Australian Monthly Wrap

August Economic Wrap

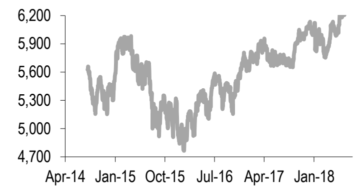
Summary - In a nutshell, both leading and hard economic data point to resilience in the global economy led by the US. This resilience continues to be tested however with investor sentiment being weighed down by ongoing trade concerns that saw additional tariffs be implemented between the US and China during August with more anticipated to come unless the two nations can reach a compromise. Business sentiment has been weighed down by the uncertainty on tariffs and trade policy with it being cited as a persistent concern across both developed and emerging markets. Australia continues to track in a mixed fashion, on the one hand GDP surprised on the upside driven in part by solid export growth (as highlighted in the *July Monthly*) and also Australia's strong population growth (more people → more demand for goods and services → stronger growth) but conversely wage inflation remains weak at 2.1% per annum, in line with inflation.

Markets - The month of August was marked by a rising US Dollar (USD) with the Australian dollar falling slightly on the back of disappointing economic data, notably the surprise miss on jobs growth and the out-of-cycle interest rate hike by Westpac (which delayed the case for RBA rate hikes further). US leading economic indicators and hard data are holding up, offering support for the Federal Reserve's ("The Fed's") efforts to raise interest rates with the next hike expected in late September. The US Dollar rose over the month with emerging market equities flat (see page 10) leading to their continued underperformance this year after ending 2017 strongly (see chart 4). The ASX underperformed global markets (see chart 2) with growth stocks in aggregate resuming their upward trajectory over the month (see chart 3) as market darlings such as Wisetech Global and Appen were traded up following their positive FY18 results.

Key economic news – The Reserve Bank of Australia left the cash rate on hold at 1.50% as expected. August marked the eleventh consecutive month of contracting home prices in Australia with a fall of 0.4% over the month according to the latest CoreLogic data with the weakness focused in Sydney and Melbourne. In the US, the Fed left interest rates on hold at 2% in August but affirmed its positive view on the US economy firming analyst predictions for a rate hike of 0.25% in September this year.

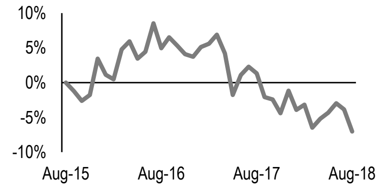
Key company news – TPG Telecom (ASX: TPM) rose strongly in August following an announced merger with mobile rival Vodafone as well as earnings that exceeded consensus forecasts and guidance. Leading tech companies Appen (ASX: APX), Wisetech Global (ASX: WTC) and Altium (ASX: ALU) delivered strong earnings growth that saw their growth potential rerated with substantial share price appreciation as a result. By contrast Speedcast International (ASX: SDA) was on the other side of the ledger with a downgrade to FY18 guidance driven by declining revenues from the Energy sector seeing its share price correct substantially.

1. S&P/ASX 200 Price Index



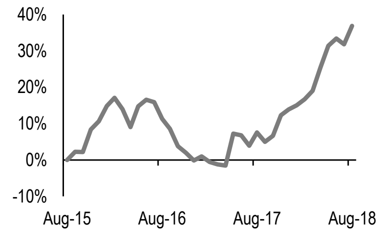
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



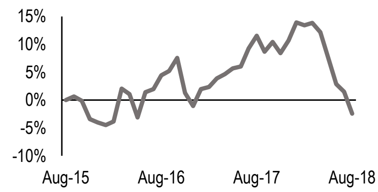
Source: Bloomberg, IOOF

3. MSCI Australia Growth relative to MSCI Australia Value



Source: Bloomberg, IOOF

4. Emerging markets vs Developed Markets, US$ terms



Source: Bloomberg, IOOF

Sector and stock returns

ASX/S&P 200 Sectors (GICS)

	Monthly	%Δ	Quarterly	%Δ
▲	Consumer Discretionary	2.73	Consumer Discretionary	7.04
▲	Consumer Staples	1.73	Consumer Staples	7.40
▼	Energy	-2.09	Energy	6.43
▼	Financials ex Property	-1.08	Financials ex Property	5.04
▼	Financials	-1.08	Financials	5.04
▲	Health Care	10.58	Health Care	15.85
▲	Industrials	2.88	Industrials	6.15
▲	IT	12.32	IT	17.95
▼	Materials	-5.26	Materials	-3.72
▲	Property Trusts	2.18	Property Trusts	3.60
▲	Telecommunications	10.89	Telecommunications	12.74
▼	Utilities	-0.66	Utilities	2.91

Best and Worst S&P/ASX 200 Performers

Top five stocks		Bottom five stocks	
Monthly			
TPG Telecom Ltd	+50.0%	Speedcast Intl Ltd	-31.6%
Appen Ltd	+41.2%	Sims Metal Mgmt Ltd	-26.8%
Wisetech Global Ltd	+40.1%	Pact Group Holdings Ltd	-23.8%
Altium Ltd	+37.4%	Iluka Resources Ltd	-19.0%
Afterpay Touch Group Ltd	+27.9%	Western Areas Ltd	-18.8%
Quarterly			
Afterpay Touch Group Ltd	+131.8%	Bellamy's Australia Ltd	-38.1%
TPG Telecom Ltd	+55.1%	Ausdrill Ltd	-33.2%
Mayne Pharma Group Ltd	+52.9%	Speedcast Intl Ltd	-29.5%
Appen Ltd	+50.1%	Nufarm Ltd	-27.8%
Wisetech Global Ltd	+45.3%	Sigma Healthcare Ltd	-27.4%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, August 2018

	Australian Indices	Aug-18 Price	1M return (%)	May-18 Price	3M return (%)
▲	S&P/ASX 200	6319	0.63	6012	5.12
▲	All Ordinaries	6428	0.97	6123	4.97
▲	Small Ordinaries	2890	2.18	2837	1.86
	US Indices				
▲	S&P 500	2902	3.03	2705	7.25
▲	Dow Jones	25965	2.16	24416	6.34
▲	Nasdaq	8110	5.71	7442	8.97
	Asia Pacific Indices				
▼	Hang Seng	27889	-2.43	30469	-8.47
▲	Nikkei 225	22865	1.38	22202	2.99
	UK & Europe Indices				
▼	FTSE 100	7432	-4.08	7678	-3.20
▼	CAC40	5407	-1.90	5398	0.16
▼	DAX Index	12364	-3.45	12605	-1.91

Source: Bloomberg, IOOF

US equity market

The S&P 500 index finished the month up 3%. The market performance was strong across most sectors with eight of the eleven in positive territory for August. The best performers were technology (up 6.7%), consumer discretionary (up 5.0%) and health care stocks (up 4.2%). Energy and Materials stocks were points of weakness (down 3.8% and 0.7% respectively) with Industrial stocks likewise struggling to participate in the overall market rise (flat at 0%).

Australian equity market

The S&P/ASX 200 index finished the month up 0.6%. On a sector level, the best performers were technology (up 12.3%), telecommunications (up 10.9%) and health care stocks (up 10.6%). The telecommunications space rallied on the back of the proposed merger between Vodafone and TPG Telecom. TPG had been seen as a major competitive threat in the mobile phone market with this proposal reducing the market from four players to three once again. The expected reduction in competition for consumers saw Telstra shares also rally in sympathy. The worst-performing sectors were in the Materials (down 5.3%), Energy (down 2.1%) and Financials sectors (down 1.1%) with the banks trading lower before recovering slightly by month-end on the back of the Westpac decision to raise interest rates to combat heightened funding costs (in September ANZ and CBA followed suit with NAB the only major to keep rates on hold).

Fixed Income

	Fixed Income	Aug-18 yield	1M mvt (bps)	May-18 yield	3M mvt (bps)
	Aussie Cash rate	1.50	--	1.50	--
▼	10-year Bond Rate	2.52	-0.13	2.67	-0.15
▼	3-year Bond Rate	1.98	-0.11	2.10	-0.12
▼	90 Day Bank Accepted Bills SFE-Day	1.95	-0.01	1.98	-0.03
▼	US 10-year Bond Rate	2.86	-0.10	2.86	0.00
▼	US 3-year Bond Rate	2.69	-0.07	2.55	0.14

Source: Bloomberg, IOOF

During the month of August, the Australian yield curve fell unevenly with long term rates declining slightly more than short term rates. The Australian 3-year bond yield fell 11bps and the 10-year bond yield fell 13bps. The U.S. yield curve also fell in a similar fashion with shorter rates such as the 3-year yield declining 7bps and the 10-year yield, 10bps.

Australian bond yields were weighed down by a mix of concerns. Domestically the Westpac interest rate hike weighed on interest rate expectations, sending yields lower as did the weak jobs report and low wage growth of 2.1% for the June quarter (reported in August) all factors that weigh on growth expectations. To this we can add the concern on global trade wars with the tariff saga continuing between the US and China which weighed on growth expectations for China (Australia's largest trading partner) and consequently on Australian growth expectations (i.e. if trade partner growth is lower then, markets anticipate Australian growth is lower) seeing yields fall over the month. A way to think about this last point is to consider bonds as a prediction on where interest rates will be in the future. i.e. in 3 years' time the cash rate will be 1.98% (about two interest rate hikes within the next 3 years). Now if growth is lower going forward then inflation is, all else being equal, likely to be lower as well in which case rates are more likely to remain low, leading investors to buy bonds and push bond yields lower (by bidding up the price).

In July, we highlighted how the 3-month bank bill rate had declined slightly to alleviate some of the pressure on bank funding costs. The major banks at that stage had not yet followed suit in raising mortgages unlike smaller peers who are more reliant on overseas funding because of their smaller base of bank deposits. This changed in August with Westpac announcing a 14bps hike in its variable interest mortgage offerings to offset a larger than expected decline in net interest margins (the gap between the rate it lends to customers at and the cost of those funds). Regional bank Suncorp followed suit as did CBA and ANZ in early September even with the negative public sentiment towards the sector in the wake of the Royal Commission into Financial Services and its revealing coverage. This will potentially delay the case for rising interest rates in Australia as higher mortgage rates achieve the same tightening of credit conditions as an interest rate hike would.

Currencies

	Currencies	Aug-18 Price	1M return (%)	May-18 Price	3M return (%)
▼	$A vs $US	71.89	-3.17	75.68	-5.01
▼	$A vs GBP	55.48	-1.92	56.91	-2.52
▼	$A vs YEN	79.82	-3.86	82.36	-3.08
▼	$A vs EUR	61.97	-2.42	64.72	-4.25
▼	$A vs $NZ	108.68	-0.21	108.11	0.53
▲	$US vs EUR	86.20	0.77	85.53	0.78
▲	$US vs GBP	77.16	1.27	75.21	2.59
▼	$US vs CHF	96.89	-2.16	98.58	-1.71

Source: Bloomberg, IOOF

The Australian dollar (AUD) depreciated against major global currencies in August dropping to USD 0.7189 on the back of political turmoil in Canberra as well as the Westpac mortgage rate hike which delayed the case for a RBA rate hike further into the future.

The Australian dollar was weighed down by a mix of factors with the leadership dispute in Canberra lowering sentiment as it increased policy uncertainty surrounding Australia while the Westpac rate hike to combat funding pressure also added to the downward pressure. The logic in the latter case is that Westpac would be followed by the other major banks (as was the case in September, NAB excepted) which would weigh on spending by increasing mortgage payments and in effect do what an RBA rate hike would have otherwise achieved. Given this backdrop it is expected to be a drag on economic activity deferring the time until the RBA raises interest rates again, further into the future.

The US Dollar (USD) traded up over the month benefitting from safe haven demand as the global trade tensions continue to roll on leading investors to flee emerging markets while also showing stronger relative strength compared with other markets with growth ahead of the EU for example.

Commodities

	Commodities	Aug-18 Price	1M return (%)	May-18 Price	3M return (%)
▲	Aluminium	2110	1.63	2293	-7.98
▼	Copper	267	-6.38	311	-14.13
▼	Nickel	12720	-9.06	15239	-16.53
▼	Gold	1207	-2.18	1317	-8.38
▼	Silver	15	-7.04	17	-12.71
▲	Crude Oil - Brent	77	4.27	78	-0.22
▼	Lead	2065	-4.13	2460	-16.06
▼	Zinc	2464	-6.41	3100	-20.51
▲	Iron Ore	67.16	4.37	65.95	1.83

Source: Bloomberg, IOOF

Commodity prices fell over the month of August with oil, iron ore and aluminium notable exceptions. The weakness was notable in base metals such as copper which is regarded as an economic bellwether because of its widespread demand for industrial uses. Trade war concerns continue to weigh on investor sentiment on the back of fears of falling global trade which is expected to be the fall out of the tariffs being deployed between the US and China.

International oil prices rose following a larger than expected drawdown in US inventories (indicating higher than expected demand for oil) putting pressure on supply and leading prices to rise. Iron ore benefitted from speculation that production limits on Chinese steelmakers, implemented to combat pollution, would remain in place while aluminium prices gained after US export quotas were maintained against countries such as South Korea and Brazil. In the latter case, export quotas were relaxed for nickel production, contributing to the weak prices in the month.

Australia

Summary – Rates on hold with low wage inflation continuing the “lower for longer” theme. Economic growth surprised at 3.4% for the year to June 2018 but at an underlying level driven by strong consumer spending we do not expect to persist without income growth. Weaker retail trade numbers in July slightly offset by stronger exports to paint a mixed picture for Sep-18 economic growth.

The RBA held interest rates steady at 1.5% (consensus: 1.5%) as expected marking 2 years now since the last change in interest rates. Signs from the RBA statement following its August meeting point towards a downgrade in its updated inflation forecast for 2018 (confirmed in the Statement on Monetary Policy on 10 August) with the forecast for 2018 inflation dropped from 2.25% to 1.75% on the premise that one-off price declines in the Sep-18 inflation data will result in weaker inflation for the second half of 2018. This bolsters the case for interest rates continuing to remain on hold at 1.5% in the short to medium term. The RBA release also reacted to the surprise jobs report in mid-July offering a long-term view of unemployment at 5% over the next couple of years while highlighting concerns on the Chinese economy noting its slowdown in the latest GDP results as highlighted in the 20 July weekly economic commentary.

Australian overall wage growth of 0.6% was recorded for the June quarter in line with market expectations (consensus: 0.6%). Annual wage inflation remained flat at 2.1% for the year (Mar-18: 2.1%). Private sector wages grew 2.0% while public sector wages grew 2.4% for the year slightly above the annual rate for public sector wages recorded in March which was in line with the 2016 record low of 2.3%. A different wage series, average weekly earnings, was also released which showcased continued weakness.

This came against a backdrop of a tighter labour market with the unemployment rate reducing to 5.3% (consensus: 5.4%). A key driver of this move was the reduction in people seeking work with the participation rate falling from 65.7% to 65.5%. If this was flat over the two months, the unemployment rate would have risen in line with weaker jobs growth but instead fell as workers dropped from the sample. In addition, total employment growth disappointed with total employed persons falling by 3.9k (consensus: +15k). The bulk of this decline came in part-time jobs with a 23.2k reduction mostly offset by growth of 19.3k in full-time roles. This amounted to a recovery in full-time jobs growth which had declined in the March quarter but has since recovered to be up 0.73% in the year to July still dwarfed by part-time jobs growth of 1.46% over the same period.

In Australia, new capital investment for the June quarter fell 2.5% (consensus: +0.6%) with the weakness evident across both new building investment (down 3.9%) and equipment, plant and machinery (down 0.9%). This was driven primarily by a 10% decline in mining construction following falling spending on natural gas projects while weakness was also evident in non-mining businesses where spending fell 1% over the quarter. This raises the possibility that private sector investment may be a disappointment in the June quarter GDP result released next week offsetting some of the gains expected from resource exports for the June quarter. Offsetting this news was the release of expected business spending for FY19 which was in line with market expectations at 102bn

The Australian economy grew strongly at 0.9% for the Jun-18 quarter (consensus: 0.7%) and 3.4% for the year ended June 2018. Key drivers of the move were domestic demand with house consumption rising 0.7% in the quarter with spending across both discretionary and non-discretionary goods and services, reflective of the improvement in retail trade we observed in the months of April to June. Net exports added 0.1% of the 0.9% growth with the positive contribution we noted was expected in the July Monthly, reflecting the growth in production output by Australian resource companies. One concern that has been called out is the continued decline of the household savings rate which made a new post-GFC low of 1% reflecting the increased consumption funded out of savings and not increased wages. The fear is that such a situation cannot persist forever without consumers taking on more debt. Going forward the weaker retail numbers and trade balance reporting below expectations are expected to weigh on September growth as is the rate of unsustainable consumer spending.

Retail trade was flat in July (consensus: 0.3%) which was below expectations and led by declines in clothing and footwear (down 2%), household goods (down 1.2%) and department stores (down 1.9%). These declines were offset by gains in Food retailing (up 0.3%) and eating out (up 0.6%). This stands in contrast to the NAB Online Retail Sales Index which recorded monthly growth of 1.3% over the same period from a smaller base (NAB economists estimate online sales are the equivalent of almost 10% of traditional bricks & mortar retail sales). The online sales figures highlight one headwind to traditional retail sales, that of cannibalisation by online offerings with department stores for example growing online sales by 20.8% in July.

United States

Strong domestic economy continues to justify case for interest rate hikes widening gap to Australian rates. Business confidence hurt by ongoing uncertainty surrounding global trade both closer to home (Mexico and Canada) and further afield (China and the EU) with some resolution (see Mexico) but not yet weighing on the economic picture.

Trade talks figured prominently this month with a revised version of NAFTA (a trade agreement between the US, Mexico and Canada) being finalised between the US and Mexico. A matching deal between the US and Canada is still in the process of being negotiated with investors optimistic that a final deal will be reached. Concerns reappeared on the prospects of a deal between the US and the EU following comments by President Trump that the EU's offer to remove car tariffs if the US followed suit was inadequate, heightening investor fears that the conflict there might escalate. In addition, strong rhetoric on China continued with the expectation of further threatened tariffs on $200 billion of Chinese goods by President Trump. These tariffs are expected to vary between 10% on consumer goods and 25% on industrial and intermediate products.

US retail sales rose 0.5% in the month of July (consensus: 0.1%) above market expectations and 6.4% annually with rising oil prices eating into discretionary spending. Core retail sales—excluding automobiles, gasoline, building materials and food services—rose 0.5% over the month, a positive sign for underlying consumer spending which is being supported by higher wages as well as tax cuts and while GDP is not expected to match the 4.1% annualised rate of the June quarter this 0.5% growth is supportive of the current expectation for a 3% growth rate.

The Markit Services PMI for August was 54.8 falling by 1.2 points from its July reading of 56. This was driven by a slowing of output growth with business confidence however, improving from the recent low in July thanks to stronger planned investment and new business orders. Cost pressures continue to be a running theme with the impact of tariffs being cited in greater input price inflation, as was higher wage costs, that was being partially passed on to end-consumers and partially absorbed in business profit margins. The higher wages costs were also reflected in the latest wage data that saw US hourly earnings rise 2.9% year-on-year in July, the highest rate in nine years with hiring strength observed in both construction and professional services industries.

Manufacturing conditions softened slightly with the Markit Manufacturing PMI falling from its July reading of 55.3 to 54.7, a nine-month low but still above the long-run series average. The main drivers were a softening in both employment and backlog growth as well as higher input prices that were partly driven by tariffs. On a positive note, export sales resumed growth, bouncing back from the weakness of the past two months while business confidence also improved similar to the strength observed for the services sector.

China

Economic momentum is slowing, weighed down by negative sentiment on the trade front that has prompted additional stimulus to help businesses and consumers. China is running out of goods to impose counter-tariffs on however if President Trump follows through with his additional threatened measures.

On the trade war side, China responded to the implementation of US tariffs with its own 25% levy against US goods totalling $16bn including scrap metal imports from the US. It has also promised to counter the expected tariffs on $200bn of US goods with its own levy on $60bn of US imports (the smaller amount reflects the lop-sided trade balance with the US importing more from China than vice-versa). The limited ability for China to match tariffs dollar for dollar may see the Chinese government rely on other means such as using regulatory power to shut off businesses operating within China. There is past history on this front with China retaliating against the South Korean installation of a missile defence system by closing Korean company Lotte's retail operations within China and encouraging consumer boycotts against Korean products.

Chinese industrial production expanded by 6% year-on-year in July (consensus: 6.3%) below market expectations while conversely, fixed-asset investment growth slowed to 5.5% per annum also below expectations. Retail sales grew slower than expected at 8.8% per annum (consensus: 9.1%) highlighting underlying weakness in the Chinese economy that prompted the country's State Council to take more "proactive" fiscal measures to help the economy grow while avoiding too much stimulus.

The Markit manufacturing PMI for August fell slightly to 50.6 from 50.8 in July. This is nearing contractionary territory (a reading of below 50 signals shrinking business activity) but given the stimulatory fiscal policy some recovery may arise. Manufacturing production increased at the fastest pace since the start of this year but demand conditions softened with new business orders rising at the slowest pace for 15 months. The weakness in foreign demand was telling for the slow new business as export sales declined for the fifth month in a row. In addition, confidence remained subdued and little-changed from the recent low in June with trade war concerns and softer demand conditions weighing on overall sentiment.

Services activity added to the decline falling from 52.8 in July to 51.5 in August contributing to the overall China Composite fall from 52.3 in July to a five-month low of 52 in August. The composite level data highlighted the downward economic trajectory but also some signs for optimism with the future output measures climbing on expectations that expansionary credit policy and active fiscal policy will kick in although they have not done so yet. Input price inflation continued even as demand weakened.

Europe

Trade concerns and Brexit remain prominent in business thinking on the future with both weighing on sentiment. Green shoots however can be found in stronger growth in both the UK and the EU with some investors cautiously optimistic that a Brexit deal can be reached in time.

The European Central Bank (ECB) is expected to leave interest rates on hold in its September meeting in line with previous guidance that rate hikes would be deferred until at least July 2019. Market observers are looking to see if it will downgrade its economic forecasts with economic growth slowing relative to last year although flash growth estimates were positive with the economy expanding 0.4% in the June quarter (consensus: 0.3%) supportive of the planned tapering of ECB bond purchases for October.

The Bank of England is expected to keep interest rates on hold at 0.75% after raising them in August with concerns continuing to persist of the prospect of a British exit from the European Union without a deal that addresses myriad issues including immigration and trade. On this front, there have been some optimistic takes on comments by European Commission officials on the willingness to compromise provided the UK does likewise with some observers remaining optimistic that a deal will be put in place given the negative implications for the EU as well if it does not occur given the extent of ties between the British and continental European economies that would be disrupted in a "no deal" scenario. On a positive note the UK grew faster than expected in the June quarter with quarterly growth of 0.6% at the top of the range of market forecasts supporting the Bank of England decision to raise interest rates with the focus now on an expected 0.4% growth rate for the September quarter.

The Markit Eurozone Composite PMI bounced up slightly, up to 54.5 from its reading of 54.3 in July. A pick up in services, rising from 54.2 in July to 54.4 in August, offset weakness in the manufacturing industry which fell rising from 55.1 to 54.6 over the same period. The decline in the manufacturing sector print was driven by concerns over the business outlook weighing on business optimism with tariffs and Brexit cited as factors of concern. By contrast the services industry showed that the upturn in services business activity remains broad-based will all countries recording higher levels of activity. That pickup in activity was matched by slightly higher gains in new business although both remain down on the growth seen at December 2017. Geopolitical tensions were a factor in business expectations which were at their lowest for 21 months although this did not deter firms from hiring more workers with jobs growth continuing strongly. These survey results according to IHS Markit economists point towards quarterly growth of 0.4% for the September quarter although the decline in optimism raises concern as to whether the pace of growth can be sustained.

Emerging Markets

Weakness continues thanks to the rising US dollar and, trade wars and institutional problems prompting investors to flee the space. Valuation discount to developed markets continues to widen.

In the Emerging Markets (EM) space a running theme has been the vulnerability of these economies to a weakening in global demand and their general exposure to the commodities cycle. Turkey continues to be a point of weakness with its currency, the lira, falling further against the US Dollar as investors increasingly lose confidence with President Erdogan's tight control over the economy including monetary policy even with inflation in the double-digits. A tipping point for further weakness was the implementation of sizeable tariffs against Turkey by the US with duties on aluminium and steel imports being doubled to 20% and 50% respectively. Argentina was also a point of weakness hampered by the rise of the US Dollar with the country unveiling new measures to bring its budget into surplus in line with IMF targets set in exchange for emergency loans. These new measures include new exports taxes which have impacted some ASX-listed companies such as Orocobre (ASX: ORE) that operate there (down 17.4% in the month to date).

Actionable insights

Playing defence by asset class

Given the backdrop of higher equity valuations and low bond yields, a question that naturally arises is where can investors play defence today?

In equities, a few options worth considering as a subsector or direct play including consumer staples and health care. Direct examples of these listed on the ASX and also included in the Equities team model portfolio include CSL (ASX: CSL) and Resmed (ASX: RMD) while global healthcare is also accessible via the Global Healthcare ETF (ASX: IXJ). The logic of these sectors lies in the constant demand for their products with both food and healthcare key points of consumption that will remain strong because people need them to continue living essentially. In addition, long short managers offer a way to reduce the volatility and drawdowns of your equity holdings. While we would not expect them to participate as much when the market performs strongly we would expect them to offer some downside protection in the event of a broad market correction.

In bonds, current yields make many offerings unattractive unless you take higher risk by pursuing corporate or emerging market debt for example. As we noted in the July Monthly, the outlook for bond returns is not particularly strong. However, they can still offer a safe harbour should equity markets and other asset classes weaken but we advise adjusting your expectations lower. Bonds can still deliver positive returns but they will not perform as well as they have in past crises given the lower starting yields. In addition, where you get your exposure from is important with sovereign debt the safest option and the one most likely to play a defensive role well (corporate bonds tend to sell off substantially when the underlying equities sell off). Managers with an emphasis on quality are being reviewed for consideration on the APL in the coming months but some are already available including the PIMCO Global Bond Fund which has a 59% allocation to AAA-rated debt (the highest quality) relative to a benchmark allocation of 39.6% as at July 2018.

On the question of defensive options in alternatives, the APL is being reviewed with the prospect of further options being expanded in the coming months.

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

In summary, August was marked by reporting season with the companies listed below typically outperforming (underperforming) market expectations and being rewarded (punished) as a result. Strong growing technology names such as Appen and Altium were clear examples of the former case while Pact Group fell squarely in the latter camp.

TPG Telecom (TPG) rose strongly on the back of two factors, first, its proposed merger with mobile phone operator Vodafone which stands to create a diversified telecommunications company with sizeable market shore both in mobile and broadband. This also benefitted TPG by reducing competition for the combined entity as TPG had only just recently begun to build its position in the mobile phone market as a fourth player in this space, a merger reduces competition and the price pressure it brings by shrinking the number of market players. Second, TPG reported an updated earnings forecast ahead of previous guidance with EBITDA of $840m. This was another positive piece of information building on a month of positive news. The prospect of reduced competition saw other rivals in the mobile phone market such as Telstra rise on speculation of reduced competition.

Appen Ltd (APX) rose following a strong half-year result that saw underlying EBITDA double on FY17 with the company signalling guidance that the full year result will reflect similar growth in underlying earnings. Appen also highlighted its successful acquisition and integration of US-based Leapforce that broadened its product offering and was earnings-accretive as well as industry trends in favour of secure work flows that have benefitted its product offerings.

Wisetech Global Ltd (WTC) gained on the back of strong revenue and earnings growth with 44% and 28% increases respectively on FY17 results. The gap between revenue and profit growth, driven by a slew of lower margin acquisitions over the course of FY18, was not a weak point of the result with investors focusing on the added depth these acquisitions offer to deepen the Wisetech offering in new markets by offering a software solution customised to the unique customs reality of that jurisdiction.

Altium Ltd (ALU) saw record revenue growth of 26% for FY18 and margin expansion with the 26% growth leading to a 34% increase in earnings for the full-year result. The company also built on its recurring revenue base of subscriptions with over 10% growth adding new users while this growth was also supported by actual cashflow which was up by approximately 35% for the year. These positives translated into a full dividend payout of $0.14 growing full year dividends by 17%.

Speedcast International Ltd (SDA) shares sank after it downgraded full-year guidance from an EBITDA figure of $US155m to $US135m - $US145m i.e. a fall of 6.5-13% on forecasts it had only issued in May of this year. The first-half earnings (Speedcast reports on a calendar year basis) also disappointed with a 17% drop in earnings from the energy sector as there were delays in oil projects and fewer offshore oil rigs being deployed. This pointed to a reluctance amongst business to re-activate more expensive offshore oil sites even as oil prices rose over the first half of 2018.

Sims Metal Management Ltd (SGM) sank after signalling headwinds to the scrap metal market following the implementation of tariffs against Turkey (a key player in the global market) by the United States. The impact of these tariffs added to lira (the Turkish currency) depreciation and sent import prices from Turkish steel mills plummeting with investors translating this into lower earnings for Sims Metal Management. In addition, China's tariffs implemented on August 23 included a 25% levy against scrap metal imports from the US which is also expected to weigh on the industry.

Pact Group Holdings Ltd (PGH) shares fell after delivering earnings below consensus estimates with profit contracting from FY17 to $94.7m, 10% below the consensus estimate of $105.6m. The result was heavily impact by rising resin and energy prices with the inflation in input costs only partially absorbed by clients in FY18 with management also guiding a $7m impact to first half FY19 results consequently. Combined the miss on FY18 earnings and the negative guidance for FY19 both sent the stock lower.

Iluka Resources Ltd (ILU) dropped following the release of its first half results which saw the company benefit from rising prices of mineral sands but disappoint operationally with difficulties in improving its Sierra Rutile expansion projects indicating a 40% to 60% uplift in the capital spending originally estimated. That increase in capital spending lowered expectations for future profits (as more money is required to invest in the business to generate those earnings) with the company also highlighting disappointing progress in improving the current production at Sierra Rutile that also incurred increased costs to address. Taken together the flagging of higher than expected capital spending combined with the ongoing costs of rectifying operational issues with its overseas projects weighed on the share price.

Source: ASX company announcements, Bloomberg

Movers and Shakers for August 2018

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month ∆ (%)	Quarter ago close ($)	Quarter ∆ (%)	Year ago, close ($)	Year ∆ (%)
TPM	TPG Telecom Ltd	8.64	5.76	50.0	5.57	55.1	5.49	57.4
APX	Appen Ltd	15.33	10.86	41.2	10.21	50.1	4.69	226.9
WTC	Wisetech Global Ltd	21.36	15.25	40.1	14.70	45.3	7.99	167.3
ALU	Altium Ltd	28.03	20.40	37.4	20.92	34.0	9.97	181.1
APT	Afterpay Touch Group Ltd	18.13	14.18	27.9	7.82	131.8	3.77	380.9
WEB	Webjet Ltd	16.99	13.35	27.3	12.48	36.1	11.91	42.7
BRG	Breville Group Ltd	13.57	10.74	26.4	11.62	16.8	11.06	22.7
SWM	Seven West Media Ltd	1.01	0.83	21.1	0.82	22.6	0.70	44.6
A2M	A2 Milk Co Ltd	11.50	9.60	19.8	9.93	15.8	5.04	128.2
MYX	Mayne Pharma Group Ltd	1.19	0.99	19.7	0.78	52.9	0.67	76.9

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	4.24	6.20	-31.6	6.01	-29.5	3.64	16.5
SGM	Sims Metal Management Ltd	12.56	17.15	-26.8	15.95	-21.3	14.90	-15.7
PGH	Pact Group Holdings Ltd	4.12	5.41	-23.8	5.66	-27.2	5.10	-19.3
ILU	Iluka Resources Ltd	9.28	11.45	-19.0	11.20	-17.1	9.47	-2.0
WSA	Western Areas Ltd	2.63	3.24	-18.8	3.38	-22.2	2.70	-2.6
ORG	Origin Energy Ltd	7.95	9.77	-18.6	9.60	-17.2	7.65	3.9
PRY	Primary Health Care Ltd	2.78	3.40	-18.1	3.63	-23.4	3.31	-16.0
GEM	G8 Education Ltd	2.06	2.49	-17.3	2.49	-17.3	3.86	-46.6
SYR	Syrah Resources Ltd	2.54	3.01	-15.6	3.15	-19.4	2.97	-14.5
FLT	Flight Centre Travel Group Ltd	58.42	68.01	-14.1	61.62	-5.2	48.35	20.8

Source: Bloomberg, IOOF

Long-term asset class performance to August 2018 (in AUD)

	Asset	1-mth	3-mth	6-mth	1-yr (Annualised)	3-yr (Annualised)	5-yr (Annualised)	7-yr (Annualised)	10-yr (Annualised)	15-yr (Annualised)	20-yr (Annualised)
Shares	Australia	1.4%	6.2%	7.3%	15.4%	11.5%	8.9%	10.5%	6.8%	9.3%	9.4%
	World ex Australia	4.8%	9.9%	12.7%	25.0%	11.6%	15.2%	17.7%	9.1%	7.4%	4.9%
	World ex Australia (Hedged)	1.5%	5.0%	6.1%	14.7%	13.1%	13.3%	14.8%	9.5%	9.9%	N/A
	Emerging Markets	0.0%	-0.3%	-3.2%	8.9%	10.7%	9.5%	8.7%	5.3%	8.9%	N/A
Property	Australian Property	2.7%	6.0%	14.2%	15.8%	10.5%	13.0%	14.7%	5.9%	6.2%	N/A
	Global Property	5.2%	11.6%	20.1%	15.0%	7.7%	13.3%	14.4%	7.1%	N/A	N/A
Fixed income	Australia government bonds	0.8%	1.5%	2.8%	3.9%	3.0%	4.5%	4.7%	5.7%	5.6%	5.8%
	Australia corporate bonds	0.8%	1.3%	2.2%	4.0%	3.8%	4.8%	5.5%	6.4%	6.0%	6.2%
	Australia floating rate bonds	0.3%	0.7%	1.2%	2.6%	3.0%	3.2%	3.9%	4.4%	4.9%	N/A
	Global government bonds (Hedged)	0.1%	0.3%	1.3%	1.1%	3.5%	5.0%	5.4%	6.4%	6.7%	N/A
	Global corporate bonds (Hedged)	0.4%	0.7%	0.8%	0.2%	4.5%	5.5%	6.4%	7.6%	7.1%	N/A
	Global high yield bonds (Hedged)	-0.9%	0.3%	-0.7%	0.3%	7.3%	7.1%	9.1%	10.4%	10.2%	N/A
	Emerging Market bonds (Hedged)	-1.8%	-0.6%	-3.0%	-4.2%	5.5%	6.7%	6.4%	8.2%	9.5%	12.0%
Cash	S&P/ASX Bank Bill Index	0.2%	0.5%	1.0%	1.9%	1.9%	2.2%	2.7%	3.2%	N/A	N/A

Source: Bloomberg, IOOF

* AUD total returns as at August 2018 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.

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Appendix – Index sources

Asset class	Index
Australia	S&P/ASX 200 Accumulation Index
World ex Australia	MSCI World ex Australia Net Total Return Index in AUD
World ex Australia (Hedged)	MSCI World ex Australia Hedged AUD Net Total Return Index
Emerging Markets	MSCI Emerging Markets EM Net Total Return AUD Index
Australian Property	S&P/ASX 200 A-REIT Accumulation Index
Global Property	MSCI World Real Estate Net Total Return Index in AUD
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 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	S&P/ASX Bank Bill Index

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Research Analyst Disclosures:

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