

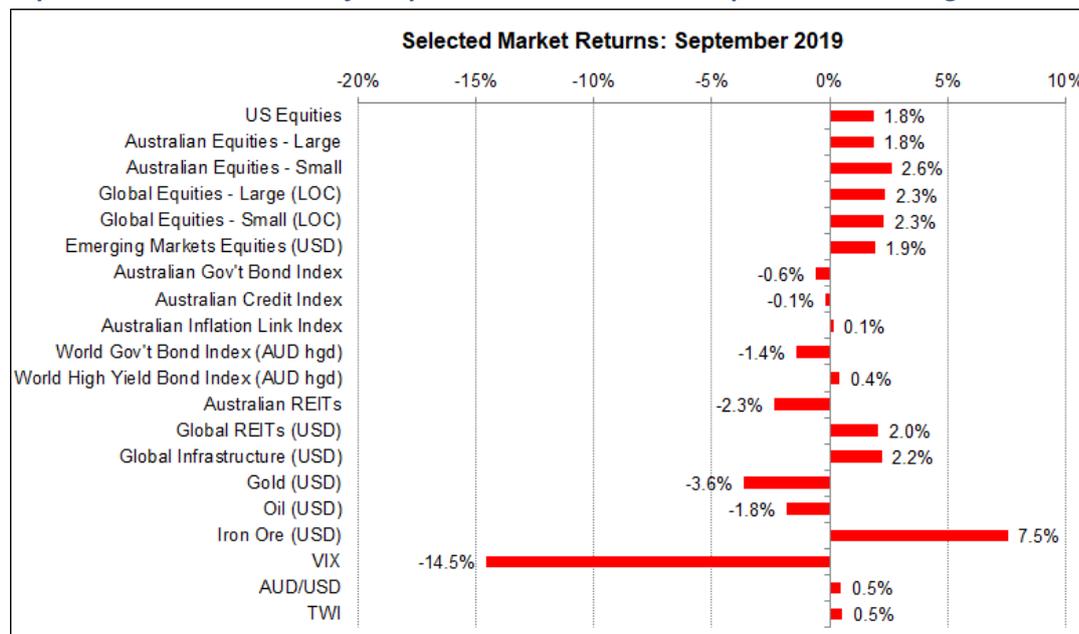
### *In summary*

September's market action was in clear contrast to the previous month, with concerns about global growth, trade wars and geo-politics giving way to a more optimistic mood in which the relative performance of key asset classes reversed. In particular, equities rallied while bonds & gold sold off.

The seasonal thinness of markets improved in September as investors returned to work in time to take advantage of a more balanced news flow. There were signs of a more conciliatory approach by both the US and China to the trade dispute, central banks around the world eased monetary policy, and the US economy posted more good data on employment and household spending. On the negative side, manufacturing activity around the world slipped further, adding to fears of recession, while a drone attack on Saudi oil fields caused a sharp, but transitory, spike in the price of oil.

At the end of the day, much of the price action between August and September simply cancelled itself out. However there is more to this than meets the eye, because the volatility reflects uncertainty, of which there is plenty in the world and not just economic. Geopolitical developments including Brexit, the move to impeach Trump, and increasingly violent protest in Hong Kong all contributed.

### *September saw a reversal of the pessimistic sentiment and price action in August*



Source: Thomson Reuters, Bloomberg

### *Key developments in September*

The key question preoccupying markets continues to be whether the world is sliding into recession. Attention is focussed on the difference in performance between manufacturing and service sectors around the world. Manufacturing has been hit hard this year by the slowdown in China and the trade dispute. Latest data show Germany's manufacturing sector, for example, is effectively in recession already and the situation in the US seems to be heading there. In Australia, business conditions are still slipping. Weakness in export orders is a common factor driving the manufacturing slowdown.

However, service sector activity has generally been better. This makes sense since manufacturing produces a lot of internationally traded goods, while the output of the services sector tends to be consumed at home and so depends more heavily on local employment conditions. It is important to remember that the services sector in many developed economies, is larger than manufacturing.

The markets are increasingly concerned that, with no end in sight for the trade dispute, the weakness in manufacturing will spill over into the rest of the economy and tip it all into recession. Considering this, the markets are closely watching the PMI reports, employment data, retail sales and policy announcements from the central banks. Most attention is focussed on the US, but the risks in Europe are becoming more pronounced.

Key data in released in September included:

- the US manufacturing PMI fell for the fifth month in a row to 49.1, below the key expansion/contraction level of 50, while the services PMI was 56.4;
- the composite PMI in the Eurozone fell to 50.4 in September from 51.9 in August, and in Germany the composite PMI fell to 49.1 in September, from 51.7 in August;
- US employment growth has slowed from last year's pace, but is still strong enough to keep the unemployment rate around 3.7%; wages growth in the US has peaked and is slowing;
- Australian GDP growth was weak in Q2 19 (+0.5%) and just 1.4% over the year to the quarter; housing construction and consumption continued to be a drag on growth; public sector spending and net exports were the main drivers of growth in the quarter.

Against this backdrop, there have been further moves to ease monetary policy. The US Federal Reserve cut the Federal funds rate target range by 0.25% to 1.75%-2.00% and said it would be ready to do more if necessary. In Europe, the ECB announced a new stimulus package, including pushing interest rates further into negative territory and buying more bonds. However, the markets are not convinced the ECB can be very effective no matter what it does. The Peoples Bank of China announced further cuts to bank reserve requirement ratios in order to boost lending, but the opaqueness of China's financial system makes it hard to assess the effectiveness of the move.

Here in Australia, the Reserve Bank left the cash rate unchanged at 1.0%, but markets still expect the RBA to cut to 0.5% by the end of the year. There has been increasing debate about how effective further interest rate cuts by the RBA can be at this stage, and speculation that the RBA will have to resort to "unusual measures" – that is, some form of quantitative easing. So far the RBA has been coy about this, but in recent speeches they have made it clear they do not want the A\$ to appreciate. Given the RBA is running out of room to cut interest rate relative to the US, it is highly likely they will resort to intervening in the currency markets to sell the A\$ if necessary. In September, the A\$/US traded in a range of US\$0.67 – 0.69 for a net gain of 0.5% in the month.

Equity markets were pleased to see these moves by central banks in September, even if there were some reservations about their effectiveness. The main thing was that policy makers were not ignoring the signs of weaker global economic activity. This, plus some more encouraging signs about the US-China trade talks, helped equities to rally and bonds to retreat in September. But many uncertainties remain, so that further volatility it to be expected in coming months.

Geo-political developments contributed to this climate in September:

- The Democrats announced an impeachment inquiry into President Trump's role in the "Ukraine affair". It's not clear if the Democrats will be successful, and even if they are in the House, where they control the numbers, they are unlikely to succeed in the Senate;
- In the UK, things went from bad to worse for Boris Johnson seeking to deliver Brexit before 31 October. Not only did the Supreme Court rule his proroguing of Parliament to be unlawful, but further defections eliminated his Parliamentary majority. It seems more likely the UK will have a General Election before the year is out than a solution for Brexit;
- In Hong Kong, protests continued as demonstrators kept pressure on Xi Xingping ahead of 70<sup>th</sup> anniversary celebrations in October; This situation does not look like ending soon;
- A drone attack on Saudi oil fields caused enough damage to push the oil price up sharply on fears of reduced global supply. However, these concerns evaporated surprisingly quickly and the price of oil finished September nearly 2% down for the month.

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