

The Antipodean



The big macro themes for the week



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It has been a big week for financial markets with the US Dow Jones chalking up a fresh record high in time for the 30th anniversary of the 1987 stock market crash. On the other side of the world, the long-awaited 19th Party Congress in China was opened with a soporific three-and-a-half hour long speech by President Xi Jinping. Closer to home, in the age of weak political mandates, yet another coalition government has been formed, this time in New Zealand. For multi-asset investors the big themes for the week were around interest rate expectations in Australia, Trump's influence over the Japanese equity market, and the re-emergence of value over growth.

1. Next move in Australian rates?

September employment data printed stronger than expected this week, leaving us with the longest run of consecutive monthly job gains since 1994. This comes after a rebound in consumer confidence, a pickup in non-mining investment and tentative signs that the downturn in building approvals is over. All of this supports the case for the next move in rates being up. Retail sales remain very weak however which, together with weak household balance sheets and poor wages growth, supports the "no change" camp. Who to follow? NAB analysis suggests we go with the global crowd. They find global monetary policy developments add value to anticipating RBA policy moves. This is consistent with RBA Governor Lowe's comment that "an increase in global interest rates would, over time, be expected to flow through to us, just as the lower interest rates have." Bottom line: if domestic unemployment and inflation conditions continue to improve, and the rest of the world continues to lift rates (US, Canada, and likely UK soon), it is only a matter of time before the RBA follows. Current market pricing has just a 36% probability of a rate hike by mid-2018, up from 33% before the employment report. There is a risk then that the market is being too complacent about the timing of the next move up in rates.

2. Donald Trump and the Japanese yen

Donald Trump is becoming a more important driver of the yen these days than Shinzo Abe despite this weekend's Japanese election. Ten-year Treasury yields and the USD/JPY have become more correlated recently. That is, a higher US bond yield is associated with a higher USD/JPY. US yields rose slightly this week but are up 60bps over the last 12 months in part on the back of Donald Trump. This in turn is driving the Japanese equity market where the correlation to the yen is highly negative ie weaker yen, stronger equity market. While it is difficult to objectively demonstrate causality, logically a weak yen leads to greater export competitiveness, and in an export-oriented economy like Japan's, this is vitally important to corporate earnings. This week the USD is up 0.7% against the yen. Meanwhile, Japanese equities have outperformed the rest of the world rising by 1.3% on the TOPIX. This suits our current overweight position in TOPIX versus the German DAX.

3. The re-emergence of value over growth

US growth stocks (think FANG – Facebook, Amazon, Netflix, Google) have outperformed value during most of this year's US equity rally, amid a lower-for-longer backdrop. As inflation expectations pick up, this pattern could start to change, with value stocks benefiting more from higher inflation. Supporting the case for higher inflation is the tightness of the US labour market. US Jobless Claims fell to their lowest levels since 1973 this week's. This US economic recovery has lasted more than 100 months – the longest since business cycle records began. As Mervyn King noted at this week's Citi Conference, "We haven't un-invented the business cycle". Inflation will emerge with tighter labour markets. We continue to expect the Fed to raise rates again at their December meeting and for the balance sheet reduction to have little overall impact on financial conditions. Value has typically outperformed growth stocks and the broad index in rate hiking cycles. For this reason, we like our overweight position in the US Russell 1000 Value Index versus the broader S&P 500 Index.

Summary of World Markets

19 October 2017

Market price movements		Latest Level	Weekly change	Month to date	Qtr to date	Yr to date	Rolling 12 mths
World Equity Indices (Price)							
Australia	ASX 200	5896.1	1.4	3.8	3.1	4.1	8.6
	ASX 300 A-REIT Index	1328.6	1.3	1.5	2.5	-3.1	0.1
	Resources	3649.7	1.0	3.2	10.9	8.8	16.8
U.S.	S & P 500	2562.1	0.3	1.7	5.7	14.4	19.7
	Nasdaq	6605.1	0.0	1.7	7.6	22.7	25.6
	Russell 1000 Value	1180.5	0.3	1.1	3.6	7.1	15.2
Canada (TSEI)	Canada (TSEI)	15818.0	0.1	1.2	4.2	3.5	5.9
U.K.	FTSE 100	7523.0	-0.2	2.0	2.9	5.3	7.2
France	CAC 40	5368.3	0.3	0.7	4.8	10.4	18.3
Germany	DAX	12990.1	0.0	1.3	5.4	13.1	21.3
Italy	MIB 30	22133.2	-1.3	-2.5	7.5	15.1	28.9
Euro	Stoxx 50	3602.1	-0.1	0.2	4.7	9.5	17.0
Swiss	SMI	9233.5	-0.8	0.8	3.7	12.3	14.9
Sweden	OMX	1647.0	0.3	0.6	2.8	8.6	12.4
Spain	IBEX 35	10197.5	-0.6	-1.8	-2.4	9.0	12.1
Hong Kong	Hang Seng	28159.1	-1.1	2.2	9.3	28.0	20.5
Japan	Nikkei	21448.5	1.4	5.4	7.1	12.2	24.8
	TOPIX	1730.0	1.3	3.3	7.3	13.9	26.7
Korea	Composite	2473.1	0.0	3.3	3.4	22.0	21.6
Taiwan	TWSE	10760.3	0.3	3.6	3.5	16.3	15.6
Singapore	Straits Times Index	3334.9	0.5	3.6	3.4	15.8	17.8
Malaysia	KLCI	1744.0	-0.6	-0.7	-1.1	6.2	4.4
Thailand	SET	1683.4	-1.7	0.6	6.9	9.1	12.2
Mexico	Bolsa USD	50000.3	0.0	-0.7	0.3	9.5	3.3
Brazil	Bovespa	76283.2	-0.9	2.7	21.3	26.7	19.0
MSCI World	MSCI World	2033.3	0.3	1.6	6.1	16.1	19.5
MSCI EM	MSCI EM	1116.9	-0.8	3.3	10.5	29.5	22.6
10 Year Bonds (basis pts)							
Australia	3 year	2.11	0.00	-0.04	0.20	0.15	0.40
	10 year	2.76	-0.03	-0.08	0.17	0.00	0.48
New Zealand	10 year	2.93	-0.03	-0.04	-0.05	-0.40	0.34
Canada	10 year	2.01	-0.02	-0.09	0.25	0.29	0.89
U.S.	3mth	1.36	0.01	0.03	0.06	0.36	0.48
	2 year	1.53	0.04	0.05	0.15	0.34	0.71
	10 year	2.32	0.04	-0.02	0.01	-0.13	0.58
	30 year	2.84	0.03	-0.02	0.00	-0.23	0.35
Japan	3 year	-0.12	0.00	0.00	-0.01	0.05	0.11
	10 year	0.06	0.00	0.00	-0.02	0.02	0.12
U.K.	3 year	0.50	-0.06	-0.03	0.08	0.41	0.23
	10 year	1.28	-0.09	-0.09	0.02	0.04	0.19
Germany	3 year	-0.64	-0.01	-0.04	-0.11	0.15	0.03
	10 year	0.39	-0.01	-0.07	-0.07	0.19	0.39
France	10 year	0.81	0.00	0.07	0.00	0.13	0.53
Italy	10 year	2.02	-0.05	-0.08	-0.13	0.21	0.65
Spain	10 year	1.63	0.03	0.03	0.11	0.25	0.52
Australia/US Spread	10 year	0.45	-0.07	-0.06	0.15	0.12	-0.11
Official Interest Rates (%)				Economic Growth (yoy%)		Inflation (yoy%)	
		Latest		Latest	Previous	Latest	Previous
Australia		1.5		1.80	1.80	1.90	2.10
US		1.25		2.20	2.00	2.20	1.90
China		4.35		6.80	6.90	1.60	1.80
Japan		0.1		1.40	1.50	0.70	0.40
UK		0.25		1.50	1.80	3.00	2.90
Germany		0.0		2.10	2.00	1.80	1.80
France		0.0		1.80	1.10	1.00	0.90
Canada		1.0		3.80	4.40	1.40	1.20

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Currencies						
AUD/USD (4pm AEST)	0.79	-0.2	0.5	2.4	9.3	3.5
AUD/YEN (4pm AEST)	88.6	0.5	0.6	2.6	5.3	12.3
AUD/EUR (4pm AEST)	0.67	-0.3	0.4	-1.1	-2.7	-4.8
AUD/GBP	0.60	0.8	2.3	1.4	2.5	-3.8
USD/YEN (3pm NYT)	112.6	0.7	0.0	0.2	-3.8	8.4
EUR/USD (3pm NYT)	1.18	0.1	0.2	3.6	12.5	8.7
Australia TWI (4pm AEST)	66.2	0.6	0.0	1.1	3.6	1.8
JP Morgan EM Currency Index	69.6	-0.4	0.1	1.1	5.6	1.6
US Dollar Index	93.3	0.2	0.2	-2.5	-8.8	-5.5
COMMODITIES						
GOLD – New York (S)	1290.0	-1.1	0.4	3.2	10.7	0.2
OIL – West Texas (F)	51.3	-0.3	-0.7	9.7	-10.1	-5.9
Oil – Brent	57.2	0.1	-0.5	19.4	0.7	10.5
CBA Commodity Index (SDR)	226.8	0.1	1.3	5.1	-11.3	-6.2
CRB (F)	428.2	-0.5	0.2	-4.1	1.2	7.4
Copper (USD/ton)	316.8	1.1	7.2	16.2	25.4	49.0
Iron ore	60.9	-2.6	-1.9	-6.3	-22.8	3.7
Vix Volatility Index	10.1	4.6	5.7	-10.1	-28.4	-24.7

Source: Bloomberg

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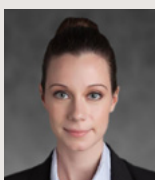
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