March 2010

AMP capital INVESTORS

Market and Economics Report

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Global economy

Review: The global economic recovery continued to gain momentum during February. US economic data remained consistent with a slow healing process. American housing construction has been the weakest link in the aftermath of the housing bubble. However, US house prices rose modestly in December, which was the seventh consecutive monthly rise. The US labour market is continuing to improve with slowing job losses (in fact they probably would have risen in February had it not been for the bad snowstorms), falling jobless claims, rising job advertisements, and unemployment remaining unchanged at 9.7%. The recovery in the US manufacturing sector has remained robust and the services sector Institute for Supply Management (ISM) index has continued to improve. Retail sales results for January were solid following a soft December result. While the US Federal Reserve (Fed) increased its discount rate, it noted that this was just a technical adjustment with financial conditions returning to normal. Fed Chairman, Ben Bernanke, reiterated his position that the Fed Funds rate will be maintained at exceptionally low levels for an extended period. Japan continued its modest recovery with mainly positive economic data over the month. Industrial production rose in January, with activity returning to late-2008 levels. Business and consumer sentiment both recorded gains in January as well. Real gross domestic product (GDP) for the final quarter of 2009 surprised on the upside. Chinese economic data pointed to continued growth momentum although some indicators were more subdued. Consumer price inflation eased and the purchasing managers index (PMI) fell back in January. The People's Bank of China once again increased the reserve requirement ratio for financial institutions by 0.5%. Further tightening had been expected, but the hike came a little earlier than anticipated. News from Europe was dominated by Greece's fiscal problems, with fears of a possible default on its large public debt. However, Greece has since committed to a harsh deficit-cutting campaign, and the European Union has committed to provide assistance if required. Overall the European economy barely grew in the December quarter, with GDP increasing by only 0.1% quarter-on-quarter (qoq).

Outlook: The global recovery is continuing and still easy monetary and fiscal conditions point to solid global growth this year, particularly in the emerging world.

Australian economy

Review: Australian economic data remains generally strong. The labour market continued to strengthen with a further 52,700 new jobs in January. Unemployment also fell to 5.3% in January. There was a surge in capital expenditure in the last quarter of 2009 and construction work done during the period was also strong. This fed through to strong December quarter GDP growth. Both consumer and business confidence remain strong and most housing indicators are solid (except for housing finance which has softened following the expiry of the first home owners boost. Retail sales were soft in December but rebounded in January. Reflecting stronger economic conditions, the Reserve Bank of Australia (RBA) tightened rates again in March and signalled more to come.

Outlook: We expect solid growth through 2010 driven by the global recovery, a housing upturn, and stronger investment. We expect the cash rate to rise to 4.75% or 5% by year-end.

International shares

February review: International shares recovered some ground during February following January's correction. The leading measure of global share market performance, the MSCI World (ex-Australia) Accumulation Index, returned +1.9% in local currencies (or +0.6% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +3.1% in local currency terms. In the European region, the Eurostoxx Accumulation Index fell -1.9% in local currencies on the back of sovereign debt concerns, whereas the UK FTSE 100 Accumulation Index returned +3.8% in local currency terms. Shares in Asia were mixed with Japan's Topix Accumulation Index falling -0.7% and China's S&P/CITIC 300 Total Return Index returning +2.5%.

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 reasonable growth in profits and still low interest rates. However, we expect a rougher ride than over the last nine months.

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

February review: During February, Australian shares regained some of the ground lost during January's correction. The S&P/ASX 200 Accumulation Index rose 2.2% for the month. Investor sentiment continued to be affected by concerns over sovereign debt and the durability of global growth. However, the reporting season was generally positive, with more Australian companies beating expectations than underperforming them.

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

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

Real Estate Investment Trusts

February review: The S&P/ASX Property 200 Accumulation Index returned +1.5% during February, underperforming the broader equity market.

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 9.5% per annum are likely.

International bonds

February review: International bond markets were varied in February. The US ten-year bond yield rose by 3 basis points (bps) to 3.61% and the UK ten-year bond yield rose by 12 bps to close the month at 4.03%. By contrast, Japan's ten-year bond yield fell marginally by 2 bps to close at 1.31% and Germany's ten-year bond yield fell by 10 bps to 3.10%.

Short-term outlook: Sovereign bond yields are likely to drift higher on expectations for eventually rising short-term interest rates and high public borrowing levels.

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

Australian bonds and cash

February review: While the RBA raised rates in March, it surprised the market by leaving the cash rate unchanged in February when the RBA Board met for the first time this year. The three-year bond yield ended the month 38 bps higher at 4.83%, whereas the ten-year bond yield closed the month only 5 bps higher at 5.41%. The three-month bank bill rate opened at 4.38% and closed 25 bps lower at 4.13%. Six-month bank bill yields also fell, opening at 4.60% and closing 18 bps lower at 4.42%.

Short-term outlook: Bond yields are likely to drift higher on the back of gradually rising global bond yields.

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

Australian dollar

February review: The Australian dollar (A$) rallied over February, rising against the US dollar (US$), 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 89.61 US cents (up 1.7% from 88.05 US cents) and JPY79.62 (up 0.6% from JPY79.1). The TWI closed the month at 69.5 (up 0.4% from 69.2). The A$ benefited from improving investor confidence in shares which in turn fuelled strong commodity prices. Increasing expectations for an interest rate rise at the March meeting also boosted the A$.

Short-term outlook: Further gains in the A$ are likely on the back of the improving global growth outlook, 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

	28 February 2010	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	32,576	+2.2%	+44.7%
MSCI World (ex-Aust Accumulation/ unhedged in A$)	3,382	+0.6%	+9.0%
US S&P 500 Accumulation Index	1,826	+3.1%	+53.6%
Dow Jones Eurostoxx Accumulation	398	-1.9%	+44.0%
UK FTSE 100 Accumulation Index	3,406	+3.8%	+45.5%
Japan Topix Accumulation Index	1,100	-0.7%	+20.4%
S&P/CITIC 300 Total Return Index	3,045	+2.5%	+55.0%
S&P/ASX 200 Property Accum. Index	19,150	+1.5%	+40.6%
UBS Global Real Estate Investors Index	967	+3.3%	+72.7%
Aust 90-day bank bill yield	4.13%	-25 bps	+97 bps
Aust 10-year bond yield	5.41%	+5 bps	+98 bps
US 10-year bond yield	3.61%	+3 bps	+60 bps
A$ in US cents	89.61	+1.8%	+40.6%
Trade-weighted index	69.5	+0.4%	+26.8%

Contact us

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