

August 2019 Review

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Volatility spikes across all asset classes

A flare up in US-China trade tensions saw financial market volatility rise sharply, with equity prices falling and interest sensitive securities rising in August. Some notable developments for the month include:

- The US Yield Curve inverted (the yield on 2 Year Treasury bonds higher than 10 Year Treasuries)
- Australian corporate earnings season was one of the weakest in years
- Germany, the UK and Singapore, amongst others, recorded negative economic growth for the June quarter

International Equities

Asset Class Return	Aug-19	3 Months	Annual
Australian Equities	-2.4%	4.2%	9.0%
Global Equities - Unhedged	0.3%	7.8%	7.3%
Global Equities - Hedged	-2.0%	4.9%	0.5%
Australian Listed Property	1.3%	8.4%	20.3%
Global Listed Property	2.0%	3.9%	8.6%
Global Listed Infrastructure	1.0%	4.1%	10.4%
Australian Fixed Interest	1.5%	3.5%	11.2%
Global Fixed Interest	2.2%	4.2%	10.0%
Cash	0.1%	0.3%	1.8%

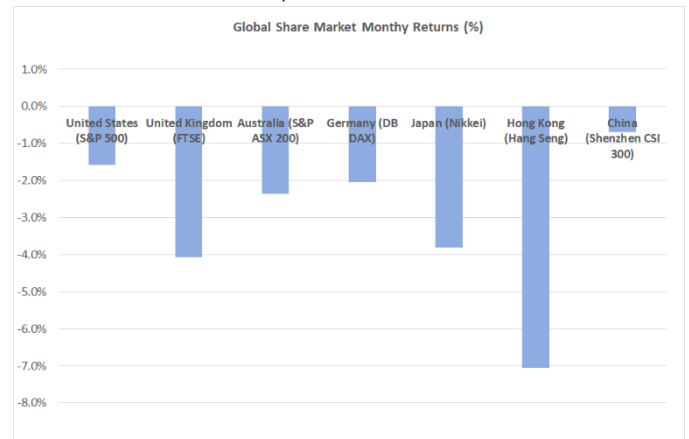
Further escalation in the U.S. China trade dispute took place last month. The United States confirmed that from 1st September, a new 15% tariff would apply to imports from China on consumer categories such as footwear and headphones. Additional consumer categories will experience tariffs in December. Other existing tariffs are set to be increased by 5%. In response, China has announced the imposition of 5% and 10% tariffs on an undisclosed list of items. In addition, China has indicated they will proceed in

December with a 25% tariff on cars imported from the U.S. and a 5% tariff on auto parts and components. The recently announced tariff increases follow a period of depreciation in the Chinese currency, the Yuan. At the end of August, the Yuan was valued at \$US 0.14, representing a 6.5% decline on the level recorded 6 months earlier. The depreciation meant that more than 7 Yuan was required to purchase \$1 US, which was considered by some market participants to signal a change in approach to exchange rate management by China's central bank, the People's Bank of China (PBOC). The fall led to speculation that the central bank was pushing down the exchange rate to make Chinese exports more competitive and offset some of the impact of the U.S. tariffs.

A combination of the ongoing escalation in tariffs, the Chinese currency depreciation and the shift in the U.S. yield curve to a negative shape (see 'Fixed Interest' section) resulted in heightened uncertainty on equity markets. All major equity markets were weaker, with the U.S. one of the better performed, with the decline in the S&P 500 Index being restricted to 1.6%.

The trade war has come at a challenging time for China's economy. Growth slowed to 6.2% (annualised) in the second quarter, the slowest growth in 27 years. The China (Shenzhen CSI 300) market delivered a negative 0.7% return. Three months of unrest in Hong Kong is having a contracting effect on that economy, with retail sales falling. The benchmark (Hang Seng) index declined a substantial 7.1% for the month.

As currency and trade tensions escalated in August, the European Central Bank signalled that it stood ready to start easing monetary conditions, possibly as soon as September. Germany, the largest economy in Europe, is struggling. The Ifo leading index indicator fell for an 11th time in 12 months in August due to weakness in the manufacturing sector. The German share market (DB DAX) fell 2.1%. The British economy contracted 0.2% in the second quarter, and there were warnings that it could shrink further still if there's a disruptive no-deal Brexit on October 31st. The new Prime Minister, Boris Johnson, is attempting to navigate towards a Brexit, with or without a deal with the European Union. The UK market (FTSE) fell 4.1% last month.



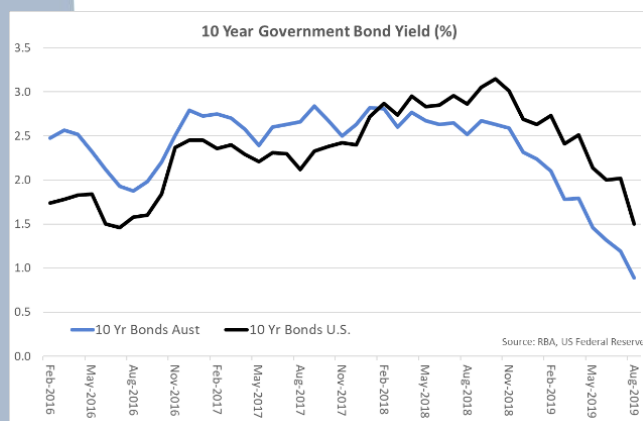
Commodities

Iron ore prices fell below \$US100 a tonne during the month, down from a peak of \$US123 a tonne only a month earlier. Nickel prices soared on the London Metal Exchange late in August after the Indonesian government brought forward a ban on exports of nickel ore. Gold, which tends to rise as uncertainty increases, rose to \$US 1,520/oz - up 6.3% for the month, and nearly 27% since the beginning of the year.

Australian Equities

The majority of ASX listed companies report their full-year results in August. Earnings announcements were somewhat disappointing, with 36% of companies beating market expectations while 37% failed to meet them. In terms of actual earnings, 59% of companies reported an increase in profits in comparison to this time last year when 77% of companies did so. For the month, the best performing sector was Healthcare (up 3.6%), followed by the interest sensitive Property Trusts (up 1.2%). Consumer Discretionary eked out a meagre return (up 0.2%). The worst performing sectors were Resources (down 7.5%) and Energy (down 5.6%); due largely to weaker iron ore prices and weaker oil prices respectively.

Fixed Interest & Currencies



In response to the tariff escalation and the Chinese currency decline, emerging-market currencies sold off as investors sought the safety of the US dollar. Investors also purchased US 10-year Treasuries, pushing the yield below that of 2-year Treasuries for the first time in 12 years. Such a yield 'inversion' has preceded every US recession by about 18 months since the 1970's; though with rates at such historical lows, the relevance of this may be questionable. Given approximately US\$16 Trillion of global bonds are trading at negative yields, US 10-year Treasuries trading at 1.5% (down from 2.0% at the start of the month) could still be considered attractive to some investors.

Despite the Australian economy enjoying its first Current Account surplus since 1975, the Australian dollar fell to its lowest level in a decade, closing out the month at US 67.2 cents. Australian Government 10-year bond yields also fell to below 1% (a record) to close the month yielding 0.89%.

Outlook and Portfolio Positioning

The substantial fall in longer term bond yields recorded over August has further reduced the attractiveness of holding longer dated bonds, which are generally yielding below current inflation rates. Variable interest rate linked investments are preferred, as they provide less risk of capital loss should bond yields revert upwards. However, it remains inappropriate to substitute bond yield related risk with higher levels of credit risk, as the yields available on credit markets also provide investors with minimal return compensation for the risk taken.

Although equities are not excessively overvalued, a cautious approach to share market exposure remains warranted. Valuations have been supported by continued declines in interest rates, and if bond yields do revert from exceedingly low levels, then share prices may come under downward pressure. In addition, evidence of declining rates of global economic growth and the escalating levels of US and Chinese tariffs is likely to ultimately impact on company earnings, which creates a challenging environment for equities.

Given the risks associated with both bonds and equities, overweight positions to cash and assets with alternative return profiles appears appropriate. Our portfolio positioning around holding unhedged foreign currency exposure across global share investments has been beneficial in recent months. This was particularly the case in August, when a lower \$A offset some, if not all, the fall in global equity values. A bias to holding unhedged currency positions remains preferred, due to the possibility that the \$A will continue to decline should the growth environment deteriorate further.

Important Information

The following indexes are used to report asset class performance and calculate the benchmark returns for this model portfolio: ASX S&P 200 Index, MSCI World Index ex Australia net AUD TR (composite of 50% hedged and 50% unhedged), FTSE EPRA/NAREIT Developed REITs Index Net TRI AUD Hedged, Bloomberg AusBond Composite 0 Yr Index, Barclays Global Aggregate (\$A Hedged), Bloomberg AusBond Bank Bill Index, S&P ASX 300 A-REIT (Sector) TR Index AUD, S&P Global Infrastructure NR Index (AUD Hedged).

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