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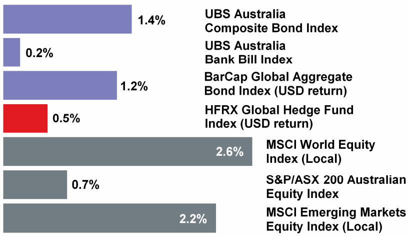
Private View

June 2014

May 2014



What's changed in May?

Global equities were generally higher in May despite some mixed economic reports and continued geopolitical tensions in South East Asia and Ukraine:

- Developed market shares rose 2.6% with Hong Kong shares 5.4% higher, German shares up 3.5%, while shares in New Zealand fell 1%. Australian shares returned 0.7%, including dividends
- Emerging market equities lost 2.2%, with gains of 8.8% in India following the election there
- 10-year government bond yields fell in Australia, US, UK, Japan and Germany
- Investment grade credit spreads narrowed by three basis points over the month to 111 basis points
- The US Dollar was slightly weaker against the British Pound, Yen and Euro, while the Australian Dollar rose by US 0.3 cents
- Gold prices fell by US$40 an ounce to US$1,250 and WTI crude oil rose by US$3 a barrel to US$103 a barrel at the end of May

Macro monitor

In the United States, the S&P 500 index finished the month at a record high. Investors shrugged off global risk points, including tensions in Eastern Europe and China, to focus on an improving US economy. While the US March quarter GDP proved to be soft, reflecting the very poor weather and an inventory drawdown, recent economic indicators were more supportive. Employment grew strongly and consumption, manufacturing and housing start indicators all beat consensus forecasts.

Generally, European equities grew more modestly over the month. Growth remains sluggish and private credit growth continues to contract. Very low inflation prompted expectations of more accommodative monetary policy, which has now been delivered.

Australian data was a little mixed, with softer-than-expected retail sales and private capital expenditure largely being offset by continued strong employment growth. The Australian budget set a sombre tone for most of the month, with the Coalition announcing the most restrictive budget in years. While measures had been broadly negative for consumer confidence, one of the few implications was on healthcare, with proposed Medicare co-payments. Elsewhere, share price performance was mixed with resources weak and banks moderately positive overall.

By James Wright, Chief Investment Officer (CIO), JBWere

Positioning

We retain an overweight recommendation in global equities. Valuations are not cheap, but nor are they overly expensive on most measures. Global economic growth is expected to improve, which should support growth in earnings and allow for share prices to move higher without the need for further P/E multiple expansion.

Information technology and healthcare have been the top performing sectors over the past twelve months, and we believe out-performance can continue as relative valuations are still attractive, and earnings growth is supported by longer term secular trends. At a stock level, we consider US-listed IT stocks to be particularly attractive.

Some commentators argue the US market is expensive compared with Europe. The basis for this view is that US margins are at high levels, and valuations are full on "normalised" earnings. In contrast, earnings remain depressed in Europe and as the economy improves there is ample scope for margin expansion. While we agree that there is more cyclical upside in Europe if the economic recovery proceeds smoothly, there is also greater risk that earnings could disappoint.

Rather than trying to time the cyclical rebound, we prefer the risk/reward of quality companies offering structural growth. With the US recovery more established and broadly-based, we have greater confidence US earnings growth can be realised. This justifies the slight valuation premium in the US.

The uncertainty around European earnings was demonstrated by 2013 results. In late 2012, analysts were forecasting double digit earnings per share growth for both Europe and the US. While the US ultimately grew by 7%, Europe's declined by 5% as the economy stagnated. As 2014 has progressed, the initially very bullish estimates for 2014 European earnings have declined.

By James Wright

Summary of policy developments

ECB introduces negative rates – The European Central Bank cut interest rates to increase inflation and will now charge banks 0.1% per annum for certain deposits. It also introduced a €400 billion funding scheme to stimulate bank lending to non-financial private borrowers.

Australia tightens budget – the Australian Government announced a tightening in fiscal conditions with broad-based expenditure cuts aimed at returning to surplus over 5 years.

Currency corner

The Australian Dollar was relatively flat over the whole of May, with a peak of US$0.9410 and low of US$0.9203 for a monthly rise of 0.3% relative to the US Dollar.

There has been a large amount of macroeconomic data in recent weeks, which would normally have the Australian Dollar moving. However, market volatility is presently at its historical lows, across all asset classes, including foreign exchange and the Australian Dollar specifically. The Australian Dollar has remained in very tight ranges, while financial markets fail to respond to the news about the macroeconomic environment.

One of the consequences is that the Australian Dollar is not responding to data releases in the same way it would normally do. The response of the Australian Dollar – US Dollar exchange rate on the day of the data release (for the year to date), is mostly lower than average. This is not to say that the macroeconomic environment is not important to the currency, just maybe not in the immediate future. It may be that beyond the mass of data to be released, the Australian Dollar remains in the tight US$0.92-0.94 range.

Looking beyond the economic data, there are a number of other factors driving the Australian Dollar. Our valuation model for the Australian Dollar is holding at relatively high levels due to the low volatility, which increases its attractiveness to foreign investors borrowing in lower yielding currencies to invest in Australian bonds. The model is currently showing that the "fair value" is now at US$0.94

Another factor is iron ore. Iron ore makes up 33% of Australia's commodity exports and thus has a significant influence on the terms of trade, so a divergence between the terms of trade and Australian Dollar is only sustainable for short periods of time. So while we acknowledge the strategic downside pressure on the Australian Dollar over time, we do not expect the adjustment to be rapid near term; unless the global environment starts to re-price risk and volatility rises.

By Nick Ryder, Investment Strategist, NAB Private Wealth

Australian Dollar and the Iron Ore Price

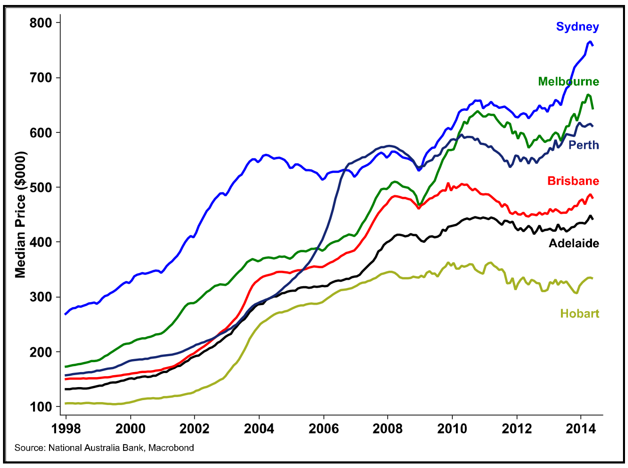
Housing update

Australian dwelling values recorded their first monthly decline since May 2013, falling 1.9% over the month. Most of the capital cities recorded a price fall with Melbourne prices down by 3.6%, Sydney prices fell 1.1% and Brisbane's were 1.3% lower in May. Prices across the five largest capital cities are up only 1.9% since the beginning of the year, and 10.9% over values a year ago.

Based on seasonal trends, April and May are usually weak months for prices, and this year's combined fall of 1.6% over these two months is less than the 1.7% fall over the same period in 2013 and the 2.1% fall seen 2012.
Other indicators of housing activity paint a picture that while activity may have eased in recent months, after the stronger conditions late last year, the cyclical recovery in housing remains intact. For example, auction clearance rates remain resilient in both Sydney and Melbourne, although running at a modestly softer pace than the most recent peak in September last year. Another indicator of activity: housing credit growth was up 0.6% in April (6.1% year-on-year), again led by investor borrowing which was up a solid 0.8% in April and 8.2% year-on-year. Housing credit growth has been running at a steady 0.5-0.6% per month since September 2013 so there's been no slowdown nor any acceleration that would worry the RBA in terms of a credit-fuelled house price bubble.

By Nick Ryder

Australian Capital City Dwelling Prices



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Global performance markets monitor – 30 May 2014

	Last Price / Level	1 Month	3 Month	Year to date	1 Year	2013	2012
Global Equity Markets Performance							
Australia - ASX200	5492.5	0.7	2.8	4.6	16.4	20.2	20.3
Japan - Nikkei 225*	14632.4	2.3	-1.4	-10.2	7.7	56.7	22.9
Japan - TOPIX	1201.4	3.4	0.1	-6.8	8.0	54.4	20.9
Hong Kong - Hang Seng	23081.7	5.4	2.7	0.7	6.9	6.6	27.5
Shanghai Composite (A&B)*	2039.2	0.6	-0.8	-3.6	-12.0	-6.7	3.2
Singapore - STI*	3295.9	1.0	5.9	4.1	-1.2	0.0	19.7
New Zealand - NZX50**	5178.4	-1.0	3.8	9.3	15.8	16.5	24.2
US Dow Jones	16717.2	1.2	3.0	1.9	11.7	29.7	10.2
US S&P 500	1923.6	2.3	4.0	5.0	18.7	32.4	16.0
NASDAQ*	4242.6	3.1	-1.5	1.6	21.5	38.3	15.9
Canada - TSX	14604.2	-0.2	3.5	8.5	18.1	13.0	7.2
Mexico - MSCI*	39220.3	1.1	5.7	-3.9	0.6	-1.2	18.2
India - Sensex*	7181.3	8.8	16.8	15.4	19.0	6.5	30.6
Brazil - Bovespa**	51239.3	-0.8	8.8	-0.5	-6.2	-15.5	7.4
UK - FTSE100	6844.5	1.4	1.8	3.2	6.6	18.7	10.0
France - CAC40	4519.6	2.3	4.7	7.4	16.9	22.2	20.4
Germany - DAX**	9943.3	3.5	2.6	4.1	18.4	25.5	29.1
Spain - IBEX	10798.7	3.8	8.1	11.0	34.6	27.8	2.8
Italy - MIB	21629.7	0.8	7.5	15.9	28.5	20.5	12.2
World/Regional Indices Performance							
MSCI World (Loc)*	4501.3	2.6	3.4	4.3	16.5	29.6	16.4
MSCI World Value	2546.9	0.8	3.3	3.7	14.2	23.3	12.1
MSCI World Growth	1865.1	2.4	1.5	2.8	15.8	24.9	14.2
MSCI AC Europe*	1086.6	2.7	3.7	6.1	14.1	21.2	16.5
MSCI Asia ex Japan USD*	568.8	3.7	5.2	3.1	4.0	0.7	19.4
MSCI Emerging Markets Local	47746.3	2.2	4.0	1.2	2.6	0.9	13.9
World EPRA/NAREIT Property USD*	4068.4	3.2	6.6	10.7	8.9	4.4	28.7
World/Regional Indices Performance							
MSCI World Cons Discretionary	178.9	2.5	-1.1	-1.2	14.8	38.3	21.4
MSCI World Cons Staples	198.2	1.5	5.7	4.2	9.1	19.2	10.2
MSCI World Energy	296.2	0.8	9.0	8.3	15.4	16.0	-1.5
MSCI World Financials	103.1	1.2	2.4	1.5	12.1	24.5	25.6
MSCI World Health Care	183.9	1.9	0.0	7.0	20.4	34.8	14.6
MSCI World Industrials	204.6	2.0	2.5	1.7	17.9	30.2	13.3
MSCI World Materials	248.3	1.2	1.2	3.8	10.2	1.6	9.1
MSCI World Telecommunications Serv	72.7	2.3	3.1	1.1	16.6	26.8	2.0
MSCI World Utilities	120.8	0.1	4.9	10.2	12.2	9.3	-2.2
MSCI World Information Technology	128.2	3.6	2.2	4.7	21.1	28.5	10.0
Global Rates Levels Change							
AUS - 10Y Govt	3.67	-0.30	-0.36	-0.57	0.24	0.96	-0.51
AUS - 3Y Govt	2.86	-0.17	0.01	-0.12	0.21	0.29	-0.46
AUS - 5Y Swap Rate	3.38	-0.22	-0.25	-0.42	-0.02	0.43	-0.95
AUS - 3Y Swap Rate	2.97	-0.15	-0.12	-0.28	-0.03	0.27	-0.95
AUS – 1Y Swap Rate	2.68	-0.05	0.05	0.05	0.00	-0.17	-1.07
AUS - 3 Month Bill Rate	2.84	-0.01	0.09	0.04	-0.13	-0.33	-1.77
US - 30Y Govt	3.33	-0.13	-0.26	-0.64	0.05	1.01	0.06
US - 10Y Govt	2.48	-0.17	-0.17	-0.55	0.36	1.27	-0.12
US - 5Y Govt	1.54	-0.14	0.04	-0.21	0.53	1.02	-0.11
US - 2Y Govt	0.38	-0.04	0.05	-0.01	0.08	0.13	0.00
US - TIPS 10Y	0.24	-0.23	-0.24	-0.54	0.33	1.51	-0.63
US - 10Y Breakeven	2.23	2.18	2.17	2.25	2.21	2.49	1.98
Bund - 30Y Govt	2.25	-0.09	-0.23	-0.50	-0.13	0.59	-0.20
Bund - 10Y Govt	1.36	-0.12	-0.27	-0.59	-0.15	0.64	-0.52
Bund - 5Y Govt	0.43	-0.13	-0.25	-0.49	-0.10	0.63	-0.45
Bund - 2Y Govt	0.07	-0.08	-0.06	-0.14	-0.02	0.24	-0.17
Gilt - 30Y Govt	3.39	-0.05	-0.12	-0.28	0.15	0.58	0.04
Gilt - 10Y Govt	2.57	-0.09	-0.15	-0.46	0.60	1.20	-0.14
Gilt - 5Y Govt	1.87	-0.06	0.25	0.01	0.97	1.00	-0.20
Gilt - 2Y Govt	0.67	-0.01	0.16	0.10	0.29	0.24	0.00
JGB - 30Y Govt	1.69	-0.03	0.04	-0.05	-0.13	-0.25	0.07
JGB - 10Y Govt	0.58	-0.05	-0.01	-0.16	-0.31	-0.07	-0.19
JGB - 2Y Govt	0.18	-0.02	-0.01	-0.07	-0.22	0.06	-0.16
Global Currency & Commodity Levels Change							
AUD/USD	0.9309	0.0026	0.04	0.04	-0.03	-0.15	0.02
EUR/USD	1.3630	-0.02	-0.02	-0.01	0.06	0.06	0.02
GBP/USD	1.6750	-0.01	0.00	0.02	0.15	0.03	0.07
JPY/USD	101.78	-0.46	-0.02	-3.52	1.06	18.56	9.80
NZD/AUD	1.0956	0.02	0.03	0.01	-0.10	-0.17	-0.06
Gold (USD Spot)	1250.69	-40.60	-75.10	45.75	-162.56	-469.40	110.54
WTI Crude (USD Spot)	103.40	3.33	0.52	5.23	9.83	6.34	-7.00
GSI Commodity Index	4999.62	-0.18	0.71	3.52	7.15	-1.22	0.08
Volatility Index (VIX) USD	11.40	-2.01	-2.60	-2.32	-3.13	-4.30	-5.38