Monthly market view

April 2011

- April saw positive returns for major global equity markets, supported by a positive earnings season in the US, further merger and acquisition (M&A) activity and signs of continued recovery in the US economy.

- Oil (+6.8%) and gold (+7.8%) prices continued to rise on geopolitical risks and on news that global inflation pressures continued to climb.

Economic overview

In an anticipated move, the Portuguese government requested a formal bailout from the European Union (EU) and International Monetary Fund (IMF). Portugal was the third EU nation after Greece and Ireland to request a bailout, after facing bond refinancing in April and June with the 10-year bond yield rising from 6.60% in December to 9.64% in April. In early May it was confirmed that the size of the bailout will be €78 billion, smaller than Greece and Ireland.

The other major news item was the move by Standard and Poor's to place the US long-term government debt rating on negative outlook. The US currently has a AAA credit rating (the highest possible). The move by S&P was an attempt to force policy makers in the US to meaningfully attempt to reduce its budget deficit and government debt levels by 2013.

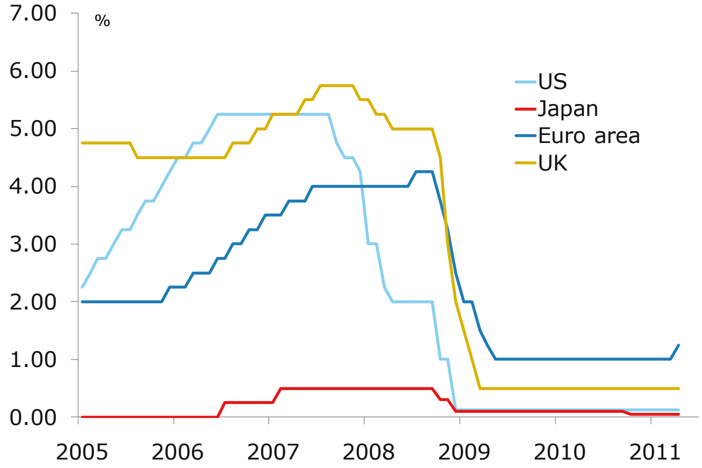
To date, US policy makers have been unable to agree on the best way to reduce the budget deficit. If no action is taken the ratings agency believes it would "render the US fiscal profile meaningfully weaker than that of peer AAA sovereigns". There is a one-in-three chance that the credit rating might be cut in the next two years, although the hope is that this action will prompt President Obama and the Republican leadership to agree on a budget action plan. The US dollar continued to decline over the month.

The US Federal Reserve (the Fed) left interest rates on hold in April and continued its bond purchasing program (quantitative easing), due to finish in June. Chairman Ben Bernanke conducted his first press conference following the interest rate decision meeting, in what is a new policy to improve communication with financial markets and the broader public. The Chairman indicated that the Fed is not yet ready to signal a start to tightening monetary policy, instead announcing that the balance sheet would remain at its June 2011 level on an ongoing basis, by reinvesting maturing securities. In other words, the Fed will continue to stimulate the economy for some time before beginning to lift interest rates or sell assets. The Fed also downgraded expectations for economic growth, inflation was upgraded and unemployment forecasts were lowered.

Economic data released in the US in April indicated Q1 2011 GDP slowed to 1.8% on an annualised basis, from 3.1% in Q4 2010. The slowdown was due to weather related issues and weakness in government defence spending, while consumer and capital spending expanded at a reasonable pace.

The European Central Bank (ECB) lifted interest rates to 1.25% from a record low of 1%, in a widely anticipated move to combat rising inflation pressures. This was the first time the ECB had lifted interest rates before the Fed and saw the euro rally against the US$ by 4.3%. The ECB is attempting to balance growing inflation pressures with continued sovereign debt issues, while treating the issues separately (see chart 1). The first inflation estimate for April in the EU accelerated to 2.8%/year.

Chart 1: Official interest rates – developed markets



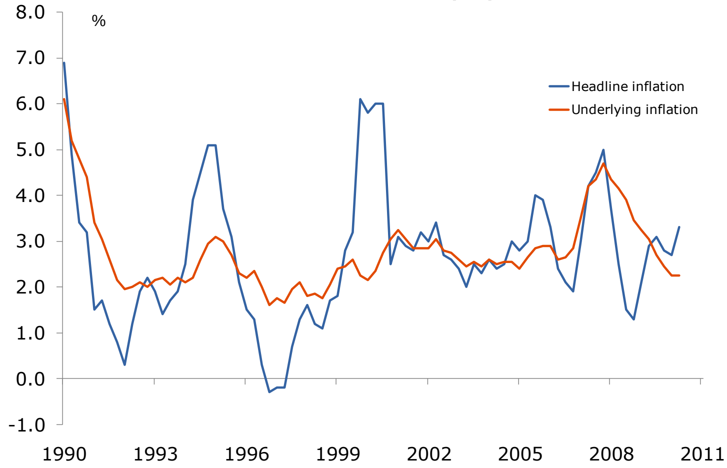
Source: RBA. Data to April 2011.

China released a range of economic data in April for Q1. GDP growth of 9.7%/year and inflation of 5.4%/year was recorded, both stronger than expected by the market. The stronger set of numbers produced further tightening measures, including higher interest rates. Further tightening measures are expected.

Data released in Japan continued to show the impact of recent natural disasters. Industrial production fell 15.3%/month, led by a 57.3%/month fall in vehicle production. Supply chain issues are being felt globally as a result. To date, most of the impact has been felt in auto production with reduced work hours and lower production in both Australia and the US.

In Australia the major economic data release was Q1 2011 CPI data. Headline inflation rose by 1.6%/quarter, which was larger than expected due to severe weather conditions and the sharp increase in the oil price. This took the annual headline inflation rate to 3.3%. Underlying inflation rose by a more subdued but still solid 1.9%/quarter, but this left the annual rate of underlying inflation at 2.3% - consistent with RBA forecasts (see chart 2). Food prices were up 2.9%/quarter, with fruit prices rising 12.5% and vegetable prices rising 16.0%. In addition, the rising world oil price saw petrol prices increase by 8.8% during the quarter.

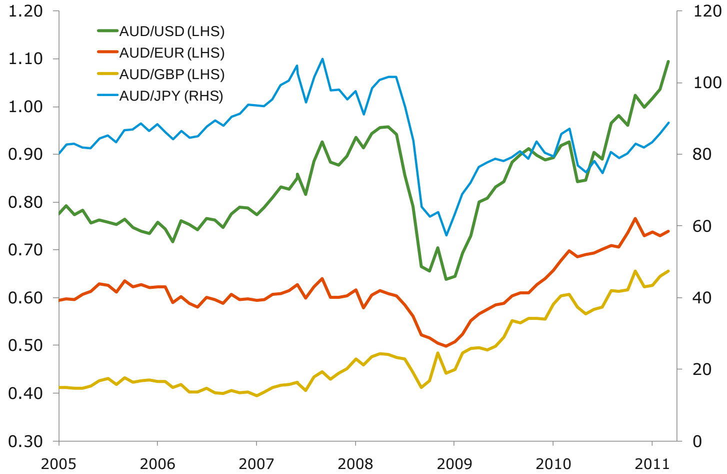
Chart 2: Australian inflation rate (%)



Source: ABS. Data to 31 March 2011.

The RBA left interest rates on hold at 4.75% in April and May, and remain happy with the "mildly restrictive stance of monetary policy". The RBA does expect underlying inflation to rise from here and Q1 GDP could possibly show a negative result when the data is released in early June. The A$ recorded fresh post float highs, finishing the month at US$1.0971 - a gain of 6.2%. Gains of 1.7% were also recorded against the pound, 1.1% against the euro and 3.6% against the yen.

Chart 3: Australian dollar



Source: Bloomberg. Data to 30 April 2011

Australian shares

Early in the month, the Australian sharemarket maintained its positive momentum from late March, but the rally dissipated in the second half of the month. The market was little changed in the month as a whole, with the S&P/ASX 200 Accumulation Index declining 0.3%.

There were some concerns that Chinese inflation would prompt authorities to introduce tightening measures, which could have negative implications for Australian exporters. Australian economic data has an important influence on the domestic sharemarket but data in other key economies, such as China, can also have an influence on investor sentiment. Investors also kept a close eye on the release of US economic data, and the subdued housing data affected sentiment towards Australian companies in the construction sector.

Risk aversion among investors resulted in further strength in the gold price. The commodity rose to new all-time highs during the month. One of the biggest drivers of the Australian equity market in April was the sharp rise of the Australian dollar. The rapid rise holds back earnings for a number of Australian companies and also deters offshore investors from investing in the Australian market. Some companies have recently updated earnings guidance and some downgrades have been evident due to the Australian dollar.

Global shares

Global equity markets recorded positive returns in April, buoyed by positive earnings results and M&A activity. At the end of April around 60% of S&P 500 companies had reported earnings, with more than 70% beating market expectations. Most of this was from cost improvements, although there are signs of revenues growing and beating expectations. The MSCI World Net Index rose 4.0% in US$ terms but fell 1.5% in A$ terms, due to the strong gains in the Australian dollar.

The Dow rose 4.0%, the S&P 500 was up 2.9% and the NASDAQ rose 3.3%. Similar to Australia, the Canadian equity market was held back by a strong currency despite higher commodity prices (particularly gold which rose 9.2%). The S&P/TSX Composite Index recorded no change and underperformed the broad global equity market index.

European markets recorded gains despite the ECB lifting interest rates for the first time since the financial crisis and Portugal seeking a bailout from the IMF and EU. Both events were widely anticipated by the market. Germany (+6.7%), Spain (+2.9%) and France (+3.0%) all rose and Portugal (-0.5%) fell. The UK FTSE rose 2.7%, after falls in March.

In Asia, Japanese equity markets recorded mixed results. The Nikkei finished the month up 1.0%, while the Topix fell 2.0%. Economic data for March is now being released, showing a sharp fall in economic activity post disasters. Asia ex-Japan also recorded mixed results with South Korea (+4.1%), Thailand (+4.4%) and Taiwan (+3.7%) recording the strongest gains in the region. Singapore (+2.4%) and Hong Kong (+0.8%) also recorded solid gains while Malaysia fell 0.7%.

In terms of sector performance in April, Healthcare (+7.1%) was the strongest performer followed by Consumer Staples (+6.0%) and Materials (+4.9%). While all sectors returned positive gains, Telcos (+2.5%) and Energy (+2.2%) were more modest.

Global emerging markets

Emerging markets underperformed developed global equity markets in April, although still recorded positive gains in US$ terms. The MSCI Emerging Markets index rose 2.8% in US$ but fell 2.6% in A$ terms.

The BRIC countries all recorded losses; Brazil (-3.6%), Russia (-0.5%), India (-1.6%) and China (-4.4%). Inflation pressures and subsequent tightening, particularly in China and India, along with the fall in commodity prices, held back equity market returns. Other countries to record losses included Argentina (-0.9%), Mexico (-1.3%) and Israel (-2.3%). Saudi Arabia rose 2.3% with the oil price rising 6.8% in the month.

Fixed interest

Government bond yields generally declined in April. The trend to higher US 10-year treasury yields continued into early April, rising to around 3.6%. However, yields subsequently declined over the rest of the month, ending at 3.30%.

German 10-year bunds continued their upward trajectory in early April, peaking at 3.49% before retracing amid heightened uncertainty over peripheral eurozone sovereign debt issues.

As in other global bond markets, 10-year UK bond yields finished the month at 3.43% (from 3.69% at the end of March). The UK bond market continued to grapple with elevated inflation in the UK and the possibility of higher interest rates.

In Japan, government bonds recovered early in April following the worst natural disaster in the nation's history, before falling along with other developed bond markets to finish down by 5 bps.

In Australia, ten-year government bond yields were volatile, beginning the month at 5.48% then rising by 19 bps to 5.67%, before falling to finish the month down 5 bps at 5.43%.

The UBS Composite Bond Index returned 0.5% in April and 6.8% over the past 12 months.

All eyes will be on the release of the Commonwealth Budget due on 10 May. Treasurer Swan has flagged a deteriorated budget position with the 2010/11 budget deficit expected to be circa $50 billion, before returning to surplus as expected in 2012/13.

Listed property

The S&P ASX 200 Property Accumulation index was up 0.2% in April, outperforming the S&P/ASX 200 by 0.5%. The commercial sector was the strongest performer and the retail sector continued to underperform against broader macro concerns.

The major news announced during the month was that Goodman Group (GMG), along with other investors, submitted a bid to acquire ProLogis European Properties. The bid was rejected and Prologis has subsequently made an all cash bid. While GMG's bid was unsuccessful, it illustrates the strength of the relationship with their capital partners.

The UBS Global property investors' index (local currency) increased 4.4% during the month, with the UK the top performing region (+6.3%) followed by the US & Canada (+5.6%). The worst performing regions were Australia (+0.3%) and Singapore (+1.7%).