Our view
Researchupdate

Australian Monthly Wrap

October 2018 Economic Wrap

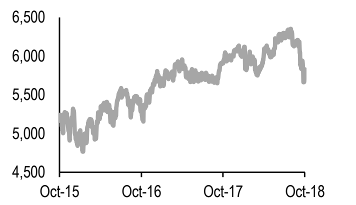
Summary - In a nutshell, both leading and hard economic data point to resilience in the US economy. Global economic momentum has slowed over the course of this year, led by weakness in China and Europe. Business sentiment has been weighed down by the uncertainty surrounding tariffs and trade policy with 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 September marking a ninth straight month while unemployment has fallen to 5%. However, in Australia, inflation remains weak, falling to 1.9% per annum and housing price weakness continues.

Markets - The month of October was marked by continuing US Dollar (USD) appreciation as investors sought a safe haven (with the yen also rising) while the Australian dollar fell in line with the general “risk off” sentiment of markets. 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 December. Emerging market equities continued to slide (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 flat relative to value stocks over the month (see chart 3) even as market darlings such as Wisetech Global and Appen corrected more sharply in line with their peers in the US.

Key economic news – The Reserve Bank of Australia left the cash rate on hold at 1.50% as expected. October marked further contraction in house prices in Australia with a fall of 0.5% over the month according to the latest CoreLogic data. The weakness remained focused in Sydney and Melbourne, down 0.7% each over the month. CPI data was below target and slightly under consensus estimates which points to interest rates continuing to remain on hold for the foreseeable future. US economic growth for the September quarter at 3.5% annualised beat expectations with the key contributor being the strength in consumer spending while core PCE remained at the 2% level (The Fed’s preferred target inflation rate).

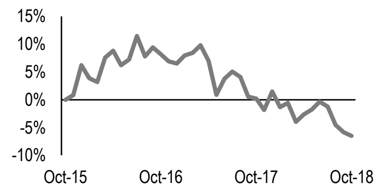
Key company news – Gold miners rallied strongly after a difficult year to date with Saracen (ASX: SAR) and St Barbara (ASX: STM) benefitting from the uptick in market volatility. Leading tech companies Appen (ASX: APX), Wisetech Global (ASX: WTC) and Afterpay (ASX: APT) fell in line with the broader sell-off in technology and other expensive (on a valuation basis) stocks globally. Stock specific news was also a highlight with Lynas (ASX: LYC) recovering some of the damage that occurred during September as subsequent government actions reduced investor fears of a complete shutdown of its Malaysian operations while Navitas (ASX: NVT) benefitted from a take-over bid led by BGH Capital, the same firm taking a tilt at Healthscope (ASX: HSO) currently.

1. S&P/ASX 200 Price Index



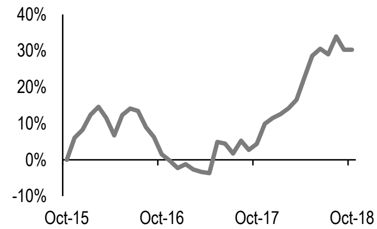
Source: Bloomberg, IOOF

2. ASX200 vs All-World, US$ terms



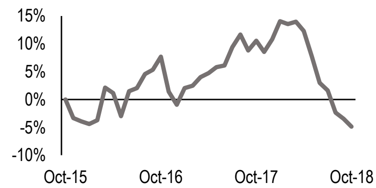
Source: Bloomberg, IOOF

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)				Best and Worst S&P/ASX 200 Performers			
	Monthly	**%∆**	**Quarterly**	**%∆**	**Top five stocks**		**Bottom five stocks**	
▼	Consumer Discretionary	-9.14	Consumer Discretionary	-11.01	**Monthly**			
▼	Consumer Staples	-6.61	Consumer Staples	-8.11	Saracen Mineral Hldgs Ltd	+31.4%	Corporate Travel Mgmt	-34.3%
▼	Energy	-13.00	Energy	-11.40	Lynas Corp Ltd	+30.4%	Syrah Resources Ltd	-30.4%
▼	Financials ex Property	-8.21	Financials ex Property	-11.33	St Barbara Ltd	+19.2%	Afterpay Touch Grp Ltd	-30.4%
▼	Financials	-8.22	Financials	-11.32	Regis Resources Ltd	+13.4%	Bellamy's Australia Ltd	-29.3%
▼	Health Care	-9.61	Health Care	-8.37	Navitas Ltd	+13.4%	Domain Holdings Aust	-29.1%
▼	Industrials	-7.02	Industrials	-7.06	**Quarterly**			
▼	IT	-13.76	IT	-4.10	Vocus Group Ltd	+42.3%	Syrah Resources Ltd	-46.8%
▼	Materials	-6.96	Materials	-9.50	Washington H. Soul Patt	+32.4%	Speedcast International	-41.9%
▼	Property Trusts	-3.29	Property Trusts	-2.97	Saracen Mineral Hldgs Ltd	+30.7%	Estia Health Ltd	-36.6%
▼	Telecommunications	-6.68	Telecommunications	6.00	Bravura Solutions Ltd	+29.0%	Pact Group Holdings Ltd	-35.5%
▼	Utilities	-5.46	Utilities	-9.51	TPG Telecom Ltd	+24.5%	Bellamy's Australia Ltd	-34.3%

Source: Bloomberg, IOOF

Equity review

Major Market Performance, October 2018

	Australian Indices	Oct-18 Price	1M return (%)	Jul-18 Price	3M return (%)
▼	S&P/ASX 200	5715	-7.93	6280	-8.99
▼	All Ordinaries	5799	-8.33	6366	-8.91
▼	Small Ordinaries	2535	-11.46	2829	-10.37
	US Indices				
▼	S&P 500	2641	-9.36	2816	-6.22
▼	Dow Jones	24443	-7.62	25415	-3.83
▼	Nasdaq	7050	-12.38	7672	-8.10
	Asia Pacific Indices				
▼	Hang Seng	24812	-10.71	28583	-13.19
▼	Nikkei 225	21048	-12.74	22554	-6.66
	UK & Europe Indices				
▼	FTSE 100	7026	-6.44	7749	-9.32
▼	CAC40	4989	-9.18	5511	-9.47
▼	DAX Index	11335	-7.44	12806	-11.48

Source: Bloomberg, IOOF

US equity market

The S&P 500 index finished the month down 9.4% while the tech-heavy Nasdaq was down 12.4%. The market performance was negative across most sectors with Utilities (up 1.9%) and Consumer staples (up 2.1%) the sole exceptions. Sell-off triggers included the aggressive stance taken by Federal Reserve officials including Chairman Powell that point towards more interest rate hikes potentially being necessary if the neutral rate (a theoretical target rate) is higher than had been previously estimated. In addition, sector leaders such as technology which have had a stellar run of earnings growth have seen expectations pared down to closer to market averages, triggering concerns of peak corporate profitability in the US. This saw technology stocks perform poorly with Amazon for example down 20.2%. Energy stocks were the second worst performers (down 11.3%) off the back of increased leniency on Iranian oil sanctions well as concerns that trade tensions were weakening Chinese oil demand, the combination of increased supply and weaker demand seeing prices fall.

Australian equity market

The S&P/ASX 200 index finished the month down 6.1%. All sectors experienced negative performance with Consumer Staples (down 4.8%), Utilities (down 4%) and Real Estate (down 3.8%) faring the best. Weakness was concentrated in technology (down 11.3%) and energy sectors (down 10.5%). The selloff in technology names such as Wisetech and Afterpay was in line with valuation concerns for technology stocks globally in a period of rising interest rates (higher rates today imply a lower premium for future growth). Energy shares fell in line with the weakness in oil prices globally as discussed above.

Fixed Income

	Fixed Income	Oct-18 yield	1M mvt (bps)	Jul-18 yield	3M mvt (bps)
	Aussie Cash rate	1.50	--	1.50	--
▼	10-year Bond Rate	2.58	-0.09	2.65	-0.07
▼	3-year Bond Rate	1.98	-0.07	2.08	-0.11
▼	90 Day Bank Accepted Bills SFE-Day	1.92	-0.01	1.9632	-0.04
▲	US 10-year Bond Rate	3.09	0.03	2.96	0.13
▼	US 3-year Bond Rate	2.87	-0.01	2.77	0.11

Source: Bloomberg, IOOF

During the month of October, the Australian yield curve fell unevenly with long term rates declining slightly more than short term rates. The Australian 3-year bond yield fell 7bps and the 10-year bond yield fell 9bps. The U.S. yield curve steepened with shorter rates such as the 3-year yield declining 1bp and the 10-year yield, rising by 3bps.

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 yields fall over the month. In addition, we saw data prints disappoint such as inflation data being below expectations. This pushes out the case for RBA interest rate hikes.

Closing US yields particularly for the 10-year belie the intra-month volatility with the 10-year reaching a peak of 3.23% earlier in the month (a 15-bps rise) before subsiding. Triggers for the 10-year movement include the fears of more US rate hikes with the market still discounting next year's Fed forecast of 3 rate hikes (leaving scope for yields to adjust further upwards should the Fed follow through with its plans). Yields subsided after this initial peak on the back of safe haven demand with the sell-off in equities attracting investors to the relative safety of bonds. In addition, some weakness evident in the latest US GDP data for both home construction and business investment added to the case for a slower pace of rate hikes.

Currencies

	Currencies	Oct-18 Price	1M return (%)	Jul-18 Price	3M return (%)
▼	$A vs $US	70.68	-2.16	74.24	-4.81
▼	$A vs GBP	55.21	-0.42	56.57	-2.40
▼	$A vs YEN	79.47	-3.24	83.02	-4.27
▼	$A vs EUR	62.13	-0.18	63.51	-2.17
▼	$A vs $NZ	108.23	-0.80	108.91	-0.63
▲	$US vs EUR	87.91	2.02	85.54	2.77
▲	$US vs GBP	78.12	1.77	76.19	2.52
▲	$US vs CHF	100.20	2.07	99.03	1.18

Source: Bloomberg, IOOF

The Australian dollar (AUD) depreciated against major global currencies in August dropping to USD 0.7068 on the back of "risk off" sentiment.

The Australian dollar was boosted intra-month by the strong labour force report showing the unemployment rate had fallen to 5%. It was subsequently weighed down by the prevailing "risk off" sentiment surrounding risk assets such as equities which saw other safe haven currencies such as the Japanese Yen also rally. The US Dollar (USD) traded up over the month benefitting from safe haven demand with the prospect of higher interest rates also attracting investors.

Commodities

	Commodities	Oct-18 Price	1M return (%)	Jul-18 Price	3M return (%)
▼	Aluminium	1976	-4.51	2085	-5.22
▼	Copper	271	-3.35	285	-4.98
▼	Nickel	11700	-6.85	14055	-16.76
▲	Gold	1232	2.98	1234	-0.14
▼	Silver	15	-1.44	16	-7.40
▼	Crude Oil - Brent	77	-7.22	74	3.37
▼	Lead	1953	-4.01	2156	-9.43
▲	Zinc	2676	1.11	2623	2.00
▲	Iron Ore	72.58	5.60	64.35	12.79

Source: Bloomberg, IOOF

Commodity prices fell over the month of October with gold, zinc and iron ore the 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 deployed between the US and China (which are set to increase further in the new year). Concerns over US stockpile builds for a sixth consecutive week (pointing to rising oil inventory) and leniency on the implementation of sanctions against Iran weighed on oil prices.

Iron ore prices benefited from increased Chinese steel mill production as these firms increased scale ahead of upcoming anti-pollutions restrictions by the Chinese government. This helped boost demand for iron ore, the key raw material in steel production. Gold prices recovered slightly on the back of volatility in equity markets (but were still flat over the last three months).

Australia

Summary – Rates on hold with low CPI growth continuing the "lower for longer" theme. Weaker retail trade numbers during September quarter slightly offset by continued trade surpluses to paint a mixed picture for Sep-18 economic growth. Housing prices continue to fall notably in Sydney and Melbourne due to a mix of tighter financing and increased supply.

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 October meeting point towards a positive reading of economic data including strong growth driven by government spending, resource exports and steady consumption growth. While it struck an optimistic tone on labour demand—strong level of job vacancies relative to size of workforce as eroding labour market slack in time and driving wages growth—the RBA did note the uncertainty regarding household income growth and the potential risk this poses to ongoing consumption and inflation.

The unemployment rate surprised with a fall of 0.3% from August to 5% (consensus: 5.3%) in September. Employment growth disappointed with total employed persons rising by 5.6k (consensus: +15k) continuing its up-down trend in recent times shifting between growing and falling total jobs growth. The bulk of this increase came in full-time jobs with 20.3k growth offset by notable weakness with the loss of 14.7k 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 1.5% in the year to September overtaking part-time jobs growth of 1.4% 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 currently sitting above the growth rate of the working age population. The main driver of the decline in the unemployment rate was the reduction in people seeking work with the participation rate falling from 65.7% in August to 65.4% in September. If this had been flat over the two months, the unemployment rate would have risen in line with weaker jobs growth to 5.4% but instead stayed constant as fewer people seeking work were included in the sample. In addition, the underemployment rate has fallen slightly to 8.3%, a range it has tracked within since 2014 which is elevated above the 20-year average. If this continues to erode, consistent with our prior reports and RBA forecasts referred to above, we expect this to be a tailwind for wage growth.

CPI data was released for the September quarter which showed a 0.4% rise (consensus: 0.5%) during the quarter and a 1.9% annual increase. This is consistent with earlier RBA forecasts in August for a slowdown in inflation as the introduction of the Child Care Subsidy helped drive child care inflation lower by 11.8% with the category, household equipment and furnishings, also declining by 1.2%. Underlying inflation was 1.75% continuing its weakness in recent years below the RBA target band and delaying the case for interest rate hikes (currently priced for early 2020 in market futures).

Retail sales grew 0.2% (consensus: 0.3%) over the month of September. On a monthly basis, most categories were flat compared with growth during August with the notable exception of food and eating up (up 0.4% and 0.5% respectively). Real retail sales—i.e. sales excluding inflation—grew 0.2% (consensus: 0.4%) during the September quarter. The quarterly view is a longer term one that strips out inflationary effects with dining out again a strong contributor (up 1.2%) but offset by weakness across other categories with food sales (a major contributor) flat in real terms. This data may see some weakness in consumer spending for September economic growth as raised in previous updates discussing the surprising strength of consumer spending in the context of low wages growth.

A surplus of $3.017bn was recorded in September (consensus: $1.7bn) above analyst expectations and the strongest result since February 2017. This points to a stronger than expected contribution to economic growth from net exports during the September quarter. The key drivers were an increase in exports prices relative to weaker growth in import prices with iron ore and LNG prices the main commodities underpinning the result. Overall the contribution by commodities to the trade surplus was reflective of higher export prices offset weaker volumes. Net exports data for GDP purposes may only contribute slightly to economic growth because of the volumes weakness (GDP data is reported on a volume basis, holding prices stable).

United States

Strong domestic economy continues to justify case for interest rate hikes with fears of more to come. Business confidence hurt somewhat by ongoing uncertainty surrounding global trade but not yet weighing on the economic picture overall although pockets of weakness in business investment and housing are emerging.

President Trump reiterated his rhetoric over the course of the year to continue down the path of further tariffs on China potentially targeting up to $267bn-worth of Chinese imports which would, in addition to tariffs already in place, account for the full swathe of imports from China. This was latched on as part of the case for the equity sell off with market sentiment jittery in response to the combination of potential negative factors.

The US economy grew at a 3.5% annualised rate in the third quarter (consensus: 3.4%) driven by strength in consumer spending which accounts for the majority of economic output and grew 4%. There were pockets of weakness however with business investment flat for the quarter while sales in new homes fell 5.5% in September and in existing homes sales down 3.4% as well.

US inflation numbers for the month of September were released with headline inflation rising 0.1% over the month (consensus: 0.2%) and 2.3% annually, slightly below expectations and down from 2.7% annual growth recorded in August. Underlying inflation measures such as the core CPI which excludes food and energy inflation rose 0.1% for the month (consensus: 0.2%) while the Federal Reserve's preferred inflation measure, the PCE price index, rose

2% in the year to August, in line with the policy target of 2%. These levels are seen as consistent with the Fed raising interest rates again in December this year by 0.25% to 2.5% overall.

Manufacturing conditions lifted slightly with the Markit Manufacturing PMI rising from its September reading of 55.6 to 55.7 in October, a five-month high. The main drivers were a pickup in new business domestically while new export orders grew at a weaker pace reflecting the impact of the rising US dollar and trade tariffs. The pickup in new business translated into another rise in backlogs (i.e. a larger future pipeline of work) while employment growth continued with input price inflation continuing due to stronger wage growth and higher raw material prices, the latter due to the ongoing effects of tariffs. To date these rising cost pressures have only partly been passed on to clients but may point to rising inflationary pressures going forward in the broader US economy.

The Markit Services PMI for October was 54.8 rising by 1.3 points from its September reading of 53.5. 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. New business increased sharply thanks to better demand conditions and new product launches with backlogs of work rising further. Business confidence also rose to a five-month high offsetting a slight fall in the pace of job creation due to the difficulty in finding suitable candidates. Taken together the positive manufacturing and services readings saw the overall composite index rise to 54.9 in October from 53.9 in September, a rate consistent with economic growth of around 2.5%, representing a strong start to the fourth quarter. This growth rate while lower than the 3.5% recorded for the year to September is still elevated compared to the post-GFC average growth rate. The slowdown is more a reflection of the one-off stimulus in tax reform gradually fading in the economic data released going forward as well as the weakness in pockets of the economy including export orders as noted in the PMI surveys.

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.

The Chinese economy grew 6.5% annually in the year to September (consensus: 6.6%), its weakest growth rate since the global financial crisis. The slowdown had been anticipated with the impact of the trade war weighing on export orders and business confidence. This has been coupled with efforts to deleverage the Chinese economy by policymakers by constraining credit growth. Efforts to combat the slow down by cutting bank reserve requirements and a possible corporate tax cut will take time to flow through the economy. Rhetoric on trade continued over the month with no new tariffs being levied but threats of more to come prompted a tit-for-tat response by the Chinese government.

Chinese industrial production expanded by 5.8% year-on-year in September (consensus: 6%) below market expectations while conversely, fixed-asset investment growth rose to 5.4% per annum (consensus: 5.3%). Retail sales also surprised growing at 9.2% per annum (consensus: 9%). These on balance highlighted some improvement with weakness still evident in industrial production further confirmed by Markit survey data discussed below. This has prompted calls for further stimulus within China with the government still focused on de-leveraging within the non-bank lending space while allowing traditional banks to expand credit.

The Markit manufacturing PMI for October rose only slightly from 50.0 in September to 50.1 in October pointing to broadly unchanged operating conditions. This remains near contractionary territory (a reading of below 50 signals shrinking business activity) but given the stimulatory fiscal policy some recovery may arise with more being done on this front as discussed above. While new business orders improved slightly, new export orders fell for the seventh consecutive month with employment indices also poor as companies continue the job shedding process that has been underway in recent years. Sentiment remains weak, hitting an 11-month low, with producers concerned over the overall subdued market conditions and the impact of the ongoing trade dispute with the US.

Services activity added to the decline falling from 53.1 in September to 50.8 in October contributing to the overall China Composite decline from 52.1 in September to 50.5 in October. The weakness in services was driven by relatively subdued demand conditions as well as the first stagnation of new business for almost 10 years. 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. Stronger than expected growth in the UK has been offset by broader EU economic weakness with the prospect of a standoff over the Italian budget also weighing on the outlook for the Eurozone.

The European Central Bank (ECB) left interest rates on hold in its September meeting in line with previous guidance that rate hikes would be deferred until at least July 2019. The ECB also began to reduce the extent of its quantitative easing (bond purchasing) program with purchases falling from €30bn per month to €15bn per month ahead of the program's conclusion next year. Italy remains a point of potential concern within the Union as the coalition government is at odds with the European Commission over its fiscal policy stance and its decision to run a deficit of 2.4% of GDP to stimulate economic growth. The Commission has stated that after factoring in the new policies being included the deficit for 2019 will be 2.9%, close to the EU threshold of 3% and may attract penalties if it is not changed. This remains a factor to watch with markets pricing in greater risk (higher yields) for Italian government debt relative to other European countries.

The Markit Eurozone Composite PMI fell during October, down to 53.1 from its reading of 54.1 in September. A decline in services activity, falling from 54.7 in September to 53.7 in October, added to weakness in the manufacturing industry which fell from 53.2 to 52 over the same period. The decline in the manufacturing sector print was broad-based with a net fall in new work the first recorded since November 2014, driven by a decline in new export orders for the first time since 2013. Given the decline in both backlogs of work (i.e. the pipeline for future work is lower) and low business expectations there is a risk for the manufacturing sector to slide into contractionary territory.

The services industry saw its slowest expansion since early 2017 with some positives, for example, the backlogs of work over recent years has prompted continued growth in employment while input costs have ticked up including higher wages with firms passing these on to customers to protect margins. Business confidence has softened further as political concerns weigh on sentiment with Italy a notable example slipping into contractionary territory with an almost 5-year low reading of 49.3 overall.

Consistent with the weakening PMI prints during the September quarter, economic growth in the Eurozone also slowed to 0.2% for the quarter (consensus: 0.4%) and 1.7% for the year to September. The weakness was driven by poor performance in Italy where the growth rate fell to 0% offset by stronger French growth of 0.4% for the quarter. Given the overall weakness it is likely that German growth also slowed (German data is released later in November). These point to difficult policy challenges ahead for the ECB in normalising interest rates and, more broadly speaking for European governments, to be proactive in stimulating growth. This is a difficult policy challenge given fiscal constraints in the form of Maastricht treaty (annual deficits cannot exceed 3% of GDP) but may need to be considered if growth continues to weaken further.

The Bank of England left monetary policy on hold at 0.75% following a rate hike in August this year. The outlook for the UK remains obscured at the lack of resolution for a final deal to determine the UK exit from the European Union. This comes as the UK economy grew 0.6% (consensus: 0.6%) in the September quarter thanks to strong performance in July from manufacturing and construction sectors with momentum weakening in recent months. Negotiations for "Brexit" remain uncertain as Prime Minister Theresa May's proposed plans face opposition from within and outside her Conservative party. The latest concerns revolve around the exact nature of a post-Brexit trade relationship with the EU as well as reciprocating commitments on social and environmental protections to ensure UK industry cannot undercut EU businesses. A final deal with the EU if it is reached will still require parliamentary approval before the final deadline at 29 March 2019 next year which is another point of uncertainty given the opposition of the Labour party to a UK exit as well as internal opposition within the Conservatives. We continue to watch this space for signs of further risk or progress in the months ahead.

Emerging Markets

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

Brazil welcomed a new President with far-right ex-army candidate Jair Bolsonaro winning the presidential election. He is the country's first right-wing president since the end of the military dictatorship in the mid-1980s. The move was made by voters following a long-running saga of corruption by the ruling left-wing Workers' Party and the loss of their preferred candidate in ex-president Lula who was imprisoned on corruption charges ahead of the election. Observers are cautious as to the progress that can made for the Brazilian economy given the fractured legislature made up of dozens of small political parties that will need to be grouped together into a workable coalition for progress to be made. Bolsonaro is viewed as pro-business and likely to deregulate. Brazilian equities rose 17.8% in USD terms for October defying corrections in other share markets in response to his election win.

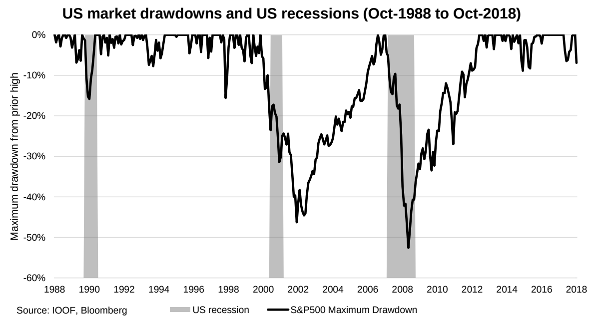
Actionable insights

Portfolio volatility and risk management

As discussed above on page 2, October was a tumultuous month for equity markets. In terms of what can be done in these situations, there are two aspects, first, considering the macroeconomic backdrop and second, considering the degree you want to manage risk within the portfolio.

On the first point, one key reason we care about macroeconomics is the strong relationship between share market losses and economic recessions as seen in chart 5. We consider the macroeconomic backdrop to highlight the level of recession risk we face both globally and domestically and whether we require portfolio readjustment as a result.

5. US market drawdowns and recessions (Oct-88 to Oct-18)



On the second point of risk management we have considered this in two ways.

First for direct equities as communicated on 12 October, we used a variable cash balance to dial down our market exposure during the month (by upping the cash weighting) and achieve a lower portfolio volatility as a result. These actions reduced losses relative to the market even given our greater active weight to healthcare which was down 9.6% vs the market being down 7.9%. Also on direct equities we reduced exposure to stocks with lower expected returns.

Second for the portfolios as telegraphed earlier we have made new additions to both the master APL and individual Dealer Group APLs. These include a viable alternative manager in GMO and a defensively-placed, sovereign bond manager in Colchester. Both additions will enable us to be more proactive in managing equity risk exposure for the portfolios going forward. They also potentially allow for us to reduce drawdowns through tilts to more defensive positioning consistent with client risk profile constraints.

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

In summary, October was marked by a broad-based sell-off in global equities with Australian, Developed and Emerging markets all falling over the month as can be seen on page 10. A combination of factors was responsible including the increased hawkish (i.e. interest rate increasing) tone taken by the Federal Reserve and its Board Members as well as concerns of peak profitability for leading US firms, the idea being that corporate profit margins are set to fall on the back of a strong US Dollar (which hurts exporter earnings) and a late-cycle US economy. On this latter point disappointing data on housing starts for example was seen as a potential leading indicator of economic weakness going forward.

In this context, gold appeared as a safe haven with ASX-listed gold miners amongst the best performers such as **Saracen Mineral Holdings Ltd (SAR)**, **St Barbara Ltd (SBM)** and **Regis Resources Ltd (RRL)**. Saracen and St Barbara benefitted from the general market turmoil while Regis Resources was rewarded by investors for record after tax profits and gold production in the Sep-18 quarter ahead of FY19 guidance.

Lynas Corp Ltd (LYC) benefitted from the reversal of some stock-specific bad news received in September. As noted in the previous economic wrap the company saw its share price tumble at the prospect of a biased government review of its Malaysian rare earth metals refining operation. Over October, the Malaysian government has addressed some of these concerns with one of the more outspoken Lynas critics who was to sit on the panel stepping down from their position while another key approval for Lynas in storing residue from its business was given a temporary extension.

Navitas Ltd (NVT) shares rose over the month on an initial takeover bid by the BGH Consortium of BGH Capital, AustralianSuper and Navitas director and former CEO Rodney Jones to take the company private at a 26% premium to the closing share price on 9 October with a $5.50 cash bid. The share price trailed following the announcement as the odds of it becoming successful were lowered with the board stating to the market that the transaction did not reflect the full value of the company.

Corporate Travel Management Ltd (CTD) sank after holding up comparatively well during the month on the back of a shorting expose by fund manager VGI Partners (ASX: VG1). The VGI Partners piece echoed a similar exercise earlier in the year that saw Blue Sky (ASX: BLA) shares tumble on the back of allegations of misreporting and cheating investors by short-seller firm Glaucus. In the Corporate Travel case, VGI raised concerns over the quality of the company's earnings as well as its overseas operations pointing out the skeleton offices in numerous spots around the world. This saw the company attempt to halt the damage with a detailed rebuttal piece disclosed on the ASX but the shares were still sold off, falling 27.5% on 31 October.

Syrah Resources (SYR) shares suffered over October following a fire at its Balama Graphite Operation that, while rectified, led to key machinery being permanently impaired and requiring replacement. This delayed the production process with full production only scheduled for mid-November leading Syrah to downgrade its Q4 guidance by 30kt to 30-35kt. This saw the shares punished by investors with the ongoing market turmoil for materials stocks (one of the weaker performing sectors) adding to the correction in share price.

Afterpay Touch Group Ltd (APT) was one of several technology stocks that were sold off during the month. This group which includes the likes of Wisetech (ASX: WTC) and Appen (ASX: APX) were notable for their high valuations coming into the month as investors had chased these stocks on a mix of positive momentum and strong earnings growth. A similar theme has been observed elsewhere including the US where technology stocks were sold off on fears of peak profitability. Afterpay as one of these companies which is yet to produce consistent earnings is more valued on its potential future growth which left it more vulnerable to a broader market sell-off as transpired during October.

Source: ASX company announcements, Bloomberg

Movers and Shakers for October 2018

ASX Code	Company Name	Closing price ($)	Month ago, close ($)	Month Δ (%)	Quarter ago close ($)	Quarter Δ (%)	Year ago, close ($)	Year Δ (%)
SAR	Saracen Mineral Holdings Ltd	2.45	1.87	31.4	1.88	30.7	1.46	68.4
LYC	Lynas Corp Ltd	2.08	1.60	30.4	2.27	-8.4	1.80	15.6
SBM	St Barbara Ltd	4.16	3.49	19.2	4.12	1.0	2.90	43.4
RRL	Regis Resources Ltd	4.22	3.72	13.4	4.46	-5.4	3.89	8.5
NVT	Navitas Ltd	5.07	4.47	13.4	4.30	17.9	4.77	6.3
EVN	Evolution Mining Ltd	2.98	2.65	12.5	2.79	6.8	2.36	26.3
MYO	MYOB Group Ltd	3.37	3.02	11.6	3.13	7.7	3.75	-10.1
SOL	Washington H. Soul Pattinson	28.88	25.96	11.2	21.82	32.4	16.71	72.8
SCP	Shopping Centres Australasia	2.57	2.40	7.1	2.40	7.1	2.35	9.4
NCM	Newcrest Mining Ltd	20.61	19.41	6.2	21.63	-4.7	22.41	-8.0

Source: Bloomberg, IOOF

ASX Code	Company Name	Closing price ($)	Month ago close ($)	Month Δ (%)	Quarter ago close ($)	Quarter Δ (%)	Year ago close ($)	Year Δ (%)
CTD	Corporate Travel Management	20.05	30.53	-34.3	28.69	-30.1	24.04	-16.6
SYR	Syrah Resources Ltd	1.60	2.30	-30.4	3.01	-46.8	3.37	-52.5
APT	Afterpay Touch Group Ltd	12.49	17.95	-30.4	14.18	-11.9	5.20	140.2
BAL	Bellamy's Australia Ltd	7.23	10.23	-29.3	11.00	-34.3	12.04	-40.0
DHG	Domain Holdings Australia Ltd	2.48	3.50	-29.1	3.18	-22.0	N/A	N/A
WTC	Wisetech Global Ltd	16.05	22.09	-27.3	15.25	5.2	11.67	37.5
NEC	Nine Entertainment Co Holdings	1.69	2.26	-25.2	2.24	-24.6	1.50	12.7
WOR	WorleyParsons Ltd	14.59	19.37	-24.7	17.43	-16.3	13.29	9.8
BIN	Bingo Industries Ltd	2.39	3.14	-23.9	2.68	-11.0	1.94	23.0
APX	Appen Ltd	10.64	13.97	-23.8	10.86	-2.0	5.40	97.0

Source: Bloomberg, IOOF

Long-term asset class performance to October 2018 (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	-6.1%	-5.9%	-0.4%	2.9%	8.2%	6.0%	9.2%	8.5%	8.6%	8.7%
	World ex Australia	-5.2%	-0.7%	4.5%	9.8%	8.3%	13.4%	16.5%	9.4%	7.2%	4.6%
	World ex Australia (Hedged)	-6.9%	-4.7%	0.0%	2.4%	9.2%	10.1%	13.5%	12.5%	9.2%	N/A
	Emerging Markets	-6.8%	-7.3%	-11.1%	-5.4%	6.8%	6.8%	7.9%	7.1%	8.4%	N/A
Property	Australian Property	-3.1%	-2.2%	4.0%	7.3%	7.1%	11.1%	14.1%	9.1%	5.9%	N/A
	Global Property	-0.3%	1.6%	9.0%	8.5%	3.8%	12.0%	13.7%	8.3%	N/A	N/A
Fixed income	Australia government bonds	0.5%	0.8%	2.3%	3.1%	2.8%	4.4%	4.7%	5.3%	5.6%	5.5%
	Australia corporate bonds	0.5%	1.1%	2.2%	3.4%	3.8%	4.7%	5.5%	6.2%	6.1%	6.0%
	Australia floating rate bonds	0.2%	0.7%	1.4%	2.5%	3.0%	3.2%	3.9%	4.5%	4.8%	N/A
	Global government bonds (Hedged)	0.2%	-0.1%	0.3%	1.1%	2.9%	4.5%	5.2%	6.3%	6.6%	N/A
	Global corporate bonds (Hedged)	-0.7%	-0.5%	0.1%	-1.3%	3.8%	4.8%	5.9%	8.7%	6.9%	N/A
	Global high yield bonds (Hedged)	-1.5%	-1.0%	-0.7%	-1.2%	6.8%	6.2%	8.8%	14.0%	9.8%	N/A
	Emerging Market bonds (Hedged)	-2.4%	-2.7%	-2.5%	-5.4%	4.5%	5.2%	6.3%	11.2%	9.1%	11.0%
Cash	S&P/ASX Bank Bill Index	0.2%	0.5%	1.0%	1.9%	1.9%	2.2%	2.6%	3.1%	N/A	N/A

Source: Bloomberg, IOOF

* AUD total returns as at October 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
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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