	Price	5 Day % Change	3 Month % Change	1yr % Change
S&P/ASX300	69,117	-2.64%	5.29%	9.58%
MSCI World Ex-Aus. (Unhedged)	10,297	-0.66%	3.74%	9.53%
MSCI World Ex-Aus. (Hedged)	1,737	-0.79%	0.66%	1.46%
Bloomberg AusBond 0+ Composite	10,391	0.69%	4.52%	11.62%
BloombergBarclays Global Agg. (Hedged)	1,060	0.51%	4.26%	8.75%
S&P/ASX300 Property	59,724	-1.72%	10.65%	20.37%
FTSE/Epra NAREIT (Hedged)	2,828	0.18%	1.77%	8.80%
S&P Global Infrastructure (Hedged)	5,367	-0.33%	3.24%	9.68%
BarclayHedge Global Hedge Fund Index (USD)	5,788	N/A	1.55%	1.09%
AUDUSD	0.6786	-0.22%	-2.90%	-7.96%
AUDEUR	0.6058	-1.04%	-2.87%	-5.58%
AUDNZD	1.0496	0.86%	-1.04%	-6.21%
AUDGBP	0.5640	0.88%	4.75%	-1.93%
AUDJPY	71.7230	-1.08%	-6.96%	-14.20%

Source: Bloomberg, S&P Dow Jones, MSCI, FTSE/EPRA, Barclays, 11th August 2019

As China flexed its muscles back to the US last week, the short-lived sell-off in equities provided the opportunity to learn more about the responsiveness of different markets to global events.

This week we explain some of the key takeaways, which includes the fact that more equity market volatility is likely to follow, especially in Australia.

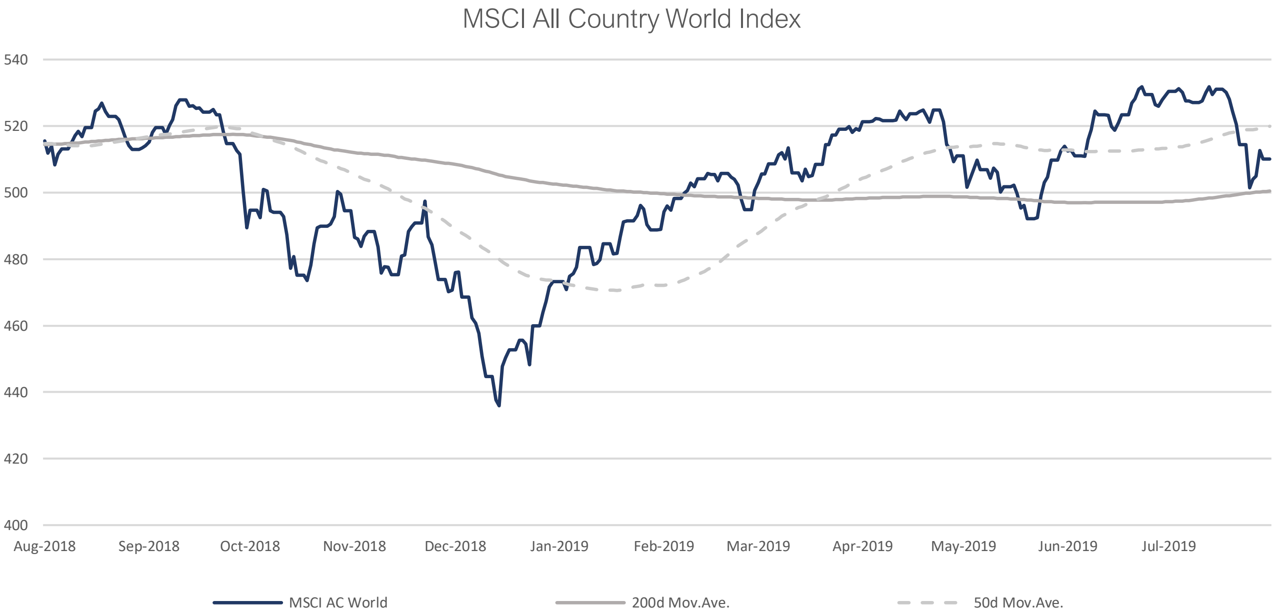
Last week was a very busy week that saw not only further developments in the trade conflict between the US and China, but also new information from central banks, from company reporting and from economic data.

1. It's highly likely that there is more equity market volatility to come.

The VIX index reached a high of just under 25 last Monday as China allowed the Yuan to slip above 7 per US dollar. As the currency stabilised, so did equity markets and the Vix was back to 18 by the end of the week. However, there are a number of reasons why the apparent calm may not last, in addition to the seasonal low volumes and history of August sell-offs.

Most importantly, it does seem as though last week saw a technical bounce, rather than an improvement in fundamentals. The MSCI World rebounded upwards off the 200-day moving average, which traditionally provides support in the absence of further negative news. And there is plenty of scope for more negative newsflow:

- The trade dispute continues, with the new 10% tariffs due to be applied by the US in only a couple of weeks' time. China has officially cancelled all purchases of US agricultural products.

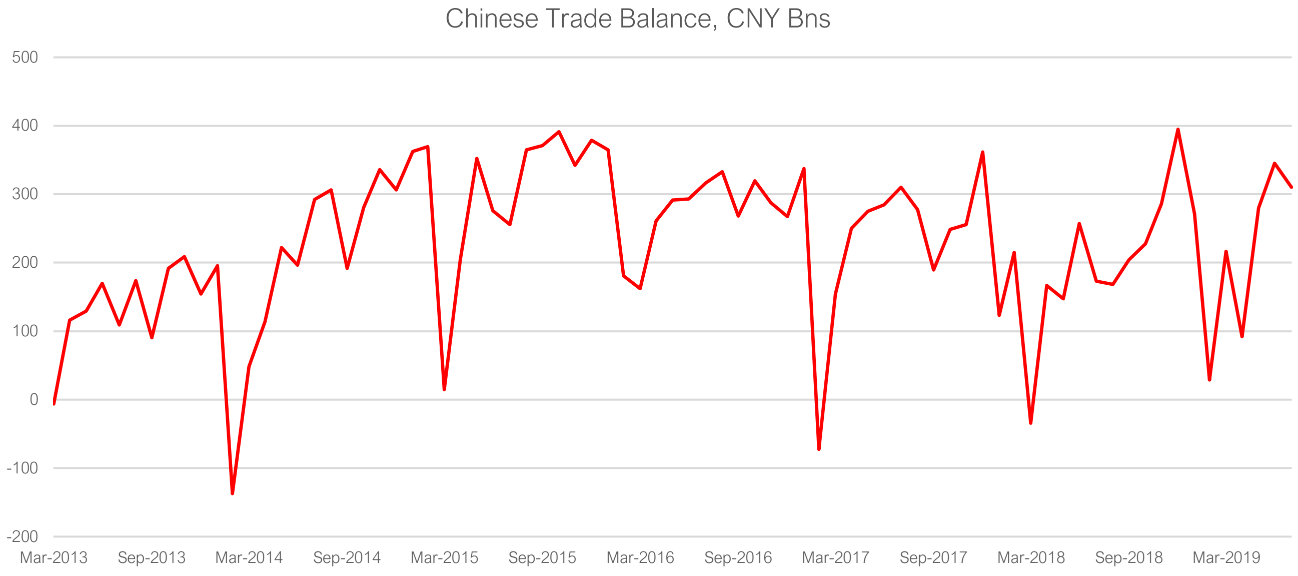


Source: Bloomberg, MSCI, 11th August 2019

- On Friday, UK GDP data showed that the world's fifth-largest economy contracted by 0.2% in the second quarter and could slip into recession even before the UK leaves the EU without a trade agreement on 31st October, now only two and a half months away.

- A vote of no confidence has been called in the Italian parliament, potentially disrupting bond markets.

The reduction in Chinese imports from the US means that Chinese trade data last week showed a fairly healthy trade balance of over CNY 310 bn for July. The question is how long the trade dispute can be contained economically. The two areas to watch are business confidence and industrial production – the latter having a very high correlation with equity earnings. This week, industrial production data will be released by the US, China and Japan.



Source: Bloomberg, CGA of PRC, 11th August 2019

2. Unlike Q4 2018, central banks are predisposed to ease monetary policy.

The deep sell-off at the end of 2018 was caused in part by the fact that central banks, notably the Fed and the RBA, were slow to acknowledge the deteriorating economic outlook with Fed even raising rates in December. The Fed has already reversed that rise, the RBA has now cut twice, and the RBNZ also cut by 0.5% to match the RBA at 1% last week. The RBNZ also specifically discussed the possibility of 0% rates, making Governor Lowe's appearance in Parliament on Friday a little more complicated.

Globally, the question is whether central bank easing can actually stave off the harmful spillovers from the trade dispute and other potential economic disturbances. Within the G4, it is probably only the Fed that can act, but it is constrained by its own domestic economic strength.

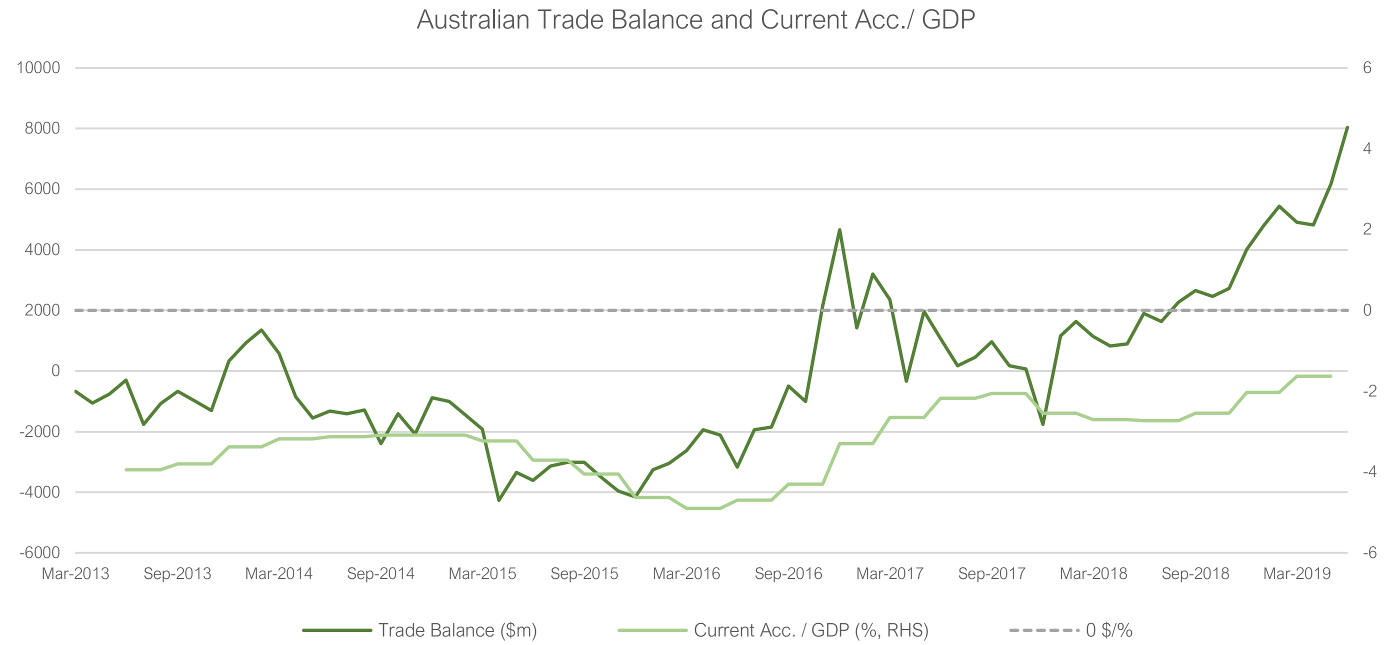
Similarly in Australia, the RBA would like to ease but is constrained by the fact that credit expansion is likely to go straight to the housing sector. If household leverage increases without economic growth, that would be a very bad outcome. The trouble is, that's not an unlikely scenario.

3. Short-term, the Australian dollar may weaken, longer-term the outlook remains positive.

We have held a more positive view on the outlook for the Australian dollar for some time. More precisely, the medium to long term drivers of population growth, stronger trade income and relatively high interest rates continue to support the outlook for a dollar above 70 US cents.

Last week, the Australian trade data for June showed a balance that was some $2bn dollars better than expected. That is an incredible figure and the external position of Australia is literally in the best shape for 40yrs.

Nevertheless, the US-China situation did cause the dollar to weaken as part of the short-term "risk-off" trade, and that weakness was exacerbated by the sharp fall in the iron ore price below $100 per tonne.



Source: Bloomberg, ABS, 4th August 2019

4. Australian equities look especially vulnerable to a pull-back.

A second key call from Harbour Reach this year has been to hold Australian equities underweight in favour of a position in gold. That position has finally come good in August. There was no material difference in performance between March and the end of July with gold up 13.4% and stocks up 11.3% in Australian dollar terms. But since the beginning of the month, gold is up 6.8% while the S&P/ASX300 has lost 3.3%, including dividends, a difference of 10.1%.

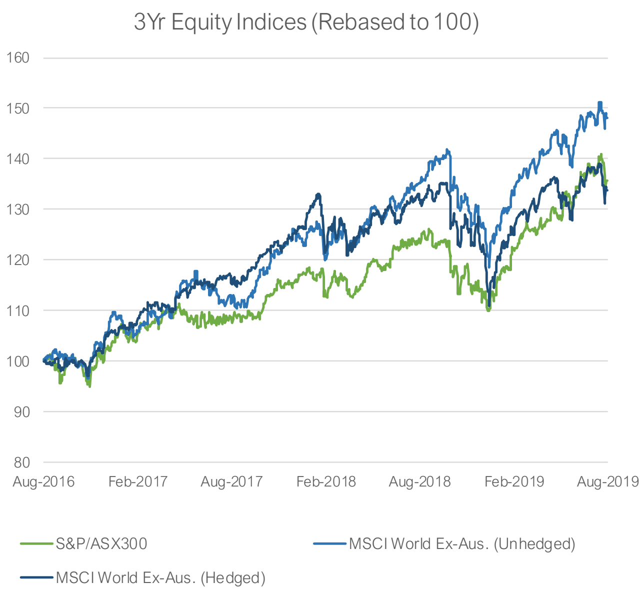
Australian stocks have lost more than their international counterparts in the sell-off too. At the lowest close, last Tuesday, Australian shares had slipped 4.9% in August, while hedged international equities had lost 4.4%, or 2.5% on an unhedged basis on their respective Monday night lows.

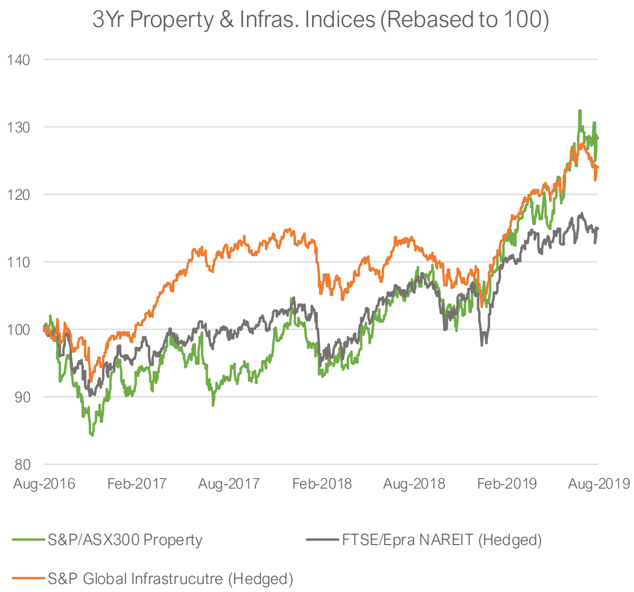
There are several reasons why Australian shares are showing more downside vulnerability. The two main reasons are the higher multiples that are attached to Australian shares, which continues to be the case, and the relatively low earnings growth. The semi-annual reporting season has just got underway with only 54 / 291 S&P/ASX300 companies having reported. But so far, EPS growth is down 3.7% on the first half of FY19 despite nearly 12% growth in sales, according to Bloomberg. Moreover, next year's estimates are already being cut. Historically, Australian analysts tend to overestimate earnings, while internationally analysts tend to be too conservative. This season does not appear to be any different.

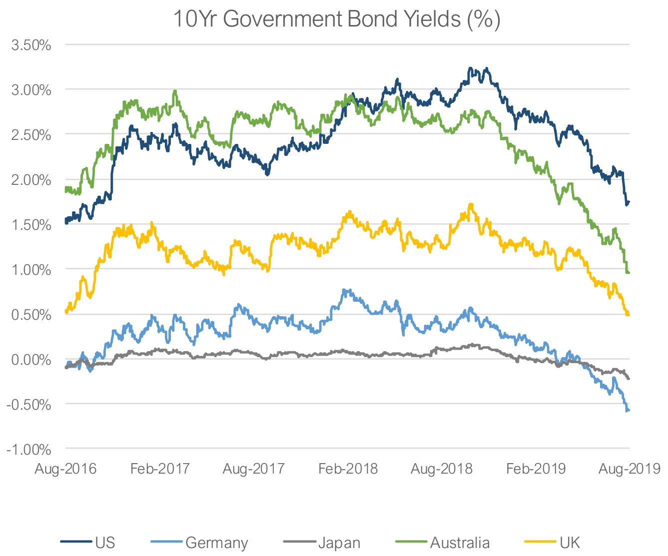
These reasons alone are already sufficient to be relatively cautious on Australian shares. But we think there is an added danger that the market is already factoring in too many interest-rate cuts. It is quite possible that the cash rate goes to 0.50% - in fact, even more likely than it was a week ago. But if the housing market does take off and the RBA responds by simply not easing, Australian stocks should take another leg down.

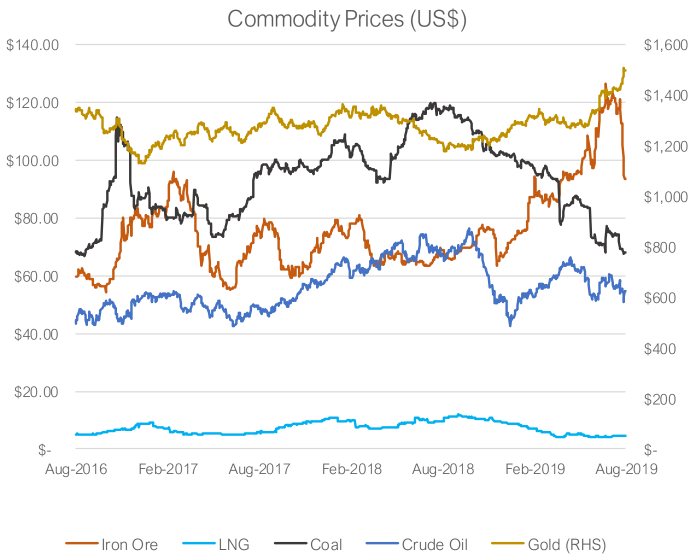
Significant Upcoming Data:

	Monday	Tuesday	Wednesday	Thursday	Friday
Australia		NAB Business Cond. & Conf.	Westpac Consumer Confidence; Wage Price Index	Employment Data	
US	Monthly Budget Statement	CPI; NFIB Small Business Optimism; Real Ave. Hourly Earnings	MBA Mortgage Applications; Import/Export Prices	Industrial Production; Retail Sales; Philly Fed and Empire Manuf. Surveys; Unit Labor Costs; Capacity Util.; Weekly Jobless Claims; Business Inventories; NAHB Housing Index	Housing Starts; Building Permits; UMich Cons. Sentiment
Europe	Danish & Polish CPI	ZEW Surveys; UK Unemployment	Eurozone & German GDP; UK & Swiss CPI	Norwegian Interest Rate Decision; UK Retail Sales; Dutch Unemployment	Eurozone Trade Balance
Japan	PPI; Tertiary Ind. Index; Machine Tool Orders	Core Machine Orders	Industrial Production; Capacity Utilisation		
China	FDI		Ind. Prod.; Retail Sales; Jobless Rate; Property Investment	New Home Prices	









Source: Bloomberg, S&P Dow Jones, MSCI, FTSE/EPRA, 11th August 2019

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