

Market and Economics Report



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

Global economy

Review: During July, the International Monetary Fund (IMF) upgraded its global growth forecast for 2010 to 4.6% from 4.2%. However, the IMF conceded that “downside risks have risen sharply amid renewed financial turbulence”. In the US, the Institute for Supply Management manufacturing survey edged down in June and July, but by far less than expected and remains at levels consistent with solid growth. US consumers have also become more cautious, cutting retail spending in light of concerns over weak job prospects and tight credit availability. The housing market continues to struggle, with house prices making only sedate gains in the last year after deep declines. However, the unemployment rate surprised the market in July by falling to 9.5% rather than rising to 9.8% as expected. Further, various labour market indicators are pointing to continuing private sector jobs growth. Japan continued on a recovery path during July. Japanese industrial production rose only 0.1% in May but this brought the annual gains to 20.4%, reflecting a sharp revival in global demand for cars and electronics after the savage downturn in 2008-2009. Japan’s labour market is showing signs of improvement, with the jobs to applicants ratio rising to its highest level in the past 15 months. Japan’s small business confidence measure was more encouraging, rising to its highest reading in three years. Economic indicators showed that China’s economy is cooling faster than anticipated, making it likely that Chinese authorities will soon begin to loosen regulatory measures. Gross domestic product (GDP) growth slowed to 10.3% year-on-year (yoy) during the June quarter, compared with 11.9% yoy in the March quarter. Industrial production growth slowed sharply to 13.7% from 16.5% in June, but only slowed marginally in July. Despite the recent sovereign debt crisis in Europe, economic indicators generally suggest that the recovery is proceeding in the Euro-zone. The region’s business conditions indicators for July showed an improvement in June, particularly for the manufacturing sector. During July, European regulators conducted stress tests on 91 of the region’s banks. The results showed only seven banks failing to meet their capital adequacy criteria. The European Central Bank kept its key policy interest rate on hold during the month.

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

Australian economy

Review: Politics took centre stage over July as the Federal Labor Government called a national election for 21 August 2010. Prior to calling the election, Prime Minister Julia Gillard reached a compromise with key players in the mining industry regarding the controversial Resource Super Profits Tax (RSPT). The Government also issued revised budget guidance following upgrades to

real GDP forecasts and commodity prices. The Reserve Bank of Australia (RBA) kept the cash rate on hold at 4.5% at its July and August meetings, noting concerns over “ongoing tensions in European financial markets”. The labour market remained robust with 45,900 new jobs created in June and unemployment remaining steady at 5.1% following May’s downward revision from 5.2%. Importantly, the June quarter consumer price index showed that inflation was lower than expected and only slightly above the RBA’s target range at 3.1%. News on the trade front was very good with a record surplus in June. Retail sales growth was subdued in May and rose modestly in June, but consumer confidence continues to be strong in August. Business confidence fell slightly in June and housing sector weakness was clearly evident in new home sales and building approvals, both of which fell in June.

Outlook: We expect continued 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

July review: The leading measure of global share market performance, the MSCI World (ex-Australia) Accumulation Index, returned +5.8% in local currencies (or +0.7% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +7.0% in local currency terms. In the European region, the Eurostoxx Accumulation Index returned +6.3% and the UK FTSE 100 Accumulation Index returned +7.1%, both in local currency terms. Shares in Asia were also positive with Japan’s Topix Accumulation Index returning +1.0% and China’s S&P/CITIC 300 Total Return Index returning +12.1%.

Short-term outlook [six to 12 months]: Global shares are likely to provide modest returns on a 12-month plus view. Volatility is likely to remain high until the global economy settles into a sustainable growth path.

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

July review: Australian shares bounced back from three consecutive months of negative performance to finish July up by 4.5% as measured by the S&P/ASX 200 Accumulation Index. Investor sentiment was boosted by better-than-expected earnings results from both the US and European reporting seasons. Prime Minister Julia Gillard’s compromise regarding the RSPT also removed some uncertainty.

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.

Real estate investment trusts

July review: The S&P/ASX Property 200 Accumulation Index rose 1.0% during July, underperforming the broader S&P/ASX 200 Accumulation Index which returned 4.5% for the month. The market was cautious over concerns about the European bank stress tests and some softer economic data from the US.

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 9% per annum are likely.

International bonds

July review: The combination of positive US company earnings figures, no surprises from European bank stress tests and broadly positive economic data drove risk markets higher in July. Volatility of bond yields globally was relatively subdued, resulting in global bond markets trading in fairly tight ranges across the month. The US ten-year bond yield fell by 3 basis points (bps) to 2.91% and Japan's ten-year bond yield fell by 2 bps to close at 1.07%. In Europe, the UK ten-year bond yield fell by 3 bps to close the month at 3.33%, whereas Germany's ten-year bond yield rose by 9 bps to 2.67%.

Short-term outlook: Sovereign bond yields are likely to remain under pressure in the short term as concerns of a double-dip recession remain, but are likely to move higher as economic conditions improve towards the end of the year.

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

Australian bonds and cash

July review: The RBA kept interest rates on hold at 4.5% in July and August. A moderation in both global and domestic economic data resulted in the market pricing in an extended pause for the RBA's monetary policy setting, particularly after a softer-than-expected inflation result. Three-year Australian government bonds opened the month at a yield of 4.39% and closed 17 bps higher at 4.56%. Ten-year bonds traded similarly and the yield closed the month 14 bps higher at 5.20%. The three-month bank bill yield opened at 4.92% and fell 15 bps to close at 4.78%, the six-month bank bill opened at 5.00% and closed 6 bps lower at 4.94%.

Short-term outlook: Australian bond yields are likely to drift sideways, but economic data in Australia will continue to be strong.

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

Australian dollar

July review: The Australian dollar (A\$) rallied over 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 90.42 US cents (up 7.5% from 84.09 US cents) and JPY78.18 (up 3.8% from JPY74.36). The TWI closed the month at 69.4 (up 2.1% from 67.3). The improvement in investor confidence flowed through to commodity prices which helped the A\$, as did a falling US\$.

Short-term outlook: 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 July 2010	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	31,977	+4.5%	+10.1%
MSCI World (ex-Aust Accumulation/ unhedged in A\$)	3,356	+0.7%	+0.5%
US S&P 500 Accumulation Index	1,835	+7.0%	+13.8%
Dow Jones Eurostoxx Accumulation	415	+6.3%	+10.3%
UK FTSE 100 Accumulation Index	3,394	+7.1%	+18.2%
Japan Topix Accumulation Index	1,056	+1.0%	-9.1%
S&P/CITIC 300 Total Return Index	2,706	+12.1%	-20.6%
S&P/ASX 200 Property Accum. Index	19,076	+1.0%	+18.8%
UBS Global Real Estate Investors Index (hedged in A\$)	1,062	+7.7%	+37.6%
Aust 90-day bank bill yield	4.78%	-14 bps	+158 bps
Aust 10-year bond yield	5.18%	+12 bps	-42 bps
US 10-year bond yield	2.96%	+2 bps	-67 bps
A\$ in US cents	91.27	+8.5%	+8.4%
Trade-weighted index	69.4	+3.1%	+5.6%

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Private Client Services on 1800 188 013

Wholesale Investors

AMP Capital's Client Service Team on 1800 658 404

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