Our view

Researchupdate

Economic Wrap

February 2019

Summary

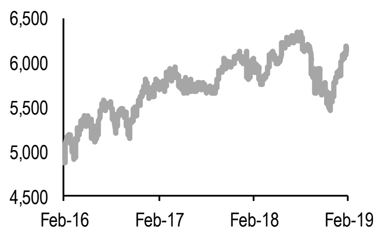
- Hard economic data point to resilience in the US economy with solid growth relative to the rest of the developed world with some signs of emerging weakness in leading indicators.
- Global economic momentum has slowed in 2019, led by weakness in Europe and China. More China plans for stimulus as a result.
- On the Australian front, some of the warning signs called out last year such as the prospect of weaker consumption came to fruition along with weaker property markets, as we saw December quarter GDP growth below expectations prompting calls for interest rate cuts by the RBA.
- In keeping with the slower growth outlook Australian bonds have rallied further while US yields ticked up on the back of stronger than expected growth into December and trade deal optimism.

Markets – February was marked by a continuation of "risk on" sentiment with all asset classes (except global government bonds) offering positive returns (see page 10) led by equities particularly on the small cap spectrum with Australian and global small caps up 6.8% and 6.3% respectively. Optimism continued to be stoked by reports on trade deal breakthroughs between the US and China with tangible progress seen in President Trump's decision to suspend tariff increases that were due to commence on 1 March. We saw emerging market equities fade slightly relative to developed markets (see chart 4) with US Dollar strength a notable driver. The ASX kept up with global markets (see chart 2) after the rally in the banking sector post the Royal Commission Final Report with value continuing to underperform growth stocks on a relative basis (see chart 3) as tech company and other growth stocks benefitted from the continuation of "risk on" sentiment as well as positive earnings results.

Key economic news – The Reserve Bank of Australia shifted its policy setting to a neutral stance, abandoning the call that the next move in rates was likely to be up on the back of weaker economic data. February marked further contraction in house prices in Australia with a fall of 0.7% according to the latest CoreLogic data. The weakness remained focused in Sydney and Melbourne, both down 1%. Wage inflation grew in line with expectations at 2.3% year-on-year with the RBA maintaining its optimism that a tighter job market will translate to stronger growth and inflation in time.

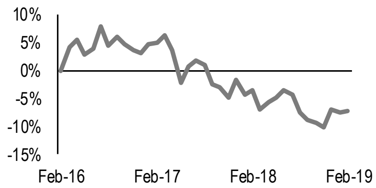
Key company news – Stock-specific news items were notable with Appen (ASX: APX) and Breville Group (ASX: BRG) benefitting from positive surprises above earlier guidance. By contrast the likes of Blackmores (ASX: BKL), Pact Group Holdings (ASX: PGH) and Bingo Industries (ASX: BIN) were sold off after they disappointed expectations with a slowing economy cited for the weakness of both Bingo and Pact Group.

1. S&P/ASX 200 Price Index



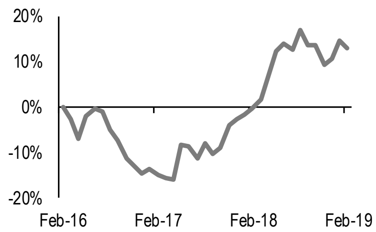
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



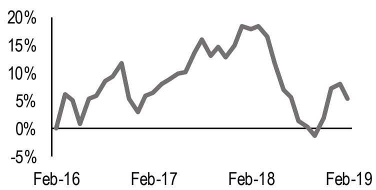
Source: Bloomberg, IOOF

3. MSCI Australia Growth relative to MSCI Australia Value



Source: Bloomberg, IOOF

4. Emerging markets vs Developed Markets, US$ terms



Sector and stock returns

ASX/S&P 200 Sectors (GICS)

	Monthly	%Δ	Quarterly	%Δ
▲	Consumer Discretionary	4.82	Consumer Discretionary	7.23
▼	Consumer Staples	-2.34	Consumer Staples	1.81
▲	Energy	6.23	Energy	16.09
▲	Financials ex Property	8.12	Financials ex Property	4.51
▲	Financials	8.12	Financials	4.51
▲	Health Care	0.96	Health Care	7.89
▲	Industrials	6.01	Industrials	8.05
▲	IT	7.03	IT	12.31
▲	Materials	5.98	Materials	19.43
▲	Property Trusts	1.22	Property Trusts	7.34
▲	Telecommunications	2.62	Telecommunications	5.09
▲	Utilities	2.78	Utilities	11.17

Best and Worst S&P/ASX 200 Performers

Top five stocks		Bottom five stocks	
Monthly			
Automotive Hldgs Grp Ltd	+47.9%	Blackmores Ltd	-27.7%
Appen Ltd	+46.7%	Pact Grp Hldgs Ltd	-23.2%
Breville Group Ltd	+43.4%	Saracen Mineral Hlds	-23.1%
Ausdrill Ltd	+38.1%	Mcmillan Shakespeare	-21.0%
Speedcast International Ltd	+33.3%	Bingo Industries Ltd	-20.1%
Quarterly			
Appen Ltd	+68.4%	Costa Group	-29.8%
IDP Education Ltd	+63.0%	Mayne Pharma Group	-28.6%
Fortescue Metals Group	+51.5%	Blackmores Ltd	-24.8%
Altium Ltd	+45.7%	Bingo Industries Ltd	-24.8%
Breville Group Ltd	+43.6%	Eclipx Group Ltd	-21.0%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, February 2019

	Australian Indices	Feb-19 Price	1M return (%)	Nov-18 Price	3M return (%)
▲	S&P/ASX 200	6169	5.19	5667	8.86
▲	All Ordinaries	6253	5.31	5749	8.76
▲	Small Ordinaries	2765	6.54	2574	7.41
	US Indices				
▲	S&P 500	2784	2.97	2760	0.88
▲	Dow Jones	25916	3.67	25538	1.48
▲	Nasdaq	7533	3.44	7331	2.76
	Asia Pacific Indices				
▲	Hang Seng	28633	2.47	26507	8.02
▲	Nikkei 225	21385	2.94	22351	-4.32
	UK & Europe Indices				
▲	FTSE 100	7075	1.52	6980	1.35
▲	CAC40	5241	4.96	5004	4.73
▲	DAX Index	11516	3.07	11257	2.30

Source: Bloomberg, IOOF

US equity market

The S&P 500 index finished February up 3% while the tech-heavy NASDAQ fared slightly better, up 3.4%. The market performance was positive across all sectors. Industrials (up 6.1%), Information Technology (up 6.6%), Utilities (up 3.6%) and Materials (up 3%) were the top performing sectors. Defensive sectors such as real estate (up 0.8%) and health care (up 1%) were relative laggards compared to the overall market. One catalyst was ongoing dovish remarks by the Fed with increased discussion on ending its quantitative tightening (running off bonds from its balance sheet) later this year. The logic is that given quantitative easing was good for stocks → quantitative tightening is bad for stocks and therefore no more quantitative tightening is good for stocks. In addition, US stocks were supported later in the month by President Trump's decision to suspend the scheduled implementation of tariffs against China on 1 March after citing substantial progress on trade talks.

Australian equity market

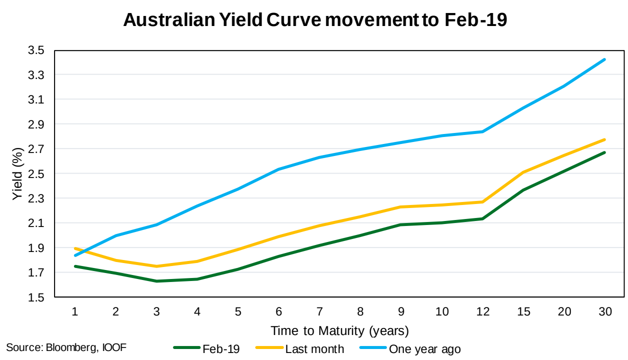
The S&P/ASX 200 index finished the month up 5.2%. Most sectors were in positive territory with consumer staple stocks (down 2.3%) the sole exception, dragged down by the poorly-received results of Coles (ASX: COL) and Woolworths (ASX: WOW). Financials were the top performing sector (up 8.1%) followed by technology (up 7%) and energy (up 6.2%). The market fears revolving around the Final Report by the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* did not materialise. While there were recommendations that will impact the sector, the heaviest weights, the major banks, fared better than expected after the release of the final report byCommissioner Hayne. Bank stocks rallied and have now almost recovered to their prices from a year ago. NAB (ASX: NAB) is one exception with the exception of whose CEO and Chairman departed during the month following scathing criticism by the Commissioner within the final report. Energy stocks continued to rally in line with the recovery in broad oil prices which are up over 20% since the start of this year while technology stocks benefitted from a well-received earnings season that saw a number of companies beat expectations such as Appen (ASX: APX) and Altium (ASX: ALU).

Fixed Income

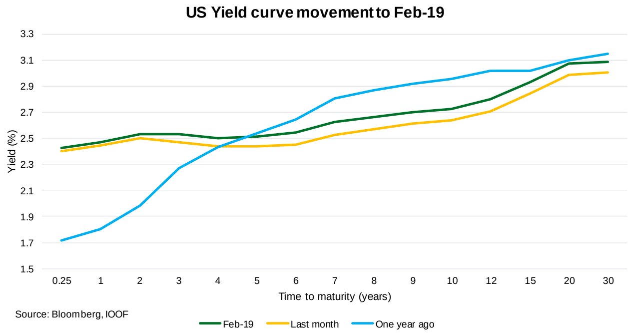
	Fixed Income	Feb-19 yield	1M mvt (bps)	Nov-18 yield	3M mvt (bps)
	Aussie Cash rate	1.50	--	1.50	--
▼	10-year Bond Rate	2.10	-0.14	2.59	-0.49
▼	3-year Bond Rate	1.63	-0.12	2.01	-0.38
▼	90 Day Bank Accepted Bills SFE-Day	1.87	-0.18	1.95	-0.08
▲	US 10-year Bond Rate	2.72	0.09	2.99	-0.27
▲	US 3-year Bond Rate	2.49	0.06	2.80	-0.31

Source: Bloomberg, IOOF

The Australian yield curve flattened in February with the 3-year bond yield declining 12bps and the 10-year bond yield by 14bps. In Australia, bond yields continue to be weighed down by a mix of concerns. While the labour market has held up well in recent months other economic indicators point towards a slowdown domestically. Weaker retail sales and the fall in the value of construction work completed weakened expectations for December quarter economic growth which proved prescient given the miss discussed below.



The U.S. yield curve steepened following strength in economic growth for the December quarter. The US economy grew slower in the quarter but above investor expectations. An uptick in business investment and solid consumer spending over the quarter offset concerns on retail trade after a decline in monthly sales growth during December.



The US yield curve was also influenced by pressure from corporate debt issuance as well as additional optimism on global growth which helped push yields higher. The flipside of the Australian case is notable with this month's yields (in **green**) above last month's (in **yellow**) at all parts of the curve but more pronounced at longer durations.

Currencies

	Currencies	Feb-19 Price	1M return (%)	Nov-18 Price	3M return (%)
▼	$A vs $US	70.94	-2.46	73.06	-2.90
▼	$A vs GBP	53.49	-3.59	57.30	-6.65
▼	$A vs YEN	79.02	-0.21	82.98	-4.77
▼	$A vs EUR	62.39	-1.79	64.57	-3.38
▼	$A vs $NZ	104.22	-0.92	106.36	-2.01
▲	$US vs EUR	87.94	0.66	88.35	-0.46
▼	$US vs GBP	75.40	-1.15	78.43	-3.86
▲	$US vs CHF	99.82	0.40	99.79	0.03

Source: Bloomberg, IOOF

The Australian dollar (AUD) fell by 2.46% to USD 0.7094. This move was driven by disappointing economic data during February which pointed towards a miss in GDP figures. In addition, the weakening state of the economy outside of the labour market has prompted calls for rate cuts. These have intensified since the RBA shifted to a more neutral policy setting by moving away from its refrain that the next move in rates "was likely to be up". The US Dollar rose against most major currencies as investors rewarded the stronger performance of the US economy relative to other countries such as Europe and Japan. This also appeared in the divergence of PMI data between the US and other developed markets with business activity remaining stronger. Investors also grew more optimistic on the Brexit front pricing in expectations of a delay to the UK exit. This saw the pound appreciate against other currencies as investors anticipated a less disruptive exit after further negotiations with the EU.

Commodities

	Commodities	Feb-19 Price	1M return (%)	Nov-18 Price	3M return (%)
▼	Aluminium	1895	-0.88	1964	-3.54
▲	Copper	295	5.53	279	5.63
▲	Nickel	12991	4.37	11219	15.79
▼	Gold	1316	-0.69	1232	6.84
▼	Silver	16	-3.29	14	9.28
▲	Crude Oil - Brent	66	6.69	59	12.47
▲	Lead	2151	1.88	1972	9.09
▲	Zinc	2806	2.45	2535	10.67
▲	Iron Ore	87.33	14.86	72.28	20.82

Source: Bloomberg, IOOF

Commodity prices continued to recover further seeing broad-based gains except for aluminium and precious metals. Iron ore strengthened thanks to tight supply following the Brazilian mining disaster in late January where one of the dams of mining giant Value collapsed compelling it to halt major operations for a period of time. Continued lower output from Anglo's Minas Rio mine has contributed to tighter iron ore supply. Oil was assisted by a mix of the OPEC agreement to cut production as well as a less hawkish Federal Reserve policy outlook (positive for growth and therefore oil demand) and lower US fuel stockpiles (lower inventory implies higher future demand and there is less existing stock to draw from). Nickel continued to benefit from the existing supply deficit although industry observers note its value looks increasingly stretched. Gold prices fell on the shift in sentiment to "risk on" as well as higher US bond yields.

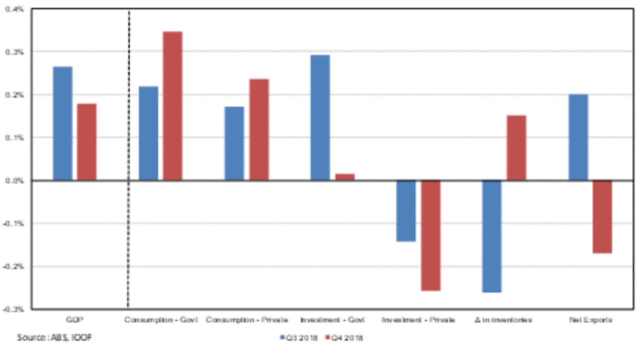
Australia

A slew of negative data has seen markets price in an end to the "lower for longer" theme for interest rates by favouring a cut not a hike. Growth has slowed since June 2018 due to weaker private consumption and investment growth. Calls for rate cuts on the back of weaker consumer spending and house prices need a step lower in labour markets to be made out. This is not yet the case with unemployment remaining low and jobs growth strong.

The Australian economy grew 0.2% during the December quarter (consensus: 0.5%) and 2.3% for 2018 (RBA forecast: 2.75%). The weaker-than-expected result was driven by weaker investment spending relative to the September quarter result across both the public and private sector as well as lower net export volumes. In addition, although consumption contributed to growth it was at a slower pace than previous years with household consumption growing 0.24% in the quarter (0.96%

annualised), notably short of the post-GFC average of 0.38% (1.5% annualised). Taken together these figures point towards a weaker outlook for the economy and add to the case for lower interest rates going forward with markets continuing to price in at least one cut by October this year.

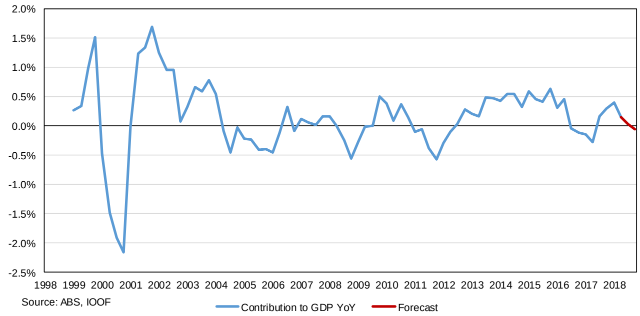
Contributions to QoQ GDP Growth (ppts)



The growth outlook will be supported by population growth as well as continued government spending but may continue at its slower pace in the short term. Support from interest cuts and fiscal stimulus could also help offset the impact of a weaker consumer with the government expected to propose additional tax cuts for the upcoming Federal Budget.

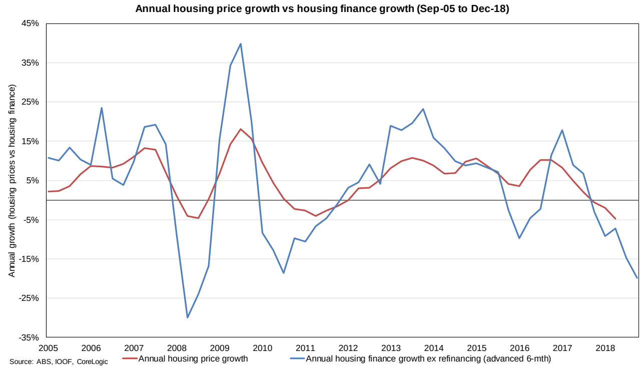
Moving to property markets, total dwelling approvals in Australia rose 2.5% in January in December (consensus: +1%), surprising consensus forecasts while the December result was also revised upwards from an 8.4% decline to an 8.1% drop. The improvement was led by an uptick in unit approvals (up 2.7%) with these moves concentrated in Sydney offsetting a month-on-month decline in Victoria and Queensland. While the January numbers are a welcome result we caution that this series is volatile, and these changes may reverse with the next update as one month does not alleviate the declines experienced over the past year. Dwelling approvals offer a good leading indicator for residential construction activity as they point to the scale and growth of the construction pipeline. This is illustrated below where we see our forecast contribution to growth of residential construction (the **red line**) vs historic levels. We anticipate residential construction investment making a weaker and potentially negative contribution to growth by the June quarter this year.

Residential construction growth contribution, actual and forecast (Sep-98 to Jun-19)

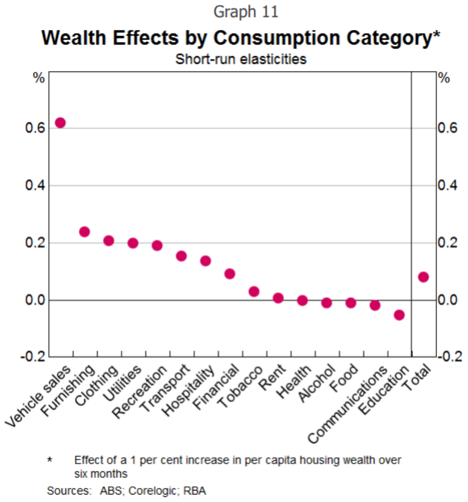


The ABS reported lending data for households and business to December 2018. The decline is housing credit growth continued with total lending for dwellings (excluding refinancing) falling 19.8% from December 2017. The below chart captures the significance of this for house prices using a combination of the ABS and CoreLogic data series (CoreLogic for the December quarter only). Credit growth (in blue) has been a good forward indicator for the future direction of house prices (in red) on the basis that more money chasing a limited supply of houses leads to price inflation. The current trend points towards further correction in prices over the next half-year. This supports the negative growth expectations by both ourselves and other research houses.

Annual housing price growth vs housing finance growth (Sep-05 to Dec-18)



The RBA held interest rates steady at 1.5% (consensus: 1.5%) in its March meeting as expected marking over two and a half years since the last change in interest rates in August 2016. The housing market has become a larger factor in the bank's deliberations. The February meeting minutes disclosed internal research that had been undertaken to understand the vulnerability of the economy to a housing slowdown. This was discussed in a subsequent speech by Governor Lowe citing the different causes of both the run up in prices and subsequent decline. The overall tone struck here was to reassure observers that the correction would not have severe consequences. As proof of this the below chart was produced to argue against the advocates of a negative "wealth effect" by pointing to the relatively low sensitivity of most consumption spending to changes in housing wealth.



Source: *The Housing Market and the Economy*, RBA

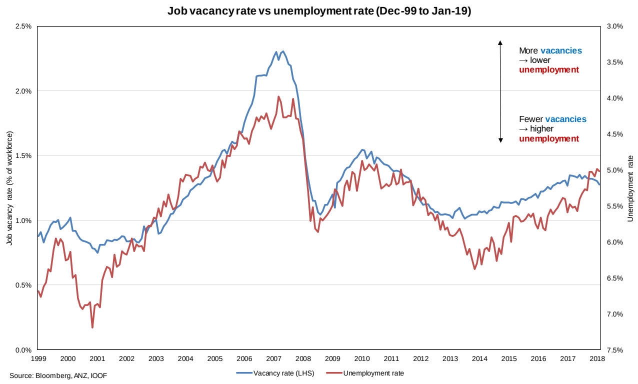
We are sympathetic to the RBA position but note regardless the possible headwind declining wealth poses to consumer spending particularly with wage growth remaining contained.

A subsequent piece of research from the Bank discussed the importance of the change in interest rates as a key driver of house prices. The bank retains the capacity to lower rates should the economy slow further, and this may provide some support to prices. Until the supply of credit resumes growing we see the correction continuing to persist in the short term.

Retail sales in nominal terms rose by 0.1% in January (consensus: 0.3%) disappointing market expectations. The consumer restraint appearing in the December numbers continued. Discretionary spending (i.e. excluding food) was flat month-on-month versus December with food spending driving the 0.1% growth. A weaker consumer outlook has been flagged as a potential risk over the past year with consumption in 2018 occurring against a backdrop of a falling savings rate which implied less capacity to spend more without taking on debt. Given the importance of consumption to overall economic growth this points a headwind in the growth outlook for this year. We saw confirmation of this in the weaker growth numbers for the December quarter that saw consumption growing below the post-GFC average and the saving rate tick up. We remain cautious on the growth outlook going forward.

Wage growth data saw a 0.5% rise (consensus: 0.6%) for the December quarter and 2.3% growth for 2018. This was below market expectations for the quarter with the slight weakness driven by private sector wages growing 2.3% for the year versus public sector growth of 2.5%. The underutilisation rate (underemployment plus unemployment) fell slightly to 13.1% in January from 13.2% in December. This should add upward pressure to wage growth but may be offset by weakness in other economic sectors such as residential construction as well as the lower job creation trajectory expected based on NAB business survey data.

On the positive side, jobs growth of 39.1k (consensus: 16.5k) beat expectations in January. This was driven by full-time employment growth of 65.4k jobs more than offsetting the loss of 26.3k part-time roles. The unemployment rate held steady at 5% (consensus: 5%) with the improved job creation being offset by an increase in the participation rate from 65.6% in December to 65.7% in January as more people seeking work entered the ABS sample. If the participation rate had held steady at the December rate, we would have seen unemployment decline to 4.9% in line with the improved job creation. While a positive note has been struck with the job creation we caution that this data series remains volatile and it remains to be seen whether this will mark an inflection point with the pace of jobs creation slowing towards the end of 2018 (full-time job creation weakened in November and December) and other leading indicators such as business surveys pointing towards a slower pace of hiring at this juncture. These have been confirmed by the latest job vacancy data (in **blue**) which point towards weaker hiring intentions in recent months, a signal that may see employment soften and **unemployment** rise.



On balance the risks to the Australian economy have tilted to the downside. This is reflective of the slowing economic momentum elsewhere in the world as well as the high indebtedness of Australian households. While slower growth remains the likelier outcome, we acknowledge the possible deployment of interest rate cuts and government spending to support the economy.

United States

Domestic economy continues to perform well relative to other developed markets with jobs creation and business expansion both notable. Business optimism has held up with the prospects of a trade deal with China becoming more likely while the economy grew better than expected in the December quarter.

The US and China truce has been extended with President Trump suspending the implementation of the 1 March tariffs after citing substantial progress in the talks to date. At the time of writing some formalised deal or workings thereof remains elusive. However, the fact remains that talks continue at a senior level which is a good sign (i.e. no talks implies no deal). In addition, continued media reports hint at the outlines of a final deal for Presidents Trump and Xi to agree upon. While uncertainty on its final outcome continues to impact business confidence, on balance, the “trade war” threat appears to have abated.

The prospect of another partial government shutdown has passed with President Trump wringing concessions from House Democrats for funding his border barrier proposal and declaring a Federal emergency to secure the remaining funding required. While this sets a worrisome constitutional precedent of unilateral Presidential action the economic concerns of the move appear to have passed. The shutdown that did end in January is expected to detract from March quarter growth however.

The US economy surprised with growth of 0.5% for the December quarter and 2.9% for 2018 (consensus: 2.3%). The Commerce Department estimated the partial government shutdown that began in December detracted 0.1% from growth in the quarter. Consumer spending grew at 2.8% while business spending recovered with 6.7% growth. The impact of higher interest rates was felt in the homebuilding sector as residential construction contracted at a 3.5% rate, its further straight quarterly decline. While a welcome result some caution is warranted as the trade dispute with China complicates the trade outlook while there have been some signs of emerging unemployment in the volatile initial jobless claims series. We continue to watch this space to see if stronger than expected signs of a slowdown begin to emerge.

Manufacturing conditions weakened in February with the Markit Manufacturing PMI falling from its January reading of 54.9 to 53. This slowing in growth reflected a similar weakening in order book growth. In part this follows from a strong January result with both order book and output trends slowing as capacity constraints are relieved from cooler demand by clients. Price pressures have moderated compared to levels seen last year. While the export outlook picked up with increased new orders from foreign clients, business confidence was undermined not only by the ongoing cost and uncertainty impact of tariffs but also wider political uncertainty. On that point the partial government shutdown during January and threats of a subsequent one in February stand out as prime examples with the pace of economic activity less able to offset this.

The Markit Services PMI for February was 56, a notable uptick on its January reading of 54.2. The increase was driven by a mix of greater client demand and favourable economic conditions that drove business activity and new business orders. In addition, new exports orders resumed growth after two months of decline with firms matching this surge in demand with renewed hiring to support capacity. In contrast to the manufacturing sector this uptick saw inflationary pressures rise and be passed on to end clients. The Composite Index (services and manufacturing combined) rose to 55.5 in February from 54.4 in January with the growth in services output offsetting a slower pace of growth in manufacturing. Taken together these surveys remain consistent with annualised GDP growth of 2.6% to start the year in contrast to other major economies discussed below according to IHS Markit. This is in line with our economic outlook presented in the December quarterly where we see the pace of growth in the US slowing while noting that cost pressures have abated, weakening the case for rate hikes by the Fed.

China

Economic momentum has improved in manufacturing but slowed on balance although positive signs have begun to emerge. Slower growth is expected as part of the government’s target for 2019 but with renewed stimulus to combat the weaker domestic backdrop. The trade deal status with the US remains unresolved, weighing on business confidence.

The Chinese government outlined its Budget and growth targets for 2019. Key points were a relaxation of the growth target from 6.5% in 2018 to 6-6.5% for 2019 and an increase in the budget deficit from 2.6% of GDP to 2.8%. The increase in the budget deficit will be put towards additional tax cuts for companies including consumption taxes and higher infrastructure spending. On the infrastructure front, local governments will be permitted to issue 2.15 trillion-yuan (USD 320bn) worth of special purpose bonds in 2019, an increase of 59% on the allowance for 2018 to fund targeted infrastructure projects. These measures should help the country's manufacturing sector which is more exposed to infrastructure investment spending with initial positive signs appearing to emerge as discussed below.

The Markit manufacturing PMI for February remained fractionally within contractionary territory with a move to 49.9 in February up from its January reading of 48.3. The improvement was triggered by growth in new orders which had contracted over the previous two months. In a positive sign the weakness in domestic demand abated while new export orders remained in contractionary territory but with the pace of weakness slowing. Key contributors to the improvement in domestic demand were the mix of monetary policy stimulus and the issuance of special purpose bonds by local governments in China.

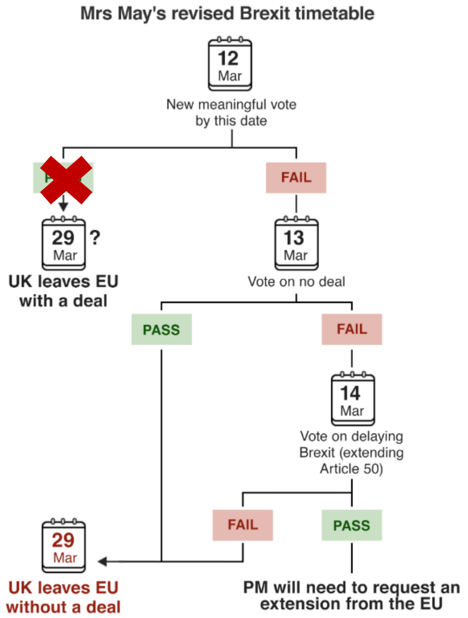
Services activity fell to 51.1 in February, down from 53.6 in January. This contributed to the overall China Composite falling slightly to 50.7 in February, down from 50.9 in January. The weaker services sector result was driven by slower new export order growth as well as weaker business confidence. It also marked a resumption to contracting export sales with cost pressures rising slightly for services firms. Overall this result illustrates how stimulus helped offset an even worse decline thanks to the improvement in manufacturing output. The weaker domestic backdrop will prove to be a challenge even if a final trade deal is agreed with the US, but renewed stimulus efforts should, on balance, offset this.

Europe

Trade concerns and Brexit remain prominent in business thinking on the future with both weighing on sentiment. The ECB surprised markets with the size of its growth downgrade and renewed stimulative efforts that see rate hike discussion deferred into 2020. Some green shots of activity in the latest Composite PMI may help growth stabilise at this lower level.

The UK draws closer to a "no deal" scenario for Brexit as we highlighted in our previous Monthly report. That scenario remains a live possibility for 29 March if key votes this week do not play out as markets and other observers expect.

The below infographic from the BBC is a useful summary for events in the days ahead.



Source: [*Brexit: 'Legally binding' changes to EU deal* agreed](), BBC

At the time of writing, PM Theresa May secured legally binding changes to her Brexit deal that would ostensibly prevent the EU keeping the UK within the union indefinitely over the backstop arrangement for the Northern Ireland border. In addition, there was a commitment by both the EU and UK to replace the backstop with alternative arrangements by December 2020. The concessions had seen some observers speculate that a successful deal vote could now occur by placating some of the fiercest opposition to the deal previously put to Parliament. However the 12 March vote on this altered deal was defeated after the Attorney General contradicted the government stance and said the renegotiated deal could still bind the UK to the EU in effect. Now a vote on 13 March for exiting without a deal is also expected to fail due to fears regarding the possible negative trade and economic consequences. If the 13 March vote fails, then a third vote on 14 March is expected (if it goes ahead) to see MPs vote in favour of delaying the exit process. This move requires agreement by EU members and it is uncertain at this juncture whether that will be forthcoming. Muddying the waters further has been the assertion by EC President Juncker that there would be no subsequent negotiations if the renegotiated deal fails in Parliament. Without resorting to speculation concrete details remain absent similar to last month. Until the position becomes clearer we continue to watch developments in this space. Importantly it is useful to contemplate why in particular we focus on Brexit and give it this attention. In that light, we note that direct UK exposures in model portfolios is limited (i.e. there is no sizeable overweight that investors in the models are exposed to in either bonds or equities). Second order effects that hit other markets and asset classes may arise in time and we will address such risk management concerns as and when they arise.

Moving to Eurozone monetary policy, the ECB surprised markets by downgrading its growth forecast for 2019 to 1.1% from 1.7% and outlining further monetary policy easing, a possibility we highlighted in last month's report. Key reasons for the downgrade include the uncertainty over Brexit, China growth cuts and self-inflicted regulatory harm to the European auto industry as highlighted in previous reports. The lack of government stimulus in general has also limited growth prospects in the face of an external trade slowdown. The implementation of rate hikes pencilled in for discussion later this year has been delayed further into 2020 as a result. The ECB has also outlined the implementation of TLTROs (targeted, long-term refinancing operations) that enable banks to borrow from the ECB at 0% interest provided they lend the capital to businesses and consumers (instead of potentially misusing the cheap funding to finance speculative investments). While these efforts should help somewhat unless fiscal policy is employed in a more active fashion we remain sceptical on the lasting effectiveness of these proposals. It remains difficult to escape the reality that the Eurozone in aggregate struggles to generate demand for its productive capacity leaving it vulnerable to global shocks particularly if fiscal policy is unavailable to act counter-cyclically. The increased spending plans by France and Italy should be helpful on that front but may still prove inadequate.

The Markit Eurozone Composite PMI halted its slide since 2018 with a reading of 51.9 in February, up from 51 in January. Key to this was improvement in both Germany and France while Italy contracted by less. Helpful factors including the easing of one-off hits in the form of the French yellow vest protests and the new emissions rules for the auto sector. In addition, the strength was led by the services sector which rose from 51.2 in January to 52.8 in February driven by overall new business growth and slightly higher business confidence. However, the manufacturing sector remains vulnerable with an increase in the decline of new orders and signs of excess capacity that will need to be eroded before increased production investment is warranted. This is reflected in the contraction recorded for the latest result with the February print for Manufacturing PMI at 49.3 (i.e. manufacturing sector activity fell in the month) down from 50.5 in January with new export orders a point of weakness explained by a mix of trade and political uncertainties (i.e. Brexit). The run rate of existing PMI results point towards a slight pickup in growth from 0.1% in January to 0.2% in February according to IHS Markit economists but unless followed by further improvement in March it is unlikely growth will beat the 0.2% quarterly result in December.

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

Automotive Holdings Group (AMG) saw its share price rise on the back of a well-received interim result with investors focused on the future. The signalling by management that tougher industry conditions were easing as well as traction in its online used car business and refrigerated logistics business saw investors look through the sizeable impairment of $226m (around one third of its current market value) to anticipate stronger future earnings.

Appen Ltd (APX) shares were well-received in the month as the company continued to upgrade guidance on both the top line (revenues) and bottom line (profitability as measured by EBITDA) with its Leapforce acquisition reaping ongoing dividends for investors. On Leapforce the company also guided towards a near-complete integration of the acquisition with efficiency savings of $6m being reinvested in engineering development.

Breville Group (BRG) stock reached all-time highs on the back of strong first-half results with revenues growing 15.4% and profit growth of 14.8% over the same period. The results were in line with expectations driven in part by the depreciation of the Australian dollar over the period as well as strong growth in its lower-margin Distribution business where Breville acts as a middleman for products designed and developed by another company such as Nespresso. The result was also notable for its strong local growth with the mature ANZ business seeing revenue growth of 7.9% over the period notwithstanding a weaker retail backdrop. Finally, the company has continued to successfully enter new markets with strong sales driven by the latest such entry into Germany and Austria while at the same time continuing to reinvest in the business and develop new product lines.

Ausdrill (ASL) climbed following a recent major contract win in India by its Barminco subsidiary worth approximately $100m. In addition, the firm benefitted from two additional factors, confirmation of its FY19 earnings guidance as well as the successful revamping of the group structure to create the second-largest mining services firm in Australia with balance sheet strength maintained and credit ratings upgraded by S&P and Moody’s.

Blackmores (BKL) shares struggled during February following disappointing guidance for the second half of the year and the resignation of CEO Richard Henfrey. The company’s key China business was the main contributor with CEO Henfrey explaining that the firm’s direct to consumer shift away from existing *daigou* (Chinese reseller) distribution chains would take time to have effect. Analysts have focused on the greater competition for the company’s vitamin offerings as being a longer-term headwind to growth as well.

Pact Group Holdings (PGH) was punished by investors with an asset write-down of up to $340m and signalling the persistence of tougher trading conditions for the packaging business’ Australian operations. The update also reflects a second downgrade to expected earnings. Prior to its AGM last year, it had forecast full-year EBITDA of $270m - $285m. At the AGM this was downgraded to $245m. As of the latest February update full-year EBITDA is estimated to be in the range of $230m to $245m. Key to this trend has been higher raw material costs as well as weaker demand for certain business segments.

Saracen Mineral Holdings (SAR) fell on the back of disappointing underlying results which showed a 1% rise in statutory EBITDA to $104.1m and a 7% decline in net profit before tax to $61.2m. On an underlying level NPAT improved from $37.2m to 45.3m with another contributing factor the decline in the gold price over the month as US yields rose.

Source: ASX company announcements, Bloomberg, AFR

Movers and Shakers for month of February 2019

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month Δ (%)	Quarter ago close ($)	Quarter Δ (%)	Year ago, close ($)	Year Δ (%)
AHG	Automotive Holdings Group Ltd	2.30	1.56	47.9	1.63	41.1	3.71	-38.0
APX	Appen Ltd	23.41	15.96	46.7	13.90	68.4	10.39	125.3
BRG	Breville Group Ltd	15.75	10.98	43.4	10.97	43.6	12.79	23.1
ASL	Ausdrill Ltd	1.74	1.26	38.1	1.45	20.0	2.51	-30.7
SDA	Speedcast International Ltd	3.88	2.91	33.3	3.28	18.3	5.53	-29.8
ALU	Altium Ltd	33.00	24.95	32.3	22.65	45.7	20.23	63.1
IEL	IDP Education Ltd	14.90	11.35	31.3	9.14	63.0	7.24	105.8
VEA	Viva Energy Group Ltd	2.41	1.84	31.0	1.98	22.0	N/A	N/A
AOG	Aveo Group	2.12	1.62	30.9	1.70	24.7	2.64	-19.7
IFL	IOOF Holdings Ltd	6.58	5.03	30.8	6.90	-4.6	10.43	-36.9

Source: Bloomberg, IOOF

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month Δ (%)	Quarter ago close ($)	Quarter Δ (%)	Year ago close ($)	Year Δ (%)
BKL	Blackmores Ltd	93.25	129.01	-27.7	123.98	-24.8	128.40	-27.4
PGH	Pact Group Holdings Ltd	2.91	3.79	-23.2	3.43	-15.2	5.60	-48.0
SAR	Saracen Mineral Holdings Ltd	2.59	3.37	-23.1	2.47	4.9	1.62	59.9
MMS	Mcmillan Shakespeare Ltd	12.12	15.35	-21.0	14.15	-14.3	17.58	-31.1
BIN	Bingo Industries Ltd	1.67	2.09	-20.1	2.22	-24.8	2.48	-32.7
SIQ	Smartgroup Corp Ltd	8.48	10.46	-18.9	10.17	-16.6	11.44	-25.9
NUF	Nufarm Ltd	5.24	6.24	-16.0	6.06	-13.5	8.15	-35.7
MYX	Mayne Pharma Group Ltd	0.70	0.81	-13.0	0.98	-28.6	0.73	-4.1
SYR	Syrah Resources Ltd	1.37	1.57	-12.5	1.63	-16.0	3.42	-59.9
ING	Inghams Group Ltd	4.04	4.60	-12.2	4.39	-8.0	3.70	9.2

Source: Bloomberg, IOOF

Long-term asset class performance to February 2019 (in AUD)

					Annualised						
	Asset	**1-mth**	**3-mth**	**6-mth**	**1-yr**	**3-yr**	**5-yr**	**7-yr**	**10-yr**	**15-yr**	**20-yr**
Shares	Australia	6.0%	9.9%	-0.3%	7.1%	12.9%	7.3%	10.0%	11.1%	8.8%	8.6%
	Australia - mid cap	5.0%	7.9%	-5.4%	0.9%	14.4%	12.1%	11.9%	12.9%	9.6%	9.7%
	Australia - small cap	6.8%	8.0%	-3.1%	3.5%	13.4%	7.7%	4.6%	9.4%	6.0%	5.7%
	World ex Australia	5.5%	5.3%	-2.2%	10.3%	12.9%	11.7%	16.1%	12.0%	7.3%	4.2%
	World ex Australia (Hedged)	3.4%	1.5%	-3.5%	2.4%	13.3%	9.4%	12.4%	15.3%	8.7%	N/A
	World - small cap	6.3%	6.7%	-6.0%	8.8%	13.9%	11.0%	16.5%	14.6%	8.9%	8.7%
	Emerging Markets	2.7%	8.9%	2.0%	-1.3%	15.2%	9.0%	8.3%	9.1%	8.5%	N/A
	Global Infrastructure (Hedged)	2.8%	5.5%	6.6%	14.4%	11.4%	10.0%	12.1%	15.0%	N/A	N/A
Property	Australian Property	1.8%	9.9%	4.1%	18.9%	8.6%	13.0%	14.3%	14.4%	5.9%	N/A
	Global Property	3.0%	7.2%	4.7%	25.8%	7.8%	12.1%	14.6%	13.9%	N/A	N/A
Fixed income	Australia government bonds	1.0%	3.4%	3.7%	6.6%	3.4%	4.8%	4.8%	5.2%	5.7%	5.8%
	Australia corporate bonds	0.9%	2.3%	2.7%	5.0%	4.3%	4.8%	5.5%	6.1%	6.1%	6.1%
	Australia floating rate bonds	0.4%	0.8%	1.4%	2.6%	3.1%	3.1%	3.7%	4.6%	4.8%	5.0%
	Global government bonds (Hedged)	0.0%	2.3%	2.6%	4.0%	2.6%	4.7%	5.0%	6.1%	6.5%	N/A
	Global corporate bonds (Hedged)	0.4%	3.4%	1.9%	2.7%	4.4%	4.8%	5.6%	8.5%	6.7%	N/A
	Global high yield bonds (Hedged)	1.4%	4.6%	3.7%	2.9%	9.4%	6.2%	8.1%	14.0%	9.6%	N/A
	Emerging Market bonds (Hedged)	1.0%	7.1%	5.7%	2.2%	6.4%	6.2%	6.4%	10.6%	9.1%	11.2%
Cash	S&P/ASX Bank Bill Index	0.2%	0.5%	1.0%	2.0%	1.9%	2.1%	2.5%	3.0%	N/A	N/A

Source: Bloomberg, IOOF

* AUD total returns as at Feb-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	ASX Accumulation Midcap 50 Index
Australia - small cap	ASX Accumulation Small Cap Ordinaries 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
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
Global infrastructure (Hedged)	FTSE Global Core Infrastructure 50/50 100% Hedged to AUD Net Tax 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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