

MARKET WATCH



Point of view: On the ground insights from Japan.

Toshiaki Yamashita,
Managing Director of Japan,
AMP Capital

Japan's government has designed and implemented a bold plan to awaken its economy, as it has struggled with persistent asset price deflation and its global output has increasingly shrunk.

To re-animate Japan's economy Prime Minister Shinzo Abe has begun to implement a mix of strategies:

- > increase government spending
- > achieve inflation
- > open closed industries.

Japan has already embarked on aggressive actions to get inflation and deliver a reasonable amount of growth. While challenges exist, these efforts have showed some early signs of success.

Overall sentiment has been optimistic. People and businesses are encouraged about what could occur within Japan's economy.

Japan requires a change in people's mindset. In order to underpin a sustainable inflationary environment, consumers and companies would need to be willing to purchase goods and invest. An important observation will be to monitor cash accounts to track if Japan is moving from a savings environment to an investment environment.

To change people's mindset a key factor will be sustainable wage increases. If wages increase, consumption should improve and that's positive for corporate profits. The aim is to get the Japanese economy into this cycle.

The government has been assertively working with companies and labour unions to negotiate sustainable wage increases and some companies, including Toyota and Panasonic, have already announced they will increase staff salaries.

On the other hand, given high levels of government debt, Prime Minister Abe has decided to raise Japan's sale tax by 3% in April with some discussions of another increase. The proposed consumption-tax rise will bring the rate to 8% from the current 5%.

However, if factors such as sustainable wage increases are included in the period ahead, than this will likely offset the impact of a tax hike.

The government appears serious about raising wages to help foster an inflationary environment, and has articulated it would provide further stimulus if the tax hike resulted in a persistent negative impact.

In addition, there are discussions of structural reforms to the economy, to open closed industries, including efforts to make supply side (e.g., gains from trade) more effective and boost work force participation (e.g., more female workers). This has been articulated as politically challenging.

While any change is slow, measured and not without its obstacles, as Abe has political consolidation to 2016 his ability to leverage changes will be made easier than if there was a split parliament.

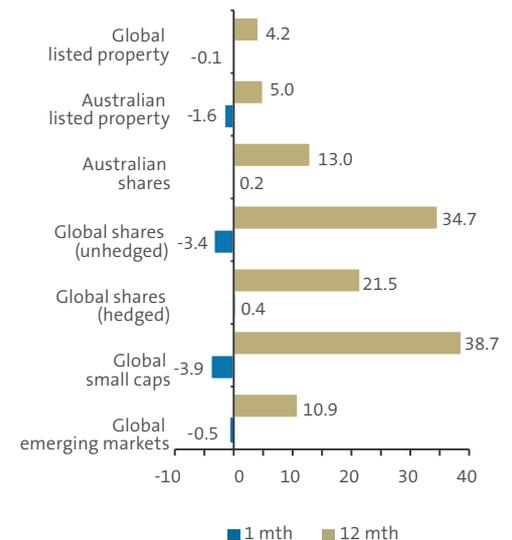
A more prosperous Japan would be a strong source of global demand. It will be interesting to see the degree to which the reflationary and reform policies deliver the desired economic impact.

Click here for a full version of the interview with Toshiaki Yamashita, Managing Director of Japan, AMP Capital

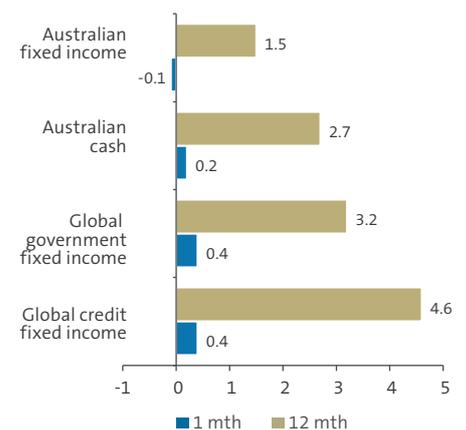
In brief – April 2014 edition

- > The public jury is out on Japan's bold plan to awaken its economy - on the ground sentiment is optimistic.
- > A success and some set-backs surrounding the US stimulus unwind.
- > Domino's Pizza continues its global expansion into Japan.
- > While shares are well-placed to rise, the road will likely be bumpy.

Growth markets (%)



Debt markets (%)



The success and set-backs of a stimulus unwind



The US Federal Reserve's (Fed) process of 'quantitative easing' (QE) – a program of buying US government bonds and mortgage securities – is gradually winding back.

The Fed had been buying US\$85 billion of assets each month until the tapering process began in January. Further reductions were made in both February and March. The monthly asset purchases now total US\$55 billion. Most analysts expect this US monetary stimulus program will end later in 2014.

Despite concerns over the impact of reducing US stimulus, the tapering of Fed asset purchases is actually a success story for the US economy. **The unwind of stimulus is symbolic of a stronger US economy that can sustain growth without assistance.**

While the central bank sees "strong underlying strength" for the US economy the Fed is still giving guidance that US interest rates will remain near 0% for a "considerable time". This suggests low US interest rates will prevail until 2015, which should help support economic growth.

However, the pathway to ending quantitative easing may not be smooth. Tapering has catalysed capital outflows from emerging economies and weaker currencies.

While emerging nations have strong long-term growth prospects, the immediate financial and political risk associated with tapering make emerging countries less enticing in the short-term.

A number of emerging economies have been using the previous capital inflows associated with QE to finance large budget and current account deficits. When interest rates normalise, countries shouldering large current account deficits will see the cost of servicing their debt rise. Since mid-2013, capital flows have been moving away from emerging economies, sparking concerns over their financial stability. Those emerging economies which have experienced persistent high inflation had to raise interest rates to support their currencies. However, high interest rates have a negative impact in weakening economic activity. This has contributed to a bumpy ride for some emerging economies.

While the Fed's tapering of asset purchases is actually a good news story for US economic growth, it does have some adverse consequence for those nations who have significant economic, financial and political risks. These issues are being closely monitored.

A return of ups and downs

Share markets have seen a hint of volatility recently as investors have begun to worry about the economic health of a number of important emerging economies.

While the impact of volatility was short-lived, the episode and some current developments suggest the potential for rising market volatility in the period ahead.

Central banks, which have previously acted to stamp down rising volatility before it could become entrenched, may be less likely to pursue such a policy.

There are several pressure points which command investors focus at present:

- > The managed slowdown in China which has put downward pressure on commodity prices as well as demand for imports from other parts of Asia.
- > Fears of a reversal of flows of capital from the emerging world as the US Federal Reserve unwinds its unusually accommodative monetary policy.
- > The spread of geo-political tensions.

There is always a 'tensions list' associated with market expectations. Nevertheless, the widely-held consensus is that market outcomes this year will be a continuation of 2013.

This means that share markets are likely to go up and bond prices will likely go down, with returns likely to be more muted in magnitude than last year.

While the risks for share market price fluctuations are present, the experience of a bumpy ride in the year should not detour astute investors from focusing on their longer-term strategic goals.

Domino's Pizza grabs for a large slice of Japan

Domino's Pizza Enterprises, the iconic operator of one of Australia's largest pizza franchises, has continued its global expansion by acquiring a 75% stake in Domino's Japan.

Domino's has been operating in Australia since 1984 and has opened over 500 stores domestically. Growth momentum is positive. Previously the enterprise took over the master licences of Domino's in Europe and more recently in Japan.

Today, Domino's generates almost A\$850 million in sales each year and is regarded as one of the best online retailers in the country, thanks to an easy-to-use mobile ordering system.

Since taking control of Japanese operations in August 2013, the Australian-led management team have implemented a novel marketing plan and a strategy to migrate pizza stores into prominent locations. The strategy has led to strong same-store-sales growth, giving management the confidence to expand store rollout ambitions, raising the target number of stores from 600 to 700 over the next few years. Domino's has now become the second largest pizza chain in Japan, and at its current growth rate, is well placed to compete for the top position in the not too distant future



Economic indicators

Gross domestic product (annual rate %)*	Latest	Current	Previous	1 year ago
World (IMF/OECD)	2013	2.5	n/a	3.3
Australia	Dec-13	2.8	2.4	2.8
China	Dec-13	7.7	7.8	7.9
European Union	Dec-13	0.5	-0.3	-1.0
United States	Dec-13	2.7	2.0	2.0
Inflation (annual rate %)*	Latest	Current	3 months ago	1 year ago
Australia	Dec-13	2.7	2.2	2.2
China	Feb-13	2.0	2.5	3.2
European Union	Mar-13	0.5	0.8	1.7
United States	Feb-13	1.1	1.2	2.0
Official interest rates (%)*	Latest	Current	3 months ago	1 year ago
Australia	Mar-13	2.50	2.50	3.00
China	Mar-13	2.80	3.15	2.68
European Union	Mar-13	0.25	0.25	0.75
United States	Mar-13	0.25	0.25	0.25
Bond yields (%)	Latest	Current	3 months ago	1 year ago
Australia 3Y	Mar-14	2.99	2.95	2.88
Australia 10Y	Mar-14	4.09	4.24	3.40
United States 2Y	Mar-14	0.42	0.38	0.24
United States 10Y	Mar-14	2.72	3.03	1.85

Exchange rates

Official interest rates (%)*	Latest	Current	3 months ago	1 year ago
Australian Dollar / Chinese Renmimbi	Mar-14	5.7628	5.4158	6.4784
Australian Dollar / Euro	Mar-14	0.6724	0.6492	0.8119
Australian Dollar / Great British Pound	Mar-14	0.5559	0.5401	0.6865
Australian Dollar / Japanese Yen	Mar-14	95.4511	94.0314	98.0159
Australian Dollar / United States Dollar	Mar-14	0.9268	0.8946	1.0425

Share market analysis

Sharemarkets (in local currency)	5yrs (%pa)	3yrs (%pa)	1yr (%)	3 months (%)	1 month (%)
Australia : ASX 300 Accum	13.2	8.0	13.0	2.0	0.2
Germany : DAX	18.5	10.7	22.7	0.0	-1.4
global emerging markets : MSCI in AUD	8.1	0.7	10.9	-3.9	-0.5
Japan : Nikkei	12.8	15.0	19.6	-9.0	-0.1
United Kingdom : FTSE 100	10.9	3.7	2.9	-2.2	-3.1
United States : S&P 500	18.6	12.2	19.3	1.3	0.7

**Data is most current available

+Rates are expressed as 1 Australian Dollar (IMF/OECD) purchasing-power-parity

Indices: Global shares: MSCI World ex AU Accumulation, Asian shares: MSCI AC Far East ex JP Accumulation, Emerging market shares: MSCI Emerging Markets Accumulation, Australian Shares: S&P ASX 200 Accumulation Index AUD, Global bonds: Barclays Global Aggregate Index Hedged AUD, Australian bonds: UBS Composite All Maturities Index AUD, G-REITs: UBS WARBURG Global Investors Index Accumulation Hedged AUD, A-REITs: S&P ASX 200 A-REIT Accumulation Index AUD, Direct Property: Mercer Unlisted Property Index, Cash: UBS 90 Day Bank Bill Index AUD.

Important note: While every care has been taken in the preparation of this document, AMP Capital Investors Limited (ABN 59 001 777 591, AFSL 232497) and AMP Capital Funds Management Limited (ABN 15 159 557 721, AFSL 426455) makes no representations or warranties as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided.