Monthly Market Review – October 2016

How the different asset classes have fared *(As at 31st October 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	2.9	2.4	2.1	1.8	1.0	0.5	0.1
Australian Bonds[2]	6.4	5.8	5.8	4.0	4.6	2.2	-1.1	-1.3
International Bonds[3]	7.6	6.7	6.9	6.7	6.5	2.1	-1.6	-1.3
Australian Shares[4]	4.5	9.0	4.3	6.6	4.6	3.8	-3.1	-2.2
International Shares Unhedged[5]	4.1	16.8	11.9	-5.4	-1.2	2.5	-1.4	-1.4
International Shares Hedged[6]	6.3	14.2	8.9	3.3	4.6	5.5	0.5	-0.5
Emerging Markets Unhedged[7]	3.7	7.5	5.4	2.4	11.2	9.7	3.9	0.8
Listed Infrastructure Unhedged[8]	4.1	14.0	11.7	-1.2	8.2	2.2	-3.2	-2.3
Australian Listed Property[9]	0.7	16.8	13.6	6.4	5.2	-3.7	-14.0	-7.7
Int. Listed Property Unhedged[10]		16.4	14.5	-2.9	-0.2	-1.4	-10.5	-5.7

[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 left interest rates unchanged at its October meeting and again sat pat in November. Markets see this continuing with only a 6% chance of a rate cut at the last meeting of the year in December, and around 70% probability of interest rates remaining at the current 1.5% right out to October next year.

Bonds

Both domestic and off shore bond markets went backwards in October. With bond yields at multi decade lows, just a whiff of possible inflation and interest rate rises in the US was enough to see bond yields (the "interest rate" bonds pay) move higher over the month. When bond yields go up bond prices go down; causing a capital loss and hence the negative total return.

Since mid-July the 10 year US government bond has gone from a yield of 1.36% to 1.85% towards the end of October. This doesn't sound like much of an increase, but given the low starting level, it's a 34% increase in a short period.

US unemployment is now less than 5%, annual economic growth is at 3% and wage inflation finally looks like it's coming through. This has seen the market putting a 3 in 4 chance of the US central bank (the "Fed") increasing US interest rates at its December meeting.

Australian bond yields have been pulled up by the US market (and prices down). Since the end of July the Australian 10 year government bond has gone from 1.8% to 2.3%, a 31% increase.

Australian Equities

Australian equities had a negative month in October. Healthcare (-8%), industrials (-3%), utilities (-3%) and energy (-2%) were all in the red. Materials stocks were one of the few sectors to generate positive returns (+1%).

Australian listed property continued to come back down to earth. With bond yields at record lows, investors had sought out safe, defensive stocks offering a steady dividend higher than bond yields. Listed property stocks are prime so called "bond proxies". Now with real bonds starting to pay more the relative attractiveness of holding a substitute lessoned.

International Shares

Developed market shares also had a poor October overall. US stocks fell 2% (in US dollars) over the month. As well as the likelihood of an interest rate rise in December, uncertainty over the presidential election weighted on stocks. European stocks appreciated by 1.3% (local currency) off the back of some encouraging macroeconomic data. Japanese equities surged ahead by 6% in local currency terms. The yen weakened over the month against most of Japan's trading partners providing some support to Japanese exporters and bolstering equity investor sentiment.

Emerging markets out performed developed markets over the month. Brazil led the way with a gain of 14.5% (in AUD) off the back of congressional approval of a budget spending cap which was considerably ahead of market expectations.

International listed property sold off as bond proxies in common with Australian listed property. Some listed infrastructure stocks, such as utilities, also got caught by this. More growth oriented infrastructure stocks, such as ports and rail roads, are less bond like and so the overall asset class did not sell off to the same extent as listed property.