

Market Overview

Australian Shares

- Australian shares did well, though the bulk of the gains occurred in January and February and prices have not pushed on a lot since then:
 - The S&P/ASX 200 Accumulation Index was up 10.89% for the quarter

International Shares

- World shares have extended their strong recovery from the sell-off of late 2018, when investors had become nervous about the global economic outlook:
 - For the Financial Year to date, the MSCI World index of developed markets is now up 11.47%

Australian Property

- Against the renewed “hunt for yield” backdrop, the AREITs have done well:
 - For the Financial Year to date, they have delivered a total return including dividend income of 14.66%

Australian Cash and Fixed Interest

- Short-term interest rates have fallen since the start of the year:
 - The 90-day bank bill yield is down to 1.83%.
- Long-term interest rates have continued to fall:
 - Remarkably, the 10-year government bond yield has been as low as 1.74% (28 March)

International Cash and Fixed Interest

- Yields in all the major bond markets have moved lower since the start of the year:
 - In the key U.S. Treasury market, the 10-year yield is down from the end of 2018, and is now well below its recent peak last September
- The bellwether of abnormally low global bond yields remains the Swiss market:
 - There, an already negative yield in January has become a tad more negative again

Australian Dollar

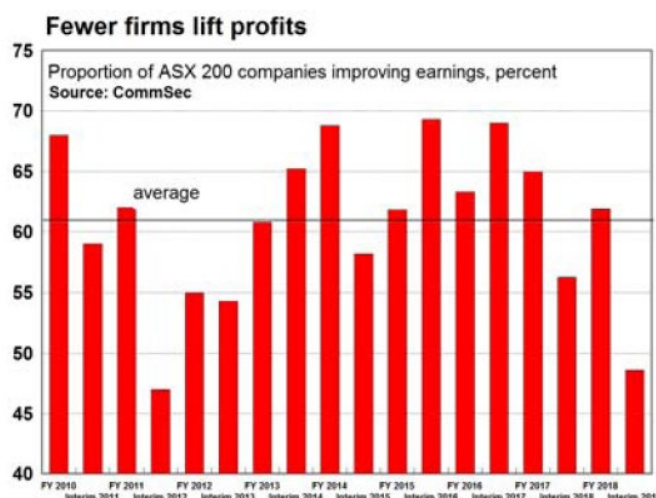
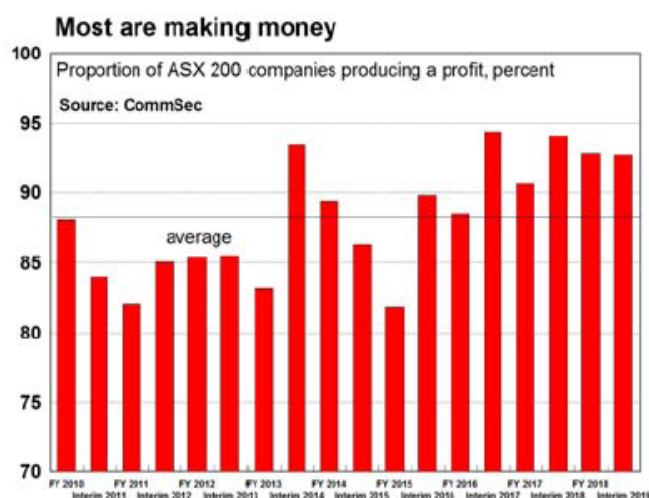
- The Australian dollar has appreciated this year to its current 70.95 U.S. cents

Reporting Season Wrap

The overall tone of the interim (half-year) Australian reporting season in March turned somewhat negative with Corporate Australia not doing as well as a year ago. Companies have had to deal with a raft of negative influences, the predominant ones being:

- The China-US trade war;
- Brexit and other global political factors;
- Falls in Australian home prices, on-going soft wage growth, and low consumer confidence.

Despite the tougher business environment, companies are still generating profits. 93% of the companies reporting their half-year (interim) results reported a net profit after tax, which is near the record high in the equivalent earnings season in February 2018. However, only 49% of those companies lifted profits compared with a year ago, when business surveys were recording the best operating conditions for over 20 years.



The key themes of the reporting season were as follows:

Resources and related mining exposures deliver good results

Aggregate profits and dividends rose in 2018, but most of the gains were from the big miners and subsequent windfall from the strong rebound in commodities prices since 2016, and recovery from the big losses in the oil and gas, steel and mining sectors from the 2015 commodities collapse.

Financials and Consumer Discretionary disappointed

The major banks all reported poor full-year results (CBA has a June year and the other three have September years). Profits in the big banks were down across the board with weak revenue growth and rising costs of regulatory penalties and the headwinds related to the recent Royal Commission. Consumer Discretionary was also weak overall, with many experiencing slowing top line organic growth.

Costs continue to rise, as has been the case for the past year

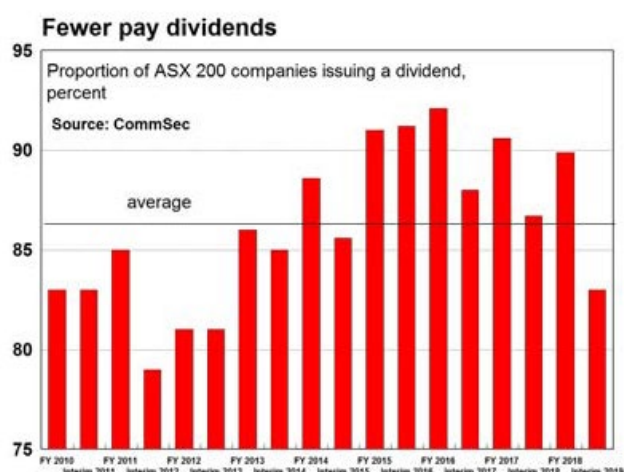
A number of companies reported increases in the cost of doing business. More people are being employed and wage growth is higher than a year ago. The cost of materials and transport also lifted in the second half of 2018, especially fuel prices. This has now led to growth in the cost of expenses exceeding that of revenues.

Reporting Season Wrap

Companies are still keen to pay dividends

The good news is that of the companies that reported, 83% elected to pay a dividend for the half-year., however, this is below the longer-term average of 86%. Although some companies (especially in the resources sector) reported “special” dividends, many investors had believed that more companies would be paying or lifting dividends ahead of proposed changes in franking policies advocated by the opposition Labor Party.

Of the companies paying a dividend, only 58% elected to lift dividends, which was the smallest proportion in around six years. The trend was actually in favour of companies keeping dividends stable – this was around 24%, the highest proportion in six years.



The tougher business environment meant it was harder for companies to lift dividends and to also lift cash levels. In aggregate, company cash holdings only rose by 5.0%, but there was a relatively even split of those lifting cash levels to those trimming cash levels.

Looking ahead

Over the past couple of years, many companies have taken the safe option of paying out dividends and buying back shares in order to keep shareholders happy.

However, the latest reporting season has shown that many companies are now opting for a greater balance of adequate cash levels to pay out dividends, in addition to increasing cash holdings (along with modest levels of borrowings) for reinvestment in the business and for new opportunities such as entering new markets or engaging in mergers and acquisitions.

Looking ahead, the business conditions for the two main sectors of the stock market, resources and financials, look more challenging but for differing reasons.

Banks will likely continue to suffer from lower lending growth and higher costs of remediation and compliance, as well as bad debts from the property slowdown as demand for new and existing homes eases over the coming year. Miners (including oil and gas) are unlikely to repeat their windfall gains as the commodities price rebound of 2016 to 2018 has stalled as the global economy slows.

In other sectors, cyclical weakness will probably hit construction, building materials, transport and retailers, although the lower Australian dollar will provide support for companies reporting results in US dollars.

Reporting Season Wrap

Finally, if the China-US trade issues are resolved, then business sentiment and conditions should lift across the globe, including in Australia. The main domestic issue is whether falling Sydney and Melbourne home prices lead to lower spending and employment growth, and thus a loss of economic momentum, which will have a negative effect on business revenue and profits.

Reporting Season Wrap