

## Market Update June 2013

### Market Overview

The two drivers of world stock markets in recent years – the ‘easy money’ policies of central banks and the ‘China boom’ – are both showing enough cracks to have investors worried and markets falling. The slowdown of China in particular will impact Australia for some time, but fortunately, the RBA has more room to move than most other central banks. In a time of record low interest rates, and a market that has fallen over 10% of late, there are still companies yielding a sustainable 6-9% on a gross dividend basis.

Global financial markets were volatile in June, with sharemarkets falling sharply and government bond yields jumping higher. These market moves came after the US Federal Reserve (The Fed) provided a more positive assessment of the US economy, signalling that a moderation in its aggressive quantitative easing (QE) program could occur later this year.

### Australian Shares

Australian equities suffered heavy losses in June, reversing all the gains made in the first five months of 2013. Concerns over the domestic growth outlook and poor business sentiment contributed to a growing number of company downgrades. The S&P/ASX 200 Index declined by 2.5% (Accumulation Index, -2.3%) over the month.

Sentiment towards the Australian sharemarket continued to be affected by offshore events in June, such as expectations that the Fed would taper its QE program later in the year. A spike in Chinese interbank interest rates did little to support investor sentiment towards equity markets in the Asia Pacific region, in particular.

There have been increasing concerns about a moderation in Australian economic activity. The big question remains whether the non-mining sector can offset the clear slowdown that is occurring in the mining sector. Several miners and companies that provide service to the sector continued to downgrade their earnings expectations in June. Various companies in this area of the market are restructuring, cutting costs and deferring capital expenditure plans. A number of companies in other areas of the market also issues disappointing earnings outlooks during the month, suggesting that business conditions are subdued across the broader domestic economy.

The market weakness in May and June was disappointing, but it was insufficient to prevent Australian shares from recording their strongest gains in six years in the 2012/2013 financial year. In the 12 months ending 30 June 2013, the S&P/ASX 200 Accumulation Index added nearly 23%.

### Australian Dollar Commodities and Cash Rates

The Australian dollar (AUD) depreciated by 4.5% against the US dollar (USD) in June ending the month at \$US0.9138, its lowest level since October 2010.

Commodity prices generally declined, led by gold (-11.0%), as rising short-term interest rates pushed the precious metal to a 3 year low. However, oil (+5.0%) bucked the trend, rising on supply concerns over fears that the Syrian conflict may spread.

Locally, the Reserve Bank of Australia (RBA) left its cash rate unchanged at 2.75% in June, citing the positive effects from previous easing on non-mining sectors of the economy (i.e. the housing sector). However, the minutes from the RBA Board described the AUD as “high” despite it depreciating more than 10% against the USD in the past two months.

## **Property**

Australia listed property securities dipped by 0.8% in June. Diversified property securities generated the strongest returns, while the commercial segment, consisting of office and industrial assets, underperformed over the 12-month period.

## **Global Shares**

The MSCI World Index (developed markets) fell by 2.6% in US dollar (USD) terms (+2.5% in AUD terms) in June. Following Dr Bernanke's press conference, the Index fell by 3.5% on 20 June 2013 – its largest one day fall since November 2011.

S&P500 Index defensive sectors outperformed in June, led by Telecommunications, Consumer Staples, Health Care utilities. Cyclical sectors such as Materials and Energy were among the poorest performers, led lower as selling pressures associated with the Fed's comments were intensified by concerns over China's slowing economy and banking system.

Equity markets also tumbled across the Atlantic, however, ECB President Draghi calmed the market somewhat by assuring that aggressive loose monetary policy would remain in place for a long time to come, potentially de-coupling from US policy. Core European equity markets such as Germany (-4.7%), Holland (-5.2%), and France (-5.3%), performed better than the peripheral markets of Italy (-11.5%) and Spain (-6.7%).

The MSCI Asia ex-Japan Index fell by 6.3% in USD terms (-1.4% in AUD terms), led lower by a decline in Chinese equities. The Shanghai Composite Index fell by 14.0%, dragged down by a combination of economic growth concerns, policy risks and a slowdown in credit growth.

## **Global Emerging Markets**

The MSCI Emerging Markets EMEA Index declined by 5.1% in USD terms (-0.1% in AUD terms) over the month.

The rise in US Treasury yields and falling commodity prices also drove down the emerging market currencies, causing several countries to intervene in currency markets.

## **Implication for Investors**

The ending of US QE program will see some changes in the relative performance between asset classes and within asset classes. The most immediate challenge for investors is to navigate the unwinding of the distortions that QE created, but during this process shares and credit are likely to continue outperforming government bonds. The region most exposed to the QE withdrawal is the emerging markets as the process is likely to culminate in lower asset prices, rising interest costs and (probably) lower tolerance for risk. Fortunately, in Australia the depreciation of the Australian currency is doing a lot of the RBA's work and this is allowing cyclical sectors that were constrained during the mining investment boom, experience a bit more support. However, the currency is unlikely to be at a level that the RBA sees as appropriate, as it still remains 24% above its post 1983 average. In this universe, weak business models are likely to be exposed, whereas companies generating strong surplus cashflow are better placed to deliver on elevated earnings guidance, and any firm that missed on earnings is likely to be punished more harshly by investors than has been the case since 2009.

*Acknowledgements:- Perpetual Investments "Financial Year 2014 in Focus"  
Perpetual Perspective "Will Rising Yields Sink All Assets"  
Colonial First State "Market View, June, 2013"*

