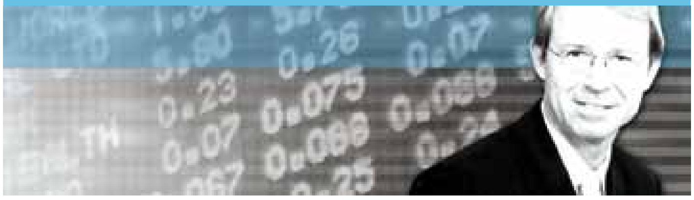
October 2009

Market and Economics Report



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

Global economy

Review: Further signs of recovery in the global economy appeared during September. US economic data continued to improve during the month, reinforcing the impression that the US economy is now recovering. Retail sales surged in August, rising by 2.7% month-on-month (mom). Even excluding the impact of the 'cash for clunkers' scheme, retail sales were solid, with a rise of 0.6% mom. The Institute for Supply Management composite survey indicated that the US manufacturing sector has now moved into a solid expansion phase. On the negative side, the unemployment rate rose to 9.7% in August. However, unemployment is a lagging indicator, therefore this data is still consistent with an economy slowly turning the corner towards recovery. Confirming the improvement, the US Federal Reserve upgraded its assessment of the US economy from 'levelling out' to actually 'picking up'. Japan's economy also appeared to be in gradual recovery mode. July's Leading Index showed improving prospects for the September quarter with a rise of 2.6% mom. The manufacturing sector is also showing signs of life, registering an increase in industrial production. Although Japan's gross domestic product (GDP) growth for the June quarter was downgraded to 0.6% quarter-on-quarter (qoq) from the original estimate of 0.9% qoq, this is still a marked improvement on the March quarter's result of -3.3% qoq. Economic data from China was positive during September, although in a speech on 10 September China's Premier Wen Jiabao indicated caution about whether this was a sustainable recovery yet. In contrast, the Asian Development Bank upgraded its forecast for China's 2010 growth from 8% to 8.9%. China's manufacturing sector accelerated despite sluggish export performance. Industrial production, fixed asset investment and retail sales all rose in August, with increasing domestic demand serving to offset falling exports. The European economy showed signs of a steady recovery emerging. Business surveys continued to improve with Germany's ZEW sentiment index, Europe's Purchasing Managers Index (PMI) and the German IFO business index all posting increases. So far, Europe's recovery is being led by its two largest economies, France and Germany, which both recorded GDP growth of 0.3% in the second quarter of 2009 while the broader Euro-zone economy contracted by 0.1%. The European Central Bank (ECB) kept interest rates on hold once again and noted that it expects only "a very gradual recovery". Even the UK economy is starting to revive with improvements in industrial production suggesting a modest recovery. The chief economist of the Bank of England, Spencer Dale, noted that Britain's economy "has turned a corner... but the recovery will be slow."

Outlook: The global recession appears to be ending. Monetary and fiscal easing seems to have gained traction, pointing to solid global growth in 2010.

Australian economy

Review: The Australian economy continued to show signs of recovery in September as economic data released during the month was largely positive. The Westpac-Melbourne Institute's consumer sentiment survey and the National Australia Bank business survey both recorded strong surges. Retail sales figures for both July and August were released during the month, with July showing a drop of 1.0% but August recording a rise of 0.9%. Australia's real gross domestic product (GDP) for the June quarter was better than expected and rose 0.6%, its biggest gain in over a year. Against this, labour conditions were mixed with the unemployment rate remaining steady, but the actual 'hours worked' falling. In other negative news, the trade deficit grew to A$1.6 billion in July, following a strong rise in imports. The Reserve Bank of Australia (RBA) left rates on hold in September but increased the cash rate by 0.25% to 3.25% in October. The central bank justified this decision by highlighting that "the global economy is resuming growth". However, while the RBA's Financial Stability Review stressed that challenges remain, the broad picture was consistent with its growing confidence in the economic outlook.

Outlook: The Australian economy is showing signs of improvement ahead of a sustainable recovery from later this year and through 2010, driven by global recovery, a housing upturn, stabilising employment and stronger investment helped by fiscal stimulus.

International shares

September review: The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned +2.9% in local currencies (or -0.9% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +3.7%. In the European region, the Eurostoxx Accumulation Index returned +4.4%; while the UK FTSE 100 Accumulation Index returned +4.8%. Shares in Asia were mixed as Japan's Topix Accumulation Index returned -5.1% and China's S&P/CITIC 300 Total Return Index returned +6.2%.

Short-term outlook [six to 12 months]: After the strong rebound, a short-term correction is likely sooner or later. However, global shares are likely to provide good returns on a 12-month plus view, given the likelihood of better economic conditions in 2010 and still attractive valuations.

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 8% per annum on average.

Australian shares

September review: The Australian share market tracked steadily higher over September. The S&P/ASX 200 Accumulation Index returned +6.6% for the month making it the sixth consecutive month of growth. The market was pushed higher by continuing signs that economic growth is on a more solid footing. Investors appear increasingly convinced that Australia has fared better than most countries during the financial crisis.

Short-term outlook: The Australian share market is vulnerable to a short-term correction. However, 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 anticipate 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 11% per annum are likely.

Real Estate Investment Trusts

September review: The S&P/ASX Property 200 Accumulation Index returned +9.8% during September, outperforming the broader equity market. September was the sixth consecutive month of positive performance for the listed property sector, with the S&P/ASX Property 200 Accumulation Index returning 50.2% over the six months to the end of September.

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 12% per annum are likely.

International bonds

September review: International bond yields largely fell in September. The US ten-year bond yield fell 10 bps to 3.30% and Japan's ten-year bond yield fell 1 basis point (bp) to close at 1.30%. In the European region, Germany's ten-year bond yield fell 4 bps to 3.22%; while the UK ten-year bond yield rose 3 bps to close the month at 3.59%. The fall in yields was attributable to a reduction in inflation expectations, and a number of foreign central bank speakers cooling market expectations for rate hikes and settling inflation fears.

Short-term outlook: Sovereign bond yields are likely to remain low in the short term on the back of the uncertainty about the strength of an economic recovery and falling inflation.

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

Australian bonds and cash

September review: Over the course of September, Australia's bond market was supported by global trends. The yield on the Australian ten-year bond fell 12 bps to 5.30%, while the three-year bond yield fell 13 bps to 4.95%. US ten-year bond yields fell 8 bps (to 3.30%), resulting in a slight narrowing in the Australian and US ten-year bond spread to 200 bps. Bank bill yields were volatile during September. The three-month bank bill rate opened at 3.49 and closed 11 bps lower at 3.38. Six-month bank bill yields also fell, opening at 3.83 and closing 5 bps lower at 3.78%.

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

September review: The Australian dollar (A$) pushed higher again in September, rising against the US dollar (US$), 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 88.39US cents (up 4.8% from 84.38US cents) and JPY79.34 (up 1.1% from JPY78.44). The TWI closed the month at 68.2 (up 2.9% from 68.2).

Short-term outlook: Further gains in the A$ are likely on the back of the improving global growth, strong demand from China, 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 September 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	32,870	+6.2%	+8.3%
MSCI World (ex-Aust Accumulation/ unhedged in A$)	3,391	-0.9%	-13.4%
US S&P 500 Accumulation Index	1,733	+3.7%	-6.9%
Dow Jones Eurostoxx Accumulation	416	+4.4%	-1.4%
UK FTSE 100 Accumulation Index	3,224	+4.8%	+9.5%
Japan Topix Accumulation Index	1,120	-5.1%	-14.6%
S&P/CITIC 300 Total Return Index	2,763	+6.2%	+35.5%
S&P/ASX 200 Property Accum. Index	20,459	+9.8%	-23.7%
UBS Global Real Estate Investors Index	926	+5.8%	-25.3%
Aust 90-day bank bill yield	3.38%	-11 bps	-394 bps
Aust 10-year bond yield	5.30%	-12 bps	-10 bps
US 10-year bond yield	3.30%	-10 bps	-52 bps
A$ in US cents	88.39	+4.8%	+11.3%
Trade-weighted index	68.2	+2.9%	+7.6%

Contact us

If you would like to know more about how AMP Capital can help you, please visit ampcapital.com.au, or contact one of the following:

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