

MARKET WATCH

AUGUST 2014

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- > 5 things investors need to know about hybrid securities
- > Infrastructure boom: Opportunities for industrial property
- > Natural gas extraction: What's the 'fracking' problem?

AUSTRALIAN DOLLAR: WHERE TO NEXT?

Following its dramatic change of fortune in 2013, the Australian dollar (A\$) has hovered in the US\$0.87-0.95 range since the beginning of 2014, but where is it heading from here?

Broadly speaking, the A\$ is seen as overvalued and is expected to depreciate. However, the timing of this is uncertain.

In the near term, supporting a higher A\$ are near zero interest rates and easy monetary conditions in the US, Europe and Japan. These measures make it more attractive to park money in Australia because it has higher interest rates.

On the other hand, signals that the A\$ may fall at some point include weaker

commodity prices and an increasing likelihood that the Bank of England and the US Federal Reserve will start to increase interest rates before the Reserve Bank of Australia. In addition, the \$A is considered overvalued (allowing for relatively high Australian costs and prices) and this is slowing the rebalance of the economy away from a reliance on mining investment.

Given that the A\$ has already corrected some its significant overvaluation compared to commodity prices and interest rate differentials, we expect the eventual resumption of its depreciation to unfold over a run of years rather than via a sharp short term fall.



BY:
DR SHANE OLIVER
Head of Investment Strategy and
Chief Economist, AMP Capital



“The A\$ is seen as overvalued and is expected to depreciate.”

5 THINGS INVESTORS NEED TO KNOW ABOUT HYBRID SECURITIES

The ongoing search for income has led some investors to turn to hybrids. While these securities present an alternative source of income that is often higher than cash, they also come with additional risks and structural complexities. As such, hybrids require careful analysis to determine whether the return provided is sufficient compensation for the risks that investors bear.

5 things you need to know

- 1. Not all hybrids are created equal:** Some hybrids will behave more like shares, and others more like bonds. Even though banks and other financials dominate issuance, investors should consider that each type of hybrid security has a unique risk and reward characteristic.
- 2. Hybrids can be highly volatile:** Like shares, the market price of listed hybrid securities may fall below the price that the investor originally paid, especially if the company suspends or defers interest payments, or if its performance or prospects decline.

3. Hybrids are generally less liquid than shares: This means that there are fewer buyers and sellers in the market for this type of investment and investors that need to sell quickly, may have to accept a lower price.

4. Hybrids are often unsecured: Repayment of the initial capital or ‘principal’ is not guaranteed. In a wind-up scenario, hybrid investors are among the last to recover their funds.

5. Hybrids can be complicated: It is critical that investors fully understand all the terms and conditions as these will have a significant impact on whether the hybrid meets expectations.

Investors that value a steady return and capital stability may find hybrids unsuitable. Overall, we do not believe hybrids should be relied upon by investors as the sole source for a consistent and foreseeable income stream.



BY:
DAVID CARRUTHERS
Head of Credit and Core,
AMP Capital



“Investors that value a steady return and capital stability may find hybrids unsuitable.”

INFRASTRUCTURE BOOM: OPPORTUNITIES FOR INDUSTRIAL PROPERTY

With over \$239 billion* in transport projects underway and in the pipeline, the boost to infrastructure spending announced in the 2014-15 Federal Budget will create opportunities for investors.

Over the next decade, we expect that the large volume of road and rail projects will improve mobility and reduce congestion across the major cities. This will benefit 'cheaper' emerging locations in western Sydney, Melbourne and south-west Brisbane (and areas close to inland ports) when they complete.

In our view, the following key projects will have the biggest impact on the industrial property landscape over the long term:

- **Sydney:** The Westconnex project (linking the M4 to South Sydney and expanding the M5 East tunnels), Badgerys Creek Airport infrastructure, Sydney Rail Freight Strategy
- **Melbourne:** Port of Hastings, Victorian Freight and Logistics Plan, East Link
- **Brisbane:** Legacy Way/Clem7 tunnels, Ipswich to Port Brisbane Freight line, Bromelton and Ebenezer Intermodal Terminals
- **Perth:** Port of Kwinana, the Perth Freight Link/Gateway WA project

* Access Economics March 2014 Investment Monitor



BY:
MICHAEL KINGCOTT
Head of Property Investment Strategy
and Research, AMP Capital



“We expect that the large volume of projects will improve mobility and reduce congestion.”

WHAT'S THE 'FRACKING' PROBLEM?

Fracking (or hydraulic fracturing) is a technique that makes it possible to extract natural gas by fracturing rock layers that were once unreachable deep within the earth. It was a game-changer in the commercialisation of the well-known and vast shale gas deposits in the US. In particular, the ability to drill horizontally meant that access to natural gas could be increased by up to 50 times per well.

Environmental considerations

In order to get projects approved, built on time (as well as on budget) and also manage potential long-term liabilities, companies need to manage the environmental and social issues surrounding fracking. Generally speaking, the key environmental issues or concerns include the potential contamination of groundwater; the disposal of water run-off from coal seam dewatering; long-term integrity of the wells; and sourcing water for the fracking process.

Social issues surrounding fracking are largely universal around the globe and include misinformation and lack of trust in the community due to poor practices by early players in the industry and the issue of landowner rights over what happens on their property and what appropriate compensation would be.

Final thoughts

Occasionally, a game-changing, disruptive technology appears on the scene. The full ramifications of these innovations are rarely fully known or valued immediately and it takes time for the new industry to emerge and adjust to the new status-quo. This leaves the development of fracking activities – particularly in Australia – in a sort of stasis while legislators attempt to catch-up with the rapid evolution in technology and increasing community concerns.



BY:
DR IAN WOODS
Head of ESG Research,
AMP Capital



“Social issues surrounding fracking are largely universal around the globe.”

Economic indicators

Gross domestic product (annual rate %)*	Latest	Current	Previous	1 year ago
World (IMF/OECD)	31 Dec-2013	2.8	n/a	3.3
Australia	31 Mar-14	3.5	2.7	2.1
China	30 Jun-14	7.5	7.4	7.5
European Union	31 Mar-14	0.9	0.5	-1.1
United States	30 Jun-14	2.4	1.9	1.8
Inflation (annual rate %)*	Latest	Current	3 months ago	1 year ago
Australia	30 Jun-14	3.0	2.9	2.4
China	30 Jun-14	2.3	2.5	2.7
European Union	31 Jul-14	0.4	0.5	1.6
United States	30 Jun-14	2.1	2.1	1.8
Official interest rates (%)*	Latest	Current	3 months ago	1 year ago
Australia	31 Jul-14	2.50	2.50	2.50
China	31 Jul-14	3.20	2.91	3.70
European Union	31 Jul-14	0.15	0.15	0.50
United States	31 Jul-14	0.25	0.25	0.25
Bond yields (%)	Latest	Current	3 months ago	1 year ago
Australia 3Y	31 Jul-14	2.71	2.61	2.54
Australia 10Y	31 Jul-14	3.51	3.54	3.73
United States 2Y	31 Jul-14	0.53	0.46	0.31
United States 10Y	31 Jul-14	2.56	2.53	2.58

Exchange rates

Official interest rates (%)*	Latest	Current	3 months ago	1 year ago
Australian Dollar / Chinese Renmimbi	31 Jul-14	5.7406	5.7996	5.5001
Australian Dollar / Euro	31 Jul-14	0.6948	0.6682	0.6758
Australian Dollar / Great British Pound	31 Jul-14	0.5507	0.5487	0.5920
Australian Dollar / Japanese Yen	31 Jul-14	95.6057	94.6471	88.2683
Australian Dollar / United States Dollar	31 Jul-14	0.9297	0.9266	0.8974

Share market analysis

Sharemarkets (in local currency)	5yrs (%pa)	3yrs (%pa)	1yr (%)	3 months (%)	1 month (%)
Australia : ASX 300 Accum	10.3	13.0	16.3	3.6	4.4
Germany : DAX	12.0	9.5	13.7	-2.0	-4.3
Global emerging markets : MSCI in AUD	5.0	6.1	11.3	7.9	3.5
United Kingdom : FTSE 100	7.9	5.0	1.7	-0.7	-0.2
United States : S&P 500	14.4	14.3	14.5	2.5	-1.5

*Data is most current available

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

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