INVESTMENT BRIEF

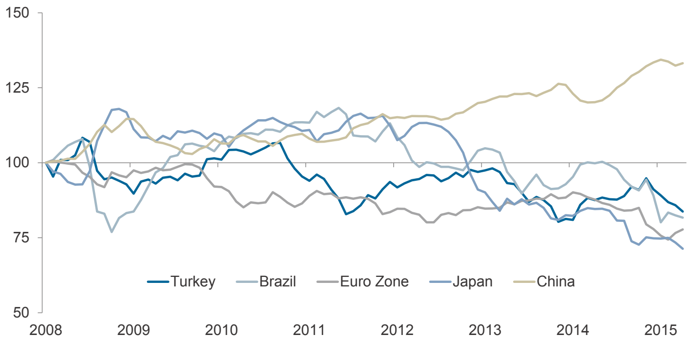
AUGUST 2015

Volatility spiked and equity markets slumped to their worst monthly performance since 2012 as investors' concerns escalated about slowing global growth and the impact of the looming US Federal Reserve interest rate hike. The New Zealand share market tumbled alongside global markets, finishing the month down 4.5%. Global bonds provided a relatively flat return over August which masked a volatile month for bond yields. The New Zealand dollar closed the month lower against all the major currencies. Investors continue to expect more interest rate cuts in the coming months. However, the significant fall in the New Zealand dollar is likely to negate the need for more aggressive action.

1. China devalues: justified or not?

Real effective exchange rates

Index, March 2008=100

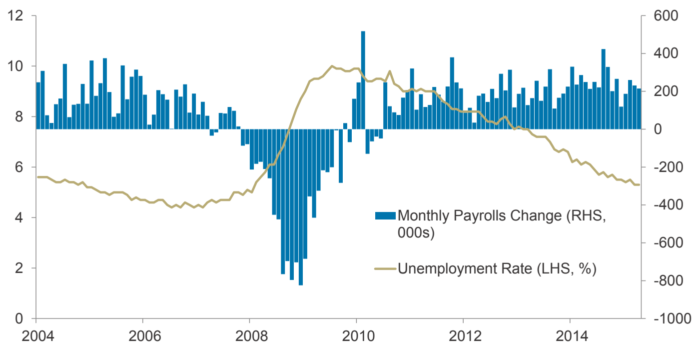


Source: BIS and AMP Capital

- China surprised markets with a devaluation of its exchange rate during August. In our view, this move was justified on the basis of the cyclical slowdown in the economy which has been the direct result of excess capacity in the real economy, high real interest rates and an overvalued exchange rate.
- Despite the slowdown in the economy and as a result of the defacto peg to the US dollar (USD), the real effective Chinese yuan (CNY) has risen 33% since March 2008.
- With the US Federal Reserve (the Fed) poised to raise interest rates, the risk is the US dollar (USD) rises further taking the Chinese yuan (CNY) higher, a move that would be unjustified. So far the move in the CNY is small and will have little impact on relative competitiveness.

2. Will volatility delay the Fed?

US labour market



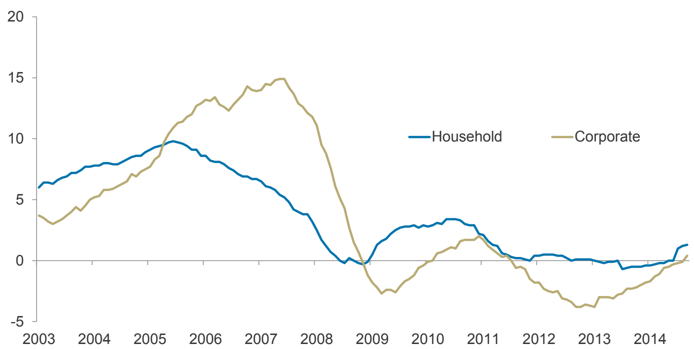
Source: US BLS

- In July the US Federal Open Market Committee (FOMC) indicated it would be ready to raise interest rates once they have seen further improvement in the labour market. Since then domestic data has been supportive of 'lift off' occurring sooner rather than later.
- Until recently markets were pricing in a greater than 50% chance of the first rate hike occurring in September, but recent volatility in global markets has seen those odds drop below 50%.
- While some degree of market volatility was to be expected as we got closer to higher US interest rates, the Fed is only likely to delay if that volatility reflects factors that may impact on US growth and/or inflation, such as a hard landing in China.

3. Eurozone growth underwhelms...

Eurozone credit growth

Annual % change



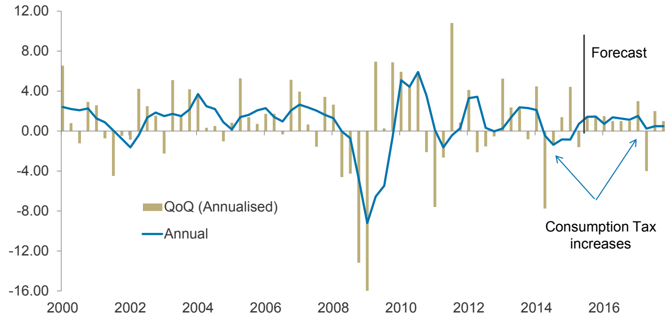
Source: ECBI

- GDP growth in the Eurozone continues to underwhelm with an increase of 0.3% in the June quarter and annual growth of 1.2% in the year to June. The three largest Eurozone economies (Germany, France and Italy) all failed to meet expectations.
- While disappointing, this annual growth is the fastest since 2011 and given current monetary accommodation, we expect a further modest improvement in growth in the period ahead.
- The question for the European Central Bank is the extent to which growth will be sufficient to provide a meaningful and sustainable increase in inflation. On that the jury remains out.

4. ...and the same goes for Japan

Japan GDP growth

Percent change



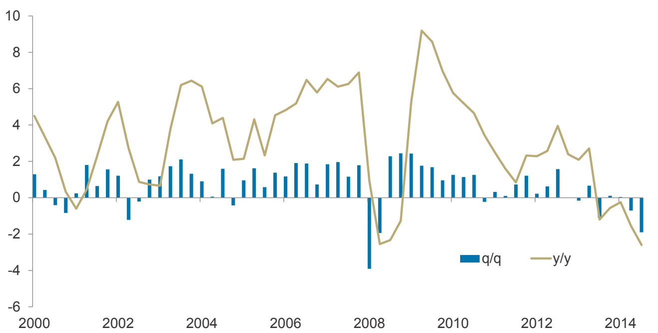
Source: Bloomberg

- Japan GDP fell an annualised -0.9% in the June quarter. Consumption was weak despite better labour market data, and exports weaker still. Capital expenditure also posted a small negative. Inventories posted a small positive contribution following the significant inventory build in the first quarter.
- Looking ahead, we think consumption will look stronger next quarter while there are pluses (US) and minuses (China) for exports. Stronger capex remains a pre-condition for any sustained pick-up in growth.
- The Bank of Japan lowered their growth and inflation forecasts recently, but they are probably still too optimistic making further monetary easing likely.

5. Brazil recession deepens

Brazil GDP growth

% change



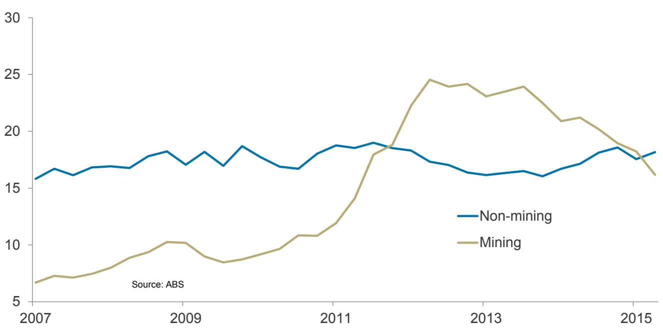
Source: IBGE

- Brazil's GDP contracted at an annual pace of -2.6% in the June quarter as the country falls deeper into recession. Brazil has been beset with structural and cyclical headwinds, while weak commodity prices and slowing growth in China have also weighed on growth.
- Structural issues on the supply side of the economy, along with an almost 60% decline in the Brazilian real, have conspired to deliver a sharp rise in inflation. As a result, the central bank has had to tighten monetary policy.
- We believe this will be the peak in the monetary policy cycle but don't expect the central bank will be able to lower interest rates until the second half of next year.

6. Encouraging signs in Australian investment

Australia real capital spending

AUD billion

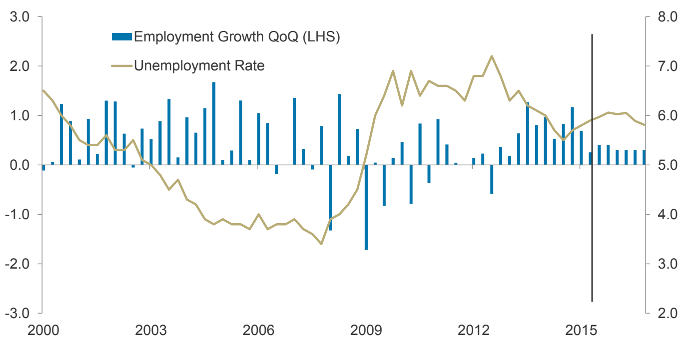


Source: ABSl

- Australia's private real business investment fell sharply by -4.0% in the June quarter. This follows the prior quarter's -4.7% decline.
- The mining sector's investment descent sharpened with a decline of -11.3% following -3.8% slide in the March quarter. Mining investment is declining rapidly given that major projects are being completed.
- Yet there was an encouraging rise in non-mining investment in the June quarter. So there are early and tentative signs of the long anticipated revival in business investment outside of the mining sector.

7. Further signs of NZ slowdown

New Zealand labour market



Source: Statistics New Zealand and AMP Capital

- Employment growth slowed in Q2 while the unemployment rate ticked higher. That said, annual employment growth was still 3.0% (68,000 jobs). We expect employment growth to continue to slow but to remain positive.
- Retail sales growth also slowed in the June quarter, although that came after a strong March quarter. Annual volumes growth has slowed from 7.4% in the year to March to 5.9% in June.
- We expect sales to slow further as employment growth slows and lower dairy incomes impact. However, still strong population growth will continue to provide support.

MARKET COMMENTARY

GLOBAL SHARES

Volatility spiked and equity markets slumped to their worst monthly performance since 2012 as investors' concerns escalated about slowing global growth and the impact of the looming US Federal Reserve interest rate hike. China's markets, economy and regulators were again in the spotlight as Chinese authorities devalued the yuan. This prompted market commentators to speculate that the Chinese economy may not be as strong as they had believed. The prospect of lower Chinese growth rattled global markets as earnings from exporters leveraged to the Chinese economy would come under pressure. China's authorities moved to reassure investors with cuts to both interest rates and required reserve ratios, together with liquidity and capital injections into some banks. This provided investors some comfort and markets rebounded to recover some losses towards the end of August. The MSCI China Index ended the month down 11.7%, while US shares declined 6.0% and Euro shares finished 9.1% lower.

NEW ZEALAND SHARES

The New Zealand share market tumbled alongside global markets, finishing the month down 4.5%. Only twelve companies in the S&P/NZX 50 Index achieved a positive return over August, with Spark being the biggest winner. The stocks that experienced the biggest falls over the month were Xero and Sky TV. Xero's share price declined 21.5% as the company reported its quarterly results that showed cash balances continue to fall as the company pursues growth opportunities. Sky TV reported a decline in subscriber numbers, but this was offset by an increasing cost per subscriber with MYSKY subscriptions rising 9%.

NEW ZEALAND LISTED PROPERTY

Domestic listed property stocks were still in negative territory over the month, ending down 2.5%, but still outperformed the broader domestic equity market. The large cap names led the market lower with Kiwi Property Group declining 5.1% and Goodman Property Trust falling 6.3%. Precinct Properties was one of a few stocks to provide a positive return over the month, returning 0.9%. The company announced a solid result in line with their guidance and outlined a strong development pipeline.

GLOBAL BONDS

Global bonds provided a relatively flat return over August which masked a rather volatile month for bond yields. Bonds rallied which saw yields for US Treasuries touch three month lows as investors sought safe-haven securities amid the global equity sell off. Bonds then sold off late in the month as equities rebounded and a US Fed representative said the recent market volatility and concerns about foreign economies have made the case for a September hike "less compelling". Yields on the US 10 year Treasury closed the month at 2.22%, up four basis points (bps) over the month.

NEW ZEALAND BONDS AND CASH

New Zealand government bonds returned 0.6% in August as yields fell across the curve. Investors continue to expect more interest rate cuts in the coming months. However, the significant fall in the New Zealand dollar (NZD) is likely to negate the need for more aggressive action. The 90 Day Bank Bill yield ended August 17 bps lower at 2.93%. Longer term dated Government bond yields also fell, with the 10 year ending on 3.25%, 10 bps lower.

COMMODITIES

A rally in the price of oil late in the month saw the broad commodity index rebound 6.8% over the last three trading days of August. The broad commodities index recovered the majority of its losses to eventually end the month down 0.7%. WTI crude bounced off an intra-day low of US$37.75 per barrel to end the month at US$49.20 per barrel, a 30% gain inside a six day trading period. The price of crude rallied following a US government report that reduced its crude production estimates as well as OPEC stating that it's ready to talk to other global producers to achieve "fair prices". The Global Dairy Trade auction finally got a reprieve following ten consecutive price declines which saw prices down at levels last seen in 2002. The 15% price jump was led by whole milk powder after Fonterra reduced the volume on offer.

GLOBAL LISTED PROPERTY AND INFRASTRUCTURE

Global listed property and global listed infrastructure both ended the month of August in negative territory, declining 5.8% and 4.1% respectively. The selloff in these two high dividend paying asset classes was not as severe as the broader equity market which was down 6.7% over the month.

NEW ZEALAND DOLLAR

The NZD closed the month lower against all the majors. The NZD fell after our biggest trading partner, China, devalued their currency which reflects a weaker Chinese economy and reduces their purchasing power. The NZD ended the month at 0.6340 against the USD, down 3.8% for the month.

	AS AT 31 AUGUST 2015	CHANGE OVER THE MONTH (%)	CHANGE OVER THE YEAR (%)
MSCI - US	7646.98	-6.1	+0.5
MSCI - UK	11742.55	-6.1	-5.8
MSCI - Germany	3212.59	-8.8	+9.6
MSCI - Japan	1913.06	-7.9	+21.9
NZX 50	5656.25	-4.5	+8.3
MSCI - World (local curr.)	4764.19	-6.6	+2.4
MSCI - World (NZD)	9857.49	-2.9	+27.1
NZ Official Cash Rate	3.00	0 bps	-50 bps
NZ 90-day bank bill yield	2.92	-18 bps	-79 bps
NZ 10-year bond yield	3.27	-13 bps	-81 bps
US 10-year bond yield	2.22	4 bps	-13 bps
NZD-USD	0.634	-3.8	-24.2
NZD (TWI)	69.5	-1.0	-12.0
NZD (MSCI weighted)	70.0	-3.9	-19.5