EconomicUpdate

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Market Highlights – June 2015

- Euro zone growth increases as investment spending plans in Australia plunge
- Global shares rose on positive economic news though emerging markets struggled
- Bond yields rose as markets continued to price out the risk of deflation
- The Australian dollar (AUD) fell as the US dollar (USD) reversed the weakness seen in April

Confirmation of pickup in euro zone growth

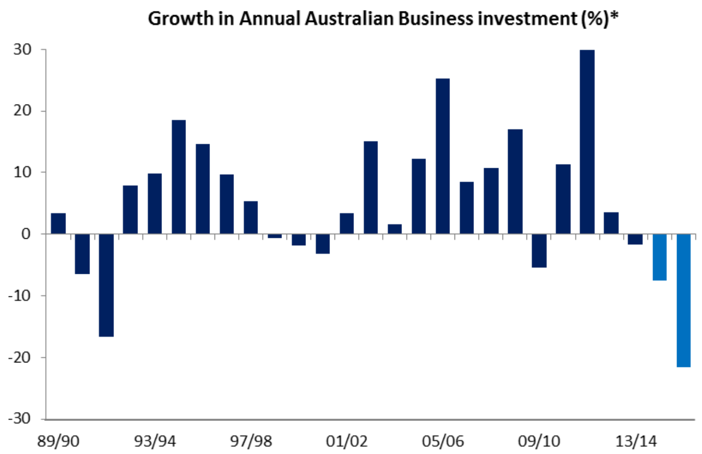
There was confirmation of the pickup in euro zone economic activity in May. The region grew by 0.4% in the March quarter, clearly above its potential growth rate. Forward looking indicators, while consolidating in May, point to continued growth in the region, further reducing concerns over the potential for a period of sustained deflation. At the same time, there were some quite positive indicators of a pickup in US housing activity. This raised hopes over the growth outlook after the disappointing, partly weather induced, decrease in activity in the March quarter.

Australian business investment plans weakened to levels only seen previously during recessions.

Elsewhere, poor economic data in China saw policymakers continue to ease policy with a further 25 basis points (bps) interest rate cut. There are some positive signs of stabilisation in the beleaguered property market, raising hopes that the Government will be successful in preventing a more worrying slowdown in growth momentum. Meanwhile in Australia, though a more electoral friendly Budget boosted consumer sentiment, business investment plans weakened to levels only seen previously during recessions.

Shares

The positive economic news helped drive a solid 1.4% gain in global developed shares in hedged AUD terms in May. While most markets posted gains, the result was underpinned by a 5% rise in the Japanese index, in local currency terms, as the companies were judged as benefiting from a renewed decline in the Japanese Yen. While there was only limited progress made by Greece in its attempts to resolve its debt situation, this had limited impact on financial markets on the whole.



Source: ABS, ANZ Global Wealth

* Figures for the 2014/15 and 2015/16 financial years are estimates based on business plans

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Emerging market shares fell 4.2% in USD terms in May, as most markets consolidated following the strong gain seen in April. This included Chinese shares, where the China MSCI index fell 3.9% in local currency terms. Australian shares also underperformed global developed shares, as rising global bond yields and falling earnings weighed on bank shares. The ASX300 returned 0.4% in May on a total return basis.

Bonds

It was a month of two halves for bond markets. Global government bond yields rose initially following the sharp rise seen in the latter part of April, as markets continued to price out the risks of deflation in Europe. However, as the month wore on, yields retreated somewhat to finish up only moderately. For instance, German 10 year bond yields finished the month 12bps higher at 0.49%, after reaching a high of 0.72% during the month. This still saw international fixed income post a negative return of 0.3% in the month. It was a broadly similar story for Australia, though the weak investment report held down shorter dated bond yields as markets saw a higher possibility of a further rate cut by the Reserve Bank of Australia (RBA). This saw Australian fixed income post a return of 0%.

Currencies

The USD rose in May, reversing part of the weakness seen in April. A lift in housing activity and comments by the US Federal Reserve (Fed) Chairperson Janet Yellen were seen as indicating that the Fed was still likely to raise rates this year. The AUD fell against most currencies after the rise seen in April, finishing the month 3.3% lower against the USD at US76.5c. The fall in the AUD boosted the returns of global shares in unhedged AUD terms in the month.

Major asset class performance as at 31 May 2015 (%)

Sector	1 month	3 months	12 months	5 Years
Australian Shares	0.4	-1.3	9.9	10.1
Global Shares (hedged)	1.4	2.2	14.0	16.7
Global Shares (unhedged)	3.5	3.5	29.2	15.1
Global Emerging Markets (unhedged)	-1.1	4.2	21.6	6.0
Global Small Companies (unhedged)	4.6	5.0	30.2	16.4
Global Listed Property	-0.7	-2.8	11.5	12.9
Cash	0.2	0.6	2.6	3.7
Australian Fixed Income	0.0	-0.3	7.5	6.9
International Fixed Income	-0.3	0.2	7.3	7.8

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

Confirmation of a pickup in euro zone growth and inflation with signs that these trends are proving more sustained than analysts had expected has important implications for investment markets. In our view, this potentially leaves financial markets at an important turning point post the Global Financial Crisis. 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, we caution that with valuations relatively full, returns are likely to prove more moderate and more volatile than that seen in recent years, especially once the Fed commences the process of gradually raising interest rates.

Meanwhile, we expect global bond yields to continue to rise from here, though continued bond purchases in Japan and Europe should keep yields at reasonably low levels. In Australia, we think bond yields will outperform its global counterparts given the still uncertain outlook for the domestic economy and potential for further rate cuts by the RBA.

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