

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 October. After a year of contraction and its worst post-war recession, the US economy began growing again in the September quarter with a 3.5% annualised rise in gross domestic product (GDP). While unemployment rose to 10.2% in October, leading labour market indicators suggest employment growth will resume early next year. Moreover, other leading indicators of the US economy such as the Institute for Supply Management (ISM) business conditions indicators point to further growth going forward. Japan's economy seems to be on the road to recovery with stronger-than-expected rises in September retail sales and industrial production, a second monthly fall in unemployment and a modest rise in the ratio of job vacancies to applicants. Japan's consumer sentiment reached a two-year high, as consumers became more optimistic after the deep downturn. China's economy continued to expand at a solid pace during the September quarter, posting 8.9% year-on-year (yoy) growth in GDP. This was up from June quarter's growth of 7.9% yoy. Chinese exports improved in September, car sales rose to new highs and both money supply and new loans were stronger than expected. The European economy showed signs that a recovery has started in the second half of this year. Various European business conditions surveys continued to improve. The European Central Bank (ECB) kept interest rates on hold once again at 1.0%. News from the UK was less positive, with the GDP contracting 0.4% quarter-on-quarter (qoq) for the September quarter. This is the sixth quarterly decline in economic activity and the longest recession since quarterly records began in 1955. UK industrial production continued to struggle, with August recording a -2.5% fall month-on-month (mom). This is a poor result considering that the weaker currency should have helped competitiveness. The Bank of England left kept rates on hold at 0.5%.

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

Australian economy

Review: The major news for the Australian economy over the last month was the Reserve Bank of Australia's (RBA) decision to raise the official cash rate by another 0.25% to 3.50%. The RBA Board commented that expansionary policy was "no longer necessary and possibly imprudent" but indicated that interest rates would be raised gradually. Consistent with the RBA's view that the threat to the Australian economy has passed, economic indicators over the last month were largely positive. Unemployment fell to the lowest rate in four months and the participation rate rose.

Consumer sentiment rose and business sentiment remained strong. Over the year, headline inflation has fallen from +5.0% year-on-year (yoy) to a more modest +1.3% yoy, the lowest reading in over ten years.

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

October review: The leading measure of global shares performance, the MSCI World (ex-Australia) Accumulation Index, returned -2.2% in local currencies (or -4.1% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -1.9%. In the European region, the Eurostoxx Accumulation Index returned -4.6%; while the UK FTSE 100 Accumulation Index returned -1.7%. Shares in Asia were mixed as Japan's Topix Accumulation Index returned -1.7% and China's S&P/CITIC 300 Total Return Index returned +9.3%.

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 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 7.5% per annum on average.

Australian shares

October review: The Australian share market performed in line with global trends over October. The S&P/ASX 200 Accumulation Index returned -2.1% for the month, falling after six consecutive months of growth. The Australian market fell on the back of falls in global shares, lower commodity prices and profit warnings from some companies about the negative impact of a continued rise in the Australian dollar.

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 9.5% per annum are likely.

Real Estate Investment Trusts

October review: The S&P/ASX Property 200 Accumulation Index returned -9.0% during October, underperforming the broader equity market. The negative result ended a six-month run of positive returns for the listed property sector.

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

October review: International bond yields rose in October. The US ten-year bond yield rose 8 bps to 3.38% and Japan's ten-year bond yield rose 12 bps to close at 1.42%. In the European region, Germany's ten-year bond yield rose 1 bp to 3.23%; while the UK ten-year bond yield rose 3 bps to close the month at 3.62%.

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

October review: Strong domestic economic data and the central bank's comments resulted in Australia's bond market selling off over the first half of October. Australian yields rose to annual highs with the three-year bond reaching 5.32% and the ten-year at 5.76% on 27 October. However concerns over the sustainability of the global economic recovery resulted in a global bond market rally over the last week of the month. Hence the three-year bond yield closed at 4.93% and the ten-year bond yield closed at 5.49%. Bank bill yields climbed steadily during October. The three-month bank bill rate opened at 3.38% and closed 56 bps higher at 3.94%. Six-month bank bill yields also rose, opening at 3.78% and closing 60 bps higher at 4.38%.

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

October review: The Australian dollar (A\$) continued to benefit from the general resilience of the Australian economy and pushed higher again in October, 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 89.96US cents (up 1.8% from 88.39US cents) and JPY81.07 (up 2.2% from JPY79.34). The TWI closed the month at 70.7 (up 3.7% from 68.2).

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

	31 October 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	32,186	-2.1%	+21.4%
MSCI World (ex-Aust Accumulation/ unhedged in A\$)	3,250	-4.1%	-14.5%
US S&P 500 Accumulation Index	1,701	-1.9%	+9.8%
Dow Jones Eurostoxx Accumulation	396	-4.6%	+11.9%
UK FTSE 100 Accumulation Index	3,170	-1.7%	+20.4%
Japan Topix Accumulation Index	1,101	-1.7%	+5.3%
S&P/CITIC 300 Total Return Index	3,022	+9.3%	+99.4%
S&P/ASX 200 Property Accum. Index	18,610	-9.0%	-7.3%
UBS Global Real Estate Investors Index	895	-3.3%	+5.8%
Aust 90-day bank bill yield	3.94%	+56 bps	-187 bps
Aust 10-year bond yield	5.49%	+19 bps	+29 bps
US 10-year bond yield	3.38%	+8 bps	-58 bps
A\$ in US cents	89.96	+1.8%	+34.4%
Trade-weighted index	70.7	+3.7%	+29.3%

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