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Market Watch

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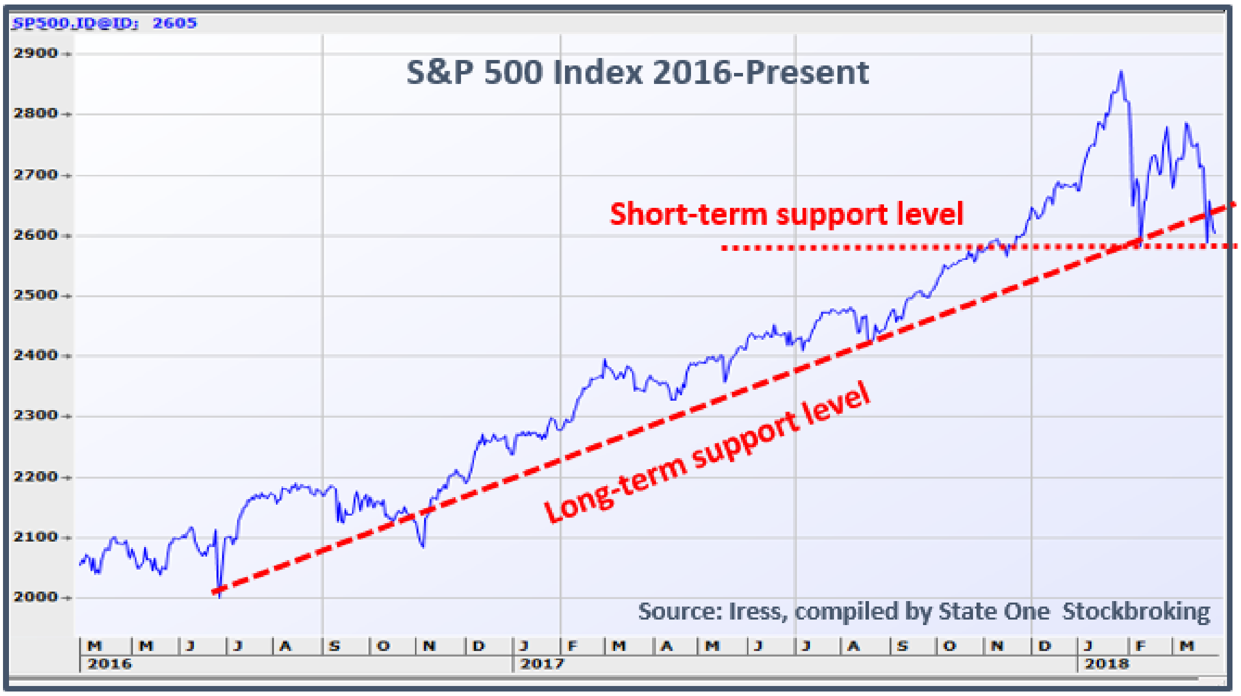
Editor's Note

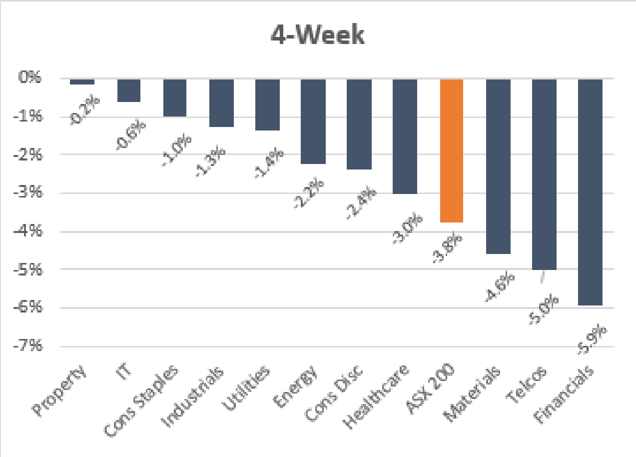
US President Donald Trump's protectionist policies have undoubtedly rattled the stock market. At current levels of 2,581 the benchmark S&P 500 Index is some 10% below its 26 January peak of 2,873.

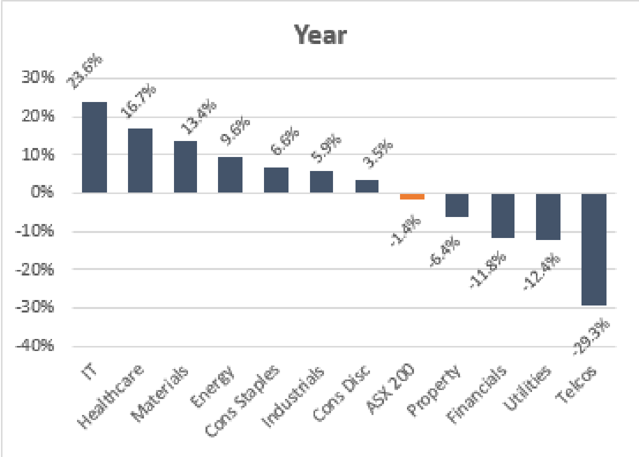
Over recent weeks, the market has swung between pessimism of an out-an-out trade war, and the (relative) optimism of an agreement on trade with China. The Index is now below its longer-term support level and is testing its short-term support level. We suggest that a break below the key 2,580 level could trigger a major sell signal. Of course, with the US market having been on a one-way ticket since early 2009, finding a support level if a serious sell-off occurs is problematic. We estimate a level of 2,100 is a potential floor level – implying an additional 20% downside potential.

Another factor negatively impacting the US market is the sell-off in the Technology Sector. The so-called FAANG group (Facebook, Apple, Amazon, Netflix, Google) have underpinned the increase in the broader market, with these tech giants driving 25-50% of daily returns, and the tech weighting in the S&P 500 Index increasing from 18% to 28% over the past five years. However, recent concerns over information privacy breaches at Facebook have seen its stock price plummet 22% from recent highs, and fears of increased government oversight has spilled over into the sector as a whole. We recommend that investors closely watch the US tech over the next quarter as a pointer for the broader US market.



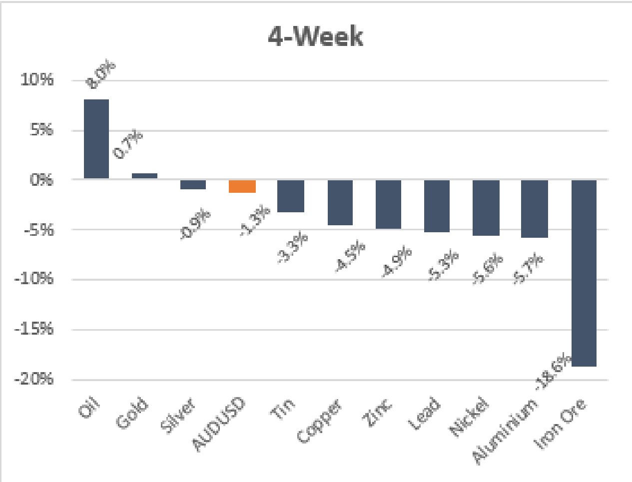
ASX 200: sector performance over past four weeks and year

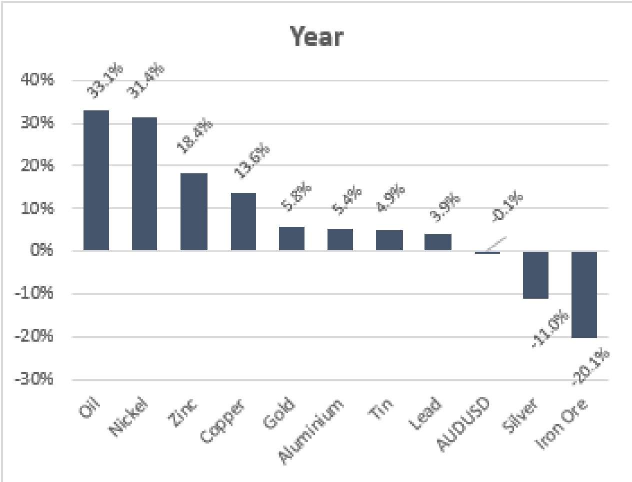




Source: IRESS, compiled by State One Stockbroking

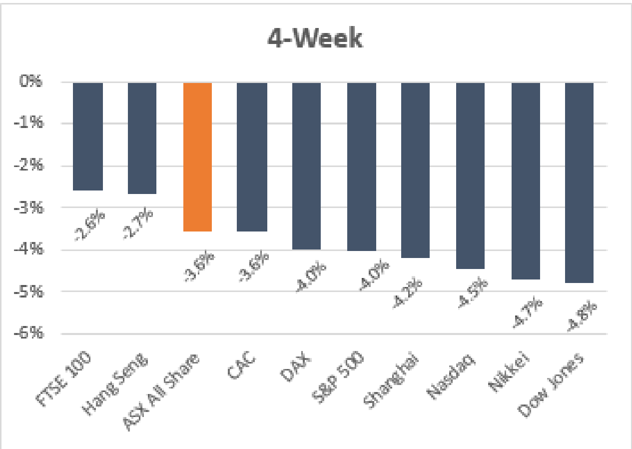
Commodities and AUDUSD: performance over past four weeks and year

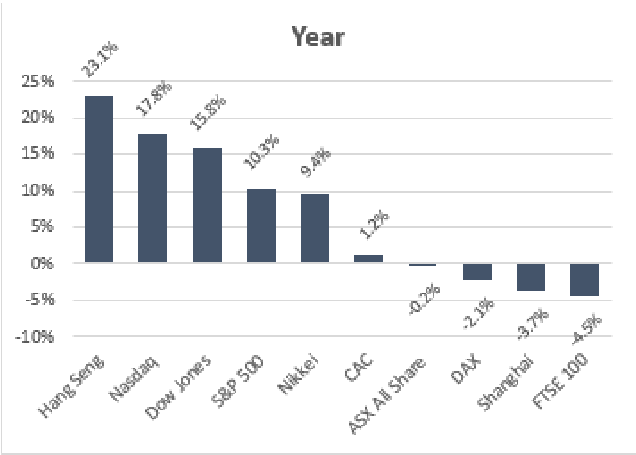




Source: IRESS, compiled by State One Stockbroking

World Indices: performance over past four weeks and year (local currency)



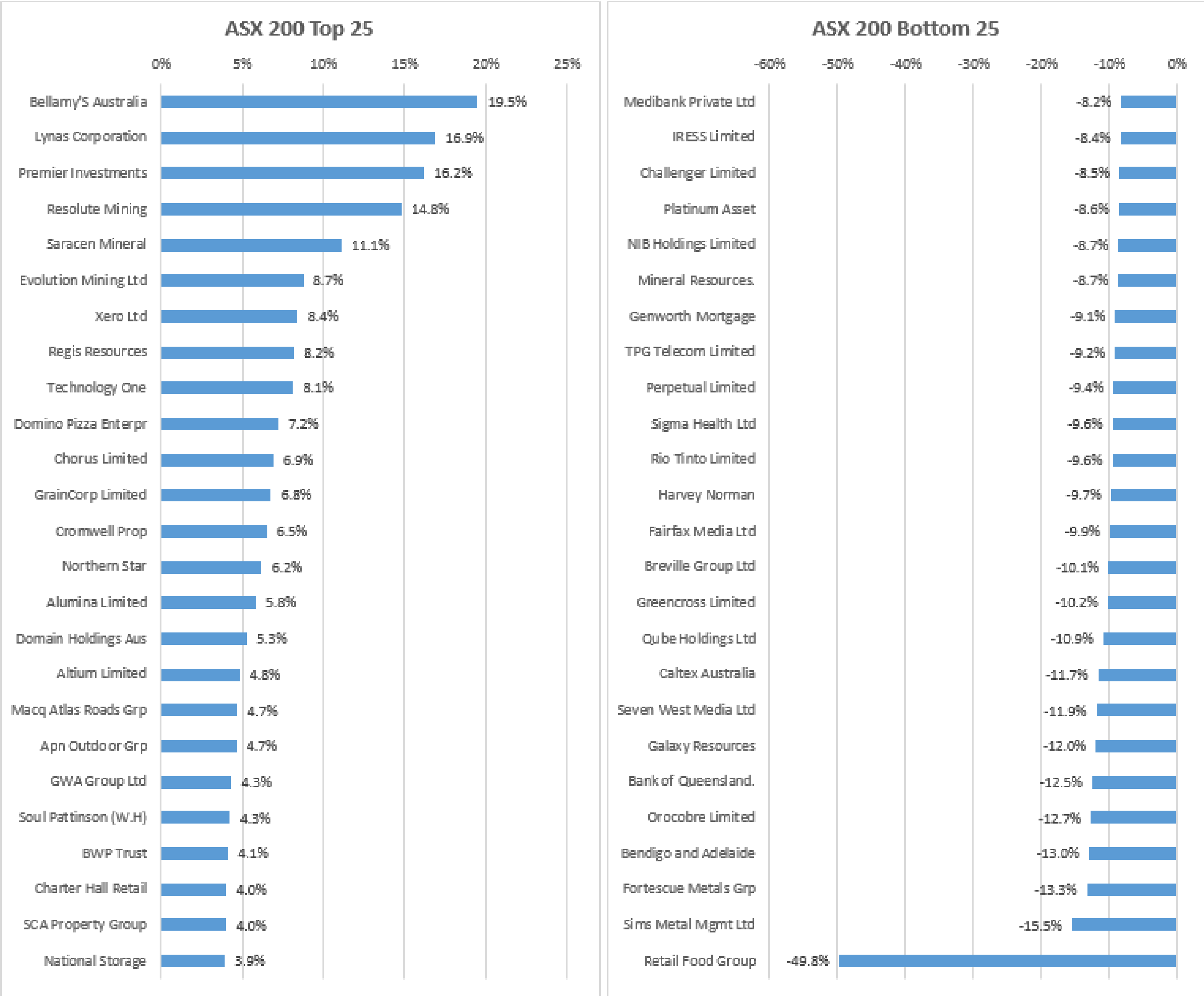


Source: IRESS, compiled by State One Stockbroking

Commentary

- The FTSE/ASX 200 Index lost -3.8% in March; all sectors lost ground although the Property sector almost broke even, only losing -0.2%; the Financials sector was the worst performer, posting a 5.9% loss.
- March was a broadly negative for commodities, although oil was a notable stand-out posting a significant 8% gain; on the back of fears of a trade war and steel tariffs in particular, iron ore prices fell nearly 19% in March.

ASX 200: top 25 and bottom 25 performing stocks over the past four weeks (% gain/loss)



Source: IRESS, compiled by State One Stockbroking

- **Top performer**: Bellamy's Australia (ASX: BAL) appreciated by 19.5% on back of broker upgrades following impressive 1H FY18 results and outlook guidance.
- **Worst performer**: Retail Good Group (ASX: RFG) fell 50% on the back of business - wide review update and continued market concern over the longer-term viability of the group's business portfolio.

Month in review - *events that caught our eye in March*

ASX continues to come under fire from fund managers for lax standards on accepting tech “trash” listings; follows on from collapse of GetSwift and Big Un. Fallout negatively impacting sentiment towards the smaller tech companies on the exchange.

US President Donald Trump agrees to meet North Korean leader Kim Jong-un, but location, timing and meeting content still uncertain…...still, viewed as a +ve step in diffusing tension between the countries.

Ireland beat England on St Patrick’s Day to win the 2018 Grand Slam. Ireland now ranked second to New Zealand in the World Rugby Rankings.

US President Donald Trump signs memorandum that could impose tariffs on up to US$60bn of imports from China, sparking fears of a trade between two countries that collectively account for 40% of global GDP.

James Packer resigns as a director of Crown Resorts (ASX:CWN), and books into a A$5,000/night mental health facility outside Boston, US.

CommonwealthBank

New CBA boss Matt Comyn executes purge of former CEO Ian Narev’s old guard in attempt to restore the bank’s battered reputation.

Intelligence from Britain on a nerve agent attack on former Russian double agent Sergei Skripal and his daughter, leads to 150 suspected Russian spies being expelled from some 25 countries.

Cricket Australia in absolute chaos as Steve Smith, David Warner and Cameron Bancroft sent home from South African test series after ball tampering fiasco in Cape Town. Coach Darren Lehman cleared of involvement at this point.

RioTinto

Rio Tinto effectively sells out of the Australian coal sector after selling $4.2bn of coal assets in three separate deals……divestment seen as a politically-motivated move as well as an economic/portfolio decision.

Are Hybrids and Bonds the same thing?

Dawn Chia
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Investors sometimes think that bonds and hybrids work the same way and may present the same risk. Think again!!

Bonds are a fixed income investment in which an investor loans money to an entity, which normally is a corporate or government, and receives a fixed interest rate over a specified period of time. The risk of the bond can be weighted by the rating benchmark given be companies like Moodys or Standard & Poor. Non-investment grade bonds or "junk bonds" usually carry ratings of "BB+" to "D" (Baa1 to C for Moody's) and even "not rated." Bonds that carry these ratings are seen as higher risk investments that are able to attract investor attention through their high yields. Bonds of such ratings run the risk where the sale of a bond is difficult due to lack of liquidity.

Hybrids have a higher risk in comparison to corporate bonds. Each hybrid has different conditions, risk, time frame and interest rate offered and could have particularly complex features and risk:

<u>Market price volatility:</u> Like company shares, the market price of listed hybrid securities may fall below the price you originally paid, especially if the company suspends or defers interest payments, or if its performance or prospects decline. Changes in the company's share price and in other interest rates may also impact the value. Bond price are affected by the rating issued by rating agencies and news on the company. Bonds are generally a risk rating 2, considered low risk after cash and Term Deposits. The liquidity of the bond market is generally diverse tradable OTC.

<u>Subordinated ranking</u>: Hybrid securities are generally unsecured, meaning that repayment is not secured by a mortgage or security over any asset. If the company issuing the hybrid securities becomes insolvent, hybrid investors generally rank behind senior bondholders and other creditors and have to line up behind them in the queue.

<u>Non-viability clause</u>: Hybrids recently issued by banks and insurance companies have a non-viability clause. This means that if the bank or insurance company experiences financial difficulty they may be required to convert the hybrids to shares. If the shares are worth less than the hybrids, this could mean a loss for investors. Bonds do not have a non-viability clause and will remain a debt that will not change over the course of its lifetime. The bond could be a poorer rating when the company is experiencing difficulties or adverse news affecting the company.

<u>Conversion to shares</u>: Some hybrids issued by banks and insurance companies are scheduled to convert into shares after a fixed period. This is subject to conditions and the bank or insurance company may have the option to redeem or 'buy back' the hybrid before this occurs. Bonds do not convert to shares and remain a debt of the lifetime of the product.

<u>Deferral of interest payments</u>: Some hybrid offers allow the company to suspend interest payments for a number of years, leaving you temporarily out of pocket. The security's market price may fall due to the decision to hold back interest payments. Bonds do not have a deferral of payment but the bond could be at risk from a good rating to a Junk Bond. Upon that, the value of the bond could not be sold to thin liquidity.

<u>Early termination</u>: Some offers allow the company to terminate or 'buy back' the investment early but do not give that same right to investors. Bonds give the investors a two-way street. You can sell the bond with the coupon paid up to the point of sale.

<u>Extremely long timeframes</u>: Some hybrids have investment terms lasting several decades. For example, a 40-year-old investing for a 60-year term would need to live to 100 to see their investment mature. You may be able to sell the security on a secondary market such as the ASX, but only if there is a demand for that security. The risk of a company defaulting on its obligations or eventually facing financial difficulties increases also over the long term. Bonds generally run over 10 years in duration.

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