

Investment Brief



Global

- **Review:** Developments around the Greek debt crisis remained the focus for markets over the month. The risk of a Greek sovereign default rose substantially, and that in turn raised worries about contagion across to countries such as Portugal and Ireland. Meanwhile, global economic data generally continued to disappoint, suggesting the growth momentum had clearly slowed.
- US economic data released during June remained subdued. Business surveys displayed a softer tone in May, with the ISM manufacturing survey falling by 6.9 points to 53.5, its lowest level in the past year. The labour market also struggled, recording disappointing payroll growth of 54,000 compared to April's increase of 232,000. The US unemployment rate edged 0.1% higher to 9.1% in May, reflecting the subdued jobs growth. Retail sales retreated with a fall of 0.2% month on month (MoM) after April's mild rise of 0.3% MoM. At the June Federal Open Market Committee (FOMC) meeting, the US Federal Reserve (Fed) recognised a "slower pace of recovery" by downgrading the 2011 growth forecast from approximately 3.2% to 2.8%.
- Within the Euro zone, Greece came under severe pressure during the month. The likelihood of a sovereign debt default increased and Moody's downgraded Greece's credit rating to Caa1. Greece's Prime Minister survived a parliamentary vote of confidence, and fortunately, further austerity measures to reduce the budget deficit were passed.
- Europe's business surveys responded adversely to the stress in sovereign bond markets as well as to the European Central Bank (ECB) interest rate rise of 0.25% to 1.25% in April. Europe's manufacturing PMI fell by 2.6 points to 52.0 in June, which showed a softening European manufacturing sector. The region's unemployment rate remained elevated at 9.9% in April and May. Germany's IFO Business Climate Index proved more resilient. It highlighted that the German economy remains the main source of strength for Europe. June's IFO reading edged up 0.3 points to 114.5 and is just below the 20 year high of 115.4 recorded in February 2011.

- In Japan, signs emerged that economic activity is starting to stabilise. May's manufacturing PMI rose and a survey of economic confidence bounced, both solidly. There were also gains in exports and a strong rise in an industrial activity index. These results suggest a moderation in the supply shock to Japan's production capability from the March natural disaster.
- Chinese economic data released in June was generally solid and provided a degree of relief given fears of a hard landing. China's manufacturing PMI fell modestly to 52 in May from 52.9 in April. Industrial production and fixed asset investment came in above expectations, recording 13.3% year on year (YoY) and 25.8% YoY respectively. Retail sales were broadly in line with expectations, increasing by 16.9% YoY. China's inflation rose to 5.5% YoY in May, but this was less than feared.
- **Outlook:** Clearly global growth has lost momentum over recent months. However, we remain of the view that the current soft patch is likely to prove temporary and the underlying fundamentals for the global economy are not as troubling as some fear. Given that monetary policy settings are extremely easy and that financial conditions have not materially deteriorated (credit spreads and bank lending standards), the global economy should be able to ride out this run of slower activity over coming months before reviving later this year.

New Zealand

- **Review:** Key economic data released during June added to evidence that the New Zealand economy is on a relatively firm footing, despite the global ructions in recent months and the February earthquake in New Zealand.
- The terms of trade rose another 0.9% over the March quarter taking it to its highest since March 1974. In addition, the ANZ commodity price index reached a new record high with another 0.3% gain in May.
- The REINZ monthly residential market report showed house sales were up 10.8% over the year to May while house prices were down by 0.7% over the same period.
- Retail sales rose 0.9% over the March quarter (in volume terms) to be up 0.8% over the year. Consumer confidence surveys showed notable improvement in consumer sentiment in June and over the June quarter, boding well for consumer spending activity in the current quarter.
- The NBNZ business outlook survey showed that general business confidence continued to improve, rising to 46.5 in June from 38.3 in May. The index is now at its highest since May last year. Not surprisingly (given expected post-quake activity), confidence was strongest in the construction sector. Meanwhile, the own-activity indicator fell moderately to 38.7 in June from 39.7 in May. It nonetheless remains above the historic

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average and continues to signal an above trend rate of growth towards the end of this year.

- The BNZ-BusinessNZ Performance of Manufacturing Index was up 2.7 points in May to record 54.7, the highest level of manufacturing activity since June last year. Meanwhile, the BNZ-BusinessNZ Performance of Services Index rose slightly in May to 52.8 from 52.6 in April, to be at its highest level of services sector activity since September 2010.
- As widely expected, the Reserve Bank of New Zealand (RBNZ) left the Official Cash Rate (OCR) unchanged at 2.5%. The accompanying statement was more upbeat than its previous statement, reflecting the improving New Zealand economic outlook.
- The number of short-term visitor arrivals to New Zealand was down 0.3% in May, while a net migrant inflow stood at -360 in May. This was the third month in a row that recorded a monthly net migrant outflow since the February earthquake, with increased departures from Christchurch (mostly going to Australia).
- The number of new dwelling consents rose 2.2% in May, while the number of consents ex-apartments rose 0.9%. The core series (ex-apartments) have now risen for three consecutive months. While the level of residential construction activity remains very weak, there are signs that it is currently in a bottoming process. It is likely to improve significantly from current multi-decade lows on the back of eventual reconstruction in Canterbury.
- **Outlook:** New Zealand's growth momentum should pick up notably over the second half of this year. Reconstruction in Canterbury is expected to boost the level of economic activity significantly over the coming years and the backdrop of strong export commodity prices and the favourable terms of trade will continue to be supportive of growth. Downside risks to this optimism are weaker global economic activity and a cautious household sector on the back of elevated household debt. Fiscal consolidation also will weigh on activity over the coming years.

International shares

- **Review:** Global share markets experienced a sharp correction during June. Concerns about the Greek solvency and the slowdown in global growth served to undermine investor confidence. However, the last week of the month saw a solid rise in shares as the Greek parliament voted in favour of more austerity measures and as European banks looked to be heading towards some form of voluntary debt rollover on Greek bonds. Renewed confidence that China's monetary tightening is close to an end also boosted sentiment.
- The leading measure of global share market performance, the MSCI World Index, returned -1.5% in local currencies (or -1.9% in unhedged New Zealand dollar (NZD) terms). The US shares fell another 1.7% over the month of June after a 1.1% decline in May. European equities were mixed, with Germany up 1.1%, Italy down 3.7%, and France and the UK down slightly by 0.2% and 0.4% respectively. In Asia, Japanese shares appeared to bottom out after three consecutive monthly declines, rising 0.9% for the month. Shares in emerging Asia underperformed the developed markets, recording a decline of 2.3% for the month. Easing concerns around a hard landing in China saw Chinese shares outperform with a gain of 1.4% for the month.

- **Outlook:** While volatility will likely remain high in the global share market for sometime yet, our broad assessment remains that shares will continue to climb the 'wall of worry' this year helped by still cheap valuations, solid corporate earnings and easy global monetary conditions.

New Zealand shares

- **Review:** The New Zealand equity market underperformed the global equity market in June. While improving local economic data was also supportive of the New Zealand equity market, ongoing major aftershocks in Christchurch, as well as market talk of earnings downgrades in some corporate names, have dampened sentiment.
- The NZX50 Index fell 2.8% over the month while the NZX Portfolio Index recorded a 2.4% decline for the month.
- **Outlook:** Our valuation metrics continue to show New Zealand equities to be good value against bonds but not so good against global equities. New Zealand equities are likely to lag any positive trend in global shares given their low beta nature, but equally they would perform relatively better should global shares suffer a bout of weakness along the way.

New Zealand listed property

- **Review:** The New Zealand listed property sector posted a 1% return for June, outperforming the NZX50 which had a soft month, down -2.7%. The strongest performers in June were AMP NZ Office (ANO) and Argosy (ARG), returning 2.4% and 2.1% respectively. Only two listed property vehicles (LPVs) had negative returns.
- Overall the listed property sector has returned 7.7% for the June quarter. Leading performers for the quarter were ARG, up 17.5% and Vital Healthcare (VHP), up 12.2%. In the last 12 months, the listed property sector has returned 22.8%, compared with the NZX50's return of 17.5%.
- ARG and VHP both currently have management internalisations in progress, with unitholders due to vote in August. DNZ Property (DNZ) continues to express interest in merging with ARG.
- **Outlook:** Increasing levels in tenant enquiry and activity together with improved banking conditions indicate a modest recovery in 2011. Yield continues to be the main focus for investors while interest rates remain low. Dividends in FY2012 may reduce due to tax changes, however, the dividend yields remain attractive. Stabilising of revaluations may see some of the more heavily discounted LPVs reduce the level of discount to Net Tangible Assets (NTA).

International bonds

- **Review:** International bond markets rallied further during June as the weaker global economic activity and the intensifying Greek debt crisis led to increased demand for safe-haven. However, as shares staged a solid rebound towards the end of the month, bonds came under pressure with yields rising from their lows.
- The US ten-year bond yield ended the month up 10 basis points (bps) at 3.16% while Japan's ten-year bond yield was down 3 bps to close at 1.14%. In Europe, the UK ten-year bond yield rose 9 bps to close the month at 3.38%, while the ten-year bond

yields in Germany and Australia were flat at 3.03% and 5.21% respectively. Reflecting the rising default risk, the yield on Greek 10-year sovereign bonds surged to around 18%.

- **Outlook:** Softer economic data has helped sovereign bonds in key countries perform well over the last few months as yields have fallen. Considering the prospect that the global recovery regains momentum later this year and given that bond yields are already at such low levels, global bonds offer poor returns from a long term perspective.

New Zealand bonds and cash

- **Review:** Despite the improving domestic economic data and rising inflation expectations, New Zealand bond yields fell further during the month. Demand for New Zealand government bonds continued in June with the fragile risk appetite in financial markets further supporting the sentiment for bonds. Cash and money market rates remained low due to no near term prospect of a rate hike from the RBNZ.
- The RBNZ sees underlying inflation remaining constrained for now, and as such the central bank left the OCR unchanged at 2.5%. However, the RBNZ expects the underlying price pressures to rise over time in line with a rise in growth momentum. In its June Monetary Policy Statement, the bank effectively signalled an increased probability of a rate hike before the year end, although it will be the dataflow over the coming months that will ultimately dictate when the monetary policy tightening resumes.
- The five-year government bond yield ended the month 13 bps lower at 4.03% while the ten-year rate ended the month down 4 bps at 5.07%. Meanwhile, the five-year and ten-year swap rates were down 7 bps and 1 bp respectively.
- **Outlook:** With no prospect of a rate hike in the near term, New Zealand rates are likely to remain relatively well anchored. However, as the economy recovers from the current weakness over the second half of this year, yields should start to move higher fairly rapidly in anticipation of the eventual resumption in the tightening cycle.

New Zealand dollar

- **Review:** Despite the subdued risk appetite during the month, the NZD remained well supported as New Zealand economic data showed further signs of underlying economic resilience and momentum. Rising inflation expectations and the prospects of resumption in monetary policy tightening over the coming year also helped the NZD remain reasonably firm in the environment of elevated risk aversion in financial markets.

- The NZD was more or less flat against most major currencies. It was up 0.4% against the US dollar touching a post float high of around 0.8320. Meanwhile, the NZD was down 0.2% against the yen while it fell 0.4% against the euro. The NZD was particularly strong against the sterling on the back of falling rate hike expectations in the UK and further signs the UK economy has stalled. On a MSCI-weighted basis, the NZD was up 0.4% while it was up just 0.1% on a trade-weighted basis.
- **Outlook:** The NZD is likely to be broadly range-bound over the coming year or so. In the near term, the strong commodity prices and improving local economic data should be supportive of the NZD. However, the long term valuation measure suggests the NZD is becoming increasingly overvalued. The demanding valuation makes the currency vulnerable to external shocks and any near term pullbacks.

Summary

Key financial markets summary

	As at 30 June 2011	Change over the month (%)	Change over the year (%)
MSCI - US	4679.90	-1.7	+31.5
MSCI - UK	9626.24	-0.4	+25.0
MSCI - Germany	2244.69	+1.1	+24.2
MSCI - Japan	989.82	+0.9	+3.3
NZX-50	3448.35	-2.8	+16.0
MSCI - World (local currency)	3107.13	-1.5	+22.5
MSCI - World (NZD)	5486.39	-1.9	+9.2
NZ Official Cash Rate	2.50	0 bps	-25 bps
NZ 90-day bank bill yield	2.67	-2 bps	-47 bps
NZ 10-year bond yield	5.07	-4 bps	-27 bps
US 10-year bond yield	3.16	+10 bps	+23 bps
NZD-USD	0.8259	+0.4	+20.1
NZD (TWI)	71.1	+0.1	+7.0
NZD (MSCI weighted)	81.8	+0.4	+12.7