Our view

Researchupdate

Australian Monthly Wrap

November 2018 Economic Wrap

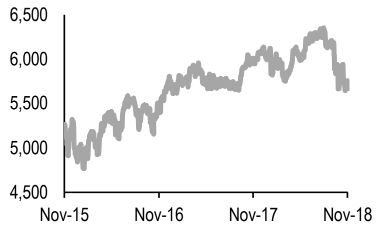
Summary - In a nutshell, both leading and hard economic data point to resilience in the US economy. Global economic momentum continued to slow this year, led by weakness in China and Europe. We will likely see slower growth in the US next year as the effects of the fiscal stimulus wear off. Business sentiment has been weighed down by the uncertainty surrounding 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 export surpluses continue to be recorded with October marking a tenth straight month while the unemployment rate remained at 5%. Wage inflation ticked up, backed up by the tighter labour market while housing price weakness continues on the back of more robust lending standards. The prospect of a more chaotic Brexit outcome increased with markets pricing in an increased chance of a "no deal" outcome that may see more volatility going forward.

Markets - The month of November was marked by a strengthening Australian Dollar (AUD) with expectations firming for Australian assets following the continued strength of the labour market and surprise strength of the trade surplus for September (released in October). US leading economic indicators and hard data are holding up on balance, offering support for the Federal Reserve's ("The Fed's") efforts to raise interest rates with the next hike expected in December although signs of weakness are emerging. Emerging market equities staged a slight bounce back (see page 10) clawing back some relative underperformance this year (see chart 4). The ASX underperformed global markets (see chart 2) with value (down 1.1%) outperforming growth (down 4.9%) on a relative basis over the month (see chart 3) even as the IT sector (predominantly growth companies) was the sole positive domestically (up 0.9%).

Key economic news – The Reserve Bank of Australia left the cash rate on hold at 1.50% as expected. November marked further contraction in house prices in Australia with a fall of 0.7% over the month according to the latest CoreLogic data. The weakness remained focused in Sydney and Melbourne, down 1.4% and 1% respectively over the month. US inflation remains contained with core PCE (The Fed's preferred target inflation rate) falling slightly below target at 1.8% for October.

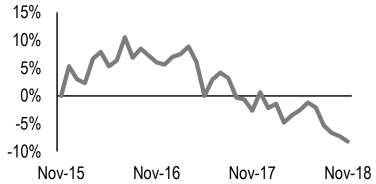
Key company news – Stock-specific news items were prominent in November with a number of companies hosting their AGMs and providing trading updates that saw the likes of G8 Education (ASX: GEM) and Appen (ASX: APX) benefitting from positive news flow. G8 Education saw an uptick in usage rates for their childcare centres nationally while investors rewarded Appen for an earnings upgrade driven by strong demand from existing clients. In contrast Lendlease (ASX: LLC) announced issues in its Engineering and Services Business that saw it take a $350m provision due to slower progress on a number of key infrastructure projects. CYBG (ASX: CYB) shares fell after it highlighted planning for Brexit uncertainty in its FY19 outlook while Trade Me Group (ASX: TME) benefitted from a takeover bid by private equity.

1. S&P/ASX 200 Price Index



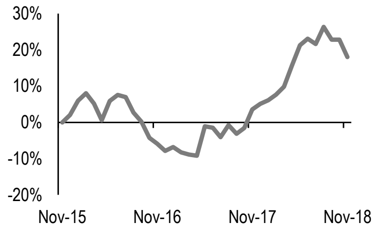
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



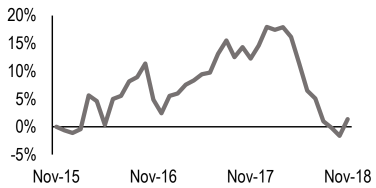
Source: Bloomberg, IOOF

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	%∆	Quarterly	%∆
▼	Consumer Discretionary	-5.07	Consumer Discretionary	-16.92
▼	Consumer Staples	-3.14	Consumer Staples	-10.83
▼	Energy	-10.35	Energy	-16.49
▼	Financials ex Property	-0.34	Financials ex Property	-8.50
▼	Financials	-0.34	Financials	-8.50
▼	Health Care	-4.06	Health Care	-18.22
▼	Industrials	-0.60	Industrials	-8.34
▲	IT	0.94	IT	-11.35
▼	Materials	-4.88	Materials	-7.40
▼	Property Trusts	-0.44	Property Trusts	-5.28
▼	Telecommunications	-3.20	Telecommunications	-8.03
▼	Utilities	-2.09	Utilities	-9.48

Best and Worst S&P/ASX 200 Performers

Top five stocks		Bottom five stocks	
Monthly			
G8 Education Ltd	+36.6%	Lendlease Group	-28.1%
Appen Ltd	+30.6%	CYBG Plc – CDI	-25.8%
Orocobre Ltd	+29.7%	Bluescope Steel Ltd	-21.9%
Trade Me Group Ltd	+27.4%	Fletcher Building Ltd	-19.7%
Costa Group Holdings Ltd	+24.8%	Santos Ltd	-16.9%
Quarterly			
G8 Education Ltd	+35.9%	CYBG Plc - CDI	-38.5%
Saracen Mineral Hldgs Ltd	+30.7%	Lendlease Group	-38.2%
Inghams Group Ltd	+19.9%	Syrah Resources Ltd	-35.8%
Evolution Mining Ltd	+18.5%	Bluescope Steel Ltd	-35.1%
Vocus Group Ltd	+17.5%	Bellamy's Australia Ltd	-33.2%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, November 2018

	Australian Indices	Nov-18 Price	1M return (%)	Aug-18 Price	3M return (%)
▼	S&P/ASX 200	5667	-2.80	6319	-10.32
▼	All Ordinaries	5749	-2.77	6428	-10.56
▼	Small Ordinaries	2574	-0.44	2890	-10.95
	US Indices				
▲	S&P 500	2760	1.79	2902	-4.87
▲	Dow Jones	25538	1.68	25965	-1.64
▲	Nasdaq	7331	0.34	8110	-9.61
	Asia Pacific Indices				
▲	Hang Seng	26507	6.11	27889	-4.95
▲	Nikkei 225	22351	1.96	22865	-2.25
	UK & Europe Indices				
▼	FTSE 100	6980	-2.07	7432	-6.08
▼	CAC40	5004	-1.76	5407	-7.45
▼	DAX Index	11257	-1.66	12364	-8.95

Source: Bloomberg, IOOF

US equity market

The S&P 500 index finished the month up 1.8% while the tech-heavy Nasdaq was only up 0.3%. The market performance was positive across most sectors with Healthcare (up 6.8%), Real Estate (up 5.3%) and Materials (up 3.8%) the leading sectors while Energy (down 2.2%) and Technology stocks (down 2.1%) continued to sell off. The market in November benefitted from Fed Chairman Powell walking back on his "far from neutral" remarks in October by stating the current target rate was "close to neutral" implying that the current setting only had scope for limited rate hikes. Energy shares struggled in the face of the continued weakness in oil prices while Technology shares continued to struggle on peak growth concerns. On this last point, it is useful to note that in recent years the growth rate for Technology sector earnings had been well-above the market. However, in recent months, estimates have weakened led by concerns over Apple and iPhone unit growth with forward growth now more in line with the broader market. In that instance, investors are less inclined to pay a hefty valuation multiple which has helped see the sector be sold off.

Australian equity market

The S&P/ASX 200 index finished the month down 2.8%. All sectors excluding IT experienced negative performance with Financial stocks i.e. major banks (down 0.3%), industrials (down 0.6%) and Real Estate (down 0.4%) faring the best. Weakness was concentrated in energy (down 10.4%) and consumer discretionary stocks (down 5%). Energy shares fell in line with the weakness in oil prices globally as discussed below while consumer discretionary stocks struggled following weaker AGM updates and concerns about the sustainability of consumer spending. The sectors that held up best were typically bond proxies such as A-REITs which benefitted from the decline in longer-term bond rates over the month.

Fixed Income

	Fixed Income	Nov-18 yield	1M mvt (bps)	Aug-18 yield	3M mvt (bps)
	Aussie Cash rate	1.50	--	1.50	--
▼	10-year Bond Rate	2.59	-0.03	2.52	0.07
▲	3-year Bond Rate	2.01	0.02	1.98	0.03
▲	90 Day Bank Accepted Bills SFE-Day	1.95	0.04	1.95	--
▼	US 10-year Bond Rate	2.99	-0.16	2.86	0.13
▼	US 3-year Bond Rate	2.80	-0.13	2.69	0.11

Source: Bloomberg, IOOF

During the month of November, the Australian yield curve fell unevenly with long term rates declining while short term rates rose. The Australian 3-year bond yield lifted 2bps and the 10-year bond yield fell 3bps. The U.S. yield curve flattened with shorter rates such as the 3-year yield declining 13bp and the 10-year yield, falling 16bps.

Australian bond yields were weighed down by a mix of concerns. The broader selloff in equity markets saw investors bid up safe haven assets, seeing longer-term yields fall over the month. The uptick in shorter bond rates can be attributed to some of the positive inflation news during the month with wage inflation in line with consensus while jobs growth continued and unemployment remained low at 5% increasing positive sentiment towards RBA rate hikes in the shorter-term.

Closing US yields continue to track in a volatile fashion with an intra-month of 3.23% reached during October for the 10-year yield that now sits at 2.59%. Triggers for the 10-year movement include safe haven demand with the continued volatility in equities attracting investors. In addition, sentiment towards future growth appears to be tracking lower with the US yield curve flattening over the month and inverting for certain durations in early December. Yield curve inversion has been a useful indicator of recessions in the past with bond markets pricing in lower growth than equity markets but one with uneven application with it indicating a recession between 12 to 24 months ahead of its occurrence depending on the particular spread being discussed. The most reliable past indicator has been the spread between the 3-month Treasury Bill and the 10-year Treasury Bond which remains positive at 47bps. Concerns over the tightness of monetary policy have been reflected in comments by Federal Reserve Chairman Jerome Powell who noted rates were much closer to neutral in a November speech, walking back from remarks that had contributed to the October sell off that rates were "far from neutral". The logic of this last point is that the Federal Reserve targets a neutral rate of interest with its interest rate changes. If that neutral rate was much higher than current levels it implies more rate hikes are necessary which led investors to price this possibility into bond markets and contributed to rising bond yields during October (as bonds are sold their yields rise).

Currencies

	Currencies	Nov-18 Price	1M return (%)	Aug-18 Price	3M return (%)
▲	$A vs $US	73.06	3.29	71.89	1.63
▲	$A vs GBP	57.30	3.41	55.48	3.27
▲	$A vs YEN	82.98	3.87	79.82	3.96
▲	$A vs EUR	64.57	3.26	61.97	4.20
▼	$A vs $NZ	106.36	-2.01	108.68	-2.13
▼	$US vs EUR	88.35	-0.06	86.20	2.49
▲	$US vs GBP	78.43	0.11	77.16	1.65
▼	$US vs CHF	99.79	-1.05	96.89	2.99

Source: Bloomberg, IOOF

The Australian dollar (AUD) appreciated against major global currencies in November to USD 0.7306 on the back of "risk on" sentiment and positive economic news. The Australian dollar was boosted intra-month by the strong labour force report showing the unemployment rate had remained at 5% as well as wage inflation in line with consensus forecasts and positive trade surpluses with a surprisingly strong September result. The US Dollar (USD) traded weaker against most major currencies on the back of Chairman Powell's comments. An exception to US Dollar weakness was the British pound that weakened on the back of ongoing concerns over a possible "no deal" Brexit.

Commodities

	Commodities	Nov-18 Price	1M return (%)	Aug-18 Price	3M return (%)
▲	Aluminium	1967	0.42	2131	-7.71
▲	Copper	279	4.09	269	3.57
▼	Nickel	11149	-2.77	12822	-13.05
▲	Gold	1226	0.43	1212	1.13
▼	Silver	14	-1.26	15	-3.07
▼	Crude Oil - Brent	59	-22.21	77	-24.17
▲	Lead	1968	2.34	2079	-5.35
▲	Zinc	2595	3.19	2454	5.75
▼	Iron Ore	72.28	-0.73	67.16	7.62

Source: Bloomberg, IOOF

Commodity prices broadly tracked higher over the month of November with oil, nickel and iron ore the notable exceptions. Oil prices fell on the back of delayed implementation of Iranian oil sanctions, continued strength in US production (which saw the US emerge as a net oil exporter for the first time in decades during December) and fears for global growth crimping future demand. Nickel and iron ore prices fell on the back of falling steel prices in China with investors concerned about the country's economic health as both iron ore and nickel are key components of steel. They have seen less demand from Chinese steel mills due to low steel prices delaying the need for producers to stock up on these raw materials.

Australia

Rates on hold with weaker than expected economic growth continuing the "lower for longer" theme. On the positive, wage growth and continued trade surpluses are supportive of growth, however, housing prices continue to fall notably in Sydney and Melbourne due to a mix of tighter financing and increased supply weighing on the forward outlook for construction activity.

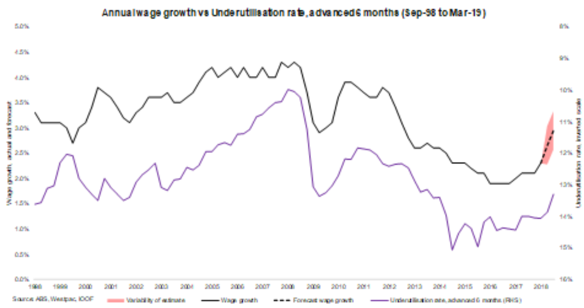
The RBA held interest rates steady at 1.5% (consensus: 1.5%) as expected marking over 2 years since the last change in interest rates in August 2016. Signs from the RBA statement following its November meeting point towards weakening optimism in its expression of concern over a slowdown in global trade. By contrast it welcomed the uptick in wage inflation but maintained its belief that any further lift will be gradual. There was also some mention of the weakness in the housing market including the slowdown in lending growth and reduced appetite for mortgage risk amongst lenders. These may see the bank weakening its stance that “the next move in rates will be higher” in coming months as the GDP growth figures released after the meeting point to a likely miss on the RBA’s growth forecast for 2018 of 3.5% growth.

The Australian economy grow 0.3% (consensus: 0.6%) during the September quarter and 2.8% for the year to September. The miss on market expectations was attributable to the weaker consumption growth of 0.3% over the quarter with weak income growth remaining an ongoing theme while the contribution of residential construction looks set to weaken on the back of declining housing approval figures which are good forward indicators for new construction activity. In addition, business investment also detracted due to the completion of major LNG gas projects with this activity no longer being reflected in the national accounts. Public spending remains a growth driver led by infrastructure projects at the state level and may help to offset some of the weakness in construction activity going forward given the pipeline of projects still due to be constructed. In addition, the continued decline in the savings rate to 2.4% in September may pose a headwind to future consumption if the uptick in wage growth discussed below does not eventuate

The unemployment rate held steady at 5% in October (consensus: 5.1%). Employment growth surprised with total employed persons rising by 32.8k (consensus: +20k) continuing its up-down trend in recent times shifting between growing and slowing total jobs growth. The bulk of this increase came in full-time jobs with 42.3k growth offset by notable weakness with the loss of 9.5k part-time roles. This continued the overall recovery in full-time jobs growth which had declined during the March quarter but has since recovered to be up 2.1% in the year to October while part-time jobs growth has weakened to 0.9% over the same period. We caution that due to the volatility of monthly moves in jobs creation this trend may reverse by the end of the year with the full-time job creation growth rate of 2.1% year-to-date above working age population growth of 1.4% over the same period. A key driver of the stable unemployment rate was the increase in people seeking work with the participation rate rising from 65.5% in September to 65.6% in October. If this had been flat over the two months, the unemployment rate would have fallen in line with the stronger than expected jobs growth to 4.9% but instead stayed constant as more people seeking work were included in the sample.

Wage data for the September quarter saw quarterly wage growth of 0.6% (consensus: 0.6%) and annual growth of 2.3% for the year to September. This is a welcome sign, particularly for the annual growth rate, that wage growth may be recovering in line with the RBA forecasts. Over the shorter term, consistent with our previous statements, the gradual decline in the unemployment rate has seen overall labour market capacity tighten further this year which should lead to some improvement in wage growth over the next half year to March 2019.

5. Annual wage growth vs labour market capacity



Retail sales grew 0.3% (consensus: 0.3%) over the month of October. On a monthly basis, most categories were positive compared with flat growth in September with the notable exception of the “eating out” category (down 0.9%). The positive growth was led by the clothing, footwear and accessories category (up 2.6%) and household goods category (up 0.5%). This marks a welcome resumption of growth following weaker performance in the September quarter relative to the June quarter this year. Online retail sales continue to grow accounting for 5.9% of total retail sales and marking the highest level recorded in the series which may spike higher in the lead up to Christmas sales and one-off online events during November.

October marked another trade surplus of 2.3bn (consensus: 3bn) making this a tenth consecutive result to mark 2018. The 3.02bn recorded in September was also revised downwards to 2.94bn. The surplus narrowed with an uptick in coal and LNG exports as well as tourism being offset by strong investment imports such as machinery and equipment and higher oil import costs (reflecting the higher oil prices during October).

United States

Domestic economy has begun to show other pockets of weakness such as the rise in initial jobless claims but remains strong on balance. Business confidence has been hurt by ongoing uncertainty surrounding global trade which may be supported by the temporary "ceasefire" with China.

The US and China reached an interim agreement during the month that pushed back the Trump Administration's planned hike into March. Tariffs of 10% on $200bn of Chinese imports into the US had previously been set to increase to 25% on 1 January 2019. This deal provides a stopgap that has also seen China for example reduce tariffs on US auto imports from 40% to 15% this week. However, observers and markets remain sceptical about a final resolution to the tensions between both countries. This is due to the confusion surrounding the specifics of this agreement with inconsistent communication by both US and Chinese representatives (Beijing has for example not acknowledged the 90-day time limit articulated by the White House). In addition, the extent of US demands on intellectual property protection and reduction of non-tariff barriers seem unlikely to be met by complete agreement from China in such a short timeframe. Finally, the arrest of Huawei CFO, Meng Wanzhou, over the violation of US sanctions against Iran is perceived as a barrier to trade resolution given the timing of the move (as a way to subtly pressure China through non-trade means).

US core inflation numbers for the month of October showed that the Federal Reserve's preferred measure of underlying inflation, Core PCE, grew 1.8% in the year to October. This rate had in prior months remained at the 2% mark, a level targeted by the Fed, and the dip below the 2% threshold may indicate some underlying slowdown in the pace of US economic growth. Given economic strength evident across other sectors—e.g. wage growth at 3.1% year-on-year—it remains likely that the Fed will "look through" these measures and feel justified in hiking interest rates at its 19 December meeting with markets pricing a 80% chance of a 0.25% rate hike. We note however that the uptick in initial jobless claims has been a leading indicator for economic slowdowns in the past. While this is a volatile series the increase over the past two months is one of several factors we are watching to see whether the yield curve inversion discussed above will be confirmed in economic results.

Manufacturing conditions declined slightly with the Markit Manufacturing PMI falling from its October reading of 55.7 to 55.3 in November. The main drivers were a slower pick up in overall output growth, the joint-slowest in over a year, as well as weaker business confidence offset by increases in new business orders including new export orders which grew at their fastest pace in nine months. While employment continues to grow with the strong demand being cited as the driver for more new hires, backlogs of work continue to increase. To sate the strong demand, input purchases have continued to grow strongly with buying activity also driven in part by fears of further tariffs and the resulting pick up in raw material costs. Inflation flowing through in the form of higher material prices has been partly passed on to clients but remains a headwind to profitability. Business confidence dipped to its weakest level since September 2017 with some operators concerned about the current sustainability of the strong growth in new business orders. The manufacturing PMI data are consistent with forecasts for slower growth in the December quarter of 2.5% according to IHS Markit economists with a slowing of growth unsurprising given the lessening impact of the fiscal stimulus earlier in the year.

The Markit Services PMI for November was 54.7 in line with its October reading of 54.8. Expansion in new business and solid client demand underpinned this reading while the underlying momentum of new business growth has slowed to its weakest level for 13 months. An uptick in new export orders was also recorded alongside employment growth. Similar cost pressures to manufacturing firms were faced by services firms with both input cost inflation and output charge inflation (prices that businesses pass on to customers) rising but only partially being passed through. This input cost inflation was driven by higher fuel and labour costs, the former of which may weaken in line with the general decline in oil prices. Taken together the manufacturing and services readings saw the overall composite index fall slightly to 54.7 in November from 54.9 in October, a rate consistent with economic growth of around 2.5%, representing a continuation of solid growth into the fourth quarter. New business growth has remained resilient overall but is still growing at its slowest pace in over a year as demand has softened while business expectations for the year ahead are weaker than they were at the start of 2018.

China

Economic momentum is slowing, weighed down by negative sentiment on the trade front that has prompted additional stimulus to help businesses and consumers. This stimulus may need to be further increased to combat the broader slowdown being observed in business survey data.

Chinese industrial production expanded by 5.9% year-on-year in October (consensus: 5.7%) and fixed-asset investment growth rose to 5.7% per annum (consensus: 5.5%), both ahead of market expectations. Retail sales surprised on the downside growing at 8.6% per annum (consensus: 9.1%). These on balance highlighted some improvement driven perhaps by the focused government stimulus efforts to date. The prospect of further easing with cuts to bank reserve requirements may help businesses and consumers particularly when paired with the hiatus in trade tariffs until March per the deal with the US.

Chinese export growth accelerated in October, rising 15.6% over the year (consensus: 12%). A key driver appears to be companies “front-running” higher tariffs in January next year by trading more now. A similar impact was seen ahead of previous tariff increases in US data. Given PMI data pointed to export orders being in negative territory for the past five months, this effect is seen as unlikely to persist going forward pointing towards another factor in the slowdown of the Chinese economy unless economic stimulus acts as a sufficient offset.

The Markit manufacturing PMI for October rose only slightly from 50.1 in October to 50.2 in November pointing to broadly unchanged operating conditions. This remains near contractionary territory (a reading of below 50 signals shrinking business activity) but some positive signs have emerged with measures of future output and new orders improving over the month, the latter a sign perhaps of government stimulus gradually taking effect. Domestic demand has improved but overseas demand has remained constrained with new export orders declining for eight consecutive months. Job creation also remains poor with workforce numbers continuing to decline albeit at a slower pace while weaker than expected demand conditions saw a build-up in inventory for the first time in seven months. Sentiment improved slightly from its 11-month low but remains weak without deteriorating materially further.

Services activity bounced back strongly rising from 50.8 in October to 53.8 in November contributing to the overall China Composite improvement from 50.5 in October to 51.9 in November. The strength in services activity was driven by the sharpest increase in new orders since June this year with a modest increase in new business from overseas. Expectations of continued growth in new orders saw job creation continue for second consecutive month while output cost inflation fell slightly from October, weakening business profit margins and business confidence for the next year declined. At a Composite level, the improvement in economic activity was mainly driven by improved domestic demand given the decline in new export business a sign of potential stabilisation within the Chinese economy that may improve further if a positive outcome is reached on the trade disputes with the US.

Europe

Trade concerns and Brexit remain prominent in business thinking on the future with both weighing on sentiment. Geopolitical turmoil within France has prompted increased fiscal spending with fears that this will embolden Italy on its budget dispute with the European Commission.

France has been beset by so-called “Yellow Vest” protests from thousands of citizens where weak economic growth and still-elevated unemployment crystallised into a protest movement, sparked by a regressive fuel tax from the Macron government. President Macro has pledged increased government spending including a higher minimum wage and the removal of the fuel tax in a bid to quell the protests. On initial estimates these may see France incur a budget deficit amounting to 3.5% of GDP. These efforts may make resistance to Italian plans for increased fiscal spending increasingly untenable. Both Italy and France are subject to the Maastricht treaty constraints for fiscal deficits to be at or below the 3% of GDP threshold. Italian efforts to lower the retirement age and legislate tax cuts with the outcome of a 2.2% budget deficit may be more likely to occur in this case unless the Commission is willing to sanction both. In the past, it has been a rule unevenly applied with the likes of Germany also escaping sanction for its violation. This may pose a net gain for the EU if it encourages fiscal spending given the still weak demand conditions there with unemployment remaining elevated at 9.3% and 9.7% for France and Italy respectively (in contrast to the Australian rate of 5% or the US rate of 3.7%).

The Markit Eurozone Composite PMI fell during November to 52.7 from its October reading of 53.1. A decline in services activity, falling from 53.7 in October to 53.4 in November, added to weakness in the manufacturing industry which fell from 52 to 51.8 over the same period. The decline in the manufacturing sector print was led by the major economies with Germany, France, Italy and the Netherlands all marking new lows. While the PMI remained in expansionary territory for a sixty-fifth consecutive month the 51.8 reading marked its lowest level since August 2016. Weakness was focused on the investment goods sector while export trade overall was down for a third-consecutive month with cost pressures remaining elevated. November marked a second decline in new orders with the faltering demand in part attributed to weak conditions in the autos industry. Sentiment remained broadly unchanged from its near six-year low in October with political concerns such as the unrest in France and the budget dispute surrounding Italy weighing on sentiment as do broader trade concerns.

The services industry saw its slowest expansion since 2016 with the weakness centred on Germany although on the positive side new business orders continued to grow albeit at the weakest rate in over two years. Input cost pressures remain evident and have led companies to partially pass these on to end customers although competition has weakened the extent of this inflation. Business confidence has remained weak with sentiment at its lowest level in almost four years driven by concerns at both the political and economic level, the latter predominantly due to trade concerns. Overall these levels of economic activity point to limited GDP growth of 0.3% for the December quarter which may be exacerbated by any economic disruption brought on from Brexit.

The UK appears to have moved one step closer to a "no deal" Brexit which would see the country revert to pre-EU trade agreements and incur limitations on free movement of goods and people as well as face EU trade barriers (as it would no longer be a part of the single EU market). This follows from a deal being reached in November that failed to satisfy key stakeholders in the "Leave the EU" camp within the Conservatives Party as well as members of the Labour Opposition. A vote was due to be held in Parliament on the proposed deal (which had EU acceptance) but this was withdrawn by Prime Minister May when it remained clear that she and her party faced a clear defeat on the agreement as it currently stands. Instead she has travelled to Brussels in a bid to potentially salvage a deal with new concessions although this remains difficult to see occurring given the tough negotiating stance adopted by the EU. As with the initial Brexit vote these geopolitical ructions may contribute to further market volatility and have arguably done so for businesses with UK-exposure as a number of these names listed on the ASX have been sold off more so than the broader market in recent weeks e.g. CYBG. We continue to watch developments in this space and note that UK exposures to the extent that these are within underlying portfolio funds are limited to being part of a broader portfolio.

Emerging Markets

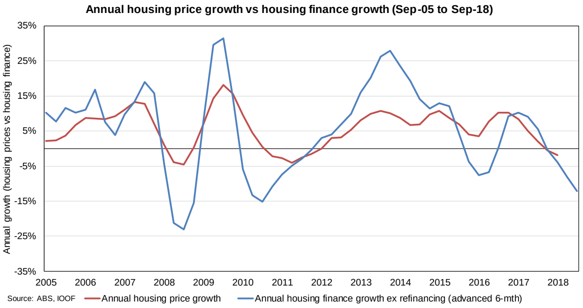
An uptick in performance for emerging market (EM) equities thanks in part to the weakening US dollar. The prospect of trade talk resolution between the US and China bolstered the broader EM market. Valuation discount to developed markets remains notable relative to historical levels.

Actionable insights

Australian housing prices

As discussed above on page 1, November saw a continuation of weakness in housing prices nationally led by the decline in the Sydney and Melbourne markets. A key factor contributing to this has been the weakening growth of mortgage lending with negative annual growth from late 2017 onwards. Chart 5 was reproduced in our 9 November weekly commentary and has been updated for the ABS Sep-18 quarterly price data released this week. We note that the ABS housing price data has a strong relationship with mortgage lending with the latter a useful indicator for the future direction of house prices over the next 6 months. On this basis, more weakness in prices appears likely, consistent with the CoreLogic data which may see a peak to trough decline of 10% or more.

5. Annual housing price vs housing finance growth



Consistent with our earlier pronouncements we note that this decline poses a risk to economic growth which has translated into weaker housing approvals and a weaker outlook for the residential housing construction sector, coupled with a weaker consumption outlook due to a negative wealth effect (the idea being that consumers will spend less as their wealth declines with the drop in house prices). We have seen a one-off sizeable miss in GDP growth for the September quarter discussed above. If that trend continues it may point to reducing exposure to cyclical sectors and positioning portfolios more defensively. The current equity model portfolio allocations have already reflected the weaker confidence in consumer spending with an absence of consumer discretionary exposure and reduced weighting to cyclicals as our views on both stock-specific dynamics and the macro setting have weakened in recent times.

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

In summary, November was marked by a series of annual general meeting (AGM) updates where companies commented on their FY19 outlooks as well as providing, in some cases, an initial trading update on the financial year to date. As is often the case a number benefitted and as discussed below some pointed to a weaker year ahead.

G8 Education Ltd (GEM) saw its share price rise on the back of an increased take-up rate in its childcare centres discussed in its FY18 AGM with occupancy rates ahead of management expectations as it maintained its calendar-year guidance of operating income (earnings before interest and taxes) of $136-139m.

Appen Ltd (APX) benefitted from an earnings upgrade with FY18 underlying EBITDA set to be $62-65m an increase of over 10% from its prior guidance of $54-59m. The firm saw a notable uptick in monthly revenue from its sizeable existing client base which comprises leading US technology firms such as Facebook which drove the earnings upgrade.

Trade Me Group (TME) shares spiked higher as it received a takeover proposal from private equity firm Apax Partners looking to acquire the company for NZD 6.40, a premium of over 15% on the prevailing market price. Subsequent to the end of November a second, competing bid from Hellman & Friedman at NZD 6.45 was also received prompting speculation of a bidding war between the two.

Lendlease Group (LLC) shares sank following an earnings downgrade due to construction overruns form its Engineering and Business division tied to certain major infrastructure projects such as the North Connex in Sydney. These saw the firm take on a $350m provision (after-tax) which will lower current year profit substantially with shareholders punishing the firm accordingly.

CYBG (CYB) is a UK-based bank whose CDI is listed on the ASX as a result of an IPO by NAB in early 2017. As such its business is highly exposed to the UK economy with investors punishing the stock over the month for that exposure and its highlighting of efforts to shore up the bank ahead of an undetermined Brexit outcome. The fear here is that any drop off in UK economic growth will flow into weaker credit demand and possibly more bad debts on its existing loan book, crimping both growth and profitability. In addition, CYBG flagged unexpected margin deterioration in its recent acquisition Virgin Money that also weighed on investor sentiment.

Fletcher Building (FBU) weakened on the back of slowing Australian residential market which saw the company guide for lower operating income relative to FY18 for the year ahead. Subsequent data from CoreLogic highlighted on page 1 saw house prices continue to slide, which accompanied by the decline in housing approvals pointed towards a weaker domestic market that saw the share price decline further.

Source: ASX company announcements, Bloomberg, QVE manager remarks

Movers and Shakers for November 2018

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month ∆ (%)	Quarter ago close ($)	Quarter ∆ (%)	Year ago, close ($)	Year ∆ (%)
GEM	G8 Education Ltd	2.80	2.05	36.6	2.06	35.9	4.41	-36.5
APX	Appen Ltd	13.90	10.64	30.6	15.33	-9.3	7.14	94.7
ORE	Orocobre Ltd	4.32	3.33	29.7	4.25	1.6	6.23	-30.7
TME	Trade Me Group Ltd	5.68	4.46	27.4	4.92	15.4	4.26	33.3
CGC	Costa Group Holdings Ltd	7.61	6.10	24.8	7.23	5.3	6.30	20.8
GXY	Galaxy Resources Ltd	2.70	2.19	23.3	2.73	-1.1	3.85	-29.9
WTC	Wisetech Global Ltd	18.70	16.05	16.5	21.36	-12.5	12.13	54.2
APT	Afterpay Touch Group Ltd	14.42	12.49	15.5	18.13	-20.5	5.00	188.4
CTD	Corporate Travel Management	23.01	20.05	14.8	32.68	-29.6	20.33	13.2
TNE	Technology One Ltd	6.23	5.44	14.5	5.53	12.7	5.02	24.1

Source: Bloomberg, IOOF

ASX Code	Company Name	Closing price ($)	Month ago close ($)	Month ∆ (%)	Quarter ago close ($)	Quarter ∆ (%)	Year ago close ($)	Year ∆ (%)
LLC	Lendlease Group	12.66	17.60	-28.1	20.49	-38.2	15.90	-20.4
CYB	CYBG Plc - CDI	3.62	4.88	-25.8	5.89	-38.5	5.63	-35.7
BSL	Bluescope Steel Ltd	11.23	14.37	-21.9	17.31	-35.1	13.61	-17.5
FBU	Fletcher Building Ltd	4.47	5.57	-19.7	5.84	-23.5	5.93	-24.7
STO	Santos Ltd	5.52	6.64	-16.9	6.78	-18.6	5.08	8.7
ASL	Ausdrill Ltd	1.45	1.72	-15.5	1.62	-10.2	2.28	-36.5
CSR	CSR Ltd	3.00	3.53	-15.0	4.31	-30.4	4.59	-34.6
DMP	Domino's Pizza Enterprises Ltd	45.99	54.01	-14.8	54.10	-15.0	47.00	-2.1
JHX	James Hardie Industries-CDI	16.00	18.79	-14.8	21.17	-24.4	21.50	-25.6
S32	South32 Ltd	3.10	3.62	-14.4	3.48	-10.9	3.26	-4.9

Source: Bloomberg, IOOF

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

	Asset	1-mth	3-mth	6-mth	Annualised 1-yr	3-yr	5-yr	7-yr	10-yr	15-yr	20-yr
Shares	Australia	-2.2%	-9.3%	-3.7%	-1.0%	7.7%	5.8%	9.4%	9.0%	8.6%	8.3%
	Australia – small cap	-0.4%	-10.3%	-8.0%	-1.6%	10.4%	7.1%	4.8%	7.8%	5.8%	5.7%
	World ex Australia	-2.0%	-7.1%	2.1%	3.9%	8.2%	11.7%	16.0%	9.7%	7.1%	4.2%
	World ex Australia (Hedged)	1.2%	-5.0%	-0.2%	1.9%	9.3%	9.8%	13.8%	13.3%	9.2%	N/A
	Emerging Markets	1.1%	-6.4%	-6.6%	-5.5%	9.1%	6.6%	8.6%	7.9%	8.5%	N/A
	Global Infrastructure (Hedged)	2.7%	1.0%	4.6%	0.4%	9.3%	9.9%	12.3%	13.2%	N/A	N/A
Property	Australian Property	-0.4%	-5.2%	0.4%	1.4%	8.0%	11.6%	13.6%	9.0%	5.7%	N/A
	Global Property	1.1%	-2.3%	9.0%	5.2%	5.2%	12.5%	13.9%	10.3%	N/A	N/A
Fixed income	Australia government bonds	0.3%	0.3%	1.8%	2.4%	3.2%	4.5%	4.4%	5.0%	5.7%	5.6%
	Australia corporate bonds	0.1%	0.4%	1.8%	2.8%	4.0%	4.7%	5.3%	6.0%	6.1%	6.0%
	Australia floating rate bonds	0.1%	0.5%	1.3%	2.4%	3.0%	3.1%	3.8%	4.5%	4.8%	N/A
	Global government bonds (Hedged)	0.6%	0.3%	0.6%	1.3%	3.0%	4.6%	5.2%	6.0%	6.6%	N/A
	Global corporate bonds (Hedged)	-0.3%	-1.4%	-0.7%	-1.7%	3.5%	4.6%	6.1%	8.4%	6.8%	N/A
	Global high yield bonds (Hedged)	-0.9%	-0.9%	-0.7%	-1.7%	6.8%	5.9%	9.0%	14.7%	9.7%	N/A
	Emerging Market bonds (Hedged)	-0.6%	-1.3%	-2.2%	-6.1%	4.3%	5.5%	6.3%	10.7%	8.9%	10.7%
Cash	S&P/ASX Bank Bill Index	0.2%	0.5%	1.0%	1.9%	1.9%	2.2%	2.5%	3.1%	N/A	N/A

Source: Bloomberg, IOOF

* AUD total returns as at November 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.

Appendix – Index sources

Asset class	Index
Australia	S&P/ASX 200 Accumulation 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
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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