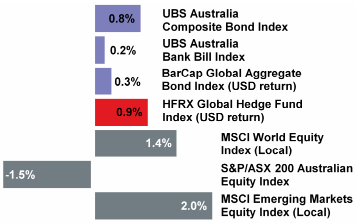
nabprivatewealth

Private Wealth View

July 2014

June 2014



What's changed in June?

Global equities were generally higher in June with gains in the United States offset by small declines in Europe:

- Developed market shares rose 1.4% with Canadian shares 4.1% higher, while European equities fell 0.8%. Australian shares were 1.5% lower
- Emerging market equities gained 2%, with another strong rise of 5.4% in India following the elections there in May
- 10-year government bond yields fell in Australia and Germany but were higher in the US and UK
- Investment grade credit spreads narrowed by two basis points over the month to 109 basis points
- The US Dollar was slightly weaker against the British Pound, Yen and Euro while the Australian Dollar rose by US 1.2 cents
- Gold prices rose by US$77 an ounce to US$1,328 and WTI crude oil rose by US$2.70 a barrel in June, to US$106 a barrel

Macro monitor

Global equities ignored somewhat stretched valuations and geo-political events and continued the strong run into the end of the financial year. The global market (MSCI World Index) rose 1.4% in local currency terms to be up 22.4% over the year.

The United States S&P 500 index returned 2.1% in June to finish the month just short of the record high set earlier in the month. While the March quarter GDP was revised down further during June, other more contemporaneous economic releases were supportive of equities. Manufacturing and services surveys of activity were both up on the previous month, and employment continued to track well, with 217,000 jobs added in May, and the unemployment rate marginally better than expected at 6.3%.

European equity markets were down in June. Over the financial year, continental Europe was relatively strong, with Germany up 23.5% and France up 17.4%. Growth remains sluggish and the market is speculating that the ECB will be forced to introduce a version of quantitative easing. In the UK, the market grew a more modest 8.5% over the year as the economy strengthened and the market speculated on rate rises before the end of 2014.

The Australian equity market was softer in June, falling 1.5%. While the market was up 17.4% over the year, most of the gains were made early in the year, with the S&P/ASX 200 only up 3% over the last six months. The March quarter GDP was relatively strong, rising 3.5% year-on-year, with the largest contribution from export income and inventories, while the contribution from domestic demand continues to be relatively modest.

By James Wright, CIO, JBWere

Positioning

We continue to retain an overweight recommendation to global equities – particularly the US. We are encouraged by the improvement in the US economy which will flow through to corporate earnings. However, with the US market at all-time highs and valuations a little stretched, it is unlikely that investors will re-rate equities even higher. In Europe, growth has slowed more recently and we are increasing confident that that the authorities will need to adopt more stimulatory policy to encourage growth going forward. While valuations currently look a little expensive given the current economic climate, a policy-induced higher growth trajectory should support earnings over the next year.

The Australian Dollar is remaining persistently high. The RBA has clearly indicated that they think the currency is overvalued – stating that the currency is uncomfortably high for the traded goods sector. Long term models of the currency suggest that the Australian Dollar should be considerably lower, and that investors are underestimating the chance of a significant fall in the currency at some point. This lends further weight to our overweight unhedged international equity position.

We are more neutral on Australian equities as we head into this reporting season. While mining export volumes are improving and commodity prices have stabilised somewhat over recent months, the sector is still transitioning, and we are expecting some patchy results across the sector. The non-mining sector of the economy continues to struggle and we not expecting many positive surprises in FY2014 results.

Summary of policy developments

UK introduces macro prudential rules – To curb risk lending and a property bubble, the Bank of England introduced a 15% cap on the proportion of new loans that UK banks can write where the loan-to-income ratio is more than 4.5 times.

China adds stimulus – The People's Bank of China cut the level of reserves required to be held by Chinese banks that have a significant portion of their lending to the agricultural sector and smaller companies.

Currency corner

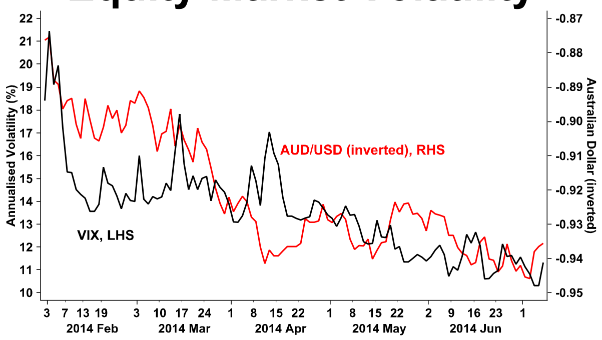
The Australian Dollar traded in a two cent range in June, with a peak of US$0.9447 and low of US$0.9230 for a monthly rise of 1.3% relative to the US Dollar. Over the month the US Dollar weakened slightly against the Euro, Pound and Yen as well as the Australian Dollar.

The RBA's June meeting minutes which were published on 17th June contained the line, 'It was difficult to judge the extent to which (low interest rates) would offset the expected substantial decline in mining investment and the effect of planned fiscal consolidation'. This saw the currency fall by around half a US cent mid-month only to recover back above US$0.94 after the Fed meeting in the United States which saw the US Dollar lose ground. The bounce in iron ore prices and decline in equity market volatility also supported the Australian Dollar over the month.

The main driver of currency support continues to be lower volatility in financial markets which supports the "carry trade" – borrowing in US Dollars and investing in higher yielding Australian Dollar deposits. The NAB FX Strategy Team short term valuation model that references the exchange rate against two-year interest rate differences between Australia and the United States, industrial metals prices, the gold price and the VIX (a measure of implied volatility in the US S&P 500 index) shows that almost the entire rise in the Australian Dollar, since the January lows, has come from the decline in the VIX index. There has been some added support from the recovery in the gold price in recent weeks. The model is currently showing that the "fair value" is now at US$0.95, although our longer term forecast is for the currency to decline to US$0.83 by June 2015 driven by US interest rate rises.

By Nick Ryder, NAB Private Wealth Investment Strategist and the NAB FX Strategy Team

Australian Dollar versus Equity Market Volatility



Source: National Australia Bank, Macrobond

Housing update

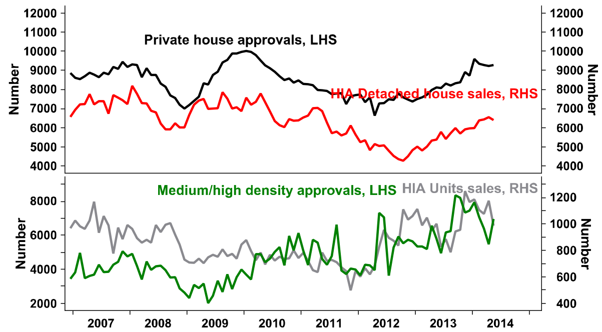
Australian dwelling values bounced back from May's seasonal 1.9% decline to post a 1.4% return in June with most of the capital cities showing price rises. Prices rose 1.7% in Sydney and 1.8% in Melbourne, 1.3% in Brisbane and 1.2% in Perth. Over the financial year capital city prices rose 10.1% with the highest gains in Sydney (15.4%), followed by Melbourne (9.4%) and then Brisbane (7%), with the other capitals showing more modest gains of 3-5%.

Looking at quarterly price data, quarterly price rises peaked at 4% in August 2013 and since then price growth trends have eased back. Other indicators, such as auction clearance rates, remain resilient in both Sydney and Melbourne at around 60%, while vendor discounting and the number of new listings are also supportive for property prices.

Another indicator of activity in the housing market: housing credit has been showing relatively steady growth since September 2013. In May, housing credit was up 6.2% year-on-year, again led by investor housing which was up 8.3% year-on-year. For the RBA, housing is one sector where low interest rates are finding their mark and it should give them some confidence that, if the labour market retains a measure of stability, housing demand and activity will continue to do its job as a source of growth for the economy. With 50-year lows in interest rates for borrowers, the RBA is reluctant to cut rates again and they don't believe there is a housing bubble, but they also don't want to create one.

By Nick Ryder

Building Approvals and New Home Sales



Source: NAB, Macrobond

nabprivatewealth

Global performance markets monitor – 30 June 2014

	Last Price / Level	1 Month	3 Month	Year to date	1 Year	2013	2012
Global Equity Markets Performance							
Australia - ASX200	5395.7	-1.5	0.9	3.0	17.4	20.2	20.3
Japan - Nikkei 225*	15162.1	3.6	2.3	-6.9	10.9	56.7	22.9
Japan - TOPIX	1262.6	5.3	5.1	-1.9	13.6	54.4	20.9
Hong Kong - Hang Seng	23190.7	1.3	6.9	2.0	15.4	6.6	27.5
Shanghai Composite (A&B)*	2048.3	0.4	0.7	-3.2	3.5	-6.7	3.2
Singapore - STI*	3255.7	-1.2	2.1	2.8	3.3	0.0	19.7
New Zealand - NZX50**	5141.5	-0.7	0.0	8.5	15.8	16.5	24.2
US Dow Jones	16826.6	0.7	2.8	2.7	15.6	29.7	10.2
US S&P 500	1960.2	2.1	5.2	7.1	24.6	32.4	16.0
NASDAQ*	4408.2	3.9	5.0	5.5	29.5	38.3	15.9
Canada - TSX	15146.0	4.1	6.4	12.9	28.7	13.0	7.2
Mexico - MSCI*	40750.6	3.9	5.6	-0.1	5.3	-1.2	18.2
India - Sensex*	7571.0	5.4	14.8	21.6	32.0	6.5	30.6
Brazil - Bovespa**	53168.2	3.8	5.5	3.2	12.0	-15.5	7.4
UK - FTSE100	6743.9	-1.2	3.2	1.9	12.3	18.7	10.0
France - CAC40	4422.8	-1.7	3.2	5.7	22.3	22.2	20.4
Germany - DAX**	9833.1	-1.1	2.9	2.9	23.5	25.5	29.1
Spain - IBEX	10923.5	1.4	6.9	12.6	47.9	27.8	2.8
Italy - MIB	21283.0	-1.2	0.1	14.5	43.6	20.5	12.2
World/Regional Indices Performance							
MSCI World (Loc)*	4565.4	1.4	4.6	5.8	22.4	29.6	16.4
MSCI World Value	2589.7	1.7	4.0	5.5	20.8	23.3	12.1
MSCI World Growth	1895.1	1.6	4.3	4.4	22.5	24.9	14.2
MSCI AC Europe*	1077.8	-0.8	3.5	5.3	20.4	21.2	16.5
MSCI Asia ex Japan USD*	579.5	1.9	6.2	5.1	13.8	0.7	19.4
MSCI Emerging Markets Local	48694.0	2.0	4.2	3.3	11.2	0.9	13.9
World EPRA/NAREIT Property USD*	4123.8	1.4	7.9	12.2	14.4	4.4	28.7
World/Regional Indices Performance							
MSCI World Cons Discretionary	181.8	1.6	3.3	0.3	18.9	38.3	21.4
MSCI World Cons Staples	198.5	0.2	4.6	4.3	12.6	19.2	10.2
MSCI World Energy	309.6	4.5	11.1	13.2	26.9	16.0	-1.5
MSCI World Financials	104.1	1.0	3.0	2.5	17.6	24.5	25.6
MSCI World Health Care	188.7	2.6	5.5	9.8	25.9	34.8	14.6
MSCI World Industrials	205.8	0.6	3.4	2.3	22.4	30.2	13.3
MSCI World Materials	251.3	1.2	4.2	5.1	21.5	1.6	9.1
MSCI World Telecommunications Serv	72.5	-0.2	2.9	0.9	18.3	26.8	2.0
MSCI World Utilities	124.7	3.2	5.7	13.7	19.0	9.3	-2.2
MSCI World Information Technology	131.0	2.2	5.7	7.0	27.9	28.5	10.0
Global Rates Levels Change							
AUS - 10Y Govt	3.54	-0.13	-0.56	-0.70	-0.23	0.96	-0.51
AUS - 3Y Govt	2.69	-0.16	-0.44	-0.28	-0.06	0.29	-0.46
AUS - 5Y Swap Rate	3.29	-0.09	-0.46	-0.51	-0.30	0.43	-0.95
AUS - 3Y Swap Rate	2.93	-0.04	-0.30	-0.32	-0.15	0.27	-0.95
AUS – 1Y Swap Rate	2.65	-0.03	-0.04	0.02	-0.02	-0.17	-1.07
AUS - 3 Month Bill Rate	2.95	0.11	0.20	0.15	-0.05	-0.33	-1.77
US - 30Y Govt	3.36	0.03	-0.20	-0.60	-0.14	1.01	0.06
US - 10Y Govt	2.53	0.06	-0.19	-0.49	0.04	1.27	-0.12
US - 5Y Govt	1.63	0.09	-0.09	-0.11	0.24	1.02	-0.11
US - 2Y Govt	0.46	0.08	0.03	0.07	0.10	0.13	0.00
US - TIPS 10Y	0.26	0.02	-0.33	-0.52	-0.21	1.51	-0.63
US - 10Y Breakeven	2.27	2.23	2.13	2.25	2.02	2.49	1.98
Bund - 30Y Govt	2.17	-0.07	-0.26	-0.58	-0.31	0.59	-0.20
Bund - 10Y Govt	1.25	-0.10	-0.32	-0.69	-0.47	0.64	-0.52
Bund - 5Y Govt	0.35	-0.08	-0.29	-0.58	-0.39	0.63	-0.45
Bund - 2Y Govt	0.03	-0.04	-0.14	-0.18	-0.16	0.24	-0.17
Gilt - 30Y Govt	3.43	0.03	-0.09	-0.25	-0.18	0.58	0.04
Gilt - 10Y Govt	2.67	0.10	-0.06	-0.36	0.22	1.20	-0.14
Gilt - 5Y Govt	2.03	0.16	0.06	0.17	0.60	1.00	-0.20
Gilt - 2Y Govt	0.87	0.20	0.16	0.31	0.46	0.24	0.00
JGB - 30Y Govt	1.69	0.00	-0.03	-0.05	-0.14	-0.25	0.07
JGB - 10Y Govt	0.57	-0.01	-0.08	-0.17	-0.28	-0.07	-0.19
JGB - 2Y Govt	0.17	-0.01	-0.03	-0.08	-0.14	0.06	-0.16
Global Currency & Commodity Levels Change							
AUD/USD	0.9430	0.0121	0.02	0.05	0.03	-0.15	0.02
EUR/USD	1.3691	0.01	-0.01	-0.01	0.07	0.06	0.02
GBP/USD	1.7103	0.04	0.04	0.05	0.19	0.03	0.07
JPY/USD	101.30	-0.48	-1.89	-4.00	2.18	18.56	9.80
NZD/AUD	1.0770	-0.02	0.01	-0.01	-0.10	-0.17	-0.06
Gold (USD Spot)	1327.19	76.50	43.55	122.25	94.05	-469.40	110.54
WTI Crude (USD Spot)	106.07	2.67	4.50	7.90	9.71	6.34	-7.00
GSI Commodity Index	5105.46	2.12	2.69	5.71	10.40	-1.22	0.08
Volatility Index (VIX) USD	11.57	0.17	-2.31	-2.15	-5.29	-4.30	-5.38