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Market Watch

February 2016

Market and economic overview

Summary

In Australia, the RBA left the official cash rate on hold at 2% on 1 March 2016. The US Federal Open Market Committee (FOMC) is scheduled to meet 15 to 16 March 2016 and the European Central Bank (ECB) scheduled to meet 10 March 2016. The Bank of England (BoE) left policy unchanged when it announced its decision on 14 January 2016, as expected. The Bank of Japan (BoJ) left policy unchanged when it announced its decision on 4 February 2016, as expected.

Australia

The Reserve Bank of Australia (RBA) left the official cash rate on hold at 2% in February and again on 1 March 2016 - where it has remained since May 2015. The next RBA Board meeting is 5 April 2016.

The RBA statement remained relatively upbeat on the domestic economy "the Board judged that there were reasonable prospects for continued growth in the economy", while maintaining a cautious easing bias. The RBA notes that "continued low inflation may provide scope for easier policy, should that be appropriate to lend support to demand."

GDP growth was revised up to 2.5% from 2.25% for 2015. While the range of GDP growth expected for 2017 was lowered slightly to 2.5% to 3.5% down from 3% to 4%. The first look at GDP growth for June 2018 is at 3% to 4%.

Inflation forecasts were also revised, June 2016 CPI inflation forecast has been cut to 1.5% per year from 1.5% to 2.5% per year previously, headline inflation is then forecast at 2% to 3% from December 2016 onwards. Underlying inflation is forecast at the bottom-end of the 2% to 3% target range as at June 2016 and then within that range out to June 2018.

House prices continued to increase in February, albeit at a slower pace, rising 0.5% per month and 7.6% per year according to RPData-Rismark. House price gains remained the strongest in Sydney (+9.5% per year) and Melbourne (+11.1% per year).

Q4 2015 GDP data (released 2 March) rose 0.6% per quarter, increasing the annual pace to 3.0% per year, the fastest pace of growth since Q1 2014. Growth was driven by household consumption (+0.4%/pts), public investment and inventories (each up 0.2%/pts), while trade was flat and non-residential building was the largest drag (-0.5%).

Labour market data surprised on the downside, although there are some data quality issues related to sample rotations. The official seasonally-adjusted data showed 7,900 jobs were lost in January, below the +13,000 the market expected after a revised loss of 800 jobs in December.

The unemployment rate increased to 6.0% in January, still well below its most recent peak of 6.4% in January 2015 and below the RBA's 2H15 forecast.

US

The second estimate of Q4 2015 GDP showed growth was 1.0% on a seasonally-adjusted-annualised-rate, compared to the first estimate of 0.7%. The upgrade was due to a larger gain in inventories than previously expected and came despite small downgrades to consumption, investment, exports and government spending.

The US labour market continued to improve. A total of 151,000 jobs were added in January, although this was less than the 190,000 the market expected. The unemployment rate decreased to 4.9% despite a 0.1% increase in the participation rate to 62.7%. Average hourly earnings increased by 0.5%, more than expected, keeping the annual gains at 2.5% per year.

Despite the continued decline in the oil price and the strong US dollar, inflation printed flat for the month while the base effects increased headline inflation to 1.4% per year in January, up from 0.7% per year in December 2015. The Fed's preferred measure of inflation - Core Personal Consumption Expenditure Price Index - was up 0.3% in January, taking annual gains to 1.7%, the highest since November 2012.

Europe

Minutes of the January ECB meeting were released and pointed to a healthy debate on what action should be taken in order to bring inflation closer toward the 2% target.

GDP data was released for the euro area, increasing at 0.3% per quarter, lowering the annual growth to 1.5%, from 1.6% per year. Germany grew by 0.3% per quarter, while Spain (+1.2% per quarter), Portugal (+0.2% per quarter) and France (+0.3% per quarter) all recorded growth. Greece (-0.6% per quarter) recorded negative growth.

The first estimate of February CPI for the euro area was recorded at -0.2% per year, a decrease from the +0.3% per year in January. A renewed decline in the price of oil and continued soft food prices led to the decline. Core inflation was 0.7% per year, down on January's figure of 1.0% per year.

UK

The Bank of England (BoE) left policy unchanged when it announced its decision on 4 February 2016, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn. For the first time in six months it was a unanimous decision from the nine member board.

Q4 2015 GDP increased 0.5% per quarter, keeping the annual rate at 1.9% per year. Growth continues to be driven by strong consumer spending (+0.7% per quarter) which helped counter the decline in exports and business investment.

CPI data showed inflation decreased by 0.8% in January, dragged down by the continued fall in energy prices. The annual rate of inflation increased to 0.3% per year from 0.2% per year while core inflation decreased from 1.4% per year to 1.2% per year.

Japan

The Bank of Japan's (BoJ) policy board did not meet in February, the next meeting is 15 March 2016.

Q4 2015 GDP data was released, with the Japanese economy contracting by 0.4% per quarter, annualising at -1.4% per year. This was a deterioration on Q3 2015, with growth 0.3% per quarter and annualising at 1.3%.

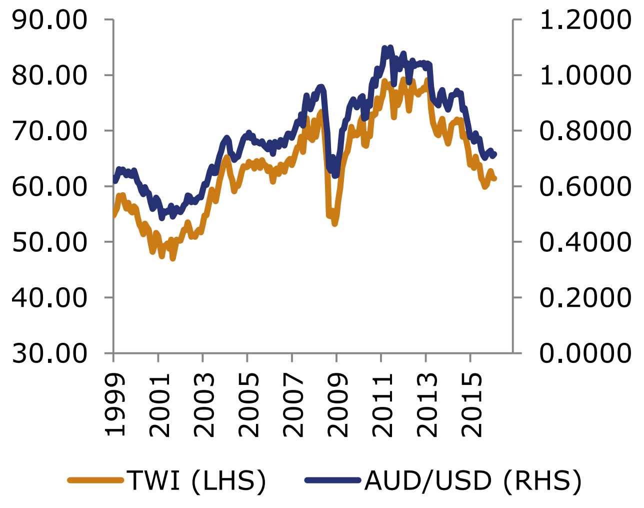
Headline CPI was flat over January while the core measure excluding food and energy decreased 0.1% to 0.7% per year, both well below the BoJ's 2% target.

Australian dollar

The Australian dollar was mixed against the major currencies in February. The AUD finished up 0.9% against the USD to $US0.7150. These gains occurred partly due to reduced expectations of the US Federal Reserve continuing to raise interest rates in 2016.

The Australian dollar rose against the euro (0.5%) and sterling (+3.3%) but fell against the yen (-5.9%) and NZ dollar (-0.8%) over the month of February.

AUSTRALIAN DOLLAR MIXED IN FEBRUARY



Source: Bloomberg as at 29 February 2016

Commodities

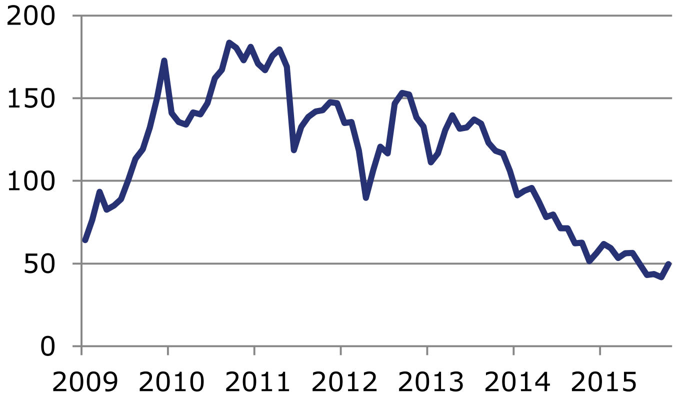
Commodity prices were stronger in February, driven by signs of excess supply leaving the market and a fall in the USD.

The price of West Texas Intermediate Crude finished the month at $US33.8/bbl, up 0.4%, while the price of Brent was down 0.7% to $US36.6/bbl.

Iron ore prices were stronger in February, up 18.9% to $49.6/metric tonne, as measured by the benchmark price of iron ore delivered to Qingdao China – 62% Ferrous Content.

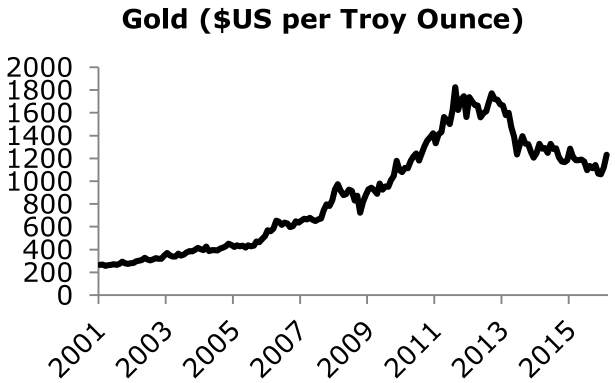
Nickel (-1.2%) fell in January, while Gold (+10.3%), Aluminium (+3.6%), Zinc (+8.7%) Copper (+2.9%) and Lead (+2.0%) made gains.

IRON ORE UP IN FEBRUARY



Source: Bloomberg as at 29 February 2016

STRONG START TO THE YEAR FOR GOLD



Source: Bloomberg as at 29 February 2016

Australian equities

January's weakness in the Australian sharemarket persisted during February, with the S&P/ASX 200 Accumulation Index declining a further 1.8%.

The market was dragged lower by weakness in the Financials sector, which accounts for more than 45% of the Index. Widening credit spreads and increased funding costs prompted investors to become concerned about margins and profitability in the sector.

On the positive side, several stocks in the Materials sector performed relatively well. This partly reflected a rebound in some commodity prices from low levels – the iron ore price increased during the month, for example.

Following a long period of subdued commodity prices, most mining companies have been focusing on cost-out initiatives and capital expenditure cuts. Progress on both fronts was outlined during February, when most companies announced their latest financial results. In some cases, cost savings enabled mining companies to exceed consensus earnings expectations and helped stocks in this area of the market to outperform.

In other sectors, the tone of earnings releases was less bad than the market had been anticipating. Around 40% of companies beat consensus revenue expectations, which augurs well for the Australian economy going forward. In spite of these encouraging indicators, consensus earnings growth expectations for both FY16 and FY17 declined modestly during February.

Listed property

The 'reporting season' was generally a favourable one for listed property securities. A number of stocks including Stockland (+2.0%) and Vicinity Centres (+6.9%) upgraded earnings guidance for the full year, helping to support investor sentiment towards the sector.

The S&P/ASX 200 Property Accumulation Index rose 2.9% in February, extending gains in the 2016 year to date to more than 4%. The relatively stable, income-producing characteristics of property stocks have clearly appealed to investors during a period where the broader Australian sharemarket has fallen around 7%.

The Industrial sub-sector was the standout performer during the month, aided by solid returns from Goodman Group (+6.7%). The company's 9% improvement in interim profit exceeded consensus expectations and management lifted full year earnings growth forecasts from +6% to +7.5%.

Overseas property securities also gained ground, with the FTSE EPRA/NAREIT Global Developed Index adding 0.5% in US dollar terms. Asian markets including Japan and Singapore performed particularly well. UK property stocks continued to underperform, however, as speculation that Britain could exit the European Union weighed on investor sentiment.

Global developed market equities

Global financial markets continued their volatile start to 2016, with most equity markets recording losses in early February before recovering somewhat by end of month. Falls continued at the start of the month with concerns over weaker economic growth and the continued slide in commodity prices. These were exacerbated early in the month with doubts around the effectiveness of negative interest rates in improving growth and inflation and their potentially negative impact on bank profitability.

Financials in particular were down during the month over concerns on banks' abilities to repay interest on their riskier debt obligations and the impact of regulation and negative rates on profitability, before recovering into month end.

With large volatility in equity markets and signs of downside risks to global growth, there was renewed speculation over central bank policy announcements with further easing measures expected and doubts over the US Federal Reserve's ability to raise rates.

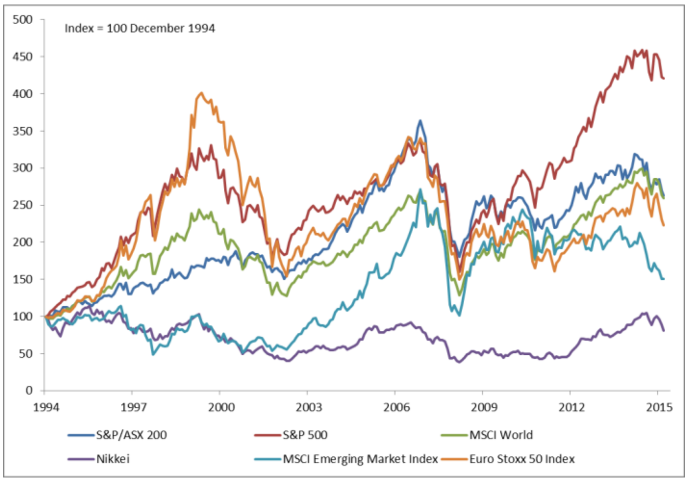
The MSCI World Index fell by 1.0% in US dollar terms in the month of February, and 1.9% lower in Australian dollar terms.

In the US, the S&P500 (-0.4%), and the NASDAQ (-1.2%) fell in January while the Dow Jones (+0.3%) rose slightly. MSCI Financials (-3.7%) was the worst performer, while MSCI Materials (+6.0%) was the best performer.

Equity markets in Europe were also weaker. The German DAX (-3.1%), Italy (-5.5%), Spain (-4.0%) and France (-1.4%) all fell. The UK FTSE 100 was up 0.2%.

In Asia, the Japanese Nikkei 225 (-8.5%) and Honk Kong Hang Seng (-2.9%) fell while Singapore (+1.4%) and Taiwan (+3.3%) rose.

ANOTHER VOLATILE MONTH FOR EQUITY MARKETS IN FEBRUARY



Source: Bloomberg as at 29 February 2016

Global emerging markets

Emerging market equities were mixed in February, with the MSCI Emerging Market Index down 0.3% in US dollars and 1.3% in AUD terms. Concerns around weaker global growth and trade contributed to these losses with the Asian region recording the largest falls. MSCI Asia Ex Japan was down 1.0%, with weakness in the Shanghai Composite Index (-1.8%) and MSCI India (-6.7%) over February. MSCI EM Latin America rose 3.4% and MSCI EM Europe, Middle East and Africa was up 1.8% in US dollar terms.

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If you have any questions, please speak to your Count Financial Adviser.

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