

Market and Economics Report



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

Global economy

Review: While the global recession continues, there are increasing signs that it is abating and several indicators are consistent with a recovery from later this year. In the US, the labour market continued to weaken with the unemployment rate rising to 8.9%, but the pace of job losses is showing signs of slowing. Improvement in the Institute for Supply Management (ISM) manufacturing index, the national activity index and consumer sentiment measures provided tentative signs that economic conditions may be stabilising and are pointing to the prospect of a recovery from later this year. Some positive indications also emerged from the US housing market, although the sector remains depressed. While tight credit conditions and the contracting labour market continued to weigh on US house prices and housing starts, both existing home sales and the US national home builders sentiment index rose. In Japan, the Tankan survey produced a dismal assessment of business conditions. However, monthly business surveys improved and industrial production rose for the first time in six months in March. A modest rebound in Japan's consumer confidence also provided some optimism. While China's economic growth slowed to 6.1% in the March quarter due to weaker exports, other data indicated renewed domestic growth momentum. Growth in industrial production, fixed-asset investment and loans have strengthened substantially. Retail sales growth remains strong and a manufacturing survey has shown improvement for the fifth month in a row. A region-wide manufacturing survey in the Euro-zone appeared to stabilise, reaching a six-month high in April, and Germany's Institute for Economic Research (IFO) business climate index also rose. The European Central Bank (ECB) made only a marginal 0.25% interest rate cut, preferring to keep its policy options open, although appeared to contemplate quantitative easing. In the UK, real gross domestic product (GDP) fell 1.9% in the March quarter, and the UK Government reduced its growth forecasts. A survey of credit conditions by the Bank of England (BoE) revealed that lending to corporations and households remains constrained.

Outlook: The global recession appears to be moderating. Monetary and fiscal easing seems to be gaining traction, pointing to a modest recovery commencing from later this year.

Australian economy

Review: The Reserve Bank of Australia (RBA) and the Government have conceded that the country is in recession. The Federal Budget delivered no great surprises but does provide additional stimulus in the form of a pension increase and infrastructure spending in the short term, ahead of measures to reduce the budget in a few years time. Recent data releases for housing finance and

approvals, retail sales and employment have been better than expected.

Outlook: The Australian economy is likely to remain weak or in recession ahead of a mild 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 10.5% in local currencies (or 5.2% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned 9.7%. In the European region, the Eurostoxx Accumulation Index returned 15.9%, while the UK FTSE 100 Accumulation Index returned 8.5%. Shares in Asia were also higher as Japan's Topix Accumulation Index returned 8.3% and China's S&P/CITIC 300 Total Return Index returned 4.6%.

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 timing and strength of an economic recovery. However, global shares are likely to provide reasonable 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 9% per annum on average.

Australian shares

Review: The Australian share market continued its upward movement in April, with the S&P/ASX 200 Accumulation Index returning 5.6% for the month. The share market was encouraged by the improved tone of data releases and some ostensible signs of stabilisation.

Short-term outlook: The Australian share market is likely to remain volatile over the next few months. However, shares should improve 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 a much higher dividend yield and reasonable growth prospects, medium-term returns of around 11% per annum are now possible.

Real Estate Investment Trusts

Review: The S&P/ASX Property 200 Accumulation Index returned 6.1%, outperforming the broader equity market. There remained a wide dispersion of returns, and outperformers in April were again those stocks perceived to be of higher risk that had been sold off in previous months. Global property securities returned 19.3%.

Short-term outlook: The next few months are likely to remain volatile due to worries about gearing levels, capital raisings and the underlying property outlook. However, real estate investment trusts have probably seen the worst, are good value from a long-term perspective and should benefit from lower interest rates.

Medium-term outlook: Now solid yields and moderate growth prospects mean medium-term returns of around 12% per annum are now possible.

International bonds

Review: International sovereign bond yields rose in April as the economic outlook improved in response to tentative signs of stabilisation in economic data. The US ten-year bond yield gained 46 basis points (bps) to 3.12% and Japan's ten-year bond yield rose 8 bps to close April at 1.43%. In the European region, Germany's ten-year bond yield increased 19 bps to 3.18%, and the UK ten-year bond yield added 33 bps to close the month at 3.50%. Corporate bond yields fell.

Short-term outlook: Sovereign bond yields may fall back in the short term on the back of the uncertainty about the strength of any 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: Australian Government bond yields were again mixed in April as expectations of a lower domestic cash rate countered the influence of a sizeable rally in the benchmark US bond market. This saw the spread between Australian and US ten-year bond yields narrow to 145 bps. The yield on the Australian ten-year bond gained 13 bps to 4.57% as ongoing concerns about an increase in the supply of bonds to fund the Government's fiscal stimulus also put upward pressure on yields. The three-year bond yield fell 3 bps to 3.44%. Bank bill yields were relatively flat in April.

Short-term outlook: Bond yields may fall back 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 April on the back of the improving tone in global economic data, 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 72.49 US cents (up 4.9% from 69.12 US cents) and JPY71.46 (up 4.6% from JPY68.32). The TWI closed the month at 59.7 (up 4.0% from 57.4).

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.

Medium-term outlook: The A\$ should rebound over the medium term, helped by a rebound in commodity prices.

Key financial markets

	30 April 2009	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	25,664	5.6%	-28.8%
MSCI World (ex-Aust Accumulation/unhedged in A\$)	3,217	5.2%	-22.0%
US S&P 500 Accumulation Index	1,418	9.7%	-35.3%
Dow Jones Eurostoxx Accumulation	334	15.9%	-37.7%
UK FTSE 100 Accumulation Index	2,616	8.5%	-27.2%
Japan Topix Accumulation Index	1,024	8.3%	-36.9%
S&P/CITIC 300 Total Return Index	2,403	4.6%	-32.4%
S&P/ASX 200 Property Accum. Index	14,445	6.1%	-56.9%
UBS Global Real Estate Investors Index	688	19.3%	-51.6%
Aust 90-day bank bill yield	3.08%	-6 bps	-472 bps
Aust 10-year bond yield	4.57%	+13 bps	-172 bps
US 10-year bond yield	3.12%	+46 bps	-61 bps
A\$ in US cents	72.49	5.7%	-22.0%
Trade-weighted index	59.7	4.0%	-15.6%

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