Monthly commentary - June 2017

Global equities went into reverse over June as our dollar moved higher at the same time as markets were looking for direction when many indices are at record highs. Losses were centered across Europe where the pan-European STOXX 600 index lost 2.7% for June, DAX shed 2.3% and the CAC 40 lost 3.1%. In London, the FTSE index lost 2.8%. Closer to home we saw the ASX 200 finish the Financial Year with a solid 14% total return.

Developments in the global economy

Australia

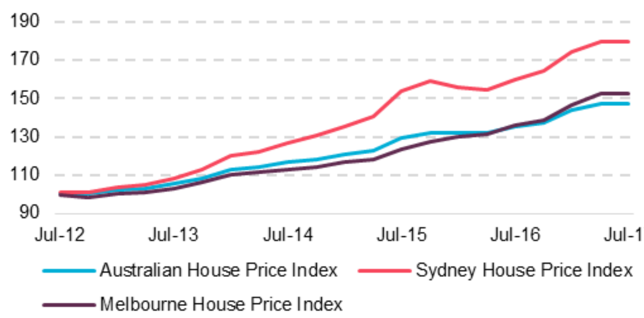
In Australia, the manufacturing and service sectors both enjoyed strong activity in June, with upbeat demand encouraging more hiring. The inaugural Commonwealth Bank/IHS Markit Purchasing Managers' Index (PMI) rose to a seasonally adjusted 56.2 in June, from 55.9 in May, still well in expansion territory.

The ANZ job advertisement series report indicated that demand for labour had grown in May, while Australia's first-quarter current account deficit narrowed to $3.1 billion, or 1.9% of GDP, which is the first deficit below 2% of GDP since 1980.

The Reserve Bank of Australia (RBA) held rates steady, while first quarter GDP growth came in at 0.3% for the quarter and 1.7% year-on-year, which was better than some economists expected. The May labour force data showed Australia's unemployment rate falling to 5.5% as another 42,200 jobs were created in May, easily beating consensus forecasts of a net 10,000 gain in jobs and an unemployment rate remaining steady at 5.7%. May was the eighth consecutive month of rising full-time employment, with the economy creating 124,000 full-time jobs since September 2016.

Data released in June by the Australian Bureau of Statistics showed that house price growth had started to cool, with house prices falling in the March quarter in Brisbane, Perth and Darwin, and apartment prices slipping in Melbourne, Adelaide, Perth and Darwin. The National Australia Bank May business survey indicated that business activity was running at above-average levels, even though business confidence had dropped back to average levels; while the Westpac Melbourne Institute's consumer survey indicated that households were less confident.

Chart 1: Australian House Prices – last 5 years (2011-2012=100)



Source: BTIS/Bloomberg

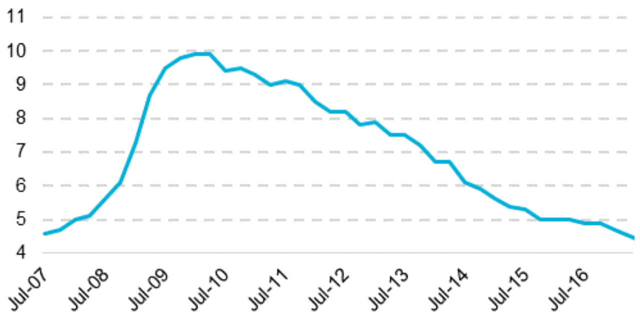
US

The US Federal Reserve raised interest rates for the second time this year, and set out plans to start cutting its US$4.5 trillion balance sheet. Investors also mulled over mixed US economic data in June. The third estimate released by the Bureau of Economic Analysis showed that real GDP increased at a 1.4% annual rate in the first quarter of 2017, a significant improvement over the second estimate of 1.2%, and the initial estimate of 0.9%.

Consumer spending, which accounts for two-thirds of US GDP, increased by 1.1%, exceeding the earlier estimate of a rise of 0.6%. Exports increased by 7%, improving over the earlier estimate of a rise of 5.8%. The ISM Manufacturing Index rebounded to hit 54.9 in May, and crucially, consumers remained upbeat with the Consumer Confidence Index rebounding to hit 118.9 in June after going backward in May.

But the May non-farm jobs report disappointed, with 138,000 fresh jobs reported, below expectations, and accompanied by 66,000 worth of downward revisions to the March and April figures.

Chart 2: US Unemployment Rate Seasonally Adjusted – last 10 years



Source: BTIS/Bloomberg

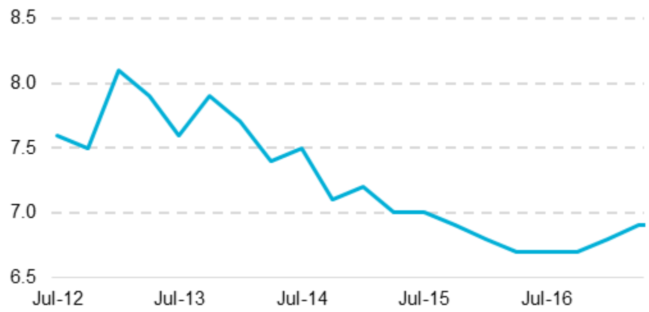
Asia

The monthly forward looking PMI figure showed China's manufacturing activity accelerated in June to 51.7, from May's 51.2 reading, helped by stronger foreign demand for Chinese goods. It was the 11th straight month of improvement in this figure. The separate non-manufacturing PMI rose to 54.9, leaving it at the second-highest level since May 2014.

Beijing continues to target economic growth of around 6.5% in 2017, compared with the 6.7% pace delivered in 2016, which was the slowest in 26 years. The economy grew at a robust 6.9% rate in the first quarter, and generally remained on solid footing in June.

Data showed that fixed-asset investment growth slowed to 8.6% in the first five months of the year, after 8.9% growth in January to April. According to the National Bureau of Statistics, the growth of private investment, which accounts for about 60% of overall investment in China, slowed slightly to 6.8% in the January to May period, from 6.9% in the first four months, suggesting a slight weakening of the private sector's appetite to invest as small and medium-sized private firms still face challenges in accessing financing.

Chart 3: China GDP Annualised – last 5 years



Source: BTIS/Bloomberg

Retail sales were more upbeat, rising by 10.7% in May from a year earlier, unchanged from April and ahead of analysts' expectations. But auto sales slowed in May, showing their first back-to-back drop since 2015 after the government rolled back a tax incentive that had boosted car sales and output last year.

MSCI announced in June that it would include Chinese domestic A-shares (shares that trade on the two Chinese stock exchanges) in its benchmark indices. This will come into effect in 2018.

In Japan, industrial production slipped 3.3% in May compared with April, a larger decline than economists forecast, while the jobless rate unexpectedly climbed. Japan's core consumer prices crept higher for a fifth straight month to 0.4% in May from a year earlier, but inflation remains far from the Bank of Japan's 2.0% target.

Europe

In Europe, anticipation of growing economic strength was slightly weakened in June as initial PMI figures from data compiler IHS Markit for June were, on first reading, quite subdued, with Germany's manufacturing and services sector, which accounts for more than two-thirds of its economy, slipping to a four-month low in June. Business activity in France also eased more than predicted in June as growth weakened in the country's services sector. On the back of these figures, Eurozone PMI growth slid to 55.7 in June, down from 56.8 in May (a reading above 50 indicates growth).

But factory activity rose to 57.3 in June from 56.8 in May. IHS Markit says the 19-nation Eurozone's manufacturing sector is enjoying its best period of health in more than six years, with the Eurozone economy growing by 0.6% in the first quarter, and unemployment at its lowest since 2009.

The PMI readings for both France and Germany hit six-year highs, while in Germany, the Munich-based Ifo Institute for Economic Research's index of business sentiment reached in June its most bullish level since the country's reunification in 1991.

Eurozone annual inflation dipped to 1.3% in June from 1.4% in May, but ECB President Draghi commented that the threat of deflation is over.

Developments in financial markets

Australian shares

The S&P/ASX 200 accumulation index managed a 0.2% rise over the month. Domestic real estate investment trusts (REITs) underperformed the broader share market, falling by almost 5% over the month. For the 2016-17 Financial Year, the Australian benchmark gained 9.3%, or 14.1% with dividends included.

Chart 4: ASX 200 – Year to 30th June

Source: BTIS/Bloomberg

International shares

A strong rotation out of tech stocks characterised June on the US stock markets, as investors finally took profits in the tech heavyweights and redeployed money into the likes of healthcare and banking stocks, which are benefiting from legislation proposed by the Trump Administration.

For the month, the Dow Jones Industrial Average gained 1.6% and the S&P 500 was up 0.5%, while the Nasdaq Composite index surrendered 0.9%. For the June quarter, the Dow Jones was up 3.3%, the S&P 500 2.6% and the Nasdaq 3.9%.

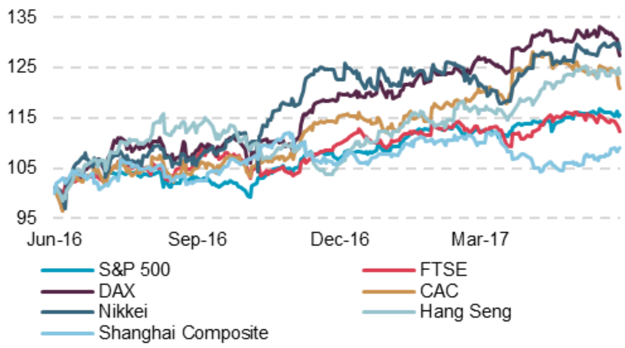
Share market volatility ticked up in June. After hitting an all-time low of 9.75 on June 2, the Chicago Board Options Exchange (CBOE) Volatility Index (VIX), which measures volatility in the stock market, surged 51% in a single day, on June 29. Over the month, the VIX appreciated by 7.4%.

In Europe, the pan-European STOXX 600 index lost 2.7% for June, as the DAX in Germany shed 2.3% and the CAC 40 in Paris lost 3.1%. In London, the FTSE index lost 2.8%.

In Asia, the Nikkei index in Tokyo advanced 2% in June, while the Hang Seng index in Hong Kong gained 0.4% and the Shanghai Composite Index added 2.4%, for its first monthly gain since February.

According to Thomson Reuters' collations, second-quarter earnings for European companies are expected to grow by 13.5% year-on-year, compared with 8% growth expected for S&P 500 companies and 6.4% for emerging markets in the Asia-Pacific Region.

Chart 5: Major market indices – one year (rebased to 100)



Source: BTIS/Bloomberg

Fixed interest

Having fallen since March, government bond yields saw a sharp spike upwards at the end of June as investors responded to a less dovish tone from central bankers. As expected, the US Federal Reserve hiked its main interest rate by 25 basis points, while the European Central Bank (ECB) and the Bank of England (BoE) both spoke about reducing the amount of economic stimulus they are providing.

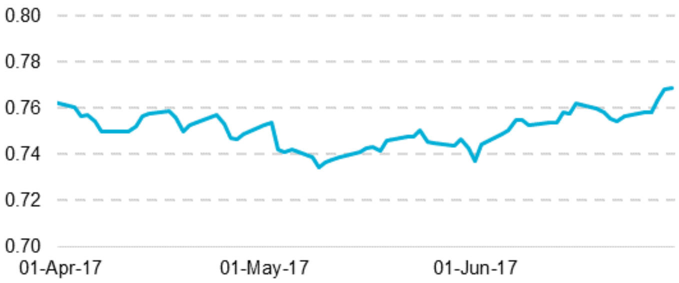
In the last week of June, remarks in a speech by ECB President, Mario Draghi were interpreted to mean the ECB would soon begin tapering the amount of purchases it is making as part of its quantitative easing program, causing yields to surge. In their local currencies, 10-year bond returns fell in the US (–0.7%), Europe (–1.6%), the UK (–1.7%), Germany (–1.6%), Japan (–0.3%), Australia (–1.5%) and Canada (–3.1%). Spreads on Australian corporate debt fell in June, as indicated by the iTraxx Australian Index losing 1.93 basis points to 83.76.

Currencies

The Australian dollar strengthened 3% against the greenback in June, which also slipped against the pound, euro and Canadian dollar. But the US dollar did manage a rise of 1.4% against the yen. The Japanese currency was weak across the board, particularly against the euro and the pound, but after being boosted earlier in June by the Fed rate hike, the US dollar was not able to take advantage of that, due to softer economic data later in the month.

The pound also had a month of two halves, hit earlier by the Fed rate hike and the result of the UK election, but bolstered toward the end by the Bank of England meeting minutes, which implied that the BoE is looking to lift rates.

Chart 6: AUD/USD – 3 month



Source: BTIS/Bloomberg

Commodities

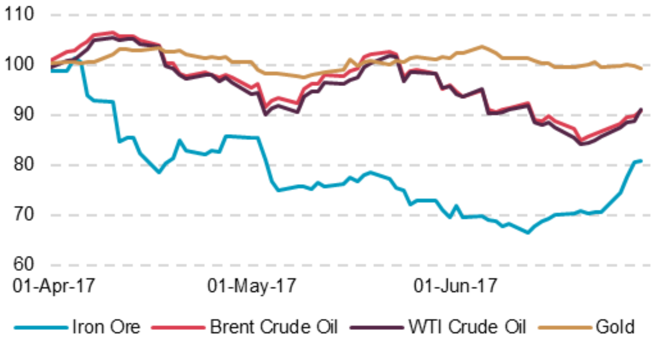
Bulk commodities were the big news in June, from an Australian perspective. The iron ore price gained 13.9% in June, helped by continuing strong demand for steel from China's property and infrastructure sectors; however, after steep losses in April and May, the commodity lost close to 20% for the second quarter.

Asia's seaborne thermal coal market unexpectedly took off in June on a sudden surge in demand from Chinese buyers, including large power utilities, after a relatively subdued May. China's demand for thermal coal has increased after heavy rains impacted hydropower capacity. Newcastle spot thermal coal cargo prices, seen as a benchmark for Asia's physical coal market, gained 10.3% in June, rallying to a three-month high after mining outages boosted demand. Coking coal, however, weakened by 5.8% in June, (8.7% for the quarter), after spiking to US$314 a tonne in mid-April following Cyclone Debbie in March.

Crude oil slipped in June (both West Texas Intermediate and Brent down around 4.7%), as the extent of US shale production growth surprised, as did output from Libya and Nigeria: although members of OPEC, the pair are exempt from the OPEC production cuts agreed in November (a deal reiterated in May), because each has suffered from repeated rebel attacks on oil infrastructure. Crude prices reached their lowest level of the year in June, below US$43 a barrel for WTI.

Gold slipped 2.2% in June in US dollar terms. The other metal of most interest to Australia, copper, jumped 4.6% in June as hedge funds increased exposure, and net long copper positions ended June nearly double the number of contracts at the beginning of May. Zinc prices staged a mid-June comeback, rallying to roughly US$1.25 a pound from a year-to-date low of US$1.10 reached earlier in the month. The Baltic Dry Index, a shipping index considered a useful proxy for the health of global trade, managed to gain 2.6%, after losing almost 21% in May.

Chart 7: Iron Ore, Crude Oil and Gold – 3 months (rebased to 100)



Source: BTIS/Bloomberg

June Market Data

Australian shares	1 Month	3 Months	1 Year	3 Years	5 Years
S&P/ASX 200 Accumulation	0.17%	-1.58%	14.09%	6.63%	11.81%
S&P/ASX 200 Industrials Accumulation	0.61%	-1.41%	12.63%	8.83%	15.00%
S&P/ASX 200 Resources Accumulation	-2.10%	-2.50%	22.92%	-3.37%	-0.21%
S&P/ASX 200 Accumulation AREIT	-4.82%	-3.40%	-6.26%	11.98%	14.14%
S&P/ASX Small Ords Accumulation	1.99%	-0.35%	7.01%	7.13%	5.66%

Global shares	1 Month	3 Months	1 Year	3 Years	5 Years
MSCI World ex Australia Unhedged in $A	-2.64%	3.62%	14.73%	12.97%	18.24%
EPRA/NAREIT Developed Index Hedged $A	0.49%	2.08%	2.22%	7.76%	11.42%
STOXX Europe 600 Total Return	-2.48%	1.19%	18.85%	7.03%	12.28%
S&P 500 Total Return	0.62%	3.09%	17.90%	9.61%	14.63%
Nikkei 225 Total Return	2.14%	6.15%	31.07%	11.73%	19.48%

Fixed interest	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg AusBond Bank Bill Index	0.14%	0.44%	1.82%	2.22%	2.52%
Barclays Global Aggregate TR Hedged A$	-0.22%	1.17%	0.47%	5.08%	5.51%

Commodities	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
Bloomberg Commodity Index	82.6017	-0.27%	-3.22%	-7.02%	-15.03%	-9.41%
Generic Brent Crude Oil	47.92	-4.75%	-9.29%	-3.54%	-24.73%	-13.30%
Generic WTI Crude Oil	46.04	-4.72%	-9.01%	-4.74%	-24.12%	-11.53%
Gold US$/oz	1241.61	-2.15%	-0.61%	-6.07%	-2.20%	-4.92%
Iron Ore	64.95	13.91%	-19.21%	16.69%	-11.60%	-13.68%

Currencies	Month End Price	1 Month	3 Months	1 Year	3 Years	5 Years
AUD/USD	0.7689	3.49%	0.79%	3.19%	-6.59%	-5.57%
EUR/USD	1.1426	1.62%	7.27%	2.88%	-5.85%	-2.04%
USD/JPY	112.39	1.45%	0.90%	8.91%	3.51%	7.09%
GBP/USD	1.3025	1.05%	3.78%	-2.15%	-8.68%	-3.68%

For more information on market activity and investments, please contact your BT relationship manager.