7.9%) and the Telecommunications sector (down 4.5%). Weakness in the Materials sector was driven by poor performance from heavy weights in Rio Tinto (ASX: RIO) and BHP Billiton (ASX: BHP). Both companies were heavily impacted by a falling iron ore price driven in part by increased supply from Brazil as well as seasonal weakness in steel demand from China and production curbs in place there for environmental reasons.

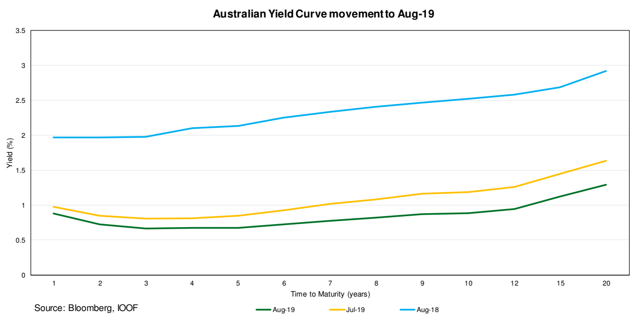
Fixed Income

	Fixed Income	Aug-19 yield	1M mvt (bps)	May-19 yield	3M mvt (bps)
	Aussie Cash rate	1.00	--	1.50	-0.50
▼	10-year Bond Rate	0.89	-0.30	1.46	-0.57
▼	3-year Bond Rate	0.67	-0.14	1.10	-0.43
▼	90 Day Bank Accepted Bills SFE-Day	0.97	-0.07	1.42	-0.45
▼	US 10-year Bond Rate	1.50	-0.52	2.12	-0.63
▼	US 3-year Bond Rate	1.43	-0.40	1.87	-0.45

Source: Bloomberg, IOOF

The Australian yield curve fell further during August (see chart 5). The 10-year bond yield fell 30ps and the 3-year yield was down by 14bps with the yield curve continuing to flatten further. The RBA left the cash rate on hold at 1% in August. It did however flag further rate cuts implicitly through its *Statement on Monetary Policy*. Within that document the Bank disclosed its economic forecasts for the next two years. As part of that it acknowledged current market pricing of two rate cuts as built into its estimates. This implies a terminal cash rate of 0.5% in the short term. Given expectations of weaker economic growth ahead, investors are "voting with their feet" to bid up existing bonds in anticipation of rate cuts sooner rather later driving the price action this month. At the time of writing market-implied rates suggest a 0.25% rate cut by December this year and a further cut later in 2020. Such a climate continues to favour holding bonds in the near term.

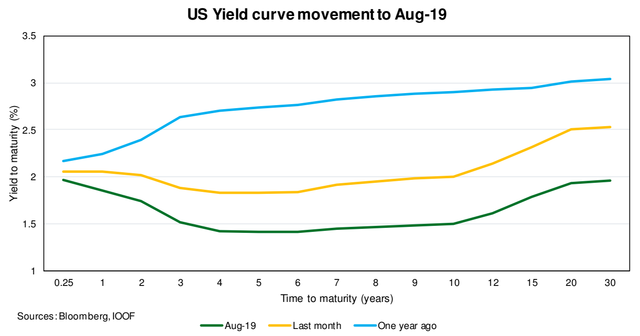
5. Australian yield curve movements to August 2019



The U.S. yield curve fell in August most notably at the longer-end of the curve with the US 10-year yield down 52bps and the US 3-year yield down 40bps. Concerns over global growth persist—EU economic growth disappointing for the June quarter—as do softening leading indicators in the US with the manufacturing PMI slowing further. Trade factors have also plagued business confidence. US growth numbers while strong relative other developed countries continue to guide slightly lower with the latest FedWatch GDP Nowcast at 1.5% for the September quarter (down from 2.1% for the June quarter)

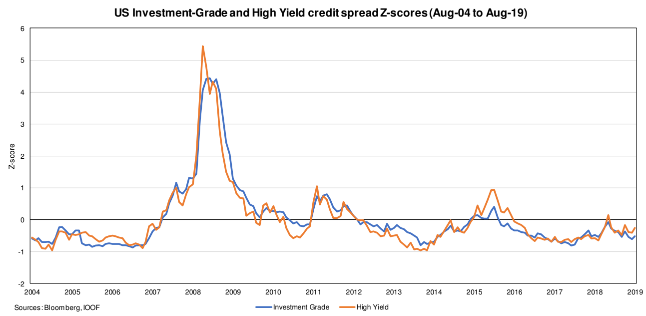
Against this backdrop market predictions of rate cuts have strengthened further with a 0.25% cut on 18 September priced in as a near certainty at the time of writing. Three rate cuts in total are anticipated by March 2020 according to the CME FedWatch Tool in response.

6. US yield curve movement to Aug-19



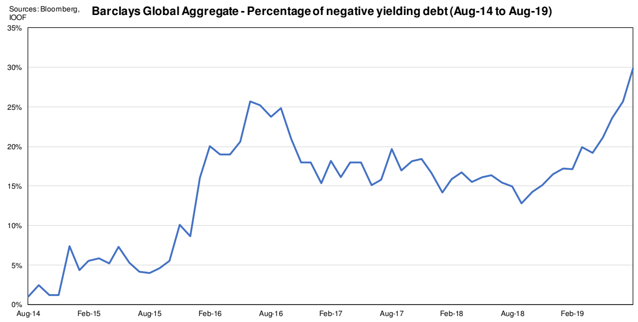
Against this dynamic of falling yields, credit risk spreads, a measure of risk appetite, have been reasonably contained although there has been some divergence this month. Using US data to illustrate, investment grade spreads (the **blue line**) increased by 0.1% during the month (reflecting their better credit quality). High yield bonds (the **orange line**) saw spreads expand by 0.4% reflecting a greater unwillingness to hold these bonds as well as weaker oil prices (high yield debt has a higher exposure to the Energy sector). Overall these movements remain supportive of a stable outlook in the near term. If spreads were widening materially that would be a sign of broader market risk aversion (investors fleeing risk assets) and bode poorly for both these riskier bonds and other risk assets such as equities.

7. US investment grade and high yield debt credit spread (Z-scores)



Negative yields continued during the month with almost 30% of the Barclays Global Aggregate (a global bond benchmark) offering a negative yield as of early September (see chart 9). This bodes poorly for long-term fixed income returns given lower starting yields. However, in the short-term expectations of more quantitative easing in Europe and US rate cuts can continue to support bond returns.

8. Percentage of Barclays Global Aggregate with negative yields



Currencies

	Currencies	Aug-19 Price	1M return (%)	May-19 Price	3M return (%)
▼	$A vs $US	67.33	-1.64	69.38	-2.95
▼	$A vs GBP	55.39	-1.60	54.93	0.83
▼	$A vs YEN	71.59	-3.85	75.12	-4.71
▼	$A vs EUR	61.32	-0.78	62.11	-1.27
▲	$A vs $NZ	106.46	2.02	106.25	0.20
▲	$US vs EUR	91.02	0.82	89.54	1.65
▼	$US vs GBP	82.22	-0.04	79.16	3.87
▼	$US vs CHF	99.04	-0.36	100.06	-1.02

Source: Bloomberg, IOOF

The Australian dollar (AUD) fell by 1.6% to USD 0.6733. The prospect of interest rate cuts as well as weakness in iron ore prices combined to drive the currency lower. Weaker global growth concerns prompted by further escalation in trade tensions also drove the AUD lower.

The US Dollar (USD) strengthened against global peers amidst increased speculation of a strong ECB stimulus package in Europe and efforts by China to allow the yuan to depreciate slightly. One exception was the Japanese Yen which saw a "flight to safety" effect rising against the US Dollar and other major currencies.

Commodities

	Commodities	Aug-19 Price	1M return (%)	May-19 Price	3M return (%)
▼	Aluminium	1733	-3.23	1801	-3.80
▼	Copper	255	-4.65	264	-3.50
▲	Nickel	18005	24.11	12035	49.61
▲	Gold	1529	6.37	1323	15.64
▲	Silver	18	10.94	15	24.30
▼	Crude Oil - Brent	60	-7.27	64	-6.30
▲	Lead	2017	0.41	1808	11.57
▼	Zinc	2209	-9.86	2510	-11.97
▼	Iron Ore	90.91	-24.25	98.76	-7.95

Source: Bloomberg, IOOF

Commodity prices had mixed performance in August.

Nickel prices rose strongly as the Indonesian government brought forward an export ban from 2022 to December this year. The Indonesian government is looking to accelerate efforts for the country to join global ranks as a steel producer (climbing the industrial value chain) rather than remain a raw nickel exporter. As the world's largest producer with 9% of global production this earlier-than-expected withdrawal of supply has triggered a sizeable rally in the metal.

Gold prices continued to benefit from a flight to safety driven by market volatility earlier in the month. In addition, it arguably benefitted from greater competitiveness relative to bonds carrying negative yields (as gold has no yield per se).

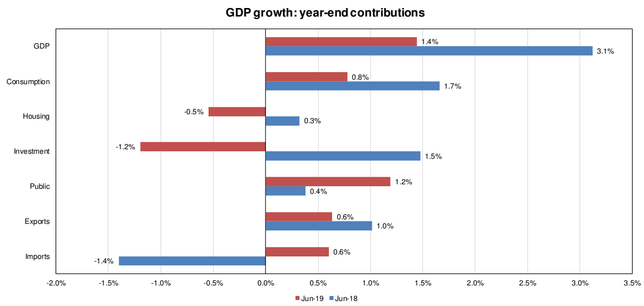
Growth concerns persisted driven by weaker leading data such as the flash Composite PMI surveys which showed US manufacturing activity contracting slightly. This saw growth-exposed commodities such as copper and oil fall during the month. Iron ore as discussed above saw a mix of seasonal weakness in activity by Chinese steel mills as well as an increased supply response from Brazil that drove prices lower. As we have noted in the past the supply deficit that drive miner share price gains this year has been regarded as a temporary phenomenon. Prices could potentially fall further if more Brazilian production is brought online with longer term forecasts by Treasury seeing iron prices at US$55 per tonne.

Australia

The latest GDP growth figures confirmed weaker economic momentum with annual growth slowing to 1.4% in the year to June in line with our expectations. The RBA rate cuts have not yet translated into stronger retail sales with July retail trade disappointing expectations.

Economic growth

The Australian economy grew in line with expectations for the June quarter up 0.5% (consensus: 0.5%) and for the year to June, up 1.4% (consensus: 1.5%). Key drivers of the weaker result relative to last year were in household spending, housing and other private investment with the latter two detracting from growth. The result was underpinned by surprisingly strong net exports with the surge in iron ore prices contributing to our first current account surplus in decades. Public spending has also been key to supporting the growth outlook accounting for 1.2% of the 1.4% annual growth rate.



These results are below the RBA forecast of 1.7% and should bring forward its rate cut decision particularly if August retail trade and labour data disappoint.

Business sector

The NAB Monthly Business survey was broadly unchanged in July. It continues to point to weaker momentum amongst Australian businesses with both business conditions and business sentiment remaining below average levels. Weakness in the employment results are suggestive of 15k jobs growth which implies no improvement in the unemployment rate contrary to the RBA's intentions. Leading indicators also remain weak with capacity utilisation at average levels and forward orders remaining negative. Inflation being faced by businesses and being passed on to consumers is also subdued.

These results are consistent with a weaker GDP contribution by the business sector. A measure of gross production by industry neatly illustrates the current dilemma. At present more cyclical sectors such as construction are encountering substantially weaker demand conditions

Consumer sector

Retail sales tracked lower in July falling -0.1% (consensus: +0.2%). Leading the falls was the "eating out" subcategory (down 0.6%) followed by clothing and accessories (down

1%) and other retailing (down 0.4%). Falls were recorded in all States except for Western Australia and the Northern Territory up 0.6% and 0.3% respectively. The NAB Online Retail Sales Index also fell over the same period (down 2%) and fell for the first time in year-on-year terms (down 1.1%). A 6.5% decline in homewares and appliances was a key driver during the month. Taken together this was a disappointing set of results given the two RBA rate cuts preceding them.

The Westpac-Melbourne Institute Index of Consumer Confidence rose to 100 in August (up from 96.5 in July). Part of this rise is due to a stronger economic outlook being expected by consumers while households are also expressing stronger interest in purchasing property following the RBA rate cuts and subsequent decline in mortgage rates. There were some initial signs of increased willingness to spend with the 'time to buy a major household item' rising also. Given the weak consumption and retail trade levels we expect that more stimulus will be needed to return consumption spending back to trend levels.

Inflation

Wage growth remained at 2.3% annual growth after climbing 0.6% during the quarter. The uptick was led by the public sector (up 0.8%) with the private sector growth remaining subdued (up 0.5%). The still sizeable slack in the labour market (discussed below) suggests stronger jobs growth is needed to see wage growth improve to a stronger pace.

The unemployment rate remained steady at 5.2%. This was accompanied by an increase in the underemployment rate from 8.2% to 8.4%. The presence of continued slack within the labour market combined with weakness from the NAB Business Survey is supportive of easier monetary policy. Unemployment remains a sizeable distance from the RBA target of 4.5% with a sustained, faster rate of jobs growth needed to deliver this goal.

Summary

On balance the risks to the Australian economy remain skewed to the downside with the economy growing at its weakest since the global financial crisis. This is reflective of the slowing economic momentum elsewhere in the world and echoed in the latest RBA forecasts. However, it is not an international cause per se, the strong export contribution attests to this. The weakness is centred on domestic demand with weaker growth remains the more likely outcome.

Asset class implications

- Favour fixed rate (e.g. bonds) over floating rate instruments.
- Be considered in cyclicals exposure particularly with respect to consumer and housing-facing names.
- Continue favouring companies with exposure to offshore earnings.

United States

Trade tension fears remain a key dynamic besetting the US economy. Higher global uncertainty and concerns over the path of business investment have increased the chances of further rate cuts by the Federal Reserve.

Policy

The Trump Administration introduced new tariffs in early September. These were flagged during August and contributed to market volatility.

The breakdown (courtesy of Axios) is as follows

US

- 1 September: 15% tariff on $112bn of Chinese goods
- 1 October: 30% tariff on $250bn of Chinese goods (up from 25%), and
- 15 December: 15% tariff on $160bn of Chinese goods (reducing the pre-Christmas impact on US consumers).

China

- 1 September: Tariffs ranging 5-10% on $75bn of US imports.
- December: Tariffs on US automobile imports

Subsequent to these moves the US and China have re-engaged for trade talks in early October. Given the breakdown of an earlier agreement in May it remains to be seen if this phase can yield substantive progress. It has prompted some optimism in financial markets with bond yields ticking up to start September on the potential for a deal.

The Federal Reserve is expected to cut interest rates on 18 September with the CME FedWatch Tool giving a 93.5% probability of a 0.25% cut according to market-implied forecasts at the time of writing. This follows a series of speeches by Chairman Powell and other Committee members emphasising the need for easier policy to keep the growth trajectory on track and alleviate the negative impact of sentiment on business activity.

Sentiment

The University of Michigan Consumer Sentiment Index fell 8.6 points during August. This was the largest such monthly decline since December 2012 when the US was beset by concerns over government finances. The decline this time was due to negative references to tariffs and fears about their impact on consumer goods. The overall level is supportive of consumer spending growth, but the concern remains that this could soften further. Increased fears of higher unemployment, weaker income growth and higher inflation are all examples of what could drive softer consumer spending.

US manufacturing conditions continued to soften slightly in August. The Markit Manufacturing PMI fell from its July reading of 50.4 to 50.3 in August. Weaker overseas demand saw new business growth slow and hurt business confidence. The lower level of business sentiment saw employment remain broadly unchanged and inflationary pressures remain contained. Taken together this result points to manufacturing being a drag on economic growth with production falling at an annualised rate of 3% according to IHS Markit economists. The Composite Index (services and manufacturing combined) fell from 52.6 in July to 50.7 in August, with weakness in services adding to a slower manufacturing sector. While the services sector continued to grow it was at its slowest pace since early 2016 with weaker growth in new orders a driving factor (also at their weakest since March 2016). Input prices fell for the first time in the survey's history due to lower interest rates and purchases prices suggesting muted inflation pressure. The slower expansion of employment is also consistent with a slowing labour market discussed below.

The PMI results are suggestive of growth slightly below 1.5% for the September quarter. This is consistent with the Atlanta Fed GDPNow forecast of 1.5% (as of 4 September). These factors remain in line with our outlook in the December quarterly of slowing US growth.

Consumer sector

US retail sales rose 0.7% in July (consensus: 0.3%) and 3.4% in the year to July. Excluding cars, gasoline, building materials and food, core retail sales were up 1% suggesting underlying consumer strength to start the September quarter which is a positive for growth.

The labour market has remained tight with unemployment steady at 3.7%. However, some leading indicators such as the PMI surveys suggest room for caution with an increase of only 3,000 manufacturing jobs in August. Weaker employment indicators in this space have been consistent with slower jobs growth in the months ahead. In addition, we saw non-farm payrolls numbers disappoint for August with growth by 130,000 jobs (consensus: 158,000).

Inflation

Headline US inflation rose 0.3% in July (consensus: +0.2%), driven by gains in oil prices and stronger housing costs. Core inflation was also up 0.3% (consensus: 0.3%). However, on a forward-looking basis the signals from the PMI data are suggestive of weaker inflationary pressures going forward with bond yields struggling to climb higher on this news (which they would if markets were pricing in an inflation "breakout" on this news).

Summary

Our base case over the next year does not suggest a US recession at this point. We believe growth can slow further before eventually recovering as the US economy deals with the shock presented by the Trump Administration's trade policies. Upside factors supporting our forecasts include expectations of lower interest rates and a possible trade deal (lower probability given the differences between the US and Chinese positions). There is also the possibility of fiscal stimulus ahead of the 2020 Presidential elections if the slowdown becomes materially worse. A trade deal or some form of trade resolution would also be a powerful spur to sentiment and economic activity. Downside risks include further trade escalation beyond what has been announced and weakness in consumer spending given other economic sectors appear likely to be drags or weaker contributors to growth.

If our view shifts materially, consistent with our Market update issued in August we will be on the front foot discussing what this means for client portfolios and suggesting actions going forward.

China

Trade war escalation with the US during the month has been a detractor and remains a source of downside risk for future growth. The case for additional stimulus appears to have strengthened given ongoing weakness in export growth and a subdued domestic outlook. Authorities are approaching this problem delicately conscious of not engaging in excessive borrowing.

Policy

The People's Bank of China has engaged in further monetary stimulus with a 0.5% reserve requirement reduction for all banks. This would help release long-term funding of the order of $184bn that could be deployed into new lending (This is the underlying logic behind this move). While a welcome effort, observers continue to expect more measures in the near term given underlying weakness in Chinese economic activity.

Sentiment

The Markit manufacturing PMI for August was 50.4, up from the July reading of 49.9. The move out of contractionary territory (readings below 50) was supported by stronger production with total new work stable as higher domestic demand offset weaker overseas sales for Chinese manufacturers. Overall business confidence softened due to trade concerns and fears over the slowing global economy. While the uptick in overall activity is welcome it is still seen as requiring further supportive policy to be sustained given the weaker export backdrop especially. In addition, sub-indices suggest confidence remains subdued while companies have also been reluctant to replenish raw material inventories (another sign of weaker expectations).

Services activity rose slightly from 51.6 in July to 52.1 in August. New orders rose including overseas demand albeit at a slower rate. We also saw an uptick in job creation amidst services firms, the fastest such growth since June 2018. Confidence for the year ahead also improved amongst services firms in contrast to the state of manufacturing.

The overall Composite PMI rose slightly in August to 51.6, up from 50.9 in July driven by stronger manufacturing and services activity. In aggregate new orders expanded while new export orders slipped. This supports the notion of a domestic-led recovery during the month. The shock of the US trade conflict has continued to weigh on demand and represents a near-term downside risk for the Chinese economy. In welcome news we saw the employment gauge hit a recent high (the highest level since January 2015) pointing to a pick up in the labour market.

Hong Kong

Protests in Hong Kong have extended for several months now exacting an economic toll on the territory with downgrades to growth forecasts. It has also seen Hong Kong banks under pressure in the equity market as well on a gloomier economic backdrop. The controversial extradition bill that helped trigger this sequence of events has been completely withdrawn. However, at the time of writing this does not appear to have been enough with ongoing protests continuing. The protestor demands extend beyond the extradition bill and include stronger democratic rights within the territory. It remains unclear when or how this will end. This poses a potential geopolitical risk as well as an ongoing economic drag that we continue to monitor for any economic or market impact.

Europe

Trade concerns and a weak manufacturing outlook weigh on the European economy. Brexit has re-asserted as an issue with the political manoeuvring by PM Johnson in his attempts to lock in exit on 31 October. Weak survey data and growth prints suggests caution on the growth outlook remains warranted with renewed calls for ECB stimulus expected to play out in the ECB September meeting this year.

PM Johnson has in recent weeks attempted to forge a path to a clear UK exit. As part of this he has actively looked to leave a “no deal” Brexit as a viable path forward. This “no deal” scenario would see the UK revert to pre-EU trade arrangements and has been described as economically harmful by a number of government institutions including the Treasury and the Bank of England (operating under certain economic assumptions).

The timeline of key events was as follows:

- He first requested the Queen to halt Parliament until mid-October in a procedural move aimed at stopping any votes that would curtail his powers to deal with the EU.
- This move was widely criticised and saw rebels within his party voting in favour of a Labour vote that would require him to pursue an extension of Britain's stay within the EU.
- His countermove to call a snap election (and take advantage eof strong polling) was defeated by a mix of Opposition and Conservative rebel MPs.

These moves have contributed to market volatility notably in the pound and equity markets. Some observers are pricing in a reduced chance of a “no deal” scenario given the lack of majority PM Johnson now has. However, this situation remains in flux and it is still possible that an early election could be called. An election or perhaps a second referendum appear to be the only paths available to clear the current impasse with both sides of the debate too starkly opposed as things stand and neither having a clear majority or consensus backing their position.

Sentiment

The Markit Eurozone Composite PMI rose in August to 51.9, up from 51.5 in July.

The region's key manufacturing industry remained in a contractionary state. It did however improve slightly within that moving to 47 in August, up from 46.5 in July. Weakness remained focused on non-consumer sectors such as investment goods. France and the Netherlands remain the only major European economies to be in expansionary territory. The weakness in new business remains embedded in exports while employers continue to cut jobs with the employment index falling for four months in succession. Weakness in this regard was most pronounced in Germany where the decline was the largest in just over eight years. Business confidence also remained challenged, slumping to levels last seen in November 2012 with German and Austrian firms their most subdued in over eight years since the survey commended. This result is one where trade war tensions continue to foster risk aversion while overall demand remains weak. These factors add to the view that the goods-producing sector will drag on growth for the September quarter.

The Markit Services Sector PMI also rose to 53.5, up from 53.2 in July marking the seventy-third consecutive month of expansion in services activity. Germany and Ireland recorded the strongest gains with the uptick driven by higher new work orders and progress in reducing the level of work still outstanding. Employment growth in services continued to be sustained. However, the pact of employment growth slowed with businesses becoming increasingly concerned over future activity as business confidence over the year ahead fell to its joint-weakest since June 2013. The overall pace of economic growth according to IHS Markit economists has improved slightly to 0.2% quarterly growth on the basis of these readings (up from 0.1%). Key to the current outlook has been the consumer, supported by a strong labour market although with the signs of weakness in hiring intentions this impulse may fade.

Italy

Concerns over Italian politics faded during the month following a failed gambit by Deputy PM Matteo Salvini. His Northern League party has been leading in the polls, so he tried to topple the current coalition government (that he was a member of) to have a snap election called. However, this manoeuvre failed as the Five Star party was able to form a new coalition with the Democratic Party (still to be endorsed by Five Star party members). This should stabilise the Italian outlook in the short term, but the still-strong polling of the Northern League and recent EU election success suggests anti-EU sentiment remains a "live" factor in Italian politics.

Company news (best and worst performers over the month of August)

Nanosonics (NAN)

Bio-tech company Nanosonics saw its shares rally on the back of strong top-line and bottom-line growth with a 40% increase in sales of its infection control products to $84.3m and a 137% rise in after-tax earnings to $13.6m (consensus: $9.8m). In addition, the firm called out its longer-term growth profile with successful take up in Japan while also launching in Europe and Israel in FY19. The company comforted investors with the promise of a material uptick in FY20 sales and earnings from a new distribution agreement signed with GE Healthcare.

Pro Medicus (PME)

Pro Medicus delivered a strong earnings result ahead of consensus with a positive outlook for the year ahead as its enterprise imaging technology becomes more embedded in different hospitals and medical institutions. Expected addition into the ASX 200 (which occurred in early September) also supported the share price performance.

Smartgroup Corporation (SIQ)

Salary packaging provider SmartGroup saw its shares rally after a strong first half result ahead of some analyst expectations with earnings of $58.8m, up 6% versus the previous half last year. Analysts have also called out the stock's potential for other catalysts including new acquisitions or capital management initiatives (e.g. share buybacks).

Lendlease Group (LLC)

Even though Lendlease saw its results weakened substantially by a poor result in its engineering division this had been well flagged. Investors focused instead of the strength of the firm's core development business and how restructuring costs in its engineering division had been kept under control. This division is what drove the weaker earnings results of $467m, down 41% from $793m in FY18. It has been beset by cost overruns on major infrastructure projects such as the Sydney NorthConnex and investors may have a short-term catalyst with the Company stating its intent to sell the division after deeming it a non-core operation.

Speedcast International Ltd (SDA)

Speedcast International was beset by disruptions during August. The company saw struggles to integrate its Globecomm acquisition last year continue with its revenue (excluding Globecomm) either flat or falling over the half year to June 2019. The company also saw Chairman John Mackay step down with another director expected to leave and several new board members expected to be added. The renegotiation of its debt facility also sparked some concern amongst institutional investors over the ability for the company to delay deleveraging in the short term.

Ooh! Media Ltd (OML)

Ooh! Media shares fell following a downgrade to the company's earnings for the year to December. Specifically, the company stated it was downgrading its previous profit guidance for EBITDA between $152m to $162m by 17% ($27m). Key to this was weakness in the broader advertising market with CEO Brendan Cook noting substantially subdued demand last seen in the aftermath of the Olympics (when customers had brought forward ad spend to take advantage of the event). This is consistent with the slower economic backdrop translating into weaker advertising spending, an experience shared experiences in the television space.

Bellamy's Australia Ltd (BAL)

Bellamy's saw a decline in its earnings by almost half to $21.7m with revenue also falling 19% to $266.2m below its guidance of $275m to $300 in sales. The company also abandoned an earlier commitment to hit $500m in revenues by FY21. This weakness can be attributable to ongoing delays in approval to sell its organic products in China via retail outlets as well as a lower birth rate amongst Chinese consumers. The miss on expectations coupled with the abandonment of the FY21 target saw a substantial fall in market value.

Iluka Resources Ltd (ILU)

Illuka Resources saw its underlying earnings fall even though overall profits rose thanks to strong iron ore sales (the company holds a royalty on iron ore production separate to its main mineral sands business. Underlying EBITDA fell 2% down to $274m with the company stating that this performance was due to the weaker global economic backdrop and geopolitical volatility including events such as the trade tensions between US and China and Brexit. It reiterated its optimism longer-term given strong underlying demand.

Sources: ASX company announcements, Bloomberg, Fund manager disclosures, *Australian Financial Review*, *Sydney Morning Herald*

Movers and Shakers for month of August 2019

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month ∆ (%)	Quarter ago close ($)	Quarter ∆ (%)	Year ago, close ($)	Year ∆ (%)
NAN	Nanosonics Ltd	6.67	5.51	21.1	4.50	48.2	3.52	89.5
PME	Pro Medicus Ltd	36.81	30.75	19.7	22.72	62.0	10.19	261.2
SIQ	Smartgroup Corp Ltd	11.16	9.40	18.7	8.75	27.5	12.80	-12.8
LLC	Lendlease Group	17.06	14.55	17.3	14.25	19.7	20.49	-16.7
APT	Afterpay Touch Group Ltd	30.98	26.74	15.9	24.15	28.3	18.13	70.9
WTC	Wisetech Global Ltd	36.93	31.94	15.6	24.36	51.6	21.36	72.9
BPT	Beach Energy Ltd	2.45	2.13	15.0	1.82	35.0	1.94	26.3
MMS	Mcmillan Shakespeare Ltd	15.94	13.86	15.0	12.93	23.3	17.88	-10.9
CCP	Credit Corp Group Ltd	28.80	25.15	14.5	24.90	15.7	23.08	24.8
CLW	Charter Hall Long Wale REIT	5.90	5.18	14.0	4.90	20.5	4.25	38.9

Source: Bloomberg, IOOF

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month ∆ (%)	Quarter ago close ($)	Quarter ∆ (%)	Year ago close ($)	Year ∆ (%)
SDA	Speedcast International Ltd	0.78	1.89	-58.9	3.77	-79.4	4.24	-81.7
OML	Ooh!Media Ltd	3.07	4.47	-31.3	4.23	-27.4	5.25	-41.5
BAL	Bellamy's Australia Ltd	7.50	10.10	-25.7	8.56	-12.4	10.96	-31.6
ILU	Iluka Resources Ltd	7.15	9.62	-25.7	9.74	-26.6	9.28	-23.0
PLS	Pilbara Minerals Ltd	0.35	0.47	-25.5	0.72	-51.4	0.81	-56.5
CTD	Corporate Travel Management	17.37	23.09	-24.8	22.79	-23.8	32.68	-46.8
WOR	Worleyparsons Ltd	12.29	16.15	-23.9	13.18	-6.8	19.48	-36.9
ING	Inghams Group Ltd	3.17	4.06	-21.9	4.20	-24.5	3.66	-13.4
A2M	A2 Milk Co Ltd	13.55	17.12	-20.9	14.68	-7.7	11.50	17.8
CGC	Costa Group Holdings Ltd	3.15	3.97	-20.7	3.95	-20.3	7.23	-56.4

Source: Bloomberg, IOOF

Long-term asset class performance to August 2019 (Total returns in AUD)

	Asset	1-mth	3-mth	6-mth	1-yr	3-yr	5-yr	7-yr	10-yr	15-yr	20-yr
					Annualised						
Shares	Australia	-2.4%	4.2%	9.3%	9.0%	11.4%	7.9%	11.0%	8.6%	8.9%	8.8%
	Australia - mid cap	-2.3%	5.0%	7.6%	1.8%	9.9%	12.2%	14.4%	9.5%	9.2%	9.6%
	Australia - small cap	-3.9%	1.4%	4.1%	0.9%	8.4%	7.8%	7.2%	4.8%	5.6%	5.5%
	Australia - micro cap	-0.7%	7.1%	17.2%	7.0%	5.6%	7.2%	3.2%	2.6%	4.9%	N/A
	World ex Australia	0.3%	8.0%	9.5%	7.6%	13.7%	13.5%	16.9%	11.8%	7.4%	4.4%
	World ex Australia (Hedged)	-2.0%	4.9%	4.1%	0.5%	10.5%	8.6%	12.7%	12.1%	9.0%	N/A
	World - small cap	-1.2%	5.9%	3.9%	-2.4%	11.5%	12.5%	16.8%	12.7%	8.7%	8.1%
	Emerging Markets	-2.7%	2.7%	0.7%	2.7%	9.7%	7.2%	9.5%	6.4%	8.4%	N/A
Property & Infrastructure	Australian Property	1.2%	8.2%	14.7%	19.4%	8.6%	13.0%	14.4%	12.4%	5.9%	N/A
	Global Property	4.2%	6.8%	11.7%	16.1%	8.3%	12.1%	13.8%	11.4%	N/A	N/A
	Global Property (Hedged)	2.0%	3.9%	6.4%	8.6%	5.6%	7.4%	10.1%	11.4%	N/A	N/A
	Global Infrastructure	3.2%	7.6%	13.5%	23.3%	13.7%	13.5%	16.4%	11.1%	N/A	N/A
	Global Infrastructure (Hedged)	1.6%	4.8%	8.5%	15.7%	10.5%	9.0%	12.6%	13.5%	N/A	N/A
Fixed income	Australia Total Market	1.5%	3.5%	7.5%	11.2%	4.7%	5.3%	5.1%	6.1%	6.0%	6.2%
	Australia government bonds	1.7%	3.8%	8.1%	12.1%	4.7%	5.5%	5.1%	6.1%	6.1%	6.2%
	Australia corporate bonds	0.9%	2.8%	6.1%	9.0%	5.1%	5.2%	5.5%	6.5%	6.3%	6.4%
	Australia floating rate bonds	0.0%	0.7%	1.6%	3.0%	2.9%	3.0%	3.5%	4.3%	4.7%	5.0%
	Global Total Market (Hedged)	2.2%	4.2%	7.5%	10.0%	3.9%	5.1%	5.3%	6.6%	6.8%	7.2%
	Global government bonds (Hedged)	2.6%	4.6%	7.8%	10.6%	3.8%	5.3%	5.5%	6.5%	6.8%	N/A
	Global corporate bonds (Hedged)	2.2%	5.1%	9.0%	11.1%	4.7%	5.5%	6.0%	7.8%	7.1%	N/A
	Global high yield bonds (Hedged)	-1.5%	2.0%	2.6%	6.4%	5.3%	5.7%	7.5%	10.7%	9.4%	N/A
	Emerging Market bonds (Hedged)	0.7%	5.5%	7.5%	13.6%	4.6%	5.9%	6.0%	9.3%	9.2%	11.3%
Cash	Bloomberg AusBond Bank Bill Index	0.1%	0.3%	0.8%	1.8%	1.8%	2.0%	2.3%	3.0%	4.0%	4.3%

Source: Bloomberg, IOOF

* AUD total returns as at Aug-19 assuming reinvestment of dividends

** Returns reflect index performance excluding any fees; Actual ETF/managed fund performance will vary due to both fees and tracking error.

Appendix – Index sources

Asset class	Index
Australia	S&P/ASX 200 Accumulation Index
Australia - mid cap	S&P/ASX Accumulation Midcap 50 Index
Australia - small cap	S&P/ASX Accumulation Small Cap Ordinaries Index
Australia - micro cap	S&P/ASX Emerging Companies Total Return Index
World ex Australia	MSCI World ex Australia Net Total Return (in AUD)
World ex Australia (Hedged)	MSCI World ex Australia Hedged AUD Net Total Return Index
World - small cap	MSCI World Small Cap Net Total Return USD Index (in AUD)
Emerging Markets	MSCI Emerging Markets EM Net Total Return AUD Index
Australian Property	S&P/ASX 200 A-REIT Accumulation Index
Global Property	FTSE EPRA/NAREIT Developed Index Net Total Return (in AUD)
Global Property (Hedged)	FTSE EPRA/NAREIT Developed Index Net Total Return (Hedged to AUD)
Global infrastructure	FTSE Global Core Infrastructure 50/50 Net Total Return in AUD
Global infrastructure (Hedged)	FTSE Global Core Infrastructure 50/50 100% Hedged to AUD Net Tax Index
Australia Total Market	Bloomberg AusBond Composite 0+ Yr Index
Australia government bonds	Bloomberg AusBond Govt 0+ Yr Index
Australia corporate bonds	Bloomberg AusBond Credit 0+ Yr Index
Australia floating rate bonds	Bloomberg AusBond Credit FRN 0+ Yr Index
Global Total Market (Hedged)	Bloomberg Barclays Global Aggregate Total Return Index Value Hedged AUD
Global government bonds (Hedged)	Bloomberg Barclays Global Aggregate Treasuries Total Return Index Hedged AUD
Global corporate bonds (Hedged)	Bloomberg Barclays Global Aggregate Corporate Total Return Index Hedged AUD
Global high yield bonds (Hedged)	Bloomberg Barclays Global High Yield Total Return Index Hedged AUD
Emerging Market bonds (Hedged)	J.P. Morgan EMBI Global Core Hedged Index Level AUD
Cash	Bloomberg AusBond Bank Bill Index

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