

MARKET UPDATE - OCTOBER 2014

Market and economic overview

Australia

- The Reserve Bank of Australia (RBA) held the cash rate steady at 2.5% at its 7 October 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% since August 2013. Most commentators are expecting the RBA to remain on hold until the second-half 2015.
- On the global economy, the RBA expects a moderate pace of growth to continue. The US is improving, as Europe continues to disappoint, while the Chinese economy has been slowing in line with policy-makers objectives and the property sector remains a near-term challenge.
- On the Australian economy, the RBA notes "most data are consistent with moderate growth in the economy" and "the Bank still expects growth to be a little below trend for the next several quarters".
- On the local currency, the RBA continues to remain concerned, noting that despite recent falls the Australian dollar "remains high by historical standards, particularly given the further declines in key commodity prices in recent months".
- The underlying rate of inflation rose by an average of 0.5% per quarter, taking the annual pace from 2.7% per year to 2.55% per year. Inflation, therefore, remains well within the RBA's 2% to 3% target range.
- The biggest source of inflationary pressures in Q3 2014 was an increase in fruit, new dwelling prices for owner-occupiers, property rates and charges and motor vehicle services.
- Unemployment data was revised by the Australian Bureau of Statistics with a new seasonal adjustment process unveiled from December 2013. As a result, the unemployment rate was revised up from 6.1% to 6.2% for September 2014. This is the highest unemployment rate since December 2002. House prices rose 1.0% per month according to RPData/Rismark, taking annual house price growth to 8.9% per year, the slowest in 12 months.

United States

- As widely expected, the Federal Open Market Committee (FOMC) of the US Federal Reserve (the 'Fed') completed the 'tapering' of its QE3 bond purchase program at its 28-29 October 2014 meeting. The Fed tapered by a final \$US15bn, completing the tapering which started at \$US85bn in December 2013. As a result the QE3 program has come to an end.
- In the accompanying statement, the Fed noted that since the QE3 program started (in September 2012) there has been "substantial improvement in the outlook for the labor market" and that there is "sufficient underlying strength in the broader economy to support ongoing progress toward maximum employment in the context of price stability".
- The Fed also highlighted some improved confidence in the US economic recovery with the economy "expanding at a moderate pace" and despite recent falls in the oil price, any near term declines in inflation would be temporary and the risks of inflation running persistently below the 2% inflation target had in fact diminished.
- The US labour market also continues to improve with 248,000 jobs added in September and the unemployment rate falling to 5.9%, the lowest since July 2008.

Europe

- The European Central Bank (ECB) left its key interest rates unchanged at 0.05% at its 2 October meeting. With interest rates now at the lower bound, focus has now turned to the size of the ECB's balance sheet in policy decisions.
- The inflation estimate for October was recorded at 0.4% per year, compared to 0.3% per year in September, which was a five-year low.

United Kingdom

- The Bank of England (BoE) left policy unchanged at its 9 October 2014 meeting, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375bn.
- However, the minutes to meeting did highlight that the majority of the Board were concerned over a premature tightening to the Bank Rate given low inflation and wages and possible shocks to the UK economy. As a result the timing of the first rate hike has been pushed further out by financial markets. There does remain a possibility they could tighten in March or April 2015, dependent on the data.

New Zealand

- The Reserve Bank of New Zealand (RBNZ) left its official cash rate on hold at 3.5% at its 30 October 2014 meeting.
- 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 its accompanying release that a "period of assessment remains appropriate before considering further policy adjustment".

Canada

- The Bank of Canada left its overnight lending rate on hold at 1.0% at its 22 October 2014 meeting and highlighted concerns over rising financial stability risks associated with household imbalances.
- The unemployment rate fell to 6.8% in September, with headline inflation remaining at 2% or above for the sixth consecutive month.

Japan

- The Bank of Japan's (BoJ) policy board convened on 31 September 2014 and decided by a 5-4 vote to expand its qualitative and quantitative easing (QQE) program in what was a universal surprise for financial markets. The BoJ will now expand its monetary base at annual rate of Y80trillion, an increase of about Y10-20 trillion on the previous target.
- The BoJ will expand its holdings of Japanese government bonds by about Y80trillion per year, up from the previous level of around Y50trillion, which is about 100% of net new issuance from the Ministry of Finance. The BoJ will triple the amount of ETFs (to Y3trillion) and REITs (to Y9billion) they will buy on an annual basis.
- The BoJ made this decision in light of the weaker than expected performance of the economy post the 1 April 2014 Consumption tax hike and in light of rising concerns over a "deflationary mindset".

China

- Q3 14 GDP data was released with growth of 7.3% per year recorded, a slight slowdown from 7.5% per year to Q2 14, slightly stronger than expected (7.2% per year).

AUSTRALIAN DOLLAR

After sharp falls in September, the Australian dollar rose 0.6% in October, finishing the month at \$US0.8798. This did hide some volatility over the month, with the Australian dollar trading as high as \$US0.8855 and as low as \$US0.8675.

However, USD strength did continue over the month with the US Dollar Spot Index rising 1.4%, with gains predominantly against the Japanese yen.

COMMODITIES

Commodity prices were predominantly weaker in October, with oil price weakness the main story of the month. Global oil supply has risen sharply of late, driven predominantly by growth in the US and the return of production in Libya.

The wheat price rose 11.5% after recent falls, while corn gained 17.5%. Beef prices continued to set record highs with the US cattle herd at a 60-year low.

Metal prices were mixed with nickel down 3.7%, tin (-3.1%) and platinum (-4.8%) also falling. On the positive side was aluminium (+4.0%), copper (+0.4%) and zinc (+0.8%).

The iron ore price fell another 2.5% in October and is down 41% since the start of 2014.

AUSTRALIAN SHARES

Australian shares performed well in October, rebounding from weakness in September. The S&P/ASX 200 Accumulation Index added 4.4% during the month.

Sentiment towards share markets globally was buoyed by the favourable performance of US equities. The S&P 500 Index rose to an all-time high in late October, supported by generally encouraging quarterly earnings releases from US-listed companies.

The Australian market was led higher by financial stocks. Two of the four major banks – ANZ Banking Group and National Australia Bank – announced their full year results towards the end of the month. Both were broadly in line with expectations. Health Care and Telecoms stocks also tended to perform relatively well.

Energy stocks tended to lag the rising market, partly due to weakness in the oil price. The Materials sector was another notable underperformer. Several stocks in these two sectors announced quarterly production reports during the month.

Elsewhere the annual AGM season got underway. At these meetings, various companies provided trading updates and, in some cases, issued revised earnings guidance for the FY15 year.

LISTED PROPERTY

The Australian listed property sector rose by 6.8% in October. Declines in Australian government bond yields increased the relative appeal of high yielding assets such as property securities. A number of A-REITs provided quarterly guidance, including GPT Group which updated its earnings growth guidance from 3% to “at least 4%”; and Stockland, which reiterated earnings growth guidance of between 6.0% and 7.5%.

GLOBAL SHARES

Global developed equity markets were mixed in October and traded with volatility. Global growth concerns dominated early in the month, with the International Monetary Fund (IMF) downgrading global growth. The IMF now expects growth of 3.3% for 2014 and 3.8% for 2015. This compared to the prior forecasts of 3.4% and 4.0% respectively. The main downgrades were driven by Japan and Europe, while for 2014 growth in the US was upgraded.

Equity markets also had to deal with the end of QE3 in the US, while late in the month the surprise Bank of Japan announcement of an expansion in the QQE program led to a strong surge in the Nikkei.

Overall, the MSCI World Developed Markets Index rose 0.6% in USD terms, but fell 0.1% in AUD given the slight gain in the AUD.

In the US, the S&P 500 Index reached an all-time high on 31 October, recovering strongly from a sharp fall mid-month on global growth concerns and the falling oil price. US company earnings released late in the month also helped buoy the market. By the end of the month, 51% of S&P500 companies had reported earnings with 71% of these beating expectations.

Overall the S&P 500 rose 2.3% for October, while the Dow Jones Index was up 2.0% and the NASDAQ rose 3.1%.

Equity markets in Europe were weaker with continued concerns over the growth outlook. Italy (-5.3%), France (-4.1%), Spain (-3.2%) and Germany (-1.6%) all fell.

The Japanese Nikkei 225 rose 1.5% over the month, however a gain of 4.8% on 31 October on the BoJ announcement was the main driver of the positive return over the month.

GLOBAL EMERGING MARKETS

Emerging market (EM) equities rose in October, with the MSCI EM Index returning +1.1% in USD terms and +0.4% in AUD terms. This return did hide considerable divergence between regions and countries with MSCI Latin America the weakest performer.

Source: Colonial First State, November 2014

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