Market watch

Investment market review

As at October 2013

Economics overview:

- **Australia:** The Reserve Bank of Australia (RBA) left the cash rate unchanged at 2.5% at the 1 October Board meeting.
- The RBA Minutes retained a mild easing bias, with members of the Board again agreeing that "it should again neither close off the possibility of reducing rates further nor signal an imminent intention to reduce them." That is, the RBA's next move remains data and Australian dollar (AUD) dependent.
- The Board also noted that "consumer confidence was above average levels and business confidence had increased, although it remained to be seen if this would be sustained." The central bank stated that "the effect of low interest rates was evident across a range of indicators and had further to run."
- Later in the month, RBA Governor Glenn Stevens remarked that rising Australian house prices are part of the "normal cyclical dynamic" which should help lift residential building construction.
- With the AUD trading as high as US$0.9746 during the month, Governor Stevens attempted to 'jawbone' the AUD lower, suggesting that its elevated level was not supported by Australia's relatively high costs and expected falls in the terms of trade. He stated that markets should expect the currency to be "materially lower" at "some point in the future".
- Economic data released in October was mixed.
- The Westpac consumer confidence index fell by 2.1%/mth in October, after strong outcomes in the previous two months.
- The NAB business survey showed that business confidence rose sharply in September (to +12pts from a revised +4pts in August) to a 3 ½-year high. However, business conditions remained weak despite a 3pt improvement to -4pts.
- Employment increased by 9,100 (consensus: +15,000) in September, pushing the unemployment rate down to 5.6%, largely due to a fall in the participation rate to 64.9%. This was its lowest level since 2006.
- Building approvals rose by 14.4%/mth in September, to their highest level since March 2010, powered by the apartment sector (+31.8%/mth).
- September quarter headline CPI surprised markets by printing at 1.2%/qtr (consensus: +0.8%/qtr) and 2.2%/yr. The RBA's preferred trimmed mean measures rose by 0.7%/qtr to 2.3%/yr. Rising petrol and utility prices were the main contributors.
- **US:** The US government began a partial shutdown for the first time in 17 years on 1 October as the US Congress failed, yet again, to agree on a US budget. Eventually, both the Democratic controlled Senate and the Republican controlled House of Representatives agreed a deal to re-open the government and suspend the debt ceiling just ahead of the 17 October deadline.
- The deal will fund the government at current levels until 15 January 2014 and suspend the debt ceiling until 7 February 2014. The US Treasury will also continue to be able to use 'extraordinary measures' to fund the government, meaning the debt limit will not need to be raised until well after the 7 February deadline, perhaps into March or even April 2014.
- The deal also establishes a Committee to work on details of a medium-term budget plan and report back on options by 13 December.
- This compromise deal was welcomed by financial markets, as it avoided the worst-case scenario of a possible default on US government debt, allowing around 800,000 furloughed government employees back to work, supporting the economy.
- As widely expected, there was no change to monetary policy settings at the FOMC's 29-30 October meeting. Open-ended asset purchases will continue at an US$85bn per month pace for the time being. There was little meaningful change to the post-meeting statement from the FOMC.
- The Committee will want to see strong employment increases, clear evidence that the drag from fiscal policy is

abating, housing activity regaining traction and inflation returning to its mandate level before 'tapering' asset purchases.

- During the month, current US Federal Reserve Vice-Chair Dr. Janet Yellen was nominated by President Obama to replace incumbent Chairman Ben Bernanke from 1 February 2014.
- US economic data was delayed due to the shutdown in the first half of October. Once released, most of these data releases surprised on the downside.
- The September US employment report was much weaker-than-expected. Non-farm payrolls rose by just 148,000, below consensus estimates for 180,000. However, the unemployment rate fell to a 5-year low of 7.2% from 7.3%, due to previous month upward revisions.
- The headline Consumer Price Index (CPI) rose by 0.2%/mth to 1.2%/yr in September – the lowest pace of inflation since April.
- The University of Michigan consumer confidence index fell to a 10-month low in October of 73.2 from 77.5 in September.
- The ISM manufacturing purchasing managers index (PMI) increased to a 2-year high of 56.2 in September (from 55.7 in August). Market estimates were for 55.0.
- The National Association of Home Builders (NAHB) index declined to 55 in October (consensus: 57) from a downwardly revised 57 in September. Housing activity lost some momentum due to the government shutdown and rising mortgage rates.
- **Europe:** The European Central Bank (ECB) kept its benchmark interest rate at 0.5% at its 2 October meeting. The Governing Council again discussed a rate cut with ECB President stressing that "growth risks remain to the downside."
- The latest Eurozone inflation and unemployment data will increase pressure on the ECB to take further action to support the economy. In October, CPI inflation fell from 1.1%/yr to a lower-than-expected 0.7%/yr (consensus +1.1%/yr). This is the lowest rate since November 2009. Energy, food and core inflation all fell - the latter is now just 0.8%/yr, a joint record low.
- Meanwhile, Eurozone unemployment rose by 60,000 in September and falls in the previous months were revised away. Given this, the unemployment rate was 12.2%, unchanged from August's upwardly revised figure. The latest figures put a dent in hopes that the labour market may have reached a turning point.
- **UK:** The MPC minutes revealed an unchanged 9-0 vote to leave the Bank of England's bank rate at 0.5% and the asset purchase target at £375bn at its 10 October meeting. The general tone of the Minutes was relatively sanguine.
- Recent UK data (September quarter GDP reached 0.8%/qtr – the highest in 14 quarters) releases point to a "robust" recovery in activity, with confidence rising and surveys signalling economic growth of around 2% over the second half of 2013.
- **Japan:** Japanese Prime Minister Shinzo Abe announced a stimulus package of at least US$50bn to offset the consumption tax hike, from 5% to 8%, due in April 2014.
- The Bank of Japan (BoJ) retained its existing policy stance at its 31 October meeting and revised up its forecast for GDP growth in fiscal year 2014/15 to 1.5%/yr from 1.3%/yr previously.
- Japanese headline CPI rose by 1.1%/yr in September – its fastest pace since October 2008.
- Whilst Japan's unemployment rate was steady at 4.0% in September, the number of employed rose by 190,000 and was up by 0.8%/yr – the strongest annual growth in six years.
- Japan's PMI rose to 54.5 in October from 52.5, the highest reading in over 3 years.
- **China:** September quarter GDP rose to 7.8%/yr (consensus: +7.8%/yr), its highest level in three quarters. The improved outcome from the previous quarter (+7.5%/yr) was due to the government's mini-fiscal stimulus program which included railway spending and tax cuts.
- NBS Manufacturing PMI for October increased to 51.4 in October from 51.1 in September - an 18-month high.

The Australian dollar and commodities:

- The Australian dollar (AUD) appreciated by 1.3%/mth in October to $US0.9463 against the US dollar (USD).
- The AUD was supported by positive Chinese economic data releases, reduced expectations of RBA policy easing and the US Federal Reserve's ongoing stimulus program.
- Commodity prices were becalmed in October. Spot Crude oil (-0.3%) fell a little after US crude inventories rebounded from 18-month lows in September. Gold (-0.4%) fell mid-month but mostly recovered its losses on the back of a weaker USD – as the US Federal Reserve delayed its QE3 taper. Iron ore (+0.4%) rose by its smallest monthly amount since September 2010.

Australian equities:

- The Australian share market rose to 5-year highs in October, with the S&P/ASX 200 Accumulation Index adding 4.0%.
- Sentiment towards global share markets was supported after the US government reached a last minute deal to

avoid breaching the country's debt limit. Better domestic confidence, housing and employment data, together with an acceleration in Chinese GDP growth also supported Australian shares.

- Banks (+6.2%) continued to enjoy their higher yielding status and improving housing activity momentum. Late in the month, both ANZ Banking Group (+8.0%) and National Australia Bank (+6.9%) reported their full year earnings for the 2012/13 fiscal year.
- A number of companies in the Materials (+3.4%) and Energy (+0.2%) sectors released their production reports for the September quarter. Rio Tinto (+4.3%) reported record iron ore production and shipments in Western Australia following the opening of its port and rail expansion. The release from Woodside Petroleum (+1.3%) was less favourable.
- A number of AGM's were held on the month. Some companies reported that they had yet to see an improvement in conditions (i.e. Wesfarmers, Asciano, Fletcher Building and Toll Holdings). Conversely, Flight Centre and JB Hi-Fi reported encouraging sales, while Stockland commented on improving housing volumes.

Listed property:

- Australian listed property securities rose by 2.6% in October, underperforming the broader market, which rose by 4.0%.
- Activity within the sector included the IPO of Australian Industrial REIT and the announcement by DEXUS Property Group of a takeover offer for Commonwealth Property Office Fund.
- Federation Centres (+8.8%) and DEXUS Property Group (+8.0%) were amongst the strongest performers.
- Retail A-REIT Federation Centres, which is exposed to defensive, non-discretionary consumer spending through its supermarket-anchored shopping malls, reported healthy tenant sales growth for the September quarter, particularly for specialty retailers.
- Investors focussed on office A-REIT DEXUS following its indicative, non-binding offer, made in conjunction with the Canada Pension Plan Investment Board, to acquire peer Commonwealth Property Office Fund. Although the initial offer was rejected, the parties remain in discussion.
- Retail A-REIT Westfield Group (-1.7%) underperformed, despite an ongoing share buy-back program, over concerns about its near-term growth prospects. Diversified A-REIT Mirvac (+0.0%) lagged the sector following out-performance in previous months.
- Listed property markets offshore rose during October, as financial markets welcomed the deal by the US Congress on the shutdown and debt ceiling.
- Overall, the UBS Global Property Investors index (local currency) rose by 3.4%. The UK (+6.8%) was the strongest-performing region, followed by the US & Canada (+4.2%) and Singapore (+4.2%). Japan (-2.1%) and Australia (+2.6%) underperformed.

Global developed market equities:

- Global equity markets began October nervously due to the US fiscal impasse. However, markets rallied strongly mid-month on news that the US Congress struck an agreement to end the partial US government shutdown and suspend the debt ceiling.
- The temporary nature of the deal served to convince market participants that the US Federal Reserve would maintain its asset purchasing program until at least December, if not into early next year. This impression was reinforced by mixed US economic data releases.
- News that the Chinese economy had lifted by 7.8%/yr in the September quarter also boosted sentiment.
- The MSCI World Developed Markets Index increased by 3.8% in USD terms and 2.5% in AUD terms during October.
- The US S&P500 Index rose by 4.5%, encouraged by positive September quarter earnings outcomes. At month-end, 51% of companies had reported with 73% exceeding mean analyst expectations of earnings.
- European markets also posted solid gains over the month with the Euro Stoxx 50 Index up by 6.0%, continuing to unwind its underperformance relative to other markets in the first half of 2013.
- Italian (+11.0%) shares led the way in the Eurozone after the Letta government survived a confidence vote.
- Japanese equities trailed other developed share markets during October. The Nikkei 225 (-0.9%) and Topix (0.0%) Indices both lost some momentum on increasing market concerns that the planned consumption tax increase in early 2014 will weigh on economic growth.

Global emerging markets:

- The MSCI World Emerging Markets ('EM') Index performed strongly in October, increasing by 4.8% in USD terms and 3.4% in AUD terms.
- EM equities outperformed their developed market counterparts for a third consecutive month, this time by 1.0%. EM equities continued to benefit from the postponement of US Federal Reserve 'tapering' expectations.
- The improving sentiment towards EM equities saw total portfolio inflows increase to US$2.7bn in October from US$1.2bn in September.

- The MSCI EM Asia Index also rose by 4.8% in USD terms and 3.4% in AUD terms.
- India (+9.8%) was the best performing equity market in Asia for a second consecutive month. The Reserve Bank of India's continued policy normalisation (where they increased the repo policy rate by 25bp to 7.75%), better-than-expected quarterly company earnings and increased risk appetite boosted performance.
- The MSCI Emerging Markets EMEA Index rallied by 4.9% in USD terms and 3.5% in AUD terms over the month.
- Poland (+6.6%) and the Czech Republic (+6.0%) led the way, bolstered by the European economic recovery and the stronger Euro currency, which hit a multi-year high at US$1.38 before closing at US$1.35 (+0.4%/mth vs. USD). Polish telecommunications company TPSA (+22.0%) was the strongest performing stock after raising guidance for the first time in years.
- Latin American equity markets followed suit, with the MSCI Emerging Markets LatAm Index rising by 4.6% in USD terms and 3.2% in AUD terms.
- Argentinian (+8.5%) shares reacted positively to the outcome of mid-term Congressional elections on 27 October. President Cristina Kirchner's party (FPV/Peronist coalition) lost, garnering just 33.15% of the national vote. This means that President Kirchner cannot amend the constitution and stand for a third term in 2015 elections. There is optimism that she will be replaced by a more 'market friendly' leader.
- EM sovereign bond yields declined during October as the 10-year US Treasury yield fell by 5bp to 2.56%. However, EM fixed interest had outflows of US$3.3bn during the month.

Asia ex-Japan markets:

- Asian equity markets began October nervously due to the US fiscal impasse. However, markets rallied strongly mid-month on news that the US Congress struck an agreement to end the partial US government shutdown and suspend the debt ceiling.
- The temporary nature of the deal served to convince market participants that the US Federal Reserve would maintain its asset purchasing program until at least December, if not into early next year. This impression was reinforced by mixed US economic data releases. News that the Chinese economy had accelerated in the September quarter also boosted sentiment.
- The World Bank downgraded its forecasts for growth in East Asia in its October update. The World Bank now expects developing East Asia to expand by 7.1%/yr in 2013 and 7.2%/yr in 2014, down from its April estimates of 7.8%/yr and 7.6%/yr, respectively. The slower expansion is projected to extend to larger middle-income countries such as Indonesia, Malaysia and Thailand due to lower investment, lower global commodity prices and below expectations export growth.
- The MSCI Asia ex-Japan Index increased by 4.3%/mth in USD terms.
- India (+9.8%) was the best performing equity market in Asia for a second consecutive month. The Reserve Bank of India's continued policy normalisation (where they increased the repo policy rate by 25bp to 7.75%), better-than-expected quarterly company earnings and increased risk appetite boosted performance.
- Philippine (+6.4%) equities reversed their September underperformance after Moody's became the third major credit ratings agency to give the country an investment grade rating.
- Moody's raised the country's credit rating to Baa3 from Ba1, citing the country's economic performance and improved governance as reasons for the upgrade.
- Strong consumption, steady remittance inflows and increased investments also contributed to a GDP growth forecast upgrade to 7.1%/yr from 6.9%/yr from the World Bank.
- The Jakarta Composite Index in Indonesia rose by 4.5% in October, propelled higher by the Materials (+12.7%) and Telecommunications (+11.0%) sectors.
- Thai equities (+4.3%) performed in-line with the regional index. Strong September quarter earnings results from Siam Commercial Bank (+11.1%) and Kasikornbank (+8.6%) drove the Financials (+4.7%) sector higher in October. However, weaker September manufacturing output, domestic demand and exports data weighed in market sentiment a little.
- By contrast, the Shanghai Composite Index in China decreased by 1.5% despite accelerating economic growth. September quarter GDP rose to 7.8%/yr (consensus: +7.8%/yr), its highest level in three quarters. The improved outcome from the previous quarter (+7.5%/yr) was due to the government's mini-fiscal stimulus program which included railway spending and tax cuts.

Global fixed interest:

- Longer-dated bond yields in the US, Europe and the UK generally tracked sideways early in the month, rising gradually as the US debt ceiling deadline approached mid-month.
- Confirmation that the US Congress had agreed on a deal to fund the government to 15 January 2014 and suspend the debt ceiling until 7 February 2014 saw a decline in longer-dated G4 bond yields, and weaker than expected US non-farm payrolls data saw yields decline further to finish the month lower overall.

- The 10-year US Treasury yield decreased by 5bp to 2.56% by month-end. The 10-year German Bund yield decreased by 10bp to 1.63%, while the 10-year UK Gilt yield also finished the month 10bp lower at 2.62%. Longer-dated Japanese Government Bond (JGB) yields continued to decline in October despite the government's efforts to revive the economy. The 10-year JGB yield fell by 9bp overall to finish at 0.59%.

Australian fixed interest:

- The UBS Composite Bond Index decreased by 0.06% in October, led lower by Treasuries (-0.31%).
- Australian bond yields increased during the month, underperforming global bond markets. The 3- and 10-year CGS yields rose by 13bp to 2.84% and 3.94%, respectively.
- This outcome may have been attributable to foreign selling of Australian CGS as the AUD continued to rally. Also, the higher-than-expected CPI print for the September quarter and reduced market expectations for further policy easing by the RBA also weighed on Australian government bonds. Improving domestic confidence and a better employment outcome together with strong Chinese growth data also helped along the sell-off.
- The slope of the Australian CGS curve remains very steep, but has started to become more volatile.

Asia ex-Japan fixed interest:

- Longer-dated Asian sovereign bond yields, as represented by the JPMorgan EMBIG Asia sovereign bond yield, fell gradually(-10bp) over the first half of the month despite the looming US debt ceiling deadline on 17 October.
- Confirmation that the US Congress had agreed on a deal to fund the government to 15 January 2014 and suspend the debt ceiling until 7 February 2014 saw an even sharper decline in yields (-23bp), and weaker than expected US non-farm payrolls data saw yields decline further to finish the month lower overall.
- Overall, the JPMorgan EMBIG Asia sovereign bond yield fell by 42bp to 4.80%, outperforming the 10-year US Treasury yield which declined by just 5bp to 2.56% in October.
- Asian corporate bonds held-up well in the first half of the month, boosted by the US Federal Reserve's decision in late September to maintain asset purchases at current levels.
- Strong primary issuance and positive economic data saw credit markets post positive returns despite the uncertainty associated with the US government shutdown.
- Asian credit markets rallied in the second half of the month following the negotiation of a short-term resolution in the US, while a strong September quarter GDP result in China saw spreads tighten further.
- The JPMorgan Asia Credit Index (JACI) returned 2.17% in October. The average spread of the JACI tightened by 14bp to 285bp over the month.
- Moody's upgraded of the sovereign credit rating of the Philippines was very well received by the markets. Moody's also highlighted the stability of the Philippines' funding conditions during the recent emerging markets volatility, reducing the country's relative vulnerability to external financial shocks. The rating upgrade brings Moody's in-line with Standard & Poor's (S&P) and Fitch, which both currently rate the Philippines at BBB-.
- Indonesia (+5.1%) was the strongest performing country of the JACI heavyweights, while Singapore (+0.7%) was the poorest performer.
- By sector, non-investment grade sovereigns (+4.1%) were the strongest performers while investment grade corporates (+1.5%) were the poorest performers.

Global credit:

- Global investment grade credit spreads were volatile in the first half of the month due to uncertainty associated with the US government shutdown and looming debt ceiling.
- Credit valuations remained fairly well supported throughout the shutdown period, and spreads tightened marginally on expectations that a last-minute deal in the US would be brokered. Janet Yellen's nomination as the next Chair of the US Federal Reserve provided a boost to credit markets in the first half of the month given her 'dovish' reputation, while confirmation mid-month of an extension to the US debt ceiling saw credit indices tighten further. Earnings results generally supported credit spreads. Some spread widening into month-end saw spreads finish flat to tighter overall. The spread of the US Lucitoss ended the month unchanged at 123bp, while the Markit iTraxx Europe SovX WE tightened by 20bp.
- High yield credit spreads widened marginally early in the month before tightening significantly to finish tighter overall.
- New US high yield issuance fell from September's record high of US$43bn to US$26bn, but this remains a heavy pace of issuance in a historical context and reflects issuers' ongoing desire to capitalise on low borrowing rates for refinancing and merger and acquisition activity. The spread for the Merrill Lynch BB-B High Yield Index tightened by 44bp to 409bp by month-end.
- Australian credit spreads shrugged-off concerns about the US government shutdown to tighten in the first half of the month, before tracking sideways to finish tighter overall. Strong technicals drove the tightening, while new issuance (i.e. Mirvac, Brisbane Airport, Abbott Point, and

Aurizon Networks) was met by strong investor demand. Overall, the Markit iTraxx Australia Index finished the month 20bp tighter at 105bp.