SEPTEMBER MARKET PERFORMANCE

Equity Markets – Index Returns*	**Index**	**At Close** 30/09/2019	**% Return** 1 Month	**% Return** 12 Months
Australia	S&P/ASX 200 Index	6688.35	1.84%	12.47%
United States	S&P 500 Index	2976.74	1.87%	4.25%
Japan	Nikkei 225 Index	21755.84	5.85%	-7.77%
Hong Kong	Hang Seng Index	26092.27	1.87%	-2.70%
China	CSI 300 Index	3814.53	0.48%	13.48%
United Kingdom	FTSE 100 Index	7408.21	2.97%	3.23%
Germany	DAX 30 Index	12428.08	4.09%	1.48%
Europe	FTSE Eurotop 100 Index	3011.22	3.56%	8.73%

Property – Index Returns*	**Index**	**At Close** 30/09/2019	**% Return** 1 Month	**% Return** 12 Months
Listed property	S&P/ASX 200 A-REIT Index	1609.80	-2.73%	18.25%

Interest Rates	**At Close** 30/09/2019	**At Close** 31/08/2019	**At Close** 30/09/2018
Australian 90 Day Bank Bills	0.94%	0.97%	1.93%
Australian 10 Year Bonds	1.02%	0.89%	2.67%
US 90 Day T-Bills	1.81%	1.98%	2.20%
US 10 Year Bonds	1.67%	1.50%	3.06%

Currency**		**At Close** 30/09/2019	**% Change** 1 Month	**% Change** 12 Months
US dollar	AUD/USD	0.67	0.22%	-6.59%
British pound	AUD/GBP	0.55	-0.87%	-0.97%
Euro	AUD/EUR	0.62	0.93%	-0.56%
Japanese yen	AUD/JPY	72.97	1.93%	-11.15%
Australian Dollar Trade-Weighted Index		59.2	0.51%	-4.82%

** Closing index values are based on price indices. Index returns are expressed as total returns in local currency.*
*** All foreign exchange rates rounded to two decimal places.*
Past performance is not a reliable indicator of future performance.

The Pulse

Some indicators point to a heightened risk of recession in the US, but for now inflation remains slightly above target and wages are still expected to rise.

The global downturn in manufacturing is deepening, although the services sector remains a bright spot, supported by consumer spending.

UK prime minister Boris Johnson remains hamstrung by the parliament and will continue negotiating the fraught issue of the Irish backstop.

The Chinese economy is feeling the pinch from the trade war as authorities continue to free up liquidity and increase spending on infrastructure to support growth.

Given the softness in Australian economic growth and inflation, the RBA is increasingly likely to cut rates a further 25 basis points to 0.50% by early 2020.

Global economies

With central banks divided on monetary policy, markets expect rates to continue to move down as global risks intensify. The US and China will re-enter trade negotiations in October, but relations between the two countries have hardly improved since talks broke down in September. Markets are not holding out hope that all issues will be resolved in one round.

US

The Fed followed through with the largely anticipated easing on 18 September, cutting the Fed funds rate to 1.75–2.00%, the second move in this cycle. According to the so-called 'dot-plot', the funds rate is expected to remain at current levels until the end of 2020 before rising to 2.1% in 2021 and 2.4% in the long term. Of note was the divergence of views among members, with two voting for no move, and one, St Louis Fed President James Bullard, voting for a more significant 50 basis point cut. The August CPI data again came in above expectations. The core CPI rose 0.3%, as it has for the past three months, taking the annual rate to 2.4%, the highest reading since early 2008. However, with the uncertainty surrounding trade, indicators of investment spending continue to tread water while business confidence has fallen for the past six quarters.
The manufacturing sector is bearing the brunt of the downturn in global trade and confidence. The ISM manufacturing index for September saw its worst reading in a decade, while the ISM services index saw its worst reading since the start of the Trump presidency. Non-farm payrolls were promising, adding 136,000 and including upward revisions to the previous two months, but not quite the blockbuster result markets were hoping for.

Europe

European data shows growth in the services economy continues to be offset by a slump in the manufacturing sector. The contraction in manufacturing is strongest in Germany, prompting the Bundesbank to warn that the country is likely in a technical recession following negative growth in the June quarter. The weakness in Germany follows a sharp drop in exports and a decline in industrial production, weighed down by a combination of turmoil in the auto industry, the escalating US-China trade war, and the prospect of a chaotic UK exit from the EU. There is growing pressure to abandon fiscal purity in favour of stimulus measures to aid monetary policy in the struggle to stimulate growth. In Italy, the coalition between the far-right League and the anti-establishment Five Star Movement collapsed when Matteo Salvini, the League party's leader and deputy prime minister, sensed a chance to capitalise on his rising popularity and demanded fresh elections. In the UK, prime minister Boris Johnson put MPs on notice that he was ready to legislate to hold a snap general election, which was duly defeated by the so-called 'rebel alliance'. Johnson has taken his proposed deal to the EU negotiators, which includes a proposal to keep Northern Ireland in the EU's customs union to prevent a hard border.

China

The Chinese economy continues to slow. June quarter GDP growth declined to 6.2%, the slowest in 27 years, and there is a risk that it could drop below 6% in the September quarter. Industrial production growth for August was just 4.4%, the weakest in 17 years, while the latest official manufacturing PMI reading was below 50 for the fifth consecutive month. With the trade war escalation, the risk is that growth continues to falter, and this has prompted a series of easing measures over the past month. The Bank of China earlier introduced a new Loan Prime rate benchmark, and the rate has been cut twice in the past two months by a total of 11 basis points to 4.2%. The bank reserve requirement ratio was also reduced for the third time this year by 0.5% to 13%, which effectively frees up a further 900 billion yuan for lending. This year the government has also sought to lift spending on public infrastructure projects such as roads and bridges by expanding quotas for the value of special infrastructure bonds that local governments can issue by about 60% to 2.15 trillion yuan. However, the easing in policy is relatively minor compared to the stimulus put in place in 2009 and 2015-16. The authorities have embarked on a deleveraging drive over recent years and are loath to add to the already high levels of debt and spending on unproductive investment projects and property.

Asia region

The Jibun Bank Japan PMIs paint a picture—similar to that of Europe—of service sector growth offset by weakness in manufacturing. Services activity appears to be growing at the fastest pace in two years, while manufacturing activity was the slowest in the past three years. August manufacturing data showed a ninth consecutive month-on-month fall in export sales on the back of softer growth across Asia, particularly in China. Retail sales rose 2% year-on-year, faster than the 0.9% growth expected, suggesting consumers may have brought forward some buying ahead of the rise in consumption tax on 1 October. Industrial output fell 1.2% in August, which was a larger drop than expected, while exports fell 8.2% over the year and imports declined by 12.0%. Exports to China fell 12.1% while those to the US fell 4.4% over the year. Turning to India, the central bank has warned that the economy will face more risks to growth in the near-term as global developments impact business investment, and bank credit flowing to the commercial sector declines. In an effort to stimulate growth, India's finance minister announced a cut to the corporate tax rate from 30% to 22%, while new manufacturing businesses started after 1 October would pay only 15% tax on income.

Australia

The Australian economy has not suffered a recession (defined as two consecutive quarters of negative economic growth) for almost 28 years, yet for many conditions will appear stagnant. Australia's per capita GDP growth rate for the year to June was -0.2% following the slightly negative result in the previous quarter and is the worst outcome since the financial crisis. At its October meeting the RBA voted to lower the cash rate to a new record low of 0.75%, citing the risks to international trade posed by the US-China trade dispute, as well as uncertainty around consumer spending, which has seen only modest increases. The unemployment rate rose slightly from 5.2% to 5.3% in August, as increased demand for labour is met with more supply, thanks to a rising population and workforce participation rate. With 'full employment' thought to be closer to 4.5%, it is difficult to see wages growth picking up much from current levels, particularly if the cyclical weakness in employment, as suggested by job ads data and business surveys, comes to fruition. From a monetary policy perspective, the likelihood of a 0.50% official cash rate by early 2020 seems to be quite high. As noted above, growth is weak and considerable excess capacity exists in the economy in general and in the labour market more specifically. The June quarter inflation data shows that core inflation is running at 1.4% and the RBA does not see it reaching 2.0% until 2021.

EQUITY MARKETS

The S&P/ASX 200 Index rose 1.8% in September with gains in the Energy, Financials and Materials sectors, and falls in Communications and Property.

The US S&P 500 Index rose 1.9% in US dollar terms, led by Financials, Utilities and Energy.

The STOXX Europe 600 Index rose 3.6%, the German DAX 30 Index rose 4.1% and the UK's FTSE 100 Index rose 3.0%.

In Asia, China's CSI 300 Index was mostly flat at 0.5%, Hong Kong's Hang Seng Index rose 1.9%, and Japan's Nikkei 225 Index rose 5.9%.

Global developed market shares excluding Australia rose 1.8% in Australian dollar terms and emerging market gained 1.6%.

Australian equities

Equity	Index/Benchmark (% p.a.)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 200 Acc. Index	1.84%	12.47%	11.88%	9.49%	10.97%
	S&P/ASX 50 Acc. Index	1.98%	15.44%	12.51%	9.03%	10.85%
	S&P/ASX Small Ordinaries Acc. Index	2.61%	3.95%	8.80%	9.60%	6.97%

Australian shares managed to reclaim some ground in September which saw the S&P/ASX 200 Index post a modest 1.8% return before falling in the first week of October. Energy was the top performing sector, returning 4.7% and clawing back some losses from the previous month. Oil price spiked in September, the result of major disruption to the oil market, which favoured energy producers like Santos (+7.2%) and Beach Energy (+3.3%). The financial services sector (+4.1%) saw broad growth over the month. Shares in IOOF (+26.0%) rose as the wealth manager completed its sale of Ord Minnett during the month and the Federal Court dismissed a case brought against it by APRA that accused executives of failing to act in members' interests. The Materials sector (+3.1%) also saw significant gains for some members, led by Western Areas (+25.0%), which benefitted from a rise in the Nickel price after the Indonesian government announced a ban on exports of raw ore. Nufarm shares (+17.0%) shot higher following the announcement that it was selling its South American business to Japanese conglomerate Sumitomo. Large cap shares rose 2.0% with solid gains from major banks and miners, but were outshone by their small cap peers, which returned 2.6%.

Investment Index/Benchmark returns*
S&P/ASX 200 Index

Sector	1 Month	3 Months	1 Year
Energy	4.66%	0.48%	-9.04%
Financials ex-Property	4.10%	3.18%	12.07%
Materials	3.07%	-3.71%	15.99%
Consumer Discretionary	2.97%	8.20%	10.26%
Utilities	1.79%	0.66%	10.91%
Consumer Staples	1.71%	11.56%	16.36%
Industrials	-0.03%	0.82%	15.12%
Information Technology	-0.59%	4.61%	13.02%
Health Care	-2.48%	7.00%	15.65%
Property	-2.73%	0.95%	18.25%
Communications	-2.95%	-3.16%	8.79%

** Total returns based on GICS sector classification*

BIG MOVERS THIS MONTH

Going up:
Energy: 4.7%
Financials: 4.1%
Materials: 3.1%

Going down:
Communications: -3.0%
Property: -2.7%
Health Care: -2.5%

Global equities

Equity	Index/Benchmark (% p.a.)	1 Month	1 Year	3 Years	5 Years	7 Years
Global	MSCI World Ex Australia Index (AUD)	1.80%	9.07%	15.04%	12.96%	16.81%
	MSCI World Ex Australia Index (LCL)	2.34%	2.65%	10.82%	8.33%	11.25%
	MSCI World Ex Australia Small Cap Index (AUD)	1.76%	1.27%	12.39%	12.72%	16.85%
Emerging	MSCI Emerging Markets Index (AUD)	1.59%	5.05%	10.56%	7.75%	8.92%
	MSCI AC Far East Index (AUD)	2.33%	2.38%	10.83%	10.50%	13.25%

Global markets adjusted to renewed geopolitical risks, including the US-China trade dispute, growing tensions in the Middle East, the threat of impeachment, protests in Hong Kong, and the ongoing Brexit saga. A drone attack on a major Saudi Arabian oil facility, which wiped out 5.7 million barrels of production per day, or around five percent of the world's supply, wrought havoc on oil markets. Economic indicators point to a rise in the risk of a US recession and a possible turning point in equities, but so far markets appear satisfied with the low rate of US unemployment, and the bullish trend since the start of 2019 remains intact. Developed market shares outside Australia rose 1.8% in Australian dollar terms as investors tentatively re-entered equities following selling in the previous month. In the US, energy shares (+3.6%) were boosted by the spike in oil prices. Marathon Petroleum (+23.5%) jumped higher, but this wasn't enough to placate major shareholders disappointed with its recent under-performance. European shares had a positive month, with the STOXX Europe 600 Index rising 3.6%, led by financial services, auto and energy sectors. In Asian markets, China's CSI 300 Index was mostly flat at 0.5%, Hong Kong's Hang Seng Index rose 1.9%, and Japan's Nikkei 225 Index rose 5.9%.

Property

Property	Index/Benchmark (% p.a.)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	S&P/ASX 200 A-REIT Acc. Index	-2.73%	18.25%	9.19%	13.59%	13.76%
Global	FTSE EPRA/NAREIT Developed Ex Australia Index (AUD Hedged)	2.95%	14.31%	7.81%	9.73%	11.02%

September was a trying month for listed property as the S&P/ASX 200 A-REIT Index lost 2.7% as a temporary rise in yields undermined values, but the broad low-rate environment is likely a positive for property as investors continue their hunt for yield. Commercial managers Charter Hall Group (-7.9%) and Dexus (-7.5%) experienced the largest drops over the month, while retail and shopping centres also struggled. The improvement in house prices since June may now be flowing through to an improvement in housing finance. However, from an activity perspective, what is important is the trajectory of dwelling construction and the associated flow-on to retail spending on household goods and furnishings. It is difficult to envisage a recovery in housing construction any time soon given supply issues and the projection of ongoing subdued wages growth. While credit to housing has improved, credit to developers and businesses appears to be affected by the royal commission. Globally, REITs had a positive month in September, rising 3.0% in developed markets. US REITs were positive in September, returning 1.5% in US dollar terms, with gains from shopping centres (+8.4%), regional malls (+5.6%) and hotels (+5.2%).

Fixed interest

Fixed Interest	Index/Benchmark (% p.a.)	1 Month	1 Year	3 Years	5 Years	7 Years
Australian	Bloomberg AusBond Composite 0+ Yr Index	-0.49%	11.13%	4.59%	5.27%	4.88%
	Bloomberg AusBond Bank Bill Index	0.08%	1.74%	1.79%	2.01%	2.25%
Global	Bloomberg Barclays Global Aggregate Index (AUD)	-1.12%	15.43%	5.96%	7.44%	7.66%
	Bloomberg Barclays Global Aggregate Index (AUD Hedged)	-0.56%	9.81%	3.66%	4.96%	5.14%

While equities were choppy, it was the bond market that revealed the full extent of investor indecisiveness. September began with a sharp sell-off in bonds as markets, which may have been partly due to higher-than-expected US inflation, along with evidence of robust consumer spending. The US 10-year Treasury yield jumped from 1.50% at the start of the month to 1.90% on 13 September, before falling back down to just over 1.50% in early October. The result was a capital loss on 10-year bonds of around 3% over a 10-day period, making the pace and magnitude of the sell-off among the most severe. Over the course of September, global bonds, measured by the Bloomberg Barclays Global Aggregate Index, fell 0.6% in Australian dollar hedged terms, while Australian bonds fell 0.5%. The 10-year minus 3-month portion of the yield curve has been inverted since May, raising concerns for some Fed members. While not the only indicator on the ‘recession dashboard’, at the very least it indicates that investors are nervous about future growth. It could also be a sign that Fed policy is too tight and that rates need to be reduced further. September also saw a spike in the overnight lending rate between US banks, which jumped to levels not seen since 2008, prompting cash injections from the Fed to support liquidity.

Australian dollar (AUD)

The Australian dollar succumbed to the lower interest rate outlook, rising to an intra-month high of around 69 US cents before falling back to 67 cents by the end of September. Expectations of the cash rate moving to 0.50%, potentially 75 basis points below market expectations for the Fed funds rate, combined with softer iron ore prices, have contributed to the weaker currency.

The information contained in this Market Update is current as at 12/07/2019 and is prepared by Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL 421445 on behalf of National Australia Bank and its subsidiaries.

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