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AMP capital INVESTORS

Market and Economics Report

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Global economy

Review: US economic data was mixed. In June, the unemployment rate dropped to its lowest level since July 2009, however non-farm payrolls came in weaker than expected. Further, consumer confidence fell by nearly 10 points in June, which was steeper than had been anticipated and broke a three-month stretch of rising optimism. Housing data displayed mixed readings. Housing starts fell in May, largely due to the expiry of the first home buyers' tax credit in April. Existing home sales were weaker, but the inventory of existing homes for sale also fell. The Institute for Supply Management manufacturing survey edged lower in June. More encouraging is that US industrial production continues to rebound, rising by 1.2% month-on-month (mom) in May. In Japan, small business sentiment rose in June, revealing the best results since October 2007. However, employment, overall household lending and industrial production fell in May. The Bank of Japan left interest rates on hold and announced a new loan scheme to commercial banks. In China, exports surged in June, however imports were weaker than expected. Retail sales were up 18.7% year-on-year in May. However, in June a leading indicator for the Chinese economy was revised down suggesting that growth is moderating faster than expected. China's purchasing managers' index also fell for the second month in June, indicating that manufacturing activity expansion is also slowing. Europe's sovereign debt concerns continued to worry investors. However, European Central Bank President Trichet expressed confidence that the vulnerable European countries would succeed in their efforts to cut their budget deficits. In June, European consumer confidence readings were steady and business confidence showed an improvement, but the consumer price index came in below market expectations. In positive news, Germany's economy continues to perform well, with industrial production rising 2.7% mom in June. The European purchasing managers' index was flat, although it remained well above the threshold which signals economic expansion. In less positive news, the unemployment rate for the Euro-zone fell to 10% in May. In the UK, jobless claims fell more than expected in May and UK retail sales rebounded. Consumer confidence, however, was weaker, house prices increased by less than expected and mortgage approvals remained unchanged in May.

Outlook: Despite obvious risks, the global recovery is continuing, but it is likely to be fairly subdued in developed countries and the risks have increased.

Australian economy

Review: In Australia, real gross domestic product (GDP) grew by 0.5% quarter-on-quarter in the March quarter and by 2.7% for the year. The Reserve Bank of Australia (RBA) kept the cash rate on hold at 4.5% at the June and July meetings, citing the adverse impacts of European debt concerns and the fact that Australian borrowing rates are around the average levels of the past decade. At the beginning of July, the Australian Government finalised a deal with the mining industry on the Resources Super Profits Tax, renaming it the Minerals Resource Rent Tax. The deal involves cutting the tax rate to 30% from 40%, increasing the hurdle rate and applying the tax to iron ore and coal only. Data releases were mixed. Australia's trade balance improved sharply in April and employment surged in May, leading to a fall in the unemployment rate to 5.2%. The Melbourne Institute Leading Indicator for April pointed to a robust growth path, however the measure predated the market turmoil of May, and since then both consumer sentiment and business confidence have fallen. Retail spending rose modestly in May and manufacturing growth remained positive in June, but slowed noticeably.

Outlook: We expect reasonable growth through 2010, driven by the global recovery and stronger 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

June review: The leading measure of global share market performance, the MSCI World (ex-Australia) Accumulation Index, returned -4.2% in local currencies (or -4.1% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned -5.2% in local currency terms. In the European region, the Eurostoxx Accumulation Index returned -1.2% and the UK FTSE 100 Accumulation Index returned -5.0%, both in local currency terms. Shares in Asia also suffered with Japan's Topix Accumulation Index returning -4.3% and China's S&P/CITIC 300 Total Return Index returning -7.3%.

Short-term outlook [six to 12 months]: Global shares are likely to provide modest returns on a 12-month plus view. Although growth is moderating, we believe the risk of a double-dip recession is low given low interest rates. However, we do expect a rougher ride than over the last 12 months.

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

June review: Australian shares posted their third consecutive monthly decline in June, with the S&P/ASX 200 Accumulation Index falling 2.6%. The market was volatile due to continuing concerns about sovereign debt issues in Europe, moderating growth expectations in China and the Federal Government's proposed Resource Super Profits Tax.

Short-term outlook: Australian shares are likely to provide positive returns on a 12-month view. Valuations are reasonable, interest rates are low and shares are likely to be buoyed by better economic conditions and rising profits in late 2010.

Medium-term outlook: Reflecting reasonable growth prospects, medium-term returns of around 9.5% per annum are likely.

Real estate investment trusts

June review: The S&P/ASX Property 200 Accumulation Index fell 0.8% during June, but outperformed the broader Australian equity market.

Short-term outlook: Most property stocks have recapitalised and 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 suggest medium-term returns of around 9% per annum are likely.

International bonds

June review: The increased risk of a lower-than-expected global growth outlook renewed the bond market rally and international bond yields fell across the board in June. The US ten-year bond yield fell by 34 basis points (bps) to 2.94% and Japan's ten-year bond yield fell by 18 bps to close at 1.09%. In Europe, the UK ten-year bond yield fell by 22 bps to close the month at 3.36 % and Germany's ten-year bond yield fell by 8 bps to 2.58%.

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

Medium-term outlook: AMP Capital expects low returns from global sovereign bonds, reflecting low bond yields.

Australian bonds and cash

June review: The RBA kept interest rates on hold at 4.5% in June and July, and the moderation in both global and domestic data resulted in the market pricing in an extended pause in the interest rate tightening cycle. Three-year Australian government bonds opened the month at a yield of 4.72% and closed 33 bps lower at 4.39%. Ten-year bond yields traded similarly and closed the month 31 bps lower at 5.06%. The three-month bank bill yield opened at 4.87% and rose 5 bps to close at 4.92%, the six-month bank bill opened at 4.95% and closed 5 bps higher at 5%.

Short-term outlook: Australian bond yields are likely to drift sideways as global bond yeilds fall, but economic data in Australia remains strong.

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

Australian dollar

June review: The Australian dollar (A$) was volatile over June, falling against the US dollar (US$) and the Japanese yen (JPY) but rising slightly against the currencies of Australia's major trading partners (as per the Trade Weighted Index [TWI]). The A$ closed the month at 84.09 US cents (down 0.8% from 84.73 US cents) and JPY74.36 (down 3.8% from JPY77.31). The TWI closed the month at 68.1 (up 0.6% from 67.5). The A$ is often susceptible to worries about global growth and increased investor risk aversion due to its commodity and high-yield status.

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

	30 June 2010	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	30,610	-2.6%	+13.2%
MSCI World (ex-Aust Accumulation/ unhedged in A$)	3,332	-4.2%	+5.2%
US S&P 500 Accumulation Index	1,715	-5.2%	+14.4%
Dow Jones Eurostoxx Accumulation	390	-1.2%	+13.6%
UK FTSE 100 Accumulation Index	3,169	-5.0%	+19.8%
Japan Topix Accumulation Index	1,046	-4.3%	-7.9%
S&P/CITIC 300 Total Return Index	2,413	-7.3%	-16.6%
S&P/ASX 200 Property Accum. Index	18,884	-0.8%	+20.4%
UBS Global Real Estate Investors Index (hedged in A$)	986	-2.9%	+39.1%
Aust 90-day bank bill yield	4.92%	+5 bps	+173 bps
Aust 10-year bond yield	5.06%	-31 bps	-48 bps
US 10-year bond yield	2.94%	-34 bps	-59 bps
A$ in US cents	84.09	-0.8%	+4.4%
Trade-weighted index	67.3	-0.3%	+4.0%

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