INVESTMENT BRIEF

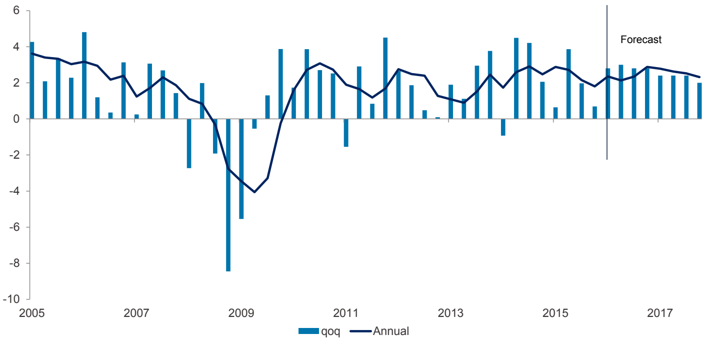
JANUARY 2016

Global equity markets around the world tumbled over January, following hard on the heels of the worst December since 2002. The recent trend of higher global bond yields also came to an abrupt end over January. Yields tumbled as the central banks renewed their dovish stance and market volatility drove investors to safe haven assets. The New Zealand share market again showed its resilience in the face of a global rout on equity markets. As largely anticipated, the Reserve Bank of New Zealand left interest rates unchanged at 2.5% at its January meeting. The RBNZ's dovish stance and a continued decline in domestic inflation saw the NZD decline against all its major trading partners.

1. US recession fears overdone

US GDP

Percent change



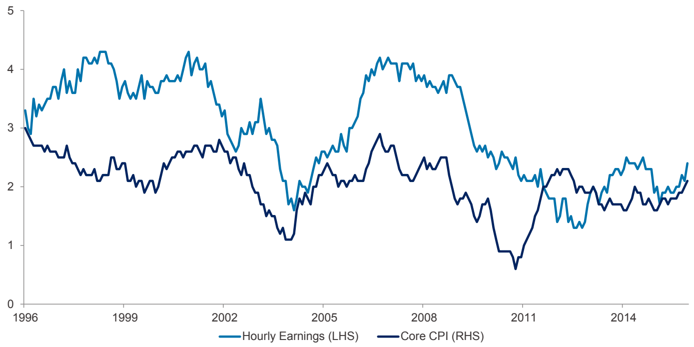
Source: US BEA and AMP Capital

- US GDP growth ended 2015 on a soft note, but for reasons that we expect will ultimately prove to be transitory. Inventories, net exports and investment in structures (oil rigs) all detracted from growth at the end of the year. On a more positive note, consumption and non-oil investment remained solid.
- The consumer remains key to our expectation of a third consecutive year of 2.0-2.5% growth in 2016. A combination of solid jobs growth, increases in the average working week, along with modest wage growth, is expected to lead to continued solid gains in aggregate labour income and consumer spending.
- Recent labour market indicators, along with the continued trend improvement in consumer confidence, remains consistent with this story. We also believe we haven't yet seen the full benefit of the real income gains that have come from weaker oil prices.

2. Still expect higher us interest rates in 2016: timing and quantum less certain

US wages and inflation

Annual % change



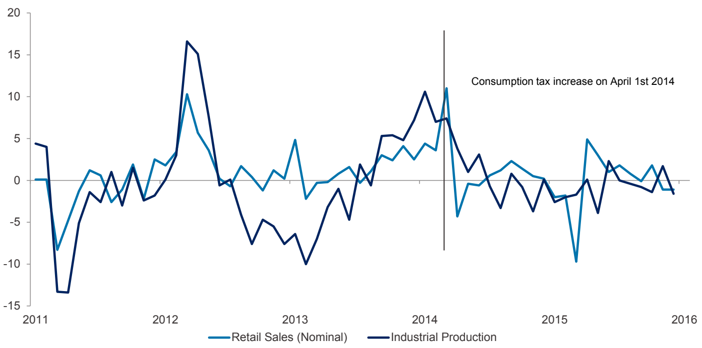
Source: BLS

- The US Federal Reserve (the Fed) began the interest rate normalisation process at its last meeting in 2015. We believe this was a prudent move as the Fed balanced the risk of going too early with going too late.
- The question for 2016 is how high and how fast? The Federal Open Market Committee's "dot plot" forecast indicates four hikes this year. However, recent data and market volatility have seen interest rate markets pricing in no rate hikes in 2016.
- We think both extremes will likely prove to be wrong. We have been assuming three hikes but acknowledge the risk is biased to less.
- The Committee will need to see firm evidence that the growth weakness at the end of last year is indeed temporary before continuing the interest rate normalisation process.

3. Will negative interest rate policy work in Japan?

Japan activity

Annual % change

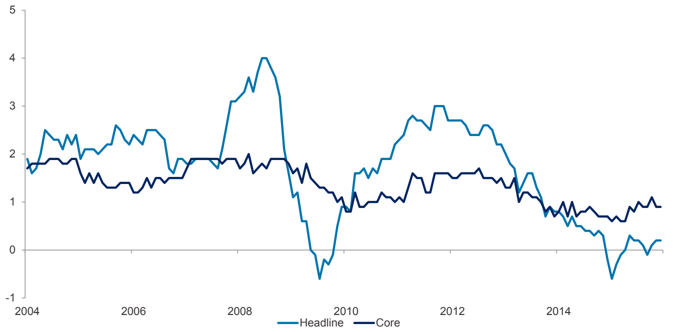


Source: METI

- In a surprise move, the Bank of Japan (BoJ) introduced a negative interest rate at its end-January policy meeting.
- We have had little confidence that Japan would see the necessary pick-up in growth to put sufficient upward pressure on prices for the BoJ to meet its mandated 2% inflation target.
- That has put the BoJ in a difficult position. Continued undershooting of its inflation expectations and the associated risk of lost credibility has seen them adopt aggressive easing measures. However, Japan's growth woes are largely structural in nature.
- We believe this latest move will have little or no impact on the real economy. At best it may support business confidence and inflation expectations in the face of the latest bout of concerns about global growth.

4. The ECB may do more

Eurozone inflation
Annual % change



Source: Eurostat

> As had been widely expected, the European Central Bank (ECB) stepped up their monetary easing in late 2015 by cutting the already negative deposit rate and extending the duration of their asset purchase programme.

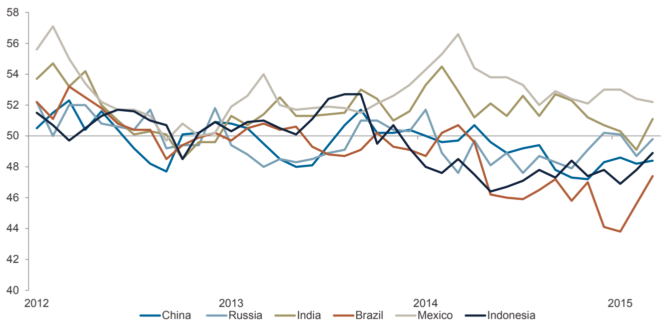
> We expect the Eurozone's economic expansion to continue at around a 0.4% per quarter pace or 1.6% per annum. This is close to our estimate of potential growth of 1.5%.

> Spare capacity is being absorbed only slowly. The unemployment rate has been trending lower but remains high at 10.4%. This is indicative of a persistently large output gap and little chance of any significant upward pressure on core inflation beyond the current level of around 1.0%.

> More recent financial market volatility and concerns about global growth means a further easing in policy cannot be ruled out.

5. Emerging market stabilisation?

EM Manufacturing PMIs



Source: MITI

> The economic outlook among the key emerging economies remains highly divergent. However, there are signs that conditions in the manufacturing sectors are stabilising, at least on average.

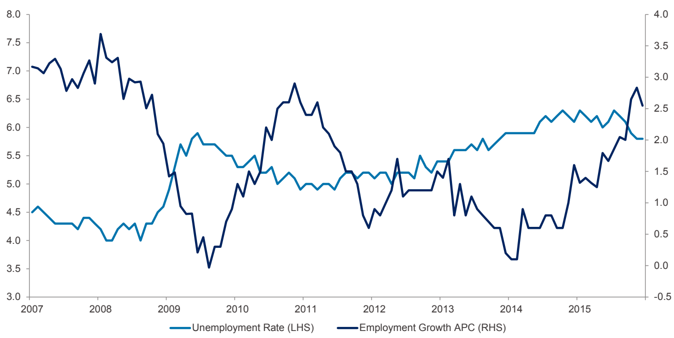
> Manufacturing PMIs were improving in most of the key emerging economies in late 2015/early 2016. The most pleasing results were for Brazil where the index was less bad and in Russia, where the economy appears to be stabilising.

> According to data compiled by Capital Economics, the average PMI across the emerging economies was up in December, and its highest level in six months. While the aggregate index is still in contraction territory, there is a gradual trend improvement underway.

> The aggregate "new orders" component, the sub-index most indicative of future growth, also increased.

6. RBA on hold

Australia labour market



Source: ABS

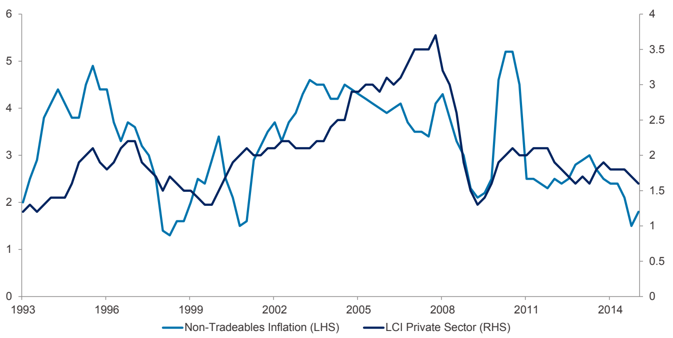
> As expected, the Reserve Bank of Australia (RBA) left interest rates on hold at its February meeting. This marks the ninth month in a row with the cash rate remaining at 2%.

> While the RBA is less upbeat on the global economic outlook, it seems more upbeat on the Australian economy and sees inflation as remaining low. It has also acknowledged slowing property price gains in Sydney and Melbourne.

> While the RBA retained an easing bias on the back of the low inflation outlook, the balancing of more positive domestic developments against recent negative global developments clearly enabled it to remain on hold for now. However, the RBA is clearly concerned about recent global and financial market developments and is waiting for more information in order to be able to judge its impact on global growth and the Australian economy.

7. New Zealand bouncing back

Inflation and the Labour Cost Index



Source: Statistics New Zealand and AMP Capital

> After a weak patch in the first half of 2015, the New Zealand economy bounced back by the end of the year. Both GDP and employment growth recovered well into the end of the calendar year.

> It's not all good news, however, as drought appears likely to have an impact on agricultural output in the early part of 2016. Dairy prices also weakened again in early 2016.

> We expect 2015 GDP growth will be finalised at 2.4% (annual average) with a similar level expected in 2016. Our forecast is currently 2.5%.

MARKET COMMENTARY

GLOBAL SHARES

Global equity markets around the world tumbled over January, following hard on the heels of the worst December since 2002. Many markets entered into bear territory which is a defined as a decline of 20% or more from the peaks made over the previous few months. Fears over China's economic slowdown, capital outflows and currency depreciation fuelled the rout at the start of January as the People's Bank of China lowered the yuan's reference rate sending shock waves through global equity markets. Post the yuan's devaluation, concerns snowballed into a wider reassessment of the global economy and central bank's willingness to support markets.

Central banks did come to the aid of equity markets late in the month renewing their dovish stance which provided a boost to shares. The ECB is expected to ease further in March and a more gradual US Fed rate hike cycle is also now expected. But it was the Bank of Japan that surprised investors as it cut interest rates into negative territory in an attempt to encourage banks to lend more. Chinese equities were hit hard over the month with the MSCI China index falling 12.3%. The US market also ended down 5.0%, and European markets fared slightly worse ending down 6.8%.

NEW ZEALAND SHARES

The New Zealand share market again showed its resilience in the face of a global rout on equity markets. While many other markets around entered into a bear market, the S&P/NZX 50 Index ended down only 2.4%, a relatively good result. Ten stocks in the S&P/NZX 50 ended in positive territory over January, with Sky City bucking the global trend to return a positive 5.4%. The largest falls were experienced by Xero, down 15.2%, and Nuplex, down 12.6%.

NEW ZEALAND LISTED PROPERTY

The New Zealand listed property market went one better than the broader New Zealand equity market and ended in positive territory, gaining 0.3% over January. The listed property market again benefited from the search for yield and safety as half the index constituents ended higher for the month. Market heavyweights, Kiwi Property Group and Goodman Property Trust, performed well, ending up 1.5% and 1.2% respectively.

GLOBAL BONDS

The recent trend of higher global bond yields came to an abrupt end over January. Yields tumbled as the central banks renewed their dovish stance and market volatility drove investors to safe haven assets. The Barclays Global Aggregate Index returned 1.75% over January. The renewed dovish stance started with the ECB which is now less positive on growth and the outlook, while the Fed acknowledged that growth in the economy slowed at the end of 2015 and stated it would monitor global economic financial developments. The Bank of Japan was the latest central bank to provide stimulus as it cut the interest rate it pays on new excess bank reserves to -0.1% in order to encourage banks to lend. Yields on the US 10-year Treasury closed the month at 1.92%, down 35 basis points over the month.

NEW ZEALAND BONDS AND CASH

As largely anticipated, the RBNZ left interest rates unchanged at 2.5% at its January meeting, stating that any further policy moves will be dependent on economic data. However, a more dovish tone to the Bank's rhetoric returned, particularly in relation to the low inflationary environment. The statement reflected the market's anxiety over China's growth and around the continued decline in commodity prices. The 90 Day Bank Bill yield ended January 4 basis points lower at 2.71%, while the 10-year NZ Government bond yield ended down 35 basis points to 3.22%.

COMMODITIES

The Bloomberg Commodities Index continued its downward trend over the month, ending 1.7% lower. Crude oil led the decline. However, WTI Crude did bounce off its January lows of US$26.55 to recover to US$33.62, down 9.2% for the month. It wasn't all one way traffic for commodities as precious metals benefited from safe haven buying, with gold ending up 5.3% for the month.

GLOBAL LISTED PROPERTY AND INFRASTRUCTURE

Global listed property went against the equities trend over the month and finished up 1.1%. Global listed infrastructure on the other hand declined 1.1% as oil sensitive infrastructure sectors were hindered by the falling price of oil.

NEW ZEALAND DOLLAR

The New Zealand dollar (NZD) continued its recent pattern, stronger one month only to fall the next. The RBNZ's dovish stance and a continued decline in domestic inflation saw the NZD decline against all its major trading partners. The NZD ended 4.9% lower on an MSCI weighted basis and 5.0% lower against the US dollar.

	AS AT 31 JANUARY 2016	CHANGE OVER THE MONTH (%)	CHANGE OVER THE YEAR (%)
MSCI - US	7528.37	-5.3	-1.3
MSCI - UK	11515.98	-2.4	-7.0
MSCI - Germany	3063.92	-8.5	-7.9
MSCI - Japan	1790.04	-7.6	+1.6
NZX 50	6170.22	-2.4	+7.4
MSCI - World (local curr.)	4625.56	-5.4	-2.4
MSCI - World (NZD)	9225.28	-0.9	+6.9
NZ Official Cash Rate	2.50	0 bps	-100 bps
NZ 90-day bank bill yield	2.70	-5 bps	-97 bps
NZ 10-year bond yield	3.24	-34 bps	4 bps
US 10-year bond yield	1.92	-35 bps	28 bps
NZD-USD	0.6484	-5.1	-10.7
NZD (TWI)	71.2	-4.3	-5.6
NZD (MSCI weighted)	72.7	-4.5	-8.7