Market Highlights – August 2015

- Concerns intensified over Chinese growth though US growth strengthened
- Global shares declined on these concerns
- Investors retreated to safe haven currencies
- Fed's policy announcement later this month will be closely watched

The US leads the way

Concerns about the Chinese economy, and Emerging Market economies (EM) more generally, intensified further in August. Chinese industrial production and investment growth both weakened. Meanwhile export growth across emerging economies remains weak. In response, Chinese authorities surprised markets by devaluing their currency (renminbi) in a move designed to support exporters.

The slowdown in the Chinese economy and EM more broadly, raised concerns over the possible impact on developed economies. Developed economies to date have been able to resist the pressures as domestically generated growth has been robust, supported by low interest rates, which encourages spending. Indeed, economic data across developed economies was stronger in August. This was led by the US where GDP in the second quarter was revised up strongly. With signs the US economy remains solid, the US Federal Reserve (Fed) still remains open to the possibility of a rate rise this year, perhaps as early as September.

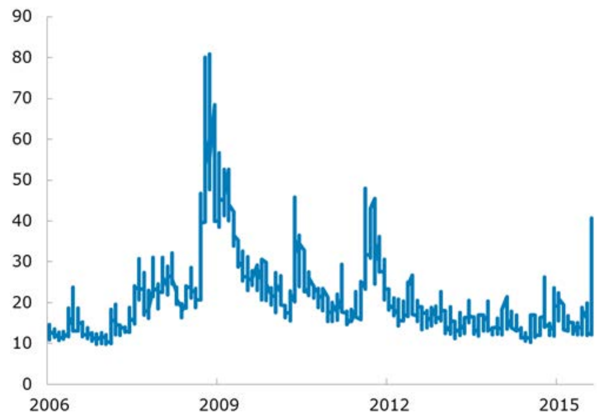
Across Australia, economic data firmed up led by stronger retail sales and a pick-up in consumer sentiment. However, despite some improvement, business plans remain consistent with a sharp decline in investment over the coming year.

Shares

Global share markets were taken on a rollercoaster ride as market volatility rose to its highest level in more than four years (refer chart) on concerns of a more prolonged slowdown in the Chinese economy and weaker growth prospects from EM.

Global developed shares declined by 9.4% in US dollar (USD) terms in the midst of this rout. Shares recovered some of this loss towards the end of the month to finish down 6.6% on a hedged Australian dollar (AUD) basis. The drop was broad based across all major markets.

VIX Index of share market volatility



Source: Bloomberg, ANZ Global Wealth

EM shares were most heavily impacted by this selloff, finishing the month down 9.2% in USD terms. This was led by Chinese shares which continued to decline despite attempts by Chinese authorities to stabilise the market.

Australian shares, being more closely associated with growth in China and emerging economies, underperfomed global shares, dropping 7.7% on a total return basis. The weakness was led by the financials and resources sector where earnings growth has been revised down due to lower growth and ongoing declines in commodity prices.

Bonds

Global government bond yields initially fell as the environment saw investors retreat to the safety of this more defensive investment. However, as share markets recovered some of their earlier losses, the focus was again on likely rate rises by the Fed given the US economy continues to grow well.

Bond yields in the US finished 7 basis points (bps) higher while German yields rose 17bps. The Barclays International Fixed Income benchmark declined 0.1%. By contrast, Australian bond yields finished the month down 10 bps as concerns over China raised uncertainty over the economy. This saw the market fully price a further rate cut by the Reserve Bank of Australia (RBA). The Australian Fixed Income subsequently outperformed its global counterpart with a 0.6% return.

Currencies

Higher market volatility saw investors retreat to 'safe haven' currencies in August. The USD rose against EM currencies but was down against the Euro and Yen which also strengthened on the safe haven trade.

The AUD fell against most currencies in the month, finishing the month 2.7% lower against the USD at US71.2c. The fall in the AUD helped offset some of the loss in global shares in unhedged AUD terms.

Major asset class performance as at 31 August 2015 (%)

Sector	1 month	3 months	12 months	5 Years
Australian Shares	-7.7	-8.8	-3.2	7.9
Global Shares (hedged)	-6.6	-6.7	4.2	15.4
Global Shares (unhedged)	-3.1	0.5	27.5	16.5
Global Emerging Markets (unhedged)	-5.8	-11	1.7	3.7
Global Small Companies (unhedged)	-1.9	1.1	28.8	18.7
Global Listed Property	-5.5	-4.8	0.7	10.4
Cash	0.2	0.5	2.5	3.5
Australian Fixed Income	0.6	1.0	6.3	6.4
International Fixed Income	-0.1	0.0	4.8	6.8

Source: JP Morgan & ANZ Global Wealth

Indexes: Australian Shares - S&P / ASX300 Accumulation, Global Shares (hedged/unhedged) - MSCI World ex Australia, Global Emerging Markets - MSCI Emerging Free Net in AUD (unhedged), Global Small Companies (unhedged) - MSCI World Small Cap exAustralia, Global Listed Property - FTSE EPRA/NAREIT Developed, Global Listed Property - FTSE EPRA/NAREIT Developed Rental Index exAustralia (hedged) with FTSE EPRA/NAREIT Developed Index ex Australia (hedged) used before April 2015, Cash - Bloomberg Bank Bill, Australian Fixed Income - Bloomberg Composite Bond All Maturities, International Fixed Income - Barclays Global Aggregate Bond Index (hedged).
Please note: Past performance is not indicative of future performance

Implications

Global growth appears likely to be lower than previously thought as emerging economies struggle to find a new growth driver. That said, we anticipate that developed economies will withstand the weaker pace of growth in EM given low interest rates and the support from lower oil prices.

Ultimately we expect global growth to remain above its new long run trend, providing support to growth assets such as shares. Still, markets are likely to remain volatilile going forward, especially at a time when the Fed is looking to raise interest rates for the first time in more than nine years.

Meanwhile, global bond yields are still expected to rise as strength in the US economy propels the Fed to lift interest rates later this year. However, quantiative easing in Europe and Japan should help offset some rise in yields across these regions.

In Australia, bond yields are expected to outperform global counterparts as uncertainty surrounding the economy's transition away from the mining sector, may lead to further action by the RBA.

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