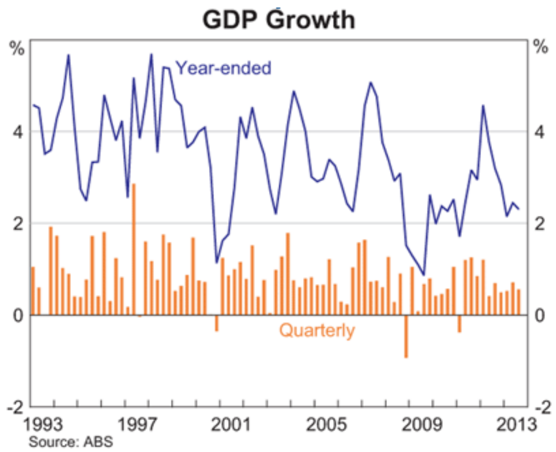
April 2014

Economic News

In **Australia**, financial conditions overall remain very accommodative. Recent economic data is finally showing some tentative signs of life outside the mining sector in Australia, suggesting that the current mix of a 2.5% policy rate and the Australian dollar hovering around USD0.90 is starting to spur the long-awaited growth rebalance. Looking ahead, the Reserve Bank of Australia (RBA) believes continued accommodative monetary policy should support demand and help growth to strengthen over time.



Indicators of business confidence have bounced over recent months. The downside risks to business investment outside of the mining sector appear to have diminished. However, resources sector investment spending is set to decline significantly and, at this stage, signs of improvement in investment intentions in other sectors are only tentative, as firms wait for more evidence of improved conditions before committing to expansion plans. The unemployment rate is now at 6.0%, the highest level in a decade, up from 5.4% a year ago.

Commodities continued their better performance this year, with the Dow Jones-UBS Commodity Index up 0.58% in March and up 7.2% over the quarter. Commodities prices may have declined from their peaks but in historical terms remain high.

In **the US**, the economy continues to grow at a moderate pace despite the recent adverse weather. The US is on track to grow by approximately 3% in 2014, providing further confidence that the world's largest economy continues to rebound, albeit only with strong stimulus support. In other good news, industrial production lifted by 0.6% and the Commerce Department reported that durable-goods orders improved by 2.2% in February. Capacity utilisation is still relatively low at 79%. The US housing market continues to recover. While most of the economic signals coming out of the US were positive, the Federal Reserve (the Fed) is still wary. "There remains no doubt that the economy and the job market are not back to normal health," Fed chair Janet Yellen said. "The recovery still feels like a recession to many Americans and it also looks that way in some economic statistics."

The Fed confirmed that its balance sheet swelled to US$4.0 trillion at the end of 2013 after it had made massive asset purchases to support the US economy. Throughout 2013, the Fed undertook US$85 billion a month in asset purchases every month. In January and February, it cut that back by US$10 billion each month, slowing the buying pace to US$65 billion.

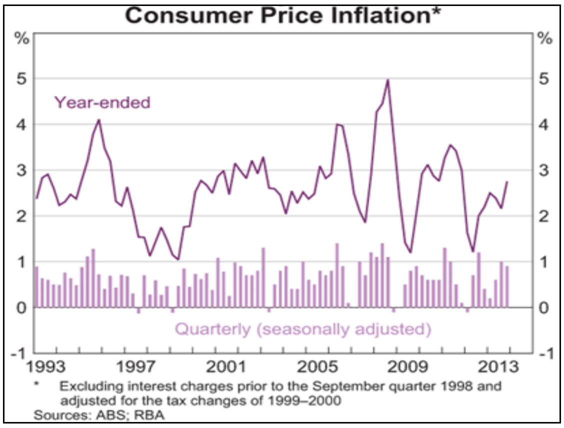
In **Asia**, China's latest economic data continued to moderate and point to a less frenetic level of economic activity. Increased concerns about China's out of control shadow banking system have had markets record their weakest start to a new year since 2010. Markets in China were rattled on 7 March by the first onshore corporate default in 17 years. Opinion remains divided as to whether this was the tip of a credit iceberg or a healthy tempering of the region's credit markets.

In **Japan**, equity markets continued their poor start to the year with a further loss this month; the TOPIX is now down 8% for the quarter in local terms. The economy faces a severe test from 1 April as a 3% rise in consumption tax is implemented; the risk of a contraction looms for the coming quarter in the world's third-largest economy.

In **Europe**, economic data continues to point to a recovery from recession, albeit a fragile one. European Central Bank (ECB) president Mario Draghi indicated that the bank sees the economy recovering but that the outlook for the European economies remains problematic due to very low levels of inflation and the risk of deflation. Inflation data showed that consumer prices rose at just 0.7% (year-on-year) in February, the same rate that triggered a surprise interest rate cut by the ECB back in November 2013.

Inflation

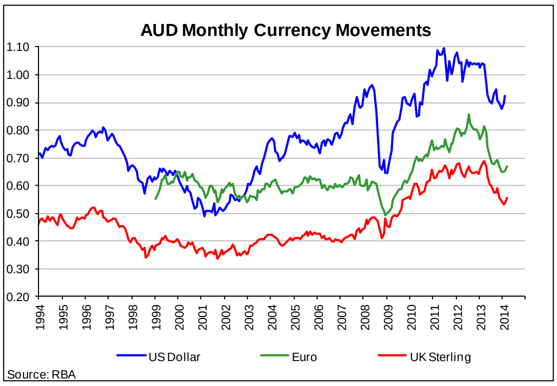
The Australian inflation rate is moving upwards towards 3.0%, as domestic prices continue to rise, despite slower growth in labour costs. This may be explained by a faster than anticipated pass-through of the lower exchange rate.



In the developed world, inflation remains at its lowest levels in decades and generally below central banks' targets. Australian inflation is high on international comparisons and this should affect the direction of interest rates. The RBA played down the risks of a rise in domestic inflation but cautioned investors on housing saying, "investors need to take care with the amount of leverage they take on".

The Australian Dollar

The Australian dollar (AUD) rose 3.1% against the US dollar (USD) in March to close at USD 0.9221. The AUD also rose 2.7% against the Euro, 3.4% against the British Pound and 4.0% against the Renminbi.

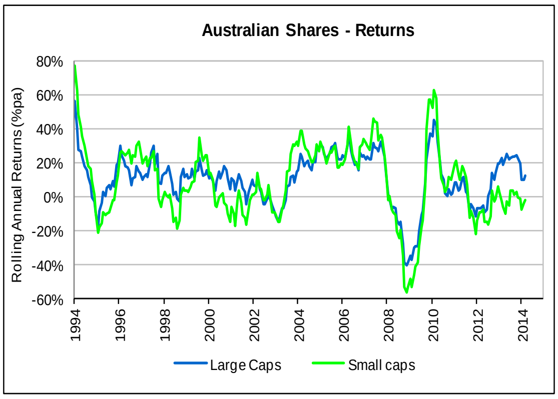


Over the past 12 months, the AUD has now fallen 11.6% against the USD, 17.8% against the Euro and 19.5% against the Pound. The fall has provided a significant boost to the competitiveness of Australian exporters.

Australian Shares

The Australian share market, as measured by the S&P/ASX300 Accumulation Index, was flat in March, up only 0.21%. Over the past 12 months ending March 2014, the S&P/ASX300 has returned a solid 13.0%.

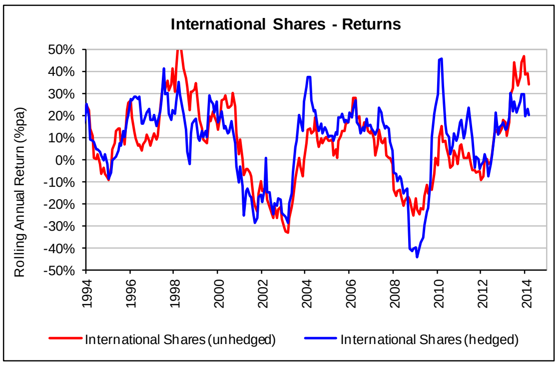
The small cap sector, measured by the S&P/ASX Small Ordinaries Accumulation Index, was down -1.2% in March. Over the past 12 months ending March 2014, the Small Ordinaries Index has been disappointing, down by -1.5%.



The February reporting season was better than expected with earnings growth picking up across most sectors. With the domestic economy remaining sluggish, many companies are finding it hard to achieve top line growth as demand for their products has not yet shown any meaningful improvement. In response to weak growth, companies have continued to focus on cost cutting as a means of maintaining or growing earnings and preventing margin contraction. Whilst this has resulted in a favourable reporting season, it is not sustainable over the longer term.

Global Shares

World share markets, as measured by the MSCI World Index, fell by -3.3% in March. The Vanguard International Shares Index (Hedged) gained ground, up by 0.4%, reflecting the impact of the stronger AUD on hedged portfolios. Over the past 12 months ending March 2014, global shares (unhedged) have returned a very impressive 33.9%.



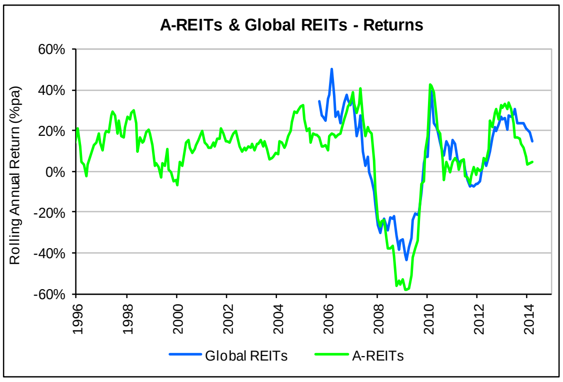
Emerging markets fell during March, with the MSCI Emerging Markets Free Index (A$) down by 0.5%. The Index has gained 10.9% over the past 12 months, lagging the developed markets by 23%.

Emerging markets continue to struggle as manufacturing activity in China remained lower than expected and investors worried about the currency crises and deteriorating fiscal situations in some of the larger emerging market countries.

Real Estate Investment Trusts (REITS)

The S&P/ASX 300 A-REIT Accumulation Index fell in March by 1.6%. Over the 12 months to end March 2014, the A-REIT sector is up but by a rather disappointing 4.9%.

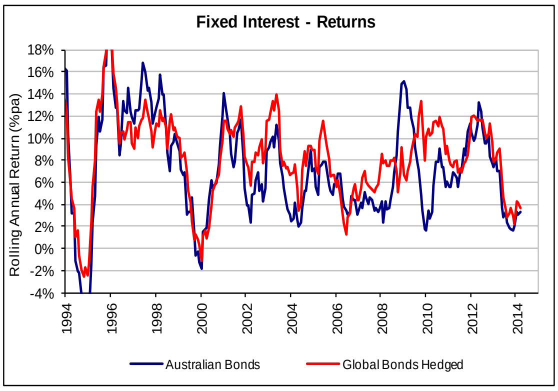
Global REITs, as measured by the FTSE EPRA/NAREIT TR Hedged Index, had a flat month, up 0.2%. Over the 12 months to March 2014, global real estate has gained 5.3%, outperforming the Australian listed property market.



Fixed Interest

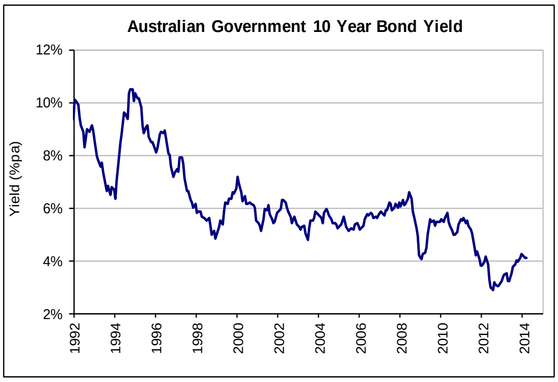
The Australian bond market, as measured by the UBS Warburg Composite Bond Index, was flat, up only 0.02% during March. Over the past 12 months ending March 2014, Australian fixed interest has returned a very modest 3.3%.

International fixed interest, as measured by the Barclays Capital Global Aggregate Index Hedged $A, gained 0.3% during March. Over the past 12 months ending March 2014, global fixed interest has returned 3.7%.



The investment case for bonds continues to be unattractive, given the very low yields on offer around the world and the increasing probability of a sustained rally in yields off this low base.

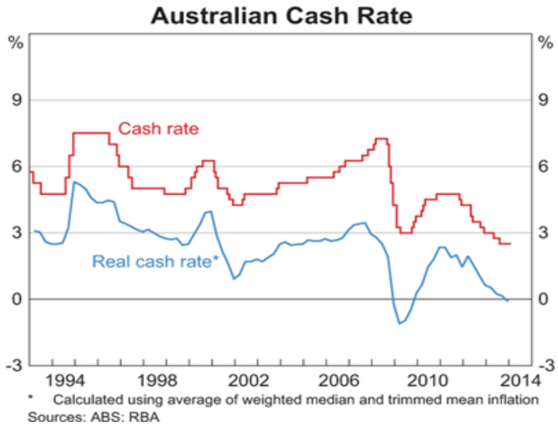
The 10 year Australian government bond yield is still very low by historical standards (4.1% as at the end of March 2014), even after rising from its low point of 2.9% in July 2012.



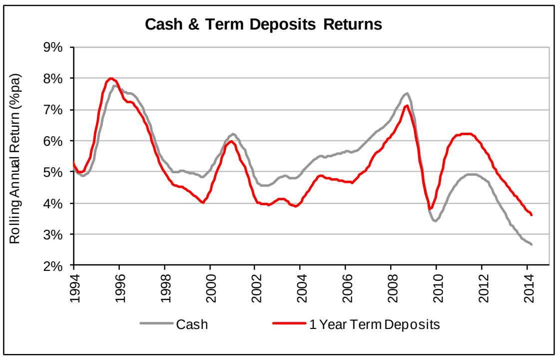
Australian bond yields remain highly correlated to global developed market bond yields, and without a near-term domestic catalyst to cause that correlation to break, Australia's yields are more likely to gradually rise, particularly in the longer end of the yield curve, which isn't supported by anchored policy rates.

Cash

The RBA has left rates unchanged at 2.5% since it cut rates by 0.25% in August 2013. The real cash rate, i.e. adjusted for inflation, is now negative.



RBA 90 day Bank Bills returned 0.20% in March, and 2.70% over the past 12 months to March 2014.



Market Returns

Market Returns to end March 2014	1 month %	3 month %	6 month %	1 year %	3 year %pa	5 year %pa	10 year %pa	15 year %pa	20 year %pa
Cash (RBA Bank Bills 90 days)	0.22%	0.64%	1.30%	2.67%	3.60%	3.86%	4.94%	5.02%	5.31%
Term Deposits (1 Year $10,000)	0.0%	0.6%	1.4%	3.3%	4.5%	4.9%	5.1%	5.0%	5.2%
Australian Fixed Interest	0.0%	1.5%	1.8%	3.3%	6.7%	6.0%	6.2%	6.1%	7.0%
Global Fixed Interest (Hedged)	0.3%	2.7%	3.5%	3.7%	8.0%	8.3%	7.5%	7.6%	8.2%
High Yield Credit	0.2%	1.5%	2.4%	5.1%	7.4%	7.6%	6.7%	6.5%	N/A
Australian REITs	-1.6%	3.0%	1.6%	5.0%	11.7%	15.7%	1.9%	5.2%	6.7%
Global REITs (Hedged)	0.2%	4.0%	5.2%	5.3%	12.0%	23.9%	N/A	N/A	N/A
Unlisted Property	0.0%	1.0%	3.4%	8.6%	8.6%	6.6%	9.1%	9.6%	9.5%
Australian Shares	0.2%	2.0%	5.4%	13.0%	8.0%	13.2%	9.2%	8.4%	9.3%
Australian Small Caps	-1.2%	0.9%	0.7%	-1.5%	-5.3%	8.8%	4.9%	4.8%	5.4%
Global Shares (Unhedged)	-3.3%	-2.3%	10.3%	33.9%	14.3%	11.6%	4.8%	1.5%	5.6%
Global Shares (Hedged)	0.4%	1.6%	10.7%	20.2%	12.0%	17.6%	6.3%	3.4%	6.6%
Global Small Caps (Unhedged)	-3.8%	-0.7%	11.8%	40.6%	15.7%	16.2%	6.5%	N/A	N/A
Emerging Markets (Unhedged)	-0.5%	-3.9%	2.3%	10.9%	0.8%	8.1%	8.0%	7.3%	4.5%
Asia excl. Japan (Unhedged)	-3.1%	-4.9%	2.2%	15.3%	5.2%	9.8%	7.5%	5.7%	3.0%
Commodities	-3.3%	-0.6%	3.9%	15.6%	-0.4%	7.8%	-0.9%	4.7%	3.4%

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