INVESTMENT BRIEF

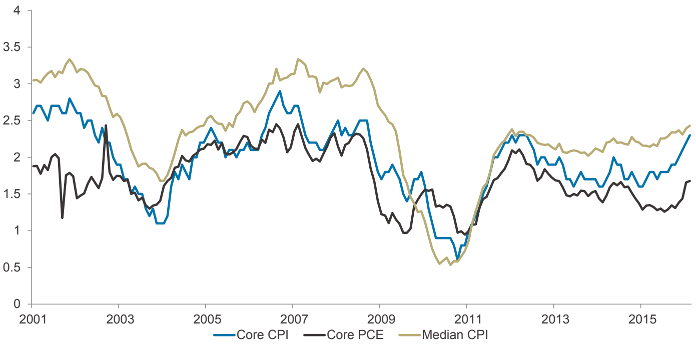
MARCH 2016

Global equity markets continued the upward trend started mid-February, ending higher over March but were unable to recover the losses experienced in January, ultimately ending the first quarter of the year down 2.0%. The New Zealand share market was again one of the best performing markets around the world. Global bonds rallied over March, as shorter term yields were influenced by central bank announcements, and New Zealand bond yields also rallied over the month. The New Zealand dollar experienced a rollercoaster ride over the month, eventually ending 1.2% stronger on a trade weighted basis.

1. Monetary policy (1): The Fed less hawkish?

US inflation

Annual % change



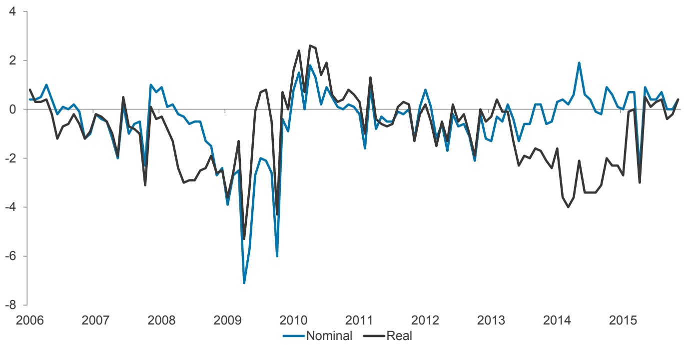
Source: BEA, BLS, Federal Reserve Bank of Cleveland, AMP Capital

- One of the concerns confronting markets at the start of 2016 was that, given the upward trajectory in key inflation indicators in the US, the US Federal Reserve would mechanistically follow through with the four interest rate increases they flagged in December, despite new concerns about the growth outlook.
- Growth concerns have moderated as more recent activity data has improved. But after recent market volatility and uncertainty about the economic outlook, the Fed tempered its interest rate outlook in March by reducing the expected number of interest rate increases in 2016 to two.
- This now brings the FOMC into line with our thinking and with a risk profile that is somewhat more symmetrical. If growth disappoints they may do less, but if inflation continues to move higher they may do more.

2. Monetary policy (2): BoJ pauses and reflects

Japan cash incomes

Annual % change



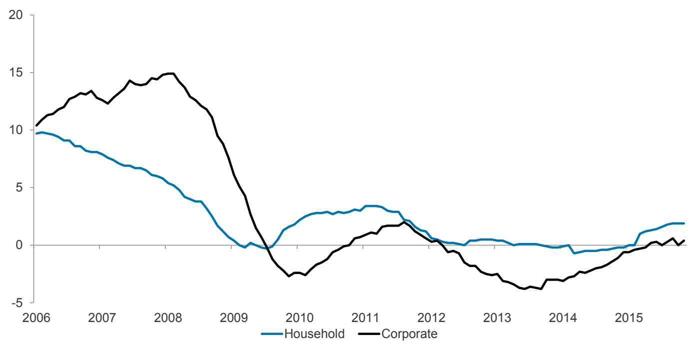
Source: Japan Ministry of HLW

- The adoption of a Negative Interest Rate Policy (NIRP) this year was mostly aimed at increasing inflation expectations ahead of the spring wage negotiations. For a sustained increase in underlying inflation, a sustained increase in unit labour costs is required. NIRP led to generalised concern about the health of the banking sector, but also the economy more generally. Wage claims were reduced and now average around 0.4%, but that seems likely to put downward rather than upward pressure on inflation.
- The BoJ will likely revise down growth and inflation forecasts at their April meeting. That would lead them to ease further at that time, but is not guaranteed. The Bank may wait for the dust to settle on NIRP before doing more.
- The answer to higher growth (still) lies with the Government and fiscal policy – the most likely first cab off the rank in that regard will be postponing next year's consumption tax increase.

3. Monetary policy (3): The ECB fires a bazooka

Eurozone credit growth

Annual % change



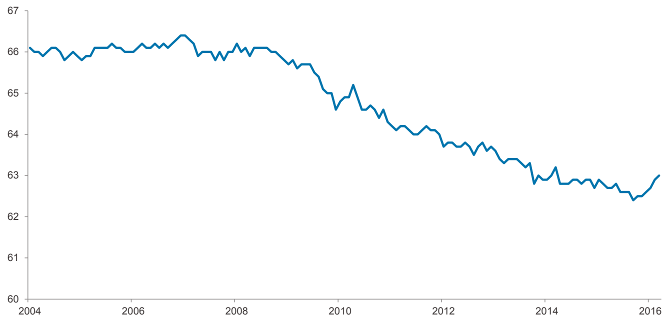
Source: ECB

- The ECB fired a bazooka earlier in the month, throwing everything at the problem of persistently low inflation in the Eurozone. The ECB has similar issues to the BoJ in that they are missing their inflation target by a large margin.
- In March the Bank expanded their asset purchase programme, cut interest rates and announced new Targeted Long-Term Refinancing Operations (TLTROs). The good news is the ECB has a greater chance of impacting the real economy than the BoJ. The most effective of the ECB's measures was their TLTRO programme which has been successful in helping unlock credit growth in the region.
- That said, with the unemployment rate is still at 10.3% across the Eurozone, it will be some time before we see wage growth putting sustained upward pressure on inflation, meaning there's still a good chance the ECB does more.

4. To participate or not to participate?

US Labour Participation Rate

Percent

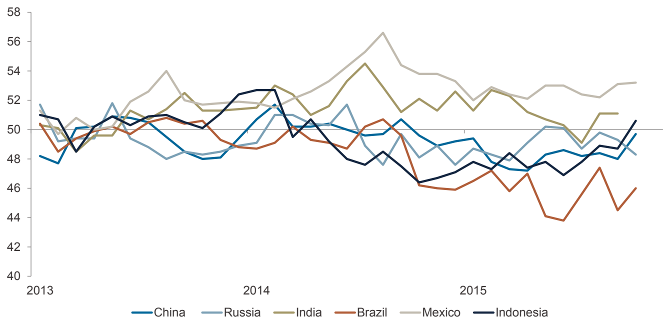


Source: US Bureau of Labor Statistics

- Two puzzling labour market developments since the Great Recession have been the weakness in labour productivity growth and the trend decline in the labour participation rate.
- The participation rate fell from around 66.0% in mid-2008 to a low of 62.4% in September 2015. People dropping out of the labour force at that rate was a significant contributor to the meaningful decline in the unemployment rate over the period.
- The question has been to what extent the decline in the participation rate has been structural (permanent) or cyclical (temporary). Our view is that the fall was mostly structural, but partly cyclical.
- The eventual answer will be of critical importance to the outlook for the unemployment rate, the degree of spare capacity and the amount of work the Fed has to do over the period ahead.

5. The lower USD reduces emerging market fears

EM Manufacturing PMIs



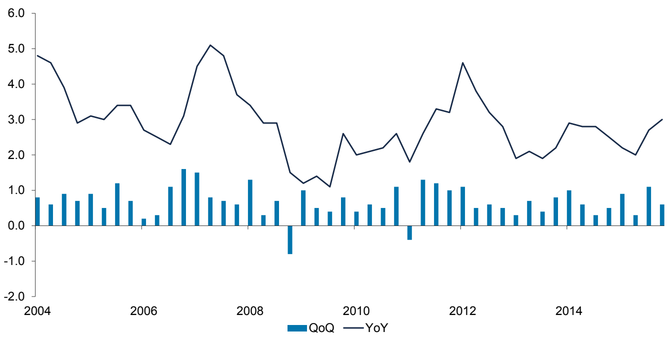
Source: Bloomberg

- The stronger USD, and with that weaker emerging market currencies, raised fears about financial stability in those economies, especially among those with high levels of USD denominated debt. The recent weakness in the USD has eased those fears.
- More fundamentally, weaker currencies among the key emerging economies generated a significant improvement in competitiveness which has sown the seeds of recovery in their manufacturing sectors.
- Activity remains uneven, however. In general, those economies that benefit from lower commodity prices and have seen positive structural reform (India, Mexico) are doing well, while those reliant on commodity income and which suffer from structural weaknesses (Brazil, Russia) will continue to struggle.

6. Australia: worst of drag from mining over?

Australia GDP

Percent change



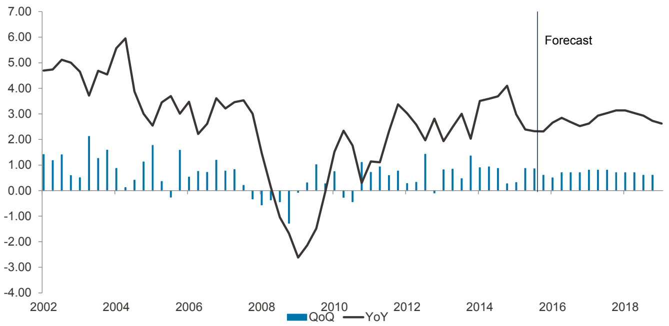
Source: ABS

- Australian Q4 2015 GDP showed a 0.6% rise which puts annual growth at an "above-trend" 3.0%. Main drivers of growth were household consumption and government investment, but this follows a large fall in the prior quarter.
- The major drag on Q4 growth was in business investment which fell -3.3%, predominately due to a fall in mining capex. The indications are that the worst of the capex drag on the economy has passed through and therefore been reflected in the data.
- There is currently a discrepancy between domestic final demand and employment growth as normally you would expect to see lower levels of employment growth at the current rates of domestic demand. One reason could be because the sectors with the highest jobs growth have been in lower investment-intensive areas, but the drop in unit labour costs has also probably played a part in keeping employment buoyant while demand has been low.

7. NZ GDP growth

New Zealand GDP

Percent change



Source: Bloomberg

- December 2015 quarter GDP growth came in at 0.9%, stronger than both market and RBNZ expectations. Annual average growth for calendar year 2015 was 2.5%. The result was largely as expected, with construction and retail sales showing strong growth in activity.
- The outlook for the economy remains one of the degree to which some large positive and large negatives offset each other. On the positive side, population growth, construction and strong tourism activity are key supports for the economy. However, the challenges in the dairy sector are a significant negative.
- On balance, we expect another year of modest growth in 2016. Our current forecast is for annual average growth of 2.6% over the calendar year.

MARKET COMMENTARY

GLOBAL SHARES

Global equities continued the upward trend started in mid-February, ending 5.6% higher over March. However despite the strong recovery, global markets were unable to recover the losses experienced in January, ultimately ending the first quarter down 2.0%. Equity markets around the world rallied over March as the US Federal Reserve (the Fed) continued to emphasise that it expects rates to increase gradually this year and confirmed global growth remains an important consideration for its policy. The European Central Bank (ECB) also helped equity markets over the month by delivering an easing package that was bigger than anticipated. This package included a cut in the deposit rate further into negative territory and an increase in the monthly asset purchases by €20bn to €80bn. Towards the end of March, the world's attention was focused on the tragic events in Brussels. The terrorist attack initially triggered modest safe-haven flows but by the end of the day the reaction was pretty muted. Eurozone shares initially fell 1.6% before ending the day relatively flat. US shares also ended little changed. Emerging market equities outperformed developed market counterparts, returning 8.3% over the month.

NEW ZEALAND SHARES

The New Zealand share market was again one of the best performing markets around the world, rallying 8.4% over March. Sky TV led the market forward, returning 20.4% as the company delivered results which were ahead of expectations. However, management remains cautious with an increasing number of customers moving towards online alternatives. Restaurant Brands was another strong performer over the month as the company announced it has entered into an agreement to acquire QSR Pty Limited, which will open the door for a KFC expansion in Australia. Shares in Restaurant Brands rallied 16.3% over the month.

NEW ZEALAND LISTED PROPERTY

New Zealand listed property delivered a solid return of 5.1%. All ten stocks in the index experienced a positive return over the month, with Vital Healthcare and Augusta leading the way forward. Goodman Property Trust announced a portfolio revaluation gain of $135 million, representing an increase of 6%. Goodman shares ended the month 6.2% higher.

GLOBAL BONDS

Global bonds rallied over March, as shorter term yields were influenced by central bank announcements. As widely anticipated the Fed left interest rates on hold, but its tone was more dovish than expected, lowering the long term interest rate expectation to 3.25% from 3.5%. The "dot plot", which shows meeting participants' interest rate expectations, was also lowered to just two 25 basis point rate hikes this year, down from four previously. The ECB also contributed to the dovish mood as it delivered a policy easing package that was more than the market anticipated. The Barclays Global Aggregate Index returned 1.08% over March. Yields on the US 10-year Treasury closed the month at 1.77%, up three basis points over the month.

NEW ZEALAND BONDS AND CASH

New Zealand bond yields rallied over the month. The RBNZ cut interest rates by 25 basis points at its March meeting, taking the OCR to a new low of 2.25%. Even though the Bank held a clear easing bias prior to March's meeting, the timing of the cut took the market by surprise. The key reasons behind the cut were the deterioration in the global growth outlook, the difficult challenges facing the dairy sector, the strength in the trade weighted exchange rate, and the recent deterioration in inflation expectations. The 90 Day Bank Bill yield ended March 22 basis points lower at 2.35%, while the 10-year NZ Government bond yield ended down two basis points at 2.95%.

COMMODITIES

The Bloomberg Commodities Index recorded its first positive month since June last year, ending up 3.8%. Oil and broader commodities rallied following dovish comments from the Fed on the path of future interest rate hikes. This saw the US dollar fall, in turn boosting commodities which are predominantly priced in US dollars. This means as the US dollar falls commodities become less expensive to international buyers. Crude oil continued to recover from its February lows. However, it was soybeans and coffee that led the market forward, gaining 10.9% and 10.8% respectively.

GLOBAL LISTED PROPERTY & INFRASTRUCTURE

Both the global listed property and global listed infrastructure asset classes rallied over the month, outperforming the broader global equity market. The two interest rate sensitive asset classes received a boost as bond yields declined.

NEW ZEALAND DOLLAR

The New Zealand dollar (NZD) experienced a rollercoaster ride over the month, eventually ending 1.2% stronger on a trade weighted basis. The NZD initially fell following the surprise cut rates by the RBNZ. However, this proved temporary as the Fed's March meeting reaffirmed its dovish tone and lowered interest rate expectations. This saw the NZD rise against the US dollar, undoing the fall following the RBNZ's surprise rate cut. The NZD ended March 4.8% higher against the US dollar.

	AS AT 31 MARCH 2016	CHANGE OVER THE MONTH (%)	CHANGE OVER THE YEAR (%)
MSCI - US	8027.01	+6.8	+0.9
MSCI - UK	11814.47	+1.7	-5.8
MSCI - Germany	3114.75	+4.8	-16.2
MSCI - Japan	1695.33	+4.4	-12.6
NZX 50	6752.42	+8.4	+15.7
MSCI - World (local curr.)	4800.69	+5.3	-4.0
MSCI - World (NZD)	9188.44	+1.9	+5.0
NZ Official Cash Rate	2.25	-25 bps	-125 bps
NZ 90-day bank bill yield	2.34	-22 bps	-129 bps
NZ 10-year bond yield	2.98	-1 bps	-25 bps
US 10-year bond yield	1.77	3 bps	-15 bps
NZD-USD	0.6909	+4.8	-7.5
NZD (TWI)	73.2	+1.6	-6.9
NZD (MSCI weighted)	75.7	+3.3	-8.6