Monthly Market Review – November 2016

The big market event over November was, of course, the election of (soon to be) President Trump.

Share markets initially sold off as it became apparent Trump was going to pull off an upset victory. An uncharacteristically conciliatory acceptance speech coupled with a Republican sweep of Congress resulted in the US share market whipsawing up as investors focussed on Trump's promises of fiscal stimulus by way of tax cuts and infrastructure spend along with deregulation. Less attention was paid to Trump's anti-globalisation, protectionist statements (at least for now).

Bonds have continued to sell off in the subsequent period. Wage inflation was already starting to come through in the US prior to the election. Now, with prospects of pro-cyclical fiscal stimulus, the market started to factor in higher prospective inflation. Additionally, this gives more room for the US central bank (the "Fed") to step back from the extraordinary monetary stimulus they've put in place and hike interest rates.

How the different asset classes have fared *(As at 30th November 2016)*

Asset Class	10 Yr % p.a.	5 Yr % p.a.	3 Yr % p.a.	1 Yr %	YTD %	6 Mo %	3 Mo %	1 Mo %
Cash[1]	4.2	2.8	2.4	2.1	1.9	0.9	0.4	0.1
Australian Bonds[2]	6.2	5.2	5.3	3.4	3.1	-0.5	-2.9	-1.4
International Bonds[3]	7.3	6.3	6.2	4.6	4.6	-0.4	-3.1	-1.8
Australian Shares[4]	4.5	10.3	5.6	10	7.2	3.1	0.6	2.5
International Shares Unhedged[5]	4.5	17.6	11.5	0.9	3.3	1.1	1.7	4.5
International Shares Hedged[6]	6.5	15.1	9.0	5.3	7.5	6.3	2.6	2.8
Emerging Markets Unhedged[7]	2.9	7.9	4.0	6.4	9.2	6.3	-1.5	-1.7
Listed Infrastructure Unhedged[8]		16.1	13.2	4.1	5.9	-3.7	-3.1	-1.2
Australian Listed Property[9]	0.3	16.4	14.9	10.3	6.0	-5.5	-11.0	0.7
Int. Listed Property Unhedged[10]		16.5	14.9	0.2	-0.2	-6.5	-8.6	0.0

[1]Bloomberg AusBond Bank 0+Y TR AUD, [2]Bloomberg AusBond Composite 0+Y TR AUD, [3]JPM GBI Global Ex Australia TR Hdg AUD, [4]S&P/ASX All Ordinaries TR, [5]MSCI World Ex Australia NR AUD, [6]Vanguard Intl Shares Index Hdg AUD TR, [7]MSCI EM NR AUD, [8]S&P Global Infrastructure NR AUD, [9]S&P/ASX 300 AREIT TR, [10]FTSE EPRA/NAREIT Global REITs NR AUD

Cash

The Reserve Bank of Australia (RBA) once again left the overnight cash rate at 1.5% at its December meeting. In the statement accompanying the decision the bank pointed to the improvement in Australia's terms of trade (how much we pay for imports vs. what we get for our exports). However, slowing employment growth and "subdued growth in labour costs" meant the case for raising rates was weakened. Additionally, the statement mentioned: subdued business investment; a high Australian dollar, and; "considerable supply of apartments is scheduled to come on stream over the next couple of years, particularly in the eastern capital cities. Growth in rents is the slowest for some decades". On balance it would seem the RBA now has an easing bias.

The day after the RBA meeting the GDP growth figures came out, with the largest quarterly contraction since the GFC (-0.5%). This saw the market swinging from expectations of rate hikes next year to a 25% implied probability of a rate cut by mid next year.

Bonds

US bond yields shot up as expectations of higher inflation and interest rate rises were factored into pricing.

The US 10 year government bond went from 1.83% to 2.45% over the month. Bond prices move in the opposite direction to yields so the jump in yields represents a capital loss for investors. Anyone holding US government bonds lost 1.5% in November.

Australian inflation has been below the RBA's target of 2-3% over the cycle for some time. This didn't change on the election of Trump.

However, while the RBA can pin the cash rate down, longer maturity bonds are priced by the market off US bonds. Consequently, Australian bond yields also moved up. The Australian 10 year government bond went from 2.22% early in November to 2.78% by the end of the month. Investors in Australian government bonds gave up 1.9% for the month.

The market did however recognise the different contrasting circumstances of Australia (adjusting to the end of the biggest mining boom the world has ever seen) and the US (which is emerging at last from the long drawn out recovery from the GFC) are in. It did this via the spread between Australian and US yields narrowing.

Australian Equities

Australian equities joined the Trump rally, returning 3% for the month.

In all the Trump related noise it was easy to miss other important market moving items in the news flow. One of these was OPEC reached agreement on cutting oil production. It remains to be seen whether this agreement is honoured and there are actual cuts. However, the fact that agreement was reached at all, and that it included non OPEC producers like Russia, saw the oil price rally. This benefited ASX listed energy companies which returned 3.7% for the month.

Rising interest rates benefit banks through wider net interest margins. This saw the S&P/ASX 200 Financials ex REITS sub index produce a 6.1% return over November.

Rising interest rates don't benefit bonds though, or stocks that have been bought as substitutes for bonds because of their perceived safe and steady dividend streams. These so called "bond proxies" were also sold off in November. However, Australian REITs (Real Estate Investment Trusts) managed to generate a small positive return (0.8%). This was probably the result of bargain hunters seeing value in the sector for the first time in a while: AREITs are still down -11.1% for the quarter ending November.

International Shares

Developed market equities returned 4.5% over November. The Australian dollar depreciated over the month, so currency hedged investors didn't do quite as well, gaining 2.8%.

The star of the show, unsurprisingly, was the US share market which popped by 6.8%. European (-0.3%) and Japanese (-0.2%) shares actually lost ground.

Emerging market stocks were where investors expressed any fears of Trump sparking a global trade war. That, along with rising US rates and dollar, saw emerging market stocks punished, with -1.7% for the month.

Bond proxies were predictably sold off. Developed market infrastructure gave up 1.2% while Global REITs ended the month flat.