INVESTMENT BRIEF

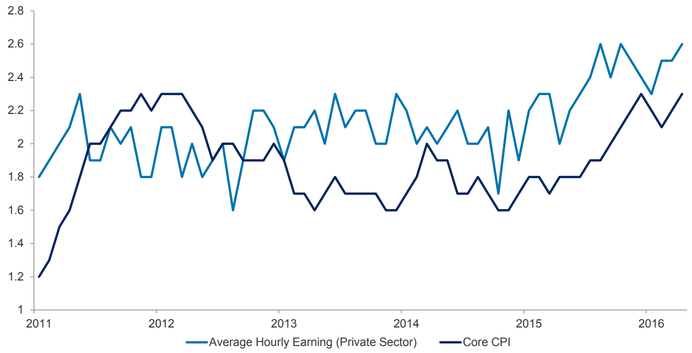
JULY 2016

Following June's surprise UK referendum result and subsequent market turmoil, developed markets around the world rallied over July with the MSCI World Index gaining 4.1%. Emerging markets performed slightly stronger, finishing up 4.2%. The New Zealand share market was once again one of the strongest performing equity markets, the S&P/NZX 50 Index surging 6.5%. Global bond yields stabilised somewhat over July which followed the bond rally experienced post Brexit. It was another strong performing month for New Zealand bonds as they rallied following an unscheduled economic update from the RBNZ which pointed towards likely interest rate cuts as inflation continues to track below target. This also saw the NZ dollar come under pressure.

1. FOMC: Just one hike in 2016?

US wages and inflation

Annual % change



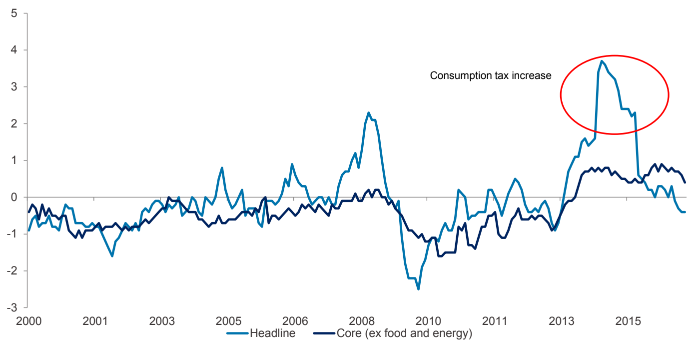
Source: Bureau of Labor Statistics

- The latest from the Federal Open Market Committee (FOMC) suggests the near-term risks to the US economy have diminished but they will be in no rush to continue the interest rate normalisation process.
- That message was reinforced by the release of Q2 GDP growth which disappointed with an increase of around half the expected pace. Business investment and inventories were key drags on growth, though real final demand still came in at a solid 2.4% over the quarter.
- The challenge for the FOMC to navigate is that while growth has disappointed recently, the economy is operating at or close to full employment and wage growth is trending slowly higher. Right now it appears likely the US Federal Reserve (the Fed) will hike only once this year, in December.

2. Can fiscal policy save Japan?

Japan inflation

Annual % change



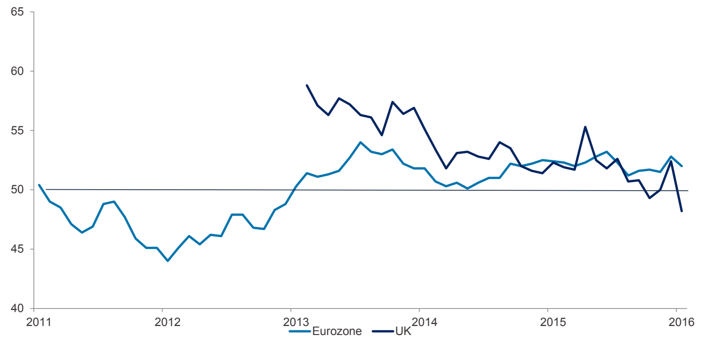
Source: Bloomberg

- Both growth and inflation data out of Japan has disappointed recently as activity data continues to oscillate between expansion and contraction while inflation is falling again.
- The recent strong showing for Shinzo Abe and his ruling coalition Government in the Upper House elections has led to expectation of broader action on low growth and deflation. The Bank of Japan eased further at the end of July and the Government announced a fiscal stimulus program. Both disappointed in terms of the quantum.
- The fiscal package comes at time when there is a growing consensus that monetary policy is at the limits of its ability to be effective. But even that can only provide a temporary boost to activity.

3. The UK and Eurozone post "Brexit"

Manufacturing PMIs

Index, seasonally adjusted



Source: Markit

- The United Kingdom's manufacturing PMI fell in July, below the 50 benchmark that delineates expansion from contraction. This supports the view the UK may be destined for mild recession in the second half of 2016 in the wake of the Brexit referendum.
- The Bank of England left interest rates unchanged in the immediate aftermath of the referendum, but is widely expected to ease at its August meeting.
- The Eurozone PMI was also weaker in July but held up reasonably well, suggesting any immediate fallout from Brexit will be minimal.
- The European Central Bank left monetary conditions unchanged in July, but said they stand willing able and ready to do more should it be required.

4. China stabilises, investment biggest headwind

China GDP growth

Annual % change

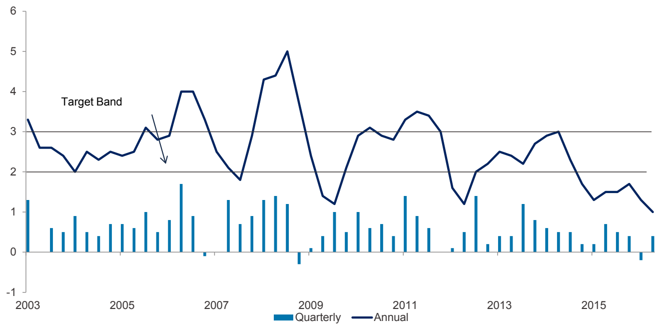
Source: NBS

- Growth in the Chinese economy was stable into the second quarter of the year, though there are signs of mounting headwinds, especially with respect to private sector investment. The economy expanded at an official 6.7% pace in the year to June, the same rate as the year to March.
- The sectoral breakdown shows the 'old China' sectors of industrial production and investment have slowed significantly while retail sales and services are still holding up in a relative sense.
- The forceful stimulus behind the growth numbers is evident in the 14.4% increase in new loans over the 12 month period along with the budget deficit widening out to a record low of -4.2%. However, rising loan growth is contributing to concerns about debt sustainability.

5. Australia eases again

Australia CPI

% change



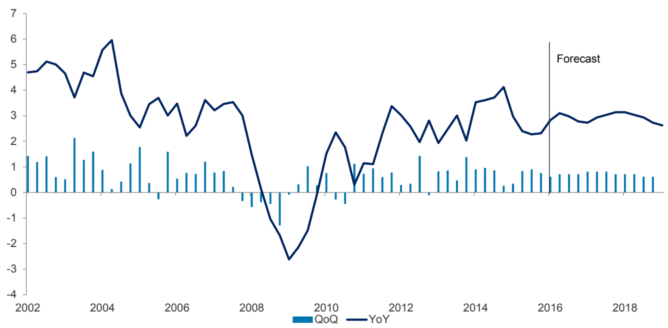
Source: ABS

- The RBA has cut the official cash rate by 0.25% taking it to 1.5%, a new record low. With the RBA seeing growth "continuing at a moderate pace", the latest rate cut is all about adding to confidence that inflation will head back to the 2-3% target zone within a reasonable time. It is also to help maintain downwards pressure on the value of the Australian dollar (AUD) in the face of ongoing delays in Fed rate hikes.
- Will there be another cut? The RBA's guidance doesn't give much away and leads many to conclude that it has reverted to a neutral bias on future rate moves. However, we are allowing for one more rate cut in November based on expectations that the September quarter inflation data will remain much lower than desired and that upwards pressure on the AUD will likely remain.

6. New Zealand economy looking solid

New Zealand GPP

% change



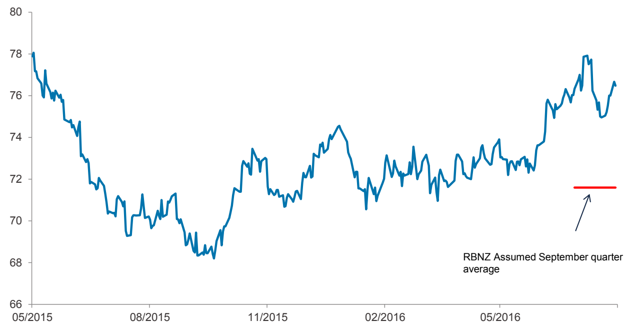
Source: Statistics New Zealand, AMP Capital

- The New Zealand economy continues to put in a solid growth performance despite the headwinds from the external sector. We expect growth of 2.5-3.0% per annum over the next two years before winding down in 2018, largely on the back of slower population gains.
- Factors impacting the external sector remain a drag on growth. Lower dairy commodity prices and the strength of the exchange rate remain a challenge for the external sector. However, it's not all bad on the external front as service exports remain strong on the back of tourism flows.
- Domestically, the strong economic growth impetus continues to come from population growth. Sectors that are growing strongly include residential construction, retail spending and core service areas such as healthcare.

7. RBNZ in a world of competitive easing

New Zealand TWI

Index



Source: RBNZ, Bloomberg

- Despite the solid growth outlook, the obvious strength of the housing market and the risks to financial stability, the Reserve Bank of New Zealand (RBNZ) appears poised to further reduce interest rates.
- Undesirable strength in the exchange rate is the most likely catalyst for further interest rate reductions. This is a function of global competitive easing and an over-reliance on monetary policy to fix the problems of low growth and low inflation. It is making the achievement of inflation mandates difficult for central banks like the RBNZ where lower interest rates are not necessary and even risk financial stability.
- The RBNZ is committed to its inflation mandate, but it remains to be seen what impact they can have on the exchange rate.

MARKET COMMENTARY

GLOBAL SHARES

Investors were quick to put June's surprise UK referendum result and subsequent market turmoil behind them as central banks around the world provided reassurance with supportive comments. Developed markets rallied over July with the MSCI World Index gaining 4.1%. Emerging markets performed slightly stronger, finishing up 4.2%. Investors pushed the US S&P 500 Index up 3.7% to hit record highs during the month as solid US economic data and a positive reporting season combined with lower-for-longer interest rates thanks to the Brexit fallout. The Bank of England voted 8-1 to keep rates unchanged. This surprised the market which was expecting action following the Brexit result, but was offset by most members expecting monetary policy to be loosened in August. Japanese equities, as measured by the Topix, rallied 6.2% despite the Bank of Japan disappointing the market by only expanding its purchase of exchange-traded funds, and leaving interest rates and its monetary base unchanged.

NEW ZEALAND SHARES

The New Zealand share market was once again one of the strongest performing equity markets around the world over the month. In what was a broad-based rally, the S&P/NZX 50 Index surged 6.5%, with only three stocks producing a negative return. Kathmandu was the strongest performer, gaining 17.6% following a profit upgrade guidance, and the company expect earnings before interest and tax to rise as much as 60%. Other top performers included Auckland International Airport, Fletcher Building and Steel & Tube.

NEW ZEALAND LISTED PROPERTY

In what was a strong rallying market, the New Zealand listed property index underperformed the broader equity market, ending up 2.4% over July. Stride Property completed the restructure of its operations, including the demerger of its subsidiary Investore Property which listed mid-July. Stride retains a 19.9% cornerstone holding in Investore. The Stride share price gained 3.4% over the month, while Investore surged 10.7% from its listing price.

GLOBAL BONDS

Global bond yields stabilised somewhat over July which followed the bond rally experienced post the Brexit referendum. The Barclays Global Aggregate Index returned 0.75% over the month. The risk-on environment saw sovereign bonds underperform corporate bonds, the reverse of what was seen in June. Central banks' supportive comments helped the market, with the Bank of England likely to move in August and the European Central bank being "ready, willing and able" to provide more monetary easing. Yields on the US 10-year Treasury closed the month at 1.45%, down 2 basis points (bps) over the month.

NEW ZEALAND BONDS AND CASH

It was another strong performing month for New Zealand bonds as they rallied following the RBNZ's unscheduled economic update on its assessment of the domestic economy. The RBNZ pointed towards likely interest rate cuts as inflation continues to track below target. The 90 Day Bank Bill yield ended July 14 bps lower at 2.28%, while the 10-year NZ Government bond yield ended down 15 bps at 2.21%.

COMMODITIES

Unlike most asset classes, commodities produced a negative return over the month. Led lower by the decline in oil prices, the Bloomberg Commodity Index fell 5.1% over July. The 15% decline in the price of West Texas Intermediate crude came on the back of reports which showed higher than expected stockpiles. Precious metals continued its rally as gold advanced 2.2% and silver gained 9.3%. However, the largest gains were experienced by cotton and nickel.

GLOBAL LISTED PROPERTY & INFRASTRUCTURE

Global listed property and global listed infrastructure participated in the broad market rally, with the former gaining 4.8% as falling interest rates benefited the defensive growth asset class. Global listed infrastructure rose 2.0%, lagging the broader market and global listed property as oil sensitive infrastructure sectors were hindered by the falling price of oil.

NEW ZEALAND DOLLAR

The New Zealand dollar (NZD) continued to rally post Brexit until the RBNZ announced new loan-to-value restrictions to be introduced by September this year to help cool the housing market. This saw the NZD come under pressure and was closely followed by an unscheduled economic update which put further pressure on the NZD. During the special assessment the RBNZ stated interest rate cuts are likely as inflation continues to track below target. Over the month the NZD strengthened 0.9% against the US dollar and 1.1% against the MSCI weighted basket.

	AS AT 31 JULY 2016	CHANGE OVER THE MONTH (%)	CHANGE OVER THE YEAR (%)
MSCI - US	8548.02	+3.8	+5.0
MSCI - UK	13048.88	+3.5	+4.4
MSCI - Germany	3240.26	+6.7	-8.0
MSCI - Japan	1663.10	+6.4	-19.9
S&P/NZX 50	7348.13	+6.5	+24.1
MSCI - World (local curr.)	5074.24	+4.1	-0.5
MSCI - World (NZD)	9304.72	+3.3	-8.3
NZ Official Cash Rate	2.25	0 bps	-75 bps
NZ 90-day bank bill yield	2.28	-13 bps	-82 bps
NZ 10-year bond yield	2.21	-13 bps	-119 bps
US 10-year bond yield	1.45	-2 bps	-73 bps
NZD-USD	0.7199	+0.9	+9.2
NZD (TWI)	76.0	-0.0	+8.4
NZD (MSCI weighted)	79.0	+0.8	+8.5