December 2009

Market and Economics Report

by Dr Shane Oliver, Head of Investment Strategy & Chief Economist

Global economy

Review: The global economic recovery has continued to gain ground, however US Federal Reserve Chairman, Ben Bernanke, noted during the month that the US economy faced some "important headwinds" that will "likely prevent the expansion from being as robust as we would hope". Nevertheless, there was great news from the US labour market with payroll employment almost flat in November and unemployment falling back from 10.2% to 10%. While housing starts were weak, house prices and home sales both improved. There was also a rebound in retail sales in October, after September's sharp falls. Against this, the Institute for Supply Management (ISM) business conditions index fell slightly in November and post-Thanksgiving retail sales were subdued. Japan's economy took some firmer steps towards a recovery with real gross domestic product (GDP) growth of +0.3% in the September quarter. Consumer sentiment stabilised during October, remaining at the two-year high it reached in September. October also saw a mild rise in job vacancies and a lower unemployment rate. In less positive news, deflationary pressures remain, with consumer prices in Tokyo showing an annual decline of -1.9% year on year (yoy). Data released during November confirmed China's growth momentum is continuing. China's Purchasing Managers Index (PMI) stayed around levels consistent with 10% growth. Industrial production growth and retail sales both surprised on the upside. Loan growth slowed sharply in October; however this should be regarded as a healthy outcome given the risks of the Chinese economy overheating. Europe's recession finally ended with the economy expanding by +0.4% qoq in the third quarter of 2009 after five quarters of contraction. Business surveys continued to improve, with Europe's PMI and the German IFO business index both reaching post-crisis highs. The European Central Bank (ECB) kept interest rates on hold and noted that "survey-based indicators continue to signal an improvement in economic activity". While Europe expanded, UK GDP contracted by -0.4% qoq in the September quarter. According to the Bank of England Governor, Mervyn King, the UK economy has "just started on the road to recovery". Some encouraging signs were the rebound in UK house prices over the year to September and the stabilisation of the unemployment rate at 7.8% over the last six months.

Outlook: The global recession appears to be over. Monetary and fiscal easing seems to have gained traction, pointing to solid global growth in 2010, particularly in the emerging world.

Australian economy

Review: The Australian economy continued to show signs of improvement. The sting in the tail though, is that the Reserve Bank of Australia (RBA) has now increased official interest rates for three months in a row, taking the cash rate to 3.75%. Comments from the RBA Board indicated that the decision was based on "further evidence that the global economy was expanding" coupled with "stronger than expected" Australian economic conditions. Among the positive economic news, building approvals and housing finance for new construction continue to strengthen, job vacancies are rising and consumer and business confidence remain high. On top of all this, employment has risen solidly over the last three months and unemployment increasingly looks to have peaked.

Outlook: While September quarter GDP may be soft, we expect a solid recovery through 2010, driven by global recovery, a housing upturn, stabilising employment and stronger investment helped by fiscal stimulus.

International shares

November review: The leading measure of global share market performance, the MSCI World (ex-Australia) Accumulation Index, returned +3.1% in local currencies (or +2.8% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +6.0%. In the European region, the Eurostoxx Accumulation Index returned +1.7%; while the UK FTSE 100 Accumulation Index returned +3.4%. Shares in Asia were mixed; Japan's Topix Accumulation Index returned -6.1% and China's S&P/CITIC 300 Total Return Index returned +7.3%.

Short-term outlook [six to 12 months]: Global shares are likely to provide good returns on a 12-month plus view, given the likelihood of better economic conditions in 2010 , rising profits and still-low interest rates.

Medium-term outlook [five to ten years]: Improved dividend yields following the share slump and profit growth around nominal GDP growth will see medium-term returns from mainstream global shares of around 7.5% per annum on average.

Australian shares

November review: The Australian share market climbed sharply in early November and then traded in a tight range until concerns over debt issues in Dubai caused the market to dip before month end. The S&P/ASX 200 Accumulation Index returned +1.8% for the month overall.

Short-term outlook: Australian shares are likely to provide solid returns on a 12-month view. Valuations are attractive and interest rates are low, and shares are likely to be buoyed by better economic conditions and rising profits in 2010.

Medium-term outlook: Reflecting much higher dividend yields and reasonable growth prospects, medium-term returns of around 9.5% per annum are likely.

Real Estate Investment Trusts

November review: The S&P/ASX Property 200 Accumulation Index returned +1.0% during November, underperforming the broader equity market. Transactions and capital raisings were a theme for the listed property sector, with over A$1 billion of major transactions taking place over November.

Short-term outlook: Most property stocks have recapitalised, most are good value from a long-term perspective, and the credit crunch is fading. As such they should provide solid returns over the next 12 months.

Medium-term outlook: Solid yields and moderate growth prospects mean medium-term returns of around 10.5% per annum are likely.

International bonds

November review: International bond yields fell in November. The US ten-year bond yield fell 19 bps to 3.19% and Japan's ten-year bond yield fell 15 bps to close at 1.27%. Germany's ten-year bond yield fell 7 bps to 3.16% and the UK ten-year bond yield fell 10 bps to close the month at 3.52%.

Short-term outlook: Sovereign bond yields are likely to remain low in the short term as global inflation and interest rates remain low.

Medium-term outlook: AMP Capital expects low returns from global sovereign bonds, reflecting low bond yields.

Australian bonds and cash

November review: Australian government bonds sold off slightly in the first two weeks of November but followed global yields and rallied substantially over the last two weeks. The yield on the Australian ten-year bond fell 25 bps to 5.24%, while the three-year bond yield fell 32 bps to 4.61%. This saw the domestic yield curve steepen overall during the month. US ten-year bond yields fell 19 bps (to 3.19%), resulting in a slight narrowing in the Australian and US ten-year bond spread to 205 bps. The three-month bank bill rate opened at 3.94% and closed 9 bps higher at 4.03%. Six-month bank bill yields also rose, opening at 4.38% and closing 4 bps higher at 4.42%.

Short-term outlook: Bond yields are likely to remain low in the short term on uncertainty regarding the growth outlook and as the inflation outlook remains benign.

Medium-term outlook: Returns from local sovereign bonds over the medium term are likely to be poor, reflecting low yields.

Australian dollar

November review: During November, the Australian dollar (A$) paused in its long rally since March, rising against the US dollar (US$) but falling slightly against the Japanese yen (JPY) and the currencies of Australia's major trading partners (as per the Trade Weighted Index [TWI]). The A$ closed the month at 91.58 US cents (up 1.8% from 89.96 cents) and JPY79.16 (down 2.4% from JPY81.07).

Short-term outlook: Further gains in the A$ are likely on the back of the improving global growth, strong demand for resources, the positive outlook for commodities and the prospect for rising local interest rates.

Medium-term outlook: AMP Capital expects the A$ to be strong over the medium term, helped by strong commodity prices.

Key financial markets

	30 November 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	32,760	+1.8%	+31.7%
MSCI World (ex-Aust Accumulation/ unhedged in A$)	3,341	+2.8%	-7.3%
US S&P 500 Accumulation Index	1,803	+6.0%	+25.4%
Dow Jones Eurostoxx Accumulation	403	+1.7%	+21.1%
UK FTSE 100 Accumulation Index	3,279	+3.5%	+26.3%
Japan Topix Accumulation Index	1,034	-6.1%	+2.7%
S&P/CITIC 300 Total Return Index	3,243	+7.3%	+93.5%
S&P/ASX 200 Property Accum. Index	18,798	+1.0%	-6.6%
UBS Global Real Estate Investors Index	920	+2.8%	+29.8%
Aust 90-day bank bill yield	4.03%	+9 bps	-69 bps
Aust 10-year bond yield	5.24%	-25 bps	+64 bps
US 10-year bond yield	3.19%	-19 bps	+27 bps
A$ in US cents	91.58	+1.8%	+40.2%
Trade-weighted index	69.1	-2.3%	+26.6%

Contact us

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