

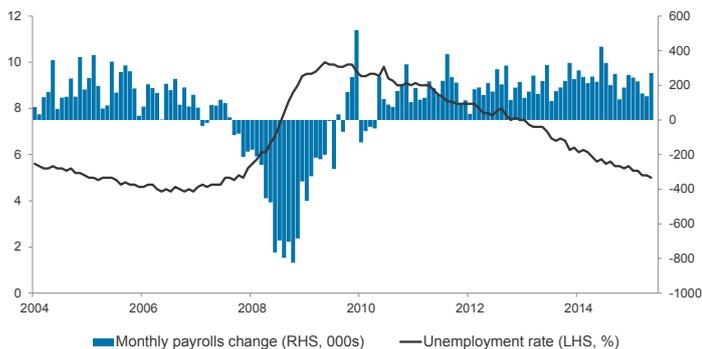
# INVESTMENT BRIEF

NOVEMBER 2015

Markets were relatively subdued over November with the exception of a short lived dip due to the events in Paris. The New Zealand share market rose alongside global markets, returning 1.9% over the month. Global bonds were influenced by the rhetoric and expectations of central banks around the world in their respective markets. The rebound of the New Zealand dollar during October was short lived as November saw the NZD down against most of the major currencies. Expectations continue to grow for a December rate hike by the US Federal Reserve.

## 1. 'Lift-off' likely in December

### US labour market



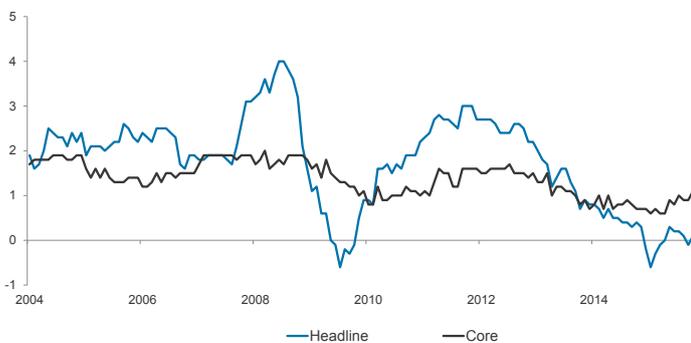
Source: US BLS

- > After delaying the start of the interest rate normalisation process in September, markets are now pricing in over a 70% chance of the US Federal Reserve (the Fed) lifting interest rates off zero at their December meeting.
- > Markets seem more comfortable with the prospects of higher interest rates than they were. This is likely a combination of factors, including the growing understanding that interest rate increases are likely to be only gradual. At the same time the European Central Bank (ECB) and Bank of Japan (BoJ) are still easing, with the increasing likelihood they will have to do more.
- > The pace of interest rate increases and the eventual peak are more critical for markets than the timing of the start of the process. Assuming the Fed start to raise rates in December, we expect the Fed funds rate to be no more than 1.25% by December 2016, and that the Fed will continue to lower its estimate of the neutral rate from 3.75% towards 3.0%.

## 2. But the ECB is likely to ease more

### Eurozone inflation

#### Annual % change



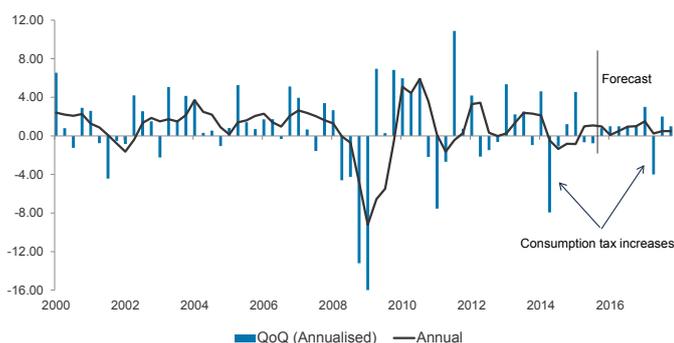
Source: Eurostat

- > As the Fed is preparing markets for the first interest rate hike in nine years, ECB President, Mario Draghi, is signalling the Bank is likely to announce further easing at its December 3 meeting.
- > The ECB has announced a review of the efficacy of its current monetary policy settings and has given strong hints that further action is likely. Mr Draghi has promised to "do what we must" to achieve the central bank's inflation target in the face of growth that remains too low to put any significant upward pressure on inflation and low inflation expectations. His comment is reminiscent of his 2012 commitment to do "whatever it takes" to save the Euro.
- > Further action could include cutting the already negative deposit rate, increasing the quantum of the current asset purchase programme or extending the duration of the programme beyond its scheduled finish of September next year.

## 3. And possibly Japan too

### Japan GDP growth

#### Percent change

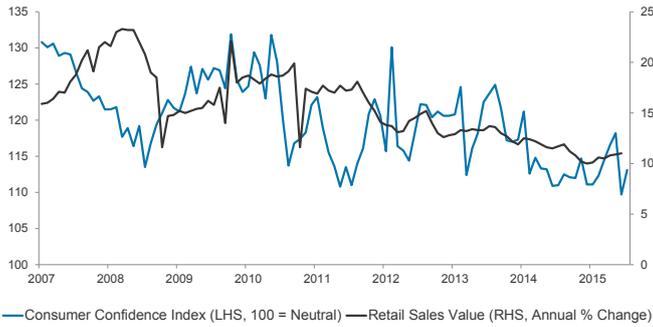


Source: BloombergMarkit

- > The Japanese economy has entered its third (technical) recession since 2012. Unlike 2014 where the recession was brought about by the unwinding of the 'rush demand' following the April consumption tax increase, there were no special factors leading to the most recent contraction in output. It underlines the fundamental weakness in the economy.
- > The most disappointing aspect was a second sharp quarterly decline in business investment which has now completely unwound the strong gains seen in the early months of 2015. Weak business investment detracts from future growth.
- > With inflation also low and unlikely to meet the BoJ's 2% target any time soon, further monetary policy easing appears likely. The impacts of the latest supplementary Budget are beginning to wane so further fiscal stimulus is also possible, but the real problem remains lack of progress in addressing Japan's fundamental structural weaknesses.

## 4. China consumer confidence recovers

### China retail sales



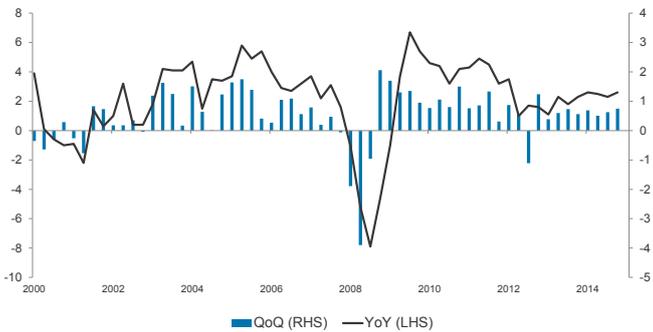
Source: MNI Westpac and NBS

- > China consumer confidence held up well during the equity market volatility in August and September only to pull back sharply in October. But consumers managed to claw some of that loss of confidence back in November. Consumer confidence is 1.9% higher than at the same time last year, not a bad result given everything that has happened this year.
- > Retail spending has been a bright spot in recent China economic news with growth in nominal spending contrasting with the continued weakness in the industrial sector. The service sector and consumption (the 'new' China) are increasing their share of economy at the expense of heavy industry (the 'old' China).
- > The recovery in consumer confidence and the improvement in retail spending do not preclude further easing in monetary policy. Real interest rates remain too high to guarantee stability in the broader economy.

## 5. It's not all bad news in Latin America

### Mexico GDP

#### Percent change

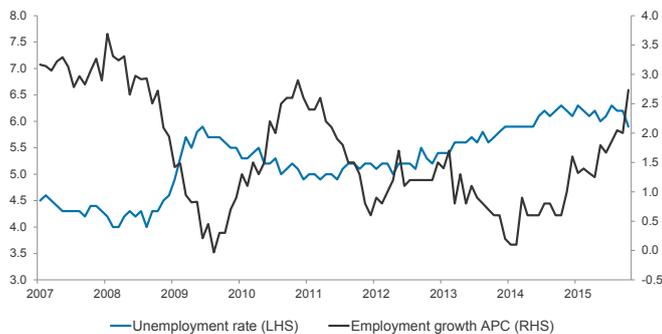


Source: MITI

- > Think Latin America and you immediately think of the current structural and cyclical problems besetting the Brazilian economy. Mexico is currently providing some Latin American relief with an economy that now appears to be on an improving trajectory after several years of disappointing growth.
- > Third quarter GDP came in at a better-than-expected 0.8% quarter on quarter (qoq) and 2.6% year on year (yoy). On a sectoral basis, growth in both the services (3.2% yoy) and primary sectors (3.8%) were strong but the industrial sector (1.2%) disappointed, a story consistent with many economies right now.
- > We expect growth will continue to gain momentum, largely on the back of continued solid growth in consumption, stronger exports (to an improving US), but also good investment-enhancing structural reform. Take note Brazil.

## 6. Strong jobs growth in Australia

### Australia labour market

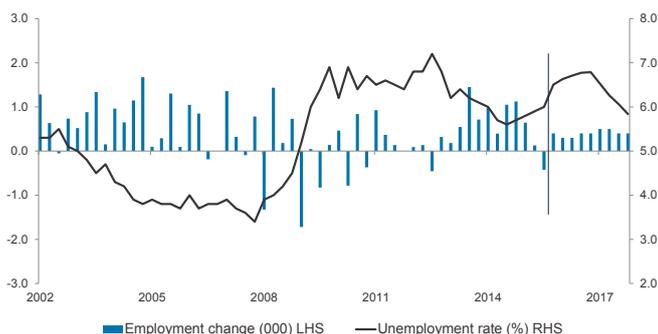


Source: ABS

- > Total employment rose by 58,600 in October, the strongest rise since March 2012, driven by a gain in full time jobs. Employment is up 2.7% on a year ago. This pushed the unemployment rate down 5.9%, from 6.2% in September.
- > There is a danger in reading too much into monthly jobs data as it can be quite volatile. Employment growth at 2.7% yoy is now running well ahead of the growth suggested by leading jobs indicators. As a result, a pullback in employment could be expected next month, and it's still premature to say we have seen the peak in unemployment.
- > That said, the ongoing strength in trend employment growth is consistent with the economy continuing to hold up reasonably well, helped by the rebalancing of the economy. That suggests the RBA will remain on hold, but with a bias to ease further.

## 7. But New Zealand labour market disappoints

### New Zealand labour market



Source: Statistics New Zealand and AMP Capital

- > New Zealand's unemployment rate rose to 6.0% in the September quarter, the combination of a fall in employment, offset by a decline in the labour participation rate.
- > The result was weaker than expected, perhaps due in part to statistical noise. What's hard to believe is the 0.7% decline in the participation rate given the strong population growth we are experiencing through net migration. The weak employment result also surprised, though this is mitigated by the fact that the decline was (mostly) in part-time employment, which could reverse out as we head into Christmas.
- > Wages added to the soft tone with the private sector Labour Cost Index up 0.4% over the quarter for an annual increase of 1.7%, slightly lower than we were expecting. By itself the result lends support to the RBNZ cutting interest rates again at the December 10 Monetary Policy Statement.

## MARKET COMMENTARY

### GLOBAL SHARES

Markets were relatively subdued over November with the exception of a short lived dip due to the events in Paris. The terrorism in France and the downing of a Russian fighter plane by Turkey, and the subsequent geopolitical tension, had the possibility to disrupt global equity markets. However, these events had little lasting impact on equity markets with developed equities returning 0.6% over the month. European equity markets rallied, supported by ECB President Mario Draghi who indicated further monetary easing is likely in December. Japanese stocks also ended higher as the likelihood of further easing increased with the economy slipping back into technical recession. US markets were subdued, finishing marginally higher as investors attention focused on the pending interest rate decision in December.

### NEW ZEALAND SHARES

The New Zealand share market rose alongside global markets, with the S&P/NZX 50 index retuning 1.9% over the month. a2 Milk led the market forward as the company lifted earnings expectations due to rapidly rising demand for its Platinum infant formula in Australia and China. a2 Milk shares ended November up 55.3%. Xero was the other high flyer over November, rallying 19.8%. The company announced its results with investors choosing to focus on an increase in revenue per subscriber rather than disappointing US subscriber growth.

### NEW ZEALAND LISTED PROPERTY

New Zealand listed property marginally outperformed the broader domestic equity market, ending 2.5% higher over the month. The gains made over November were broad based with only one stock ending in negative territory. Vital Healthcare rallied 9.1% and led the market forward, while NPT and Goodman Property Trust also experienced a strong month, returned 3.3% and 4.1% respectively. Earnings season saw the results for the majority of property companies in line or slightly better than expectations

### GLOBAL BONDS

The Barclays Global Bond Index returned 0.3% over November as the rhetoric and expectations of central banks around the world influenced their respective markets. Yields in the US moved higher, particularly for short dated bonds, as the market continued to expect the first interest rate hike in the US since 2006 to be made in December. Yields in Europe moved lower as data showed that German's economic growth slowed slightly in the third quarter and Mario Draghi said the ECB "will re-examine the degree of monetary policy accommodation" at its December meeting. Yields on the US 10 year Treasury closed the month at 2.21%, up 6 basis points (bps) over the month.

### NEW ZEALAND BONDS AND CASH

Short term New Zealand government bond yields were little changed or drifted lower over the month as the expectation of further rate cuts increased. The recent price falls in the Global Dairy Trade auction has only fuelled this expectation. The 90 Day Bank Bill yield ended November 11 bps lower at 2.85%. Longer term bond yields followed US and Australian rates higher with the 10 year NZ Government bond yield up 24 bps to 3.54%.

### COMMODITIES

The Bloomberg Commodities Index resumed its downward trend over the month, finishing down 7.0%. Commodity prices were lower across the board with the exception of a few commodities in the agriculture sector. Commodities have been in decline as concerns increased over China's growth slowdown and the elevated levels of oil inventories. Adding to the list of concerns is the expectation of a US interest rate hike which has pushed the US dollar (USD) higher. Commodities are predominantly priced in USD, so as the USD rises commodities become more expensive to international buyers.

### GLOBAL LISTED PROPERTY & INFRASTRUCTURE

Both global listed property and global listed infrastructure ended the month lower, with the former declining 0.6% while the latter declined 2.3%. The lower beta yield sensitive asset classes underperformed the broader market with rising bond yields making the asset class less attractive.

### NEW ZEALAND DOLLAR

The rebound of the New Zealand dollar (NZD) experienced in October was short lived. November saw the NZD down against all the major currencies, with the exceptions being against the Swiss franc and euro. The NZD ended 1.2% higher against the euro as expectations increased for further ECB easing. Against the USD the NZD ended the month down 2.9% at 0.6584 as expectations continued to grow for a December rate hike by the US Federal Reserve. On an MSCI weighted basis the NZD fell 1.8%.

	AS AT 30 NOVEMBER 2015	CHANGE OVER THE MONTH (%)	CHANGE OVER THE YEAR (%)
MSCI - US	8086.85	+0.3	+2.7
MSCI - UK	12019.38	+0.3	-2.6
MSCI - Germany	3537.66	+4.6	+14.4
MSCI - Japan	1979.33	+1.1	+12.1
NZX 50	6100.15	+1.9	+12.5
MSCI - World (local curr.)	4994.78	+0.7	+4.1
MSCI - World (NZD)	9829.46	+2.5	+18.9
NZ Official Cash Rate	2.75	0 bps	-75 bps
NZ 90-day bank bill yield	2.84	-12 bps	-83 bps
NZ 10-year bond yield	3.53	24 bps	-37 bps
US 10-year bond yield	2.21	6 bps	4 bps
NZD-USD	0.6584	-2.9	-16.0
NZD (TWI)	71.1	-2.5	-9.5
NZD (MSCI weighted)	73.6	-1.8	-12.4

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