# MARKET WATCH

December 2015

## Market and economic overview

### Summary

In Australia, the RBA left the official cash rate on hold at 2% on 2 December 2015. The US Federal Open Market Committee met on 15 to 16 December and unanimously began the monetary policy normalisation process by announcing a 25 basis point increase in the Fed Funds target range from 0% to 0.25% to 0.25% to 0.5%. The European Central Bank met on 3 December 2015 and announced a number of decisions to ease monetary policy further. The Bank of England left policy unchanged when it announced its decision on 10 December 2015, as expected. The Bank of Japan's policy board convened on 18 December 2015 and left its qualitative and quantitative easing program at an annual increase of ¥80trillion to its monetary base, but made some technical adjustments to its program.

### Australia

The Reserve Bank of Australia (RBA) left the official cash rate on hold at 2% on 2 December 2015 - where it has remained since May this year. The next RBA Board meeting is 2 February 2016. In announcing the on hold decision in December, the RBA reiterated its view from November that “the prospects for an improvement in economic conditions had firmed a little over recent months and that leaving the cash rate unchanged was appropriate. Members also observed that the outlook for inflation may afford scope for further easing of policy, should that be appropriate to lend support to demand”.

The Commonwealth government released its Mid-Year Economic and Fiscal Outlook (MYEFO) in December, which showed a further deterioration in Australia’s fiscal position.

The 2015/2016 Budget deficit has been revised from the May estimate of A$35.1bn (-2.1% of GDP) to A$37.4bn (-2.3% of GDP). Weakness in the nominal income side of the economy from falling terms of trade, lower commodity prices and soft income growth led to the revision.

The Budget position has also deteriorated over the next four years, with the cumulative budget deficits now estimated to be around A$26bn higher than the May 2015 estimate.

As a result Net debt of the Commonwealth government is now expected to peak at 18.5% of GDP at 30 June 2018, only a little higher than the previously expected peak of 18.0%.

This will take the face value of Commonwealth government Securities (bonds and bills) to A$429bn as at 30 June 2016, up from A$369bn as at 30 June 2015.

In other economic news, labour market data continued to surprise on the positive side, although there are some data quality issues. The official seasonally-adjusted data showed 71,400 jobs were added in November, after a revised 56,100 jobs in October. This takes the two month total to 127,500, which would make it the biggest back-to-back job gains in 28 years – but this does not seem to match up with the broader Australian economic picture.

The unemployment rate fell to 5.8% in November, well down from its most recent peak of 6.4% in January 2015.

CoreLogic RP Data for December showed house prices were flat nationally, taking annual gains to +7.8% per year.

On a capital city basis, Sydney fell 1.2% per month, after a 1.4% per month, fall in November. This is the largest back to back fall in 7 years. Elsewhere Adelaide (-1.5% per month) and Canberra (-1.1% per month) fell. Perth (+2.3% per year), Melbourne (+1.0% per month) and Brisbane (+0.9% per month) all rose in the month.

### US

The US Federal Open Market Committee (FOMC) met on 15 to 16 December and unanimously (and finally) began the monetary policy normalisation process by announcing a 25 basis point increase in the Fed Funds target range from 0% to 0.25% to 0.25% to 0.5%.This is the first increase in the Fed Funds rate since 2006 - after the Fed Funds target rate was left at zero since December 2008.

The statement accompanying the policy decision highlighted the improvement in the US economy, noting that “there has been considerable improvement in labour market conditions this year”. Overall, however, the Fed notes that “economic activity has been expanding at a moderate pace”, with household and business investment “increasing at solid rates”, housing improving further, but net exports ‘soft’.

As widely expected, in the statement the Fed emphasised (twice) that the pace of further rate hikes will be gradual, stating that “the Committee expects that economic conditions will evolve in a manner that will warrant only gradual increases in the federal funds rate” and that “the Committee expects that, with further gradual adjustments in the stance of monetary policy, economic activity will continue to expand at a moderate pace and labour market indicators will continue to strengthen”.

However, the Fed did not lower their end 2016 ‘dot’ plot estimate of the Fed Funds rate, which remains at 1.4% (ie. a 1.25% to 1.5% range) and implies four rate hikes in 2016. This is more aggressive than the approx. two rate hikes currently priced into markets.

Expectations for higher US interest rates were cemented by another solid employment report for November. A total of 211,000 jobs were added in the month, with October revised up to a gain of 298,000. The unemployment rate held steady at 5% and average hourly earnings rose 0.2% per month with annual gains at 2.3% per year.

The third estimate of Q3 2015 GDP was revised down to 2.0% on a seasonally-adjusted-annualised-rate, from the second estimate of 2.1%, still down from the 3.9% rate recorded in Q2 2015. One weak part of the US economy is the manufacturing sector, with the ISM Manufacturing Index falling to 48.2 for December, down from 48.6 the prior month. This is the lowest since June 2009 and is being weighed down by weakness in the energy sector.

**Europe**

The European Central Bank (ECB) met on 3 December 2015 and announced a number of decisions to ease monetary policy further. The interest rate on the deposit facility was cut by 10 basis points to -0.30% effective from 9 December 2015.

The interest rate on the main refinancing operations and the interest rate on the marginal lending facility remained unchanged at 0.05% and 0.30% respectively.

In relation to non-standard monetary policy measures the asset purchase program (APP) was extended until the end of March 2017, from its current September 2016 end-date or beyond if necessary until the path of inflation is adjusted to just under 2%.

Other announcements included the decision to reinvest principal payments on the securities purchased under the APP and to include a wider selection of securities that could be purchased. Euro-denominated marketable debt instruments issued by regional and local governments located in the euro area will now be included.

The estimate for CPI inflation in December was 0.3% per year for headline and 1.0% per year for core inflation, both up from November.

In other news, the Spanish general election was held on 20 December with no consensus reached on whom will form government. The ruling People’s Party recorded the largest number of votes, although not enough to form government. The opposition Spanish Socialist Worker’s Party scored second although recorded its lowest vote in history. Left-wing anti-austerity party Podemos gained support winning around 20% of votes, while the Citizens party ran fourth. With no conclusive result a coalition government could be formed or fresh elections held in 2016.

**UK**

The Bank of England (BoE) left policy unchanged when it announced its decision on 10 December 2015, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn. There was one dissent on the nine member board, the fifth meeting in a row.

The final estimate of Q3 2015 GDP was revised down to 0.4% per quarter and annual growth to 2.1% per year. The revisions were driven by lower growth out of the finance sector.

The unemployment rate fell to 5.2% for the three months to October 2015, from 5.3% with 207,000 jobs added over the period.

**Japan**

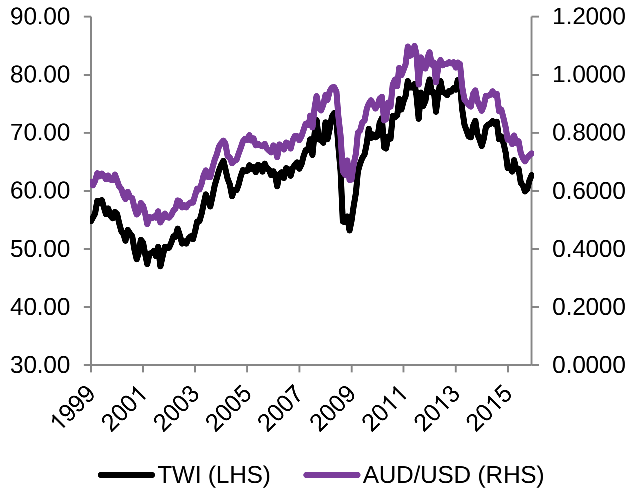
The Bank of Japan's (BoJ) policy board convened on 18 December 2015 and left its qualitative and quantitative easing (QQE) program at an annual increase of ¥80trillion to its monetary base, but made some technical adjustments to its program. This included lengthening the maturity of bonds purchased in the QQE program to 7 to 12 year’s duration from 7 to 10 years and increasing the maximum share of JREIT that the BoJ can buy.

## Australian dollar

The Australian dollar was mixed against the major cross currencies in December. The AUD finished up 0.8% against the USD to US$0.7287. These gains occurred despite the US Federal Reserve lifting interest rates for the first time since 2006. Gains in the AUD were also assisted by stronger employment data in Australia and a growing view the RBA will be on hold throughout 2016.

Over 2015 the Australian dollar fell 16.7% against the USD and 2.0% against the EUR. The AUD was also weaker against the Japanese yen (-1.5%) and the New Zealand dollar (-2.9%), but was up 2.9% against the sterling.

**AUSTRALIAN DOLLAR HIGHIEST AGAINST USD IN DECEMBER**




Source: Bloomberg as at 31 December 2015

## Commodities

Commodity prices were mixed in December with some base metals moving higher while oil moved sharply lower.

The price of West Texas Intermediate Crude finished the month at US$37.04, down 11.1%, while the price of Brent was down 17.6% to US$37.3. OPEC met on 4 December and confirmed its commitment to protect market share rather than cutting production in an over-supplied market. Over 2015 the price of Brent was down 62%.

Iron ore prices rose slightly in December, up 1.4%, after a 13.8% fall in November, as measured by the benchmark price of iron ore delivered to Qingdao China – 62% Ferrous Content. The price ended at $43.6 / metric tonne, down 44% over 2015.

Global property securities also registered gains, with the FTSE EPRA/NAREIT Global Developed Index adding 0.9%. Returns were supported by favourable

Copper (+2.6%), lead (+8.9%) and nickel (+4.2%) rose in December, although all finished 2015 sharply lower at -29.4%, -14.6% and -45.9% respectively.

## Australian equities

The Australian share market was quite volatile in December. By mid-month, the S&P/ASX 200 Accumulation Index was down around 5% and on course for a negative return in 2015 as a whole. A rally towards the end of the month, however, ensured the market registered a positive return in both December (+2.7%) and the year as a whole (+2.6%).

The market was driven higher by the Financials sector, which continues to account for more than 40% of the Index. Consumer discretionary stocks also tended to outperform during the critical pre-Christmas sales period for retailers.

On the negative side, energy stocks continued to struggle reflecting oil price weakness. This has eroded margins for producers and focused attention on the capital positions of ASX-listed energy companies. Woodside Petroleum (-4.6%) – which had made a takeover offer for Oil Search (-18.3%) in September – also announced it is unwilling to increase its bid and has walked away from the proposed deal.

In other company news, Qantas Airways (+12.4%) provided a market update, suggesting it is expecting semi-annual profit before tax of between A$875 million and A$925 million. The improvement is being attributed to the continued delivery of the company's A$2 billion transformation program, revenue growth, and the benefit of lower jet fuel prices.

Elsewhere, health care stocks including Primary Health Care (-27.1%) and Sonic Healthcare (-12.1%) struggled following the government's Mid-Year Economic and Fiscal Outlook and speculation regarding possible regulatory changes in the sector.

## Listed property

ASX-listed property securities performed well in December, with the S&P/ASX 200 Property Accumulation Index adding 4.0%. This extended returns in 2015 as a whole to more than 14%; performance that was well ahead of the broader Australian share market.

There was a fair amount of news within the sector during the month. Dexus Property Group made a takeover approach for Investa Office Fund, offering a ~5% premium to Net Tangible Assets. Westfield Corporation announced the disposal of a majority interest in five 'B grade' malls in the US and Canada for US$1.1 billion.

performance in Australia, although Singaporean stocks also performed relatively well. On the negative side, UK and Hong Kong-based companies typically underperformed and prevented the Index from making further progress.

## Global developed market equities

The MSCI World Index fell by 1.9% in US dollar terms in the month of December, and 2.6% lower in Australian dollar terms. This took returns over 2015 to -2.7% in US dollar terms and +8.9% due to the depreciation of the AUD over the year.

Equity markets were mixed through the regions, with the US and Europe weaker while some parts of Asia were stronger.

There was significant news on the central bank front to digest. Equity markets largely digested the first interest rate hike from the US Federal Reserve in a smooth fashion, while there was universal disappointment with the package delivered from the ECB. 2016 will continue to see central bank policy divergence and will likely to add to market volatility.

This was seen in the first few trading days of 2016, with sharp falls on the Chinese sharemarket due to weaker manufacturing data and continued depreciation of the Chinese yuan.

In the US, the S&P500 (-1.8%), the Dow Jones (-1.7%) and the NASDAQ (-2.0%) all fell in December. The S&P500 ended 2015 0.7% lower. The MSCI Energy sector fell 9.7% while Healthcare rose 1.4%.

Equity markets in Europe were lower, with Spain down 8.1% on the uncertain election outcome. The German DAX (-5.6%) and France (-6.5%) both also fell. The UK FTSE 100 was down 1.8%.  In Asia, the Japanese Nikkei 225 fell 3.6%, while Singapore (+0.9%), Taiwan (+0.2%) and Hong Kong (-0.4%) were mixed.

**EQUITY MARKETS LOWER IN DECEMBER**


Source: Bloomberg as at 31 December 2015. Past performance is not an indication of future performance.

## Global emerging markets

Emerging market equities were weaker in December, with the MSCI Emerging Market Index down 2.4% in US dollars and 3.2% in AUD terms taking the 2015 annual loss to 17% in US dollars. All regions recorded falls, led by Europe, Middle East and Africa, with the weaker oil price contributing to these losses, down 7.3%. MSCI EM Latin America fell 4.7% while MSCI EM Asia was down 1.0% in US dollar terms.

Argentina lifted capital controls over the month and let the Argentine Peso depreciate freely, with the Peso falling 34% against the US dollar in December.



FINANCIAL WISDOM