

Market and Economics Report



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

Global economy

Review: The global economic recovery continued in March. The highlights included a 123,000 increase in US payrolls in March and upwards revisions to employment in previous months. The US labour market finally appears to have turned the corner, with strong profit growth pointing to further employment gains ahead. Retail sales continue to grow. The Institute for Supply Management (ISM) manufacturing survey rose to its highest level since 2004 and the ISM services conditions index also improved. Against this, housing indicators were generally weak as was private sector credit. With lots of spare capacity and low inflation, Federal Reserve Chairman Ben Bernanke once again maintained the commitment to keep interest rates “exceptionally low for an extended period”. Japan’s recovery seems to be gaining momentum after two very difficult years for the economy. The unemployment rate fell to 4.9%, its lowest level in the past ten months. Business surveys and a leading indicator are also improving. The Bank of Japan left the overnight cash rate at 0.1%, but expanded the availability of fixed-rate funds (from ¥10 trillion to ¥20 trillion) in an attempt “to encourage a decline in longer-term interest rates”. Chinese economic data continued to point to strong growth momentum. Exports are trending higher, suggesting China’s export activity remains on a solid track with the global recovery. Strong import growth and surging retail sales also point to robust domestic demand. While inflation has accelerated, this is largely due to higher food prices. More tightening measures are likely in the months ahead, but this is unlikely to become aggressive so we continue to expect a soft landing for the Chinese economy. News from Europe was once again dominated by Greece’s ongoing fiscal problems. The European Central Bank kept the key policy interest rate at 1%. Meanwhile, Europe’s manufacturing sector appears to be continuing to recover. The UK budget projected a somewhat faster improvement in the budget deficit, taking it to 4% of gross domestic product (GDP) in 2014/2015 from 11.8% in 2009/2010. However, these projections look a little optimistic.

Outlook: The global recovery is continuing and still easy monetary and fiscal conditions point to solid global growth this year, particularly in the emerging world.

Australian economy

Review: Australian economic data continues to be strong. The Reserve Bank of Australia (RBA) decided to raise the cash rate in both March and April, taking it to 4.25%, citing the return to trend growth and indicating that more rate hikes are likely. December quarter real GDP showed that economic activity rose strongly by 0.9% quarter-on-quarter (qoq), the strongest pace since March 2008. The labour market remained firm with continuing strong jobs growth and rising job advertisements pointing to more gains

ahead. It is also looking very likely that big increases in iron ore and coal prices will provide a large boost to national income. Other positive data included the National Australia Bank business survey, which recorded a rise in both business conditions and business confidence, and consumer confidence which remains strong. In less positive news, building approvals fell and housing finance also fell for the fourth consecutive month as first home buyers continued to exit the market following the end of the Federal Government’s first home owners boost in December.

Outlook: We expect solid growth through 2010, driven by the global recovery, a housing upturn and stronger investment. We expect the cash rate to rise to 4.75% or 5% by year-end.

International shares

March review: The leading measure of global share market performance, the MSCI World (ex-Australia) Accumulation Index, returned +6.6% in local currencies (or +3.5% in unhedged Australian dollar terms). The US S&P 500 Accumulation Index returned +6.0% in local currency terms. In the European region, the Eurostoxx Accumulation Index returned +7.9% in local currencies and the UK FTSE 100 Accumulation Index returned +6.5% in local currency terms. Shares in Asia also gained ground with Japan’s Topix Accumulation Index returning +10.4% and China’s S&P/CITIC 300 Total Return Index returning +2.2%.

Short-term outlook [six to 12 months]: Global shares are likely to provide good returns on a 12-month plus view, given the likelihood of reasonable growth in profits and still low interest rates. However, we 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

March review: Australian shares gained momentum during March, assisted by strength in commodities and the rebound in global shares. The S&P/ASX 200 Accumulation Index rose 5.7% for the month.

Short-term outlook: Australian shares are likely to provide solid 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 2010.

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

Real Estate Investment Trusts

March review: The S&P/ASX Property 200 Accumulation Index was down 0.1% during March, substantially underperforming the broader share market with concerns about new issuance continuing to weigh on the 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 9.5% per annum are likely.

International bonds

March review: The US ten-year bond yield rose by 22 basis points (bps) to 3.83% and Japan's ten-year bond yield rose by 9 bps to close at 1.40%. However, the UK ten-year bond yield fell by 9 bps to close the month at 3.94% and Germany's ten-year bond yield fell marginally by 1 bp to 3.09%.

Short-term outlook: Sovereign bond yields are likely to drift higher on expectations for eventually rising short-term interest rates and high public borrowing levels.

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

Australian bonds and cash

March review: After an unexpected pause in February, the RBA chose to raise the cash rate at its March meeting by 25 bps to 4%. The three-year Australian bond yield closed the month 45 bps higher at 5.28%. The curve continued its flattening trend over the month as the ten-year bond yield ended the month 37 bps higher at 5.79%. The three-month bank bill rate opened at 4.13% and closed 36 bps higher at 4.49%. Six-month bank bill yields also rose, opening at 4.42% and closing 34 bps higher at 4.76%.

Short-term outlook: Bond yields are likely to drift higher on the back of gradually rising global bond yields and the increasing cash rate in Australia.

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

Australian dollar

March review: The Australian dollar (A\$) rallied again over March, rising particularly strongly against the Japanese yen (JPY), but also against the US dollar (US\$) and the currencies of Australia's major trading partners (as per the Trade Weighted Index [TWI]). The A\$ closed the month at JPY85.69 (up 7.6% from JPY79.62) and 91.67 US cents (up 2.3% from 89.61 US cents). The TWI closed the month at 71.7 (up 3.2% from 69.5). Improving investor confidence continued to flow through to the A\$, which also benefited from strong local economic data.

Short-term outlook: Further gains in the A\$ are likely on the back of the improving global growth outlook, strong demand for resources, the positive outlook for commodities 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 March 2010	Change in one month	Change in 12 months
S&P/ASX 200 Accumulation Index	34,449	+5.7%	+41.7%
MSCI World (ex-Aust Accumulation/unhedged in A\$)	3,501	+3.5%	+14.5%
US S&P 500 Accumulation Index	1,936	+6.0%	+49.8%
Dow Jones Eurostoxx Accumulation	430	+7.9%	+49.3%
UK FTSE 100 Accumulation Index	3,627	+6.5%	+50.4%
Japan Topix Accumulation Index	1,215	+10.4%	+28.5%
S&P/CITIC 300 Total Return Index	3,111	+2.2%	+35.5%
S&P/ASX 200 Property Accum. Index	19,141	-0.1%	+40.6%
UBS Global Real Estate Investors Index (hedged in A\$)	1,036	+7.1%	+79.7%
Aust 90-day bank bill yield	4.49%	+36 bps	+135 bps
Aust 10-year bond yield	5.78%	+37 bps	+134 bps
US 10-year bond yield	3.83%	+22 bps	+117 bps
A\$ in US cents	91.67	+2.3%	+32.6%
Trade-weighted index	71.7	+3.2%	+24.9%

Contact us

If you would like to know more about how AMP Capital can help you, please visit ampcapital.com.au, or contact one of the following:

Financial Planners

AMP Capital's Investment Representative on 1300 139 267

Personal Investors

Your Adviser or Financial Planner

Wholesale Investors

AMP Capital's Client Service Team on 1800 658 404

Important note: While every care has been taken in the preparation of this document, AMP Capital Investors Limited [ABN 59 001 777 591] [AFSL 232497] makes no representation or warranty as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided and may not be reproduced without express permission from AMP Capital.