

Investment brief



Global

- **Review:** The flow of global economic activity data remained positive. The IMF upgraded its outlook for the global economy, with global growth of circa 4.25% projected over 2010 and 2011. Particularly pleasing during April was the improved activity data coming out of Europe, which has so far lagged the global upturn. That said, the spotlight remained on the smaller peripheral countries of the EU, with the dire debt situation in Greece raising risks of contagion across other European countries.
- In the US, real GDP rose an annualised 3.2% in the March quarter, with a solid increase in private domestic demand evident over the past few quarters. The ISM manufacturing indicator rose to a five and a half year high and, even more encouraging, was a sign that the recovery was broadening, with the non-manufacturing ISM indicator rising to a near four-year high. Non-farm payrolls continued their improving trend, resulting in a stabilisation of the unemployment rate. There was positive news for the consumer, with confidence rising to a two-year high, strong bounces in new and existing home sales, and retail sales up a strong 7.6% year-on-year (YoY) in March. Proof of better business investment ahead was provided by ongoing improvement in core durable goods orders. Inflation pressures remained subdued with annual core CPI inflation falling to a new cycle low of 1.1%.
- After lagging so far this recovery, activity indicators in Europe were much stronger. EU purchasing manager indices rose to cycle highs as did the EC economic sentiment indicators, Germany's Ifo index rose to a new high and the country's unemployment rate fell to 7.8%. EU industrial production rose by 3.8% YoY in February, the best growth in nearly two years. As in the US, annual core CPI inflation fell to a new cycle of 0.9% YoY. Credit rating downgrades for Greece, Spain and Portugal caused a lot of concern about contagion risk in the Euro area. Early in the month the EU and IMF agreed to a support package for Greece worth €45 billion this year, but by month's end this was being re-negotiated upwards to around €110 billion and extended to cover the next few years.

- Asia remained a beacon of strength. China's real GDP rose by 11.9% YoY in the March quarter, retail sales were up 18% YoY and industrial production rose by 18.1% YoY. Singapore grew at a record pace of an annualised 32.1% in the March quarter. In Japan, the leading index published by the Cabinet Office reached its highest level since mid 2007, consistent with a steady recovery through 2010. Policy tightening remained a focus in the Asia region, given rising inflation pressures (excluding Japan). China announced an aggressive crackdown on property speculation, in particular making it tougher to get loans for second and third houses and significantly increasing land supply for residential development. At month-end it also raised the reserve requirement for banks by 50 basis points (bps) to 17%, the third increase this year. The Reserve Bank of India raised its key policy rate by another 25bps to 5.25% as did the Reserve Bank of Australia, taking its policy rate to 4.25%.
- **Outlook:** The global economic recovery is broadening and intensifying, as expected, and global GDP growth should exceed 4% this year. At this stage there are encouraging signs that a decent run rate for growth can be maintained through much of next year as well.

New Zealand

- **Review:** Economic indicators pointed to an ongoing recovery. In April, business confidence rose to its highest level in over a decade on the own-activity indicator of the National Bank survey, with widespread increases across the key measures of investment, employment and profit expectations. The level of confidence is consistent with annual GDP growth of over 5% on our model, but this rate would not be considered sustainable for any longer than a few quarters.
- Retail sales disappointed with a month-on-month fall in February, but electronic card transactions data for March were strong, suggesting a rebound in sales and consistent with improved spending growth. Consumer confidence on the Roy Morgan and Colmar Brunton measures remained above trend, consistent with a decent rebound in consumer spending.
- The CPI rose by 0.4% in the March quarter, taking annual inflation to 2.0%, with moderate inflation helped by aggressive retail discounting and the relatively weak housing market. However, a rise in tobacco tax, the start to the Emissions Trading Scheme and a likely rise in GST later in the year will push headline inflation beyond 5% within the next year.
- Fonterra lifted its projected current season payout by 7% to \$6.10 per kilogram of milk solids, driven by rising world dairy

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prices. The ANZ commodity price indices rose to new cycle highs, whether measured in New Zealand or world prices (SDR terms) in March, suggesting a very strong terms of trade boost to the New Zealand economy. New Zealand's trade balance continued to improve, with an annual deficit of just \$194 million for the year to March, the best result in seven and a half years.

- The Reserve Bank of New Zealand (RBNZ) left the Official Cash Rate (OCR) unchanged at 2.5% and tweaked its policy message, leaving its options open for either a June or July start to the tightening cycle. While in March the Bank said it would begin removing policy stimulus around the middle of 2010, this was changed to "over coming months".
- **Outlook:** New Zealand's economy is likely to experience a broad based economic recovery in line with the global economy through 2010. We expect GDP growth to average 3.5% over 2010 and 2011.

International shares

- **Review:** Global shares had a strong start to the month, reaching new highs for the cycle by the middle of the month, before sliding back down and ending up just 0.3% for April on the MSCI World Index in local currency terms. There were opposing forces, with a very strong start to the earnings season in the US and the broadening of the global economic recovery supporting equity prices but the announcement of a US Securities and Exchange Commission investigation into Goldman Sachs, followed by a Federal investigation into trading activities dampened returns in the US, while the turmoil in peripheral Europe reduced risk appetite and dampened returns in that region.
- Outperforming regions were the US and Nordic countries, Japan performed in line, while the UK and the EU area dragged the chain. Emerging markets slightly underperformed developed markets.
- **Outlook:** Global shares are taking a well-earned breather, following a strong run. We remain comfortable with valuations, the global economic recovery is still young, and rate hikes are still some time away in the major countries, so we believe our positive bias towards shares remains appropriate.

New Zealand shares

- **Review:** New Zealand shares performed broadly in line with global shares, with the NZX50 Index up 0.6% and the NZX Portfolio Index up 0.5%.
- It was a quiet month for corporate news flow. The top performing stock in the top 50 was Pike River Coal, as the market reacted favourably to its \$50 million capital raising. Restaurant Brands reported that its 2010 financial year earnings of \$19.5 million was more than double the previous year's earnings. There were no clear sectoral themes in terms of performance but of the larger companies Fisher and Paykel Healthcare, Vector and Air New Zealand significantly outperformed.
- Telecom NZ reported another downgrading of earnings, but these had largely been factored in by the market and the stock was flat for the month.

- **Outlook:** New Zealand shares remain good value relative to cash and bonds and earnings are at the beginning of an upswing from a depressed level. However, they are likely to lag any positive trend in global equities but equally they would perform relatively better should global equities suffer a bout of weakness.

New Zealand listed property

- **Review:** The listed property sector index was up 1.5% for April, outperforming the NZX 50. All the listed property vehicles were either up or flat for April, with the ING Property Trust (ING), AMP NZ Office Trust (APT) and National Property Trust (NAP) the top performers, up 4.1%, 2.7% and 2.1% respectively.
- NAP and the Kermadec Property Fund (KPF) announced full portfolio valuation updates during April. NAP's valuations were down \$5.5 million (2.8%) for the six months to 31 March 2010 and a total of \$10.4 million (4.8%) reduction for the full financial year. The easing in valuations was mainly as a result of softening office rental rates in central Auckland and Wellington. KPF valuations were down \$4.73 million (3.9%) for the full year to 31 March 2010 to \$116.7 million. KPF has unconditional sales contracts on \$14.8 million of properties, expected to be settled by 30 June 2010.
- APT has completed the sale of the five individually titled Chews Lanes retail units. The sales realised \$11.7 million before disposal costs, which is 11% above the current book values, representing a weighted average yield of 7.12%. The settlements are due to take place in June, with the proceeds used to repay bank debt.
- **Outlook:** The tax system changes will be announced as part of the Government's budget on 10 May. The changes to tax on depreciation will be of most concern to property vehicles and how this will impact their distributable income.

International bonds

- **Review:** The biggest force on global bonds during the month was probably the reduction in risk appetite, with the focus on the debt turmoil in Greece and possible contagion effects for other countries. Ratings agencies downgraded sovereign debt for Greece, Spain and Portugal. Bond yields in the major countries fell, but rose in peripheral European nations. Meanwhile CDS spreads – a proxy for the risk that investors see for sovereign default – rose across Europe including Germany, which would be the largest donor for any bailout in the region. Bonds in the US were further supported by weak inflation indicators and the ongoing message from the US Federal Reserve that rates would remain low for an "extended period".
- Looking at 10-year government rates, they fell by 17 bps in the US to 3.65%, by 8 bps in Germany to 3.02%, by 9 bps in the UK to 3.85% and by 11 bps in Japan to 1.29%. It was a different story across peripheral Europe, with 10-year rates up 250 bps in Greece, 87 bps in Portugal, 21bps in Spain, 62 bps in Ireland and Italy fared poorly as well with an increase of 12 bps.
- **Outlook:** Low inflation and low policy rates are likely to remain supportive for global bonds for some time yet and we don't expect a major breakout until we get much closer to the time when central banks look to lift rates.

New Zealand bonds and cash

- **Review:** Ongoing data suggesting economic recovery in New Zealand and a statement from the RBNZ that tightening was likely to be in “coming months” led the market to price in an increased probability that June would be the most likely start date. This helped nudge up the 90-day Bank Bill rate and put upward pressure on short dated bonds and spreads. The two-year swap rate rose by 13 bps to 4.41% while the five-year swap rate rose by 4 bps to 5.28%.
- The long end of the curve was more influenced by global rates and this helped drive down the longest bond yield by 7 bps to 5.91%, while the 10-year swap yield fell by 11 bps to 5.82%. The net effect was a significant flattening of the yield curve.
- **Outlook:** A flatter yield curve has been inevitable as we move closer to the start of the tightening cycle and there is scope for further flattening over the course of the year.

New Zealand dollar

- **Review:** The New Zealand Dollar (NZD) was strong across all the major currencies we monitor, supported by higher commodity prices and the market bringing forward slightly monetary policy tightening expectations. Higher commodity prices also supported the Australian dollar. Of the majors, the euro was the weakest, no doubt reflecting the turmoil around Greece and worries about contagion effects for the region.
- For the month the NZD rose against the following currencies: euro (+4.8%), Yen (+3.6%), USD (+3.0%), Sterling (+2.0%), and Australian dollar (+1.5%). On a trade-weighted basis the NZD rose by 3.2%, while on an MSCI-weighted basis the NZD was up 3.3%.
- **Outlook:** We don't have a strong view on the NZD at the moment but for the rest of the year it might remain in a broad trading range, with a slight upward bias, on our constructive view of the global economy and the RBNZ moving to tighten policy ahead of the G5 central banks.

Summary

Key financial markets summary

	As at 31 April 2010	Change over the month (%)	Change over the year (%)
MSCI - US	4089.28	1.6	38.8
MSCI - UK	8638.32	-2.0	35.6
MSCI - Germany	1862.30	0.0	27.9
MSCI - Japan	1130.25	0.5	20.1
NZX 50	3286.13	0.6	19.9
MSCI - World (local currency)	2860.55	0.3	33.6
MSCI - World (NZD)	5562.61	4.6	23.3
NZ Official Cash Rate	2.50	0 bps	0 bps
NZ 90 - day bank bill yield	2.73	8 bps	-13 bps
NZ 10 - year bond yield	5.92	-10 bps	67 bps
US 10 - year bond yield	3.65	-17 bps	53 bps
NZD - USD	0.7096	1.6	24.3
NZD (TWI)	66.0	2.3	15.8
NZD (MSCI weighted)	73.3	2.3	21.2