

# Market and Economics Report



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

## Global economy

**Review:** The global economy continued to show signs of stabilisation and tentative signs of approaching recovery. In the US, the manufacturing sector continued to improve steadily as measured by the Institute for Supply Management (ISM). The results of the survey revealed that the US economy is slowly healing. Retail spending is another measure which improved for the month, with June recording a 0.6% month-on-month (mom) gain in nominal retail sales. Even the pace of job losses is slowing and housing indicators appear to be bottoming. The International Monetary Fund (IMF) once again revised upwards its activity prediction for the US economy, which it now expects to shrink by a smaller -2.6% for 2009. US Federal Reserve Chairman, Ben Bernanke, noted that the US economy is expected to start a recovery, but the expansion is "expected to be gradual in 2010". In Japan, the Tankan quarterly business survey showed that business conditions started to improve during the June quarter after the savage declines of the previous year. The Japanese labour market continued to soften, as unemployment rose by 0.2% to 5.2%. In China, the purchasing managers index (PMI) rose marginally to 53.2 in June, which is a promising sign of a continued strengthening in industrial activity. The big news of the month was the announcement that China's gross domestic product (GDP) for the June quarter jumped to 7.9% year on year (yoy). This was an encouraging acceleration from the March quarter growth of 6.1% yoy. Other positive economic news from China included strong loan growth, steady and solid retail sales growth and an increase in industrial production growth. In Europe, the PMI for manufacturing continued to recover during July, rising to its highest level since August 2008. In the UK, while unemployment rose further in June, the preliminary GDP figures for the June quarter showed that the rate of contraction of the economy had slowed. Meanwhile, the Bank of England left interest rates on hold at 0.5%.

**Outlook:** The global recession appears to be ending. Monetary and fiscal easing seems to have gained traction, pointing to a recovery into 2010.

## Australian economy

**Review:** In Australia, the Reserve Bank of Australia (RBA) left the official interest rate on hold at 3.0% for the fourth consecutive month. The RBA noted that domestic economic activity had not been as weak as expected and is becoming more optimistic about the economic outlook. In line with this optimism, Australian economic data releases were generally positive. Retail sales rose very strongly in the June quarter. Consumer confidence is up strongly from its lows and this renewed confidence encouraged housing finance commitments to also rise. Additionally, there

was a strong improvement in the National Australia Bank (NAB) business survey, with business conditions and confidence up strongly. Building approvals showed a strong rebound of 9.3% mom in June, recovering somewhat from the unexpected sharp drop in May, and employment rose solidly in June leaving the unemployment rate at 5.8%. On the negative side, private sector credit remained weak and the export price index fell sharply, mainly due to a large fall in prices for coal, coke and briquettes.

**Outlook:** The Australian economy is likely to remain soft in the short term ahead of a sustainable recovery from later this year and through 2010, driven by global improvement, lower interest rates and fiscal stimulus.

## International shares

**Review:** The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned +7.4% in local currencies (or +5.4% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +7.6%. In the European region, the Eurostoxx Accumulation Index returned +9.5%, while the UK FTSE 100 Accumulation Index returned +8.6%. Shares in Asia were also higher as Japan's Topix Accumulation Index returned +2.2% and China's S&P/CITIC 300 Total Return Index returned an impressive +17.8%.

**Short-term outlook [six to 12 months]:** After the recent rebound, the next few months are likely to remain volatile given the uncertainty about the strength of the economic recovery. 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

**Review:** The Australian share market performed strongly in July with the S&P/ASX 200 Accumulation Index returning +7.3% for the month. Investor confidence was boosted as global and Australian economic data surprised on the upside. The improved tone of data has suggests that we have entered the recovery phase of the economic cycle.

**Short-term outlook:** The Australian share market is likely to remain volatile over the next few months. 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 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

**Review:** The S&P/ASX Property 200 Accumulation Index returned +2.4%, underperforming the broader equity market. The month of July was the fourth consecutive month of positive returns for the listed property securities sector. There continued to be a wide dispersion of returns, but the dispersion has decreased over the last few months.

**Short-term outlook:** With most property stocks having recapitalised and the credit crunch fading, real estate investment trusts have probably seen the worst. They are also good value from a long-term perspective. 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

**Review:** International bond yields were mixed in July, although the global economy continued to demonstrate signs of stabilisation. The US ten-year bond yield fell 5 basis points (bps) to 3.48% while Japan's ten-year bond yield rose 7 bps to close July at 1.43%. In the European region, Germany's ten-year bond yield fell 9 bps to 3.30%; while the UK ten-year bond yield added 11 bps to close the month at 3.80%.

**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 the 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

**Review:** The Australian bond market weakened over July, in line with global trends. The yield on the Australian ten-year bond gained 4 bps to 5.58%, while the three-year bond yield rose 25 bps to 4.80%, which saw the domestic yield curve flatten. Bank bill yields rose in July. The three-month bank bill rate opened at 3.16% and closed 4 bps higher at 3.20%. Six-month bank bill yields traded similarly, opening at 3.28 and closing 7 bps higher at 3.35%. Credit spreads narrowed, reflecting the improved economic outlook and reduced uncertainty.

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

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

## Australian dollar

**Review:** The Australian dollar (A\$) pushed higher in July, 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 83.75US cents (up 4.0% from 80.56US cents) and JPY79.36 (up 2.3% from JPY77.59). The TWI closed the month at 65.7 (up 1.5% from 64.7).

**Short-term outlook:** The break higher in the A\$ has opened up the prospect of further gains in the A\$ over the next six months or so, on the back of the improving global growth and commodity outlook.

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

## Key financial markets

	31 July 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	29,032	+7.3%	-10.2%
MSCI World (ex-Aust Accumulation/unhedged in A\$)	3,339	+5.4%	-11.4%
US S&P 500 Accumulation Index	1,612	+7.6%	-20.0%
Dow Jones Eurostoxx Accumulation	376	+9.5%	-20.0%
UK FTSE 100 Accumulation Index	2,872	+8.6%	-10.9%
Japan Topix Accumulation Index	1,161	+2.2%	-25.6%
S&P/CITIC 300 Total Return Index	3,410	+17.8%	+33.3%
S&P/ASX 200 Property Accum. Index	16,063	+2.4%	-37.8%
UBS Global Real Estate Investors Index	772	+8.9%	-39.0%
Aust 90-day bank bill yield	3.20%	+1 bp	-456 bps
Aust 10-year bond yield	5.58%	+4 bps	-64 bps
US 10-year bond yield	3.48%	-5 bps	-47 bps
A\$ in US cents	83.75	+4.0%	-11.0%
Trade-weighted index	65.7	+1.5%	-9.0%

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