AMP CAPITAL

MARKET WATCH

JULY 2014

- In a low yield environment, we consider some income opportunities outside of term deposits.
- As Iraq and Europe come into focus, we explore the key issues and what they mean for investors.

SEARCHING FOR INCOME IN THE CURRENT ENVIRONMENT

BY:
JEFF BRUNTON
Investment Director
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A question many investors face is where to invest for sources of income in a low yield environment. With the official cash rate sitting at 2.5% since August 2013, many investors are looking for income opportunities outside of term deposits.

There are several sources of income outside of term deposits and across the traditional risk spectrum. Income can come through shares and listed property in the form of dividends, and through bonds and hybrids in the form of coupon payments for bonds held.

Corporate bonds are traditionally considered lower down the risk spectrum than shares. Nevertheless, when exploring income investing from corporate bond issuance it is prudent to have a focus on investment-grade credit.

While the hunt for yield leaves many investors with choices surrounding how much risk to carry, it is important to invest in companies with strong corporate fundamentals where a normalisation of global growth could translate into signs of revenue and earnings growth.

"Investors are looking for income opportunities outside of term deposits."

EUROPE: EASY MONEY AND NEGATIVE INTEREST RATES

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

The European Central Bank (ECB) has recently cut the key interest rate from 0.25% to 0.15% in a move intended to boost confidence – encouraging a pickup in consumer spending and in doing so helping to create jobs and increasing economic activity. This should be good for investors in European share markets.

The ECB has also announced negative interest rates by cutting the interest rate that banks receive on their deposits held with the ECB from zero to -0.10%. This effectively penalises banks that have their cash on deposit at the ECB and encourages them to lend it out. On its own this move will have little impact as bank deposits at the ECB are very low. However, the impact really comes about via the signal its send to banks and the broader community – it wants banks to lend.

In order to help achieve this, the ECB has announced a new long-term lending program to banks called Targeted Long-Term Refinancing Operations (TLTRO). Under this unprecedented move banks will be able to borrow from the ECB to fund their non-mortgage lending at just 0.25% for four years.

These measures signal a big move in the right direction for Europe which has only seen a relatively weak recovery from the global financial crisis.

The European Central Bank has cut the key interest rate to 0.15% - but is it doing enough?

4 THINGS THAT YOU MAY NOT HAVE KNOWN ABOUT AUSTRALIAN EQUITIES

BY:
MICHAEL PRICE
Co-head of Australian Fundamental Equities, AMP Capital

With the global economic recovery picking up pace, many Australian companies are in a relatively strong position to achieve future earnings growth and therefore grow their dividends. In the current environment of low interest rates, equities provide greater appeal to many investors than term deposits and cash.

Did you know:

1. Australia has the highest 12 month dividend yield among the Group of 20 (G20)[1] nations

As of 31 March 2014, Australian equities delivered the highest 12 month dividend yield across the G20 equity markets and the highest 10 year average dividend yield at over 4% p.a.

2. Australian investors benefit from franking credits

The dividend imputation system allows investors who have been paid a dividend to receive a personal tax credit (franking credit) since the company has already paid tax of 30% on the dividend. Franking credits can add more than 1% to the post tax return from Australian equities for Australian investors.

3. Australian equities currently generate higher cash-flow than term deposits

The current grossed up[2] dividend yield of Australian equities is 5.8%. This is 2.3% greater than the average one-year term deposit[3].

4. There has been less volatility in dividends than in cash rates over the past 50 years

Over a 50-year period, dividends have been more stable than cash. Based on this, you can have a higher degree of confidence that dividend yields will remain relatively stable and grow with inflation.

Did you know that over the past 50 years, dividends have been more stable than cash rates?

1 Group of 19 countries and the European Union, with representatives of the International Monetary Fund and the World Bank.

2 Measures the rate of return from dividend payments after taking into account the benefits of imputation credits (franking credits) to the shareholder.

3 As at 30 June 2014

INVESTORS SHIFT THEIR FOCUS TO GEO-POLITICAL TENSIONS IN IRAQ

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

The risk of a long, drawn-out conflict is again unfolding in the Middle East. Thousands of militants from the Islamist ISIS group are currently raging across Iraq, increasingly engaged in fighting with the Iraqi Army and other militia groups. Since the crisis escalated, Brent crude oil and gold prices have made gains of around 3-4%.

Dr Shane Oliver, Head of Investment Strategy and Chief Economist, AMP Capital, cites two main concerns flowing from the conflict:

1. **The loss of Iraqi oil exports which amounts to around 2.3 million barrels a day (compared to global production of about 91.7 mbd) and;**
2. **The threat of wider (Sunni v Shia) Middle East conflict which may once again involve the US and its allies and runs the risk of conflict beyond Iraq threatening oil supplies.**

According to Oliver: "Global oil prices have been somewhat contained even though economic activity has been gradually picking up – which usually means increased demand – partly as a result of the US shale oil revolution."

"The US shale energy boom, along with war fatigue and budget pressures, partly helps explain why the US is reluctant to get back into Iraq and Middle East more broadly," he adds.

While the Iraq situation certainly presents some short-term risks to commodity prices and to equities, AMP Capital's view is that any reaction is likely to be limited and short-lived.

"Since the early 1970s it's clear that it's not the level of the oil price that poses a risk to global growth but its rate of change. Severe hits to growth have required a doubling in the oil price in the space of 12 months. And right now we are a long way from that," asserts Oliver.

"Severe hits to growth have required a doubling in the oil price... right now we are a long way from that."

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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	31 Mar-14	7.4	7.7	7.7
European Union	31 Mar-14	0.9	0.5	-1.1
United States	31 Mar-14	1.5	2.6	1.3
Inflation (annual rate %)*	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia	30 Mar-14	2.9	2.7	2.5
China	31 May-14	2.5	2.0	2.1
European Union	30 Jun-14	0.5	0.5	1.6
United States	31 May-14	2.1	1.1	1.4
Official interest rates (%)*	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia	30 Jun-14	2.50	2.50	2.50
China	30 Jun-14	2.90	2.80	4.94
European Union	30 Jun-14	0.15	0.25	0.50
United States	30 Jun-14	0.25	0.25	0.25
Bond yields (%)	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia 3Y	30 Jun-14	2.61	2.99	2.81
Australia 10Y	30 Jun-14	3.54	4.08	3.76
United States 2Y	30 Jun-14	0.46	0.42	0.36
United States 10Y	30 Jun-14	2.53	2.72	2.49

Exchange rates

Official interest rates (%)+	Latest	Current	3 months ago	1 year ago
Australian Dollar / Chinese Renmimbi	30 Jun-14	5.8566	5.7628	5.6177
Australian Dollar / Euro	30 Jun-14	0.6894	0.6724	0.7042
Australian Dollar / Great British Pound	30 Jun-14	0.5520	0.5559	0.6035
Australian Dollar / Japanese Yen	30 Jun-14	95.6167	95.4511	90.9167
Australian Dollar / United States Dollar	30 Jun-14	0.9439	0.9268	0.9153

Share market analysis

Sharemarkets (in local currency)	5yrs (%pa)	3yrs (%pa)	1yr (%)	3 months (%)	1 month (%)
Australia : ASX 300 Accum	11.0	10.0	17.2	0.9	-1.5
Germany : DAX	15.4	10.1	23.5	2.9	-1.1
Global emerging markets : MSCI in AUD	5.9	3.9	10.9	4.7	1.2
United Kingdom : FTSE 100	9.7	4.3	8.5	2.2	1.5
United States : S&P 500	16.4	14.1	22.1	4.7	1.9

*Data is most current available
+Rates are expressed as 1 Australian Dollar
(IMF/OECD) purchasing-power-parady