

# Investment Brief

31 OCTOBER 2011

## Global

**Review:** After much delay, Europe finally delivered another plan to the sovereign debt crisis. It is still a work in progress however and the details are yet to be finalised. US economic data has recently improved, yet Europe appears to be in recession.

America's economic growth rebounded in the September quarter with Real GDP expanding by 0.6 % quarter-on-quarter (QoQ). The Institute for Supply Management survey for manufacturing also rose to 51.6 in September. However, US growth is still too slow to materially lower the unemployment rate which held steady at 9.1% September. America's labour market recorded a modest improvement in September with payrolls increasing by 103,000 compared to August's revised +57,000 result. Retail sales rose strongly in September, increasing by 1.1% month-on-month (MoM) compared to August's revised 0.3% MoM increase. Yet the Conference Board's confidence survey for October saw a further 6.6 point decline in confidence to 39.8, the lowest result in the past 31 months. In terms of housing data, the Standard & Poor's Case-Shiller major 10-city index revealed that America's house prices have largely drifted sideways over the past three months to August. The US Federal Reserve's (Fed) Beige Book survey for September provided a cautious assessment of the US economy, with the report suggesting that the "pace of growth as 'modest' or 'slight' and contacts generally noted weaker or less certain outlooks for business conditions".

In the Euro-zone, in the face of an intensifying sovereign debt crisis, the G20 Summit meeting of finance ministers and central bankers called on Europe's leaders to "decisively address the current challenges through a comprehensive plan". Europe's 27 key political leaders subsequently met in Brussels on 23 October to discuss a "comprehensive plan" to resolve the crisis. On 26 October, European leaders announced that they had agreed to three key measures:

- Greece's government debt is to be written down to 50% of face value on a "voluntary" agreement basis with private creditors;
- European banks are to be recapitalised by either private capital raisings or public involvement with the Tier 1 capital ratio target of 9% by June 2012; and
- the European Financial Stability Facility is to be leveraged up to €1 trillion.

In a highly risky move, Greek Prime Minister George Papandreou announced a referendum on the agreed bailout which could bring down the government and cut off international funding, leaving the country facing a financial meltdown.

In terms of economic data, the European Commission's business and consumer sentiment readings deteriorated further in October to levels suggestive of a contraction in economic activity over coming quarters. Germany's IFO business climate index also showed that Europe's largest economy is experiencing slower growth momentum.

Growth prospects for Japan improved in August with the leading index falling only marginally by 0.3 points to 104.3. This index has been on a recovery path since April after the sharp decline seen after the tragic earthquake and tsunami in March. Given that Japan has suffered a contraction in activity for the past three quarters, this leading index is encouraging in suggesting a restoration of growth in the September quarter.

The Chinese economy continued to cool to a more sustainable pace in the September quarter with Real GDP slowing to 9.1% year-on-year (YoY) from 9.5% YoY in the June quarter. China's export growth also slowed sharply in September to 17.1% from 24.5% YoY in August, with growth of exports to Europe in particular slowing markedly. Adding to evidence that July marked the peak in Chinese inflation, was the September's consumer price index inflation result coming in at 6.1% YoY, slightly down from 6.2% YoY in August. China's official manufacturing purchasing manager's index rose to 51.2 in September, up from 50.9 in August, indicating that manufacturing activity growth has stabilised after a decline from its peak late last year. This supports the view that China's economy is slowing but not coming to a hard landing as many fear.

Global monetary easing cycle continued with the Bank of England announcing another round of quantitative easing, the European Central Bank announcing an extension of its bank liquidity facilities and interest rate cuts in Brazil and Russia.

**Outlook:** While the latest European debt rescue plan was initially expected to buy a bit of time to get its house in order, the political mess in Greece and Italy has started to confuse the outlook again. This is clearly not a final resolution of Europe's problems. The bank recapitalisation plan and the enhanced European Financial Stability Facility firepower appear insufficient, France is at high risk of a ratings downgrade and fiscal austerity continues to damage growth. While the recent data indicates that the US economy is growing at a modest 2% real growth pace, Europe appears to be tipping into recession as their business conditions surveys fell to levels last seen in 2009. We expect global growth to be slow but remain positive. The emerging world is stronger but also slowing. Europe remains the biggest risk.

## New Zealand

**Review:** New Zealand economic data softened during October as the ongoing global turmoil has finally started to take its toll on the sentiment and activity in New Zealand. While the data moderated, it still indicates that the New Zealand economy is continuing to grow.

The Quarterly Survey of Business Opinion showed that business confidence fell in the September quarter but remained at solid levels despite the recent global ructions. The general business confidence index fell to a net +13% from +31% previously. Domestic trading activity was broadly unchanged while expectations were also steady. It appears that the steady

improvement in the domestic economy of late, the Rugby World Cup, and the rebuild of Christchurch are helping partly offset the weaker global economic backdrop.

The Treasury opened the Crown books in the traditional Pre-election Economic and Fiscal Update. There were no significant changes to the outlook that was presented in the May Budget. Weaker world demand was offset by a stronger starting point for the domestic economy. They continue to predict a return to fiscal surplus in 2014/15 and for net core Crown debt to peak at just under 30% of GDP.

The ANZ world commodity price index fell further by 1.3% in September. While this was the fourth consecutive monthly decline, it still leaves the index up 17.3% from a year earlier and down just 4% from its record high in May.

The BNZ-Business NZ Performance of Manufacturing Index fell 1.9 points to stand at 50.8 in September. While this was the fourth consecutive monthly decline, the index remained above the expansionary threshold of 50 for six months in a row. The BNZ-Business NZ Performance of Service Index fell 0.6 points to 53.2 in September, but remains consistent with ongoing service sector growth.

Consumer confidence fell slightly to 112.2 in October from 112.6 in September.

The monthly REINZ residential market report provided further evidence that the housing market stabilised around mid-year and continues to improve. House sales were up 21.2% in September from a year earlier with house prices rising 1.7% over the month to be up 2.7% over the year to September. This was the highest annual increase since June 2010.

The total value of electronic card transactions rose 0.2% in September with transactions in retail industries up 0.4%.

The number of new dwelling consents issued fell a massive 17.1% in September to be down 3.9% from a year earlier. This follows the double digit growth registered in the previous two months.

CPI inflation surprised on the downside coming in at 0.4% for the September quarter. This was the lowest quarterly increase in the CPI since the June quarter of last year and takes the annual inflation reading to 4.6% from 5.3% recorded in the previous quarter.

The Reserve Bank of New Zealand (RBNZ) left the Official Cash Rate (OCR) on hold. The central bank reiterated the view of the world they articulated in the September Monetary Policy Statement, but acknowledged the more recent softer domestic data.

**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 rebounded sharply in October with US shares experiencing their best month since 1974. Markets were lifted by indications that European authorities were moving to recapitalise the region's banking sector. Investors also gained confidence after US economic data and profit results confirmed that the US economy is still growing. Chinese data also surprised on the upside. US corporate earnings results were mostly favourable with 71% coming in better than expected. And it's

not just due to cost cutting – revenue growth over the year to September is coming in just below 10%.

The leading measure of global share market performance, the MSCI World Index, rose strongly by 8.6% in local currencies (but rose 3.9% in unhedged New Zealand dollar terms due to the higher New Zealand dollar). US shares gained 11% over the month while German shares were also up strongly by 11.7%. The UK share market ended the month up 8.1%. Meanwhile, Japan underperformed its global peers substantially by rising just 0.9%. The emerging Asia performed broadly in line with the global market, rising 9.5% for the month.

**Outlook:** The long term value remains good for shares. The outlook for the US and China is looking okay, global monetary policy is likely to remain loose and we've entered a seasonally stronger period of the year for shares. These are all positive factors for shares. However, the event risk and a slide into recession in Europe are likely to keep the ride volatile in the short term.

## New Zealand shares

**Review:** The New Zealand share market significantly underperformed its global counterparts during October with the low Beta character of the New Zealand market muting returns in the environment of rising risk appetite. Soggy local economic data also weighed on New Zealand shares.

The NZX50 Index fell 0.3% over the month while the NZX Portfolio Index gained 1.8% 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 shares. 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 experienced a poor month overall in October falling by -0.7%, underperforming the NZX50 which fell by -0.3%. This was mostly attributable to negative returns from the larger listed property vehicles, with AMP NZ Office and Argosy down 3.5% and 2.4% respectively. Kiwi Income Property Trust was only slightly better, falling by 1.4%. Best performers during the month were Vital Healthcare Property Trust and NPT returning 3.5% and 2.1% respectively, followed by Property for Industry (PFI) up 1.7%. DNZ Property Trust (DNZ) and Goodman Property Trust both had flat months.

DNZ released their second quarter update during October which noted increases in both their occupancy levels and weighted average lease term (WALT). PFI's third quarter update had less positive characteristics, with increased vacancy and a decline in distributable profit as a result of lower rental revenue from asset sales, and increases in both interest and tax costs. The rest of the listed property vehicles will release their interim updates during the course of November.

**Outlook:** The property market appears to be recovering and the listed property sector has performed well so far in 2011 as a result. Dividend yields on offer from listed property continue to attract 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 WALTs.

## Global bonds

**Review:** International bond yields rose through October as US data releases surprised on the positive side and risk appetite improved on hopes of an EU rescue package.

The US 10-year bond yield rose ending the month up 20 basis points (bps) at 2.11%. The 10-year yields for Germany and Australia rose 14 bps and 29 bps respectively. Meanwhile, the 10-year yields for the UK and Japan were largely flat for the month, rising just 1 bp each.

**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:** Short term interest rates moved lower as the prospect of rate hikes was pushed out into 2012 on the back of lower inflation readings. Long term bond yields rose in line with the global trend.

The four-year government bond yield was flat for the month at 3.35%. The 10-year rate ended the month up 8 bps at 4.50%. The five-year swap rate rose 19 bps while 10-year swap rate ended the month up 22 bps. The 90-day bank bill fell by 16 bps to end the month at 2.71%.

**Outlook:** The ongoing global turmoil effectively pushed out the timing of the expected rate hike. We are keeping to our view of a March hike in the OCR, with the risk being we move it further out in 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:** The New Zealand dollar (NZD) rebounded sharply in October as concerns over the European debt crisis eased and risk sentiment improved. The NZD also benefitted from stronger commodity prices.

Buoyant risk appetite saw the NZD rally against the safe-haven currencies such the USD and the yen. It surged 6.2% against the US dollar and 7.5% against the yen. The NZD also gained against the euro and the Sterling, by 2.2% and 2.5% respectively. With the Australian dollar (AUD) also rising strongly, the NZD ended the month down 2.7% against the AUD.

On a MSCI-weighted basis, the NZD rose by 4.7%, while it was up 3.1% 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, 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 31 October 2011	Change over the month (%)	Change over the year (%)
MSCI - US	4465.15	+11.0	+8.2
MSCI - UK	9078.16	+8.1	+1.2
MSCI - Germany	1869.35	+11.7	-6.7
MSCI - Japan	892.58	+0.9	-5.3
NZX-50	3332.56	-0.3	+0.8
MSCI - World (local curr.)	2877.50	+8.6	+0.8
MSCI - World (NZD)	5141.10	+3.9	-3.7
NZ Official Cash Rate	2.50	0 bps	-50 bps
NZ 90-day bank bill yield	2.71	-16 bps	-49 bps
NZ 10-year bond yield	4.50	+8 bps	-73 bps
US 10-year bond yield	2.11	+20 bps	-49 bps
NZD-USD	0.8121	+6.2	+6.2
NZD (TWI)	70.4	+3.1	+3.8
NZD (MSCI weighted)	80.8	+4.7	+5.4

## Contact us

If you have any enquiries about your investment or any of AMP Capital's products or services please call us on 0800 400 499

Important note: While every care has been taken in the preparation of this document, AMP Capital Investors (New Zealand) Limited makes no representation or warranty as to the accuracy or completeness of any statement in it including, without limitation, any forecasts. Past performance is not a reliable indicator of future performance. This document has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. An investor should, before making any investment decisions, consider the appropriateness of the information in this document, and seek professional advice, having regard to the investor's objectives, financial situation and needs. This document is solely for the use of the party to whom it is provided.