

# Market Overview

## Australian Shares

- The Australian market is down from where it started the Calendar Year:
  - The S&P/ASX200 Accumulation Index returned -3.86% (after including dividends)
  - The large financials sector held back performance, and even the miners, which might have been expected to do well against the background of a clearly strengthening global economy, were also down

## International Equities

- World shares, after large rises in January but even larger falls in the first half of February, recovered in recent weeks, and the MSCI World Index of developed markets is now back roughly to where it started the Calendar Year:
  - The MSCI World Index was up by 0.79% for the quarter in Australian dollar terms
- Emerging markets have continued to outshine their developed counterparts:
  - Emerging markets tend to do relatively well in global cyclical upswings and are also on cheaper valuations than the developed markets
  - The core BRIC economies (Brazil, Russia, India, China) were up, thanks to strong rises in Brazil and Russia:
    - Chinese and Indian shares have shown little net move for the year to date

## Australian Property

- The global February equity sell-off was mainly caused by concerns about rising interest rates, an issue that is particularly relevant for property shares, and, unsurprisingly, the Australian listed property shares have continued to struggle:
  - For the quarter, the S&P/ASX200 A-REIT Index recorded a loss of 6.4%

## Australian Cash and Fixed Interest

- Short-term interest rates have crept a bit higher:
  - The 90-day bank bill yield, which had been steady around 1.75% earlier in the year, rose towards the end of the quarter to a little over 1.93%
  - Long-term bond yields have followed the lead of the U.S. bond market:
    - After peaking in February, when the 10-year Commonwealth bond yield reached 2.92% on February 5, the yield has drifted down to its current 2.60%.

## International Fixed Interest

- Bond yields have retreated a little in the U.S. over the past month:
  - At its peak on February 21, the U.S. 10-year Treasury yield had reached 2.95%, but in recent weeks it has dropped back to its current 2.74%
  - Other key global yields have also eased back with the 10-year German government bond yield dropping from its recent 0.77% high on February 15 to its current 0.50%
  - Despite the recent declines, bond yields are generally modestly higher than where they started the year, with the only important exception being Japan, where the 10-year yield has held steady at 0.04%.

## Australian Dollar

- The Australian dollar weakened marginally for the quarter against the U.S. dollar, falling from US 78.0 cents to US 76.7 cents

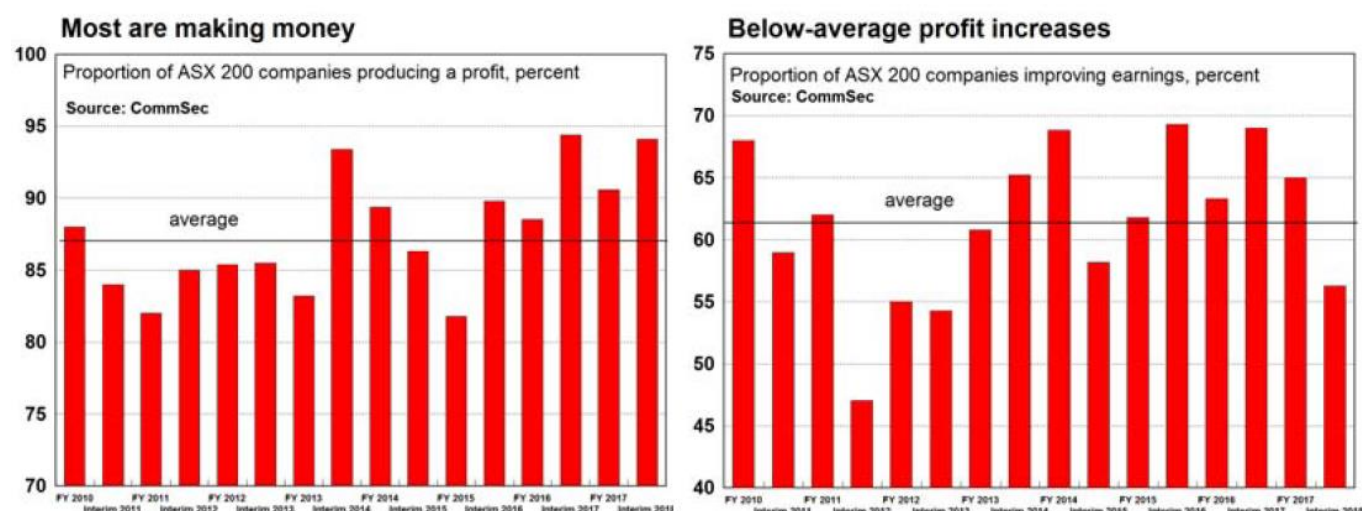
# Reporting Season Wrap

The overall tone of the interim (half year) Australian reporting season in March was reasonably positive, supported by the backdrop of a stable domestic economy, strong global equity markets and synchronised global growth. Australian corporate profits are growing, but at a slower rate for FY18 than we expected heading into the reporting season. Earnings expectations for the market have fallen since the beginning of the reporting season, however FY19 earnings expectations have lifted.

CommSec analysed all the results of the 135 ASX 200 companies reporting their interim results to the 31<sup>st</sup> December 2017. Some of the key results included:

- Revenues rose by 6.9% on the prior year
- Expenses rose by 7.8%
- Aggregate profits fell by 1.5%
- Excluding BHP, CBA and Telstra, profits increased by 3.2% on a year ago
- Dividends increased by 9.4%
- Cash on balance sheets rose by 5.6%

All but eight (94%) of the 135 ASX 200 companies reported a profit, which is above the 87% long term average. Only 56% of companies lifted profits, which is below the 61% average and the smallest in five years. Stripping out the heavyweight companies, a modest lift in aggregate profit of around 3.2% was achieved.



The key themes of the reporting season were as follows:

## *Buybacks and dividends rewarded*

Capital management remained a dominant theme during the reporting season, with investors rewarding companies for special dividends and share buybacks. Notable examples were buyback announcements from BlueScope, Computershare, Vicinity Centres, Dexus, Rio Tinto and Qantas.

## *Costs in focus in the resource sector*

Cost pressures are starting to emerge in the Resources sectors. Companies such as BHP and Rio Tinto are seeing the beginnings of some cost escalation as the east coast infrastructure boom absorbs spare labour capacity, and, segments such as drilling, struggle to fill specialist roles. Broadly speaking, some of the cost pressures are being offset as competition remains fierce in mining services work evidenced by lower margins industry-wide.

# Reporting Season Wrap

## *Rising bond yields affecting bond proxies and interest rate-sensitive sectors*

In most cases, the performance of interest rate-sensitive sectors including A-REITs, Infrastructure and Utilities was overshadowed by US bonds, which saw yields rise from 2.71% to 2.95% before settling at 2.86% during March. Looking forward, we see the US 10 year bond yield as one of the most important macro factors to influence global markets over the course of 2018 and beyond.

## *Rebounding Chinese demand*

A strong rebound in Chinese tourism is evident, with airlines seeing a better operating environment and casino operators such as Star Entertainment Group, Crown Resorts and SkyCity Entertainment Group experiencing a strong recovery in VIP activity. Agricultural and export-focussed consumer goods companies also benefitted from strong demand from China. Resource stocks are also a major beneficiary of increased Chinese demand.

## *Offshore earners outperforming, particularly in Healthcare*

In Healthcare, companies with offshore earnings, namely Resmed, Cochlear and CSL outperformed their domestic-focused peers. However, domestic hospital operators such as Ramsay Health Care and Healthscope are experiencing a period where cost pressures to the private health insurance sector are impeding profits.

## *The fundamentals for commercial (office) property are extremely strong*

A-REITs confirmed the ongoing trend that office markets on the eastern seaboard remain strong. The story of rental growth continues in the eastern- seaboard commercial property markets of Sydney and Melbourne, the cities in which most AREIT office landlord portfolios are concentrated. To 31<sup>st</sup> December, effective rents were up about 20% in Sydney and half that in Melbourne, with this trend expected to continue and have a favourable impact on valuations.

## *Retailer net profit margins are expected to fall despite more optimistic revenue growth*

Fears may have eased somewhat regarding Amazon's entry into Australia and international retailers driving price deflation, but profit margins for the retailers continue to fall. Despite the level of pessimism over revenue growth proving to be too extreme with FY19 revenue growth increasing from 2.6% to 4.0% over the reporting season, the expected profit (EBITDA) margin has been downgraded for the retailers. Competitive pressures remain strong and unlikely to abate.

## *Dividends remain in vogue*

Dividends remain in vogue but it has been apparent for the last few reporting periods, companies are seeking better balance between paying out dividends and investing in their businesses. Dividends increased by 9.4% over this reporting season but this number is expected to slow.

## **Looking ahead**

Looking ahead, many are expecting the Australian economy to grow at a faster pace over the coming year. A growing number of infrastructure projects will support prospects of construction, industrial and transport sectors. Resource companies and other companies with substantial operations overseas will benefit from a stronger global economy. The challenge will be to restrain costs.

## Reporting Season Wrap

The Australian share market is reasonably valued with the lagged price-earnings at 15.79, only slightly above the long term average as illustrated below.

