INVESTMENT BRIEF

MAY 2016

Global equities were mixed over the month, with developed markets finishing higher, while emerging market equities were down. The New Zealand share market continued to be one of the strongest equity markets around the world, gaining 3.2% in May. New Zealand listed property also continued its strong performance. Global bonds ended higher over May, led by Sovereign bonds as longer dated yields fell. New Zealand bond yields fell alongside their global counterparts over the month. The New Zealand dollar was mixed against the major currencies, and down over the month by 2.2%.

1. US growth recovering from weak Q1

US consumer confidence and retail sales

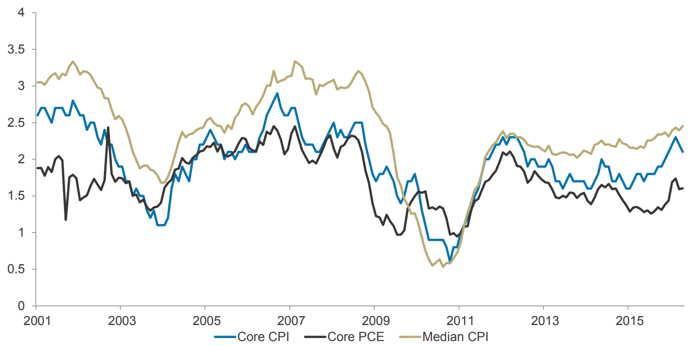
Source: The Conference Board and Department of Commerce

- Key US activity indicators are recovering into the second quarter of the year with retail sales and residential construction showing renewed upward momentum. Household consumption and residential construction underpin our expectations of continued above trend growth in 2016.
- This pick-up suggests GDP growth will bounce back from the weak start to the year. March quarter GDP came in at an annualised 0.8% (revised from 0.5%) and early indications are that June quarter GDP will come in at around 2.0%.
- Not all parts of the economy are firing, with manufacturing PMI readings recovering but still soft, and some worrisome softness in business investment. We expect a cyclical recovery as the labour market continues to tighten.

2. Summer hike off…, then on…, then off?

US inflation

Annual % change



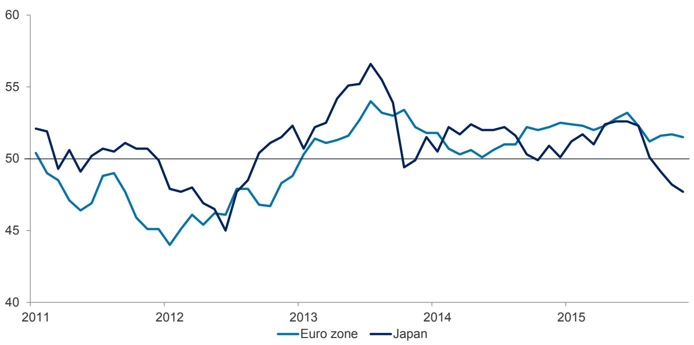
Source: BEA, BLS, Federal Reserve Bank of Cleveland

- Recent "Fed-speak", including the release of the minutes of the April FOMC meeting, had raised the odds on a summer (June or July) interest rate increase. But that was before the release of May payrolls data that saw exceptionally low payrolls growth. At the same time, the unemployment rate dipped to 4.7%, the result of a sharp fall in the participation rate.
- While this result will more than likely delay the Fed again, markets have taken the prospect of higher interest rates more in their stride this time around as many of the fears that gripped markets earlier this year have dissipated to some extent.
- In particular, US growth is recovering, China appears to be stabilising and oil prices are higher, reducing default risk in the energy sector.

3. ECB done, Japan tax hike postponed

Manufacturing PMIs

Index, seasonally adjusted



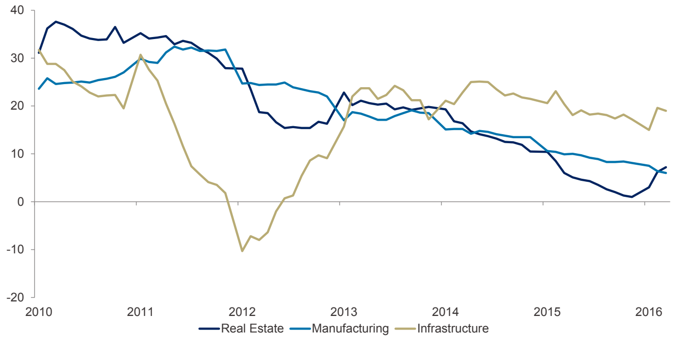
Source: Nikkei, Markit

- The European Central Bank announced no new easing measures in April or May and is currently focusing on the implementation of the measures they announced in March.
- Activity data is pointing to GDP growth of around 1.6% in 2016, slightly ahead of our estimate of trend growth. This should see spare capacity gradually absorbed and the output gap gradually closing. Only at this point are we are likely to see any sustained upward pressure on wages and prices
- Activity data in Japan remains soft, while headline inflation has dipped back into negative territory. The challenge for the Bank of Japan is whether anything they do will matter much.
- Prime Minister Shinzo Abe announced a delay in the implementation of the next tranche of the consumption tax increase. This was meant to be effective 1 April 2017 but has shifted out to 2019.

4. China stabilises, but more policy support likely

China fixed asset investment

YoY % change (cumulative)

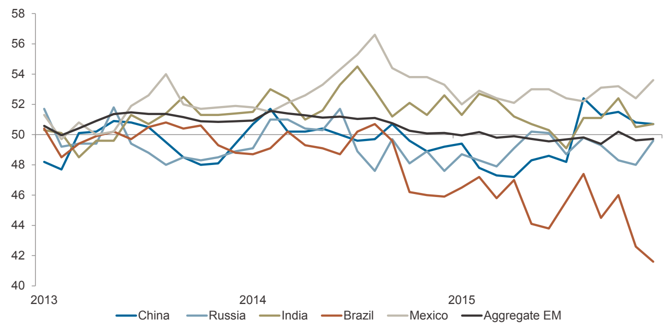


Source: NBS

- Following a "bounce" in March, Chinese activity data disappointed in April. The economy appears to be stabilising, though manufacturing remains particularly weak. Weakness in manufacturing investment is being offset by the recovery in property and infrastructure investment.
- Improving commodity prices is reducing deflationary pressures in the productive sector. This reduces the pressure on People's Bank of China to ease monetary conditions further, and means further easing to support growth is likely to be through fiscal policy.
- Further reserve requirement ratios (RRR) cuts cant be ruled out especially when the Fed moves interest rates higher again which will put Renminbi under downward pressure and see increased capital outflows.

5. Emerging economy diversity

EM manufacturing PMIs



Source: Markit, AMP Capital

- Economic performance among the key emerging economies remains highly divergent. In general, those reliant on commodity incomes while suffering structural headwinds are still struggling, while economies that are net beneficiaries of lower commodity prices and enjoying reform tailwinds are the strongest.
- India remains the strongest performer with the cyclical recovery seeing growth reaching 7.9% in the year to March. While inflation ticked higher in April, there is possibly still room for interest rate reductions from the Reserve Bank of India.
- In contrast, Brazil continues to face both cyclical and structural headwinds. The impeachment process has generated some hope of reform, though any reform will take time to impact. However, inflation appears to be peaking which may see scope for lower interest rates late this year.

6. Strong net exports in Australia

Australia CPI

% change

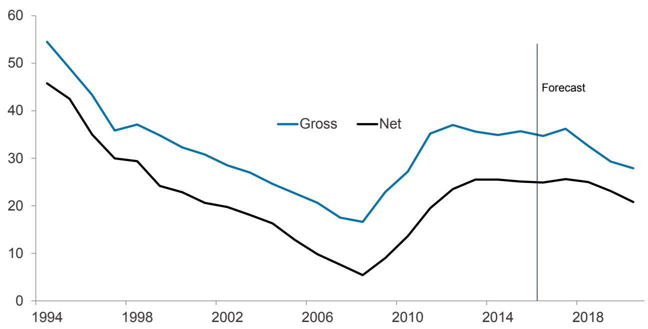
Source: ABS

- Australia's GDP growth was 1.1% in the first quarter of 2016, leaving annual growth at 3.1%, well above the estimates for trend growth and economists' forecasts of 0.8%.
- Net exports contributed significantly to growth thanks to stronger resource volume exports and a fall in imports. Household spending also made a solid contribution to Q1 growth, despite soft retail sales. Business investment detracted from growth.
- Q2 data to date has held up with building approvals moving higher, non-residential building activity up, business and consumer confidence more positive, the PMI in expansionary territory, the currency depreciating a little and the RBA cutting the cash rate. The RBA will be in no hurry to cut the cash rate again but an expectation for inflation to remain well below its target band means that further rate cuts are still on the table.

7. This is how you do fiscal consolidation

Crown debt

% of GDP



Source: New Zealand Treasury

- New Zealand's National-led Government brought down its eighth Budget in May. The overriding theme was one of continued expenditure restraint in an environment of solid economic growth. Projected rising Budget surpluses are forecast on the basis of nominal GDP forecasts that are at the optimistic end of the spectrum.
- This was very much a mid-term Budget with forecast budget surpluses, should they eventuate, providing greater choice in 2017's election-year Budget. In this Budget the Government chose to prioritise increased expenditure in core social services, innovation and infrastructure, as well as debt repayment.
- Choices open to the Government in Budget 2017 include spending in priority areas, debt repayment, tax reductions and/or restarting contributions to the NZSF. The mix of priorities could be compromised if growth forecasts don't meet Treasury expectations.

MARKET COMMENTARY

GLOBAL SHARES

Global equities were mixed over the month; developed markets finished 1.8% higher, while emerging market equities ended down 0.8%. Markets were weak initially as global growth concerns remained at the forefront of investor's minds. Stocks staged a mid-month rally as the bearish sentiment eased amid a rebound in commodity prices and weaker US data spurred speculation that the US Federal Reserve will further delay interest rate hikes. The uncertain outcome of the 23 June Brexit vote saw UK equity markets underperform its peers, with the FTSE ending relatively flat over the month. The Japanese market performed strongly, with the TOPIX rallying 2.9% over May. Japan's Prime Minister formally announced the delay of the second increase in its GST rate to October 2019. This marks the second delay in a two stage increase which was passed in 2012. US stocks finished in line with the global market, up 1.8%.

NEW ZEALAND SHARES

The New Zealand share market continued to be one of the strongest performing equity markets around the world, gaining 3.2% in May. Since the start of the year the S&P/NZX 50 Index is up 11.3% and 20.4% over the past 12 months. Orion Health continued to benefit from contract wins and was again the strongest performer, rallying 23.5% in May. This followed a gain of 20.2% in April. On the flipside, Sky TV was the laggard in the Index, ending 15.6% lower as its broadcasting model continues to come under pressure. Only 12 companies delivered negative returns over the month.

NEW ZEALAND LISTED PROPERTY

New Zealand listed property continued its strong performance, gaining 2.2% over May. Vital Healthcare and CDL Investments rallied strongly, gaining 8.9% and 7.8% respectively. Eight of the ten stocks in the S&P/NZX Real Estate Index experienced positive gains over the month. Domestic listed property has gained 9.3% year-to-date, 2.0% below the broader domestic market.

GLOBAL BONDS

Global bonds ended higher over May, led by sovereign bonds as longer dated yields fell. Yields fluctuated over the month, rising at the beginning of the month as the minutes of the late-April US FOMC meeting were released. Up until these minutes were digested the market had been discounting the odds of a rate hike. However, the minutes caused a reassessment, with the odds of a June hike more than doubled to 30%. The Barclays Global Aggregate Index returned 0.60% over May. Yields on the US 10-year Treasury closed the month at 1.85%, up two basis points (bps) over the month.

NEW ZEALAND BONDS AND CASH

New Zealand bond yields fell alongside their global counterparts over the month. Despite the unemployment rate rising to 5.7% in March, which was higher than most anticipated, the domestic labour market looks in good shape. The rise in the unemployment rate was the result of growth in the workforce combined with an increase in the participation rate which reversed some of the decline from the previous few quarters. That saw the labour force rise a spectacular 1.5% in the quarter. Given the stronger labour market, all eyes will be on the RBNZ's decision at its upcoming meeting on 9 June. The 90 Day Bank Bill yield ended May 2 bps higher at 2.43%, while the 10-year NZ Government bond yield ended down 24 bps at 2.61%.

COMMODITIES

Thanks to a mid-month rally, the Bloomberg Commodity Index ended flat over the month. Sugar and heating oil led the way forward. However, these were offset by large falls in precious metals. Crude oil continued its recovery, with West Texas Intermediate (WTI) climbing 6.7% over the month to settle just under US $50 per barrel. Dairy prices showed some gradual improvement with the NZ Global Dairy Trade auction gaining 4.6%.

GLOBAL LISTED PROPERTY & INFRASTRUCTURE

Global listed property moved in line with the broader equity market, ending up 2.0% over the month of May. Global listed infrastructure, although the asset class also ending in positive territory, lagged the broader equity market, ending up 0.9% over May.

NEW ZEALAND DOLLAR

The New Zealand dollar (NZD) was mixed against the major currencies, being stronger against the Australian dollar and Japanese yen, but weaker against the US dollar, euro and British pound. On an MSCI weighted basis, the NZD was down over the month by 2.2%. The NZD ended May 3.1% weaker against the US dollar at 0.6763.

	AS AT 30 APRIL 2016	CHANGE OVER THE MONTH (%)	CHANGE OVER THE YEAR (%)
MSCI - US	8214.23	+1.8	+1.0
MSCI - UK	12013.79	+0.2	-7.8
MSCI - Germany	3210.77	+2.3	-9.5
MSCI - Japan	1732.42	+2.6	-17.7
S&P/NZX 50	7039.41	+3.2	+20.4
MSCI - World (local curr.)	4934.77	+1.9	-3.7
MSCI - World (NZD)	9603.64	+3.8	+1.5
NZ Official Cash Rate	2.25	0 bps	-125 bps
NZ 90-day bank bill yield	2.42	2 bps	-105 bps
NZ 10-year bond yield	2.58	-28 bps	-110 bps
US 10-year bond yield	1.85	1 bps	-28 bps
NZD-USD	0.6763	-3.1	-4.8
NZD (TWI)	73.5	+0.0	-1.8
NZD (MSCI weighted)	74.5	-1.9	-5.1