March 2015

GODFREY PEMBROKE

# market update

- Global growth has improved following Central Bank monetary stimulus
- Oil prices remain volatile, the price range has stabilised, and will provide stimulus to global growth
- US economic data remains in recovery mode with improving consumer sentiment
- US bond yields rally following continued improvement in the labour market
- China continues monetary easing
- RBA keeps rates on hold (in March) but remain on a monetary easing strategy

## What's inside?



## February market performance

| Equity Markets – Price Indices | Index | At Close 28/02/2015 | % Change 1 Month | % Change 12 Months |
|---|---|---|---|---|
| Australia | All Ordinaries | 5898.48 | 6.2% | 8.9% |
| Japan | Nikkei | 18797.94 | 6.4% | 26.7% |
| Hong Kong | Hang Seng | 24823.29 | 1.3% | 8.7% |
| UK | FTSE 100 | 6946.66 | 2.9% | 2.0% |
| Germany | DAX | 11401.66 | 6.6% | 17.6% |
| US | Dow Jones | 18132.70 | 5.6% | 11.1% |
| EMU* | Euro 100 | 1189.09 | 7.2% | 15.1% |
| World** | MSCI - Ex Aus (Gross) (Hedged) | 1351.17 | 5.7% | 12.6% |
| **Property – Price Index** | **Index** | **At Close 28/02/2015** | **% Change 1 Month** | **% Change 12 Months** |
| Listed Trusts | S&P/ASX 300 A-REITS | 1288.88 | 2.9% | 28.1% |
| **Interest Rates** | | **At Close 28/02/2015** | **At Close 31/01/2015** | **At Close 28/02/2014** |
| Aust 90 day Bank Bills | | 2.33% | 2.54% | 2.62% |
| Australian 10 year Bonds | | 2.47% | 2.44% | 4.02% |
| US 90 day T Bill | | 0.01% | 0.01% | 0.06% |
| US 10 year Bonds | | 1.99% | 1.64% | 2.65% |
| **Currency*** ** | | **At Close 28/02/2015** | **% Change 1 Month** | **% Change 12 Months** |
| US dollar | A$/US$ | 0.78 | 0.51% | -12.53% |
| British pound | A$/STG | 0.51 | -2.32% | -5.14% |
| Euro | A$/euro | 0.70 | 1.12% | 7.71% |
| Japanese yen | A$/yen | 93.57 | 2.29% | 2.45% |
| Trade-weighted Index | | 64.10 | 0.31% | -6.97% |

* 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

Global monetary policy remains extremely accommodative. Central Banks, although at various stages of the monetary easing cycle, will continue to maintain an easing bias for some considerable time.

Global manufacturing Purchasing Managers' Index (PMI) data in February continues to suggest that global growth has improved. This is consistent with the International Monetary Fund's (IMF) world GDP growth forecast of around 3½% in 2015.

China, Canada, and Australia are anticipated to continue to lower interest rates, while the European Central Bank (ECB) has only just commenced its €60b per month quantitative easing program.

Although the US is at the early stage of moving interest rates off historical low levels, the Federal Reserve Chairperson, Janet Yellen, states, 'it will be a gradual process, data dependent, towards normalisation of the interest rate curve'.

Global bond yields have increased following the improved US employment data, the continued improvement in the US economy and the commencement of quantitative easing (QE) by the ECB.

Oil prices, although volatile, have shown signs of stabilisation in February as the US has been rapidly reducing the number of oil rigs, particularly non-conventional drilling operations.

China's PBoC provided further monetary stimulus with another 25bp interest rate cut to both the 1yr lending rate (to 5.35%) and the deposit rate (to 2.5%).

Global equity market valuations have continued to appreciate. The Earnings Yield / Bond Yield ratios remain extremely favourable for equities. Given the recent round of monetary easing it's anticipated that global equity markets will continue to trend higher through 2015.

## US

In the US, the February ISM Manufacturing report came in at 53.5 (down from 55.1). Despite the decline, this result continues to indicate reasonable growth in US manufacturing.

Following the strong Q3 GDP of 5%, the US economy grew at a 2.2% seasonally-adjusted rate in Q4, 2014, revised down from the previous 2.6%. It is expected that GDP in Q1, 2015 will continue to improve.

US consumer confidence pulled back in February from an 11 year high. The pull back was a reflection of recent gains in fuel prices and bad winter weather in parts of the US.

Modest improvement in non-farm payroll data continued low inflation and low interest rates will likely sustain the recent improvements in consumer sentiment. The improved economy should lead to a sustained period of improved consumer spending.

Although the CPI showed a negative headline for the yoy change in January, the encouraging sign was that core (ex food and energy) prices rose by 0.2%. In her testimony to Congress, Federal Reserve Chairperson Janet Yellen was positive about the ongoing strengthening in the labour market. She was also quite adamant that weakness in inflation was largely the result of transitory factors such as lower oil prices.

The S&P/Case Shiller composite price index of 20 metropolitan areas gained 4.5% in December yoy and above the 4.3% growth rate in November indicating that house prices in the US are still improving.

US non-farm payroll data in January came in at 257,000, with a 147,000 revision for November and December. This follows the 252,000 non-farm payroll data in December.

The USD has remained relatively steady against the EUR and AUD through February. However, over the 12 month period the USD has strengthened by 22% against the EUR and 23.3% against the AUD.

The US equity markets have continued to trend higher. Q4CY2014 S&P 500 corporate earnings have been better than expected. However, US corporate earnings estimates for 2015 have been revised downwards given the lower oil prices and impact on the Energy sector.

The earnings growth estimates in 2015 are now at 3% while revenue growth is flat. The 2016 estimated earnings growth is at 13%. The current 12-month forward P/E ratio is 17.2 based on a forward 12-month EPS estimate. This appears high relative to recent history. However, the earnings yield at 5.8% compares to the current 10 year risk free bond rate at 2% and a cash rate near zero. This gives strength to the argument that equities, although appearing expensive relative to history, remain attractive relative to bonds.

## Europe

Eurozone manufacturing data remained steady in February, relative to January data. The impact of the weaker EUR and the lower oil prices have yet to flow through to the broader Eurozone economies. However, the Eurozone PMI services data improved.

The ECB's €60b per month quantitative easing program kicks off in March and should be stimulatory for the region.

The various Eurozone business and economic sentiment readings for February were mixed. ECB President Draghi was upbeat on growth prospects in his address to the EU parliament.

The Eurozone's unemployment rate fell to 11.2% in January, down from 11.3% in December, the lowest rate since April 2012.

Greece negotiated a four-month extension to its bailout in February after tense talks with creditors. Eurozone leaders want to extend help on Greece's €240b bailout until the end of June, but the plans need to be ratified by Eurozone members.

The UK manufacturing PMI rose again in February, suggesting that the recovery has regained some pace following a mild slowdown in late 2014. The Q1, 2015 data is extending the strong 3% GDP growth experienced in 2014.

## China

In February, China's official PMI increased marginally from January. While the timing of Chinese New Year may have distorted the data, activity appears to be holding up well, suggesting that any slowdown this year is likely to be gradual rather than abrupt.

China's policymakers appear to be increasingly comfortable with the idea that the economy is undergoing a structural transition to slower growth and are likely to announce a lower official growth target for 2015 of about 7.0%.

China's PBoC provided further monetary stimulus with another 25bp interest rate cut to both the 1yr lending rate (to 5.35%) and the deposit rate (to 2.5%). This follows the cut to the Reserve Requirement Ratio (RRR) in early February. Expectations remain high that further PBoC monetary stimulus will continue over coming months.

Interestingly, the IMF expects China GDP to slow to 6.8% in 2015 and to 6.3% in 2016. This is down from the 7.4% in 2014.

China is cutting its target industrial production growth to 8% in 2015 which translates into a slower economic growth of around 7%, whilst industrial production grew at 8.3% in 2014.

China inflation rose 0.8% yoy in January, a five year a low. This will be reinforcing the weakness in the economy and keeping pressures on policymakers to inject more stimuli.

## Asia region

Over to Japan, the 2.8% yoy increase in capital spending in the Q4 was impressive and follows the 5.5% annual gain in the Q3, 2014.

Although the Japan economy disappointed in 2014, down 6.8%, largely due to the consumption tax, Japan's GDP increased by 2.2% in Q4, 2014, fuelled by exports. It does appear that the worst is over for the Japanese economy.

Over to India, the economy is shaping up for a stellar period. In its January report, the IMF anticipates India's 2016 economic growth rate will be 6.5%, ahead of China's projected 6.3%.

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market update

## Equity markets

The MSCI World ex Aus was up 5.7% in February.

The German DAX Index continued a strong recovery, up 6.6%.

The broader Euro 100 was up 7.2%.

The Japanese Nikkei Index was up 6.4%.

The US Dow Jones Equity Index was up 5.6% in February.

Australia was higher, with the S&P/ASX All Ordinaries Index up 6.2%.

## Australia

The Australian PMI fell 3.6 points to 45.4 in February, the third month of contraction; however, on a 3-month moving average basis the PMI has not been positive since mid-2013.

The RBA maintained the cash rate at 2.25% at its early March meeting. The wording has changed to 'rates steady for the time being' and 'further easing of policy may be appropriate over the period ahead'.

Although Sydney house prices and auction clearance rates continue to be buoyant, other cities are more subdued. Given the continued weak labour market and low inflation, it is expected that the RBA will remain data dependent and any further move in interest rates will be sensitive to the weaker labour market.

With the inflation rate well within the 2–3% RBA target range and with the prospect of lower interest rates and subdued wages growth, the prospect of continued low inflation rates is anticipated to keep the RBA in an accommodative mode.

With unemployment expected to rise further and the mining sector continuing to weaken, the RBA would prefer to see a lower AUD .

There are improving signs off a low base. Credit growth has continued to improve in January (+0.6% mom and + 6.2% yoy). The improvement has been driven by a slightly stronger business credit growth (+0.8% mom and now 5.5% yoy). Overall, housing credit increased 0.6% mom and by 7.1% yoy. The owner – occupied housing credit advanced 0.5% mom and 5.7% yoy. Investor lending grew 0.8% mom and 10% yoy, the mark that APRA has guided should not be exceeded.

The Westpac- Melbourne Institute Index of Consumer Sentiment improved by 8% in February, and reached its highest level in 12 months. The key factors were the RBA's interest rate cut, the lower petrol prices and the continued strength in the equity market. In fact, the S&P/ASX 200 accumulation Index is up 10.39% in 2015.

CoreLogic RP Data House prices report for February shows a rise of 0.3% across the eight capital cities after the 1.3% January rise. Sydney remains the standout with prices up another 1.4% where for most of the other capitals it was a mixed month as far as prices were concerned. The February price increases in the CoreLogic RP Data showed Sydney's auction clearance rate at 82.8% down from 87.8%. Melbourne was 76.5% from 74.9%, and nationally 77.7% vs. 77.1% previously. Price wise, Sydney is now 2.9% YTD up from 2.5% and Melbourne 2.9% YTD from 2.6%. The housing price increases are confined to Sydney.

Residential building approvals surprised again on the upside, rising 7.9% seasonally adjusted. Approvals to build apartments once again drove the strong result (+19.6% mom), though approvals for houses also recorded a second consecutive slight uptick (+0.4% mom). Overall, the data confirmed that residential construction remains at exceptionally high levels – particularly for apartments. This is providing an important offset to weaker spending in the resources sector as major projects complete.

## Australian equities

| | Index/Benchmark (% pa) | 1 Yr | 3 Yrs | 5 Yrs | 7 Yrs |
|---|---|---|---|---|---|
| **Australian** | S&P/ASX 300 Acc. | 14.19% | 15.79% | 9.55% | 5.31% |
| | S&P/ASX 50 Acc. | 14.69% | 17.80% | 10.44% | 6.70% |
| | S&P/ASX Small Ordinaries Acc. | 3.11% | -1.01% | 1.42% | -2.79% |

**Source:** FactSet

Following the RBA decision to cut the cash rate by 25bp to 2.25%, the S&P/ASX 300 Index had an extremely strong performance in February, up 6.1%. The strong performance was also aided by a better than expected H1FY2015 reporting season the announced ECB QE program and the prospect of further interest rate cuts by the RBA should economic data warrant.

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## Big movers this month

Going up:

↑ Materials 11.8%

↑ Energy 9.2%

Going down:

↓ No sectors were down

The S&P/ASX 300 Industrials Index also had a strong February, up 5.32%, while the S&P/ASX 300 Industrials Accumulation Index was up 6.10%. The 12 month S&P/ASX 300 Industrials Accumulation Index was up 20.6%.

The broader S&P/ASX All Ordinaries Index rose by 6.2% in February and on a 12 month basis, the Index was up 8.92%.

The large market caps represented by the S&P/ASX 50 Accumulation Index had a similar performance, returning 6.9% in February and on a 12 month basis the Index was up 14.69%.

All sectors were higher in February. The strong performances in February across the Materials, Energy, Consumer Discretionary and Utilities sectors were a highlight, up 11.8%, 9.2%, 7.9% and 7.9% respectively. The Financials and Information Technology sectors also performed well, up 7.6% and 7.3% respectively.

| Sector | 1 Mth | 3 Mths | 1 Yr |
|---|---|---|---|
| **Energy** | 9.2% | 0.3% | -12.0% |
| **Materials** | 11.8% | 12.6% | -3.4% |
| **Industrial** | 5.7% | 13.4% | 16.9% |
| **Consumer Discretionary** | 7.9% | 11.4% | 11.0% |
| **Consumer Staples** | 1.1% | 3.8% | -1.2% |
| **Health Care** | 6.7% | 15.7% | 30.6% |
| **Financials (ex Property)** | 7.6% | 14.7% | 22.0% |
| **Info Tech** | 7.3% | 7.4% | 6.0% |
| **Telcos** | 0.6% | 13.7% | 32.0% |
| **Utilities** | 7.9% | 16.2% | 23.9% |
| **Property** | 3.7% | 16.4% | 34.9% |

**Source:** FactSet

## Global equities

| | Index/Benchmark (% pa) | 1 Yr | 3 Yrs | 5 Yrs | 7 Yrs |
|---|---|---|---|---|---|
| Global | MSCI World Ex Aus (Gross) (Hedged) | 15.34% | 17.08% | 13.56% | 6.96% |
| | MSCI World $A Hedged (Gross) | 15.09% | 16.71% | 13.22% | 5.95% |
| | MSCI World Small Cap ($A) | 18.04% | 27.17% | 17.27% | 11.23% |
| Emerging | MSCI Emerging Mkts Free | 13.26% | 6.26% | 7.17% | 3.61% |
| | MSCI AC Far East Free (ex Japan) | 12.12% | 6.81% | 8.14% | 0.04% |

**Source:** FactSet

Global equity markets had a strong recovery in February, up 5.7%. The ECB announcement of a €60b QE program, the continuing recovery in US economic data and expectations of an extended period of low interest rates, interest rate cuts in China, Canada and Australia and the continued weakness in oil prices, each combined to push equity markets higher through February.

The MSCI World ex-Australia (unhedged) Index was up 5.3% in February, with the hedged version up 5.9%. In the year to 28 February 2015, the global equity markets performed strongly. The MSCI World Ex Australia (Gross-hedged) was up 15.3% for the 12 months to 28 February 2015.

The German DAX was up 6.6% in February.

The US Dow Jones Index was up strongly, 5.6%.

The Euro 100 Index had a strong month, up 7.2%.

The Japanese Nikkei Index was also up 6.4%.

The UK FTSE was sharply higher in February, up 2.9%.

The Shanghai Composite Index was up 3.1%

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## Australian dollar (AUD)

In February, the Australian Dollar (AUD) was steady against most currencies but weaker relative to all the major international currencies. The trade weighted index (TWI) was marginally higher at 0.31% in February and -6.97% in the 12 month period to 28 February 2015.

The AUD appreciated marginally against the USD, up 0.51% to finish the month at 78.1 US cents. On a 12 month basis, the AUD declined by -12.53% against the USD.

The AUD increased against the Euro, up 1.12% in February. On a 12 month basis, the AUD was up 7.71% against the Euro.

Against the Japanese Yen, the AUD was up 2.29% in February. On a 12 month basis, the AUD was up 2.45% against the Yen.

Against the British Pound, the AUD was down -2.32% in February. On a 12 month basis, the AUD was down -5.14% relative to the British Pound.

Over the 12 months to 28 February 2015, the best performers were the Shanghai Composite Index, the Nikkei and German DAX, up 61.0%, 26.7% and 17.6% respectively. The S&P 500 Index was up 13.2%, the Dow Jones Index was up 11.1% and the Euro 100 up 15.1%. In contrast, the worst performers were the UK FTSE and the Hong Kong Hang Seng Index up 2.0%, and 8.7% respectively.

## Property

| | Index/Benchmark (% pa) | 1 Yr | 3 Yrs | 5 Yrs | 7 Yrs |
|---|---|---|---|---|---|
| Australian | S&P/ASX 300 A-REIT Acc | 34.91% | 23.13% | 14.86% | 2.52% |
| Global | FTSE EPRA/NAREIT Dv ex AUS TR Hdg AUD | 25.65% | 19.36% | 17.71% | 7.82% |

**Source:** FactSet

The S&P/ASX 300 A-REIT Accumulation Index had another strong month, up 3.69% in February but underperformed the broader Australian market as measured by the All Ordinaries Accumulation Index, up 6.52%.

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 34.91%, which significantly outperformed the ASX300 Accumulation Index which was up 13.68%.

Over 1 and 3 years, Australian REITs (A-REITs) outperformed global REITs while this was reversed over 5 and 7 years. Global property, as represented by the FTSE EPRA/NAREIT Index, was up 25.65% 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 | 10.31% | 7.14% | 7.34% | 7.76% |
| | Australian 90 Day Bank Bill | 2.66% | 2.96% | 3.69% | 4.04% |
| Global | BarCap Global Aggregate Index | 11.13% | 11.20% | 5.14% | 5.41% |
| | BarCap Global Agg. Index Hedged | 9.73% | 7.28% | 8.30% | 8.35% |

**Source:** FactSet

In February, US 10 year bond yields increased by 21.45%. This reversed the 24.42% decline in yields January. Australian10-year bond yields increased by 0.89%, and closed the month at 2.5%.

For February, Bloomberg AusBond Composite 0+ Yr index (formerly known as the UBS Composite Bond 0+Yr Index) was up 0.28%. On a 12 month basis, unhedged global bonds returned 11.13%, outperforming Australian bonds that returned 10.31%.

Global bonds (unhedged), as measured by the Barclays Capital Global Aggregate Index, posted positive returns for the one year period ended 28 February 2015, up 11.13%. The hedged index posted a strong one year gain of 9.73%.