Market View

September 2014

Read the latest market update from the Economic and Market Research team at Colonial First State Global Asset Management.

Market and economic overview

Australia

- The Reserve Bank of Australia (RBA) held the cash rate steady at 2.5% at its 2 September 2014 meeting. There was no change to the Board's neutral policy 'guidance' and signal that there is likely to be "a period of stability in interest rates". The RBA has now left interest rates on hold at 2.5% for 13 months.
- There was limited new information released in the accompanying statement to the meeting. However in the minutes to the meeting, the semi-annual Financial Stability Review and remarks by Governor Glenn Stevens at the Melbourne Economic Forum, the RBA raised further concerns about the housing market.

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- The RBA Minutes stated "for investors in housing, the pick-up in housing credit growth had been more pronounced than for owner-occupiers, with investor demand particularly strong in Sydney and, to a lesser extent, Melbourne".
- "Members further observed that additional speculative demand could amplify the property price cycle and increase the potential for property prices to fall later. The main risks in such a scenario would likely be to the stability of the macro-economy rather than the financial system, particularly if households were to react to declines in their wealth by cutting back on their spending".
- This raised discussion over the month on whether the RBA in conjunction with the Australian Prudential Regulation Authority (APRA) will look at introducing new macro prudential tools to cool the housing market, with a focus on the investor segment in particular. The discussion is ongoing.
- Q2 2014 GDP was released with growth of 0.5% recorded for the quarter, taking annual growth to 3.1% from 3.4% per year in Q1 2014.
- The main contributors to growth were Inventories (+0.9%pts), Household consumption (+0.3%pts) and Private gross fixed capital formation (+0.3%pts). Offsetting this was net exports which detracted

-0.9%pts after its strong contribution in Q1 2014.

- The unemployment rate fell in August from 6.4% to 6.1%. There were 121,000 jobs created over the month, the strongest monthly gains since the series begun in 1978. Part-time jobs rose 106,700 and the participation rate also from to 65.2% from 64.9%. This is the second month in a row where the labour market data has surprised the market with outsized moves. This continues to raise interpretation issues, with sampling issues and methodology changes the likely cause of the sharp increase in jobs.

United States

- As widely expected, the Federal Open Market Committee (FOMC) of the US Federal Reserve announced a further $US10bn 'tapering' in the QE3 bond purchase program at its 16-17 September 2014 meeting. This takes monthly purchases down to just $US15bn.
- The Fed remains on track to deliver a final $US15bn taper in the QE3 bond purchase program at the 28-29 October FOMC meeting.
- In the accompanying statement the Fed noted that "if incoming information broadly supports…expectations of ongoing improvement in labour market conditions and inflation moving back toward its longer-run objective, the Committee will end its current program of asset purchases at its next meeting".
- In addition, the Fed has laid out its "Policy Normalization Principles and Plans" at the FOMC meeting. The plan is to gradually raise the Fed Funds target rate inside a range bound by the Interest on Excess Reserves (IOER) and the Reverse Repo program (RRP). The end to coupon reinvestment on the $US4.4tr in securities the Fed has on balance sheet will occur after rate hikes have begun. And outright sales of some of the $US4.4tr securities on balance sheet are not on the agenda.
- The Fed has maintained its view that "it will likely be appropriate" to hold the Fed Funds rate near zero for a "considerable time after the asset purchase program ends."
- US employment was weaker than expected in August (data released in September). Payrolls rose 142,000 and were the weakest number since December 2013. The unemployment rate did fall to 6.1% from 6.2% and remains at its lowest point since September 2008.

Europe

- The European Central Bank (ECB) cuts its main refinancing rate by 10 basis points to just 5 basis points at its 4 September 2014.
- The inflation estimate for September was recorded at 0.3% per year, compared to 0.4% per year in August. This is its lowest level in five years and is largely due to falling energy prices compared to 12 months ago.
- Unemployment held steady at 11.5%, unchanged from July and down from its peak of 12% in September 2013.

United Kingdom

- The Bank of England (BoE) left policy unchanged at its 4 September 2014 meeting, as expected. There were again two dissenters of the nine member Board, same as August. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn.
- GDP data for Q2 14 was revised up with the UK economy growing by 0.9% per quarter and 3.2% per year with business investment growing 3.3% per quarter helping broaden and deepen the recovery.

New Zealand

- The Reserve Bank of New Zealand (RBNZ) left its official cash rate on hold at 3.5% at its 11 September 2014 meeting, as expected.
- The RBNZ is now in "pause" mode. Having raised the Official Cash Rate (OCR) by a total of 100bps, to 3.5%, from March to July 2014, the RBNZ noted in their 11 September "Monetary Policy Statement" that "in order to better assess the moderating effects of the recent policy tightening and export price declines, it is prudent to undertake a period

of monitoring and assessment before considering further policy adjustment."

- The Q2 2014 National Accounts released 18 September, showed growth on the quarter of 0.7% per quarter, down from 1.0% per quarter recorded in both Q4 2013 and Q1 2014. Annual growth rose to 3.9% per year from 3.8% per year to March 2014.

Canada

- The Bank of Canada left its overnight lending rate on hold at 1.0% at its 4 September 2014 meeting.
- GDP slowed to 2.5% per year for data to July 2014, down from 3.1% per year, driven by a fall in oil and gas production.

Japan

- The Bank of Japan's (BoJ) policy board convened on 4 September 2014 and decided by unanimous vote to leave current monetary policy settings unchanged, as expected. The BoJ will continue to carry out money market operations so that the monetary base increases by around ¥60-70trn a year.
- The quarterly Tankan index was released with the large manufactures index rising 1 point to 13, however for large non-manufacturers fell by 6 points to 13, with the fall largely driven by the increase in the consumption tax.

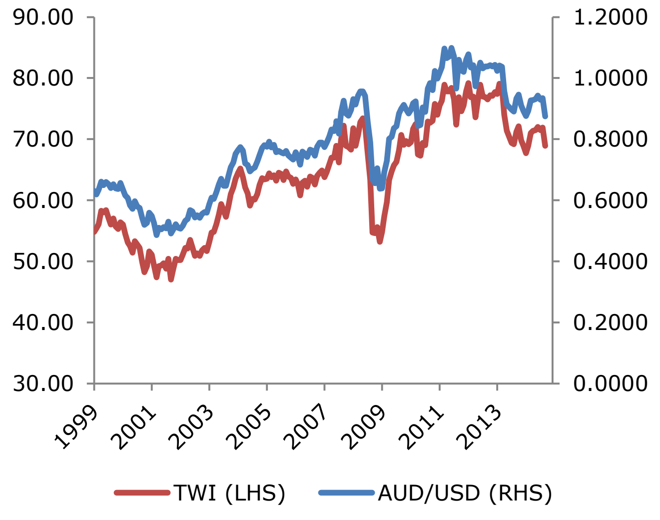
China

- There were signs of stabilisation in China's economy in September after fading momentum in August, however concerns over the pace of growth in China remain. The official Manufacturing Purchases Managers Index held steady at 51.1 while the HSBC China Manufacturing Index fell slightly, to 50.2 from 50.5.
- Property prices continued to weaken with prices in 68 out of 70 cities falling in August, compared to 64 out of 70 in July. The weakness in the residential property market prompted policy makers to ease property restrictions for the first time since the GFC. The People's Bank of China (PBOC) has lowered down-payments and mortgage rates for those applying for a loan to buy a second home. It was also announced that people applying for mortgages to buy a second home may be treated as first-time home buyers as long as they have paid off their previous mortgage. These new policies are a response to the weaker property market data evident in recent months.

Australian dollar

- The Australian dollar (AUD) fell sharply in September, down by 6.4% per month to finish September at $US0.8746, the lowest level since January 2014. The Australian dollar retreated on concerns over weaker China data and iron ore price weakness. There were concerns over the Australian housing market and the possibility of new macro prudential tools to be introduced.
- However USD strength was a key factor for the falls, with the US Dollar Spot Index, rising 3.9% in September with growing expectations of the first rate hike by the Federal Reserve in June 2015 as well as the pace of tightening in 2015 and 2016.

AUSTRALIAN DOLLAR FALLS SHARPLY



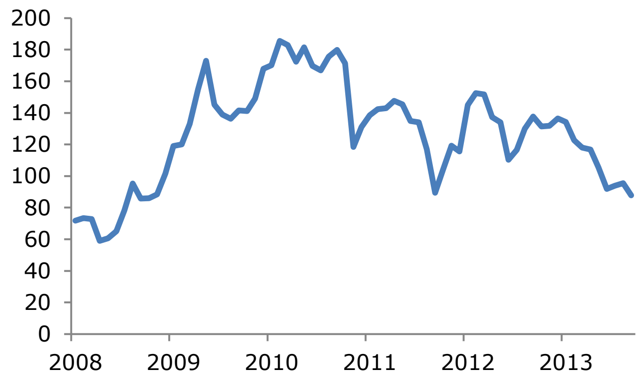
Source: Bloomberg as at 30 September 2014. Past performance is not an indication of future performance.

Commodities

- Commodity prices general fell further in September, with falls assisted by the rising US dollar and supply gains in some key commodities.

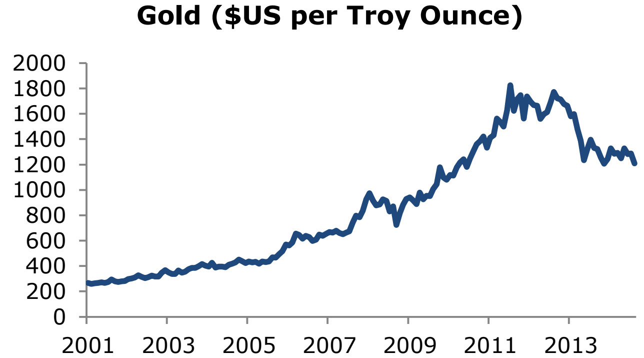
- The wheat price fell 13.2% and is down 35% since its peak in May. Strong supply is expected given favourable weather in North America and Europe over their summer. Soybeans fell 10.8% and corn was down 12.1%.
- Metal prices continued to fall in September. The iron ore price fell 11% and is now down 39% since the start of 2014. Continued concerns over China's property market and rising supply of iron ore, particularly in Australia has seen the price fall. Other metal prices also fell including; nickel (-13.2%), aluminium (-6.5%), lead (-6.3%), copper (-4.5%)
- The oil price (West Texas Crude) fell 4.1% in the month to $US91.16 a barrel and is now down 2.0% over the year with the rise of shale oil production in the US.

IRON ORE PRICE FALLS ON CONCERNS OVER CHINA



Source: Bloomberg as at 31 August 2014

GOLD LOWER



Source: Bloomberg as at 31 August 2014. Past performance is not an indication of future performance.

Australian shares

- Anticipation of the removal of Quantitative Easing in the US, a stream of inconsistent economic data and ongoing geopolitical concerns dampened sentiment towards share markets globally in September.
- Australian shares followed the lead of other global equity markets and lost ground. The S&P/ASX 200 Accumulation Index declined by 5.3% over the month.
- Weakness of the Australian dollar relative to other currencies meant returns for overseas investors were worse still. Currency weakness appeared to prompt some overseas investors to short sell Australian equities, which exerted further downward pressure on the market.
- Stocks in the banking sector were affected by regulatory concerns. Recommendations from the Financial System Enquiry are due before the end of the year and could affect capital requirements for Australian banks.
- Materials stocks also struggled, partly reflecting the subdued tone of economic data in China. This prompted questions over the sustainability of demand for bulk commodity exports and weighed on commodity prices. The iron ore price, for example, declined by nearly 12% over the month.
- Defensive areas of the market – such as health care, utilities and telecoms – unsurprisingly outperformed in this environment.

Listed property

- The Australian listed property sector declined by 5.4% in September, following strong performance earlier in 2014. An improving US economy lent increased credence to the view that US interest rate may be raised earlier than had previously been assumed, raising bond yields and reducing investor demand globally for high yielding assets such as property securities.

Global shares

- Global developed equity markets were mixed in September, driven lower by geopolitical risks, growing expectations of the normalisation of monetary policy in the US, but at the same time buoyed by further policy action in Europe. US dollar strength was a major theme over the month, impacting returns. The US dollar spot index finished the month at its highest level since June 2010.
- The MSCI World Developed Markets Index fell 2.9% in USD terms but rose 3.8% in AUD given the falls in the AUD.
- In the US the S&P 500 Index reached an all-time high on 18 September, but then fell through to the end of the month post the Federal Reserve meeting. New forecasts by the Fed Board raised the median Fed Funds rate expected in 2015 and 2016.
- Overall the S&P 500 fell 1.6% for September, while the Dow Jones Index was down 0.3% and the NASDAQ was down 1.9%.
- Equity markets in Europe were stronger in all countries, with the Germany the exception, returning flat growth. Further credit easing measures and lower rates announced by the European Central Bank buoyed markets. The euro fell 3.8% against the US dollar over the month, and is now at its lowest level since September 2012. Equity markets in Spain (+0.9%), France (+0.8%) and Italy (+2.2%) all rose.
- The Japanese Nikkei 225 rose 4.9% and benefitted from a weaker JPY against the USD. Falling 5.3% in September.

Global emerging markets

- Emerging market (EM) equities fell heavily in September weighed down by US dollar strength and country specific issues. The MSCI EM Index returned -7.6% in USD terms and -1.0% in AUD terms. This return did hide considerable divergence between regions and countries.

Need more information?

Please speak with your financial adviser or visit our website at colonialfirststate.com.au. Alternatively, you can call us on 13 13 36.