GODFREYPEMBROKE

market update

- Oil prices continue their sharp decline through December.
- Global bond yields continue to fall on the back of deflationary forces.
- The Shanghai Composite Index rises 20% in December on the back of interest rate cuts by the PBoC.
- US economic data continues to provide an improved and sustainable growth outlook.
- The Eurozone data continues its weak growth trend and raises the prospect for further monetary easing.
- The Australian Dollar continues to weaken – down 4.12% against the USD in December.

What's inside?

December market performance

Equity Markets – Price Indices	Index	At Close 31/12/2014	% Change 1 Month	% Change 12 Months
Australia	All Ordinaries	5388.60	1.7%	0.7%
Japan	Nikkei	17450.77	-0.1%	7.1%
Hong Kong	Hang Seng	23605.04	-1.6%	1.3%
UK	FTSE 100	6566.09	-2.3%	-2.7%
Germany	DAX	9805.55	-1.8%	2.7%
US	Dow Jones	17823.07	0.0%	7.5%
EMU*	Euro 100	1036.94	-2.8%	1.7%
World**	MSCI – Ex Aus (Gross) (Hedged)	1287.62	-1.0%	7.9%
Property – Price Index	**Index**	**At Close 31/12/2014**	**% Change 1 Month**	**% Change 12 Months**
Listed Trusts	S&P/ASX 300 A-REITS	1166.33	2.9%	20.1%
Interest Rates		**At Close 31/12/2014**	**At Close 30/11/2014**	**At Close 31/12/2013**
Aust 90 day Bank Bills		2.78%	2.74%	2.63%
Australian 10 year Bonds		2.73%	3.03%	4.24%
US 90 day T Bill		0.05%	0.01%	0.07%
US 10 year Bonds		2.17%	2.17%	3.04%
Currency* **		**At Close 31/12/2014**	**% Change 1 Month**	**% Change 12 Months**
US dollar	A$/US$	0.82	-4.12%	-8.53%
British pound	A$/STG	0.52	-3.70%	-2.84%
Euro	A$/euro	0.68	-1.22%	4.16%
Japanese yen	A$/yen	98.12	-3.14%	4.34%
Trade-weighted Index		66.50	-2.49%	-3.48%

* Top 100 European stocks trading on the FTSE
** Price Index – **Source:** msci.com
*** All foreign exchange rates rounded to two decimal places **Source:** FactSet.
Past performance is not a reliable indicator of future performance.

Global economies

Oil prices continued their sharp decline in December – down by 19.5% – which led to a 41.6% decline for Q4 2014.

While global equity markets were generally down in December, Australia, for the second month, went in the opposite direction, with the ASX200 performing strongly.

US economic data continued to show further resilience with Q3 GDP data revised up to 5%.

Eurozone manufacturing data continues to remain weak, heightening expectations that the ECB will require further aggressive monetary easing to stabilise the deflationary forces.

China is anticipated to continue to lower interest rates and provide further stimulus to support the ailing property market.

Following the re-election of Japan's Prime Minister Abe in December, the Government announced further targeted regional stimulus.

Australian economic data continues to adjust to declining mining investment. The residential construction sector continues to improve while the AUD weakened further through December.

Volatility in global equity markets has increased over recent months, largely because of the uncertainties created by the sharp decline in oil prices, the uncertain timing of the ECB implementing significant quantitative easing, the continued crisis in the Middle East and the pressure on the Russian economy.

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Given the weakness in the global economy and regional deflationary forces, it seems likely the US Federal Reserve will continue to show 'patience' in raising US interest rates.

While Investors are currently focussed on the uncertainties of the sharp slide in oil prices, there are significant positives to lower oil prices represented by the transfer of spending power from the oil producers to the global consumer. The response by the consumer to this increased spending power will be defining.

US

In the US, the ISM's non-manufacturing Purchasing Managers Index (PMI) fell to 56.2 in December from the near 9 year high of 59.3 in November. The report noted very subdued cost pressures, a reflection of falling oil prices. The report said it was the first decrease in input prices in 62 months.

The US economy continued to gain traction in Q4 with an increase in job creation, housing starts, manufacturing and services data and business investment. Q3 GDP was revised up to 5%, the fastest growth in 11 years.

The USD continues to gain ground against the EUR, Yen and AUD. The USD is anticipated to maintain strength against major global currencies throughout 2015.

The US CPI data continues to be relatively benign with the November data (all items) at 1.3%, down from October's 1.7%, this is largely a result of the decline in the energy prices.

Housing starts continue to be volatile and remain well below the pre-GFC levels of 1.6 million per annum.

US housing starts fell in November, down 1.6 % to a seasonally adjusted annual pace of 1.028 million units. October's starts were revised up to a 1.045 million-unit pace.

US corporate earnings continue to show resilience. The estimated S&P 500 corporate earnings growth in 2014 is 5.7%, while the 2015 estimate is 7.9%. Given the fall in energy prices, analysts have lowered earnings and revenue estimates for 2015 over the past quarter.

Valuations of US companies do not seem excessive. The current 12-month forward P/E ratio is 15.8 based on a forward 12-month EPS estimate of $127.30 per share.

The USDEUR was up 2.9% in December and appreciated 13.6% in 2014.

Europe

The Eurozone economy continued its anaemic growth in December and suffered its worst quarter for more than a year.

The Markit/CIPS composite Purchasing Managers Index (PMI) for December fell to 51.1 from 51.4 in November. It suggested the Eurozone economy grew by just 0.1% in Q4 2014.

It is expected the ECB will announce an aggressive bond-buying programme at its meeting on 22 January.

A Greek election in January has raised doubts over the country's ongoing commitment to the Eurozone.

The December Eurozone inflation fell -0.2%, the first negative data since October 2009. The November inflation was 0.3%. Lower oil prices were the main cause for the deflation data in December.

The EURUSD exchange rate was weak through December, down -2.84% for the month and -12% in 2014.

In December, the UK Treasury released its updated economic forecasts. The UK economy grew by 0.7% in Q3, and is expected to grow 3.0% in 2014. Business investment is expected to grow at 7.7% in 2014. The UK is expected to grow faster than any G7 country in 2014.

China

HSBC China Composite PMI data (which covers both manufacturing and services) signalled increased business activity in China for the eighth successive month in December, with the HSBC Composite Output Index posting 51.4 at the end of 2014 (up from 51.1 in November).

The improvement in overall output growth was a result of stronger activity growth at service providers and a weaker contraction of manufacturing production in December. It was the quickest expansion of service sector activity for three months.

The employment index improved modestly and price pressures remain muted. The services sector continued to hold up well amidst the manufacturing downturn, providing some counter-weight to the downward pressures on the economy.

The PBoC's decision to reduce interest rates has provided a strong injection across the China equity market. The Shanghai Composite Index was up 20% in December. China's Central Bank is expected to lower interest rates further in 2015.

Although the China equity market has rallied strongly off a low base, corporate valuations remain attractive.

The November core inflation of 1.6% yoy (steady compared to October) is significantly below the targeted 3.5%. NAB Economics remains of the view that GDP in 2014 will come in at 7.3% and 7% in 2015 and 6.8% in 2016.

Asia region

Over to Japan, the economy will be a strong beneficiary of the significant decline in the USD price of oil.

Japanese manufacturing activity showed sustained growth in December, suggesting domestic demand continues to recover after the impact from the sales tax increases in April 2014.

The final Markit Japan Manufacturing Purchasing Managers Index (PMI) was 52.0 in December, unchanged from the final reading in November.

Late in December, Japan's Government approved stimulus spending worth $29 billion aimed at helping the country's lagging regions and households with subsidies, merchandise vouchers and other steps. This decision follows on from the ¥30 trillion increase in the quantitative easing package announced in October.

The Government said it expects the stimulus plan to boost Japan's GDP by 0.7%.

The Government is also expected to start cutting corporate taxes from April 2015 in a bid to spur more activity and encourage firms to pay higher wages.

It's worth reiterating that at the time of the quantitative easing, the BOJ also added that the so-called "quantitative and qualitative easing" program would continue "as long as it is necessary".

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Equity markets

The MSCI World ex Aus was down -1% in December.

The Shanghai Composite Index was up 20.57% in December.

The German DAX Index declined by -1.8%.

The broader Euro 100 was down -2.8%.

The Japanese Nikkei Index was down -0.1%.

The US Dow Jones Equity Index was flat in December.

Australia rose with the S&P/ASX All Ordinaries Index up 1.7%.

Australia

The Manufacturing PMI in Australia decreased to 46.90 in December from 50.08 in November.

The AUD has continued to decline against most currencies in December. The AUDUSD was down 4%.

The Australian economy continues to adjust to the declining mining investment and the challenges around getting traction across the non-mining sector of the economy.

The RBA continues to suggest that the AUD is too high and believes that it should be considerably lower. However, higher yields in Australia remain a source of investment for international investors.

The Australian Westpac-Melbourne Institute Consumer Sentiment Index fell 5.7% to 91.1 in December. It is at its lowest level since August 2011.

Building approvals rose 7.5% in November, continuing the strong trend from the 11.5% gain in October. The November rise was led by another strong rise in apartments (+17%) and follows the 32% gain in October.

The Core Logic RP Data house price growth slowed to 7.9% in December 2014. Sydney house prices increased 12.4%, Melbourne by 7.6% while Canberra was down -0.6%. Interestingly, the annual rate of combined capital city home value growth peaked at 11.5% over the 12 months to April 2014.

NAB Economics continues to expect no change in the RBA's cash rate until a tightening cycle begins towards the end of 2015. Interestingly, the market expectations have pushed any increase in interest rates into 2017.

Australian equities

	Index/Benchmark (% pa)	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 Acc.	5.30%	14.70%	6.48%	2.02%
	S&P/ASX 50 Acc.	5.32%	16.20%	7.48%	3.30%
	S&P/ASX Small Ordinaries Acc.	-3.81%	0.58%	-2.01%	-5.64%

Source: FactSet

The S&P/ASX 300 Accumulation Index did not participate in the November global rally, but enjoyed a belated one in December, up 2.04%. The Australian equity market was positively impacted by lower bond yields, a further weakening in the AUD against most currencies and a 'no bad news' from the banking system review, namely the Financial System Inquiry (FSI).

The S&P/ASX 300 Industrials Accumulation Index also enjoyed a solid turnaround in December, up 3.01%, reflecting the prospect of an extended period of low interest rates.

The broader S&P/ASX All Ordinaries Index rose by 1.7% in December.

For the 12 months to 31 December 2014, the S&P/ASX 300 Accumulation Index posted a gain of 5.3%, while the large market caps, represented by the S&P/ASX 50 Accumulation Index, had a similar performance, returning 5.32%.

Interestingly, after weak performances across most sectors in November (other than Healthcare, Telcos and Property), sector performances were significantly higher in December. Industrials, Healthcare, Telcos and Property, were the best performing sectors, up 5.8%, 5.6%, 4.5% and 4.5% respectively. Consumer Discretionary, Energy, Consumer Staples and Materials were down -2.2%, -1.7%, -0.8% and -0.3% respectively.

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Big movers this month

Going up:

↑ Industrials 5.8%

↑ Healthcare 5.6%

Going down:

↓ Consumer Discretionary -2.2%

↓ Energy -1.7%

Sector	1 Mth	3 Mths	1 Yr
Energy	-1.7%	-17.7%	-12.3%
Materials	-0.3%	-6.1%	-11.9%
Industrial	5.8%	7.6%	11.0%
Consumer Discretionary	-2.2%	-0.3%	-0.6%
Consumer Staples	-0.8%	-4.4%	-4.3%
Health Care	5.6%	13.3%	23.0%
Financials (ex Property)	2.5%	7.2%	9.8%
Info Tech	1.8%	-0.7%	4.0%
Telcos	4.5%	12.3%	20.6%
Utilities	1.6%	3.0%	15.3%
Property	4.5%	11.3%	26.8%

Source: FactSet

Global equities

	Index/Benchmark (% pa)	1 Yr	3 Yrs	5 Yrs	7 Yrs
Global	MSCI World Ex Aus (Gross) (Hedged)	10.56%	18.63%	12.04%	4.63%
	MSCI World $A Hedged (Gross)	10.18%	18.19%	11.74%	3.67%
	MSCI World Small Cap ($A)	11.86%	26.26%	15.33%	7.73%
Emerging	MSCI Emerging Mkts Free	5.57%	8.75%	5.19%	1.86%
	MSCI AC Far East Free (ex Japan)	6.10%	10.16%	5.99%	0.02%

Source: FactSet

Global equity markets generally declined in December. Similar to November, the standout market was China with the Chinese Shanghai Composite Index up 20.57%.

The recent sharp decline in oil prices combined with the continued crisis in the Middle East, the deteriorating Russian economy and the need for the ECB to implement quantitative easing has created considerable volatility in global markets.

The MSCI World ex-Australia (unhedged) Index was up 2.63% in December, with the hedged version down -1%. In the year to 31 December 2014, the global equity markets performed strongly. The MSCI World Ex Australia (Gross-hedged) was up 7.9% for the 12 months to 31 December.

The US Dow Jones Index was flat in December.

The Euro 100 Index was also disappointing, down -2.8%.

The Japanese Nikkei Index was only marginally down, -0.1%.

The UK FTSE was down sharply in December, -2.3%.

Over the 12 months to 31 December 2014, the best performers were the Shanghai Composite Index and the S&P 500 index, up 52.87% and 11.7% respectively. The Dow Jones Index was up 7.5%, the Nikkei up 7.1%, and the Euro 100 up 1.7%. In contrast, the worst performers were the UK FTSE and the Australian All Ordinaries, -2.7%, and 0.7% respectively.

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Australian dollar (AUD)

In December, the Australian Dollar (AUD) was weaker relative to all the major international currencies.

The AUD declined by 4.12% against the US Dollar (USD), to finish the month at 81.66 US cents. On a 12 month basis, the AUD declined by -8.5% against the USD.

The AUD declined against the Euro, down -1.2% in December. On a 12 month basis, the AUD was up 4.16% against the Euro.

Against the Japanese Yen, the AUD was down 3.14% in December. On a 12 month basis, the AUD was up 4.34% against the Yen.

Against the British Pound, the AUD was down -3.70% in December. On a 12 month basis, the AUD was down -2.84% relative to the British Pound.

Property

	Index/Benchmark (% pa)	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	S&P/ASX 300 A-REIT Acc	26.79%	21.78%	12.04%	-2.06%
Global	FTSE EPRA/NAREIT Dv ex AUS TR Hdg AUD	23.07%	21.38%	15.91%	6.02%

Source: FactSet

The S&P/ASX 300 A-REIT Accumulation Index was up 4.49% in December, and outperformed the broader Australian market as measured by the All Ordinaries Accumulation Index (+1.93%).

On a 12 month rolling basis, the Australian listed property market, as measured by the S&P/ASX 300, A-REIT Accumulation Index was up 26.79%, which significantly outperformed the ASX300 Accumulation Index which was up 5.3%.

Over 1 and 3 years, Australian REITs (AREITs) outperformed global REITs while this was reversed over 5 and 7 years, Global property, as represented by the FTSE EPRA/NAREIT Index, was up 23.07% over the rolling 1 year period.

Fixed Interest

	Index/Benchmark (% pa)	1 Yr	3 Yrs	5 Yrs	7 Yrs
Australian	Bloomberg AusBond Composite 0+ Yr	9.81%	6.45%	7.33%	7.56%
	Australian 90 Day Bank Bill	2.68%	3.06%	3.74%	4.16%
Global	BarCap Global Aggregate Index	9.96%	8.59%	4.60%	4.60%
	BarCap Global Agg. Index Hedged	10.37%	7.37%	8.37%	8.45%

Source: FactSet

US 10-year bond yields were up 0.09% in December, closing the month at 2.17%. Australian 10-year bond yields were down -9.8% in December, and closed the month at 2.73%.

For December, Bloomberg AusBond Composite 0+ Yr index (formerly known as the UBS Composite Bond 0+Yr Index) was up 1.27%. On a 12 month basis, unhedged global bonds returned 9.96%, outperforming Australian bonds that returned 9.81%.

Global bonds (unhedged), as measured by the Barclays Capital Global Aggregate Index, posted positive returns for the one year period ended 31 December 2014, up 9.96%. The hedged index posted a strong one year gain of 10.37%.