> INVESTMENT STRATEGY & ECONOMICS

MARKET WATCH

AMP CAPITAL

In brief – End of year edition

- It has been a good year for this year's big economic news stories.
- Spotlight shifts to the non-mining sectors of economy and whether they will start to fill the void left by the mining slowdown.
- Upcoming key decisions for US policy makers will set a path forward for growth and deficit reduction.
- In an environment of low interest rates, growth assets gain momentum.

Wrapping up the year

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As we prepare to wrap up 2013, it looks likely to turn out to be a good year. Equity markets have rallied, the US is on a path to recovery despite all the political squabbling, China did not land hard and the euro did not break up. Below is a summary of what's been working for this year's big economic news stories.

The US and quantitative easing

Discussions surrounding stimulus have taken many twists and turns, from the need for greater amounts of stimulus to concerns that all the money printed by central banks in the US, Europe and Japan would result in a sharp rise in inflation in developed economies. What has not occurred are high levels of inflation. In fact over the last couple of years inflation has been falling with the US, Europe, Japan and Canada all having inflation rates of 1% or less. What has occurred is that the US economy is on track for a recovery, albeit slowly, and stimulus from the Federal Reserve has played an important role. *The US housing sector (the trigger of the global financial crisis) continues to show signs of recovering. Private sector deleveraging is well advanced. Private debt is down and household wealth levels are up.*

China

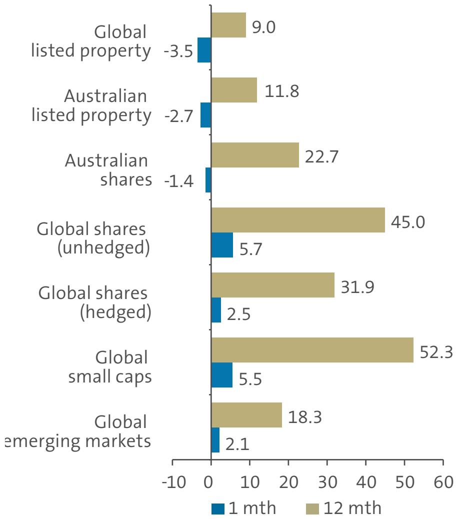
It seems that concerns surrounding China periodically come in and out of fashion. At the core of these worries are structural issues such as: China's investment-driven growth model is unstable, the housing sector is overheated, the economy has lost its competitiveness or that China has taken on too much debt. However, these worries have been overdone. There is no doubt that the slowdown in China's growth rate since 2010' high's, peaking at +12%, has unnerved investors.

But growth does seem to be stabilising around a still strong 7.5% pace for the year. *At the same time, China's leaders have taken steps to guide the world's most populous nation away from debt-driven investment in infrastructure and real estate towards a more sustainable path*. As this occurs, and if China removes some red tape barriers, it could facilitate outward investment which could represent opportunities for the US and Australia. However, China is likely to progress cautiously and slowly.

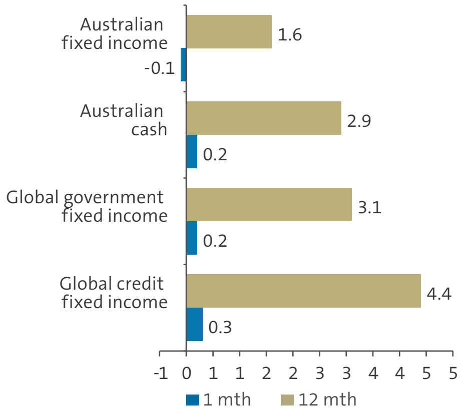
Europe

While European debt woes have been covered ad nauseam, the most intense period of the Eurozone crisis is likely behind us, risks continue to fade and growth is gradually returning. *Germany has been the main source of strength, but peripheral countries are also heading in the right direction*. The Greek budget is on track for a primary surplus this year and Moody's has upgraded its credit rating – albeit from low levels. Spain managed to exit its recession. Spain's real gross domestic product (GDP) expanded by 0.1% for the September quarter. However, Spain's economy has contracted by -1.2 % in the past year. Nevertheless, data signals that the economic recovery remains very gradual at this stage as many structural factures remain to be addressed and euro-wide unemployment remains at elevated levels of around 12%. With inflation at just 0.9% the European Central Bank has plenty of flexibility to provide further stimulus.

Growth markets (%)



Debt markets (%)



Investors focus on non-mining sectors

New figures released by the Bureau of Resources and Energy Economies (BREE) show that investment in Australia's mining industry has declined in the six months leading to October 2013. This comes as no surprise to many investors.

Ever since major mining investment projects, such as Olympic Dam, started to be cancelled or cutback over a year ago, the outlook for the Australian economy has been uncertain. As the Reserve Bank of Australia forecasts modest growth of 2-3% in 2014, and 2.25-3.25% in 2015, the focus is now on the non-mining sectors of economy and whether they will start to fill the void left by the mining slowdown.

Despite the uncertain outlook, we expect the recovery in the non-mining sectors of the economy to broaden and strengthen in the year ahead. Support is likely to continue to come from Australia's historically low cash rate, an upswing in housing investment and an ongoing medium-term decline in the Australian dollar.

Shane Oliver, Head of Investment Strategy and Chief Economist, AMP Capital says: "While mining investment is likely to trend down going forward, the impact on economic growth will be partly offset by reduced mining-related capital goods imports and a pick-up in resources exports as the new projects start producing. Improved housing investment and consumer spending will also help."

Growth assets gain momentum

This is the fourth month that the Reserve Bank of Australia has kept the cash rate at 2.5%, a record low. The easing in monetary policy that has occurred since late 2011 has supported interest-sensitive spending and asset values, but the full effects of the changes are still coming through.

The environment of low interest rates will likely remain in place for some time to come. This means continued low returns from cash and bank term deposits.

As the generally easy global and Australian monetary environment continues through next year, it will help underpin further gains in a range of assets providing more attractive income flows than those available on cash and bank term deposits. These include corporate debt, real estate investment trusts, shares and unlisted non-residential property.

With yield-related investments having performed so strongly over the last year or two and bond yields likely to gradually trend up, there is a case for those who can take on a bit more risk to consider a higher exposure to parts of the share market that have underperformed and yet will benefit as global and Australian growth picks.

DEC - JAN

S	M	T	W	T	F	S
08	09	10	11	12	**13**	14
15	16	**17**	**18**	19	20	21
22	23	24	25	26	27	28
29	30	31	01	02	03	04
05	06	07	08	09	10	11
12	13	14	**15**	16	17	18

An eye on Washington

The political sideshow in Washington may have concluded for the time being, however, kicking the proverbial can down the road means some issues will be quick to resume. An upcoming timeline of key dates for activity surrounding the US is below.

13 Dec

US Budget Committee

The US Budget Committee will meet on 13 December and US policy makers need to come to an agreement on a budget that will reduce the deficit and set a pathway forward for good policy foundations that will support growth while slowly reducing debt. A good result would be an agreement that would end the divisive fiscal showdowns that have afflicted the US Congress, including the 16 day Federal Government shutdown seen in October.

17-18 Dec

QE taper decision

The decision to taper will be impacted by the outcome of the 13 December budget deal and the unemployment rate. If employment and economic conditions improve to the US Federal Reserve's expectations it could start to stress that interest rates will remain low for longer to offset the impact on bond yields that would occur as a result of cutting back bond purchases.

15 Jan

Spending authority runs out (again)

The US Government's spending authority runs out again on 15 January. While failure to reach agreement by the13 December deadline may create uncertainty, the most likely outcome is that some sort of deal will be agreed to head off another shutdown in January. With the mid-term Congressional elections coming up, the Republicans are likely to be a bit more cooperative in order to avoid a re-run of the loss of voter support they saw in October.

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Economic indicators

Gross domestic product (annual rate %)*	Latest	Current	Previous	1 year ago
World (IMF/OECD)	2012	3.2	n/a	4.0
Australia	Sep-13	2.3	2.4	3.2
China	Sep-13	7.8	7.5	7.4
European Union	Sep-13	-0.4	-0.6	-0.7
United States	Sep-13	1.6	1.6	3.1
Inflation (annual rate %)*	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia	Sep-13	2.2	2.0	3.0
China	Oct-13	3.2	2.6	1.7
European Union	Nov-13	0.9	1.1	2.2
United States	Oct-13	1.0	1.5	2.2
Official interest rates (%)*	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia	Dec-13	2.50	2.50	3.0
China	Nov-13	3.73	3.13	2.25
European Union	Nov-13	0.25	0.5	0.75
United States	Nov-13	0.25	0.25	0.25
Bond yields (%)	**Latest**	**Current**	**3 months ago**	**1 year ago**
Australia 3Y	Nov-13	3.06	2.71	2.62
Australia 10Y	Nov-13	4.20	3.81	3.16
United States 2Y	Nov-13	0.28	0.32	0.25
United States 10Y	Nov-13	2.74	2.61	1.62

Exchange rates

Official interest rates (%)+	Latest	Current	3 months ago	1 year ago
Australian Dollar / Chinese Renmimbi	Nov-13	5.569	5.450	6.496
Australian Dollar / Euro	Nov-13	0.671	0.675	0.802
Australian Dollar / Great British Pound	Nov-13	0.558	0.576	0.651
Australian Dollar / Japanese Yen	Nov-13	93.547	87.377	86.033
Australian Dollar / United States Dollar	Nov-13	0.914	0.891	1.043

Share market analysis

Sharemarkets (in local currency)	5yrs (%pa)	3yrs (%pa)	1yr (%)	3 months (%)	1 month (%)
Australia : ASX 300 Accum	12.1	9.5	22.7	4.7	-1.4
Germany : DAX	15.0	12.0	27.0	14.8	4.1
Global emerging markets : MSCI in AUD	9.2	2.3	18.3	7.3	2.1
Japan : Nikkei	13.0	16.4	65.8	17.0	9.3
United Kingdom : FTSE 100	9.2	6.4	13.4	3.7	-1.2
United States : S&P 500	15.0	15.2	27.5	10.6	2.8

*Data is most current data available
+Rates are expressed as 1 Australian Dollar
(IMF/OECD) purchasing-power-parady

Indices: **Australian shares**: S&P/ASX 300 Accum Index: **International Shares** (Unhedged): MSCI World Ex Australia Index in AUD: **International Shares (Hedged):** MSCI World Ex Australia Index (Hedged) in AUD: **Global Emerging Markets:** MSCI Emerging Markets Index in AUD : **Australian Listed Property:** S&P/ASX 300 A-REIT Index: **Global Listed Property:** UBS Global Investors Index (Hedged) in AUD Australian Cash: UBSA Bank Bill Index **Australian Fixed Interest:** UBSA Government/Treasuries: **Global Government Fixed Interest:** Barclays Global Aggregate Govt (Hedged) in AUD **Global Credit Fixed Interest:** Barclays Global Aggregate Credit (Hedged) in AUD