

MARKET WATCH

In brief – March edition

- > It will pay to look at the composition of China's economic growth, rather than focus on the final number.
- > Reinvesting dividends lifts total returns for share investors above the price index.
- > Corporate reporting season results in good surprises.
- > Crown Resorts has benefited from the growing middle class story in China.



A deeper look at China growth

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To make better educated decisions about the impact of China's growth story on investments in the period ahead, it will pay to look under the hood of indices, and garner a deeper understanding of the composition of growth, rather than look to a final number as an indicator of salvation.

During the global financial crisis (GFC), one could observe a popular sentiment: That many Australian companies, in particular miners, and even the Australian economy as a whole, had looked to China for deliverance.

China's economy, fuelled by debt-driven investment in infrastructure and real estate, recorded double digit gross domestic product (GDP) growth for much of the past decade, including through the GFC. Chinese demand for raw materials, such as iron ore, underpinned many prospects for Australia and resource trade dependent companies.

While China will still be a voracious consumer of raw materials in the period ahead, the golden age of creating expansive toll roads and real estate development is over. This has hurt the Australian economy and segments of the Australian share market reliant on Chinese investment demand as well as contributed to a fall in the A\$.

China's leaders are seeking to guide the world's most populous nation toward consumption and away from debt-driven investment.

China announced reforms in November 2013 aimed at improving the nation's growth path over the next decade by fostering sustainable growth and reducing obstacles.

As investors try to determine the pathway of this rebalancing, the effects of uncertainty creates share market volatility.

While reforms and a rebalancing of the economy will be approached with caution, they support a way forward for a shift in quality of growth over quantity of growth.

The fundamentals of a consumer based economy are positive in the period ahead. Chinese wages keep rising and imports of food and consumer goods keep rising.

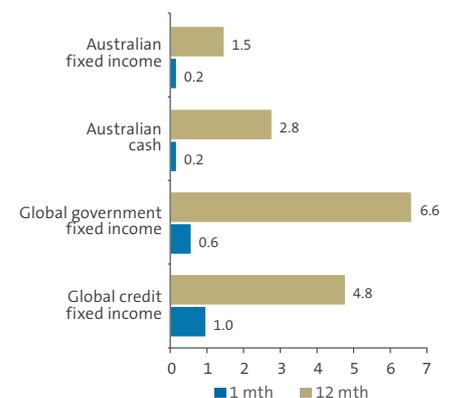
Over a decade ago, if a business desired to build a cinema in China, the project would not likely have been profitable as people's consumption habits would be to purchase cheaply pirated DVDs in the streets. Now, however, China has the 2nd highest cinema revenue after the US. With development of China and the creation of growing consumer class, more people want to be entertained and with more disposable income there is a shift in behaviours.

This bodes well for companies who can meet the growing needs and desires of an ever increasing consumer class. Chinese spending and investment will have a global impact. Tourism and China's business and consumer consumption will create an abundance of investment and business opportunities. With the golden era of debt-driven investment in infrastructure gone, Australia needs a new trick for serving the China growth story.

Growth markets (%)



Debt markets (%)



The power of reinvested dividends

Investors have been cheered by good company earnings being reported in the US and Australia.

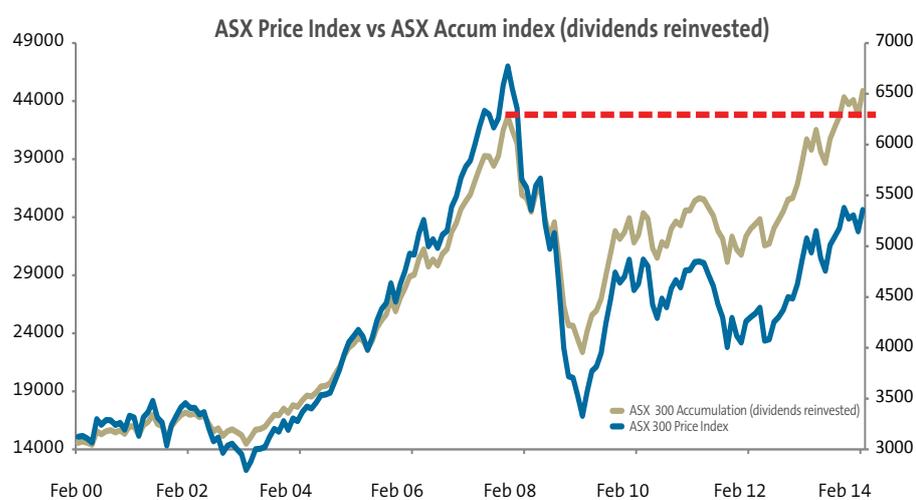
After years of highly accommodative financial stimulus, in February the US share market reached an all-time high as measured by the S&P 500.

While the reporting season in Australia was also positive, the price index, as measured by the S&P ASX 300,

is still trading 21% below its 2007 high. However, the price index is only half the story as it does not include the positive impact of dividends received (the accumulation index does).

In Australia, a significant component of investment gains come from dividends. The chart below shows while the

S&P/ASX 300 price index has moved sideways since the global financial crisis, when reinvested dividends are accounted for, the share market has actually reached an all-time high.



It is important to being able to read beyond the headlines that only focus on the prices of shares and to remember a significant component of investment gains come from dividends.

Good surprises in Australian shares

The Australian corporate earnings season for the first half of the 2013-2014 financial year unfolded during February and generally pleased shareholders.

The good results were underpinned by a significant turnaround by large resources stocks Rio Tinto and BHP Billiton and the continued strong performance by the banks including the Commonwealth Bank, ANZ and the National Australia Bank.

In aggregate, of the companies that reported:

- > 50% exceeded expectations (versus a norm of 43%)
- > 66% have seen their profits rise from a year ago (in line with a norm of 66%)
- > 64% have increased dividends from a year ago (versus a norm of 62% in the past two years)
- > 56% saw their share price outperform the market on the results day (versus a norm of 52%).

The strong reporting season confirms hopes that earnings growth is back on track and we're anticipating +15% growth this financial year driven by an expected +40% increase in resource stocks' profits, +10% rise in the financial sectors' profits and a +6% rise in profits for the rest of the market.

Stock story: Crown Resorts Limited

Crown Resorts, one of Australia's largest gaming and entertainment groups, represents a company that has benefited from the growing middle class story in China. It earns a significant part of its revenues from casinos in Macau through its investment in NASDAQ listed Melco Crown Entertainment. In the 2013 financial year, Macau generated record gross gaming revenues of A\$40.9 billion, an increase of 11.8% from 2012*. Crown's economic interest in the development of Macau Studio City, an integrated resort project expected to open in mid-2015, will broaden its exposure to the rapidly developing Asian gaming and entertainment industry. The company is also developing sites in Sri Lanka, the country's first foreign casino, undertaking an expansion of its Perth Crown casino and building a new casino at Sydney's Barangaroo development. This positions the Australian company to further participate in the growth of Asia's middle class and their increasing appetite for tourism and gaming. Currently, Crown Resorts is attractively valued relative to its peers and has strong earnings prospects through its pipeline of growth opportunities.

* Crown Limited, 2013 Annual Report, page 18

Economic indicators

Gross domestic product (annual rate %)	Latest	Current	Previous	1 Year ago
World (IMF/OECD)	2012	3.3	n/a	3.9
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	Dec-13	2.5	3.1	2.5
European Union	Feb-14	0.8	0.8	1.8
United States	Dec-13	1.5	1.0	1.7
Official interest rates (%)	Latest	Current	3 Months ago	1 Year ago
Australia	Jan-14	2.50	2.50	3.00
China	Feb-14	1.84	3.15	4.01
European Union	Feb-14	0.25	0.25	0.75
United States	Feb-14	0.25	0.25	0.25
Bond yields (%)	Latest	Current	3 Months ago	1 Year ago
Australia 3Y	Feb-14	2.83	2.95	2.74
Australia 10Y	Feb-14	4.02	4.24	3.35
United States 2Y	Feb-14	0.32	0.38	0.23
United States 10Y	Feb-14	2.65	3.03	1.88

Exchange rates

Official interest rates (%)*	Latest	Current	3 months ago	1 year ago
Australian Dollar / Chinese Renmimbi	Feb-14	5.4992	5.5686	6.3687
Australian Dollar / Euro	Feb-14	0.6479	0.6712	0.7830
Australian Dollar / Great British Pound	Feb-14	0.5340	0.5579	0.6744
Australian Dollar / Japanese Yen	Feb-14	91.3424	93.5468	94.4466
Australian Dollar / United States Dollar	Feb-14	0.8949	0.9139	1.0237

Share market analysis

Sharemarkets (in local currency)	5yrs (%pa)	3yrs (%pa)	1yr (%)	3 months (%)	1 month (%)
Australia : ASX 300 Accum	14.9	8.2	10.2	2.6	4.9
Germany : DAX	20.3	10.0	25.2	3.0	4.1
global emerging markets : MSCI in AUD	9.3	2.3	7.5	-2.8	0.7
Japan : Nikkei	14.4	11.8	28.4	-5.2	-0.5
United Kingdom : FTSE 100	12.2	4.3	7.1	2.4	4.6
United States : S&P 500	20.4	11.9	22.8	3.0	4.3

**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.

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