Year in Review; Year in Preview

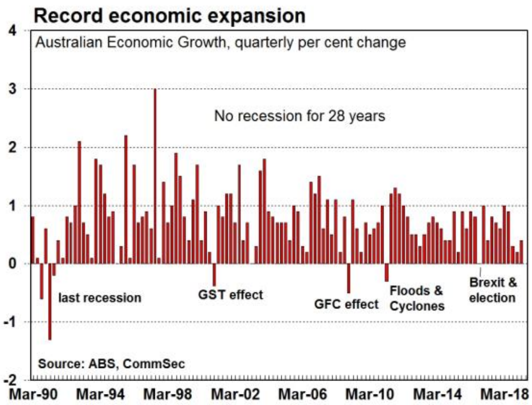
Economic & financial perspectives

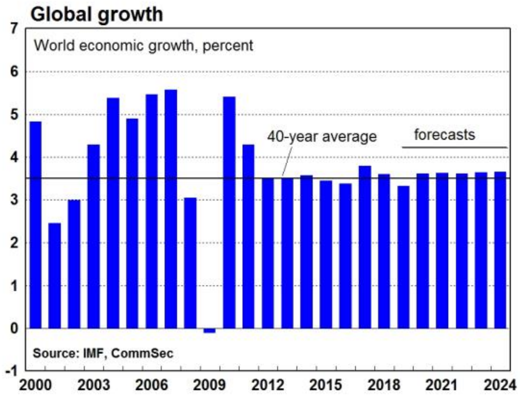
- **Record expansion: Australia's record economic expansion has completed its 28th year. Interest rates have fallen to fresh record lows; wages are growing near 2.5 per cent; underlying inflation is around 1.5 per cent; the jobless rate is 5.2 per cent.**
- **Good year for shares: Total returns on Australian shares (All Ordinaries Accumulation index) lifted by 11 per cent over 2018/19 (20-year average +9.5 per cent) and are a smidgen below record highs.**

The report is useful to assist investors to start planning for 2019/20.

What does it all mean?

- The 2018/19 financial year is now complete so it is an opportune time to see how investments, financial markets and economies have performed over the past year.
- Overall, the global economy has slowed over the past year, largely restrained by the US-China trade conflict. Central banks are now favouring rate cuts over rate hikes largely because inflation remains low. The US economy generally remains in good shape. But Chinese authorities have been stimulating their economy in response to the slowdown caused by the trade dispute with the US.
- The Australian economy is currently growing at a 1.8 per cent annual pace – the slowest pace in 9½ years. Just like other major economies, growth slowed over the year. Uncertainty over the Federal Election result also slowed activity ahead of the May 18 poll. Activity is expected to lift with election uncertainty resolved.
- The Reserve Bank has re-assessed policy settings in response to stubbornly low inflation. The Reserve Bank now believes that unemployment can fall to 4.5 per cent before igniting inflationary pressures. As a result the Reserve Bank cut the cash rate by 25 basis points in June to 1.25 per cent and has flagged another rate cut in coming months. Inflation is expected to edge higher to around 2 per cent in 2018/19 with unemployment 4.50-5.00 per cent. But much will depend on the global trade environment.
- Returns on shares lifted by 11 per cent in 2018/19 and growth of 7-11 per cent is expected in 2018/19. The Australian dollar should support the record economic expansion, largely holding in the late 60s/early 70-cent range against the greenback.





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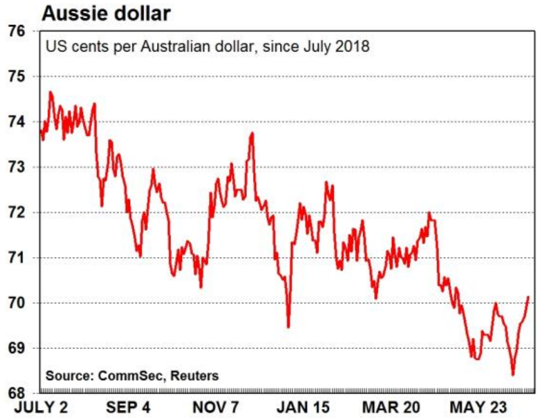
What does the data show?

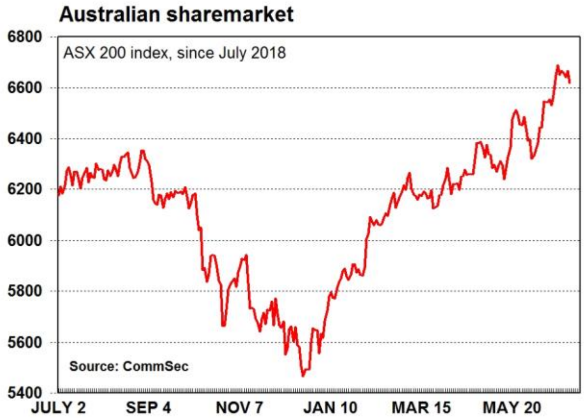
Interest rates

- The **cash rate** was reduced from 1.50 per cent to 1.25 per cent in June. It was the first rate change since August 2016.
- The market-determined **90-day bank bill rate** held between 1.18 per cent and 2.10 per cent over 2018/19 and ended the year near record lows. Yields on the long bond – **10-year government bonds** – held in a range of between 1.27 per cent and 2.79 per cent and yields and ended the year near record lows.



Currencies

- **The Aussie dollar** fell by 5.1 per cent over 2018/19. The Aussie started the year around US74 cents and ended the year near US70 cents. We have calculated that the Aussie was the 104th strongest currency (17th weakest) against the US dollar of 120 currencies tracked. The currencies of Thailand, Egypt, Uganda, Mexico, Philippines and Japan all lifted by around 2.5-7 per cent. The weakest currencies were from the economies of Argentina, Haiti, Pakistan and Zambia. Only 26 currencies of 120 currencies lifted against the greenback over the year.
- **In the first six months of 2019,** the Aussie dollar fell by 0.6 per cent against the US dollar, making it the 79th strongest of 120 currencies tracked. The currencies of Russia, Egypt, Thailand, Central Africa and Canada lifted by around 4-9 per cent. The weakest currencies were from the economies of Haiti, Argentina, Turkey, Pakistan and Ghana. Only 44 currencies have lifted against the greenback so far this year.
- The Aussie has gradually trended lower for around two years. Over most of this period US policy interest rates were rising while the Aussie cash rate was left unchanged. The Aussie has fallen from around US80 cents to US68 cents (if the January 2019 'flash crash' to US67.43 cents is ignored).

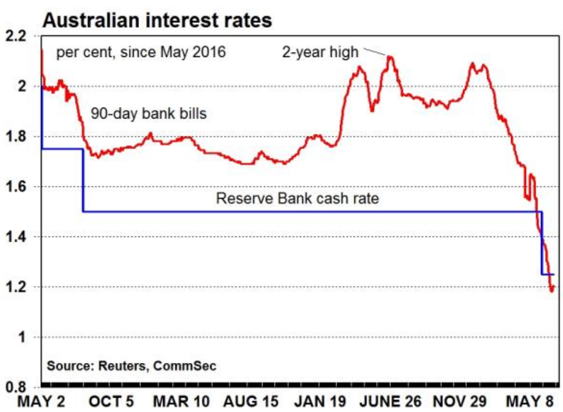


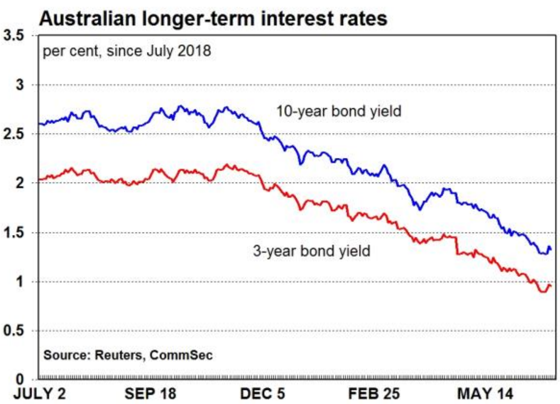
Commodities

- Commodity prices eased over the second half of 2018 in line with slower global growth but recovered some lost ground in 2019. The **Commodity Research Bureau** futures index fell by 9.7 per cent over the year, but the **CommSec daily index** rose by 5 per cent.
- The difference between the two indexes was iron ore, with its price up 83 per cent over 2018/19 while gold rose 13 per cent and coking coal rose 14 per cent. Base metal prices fell 10-20 per cent; oil fell 21 per cent while spot natural gas slid 53 per cent and thermal coal fell by 38 per cent.

Sharemarket

- **The Australian sharemarket** started 2018/19 with the All Ordinaries at 6,289.7 and the ASX200 at 6,194.6. The All Ords ended at 6,699.2 points (up 6.5 per cent) with the ASX200 at 6,618.8 (up 6.8 per cent). We estimated that Australia was 19th strongest of 72 global bourses. Overall 34 bourses recorded gains in 2018/19. The best performer was hyperinflation-affected Zimbabwe but Argentina rose 60.5 per cent and Brazil rose by 38.8 per cent. The US Dow Jones rose by 9.6 per cent. New Zealand rose by 13 per cent.





- The worst performers were West Africa, Nigeria, Kenya, Ghana, Lebanon, Oman, Pakistan and Egypt. The Irish sharemarket fell by 11.9 per cent.
- **In the first six months of 2019,** the All Ordinaries rose by 17.3 per cent, ranking Australia 11th of 72 nations. Greece, Argentina, Russia, New Zealand and China were amongst the top performers (up around 19-42 per cent) while Kuwait, Lebanon, Sri Lanka and Oman were amongst countries recording the biggest declines.

Investment returns

- **Total returns on Australian shares** lifted by 11.0 per cent over 2018/19, hitting record highs on June 20. Returns on dwellings declined by 3.6 per cent while returns on government bonds lifted by 10.2 per cent.

Sectors & size groupings

- **Of the 22 identified industry sub-sectors,** only eight recorded declines in 2018/19.
- Leading the gains was Telecom (up 42.6 per cent) from Consumer durables & apparel (up by 40.8 per cent) followed by Commercial services (up 19.4 per cent), Software & services (up 17.8 per cent) and Transportation (up 16.9 per cent).
- At the other end of the scale, Household & personal products fell by 36.9 per cent, followed by Autos & components (down 24.2 per cent), Energy (down 9.1 per cent) and Capital goods (down 8.5 per cent).
- Of the size categories, the ASX50 out-performed (up 9 per cent) from the ASX100 (up 7.7 per cent), the MidCap50 (flat) and the Small Ordinaries (down 0.9 per cent).

SECTORS & SIZE GROUPINGS

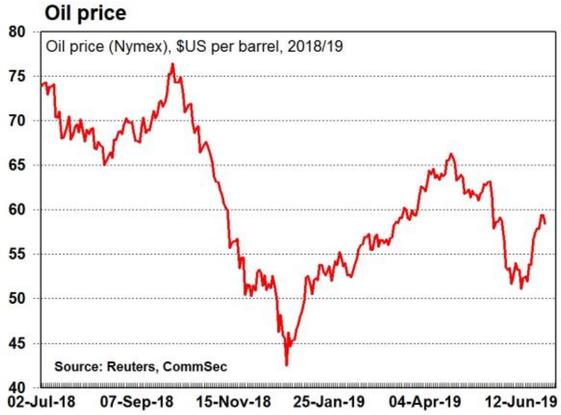
percent change over 2018/19

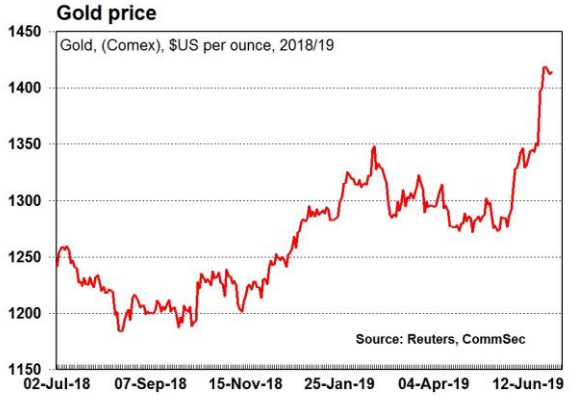
Telecom	42.6
Consumer Durables & Apparel	40.8
Commercial services	19.4
Software & Services	17.8
Transportation	16.9
Materials	14.5
Health Care Equipment & Services	11.4
Pharmaceutical & BioTech	10.6
Real Estate	9.1
ASX50	9.0
Retailing	8.2
ASX100	7.7
ASX200	**6.8**
Insurance	6.4
Food & staples retailing	3.3
Banks	2.7
Utilities	0.1
MidCap50	0
Small Ordinaries	-0.9
Diversified Financials	-3.1
Food, Beverages & Tobacco	-3.2
Consumer services	-4.1
Media	-6.2
Capital goods	-8.5
Energy	-9.1
Auto & components	-24.2
Household & personal products	-36.9

Source: iress, CommSec

What are the implications for investors?

- Returns on shares are near record highs. In fact sharemarket returns have only fallen once in the past 10 years. So an investor that has employed a diversified strategy across asset classes would be well pleased with the performance over recent years.
- The outlook for the sharemarket remains positive. The Federal Election is in the background for another three years. And the Reserve Bank has adopted a stimulatory monetary policy. The Reserve Bank now believes that the economy can operate at a faster pace, thus generating greater job growth with the hope of driving the jobless rate to 4.5 per cent.
- The cash rate was cut by a quarter per cent in June and a similar decline is expected in the next few months.





- But the Reserve Bank doesn't believe it can do it all alone – it is calling on greater fiscal stimulus.
- Certainly Federal and State governments are being active in advancing new infrastructure projects. And with budgets broadly balanced or in modest surplus, there is scope for even more fiscal stimulus to be applied.
- Over the coming year, infrastructure building and net exports will add to economic growth. The Reserve Bank hopes that the stimulatory policy settings will lead to stronger household spending as well. Weaker home building will be the main factor weighing on growth.
- Last year we noted: *"Over the coming year CommSec expects the All Ordinaries index to be near 6,400-6,600 points in December 2018 and 6,600-6,800 points in June 2019".* The December forecast proved too ambitious but the June forecast was safely achieved.
- Over the coming year CommSec expects the All Ordinaries index to be near 6,700-7,000 points in December 2019 and 6,800-7,100 points in June 2020.
- Housing markets across the nation are continuing to rebalance to reflect the increase in supply (new home construction). Lower home prices and rate cuts will ensure that first home buyers remain active. Investors are also expected to return although sharemarkets are expected to remain more attractive in the short run.
- Over 2019/20, national home prices may post small gains between 0-4 per cent. Since the Federal Election there have been signs of stabilisation of Sydney and Melbourne home prices.
- The low inflation/low interest rate environment is entrenched, meaning that lower nominal investment returns are also here to stay. So investors will need to remain flexible and alert to the returns achieved across sharemarket sectors and across asset classes to ensure that their savings are keeping pace with the cost of living.
- The 'triple L' theme (low unemployment, low inflation, low interest rates) will also dominate global markets over the coming year. In fact the US Federal Reserve is already contemplating rate cuts despite delivering the last rate hike just over six months ago.
- The Aussie dollar is expected to largely trade in the late 60s/early 70-cent range against the US dollar over most of the coming year. But interest rate differentials between the US and Australia and the US-China trade relations are the two factors that could move the Aussie out of the tight range.
- Relations between the US and China will continue to be a focus for investors. So will 'triple L'. Central banks remain fearful about weak economic growth and the potential for deflation so stimulatory policies should remain in force over the remainder of 2019.

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