

Investment Brief

30 NOVEMBER 2011

Global

Review: Global growth prospects weakened further in November, led by Europe. Economic activity moderated in Asia and emerging markets with external trade activity slowing notably. Meanwhile, US data continued to surprise on the positive side.

America's economic growth for the September quarter was revised down to +0.5% quarter-on-quarter (QoQ) from the initial estimate of +0.6%, largely reflecting a downgrade in inventories. The Institute for Supply Management survey for manufacturing edged lower to 50.8 in October. The US labour market was essentially flat with a mere 80,000 jobs added and the unemployment rate edging marginally lower to 9.0%. October nominal retail sales rose 0.5% month-on-month (MoM) and industrial production increased 0.7% MoM, revealing solid economic activity. The US Federal Reserve (Fed) left interest rates at 0-0.25% in November and maintained its commitment to "exceptionally low" interest rates until mid-2013. The Fed also downgraded its US growth forecast for 2011 in recognition of slower activity. US growth is now expected to be circa 1.6% compared to the June forecast of circa 2.8%. The Fed's November meeting minutes showed forecasts for "moderate" economic growth but also expressed concern that Europe's banking and debt crisis is a "significant downside risk". Notably, the Fed's survey of bank lending surveys showed that US banks were tightening loan standards for European banks to a "considerable" degree.

In the eurozone the sovereign debt crisis continued to intensify. After a turbulent start to the month following a referendum proposal on the European bailout package, Greece's Government survived a parliamentary vote of confidence but then decided to form a 'coalition' with the opposition. Greece's Prime Minister Papandreou resigned on 11 November and was replaced by Lucas Papademos. The political situation in Italy has taken centre stage with the resignation of Prime Minister Silvio Berlusconi after the Italian parliament passed a package of measures to restore market confidence in Italy's strained public finances. The European Commission revised its growth forecasts downwards, with Europe now expected to expand by +1.5% in 2011 and then slow further to +0.5% in 2012. Eurozone data remained weak. September quarter gross domestic product (GDP) grew by just 0.2%, driven mainly by Germany and France. Europe's purchasing managers' index (PMI) for manufacturing fell to 46.4 in November, continuing to highlight the immediate recession prospect for the region. Germany is more resilient with a slightly better PMI reading of 47.9 while the IFO business climate index rose to 106.6 in November. The European Central Bank (ECB) decided to lower interest rates by 0.25% to 1.25% at its November meeting, with new ECB President Mario Draghi conceding that Europe is seeing "slow growth" and is "heading towards a mild recession by year end".

In positive news, growth prospects for Japan continued to improve with Real GDP for the September quarter expanding

by 1.5% QoQ (or 6% annualised). This came after the 0.5% QoQ decline in Japan's Real GDP for the June quarter and 0.9% decline for the March quarter. Private consumption was particularly encouraging as was residential investment and export performance which rose solidly.

The Chinese economy continued to cool in November with manufacturing PMI falling to 50.4 from 51.2 in October. While this was the lowest reading since February 2009, the index is at levels that suggest China's industrial activity is continuing to grow but at a more moderate pace. China's export activity weakened significantly, with the new export orders sub-index falling sharply to below the 50 expansionary threshold. Meanwhile, input prices eased markedly in October, falling by 10.4 points to 46.2 which indicates inflation pressures are moderating.

Outlook: There are signs that Europe is getting closer to a point of resolution. Much uncertainty surrounds the Merkel-Sarkozy plan for a fast tracked fiscal union. However, the ECB has indicated that it would see a fiscal union, and the firm commitment it would entail to reducing budget deficits, as helping to clear the way for stronger action from it in terms of supporting troubled bond markets. At the same time the deteriorating economic outlook across Europe is getting to the point where it will be easy for the ECB to justify buying bonds more aggressively - simply on the grounds of implementing monetary policy to avoid price deflation. If all goes well, the ECB will cut rates again at its meeting on Thursday and the EU leaders summit on Friday will see eurozone countries commit to a fiscal union (with all that entails in terms of shrinking budget deficits) which should hopefully put the ECB on a path to more aggressive bond buying and quantitative easing. Of course it won't be smooth sailing - it will take time to ratify a fiscal union and slumping growth in Europe will mean that debt problems may worsen before they get better - but maybe Europe is now getting close to the beginning of the end of its problems.

New Zealand

Review: New Zealand economic data was mixed during November. While some indicators showed New Zealand is not immune to the global turmoil, other data shows the underlying resilience of the economy.

Employment rose by just 0.2% in the September quarter, up 1.1% from a year earlier. The unemployment rate unexpectedly ticked up to 6.6% in the September quarter from 6.5% previously. Private sector wage growth was steady at 0.5% QoQ in the September quarter. The uninspiring labour market data supports the market's view that the Reserve Bank of New Zealand (RBNZ) will delay its start to the tightening cycle till well into 2012.

Retail sales surprised on the upside, rising 2.2% in the September quarter in volume terms. This was the largest quarterly increase since December 2006 and was led by significant rises in supermarket and grocery stores, and accommodation sales. Core

sales (ex autos) rose 2.4%. The rise in retail sales activity broadly confirms the expected temporary boost from the Rugby World Cup.

The total value of electronic card transactions rose 1.8% in October, while transactions in retail industries were up 1.5%. Meanwhile, consumer confidence slipped to 109 in November from 112.2 last month - the lowest since May.

Business sentiment surprised on the upside. The headline index rose in November for the first time since July, rising from 13.2 to 18.3, while the own-activity indicator also rebounded to 28.8 from 26.1 to remain above its historic average. The data reflects the relative resilience of the New Zealand economy.

The BNZ-BusinessNZ Performance of Manufacturing Index fell 4 points to 46.5 in October, falling below the expansionary threshold of 50 to reach the lowest level since June 2009. The BNZ-BusinessNZ Performance of Service Index fell 2.3 points to 50.6 in October, the lowest since October 2009.

The number of new dwelling consents issued rose 11.2% in October after a 17.2% decline in September.

The RBNZ quarterly survey of expectations showed that inflation expectations eased modestly in the current quarter, with the two-year-ahead expectation falling from 2.86% to 2.82%.

Short term visitor arrivals were down 7.8% in October after having risen 43.9% since June on the back of the Rugby World Cup. Meanwhile, October saw a net migration outflow of 640. Over the year to October, there was a net migration outflow of 100, the first such annual net loss since September 2001.

The ANZ commodity price index showed that New Zealand's export commodity prices fell further by 3.5% in October, the fifth consecutive monthly decline.

Outlook: While external risks for New Zealand remain significant, the economy is likely to continue to expand over the coming year. Reconstruction in Canterbury is expected to pick-up pace over the next couple of years and the backdrop of strong export commodity prices and the favourable terms of trade will continue to be supportive of growth.

Global shares

Review: Global share markets fell over the month as the European debt crisis continued to intensify. Investor confidence also waned due to the lack of action from the G20, the failure of the US budget committee and on concerns of a Chinese hard landing.

The leading measure of global share market performance, the MSCI World Index, fell moderately by 1.2% in local currencies (but rose 2.0% in unhedged NZ dollar (NZD) terms due to the lower NZD). US shares fell 0.3% over the month while German shares ended the month down 0.7%. UK shares fell 0.1% and Japan significantly underperformed its global peers falling by 4.8%. Emerging Asia also performed poorly, falling 6.3% over the month.

Outlook: Uncertainty regarding Europe means the short term outlook for shares remains highly unclear. Against this, long term value is good, the US and China are looking okay, global monetary easing is positive and we are in a seasonally stronger period of the year. The Santa Claus rally in share markets usually starts in mid-December and pushes shares higher into early January and, if the ECB kicks in with more aggressive support for troubled Euro zone bond markets, a strong rally would be likely into year end.

New Zealand shares

Review: The New Zealand share market performed broadly in line with its global counterparts. The local economic data and corporate news were both mixed during November. The stability of the political governance and confirmation of the partial public sale of the SOEs issues are supportive of the market.

The NZX50 Index fell 1.9% over the month while the NZX Portfolio Index fell 1.6% for the month.

Outlook: Our valuation metrics continue to show New Zealand shares to be good value against bonds but not so good against global equities. New Zealand shares 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 listed property sector rose by 1.7% in November, outperforming the NZX50 which had another negative month, down by -1.8%. The NZX50 has significantly underperformed the listed property sector in the last 12 months, returning 1.7% and 12.8% respectively. The best performer during November was AMP Office Limited with a gain of 2.9%, followed by Goodman Property Trust, up 2.3%.

Interim updates released in November showed very little sign of rental growth in the sector, the exception being prime Auckland office. While occupancy levels generally remain high, Property For Industry, Argosy Property Trust and AMP Office Limited suffered slight declines. Most funds experienced a fall in distributable profit per share due to increased tax and funding costs. Kiwi Income Property Trust also disappointed investors by revealing significant write-downs of the Majestic Centre in Wellington and Centre Place in Hamilton.

Outlook: The property market appears to have stabilised and the listed property sector has performed well so far in 2011 as a result. Dividend yields on offer from listed property continue to appeal to investors while interest rates remain low. While there are ongoing global risks and uncertainties which may impact recovery, listed property vehicles have kept their balance sheets stable and have the benefit of high occupancy levels and generally strong weighted average lease terms.

Global bonds

Review: Government bonds generally gained on safe-haven demand. However, European sovereign bonds weakened. Concerns that the European crisis is spreading from the periphery saw yields on Italian, Spanish, French and Belgian bonds rise. Notably, German bonds that had previously been considered "safe-haven" assets began to rise, reflecting an additional sovereign risk premium. Global credit spreads widening was most pronounced for financial institutions as borrowing in European markets became very challenging.

The US 10-year bond yield fell 5 basis points (bps). The 10-year yields for the UK and Australia fell 13 bps and 58 bps respectively. Meanwhile, the 10-year yields for Germany surged 26 bps. The 10-year yield for Japan ended the month up 3 bps.

Outlook: Subdued economic data and elevated risk aversion has helped sovereign bonds in key countries perform strongly this year as yields have fallen dramatically. They could still rally further in the short term and are a good diversifier. However, yields are very low so expect modest medium term returns.

New Zealand bonds and cash

Review: New Zealand bond yields fell substantially as global concerns mounted. Credit spreads in New Zealand started to widen, playing some catch-up with global credit spreads.

The five-year government bond yield fell 56 bps to 3.50%. The 10-year rate plunged by 48 bps to 4.02%. The five-year swap rate was down 48 bps for the month while 10-year swap rate ended the month down 44 bps. The 90-day bank bill closed the month 3 bps higher at 2.74%.

Outlook: The ongoing global turmoil effectively pushed out the timing of the expected rate hike well into 2012. Meanwhile, long term bond yields are likely to remain under downward pressure in the near term given the fragile financial market conditions and weak global economic data.

New Zealand dollar

Review: Declining interest rate differentials, easing commodity prices and fragile risk sentiment weighed on the New Zealand dollar (NZD), which lost ground against most major currencies.

The NZD plunged against the USD and the yen over the month by 4.3% and 4.7% respectively. It was weaker against other major currencies also. It was down 1.7% against the Sterling, down 1.1% against the Australian dollar and down 0.8% against the euro. On a MSCI-weighted basis, the NZD declined by 3.2%, while it was down by 2.5% 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, relatively strong export commodity prices and positive local economic backdrop should be supportive of the NZD. However, the long term valuation measure suggests the NZD is overvalued. The demanding valuation makes the currency vulnerable to external shocks and any near-term pull-backs.

Summary

Key financial markets summary

	As at 30 November 2011	Change over the month (%)	Change over the year (%)
MSCI - US	4452.91	-0.3	+7.8
MSCI - UK	9065.03	-0.1	+3.5
MSCI - Germany	1855.56	-0.7	-8.6
MSCI - Japan	849.44	-4.8	-15.1
NZX-50	3270.20	-1.9	+0.2
MSCI - World (local curr.)	2842.27	-1.2	-0.2
MSCI - World (NZD)	5241.86	+2.0	-2.4
NZ Official Cash Rate	2.50	0 bps	-50 bps
NZ 90-day bank bill yield	2.74	+3 bps	-48 bps
NZ 10-year bond yield	4.02	-48 bps	-163 bps
US 10-year bond yield	2.07	-5 bps	-73 bps
NZD-USD	0.7775	-4.3	+4.5
NZD (TWI)	68.6	-2.5	+0.9
NZD (MSCI weighted)	78.3	-3.2	+2.5

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