

FROM THE AUSTRALIAN EQUITIES DESK

Market Commentary

The S&P/ASX 200 Accumulation Index rose 1.4% during the month. The Australian equities market underperformed global equity markets in July led by a fall in resources. Developed markets outperformed emerging markets for the fourth consecutive month. In major global developed markets, returns rebounded in July led by the Euro Stoxx 50 and US S&P 500 which returned 3.9% and 3.7% respectively. The UK's FTSE 100 returned 1.5% and Japan's Nikkei 255 ended the month up 1.1%.

During the month, the Reserve Bank of Australia (RBA) maintained the cash rate at 1.50%. The RBA continues to maintain its view on the economy with global growth strengthening and global inflation remaining low.

Domestic economic data releases were generally better than expected in July. 2Q CPI came in at 0.4% q/q with fuel price rising markedly at 7% q/q. Employment surged in June with 51,000 positions added. Meanwhile the unemployment rate was steady at 5.4%. The NAB Survey of Business Conditions rose to +15 in June (previous +14), while business confidence fell to +6 from +7. Retail sales rose a higher than expected 0.4%. Building approvals surged 6.4% in June, far outpacing the consensus of 1.0%.

In stock specific news, BHP Billiton shares rose 2.3% following its announcement of the long-awaited sale of its onshore US oil and gas assets for USD 10.8 billion. Meanwhile Macquarie Group's CEO Nicholas Moore announced he is to retire and will be replaced by Ms. Shemara Wikramanayake.

Sector returns were mostly positive in July. The best performing sectors were Telecommunications (7.9%) and Industrials (3.5%). Consumer Discretionary (2.1%), Health Care (2.1%), Financials (2.0%), Real Estate (1.0%) and Energy (0.9%) were also positive. Utilities (-1.4%) was the worst performing sector during the month, followed by Technology (-1.2%), Consumer Staples (-0.5%) and Materials (-0.1%).

The Telecommunications sector delivered its best monthly performance since January 2015. This was led by a rally in Telstra (8.4%) following the announcement that its new pricing was less aggressive than anticipated.

The Industrials sector outperformed the broader index largely driven by Brambles (11.3%), Qantas (10.0%) and Cimic Group (14.3%). Cimic performed strongly following its 1H18 results which highlighted a 10% increase in its construction business.

The Consumer Discretionary sector was buoyed by Aristocrat Leisure. Aristocrat performed well on the back of an industry survey that suggests the company continues to win market share in both the US and social/digital platforms.

The Consumer Staples sector underperformed driven largely by Woolworths (-1.4%), A2 Milk (-8.7%) and Bellamy's (-29.2%). The Technology sector underperformed the market. Key underperformers included Carsales.com (-7.8%), Xero Ltd (-4.9%) and Altium Ltd (-9.4%).

The Utilities sector was the biggest laggard, dragged down by a 6.9% drop in AGL's share price. This was following the release of the ACCC report on the electricity market which included a recommendation to re-regulate retail electricity prices.

Market Outlook

Global growth continues to show positive signs, confirming the debt deflation cycle is rolling over to a more traditional industrial cycle. Global PMI data has retracted slightly but continues to support the first synchronised global growth cycle seen in many years, and this is being reflected in strong earnings growth. However, geopolitical risks will continue to weigh on the market. The Trump initiated trade dispute is ongoing as the US continues to introduce new trade tariffs. In China, the 19th Party Congress has charted a course that involves less pollution, less reliance on property construction and further increases in the services sectors that should result in a more balanced economy. The expectation is that over the next five years, fixed asset investment will slow and GDP growth will move from around 6.5% to circa 5% as China's economy becomes consumption driven.

Our view is that the rotation towards cyclicals and value, albeit stalled, still has some way to go and should be driven by rising global inflation, and therefore earnings growth in the more economically-sensitive sectors. Comments from both the US Federal Reserve and European Central Bank suggest they are on a path of reducing their balance sheets. This is likely to put further upward pressure on bond yields, despite some central banks maintaining quantitative easing programs.

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