September 2010

Market and Economics Report

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

Global economy

Review: US economic data released over the last month has generally been soft but still consistent with an ongoing recovery, albeit a slow one. America's gross domestic product (GDP) growth for the June quarter slowed to only 0.4% quarter-on-quarter (qoq) compared with the first quarter's 0.9% growth. The US Federal Reserve (Fed) conceded at its August meeting that the recovery had "slowed in recent months". Construction spending fell to a 10-year low in July and the automobile sector recorded one of its worst months on record in August. The American labour market remained a concern in August as the unemployment rate rose to 9.6%. However, while total payrolls fell by 54,000, private sector jobs rose by 67,000 continuing the gains already seen this year. On top of this, a Challenger survey revealed a sharp drop in announced job cuts in August. The US housing market was mixed in July with home sales falling sharply but pending home sales climbing unexpectedly from a record low. In further positive news, the Institute for Supply Management manufacturing survey in August rose and remains consistent with solid growth prospects for manufacturing. Further, July's industrial production rose, retail sales grew following two negative months, and factory orders also posted a small increase for the month. Japan's economic recovery appeared to be slowing during August. Among the disappointing news, Japan's GDP for the June quarter expanded by only 0.1%, compared to the March quarter's surge of 1.1%. Japanese economic data for July showed a slight fall in unemployment but weaker-than-expected household spending and continuing price deflation. Chinese economic indicators showed that the economy is moderating to a more sustainable pace of growth, but certainly not collapsing. China's manufacturing purchasing managers index (PMI) rose slightly in August indicating continued strong growth, albeit at a more sustainable pace than seen earlier this year. Growth in industrial production, fixed investment and retail sales all slowed during July. Despite the recent sovereign debt crisis in Europe, economic indicators generally suggest that the recovery is proceeding in Europe. Euro area real GDP expanded by 1.0% qoq in the June quarter, however the growth was mixed across Europe. The large economies of Germany and France performed solidly while the more vulnerable economies of Greece, Spain and Portugal disappointed. European business sentiment surveys have remained positive despite the sovereign debt concerns. For example, Europe's PMI eased back slightly in August but remained suggestive of solid manufacturing growth while Germany's IFO Business Climate Index rose once again to reach a three-year high. As expected, the European Central Bank kept its key policy interest rate on hold at 1.0%.

Outlook: Despite obvious risks, the global recovery is continuing but at a slower-than-expected pace.

Australian economy

Review: Australian economic data remained broadly positive. The Reserve Bank of Australia (RBA) left interest rates on hold at 4.5% in August and September, deeming that the current rates setting was "appropriate for the time being", suggesting the central bank still has a tightening bias. Australia's real GDP came in stronger than expected at +1.2% over the June quarter. The labour market continued to grow, with a further 23,500 jobs created in July. Retail sales for July rose solidly and strong consumer confidence levels point to more gains ahead. On a negative note, private sector capital expenditure for the June quarter fell, but business investment plans point to strong capital spending growth ahead.

Outlook: We expect continued solid growth through the remainder of 2010, driven by the global recovery and stronger business investment. Although the RBA is on hold for now, we expect the cash rate to rise to 4.75% or 5% by year-end.

International shares

August review: The leading measure of global share market performance, the MSCI World (ex-Australia) Accumulation Index, returned -3.4% in local currencies (or -2.1% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -4.5% in local currency terms. In the European region, the Eurostoxx Accumulation Index returned -3.9% and the UK FTSE 100 Accumulation Index returned -0.1%, both in local currency terms. Shares in Asia were mixed with Japan's Topix Accumulation Index returning -5.2%, China's S&P/CITIC 300 Total Return Index rising +1.8%, and the MISCI Asia ex-Japan Index returning -0.81%.

Short-term outlook [six to 12 months]: Global shares are likely to remain volatile in the very short term as US double-dip fears persist, but are likely to provide reasonable returns on a 12-month plus view as growth continues and given that shares are now very cheap again.

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

August review: Australian share returns dropped back once again to finish August down by -1.2% as measured by the S&P/ASX 200 Accumulation Index. Despite generally strong domestic economic data, Australian shares suffered as global share markets fell due to weak economic data and worries about a return to recession in the US. The lack of an outcome in the Australian Federal Election by month-end appears to have had little impact.

Short-term outlook: Australian shares are likely to provide positive returns on a 12-month view. Valuations are reasonable, interest rates are low, and solid economic conditions and rising profits are supportive of further gains in shares.

Medium-term outlook: Reflecting reasonable growth prospects, medium-term returns of around 9.5% per annum are likely (or 10.5% if franking credits are allowed for).

Real estate investment trusts

August review: The recent reporting season saw the Australian real estate investment trust sector outperform general equities. The S&P/ASX Property Trusts Accumulation Index returned +3.7% in August, while the S&P/ASX 200 Accumulation Index returned -1.2%.

Short-term outlook: Most property stocks have recapitalised and are good value from a long-term perspective, credit conditions have improved and property transaction volume has increased. As such, property stocks should provide solid returns over the next 12 months.

Medium-term outlook: Solid yields and moderate growth prospects suggest medium-term returns of around 8.5% per annum are likely.

International bonds

August review: August was a strong month for bonds, particularly longer-dated maturities. The bond rally was initially driven by a continuation in weak US data with concerns over a possible return to recession. Bonds were also affected by the Fed's rhetoric regarding further quantitative easing. The US ten-year bond yield fell by 44 basis points (bps) to 2.47% and Japan's ten-year bond yield fell by 10 bps to close at 0.97%. In Europe, the UK ten-year bond yield fell by 50 bps to close the month at 2.83%, whereas Germany's ten-year bond yield fell by 55 bps to 2.12%.

Short-term outlook: Sovereign bond yields are likely to remain low in the short term as concerns of a double-dip recession remain, but are likely to move higher through next year as the global economic recovery continues.

Medium-term outlook: Global sovereign bonds are likely to see low returns, reflecting low bond yields.

Australian bonds and cash

August review: The RBA left interest rates on hold at 4.5% in August and September. Three-year Australian government bonds opened the month of August at a yield of 4.56% and closed 32 bps lower at 4.24%. Ten-year bond yields also fell significantly and the yield closed the month 44 bps lower at 4.76%, causing the yield curve to flatten as bonds rallied. The three-month bank bill yield opened at 4.78% and fell 3 bps to close at 4.75%, the six-month bank bill opened at 4.94% and closed 8 bps lower at 4.86%.

Short-term outlook: Australian bond yields may remain low in the short term on global growth concerns, but are likely to rise over the next year as the RBA tightens further.

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

Australian dollar

August review: The Australian dollar (A$) was volatile over August, finishing down against the US dollar (US$), 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 89.25 US cents (down 1.3% from 90.42 US cents) and JPY75.12 (down 3.9% from JPY78.18). The TWI closed the month at 69.0 (down 0.6% from 69.4). The A$ declined as investors became more cautious about weaker US economic data and concerns that the global recovery is faltering.

Short-term outlook: Notwithstanding short-term volatility, further gains in the A$ are likely on the back of strong demand for resources 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 August 2010	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	31,609	-1.2%	+2.2%
MSCI World (ex-Aust Accumulation/ unhedged in A$)	3,285	-2.1%	-4.0%
US S&P 500 Accumulation Index	1,753	-4.5%	+4.9%
Dow Jones Eurostoxx Accumulation	399	-3.9%	+0.1%
UK FTSE 100 Accumulation Index	3,390	-0.1%	+10.1%
Japan Topix Accumulation Index	1,000	-5.3%	-15.2%
S&P/CITIC 300 Total Return Index	2,755	+1.8%	+5.8%
S&P/ASX 200 Property Accum. Index	19,789	+3.7%	+6.2%
UBS Global Real Estate Investors Index (hedged in A$)	1,065	+0.3%	+21.7%
Aust 90-day bank bill yield	4.75%	-3 bps	+126 bps
Aust 10-year bond yield	4.76%	-42 bps	-66 bps
US 10-year bond yield	2.47%	-49 bps	-93 bps
A$ in US cents	89.25	-2.2%	+5.8%
Trade-weighted index	69.0	-0.6%	+4.1%

Contact us

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