Economic Update

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Market Highlights – June 2015

- US economic indicators improved as consumer spending rebounded from earlier weakness.
- Bond yields rose as expectations solidified that the US Federal Reserve (Fed) would commence raising rates this year.
- Global shares fell on the back of rising yields and, later in the month, concerns over Greece.
- The Australian dollar (AUD) rose modestly against the US dollar (USD) but eased lower against other major currencies.

Economic

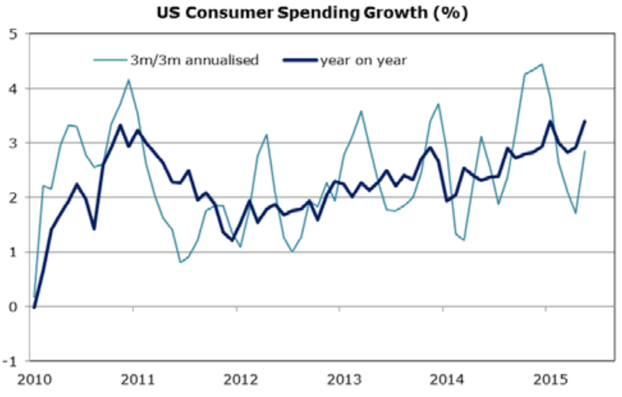
June saw a clear rebound in consumer spending in the US following the weather induced weakness seen earlier in the year. Alongside the continued strength in the labour market and improved housing activity indicators, this solidified financial markets expectations that the Fed would commence raising rates at some stage later this year. This occurred despite the fact that the latest Fed meeting indicated that the pace of rate rises may not be as quick as the Fed previously expected.

Elsewhere, the Australian economy grew at a faster pace in the March quarter. However the composition of growth was poor, with domestic spending stalling. Meanwhile Chinese policymakers continued to ease policy to support the economy, including a further 25 basis points (bps) interest rate cut.

Finally, concerns about Greece intensified late in the month as negotiations between Greece and its creditors broke down. This prompted the Greek Prime Minister to announce a referendum so the Greek people could decide whether to accept further budget cuts, and they voted against it. This raised the possibility that the Greek economy might exit the euro zone (Grexit).

Bonds

Government bond yields rose strongly again in June following the sharp rise seen in the prior two months. This saw international fixed income post a negative return of 1.2% in the month. In June a significant driver was rising expectations that the Fed would commence raising rates this year. Concerns over Greece saw a flight to perceived safe assets late in the month which saw government bond yields fall. Even with this yields finished clearly higher, with US 10 year bond yield rising 23bps to 2.42%. Peripheral bond yields rose to a greater extent given the Greek situation, though the size of the move was relatively minor compared to other episodes. It was a broadly similar story for Australia, with Australian fixed income posting a negative return of 0.9%.



Source: Thomson Reuters Datastream, ANZ Global Wealth

Financial Services Partners Pty Ltd
Level 23, 242 Pitt Street, Sydney, NSW 2000, Australia
ABN 15 089 512 587 AFSL 237590
T 1800 006 216 W www.fspadvice.com.au

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Shares

Rising interest rates initially weighed on shares in June, with the largest impact being felt in Australian shares (which have been sought after previously due to their relatively higher yield) and emerging markets shares. The increase in concerns regarding Greece weighed on shares late in the month, with European shares in particular moving lower.

Global developed market shares fell 2.8% in hedged AUD terms in June. While most markets lost ground, there was an especially large decline in Europe reflecting concerns over Greece. UK shares also had a disappointing performance given the heavy weighting to financial stocks which performed poorly in response to the rise in global interest rates.

Australian shares underperformed global developed shares as rising interest rates and falling earnings continued to weigh on bank shares. The ASX300 returned negative 5.3% in June on a total return basis. Emerging market shares fell 3.2% in USD terms in June, as most markets came under pressure from expectations of a rate rise in the US. Chinese shares dropped 7% in local currency terms as the previous sharp rise in shares continued to unwind.

Currencies

The Australian dollar rose 0.8% against the USD at US77.1c. This reflected a softening in the USD, with the AUD actually falling modestly against most other currencies.

Major asset class performance as at 30 June 2015 (%)

Sector	1 month	3 months	12 months	5 Years
Australian Shares	-5.3	-6.5	5.6	9.5
Global Shares (hedged)	-2.8	-0.3	9.1	14.6
Global Shares (unhedged)	-2.7	-0.1	25.2	15.4
Global Emerging Markets (unhedged)	-3.0	0.1	16.5	5.7
Global Small Companies (unhedged)	-1.1	1.0	25.4	17.6
Global Listed Property	-4.4	-8.4	5.7	12.5
Cash	0.2	0.6	2.6	3.6
Australian Fixed Income	-0.9	-2.0	5.6	6.4
International Fixed Income	-1.1	-1.7	5.6	7.3

Source: JP Morgan & ANZ Global Wealth

Indexes: Australian Shares - S&P / ASX300 Accumulation, Global Shares (hedged/unhedged) - MSCI World ex Australia, Global Emerging Markets - MSCI Emerging Free Net in AUD (unhedged), Global Small Companies (unhedged) - MSCI World Small Cap ex Australia, Global Listed Property - FTSE EPRA/NAREIT Developed, Global Listed Property - FTSE EPRA/NAREIT Developed Rental Index ex Australia (hedged) with FTSE EPRA/NAREIT Developed Index ex Australia (hedged) used before April 2015, Cash - Bloomberg Bank Bill, Australian Fixed Income - Bloomberg Composite Bond All Maturities, International Fixed Income - Barclays Global Aggregate Bond Index (hedged).

Implications

The situation in Greece has the potential to add to uncertainty and with it volatility in the near term, especially as the Greek population have voted no to further austerity measures.

Outside of Greece, we remain of the view that the trends of pickup in euro zone growth and inflation are proving to be sustained. The combination of solid growth in global activity, low but positive inflation and continued extremely stimulatory monetary policy should remain a positive environment for growth assets. However, weakening economic growth along with share market weakness in China and an approaching hike by the Fed are sources of risk in the period ahead.

Events are unfolding quickly with regards to the Greece situation; this report contains information that is correct at the time of writing – current at 3 July 2015.

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T 1800 006 216 W www.fspadvice.com.au

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