

Investment brief



Global

- **Review:** Economic data released in March showed that a broadly based global economic recovery remained on track. Weak inflation pressures in the developed world were keeping central banks at bay on rates, but with a pick-up in emerging market inflation, central banks in those regions were more focused on tightening policy.
- The tenor of data in the US remained positive. Employment trends were clearly improving but the prospect for a decent rise in employment in February was held back by unusually wintry conditions in the survey week, keeping the unemployment rate steady at 9.7%. The widely watched manufacturing ISM indicator slipped in February, but remained comfortably in expansion territory and the non-manufacturing indicator rose to a 28-month high. Retail sales were stronger than expected, showing a clearly improving trend and consumer confidence lifted a little. Durable goods orders remained on a strong upward trend, indicating improving business investment. The housing market remained a weak spot. While house prices were on a rising trend, activity levels remained very depressed. The core consumer price index rose by 1.3% year-on-year (YoY) in February, a 6-year low, and the Federal Reserve reiterated its policy message that low rates would be maintained for an 'extended period'.
- In the euro area, the key leading indicators surprised on the upside, with further gains in the performance of manufacturing index, Germany's Ifo business expectations index reaching almost a 3-year high and EU industrial production rising strongly in January by 1.5% month-on-month. Domestic demand in the region remained poor, however, with real retail sales still down on year-earlier levels. The spotlight remained on Greece. The country offered a fiscal plan to help bring down its deficit and, after much to-ing and fro-ing an accord was finally agreed, with the European Union and International Monetary Fund together providing a support mechanism for countries in serious financial difficulty.
- In Asia, China remained a powerhouse, with industrial production in the first two months of the year up 20.7% YoY and retail sales up 17.9%. The rise in the CPI to 2.7% YoY

February vindicated the central bank's tightening stance on policy, but also raised concern about whether policy tightening was fast enough and when the yuan would be revalued higher. Inflation pressures in India led its Reserve Bank to raise its policy rate by 25 basis points (bps) to 5.0%, while the Reserve Bank of Australia lifted its policy rate for a fourth time by 25 bps to 4.0%. Indicators in Japan pointed to further economic expansion, but ongoing deflationary pressures led the Bank of Japan to double its 3-month lending operations, going against the trend of other major countries which were winding back quantitative easing measures.

- **Outlook:** The global economic recovery is broadening and intensifying, as expected, and global GDP growth should exceed 4% this year. But for this to be sustained into next year, we need to see a more meaningful pick-up in final demand, otherwise the recovery so far – driven by temporary fiscal stimulus and changes in inventories – will not be sustained.

New Zealand

- **Review:** The New Zealand economy ended 2009 on a decent note, with GDP up 0.8% quarter-on-quarter, reflecting increased private consumption, a bounce in residential investment and inventory rebuilding. With further expansion highly likely for the March 2010 quarter, we can safely say that we are now one year into the economic recovery in New Zealand.
- Economic momentum might have faded a little at the beginning of 2010. Core electronic card transactions were down slightly over January and February and sales including autos were flat. House sales weakened over January and February combined, but on a more positive note dwelling consents continued to trend higher, pointing to further improvement in residential investment.
- Business and consumer confidence slipped slightly in March, but these remained at above-average levels and were therefore consistent with above-trend growth.
- Credit growth remained flat (annual growth of 0.1% YoY was the weakest since our historical series began in the late 1980s), indicating that households and businesses were deleveraging.
- In its Monetary Policy Statement, the Reserve Bank of New Zealand (RBNZ) left the Official Cash Rate at 2.5% and again ran the line that '...we continue to expect to begin removing policy stimulus around the middle of 2010'. Its inflation forecasts showed a track that reaches the 2.5-3% inflation mark by the middle of next year and stays there throughout the forecast period, highlighting the asymmetry around policy, with plenty of scope to tighten and no chance of any further easing.

Investment enquiries

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Feedback

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- **Outlook:** New Zealand's economy is likely to recover broadly in line with the global economy through 2010. We expect GDP growth to average just over 3% this year, following the contraction of circa 1.5% last year.

International shares

- **Review:** Global shares were on a steady upward path during the month and reached a new high for the cycle. Investor risk appetite increased on the positive global economic trends and there was less concern about some of the issues that affected sentiment earlier in the year like Greece debt funding and China policy tightening.
- The MSCI World Index in local currency terms was up a considerable 6.6% in March and 4.8% for the quarter. The one year anniversary of the recovery in global shares passed, with the index up circa 70% since the low in early March 2009. Outperforming markets during the month were Japan and Europe, while the US and UK marginally underperformed.
- The best performing sectors for the month were the most economically sensitive ones of industrials, materials and consumer discretionary, while the worst performing sectors were defensive health care, consumer staples and utilities.
- **Outlook:** After a double-digit bounce since early February, we wouldn't be surprised to see markets take a breather over the short term. However, 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 was the worst performing developed market during the month, with New Zealand shares lagging the global bounce. The NZX 50 rose by 3.5%, while the NZX Portfolio Index rose by 4.2%. Quarterly performances were 1.2% and 2.3% respectively.
- The earnings season ended on a strong note. Companies who reported or provided trading updates during the month dominated the top of the leaderboard. NZ Refining was the best stock in the top 50. Its trading update showed a significant improvement in refining margins and corporate activity in the sector, with Infratil and the New Zealand Superannuation Fund teaming up to buy Shell New Zealand's assets, which included a stake in NZ Refining. Retailers Restaurant Brands, Kathmandu Holdings, Pumpkin Patch and Warehouse Group all outperformed, following trading updates, while Hallenstein Glassons underperformed. Other noteworthy positive results came from Guinness Peat Group and Vector.
- One of the weakest performers in the top 50 was Telecom, which strongly underperformed with government regulation continuing to impact the stock. The government confirmed plans for a rural broadband service, paid for via a restructuring of the Telecommunications Service Obligation, which Telecom said would cost it \$168 million in EBITDA over the next three years. Property stocks also underperformed during the month as did NZX following its full-year result.
- In the smaller company space, NZ Windfarms fell, with the company looking to raise \$31.4 million via a rights issue.

- **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 shares, but equally they would perform relatively better should global shares suffer a bout of weakness.

New Zealand listed property

- **Review:** The listed property sector index was down 0.1% for March, underperforming the broader sharemarket, the NZX 50. Property For Industry was the top performer for the month, up 3.9%. AMP NZ Office Trust and Kiwi Income Property Trust were both down over March, 2.6% and 1.0% respectively.
- ING Medical Properties Trust has announced the unconditional sale of the Central Hawkes Bay Health Centre in Waipukurau to settle in June 2010. The sale is part of its portfolio and capital management strategy to sell down the Trust's lower value and non-core assets with funds used to repay debt. The sales price of \$4.3 million is approximately 6% above the 30 June 2009 valuation.
- Kiwi Income Property Trust officially opened the third stage of redevelopment of The Plaza Shopping Centre in Palmerston North during March. The overall development is expected to be completed within the initial capitalised budget of \$93 million.
- **Outlook:** With a number of the listed property vehicles having a financial year end of 31 March 2010, full year revaluations and financial results will be released over the next few months. These will provide the market with further information around capitalisation rate movements and market rental expectations. The effect of the tax system changes that will be announced as part of the Government's May 2010 budget is an important focus for all the listed property vehicles, particularly how these changes will impact distributable profit.

International bonds

- **Review:** Fiscal concerns in the US, perhaps triggered by the passage of the substantial health reform bill, led to a bad run of Treasury auctions, putting significant upward pressure on rates. The US 2-year Treasury rate rose by 20 bps to 1.02% while the 10-year rate rose by 22 bps to 3.83%. The trend fall in swap spreads, which has been largely driven by the increasing supply of US Treasuries accelerated on this move, with 5 and 10 year US swap spreads falling to record lows and making a move into negative territory. However, it looked like the recent move down in swap spreads was more linked to technical issues amidst strong coupon debt issuance by corporates.
- Higher US rates flowed through into Australian and New Zealand rates, with the former also influenced by expectations of a slightly more aggressive tightening stance by the Reserve Bank of Australia. Elsewhere there was no noticeable impact. Despite fiscal concerns as well in the UK and some scepticism over the improved budget deficit projection, the 10-year UK gilt rate fell by 9 bps to 3.94%. In Germany, the 10-year rate fell by 1 bp to 3.09% while in Japan it rose by 10 bps to 1.40%.
- **Outlook:** Global bond rates are near the top of a trading range 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:** The RBNZ's Monetary Policy Statement was in line with market expectations, so there was little change in the expected forward track of rate hikes. If anything, there was a modest pushing out of timing for the first rate hike by the market, which encouraged a 7bps fall in the 90-day bank bill rate to 2.65%.
- The sell-off of US and Australian Treasuries influenced New Zealand rates. The 5-year government stock rate rose by 16 bps to 5.18%, while the longest bond rate rose by 22 bps to 5.98%. Swap rates rose by 10 bps for the 5-year and 10-year maturities.
- **Outlook:** Rate hikes remain inevitable, but with weak credit growth, the Bank can probably afford to wait until mid-year. A flatter yield curve is also inevitable with the short end likely to do most of the work this year.

New Zealand dollar

- **Review:** With the increase in risk appetite, stronger global economy and rising commodity price environment, the New Zealand and Australian dollars were well supported during the month. Further quantitative easing was a negative factor for the yen, while the woes of Greece and increased concerns about the long-term viability of the euro area weighed on the euro and, by association, sterling. So, of the majors, the US dollar was the best performing by default.
- In other currency news, throughout the month there seemed to be mounting pressure on China's central bank to revalue the yuan. The US Treasury Department is due to release its semi-annual report on foreign exchange markets and there was some speculation that China would be labelled as a 'currency manipulator', which would allow duties to be imposed on a range of Chinese products imported into the US.
- For the month, the NZD was up against most of the major currencies we monitor, with a rise of 2.3% on an MSCI-weighted and trade-weighted basis, with movements on the following cross rates: yen (+6.8%), euro (+ 2.5%), sterling (+2.0%), USD (+1.6%) and AUD (-0.9%). For the quarter, the NZD was down slightly (-0.5% on an MSCI-weighted basis) with rises against the euro and sterling not quite offsetting falls against the USD, yen and AUD.
- **Outlook:** We don't have a strong view on the NZD at the moment. However, for the rest of the year it might remain in a broad trading range with a slight upward bias, based 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 March 2010	Change over the month (%)	Change over the year (%)
US – S&P 500	1169.43	5.9	46.6
UK – FTSE 100	5679.64	6.1	44.7
German – DAX	6153.55	9.9	50.6
Japan – Topix	978.81	9.5	26.5
NZ – NZX 50	3267.99	3.5	26.2
MSCI (local currencies)	2851.80	6.6	47.1
NZ Official Cash Rate	2.50	0.0	50 bps
NZ 90-day bank bill yield	2.65	-7 bps	-70 bps
NZ 10-year bond yield	5.98	22 bps	71 bps
US 10-year bond yield	3.83	21 bps	116 bps
NZD in US dollars	0.7096	1.6	24.3
NZD TWI	73.3	2.3	21.2
MSCI-weighted NZD	66.0	2.3	15.8