Comment on investment markets in September 2014

MJW Investments

6 October 2014

	1 month	3 months	1 year	5 years pa	10 years pa
NZX 50	1.1	2.8	12.4	12.2	7.8
ASX 200 (AUD)	-5.4	-0.6	5.9	6.8	8.4
MSCI World (unhedged)	4.5	9.9	19.9	9.2	5.6
MSCI World (NZD hedged)	-0.7	1.7	18.3	13.2	7.9
MSCI Emerging Markets (LCT)	-4.2	0.7	8.6	6.6	11.2
NZX NZ Government Stock	0.1	1.8	5.2	5.6	6.1
Barclays Global Aggregate	0.0	2.0	8.7	7.0	7.8
NZD/USD	-6.9	-11.0	-6.4	1.5	1.4
NZD/AUD	-0.5	-4.0	0.0	1.7	-0.5

Markets

Developed share markets In local currency terms, global share markets were down with the MSCI Developed Markets Index (NZ dollar hedged) down 0.7% for the month. Denmark and Japan had returns over 4% for the month while Portugal was down 5.6% and Hong Kong was down 7.1% on the basis of recent events there.

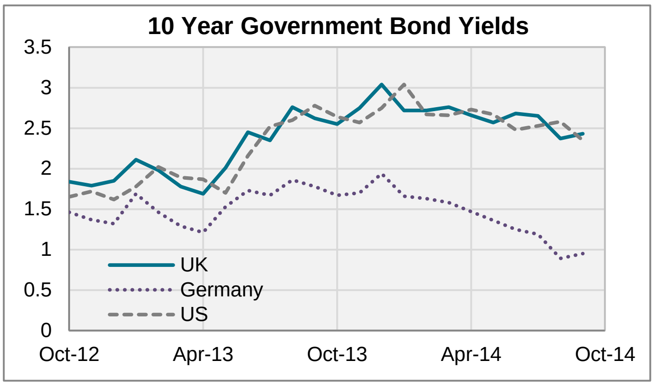
Emerging markets The MSCI Emerging Markets Index was down 4.2% in local currency this month. Most countries had negative returns although India was up marginally. The Czech Republic was up a strong 6.9% while Brazil was down a sizeable 11.6% and Greece was down 8.9%.

Bonds Over September, 10 year US Treasury rates reversed their previous drop, rising from 2.35% to 2.52%. In New Zealand, while the 10 year yield fell 41 bps in August, it has risen again in September from 4.06% to 4.14%.

Economies

US The US economy has performed strongly in 2014. September saw the number of new jobs reach 248,000 and the jobless rate decrease to 5.9 percent in September, the first time since the GFC it has been below 6%. Looking at the last year, the unemployment rate and the number of unemployed persons were down by 1.3% and over 1.7 million, respectively. The issue which is concerning the Fed and which is holding it back from raising interest rates is the slow increase in wage rates which are predicted to increase by just 0.4% year-on-year in Q4 2014. The Federal Open Market Committee sets the interest rates at its regular meeting and while the views of its members on the future path of the rates differ the consensus would see rates rise in the middle to late next year.

The strong economy is witnessed by the latest restatement of the US GDP for the second quarter with an annual rate of 4.6%. There are as ever some soft spots with consumer confidence falling in September for the first time in five months and house prices per the Case-Shiller index are up 5.6% for the year compared to 6.3% in the previous month. The upper chart alongside showing the kick up in the US dollar versus the EU confirms the strength in the economy.



Europe While the US (and Chinese economies) together paint a reassuring picture of growth the story in Europe is one of weak economic growth and falling interest rates – see the chart to the right. The latest bad news saw the German manufacturing industry contract for the first time in 14 months with the manufacturing PMI index for Germany slipping below

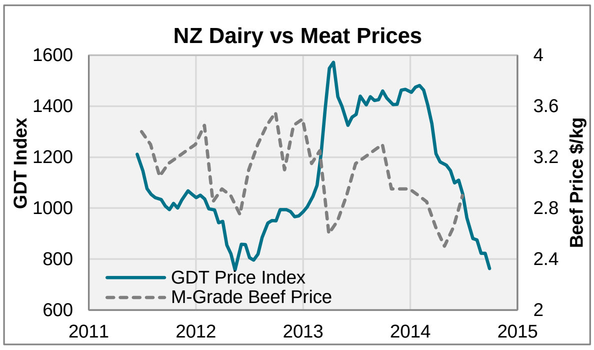
50.0 to 49.9 for September. A reading below 50 means the level of manufacturing is contracting. The chart to the right shows the ups and downs of the fortunes of the manufacturing sector and currently the trend is worryingly down. Deflationary pressures persist, with both input and output prices falling since the previous month. Any sign of deflation will act to undermine the efforts to achieve economic growth. Fitch Ratings are still forecasting a Eurozone GDP growth rate of 0.9% in 2014, with a small pick-up to 1.3% in 2015 and 1.5% in 2016. However compared to the rest of the world these numbers are just too low. France is not in great shape: with President Hollande under political pressures he has been reluctant to put France's house in order and the Finance Minister announced that France's budget will stay above the EU maximum limit of 3% until 2017. This statement reneged on previous commitments made.

The main exception to the weak European story is the **UK** with growth for Q2 up 0.9%, an increase on the previous estimate and the strongest quarterly growth since the second quarter of 2010, according to the Office for National Statistics (ONS).

China The eyes of the world are currently on Hong Kong and how the call for more democracy there will play out in the immediate future. While Hong Kong is important to the Chinese economy, one view is that it will be sacrificed if the Chinese Party in Beijing decides they have to forcibly end the protests. Alternatively the leadership could accede to the protesters' demands, knowing that ultimately real control still lies in Beijing. A negative response will be seen as dealing a serious blow to the Hong Kong economy which has played an important role in facilitating trade between China and the world; this will of course spill off into mainland China. While there are doubts regarding China the general picture for the economy still looks reasonable with the HSBC/Markit Manufacturing Purchasing Managers' Index(PMI) at 50.2 in September, unchanged from August reading, although this was itself a 3-month low. A worrying statistics in the survey was weakness in the job market, with the manufacturing employment sub-index shrinking for the 11th consecutive month. Chinese leaders need to avoid raising unemployment.

Australia – The share market in Australia was down in September, reflecting concern with the direction of the economy and in particular concern over the expected future direction of iron ore prices. Iron ore prices are over 40% below where they were at the start of the year with double digit percentage decreases for all three quarters this year.

New Zealand The outlook for NZ remains positive although dairy prices fell again this week, reaching levels not seen since early 2012. It is estimated that this latest drop will see the dairy industry contribute 2.5% less to economic growth this season compared to last. The chart alongside includes beef prices which are on the rise, if from somewhat low previous levels. The election has come and gone and business has continued as normal with some relief that the agreement between the RBNZ and the new Minister of Finance is not going to have to be changed. If Labour had managed to form a Government, while we would have seen some changes it is hard to envisage that they would have implemented their proposals to use changes in the KiwiSaver contribution rate to boost and cool the economy.



Outlook

In their monthly update on markets, our Towers Watson Colleagues commented that the biggest surprise this year has been the strong returns from long-dated bonds. This is in stark contrast to what most market participants were expecting at the start of the year. Towers Watson continue with their positive outlook for the valuation of emerging market equities.

The outlook for New Zealand is generally positive. The value of the NZ dollar is expected to fall, which is good news for exporters. This could, however raise inflationary concerns and is bad news for those wanting to purchase foreign goods.

Mark Weaver