Ausbil Investment Markets

Report

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Ausbil Investment
Management Limited
ABN 26 076 316 473
ACN 076 316 473
AFSL 229722

International economic review

Economic Review

Reflation is the new trade position adopted by financial markets, with global bonds under severe pressure, the US dollar appreciating and US equities setting new highs. Growth linked commodities have surged higher with base metals and iron ore outperforming, while gold has fallen away.

The Organization of Petroleum Exporting Countries (OPEC) has agreed to cut production to 32.5 million barrels per day, or just under 4%, starting in January 2017. The planned cut, which is the first in eight years, will bring supply and demand into balance in 2017. This is ahead of expectations and will be supportive of the improving fundamental outlook for oil prices. The OECD also revised its growth forecasts higher for 2017 and 2018 and advocated the use of collective fiscal policies to escape the persistent low growth trap. The aim is to raise the global growth rate to 3.5% from 3%.

United States
Against many expectations, Republican Party candidate, Donald Trump, will become the 45th President of the United States. In the congressional races, Republicans retained control of the House and retained a narrow margin in the Senate, marking the first time that one party will control the White House and Congress since 2010. Markets were calmed by Trump's post-election message of unity. He said: "I pledge to every citizen of our land that I will be president for all Americans."

The Federal Reserve left policy unchanged at the November meeting and repeated that the case for a rate increase "has continued to strengthen." Chair Yellen's prepared testimony before the US Joint Economic Committee stated that "the case for an increase in the target range had continued to strengthen and that such an increase could well become appropriate relatively soon" and that "the evolution of the economy will warrant only gradual increases." Yellen noted that the Fed would factor in the fiscal policies of the Trump administration as they impact the outlook for growth and inflation and she highlighted that the market reaction to the outcome of the election was consistent with expectations of more expansionary fiscal policies that could have inflationary consequences.

Q3 GDP accelerated to a 3.2% pace and the outlook remains resilient, driven by consumption and a solid labour market. The Fed's preferred measure of core inflation accelerated to 1.7% in October, compared to 1.4% a year earlier. Diminishing labour market slack and the fading effects of declining energy prices will push core and overall PCE inflation up towards 2%.

Europe
The euro area grew at a 0.3% pace in Q3, matching the rate for Q2. The annual rate stands steady at 1.6% for the Euro area, with Germany at 1.7%, France at 1.1%, Italy at 0.9% and Spain at 3.2%. The PMI's released since June have proven to be resilient in the core countries as the expected impact from Brexit has been negligible to date. The composite index is pointing to a quarterly growth rate accelerating to 0.4% for Q4, with the annual rate steady at 1.6%. The expansion gathered pace in October as faster output growth was seen in both the manufacturing and service sectors. Both the German Ifo and ZEW business expectations surveys have recovered strongly from their sharp falls following the vote on Brexit. The ZEW measure for the euro zone has risen to positive 15.8 from the low negative 14.7 in July.

United Kingdom
The High Court ruled that as the triggering of Article 50 is irrevocable, Parliament's vote is mandatory before the process of exiting from the EU can begin. Now that Parliament is involved, it may reduce the risk of a 'Hard Brexit' from being implemented.

It was confirmed that Governor Carney would stay on until June 2019. On 3 November the Bank of England (BoE) left policy unchanged at 0.25% with a neutral bias. Members noted that policy could move either way depending on the economic outlook. They also declared there is a limit to the extent to which above-target inflation can be tolerated, implying that rate cuts have become less likely in the short term. The BoE revised its inflation and growth forecasts higher, out to the 2019 horizon.

International economic review

China
The CNY currency continued to incrementally devalue against the USD to 6.89, from 6.49 at the start of 2016. Economic momentum started on a positive note in the December quarter. The official government and private sector October PMI surveys are both at two year highs and have moved further into expansionary territory. New orders being the main driver in both surveys. Industrial production and fixed asset investment growth increased. Private business investment grew by a mere 2.9%, while public investment via State Owned Enterprises increased by 20.5%. Producer input prices have accelerated further into positive territory to 1.2% (first time, in 5½ years) from the extreme low of negative 6%. The rise in commodity prices is flowing across most sub-categories of the PPI. The pace of house price growth (average prices of new homes in 70 Chinese cities) continues to accelerate, increasing at an annual rate of 12.3% in September.

Japan
The Bank of Japan (BoJ) policy meeting kept rates unchanged on 1 November. In their semi-annual Outlook Report, board members again delayed their forecast in meeting the 2% inflation target to 2018 from 2017 previously. The details showed moderate downgrades to core CPI forecasts in each year through to 2018, while the GDP outlook was adjusted slightly. The BoJ noted that the risks to growth and prices were to the downside.

Q3 GDP grew at a higher than expected 0.5% for the quarter, taking the annual rate to 0.8%. Net exports made an outsized contribution to growth together with modest gains in private and public consumption and residential investment. There was a modest drag from public investment.

Australia
At the 1 November meeting, the Reserve Bank of Australia (RBA) left policy unchanged at 1.5%, with forward guidance remaining at 'neutral'. With regard to the housing market, it was noted that "assessing conditions had become more complicated" and that "while overall conditions had eased relative to 2015, some indicators had strengthened over the previous few months." The released minutes reinforced the positive outlook from the November Statement on Monetary Policy. Economic growth was forecast to be at potential (2.8%) in the near term and then "a little above potential growth" in the medium term, while employment growth forecasts were revised lower, but the unemployment rate forecast was unchanged. The RBA upgraded the outlook for nominal income growth on the basis of rising terms of trade and adopted a more positive outlook for global inflation, while lessening the downside risk to Chinese growth.

At a recent speech on 'Buffers and Options', RBA Governor Lowe did not change the outlook following the election of US President Trump. Lowe focused on financial system stability and expressed his desire for Australia's 'buffers' to be strengthened, implying that income growth should rise faster than the accumulation of household debt. Lowe is reluctant to cut rates to stimulate consumer demand as "it is unlikely to be in the public interest, given current projections for the economy, to encourage a noticeable rise in household indebtedness, even if doing so might encourage slightly faster consumption growth in the short term." He also highlighted that "inflation remains low, but the latest reading did not suggest that it was moving lower still."

Employment has slowed, growth has been in part time work, with a net loss in full time positions, while hours worked have stabilised at a lower level. Residential building approvals, dwelling commencements and final completions are consolidating around cycle highs. The pipeline of residential construction work yet to be completed will remain high for the next two years.

Global Outlook

Global monetary policy divergence is in progress as the United States sets about normalising interest rates over a number of years. The concept of the 'neutral federal funds rate' (estimated to be at 0% real and 2% in nominal terms) will be an important guidepost for driving policy. The offset from lower oil and commodity prices is fading, while the measures of core inflation are expected to return to the 2% target level. We expect the US Federal Reserve to hike rates by 25 basis points in December 2016. If activity and inflationary pressures re-accelerate, we would expect the Fed to act more aggressively in 2017 and play catch up against a stable and less uncertain global environment. In Europe and Japan, QE programmes are under review.

Australian Economic Outlook

Australia is in a structural transition with the drivers of growth adjusting away from the previous resources boom. We expect real GDP growth at trend, which is estimated at 2.8%. The lower cash interest rate is providing ongoing support to aggregate demand and the Australian dollar is helping to drive domestic production, particularly in the services sector. Core inflation is undershooting the low end of the 2-3% target band, with benign wage inflation around 2%. Business confidence has trended higher and consumer confidence has become more favourable in the surveys. Employment growth, despite being moderate, would see the unemployment rate consolidate below 6%. Lower wages and greater flexibility allows businesses to expand their workforces, prior to embarking on business investment.

Employment growth is supporting household income and in turn private consumption. Housing remains a key beneficiary in the near term. Construction, net exports and infrastructure spend are important drivers for growth in the year ahead. Given we believe oil prices have bottomed and commodity prices have based, we expect the fair value for the AUD/USD exchange rate to be 0.75 for the remainder of 2016 and average 0.78 for 2017 and average 0.80 for 2018. We expect the record low cash interest rate at 1.50% to stay unchanged for the next two years, before gradual rate hikes commence in June 2018.

Fixed Interest

As measured by the Bloomberg AusBond Government Bond Index (0+ years), the debt market produced a return of negative 1.68% in the month of November and positive 3.33% for the year. The (0-5 years) Index returned negative 0.39% and positive 2.47% for the year.

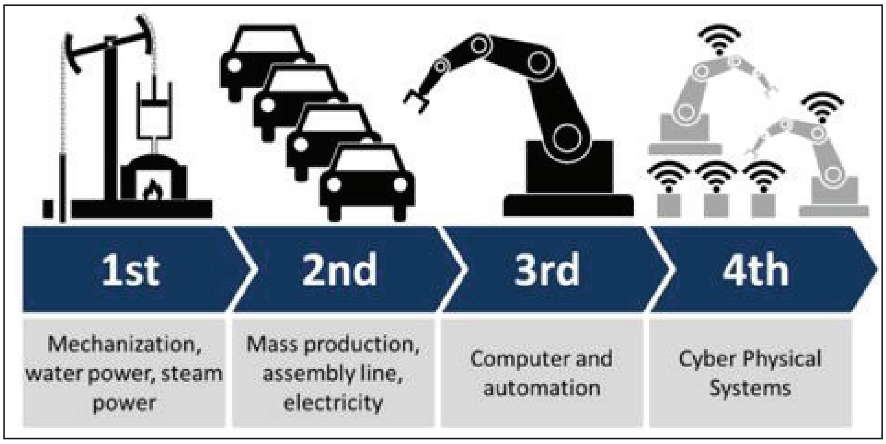
2016	US	US	Aus	Aus
Month end	**Nov**	**Oct**	**Nov**	**Oct**
2yr	1.11%	0.84%	1.76%	1.64%
10yr	2.38%	1.83%	2.72%	2.35%
2/10 yield curve	1.27%	0.98%	0.96%	0.70%
10yr indexed	0.42%	0.09%		
10yr spread to US			0.34%	0.52%

Global sovereign long dated bond yields surged higher (prices fell) and yield curves steepened sharply. The driver being “pro-growth” policies assumed to be implemented by US President elect Trump. US 2-year yields closed higher by 27 basis points and the 10-year rose by 56bps. The positive sloped 2/10 yield curve widened by 29bps. The inflation indexed US10-year real yield surged higher to 0.42% from 0.09%. Australian yields move higher with 2-year yield up 12bps, 10-year up 38bps, and the 2/10 yield curve wider by 26bps. The 10-year spread to US narrowed by 18bps.

Telecoms: Keeping pace with the Fourth Industrial Revolution

Look around and you can see how technology has changed the way we live our lives, even as recently as five years ago. The pace of change from here is expected to be exponential. Mobility and connectivity have become a must have in human lives and we are just at the start of the Fourth Industrial Revolution.

The Fourth Industrial Revolution
The Fourth Industrial Revolution is characterised by new technologies that are bringing together digital, physical and biological worlds[1], impacting all disciplines, economies and industries. It is the so called cyber-physical systems, cloud computing and the Internet of Things (IoT), which are not just driving changes and efficiencies through the production line, but are transforming everything we do.



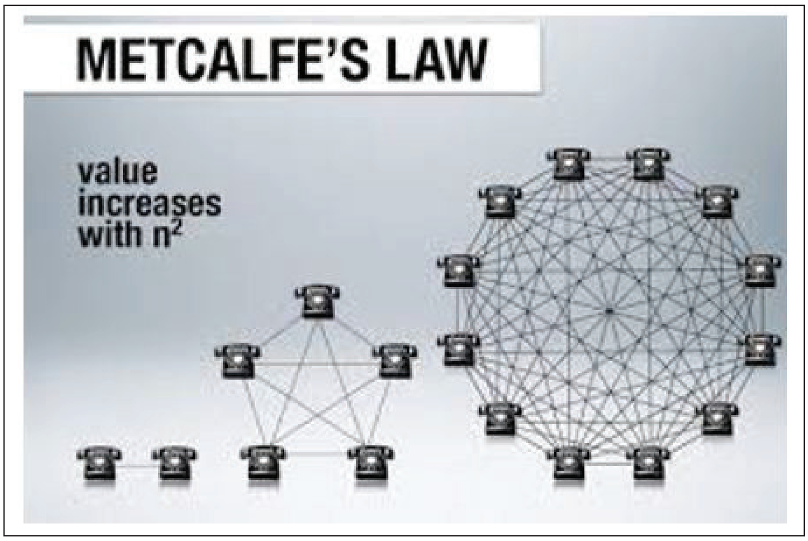
Source: Christoph Roser at AllAboutLean.com

Everything is changing - the way we connect, feel, live and work. Billions of people will be connected in real time, anytime and anywhere. Ericsson has forecast that there will be more than six billion smartphone users globally by 2020, which will represent about 70 percent of the world's population. On top of that, the telecommunications company has also estimated there will be around 26 billion connected 'things' by 2020. We are on the verge of a paradigm shift.

Connectivity is pervasive, data storage is limitless with cloud computing, hardware is becoming increasingly cheap and at a price that everyone can afford. Moore's Law continues and Metcalfe's Law is driving value through the network effects. Moore's Law states that the number of transistors on integrated circuits has doubled every year since their invention. Moore's Law also predicts that this trend will continue into the foreseeable future. Metcalfe's Law states that the value of a telecommunications network is proportional to the square of the number of connected users of the system (n^2).

Think of Facebook, LinkedIn and Twitter, just to name a few. The more users on the network, the more valuable the service is to the community and social networking has already become a big part of our daily life.

[1] The Fourth Industrial Revolution by Klaus Schwab



Source: List.ly co-founder

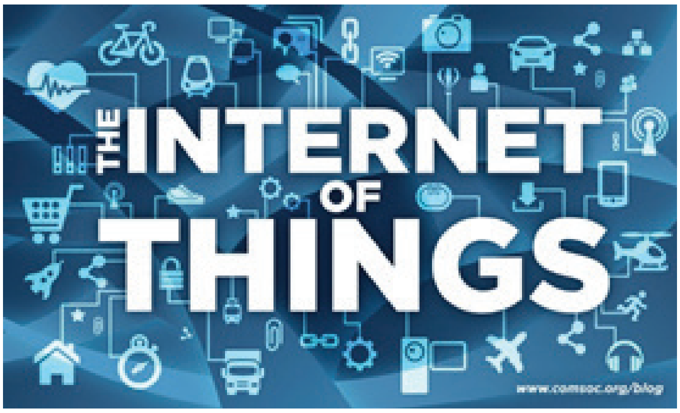
The new wave of Technology Innovation

Businesses that are able to keep pace, be agile and adapt to these changes will benefit the most. The impact of the technology innovation will be disruptive to nearly every industry and process. Connected cars or driverless cars, connected home, smart cities, artificial intelligence, robotics, bitcoin, blockchain, 3D printing, biotechnology and nanotechnology are all examples of new technology innovation and advances that are still in their infancy. The opportunity for new products and services is limitless.

Is the Telecommunication Sector keeping pace?

We are living in a highly competitive world and competition continues to dial up. The telecommunication sector is at the heart of these changes, and the opportunities arising from this revolution are very significant. Telecoms need to invest and be ready to compete as the change will come thick and fast. Billions of dollars are being invested in this market into network infrastructure and technology platforms to support the needs of devices.

IoT is about the 'Things', connectivity, real-time data in the cloud and analytics. Connectivity and data analytics are the areas where telecoms can play and are playing. We know that the three key players, Telstra, Optus and Vodafone are getting their networks ready for the IoT and the exponential growth in demand for data.

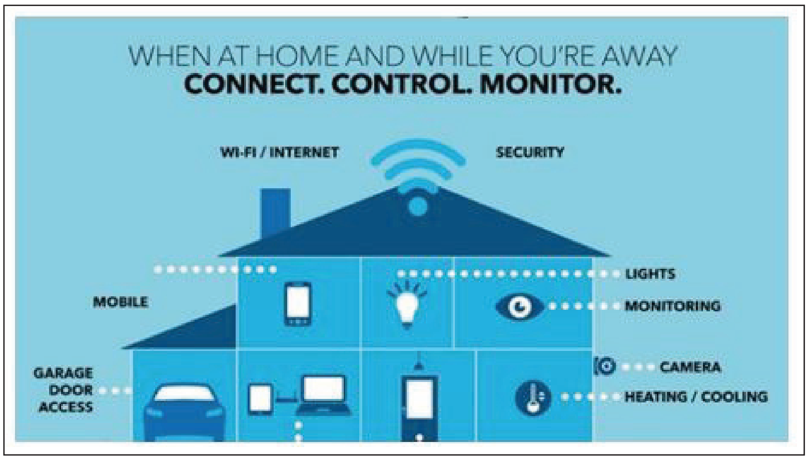


Cellular networks will have a significant role to play in the world of IoT, providing the connectivity. Telstra, Optus and Vodafone have been running field trials for their IoT networks and are planning for network wide deployment. They are also getting network ready for 5G, or fifth generation wireless systems. The real-time data will be collected and stored in the cloud and then it is about how you analyse this real-time information to provide crucial operational insights. Telecoms are well positioned to provide the platforms and software for data analytics and will play a vital role in assisting companies to connect the insights back to their business.

IDC, and information technology research firm, has forecast that IoT will grow to a $1.7 trillion market opportunity globally by 2020. A significant part of this revenue opportunity is in the end user products, however, the revenue opportunity in connectivity and analytics remains significant.

We have seen telecoms discontinuing the revenue model from charging traditional voice minutes and SMS, to a bundled service which offers unlimited voice and SMS with limited data. The usage of data will be the most significant area of growth. New economic models will continue to evolve and the industry needs to continue to keep pace with the changes, to be competitive, predictive and pre-emptive.

There is also increased focus by the telecom providers to control communication at home. If you control home communication, you will get a large share of the consumer wallet. Connected home is the next iteration of what we have now, largely just triple-play or quadruple-play (fixed voice, fixed broadband, pay TV and mobile). Being able to connect, control and monitor everything inside your home when you're at home, and while you're away, on a single platform will change the way we live. For the provider, it is a new revenue stream as well as churn reduction exercise.



Source: www.padtronics.com

E-Health (or Health Informatics) is the other area that the telecom providers are actively engaging in, providing solutions, connectivity and the platform that will transform the way healthcare is delivered to the community in a safer, more affordable, better quality and sustainable way.

The telecom industry continues to be a highly regulated industry and regulators need to adapt to this new, fast-changing environment to embrace the technology disruption that the Fourth Industrial Revolution brings as it shapes the future and benefits consumers and the economy.

Cloud and SaaS (Software as a Service) providers are also well positioned to ride the wave of the Fourth Industrial Revolution.

Ausbil Investment
Management Limited
Level 27
225 George Street
Sydney NSW 2000
Australia
Toll Free 1800 287 245

Contactus@
ausbil.com.au

ausbil