Monthly Markets

October 2014

The US Federal Reserve officially ended their quantitative easing program in October while, across the Pacific, the Bank of Japan announced that it was ramping up its own QE program. This follows the ECB in July announcing their asset-backed securities and covered bonds buying program. These announcements clearly highlight the divergence in global monetary policies.

In the US, the economic recovery continues with further improvement in its labour market. In October, the unemployment rate fell from 5.9% to 5.8% although the 214,000 jobs added fell below expectations. US inflation remains subdued at 1.7% y/y in September, providing room for the US Fed to remain dovish and delay raising its policy rate. Other measures of activity also pointed towards solid growth in the US. The manufacturing Purchasing Manager Index (PMI) recorded 55.9 which, despite having fallen from 57.5 from the previous month, is still at a relatively high level.

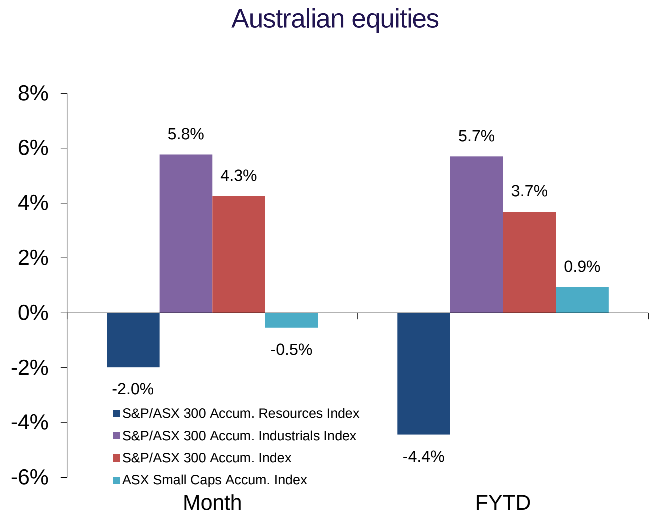
Ongoing risk of deflation in Europe was represented in its latest Harmonised Index of Consumer Prices (HICP) for the EU region. It was reported to be -0.1% m/m for October. There was a similar result for Europe's largest economy, Germany (-0.3% m/m) with the main cause being falling energy costs. Although the ECB made no changes to its policy this month, the latest round of data suggests that more action may be needed.

The surprise of the month came from the Bank of Japan (BoJ) making an unexpected announcement to expand their QE program. The BoJ plans to increase its asset purchasing program from JPY60-70 trillion to JPY80 trillion a year. The driving force behind the BoJ's action was the Bank's fear that its previous program was not sufficient to achieve its 2% inflation target as data showed that the Japanese economy was weakening. Those fears proved to be rightly placed later in the month as third quarter GDP growth unexpectedly showed Japan entering a recession with -0.4% q/q growth. Following this, Prime Minister Shinzo Abe made an announcement regarding early elections to attempt to extend his term and to see through his "Abenomics" policies. The planned second consumption tax increase for next year is also to be delayed for 18 months.

Coinciding with the BoJ announcement, Japan's Government Pension Investment Fund (GPIF), which manages JPY127 trillion in assets, announced that it would boost its domestic and international equities allocation from 24% to 50% while reducing its domestic bond allocation from 60% to 35%. The new allocation is aimed to encourage investor interest in the Japanese equity market and to spur sentiment.

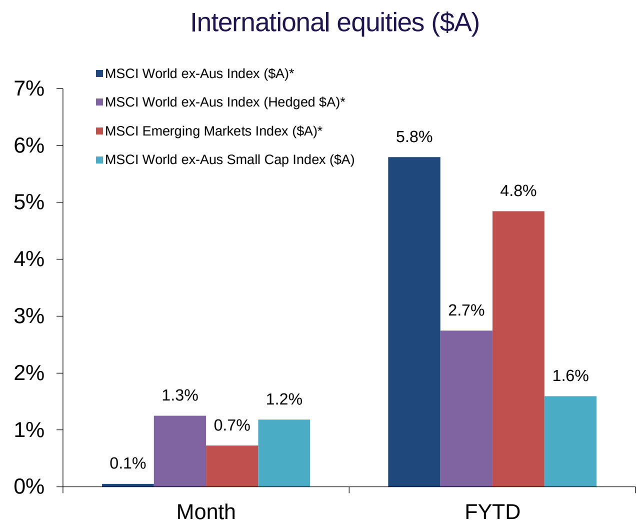
Uncertainty over Chinese growth continues to loom. China recorded its weakest growth since the first quarter of 2009 with 7.3% y/y GDP growth. Additionally, its official PMI reading came in lower for October at 50.8 with its forward looking components falling as well (new orders and business expectations). Although industrial production growth recovered from its unexpected and significant fall in August, it is still at a relatively slow 7.7% y/y.

Domestically, the RBA kept interest rates unchanged at 2.5%. Although October's unemployment rate rose to 6.2% from 6.1%, the RBA noted that some of its forward indicators on employment have been improving this year.



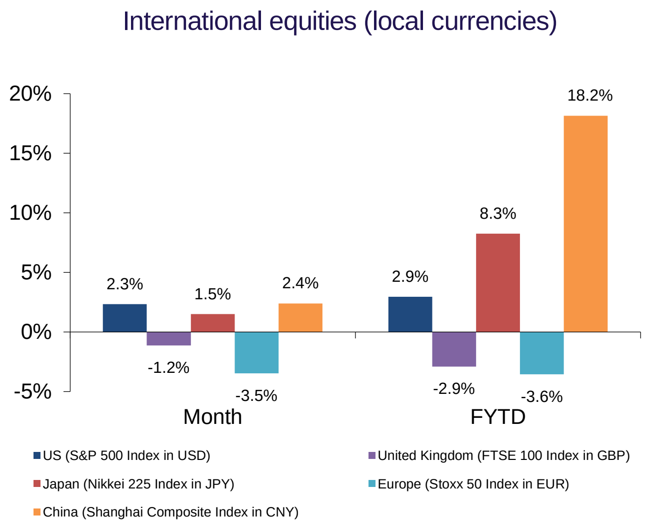
After a horrendous month in September, Australian equities bounced back sharply in October, recovering most of their losses from the previous month.

Most sectors recorded a positive return for October with the exception of Energy (-3.6%) and Materials (-0.2%) due to continued weakness in commodity prices (oil and iron ore).

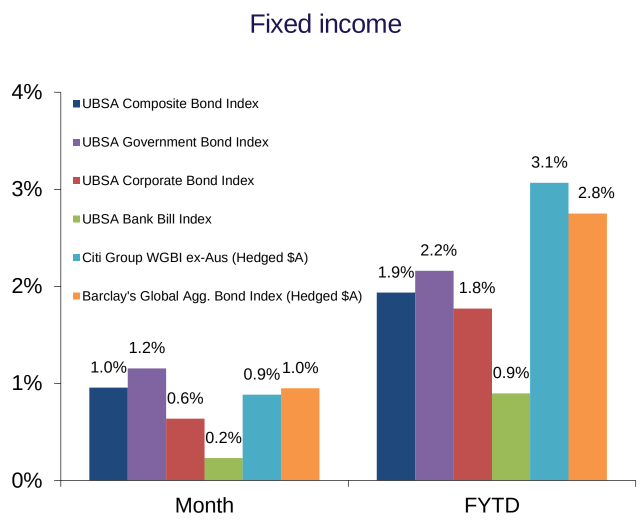


Both developed market and emerging market equities performed positively over the month, more so developed market equities. The slight appreciation of the Australian dollar after its dramatic fall last month meant that unhedged developed market equities underperformed their hedged counterpart.

By country, China (4.2%) was the standout positive contributor to the emerging markets index.

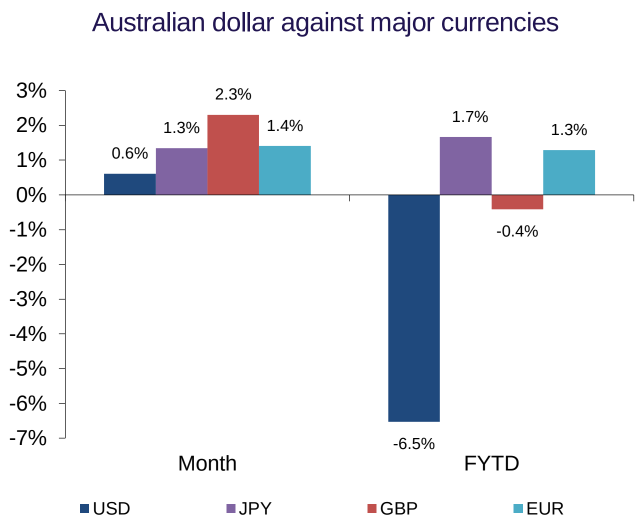


Negative economic data continued to weigh on European equities in October. Conversely, US equities maintained positive momentum over the month. These patterns appear to reflect the divergence in regional growth and central bank policies.



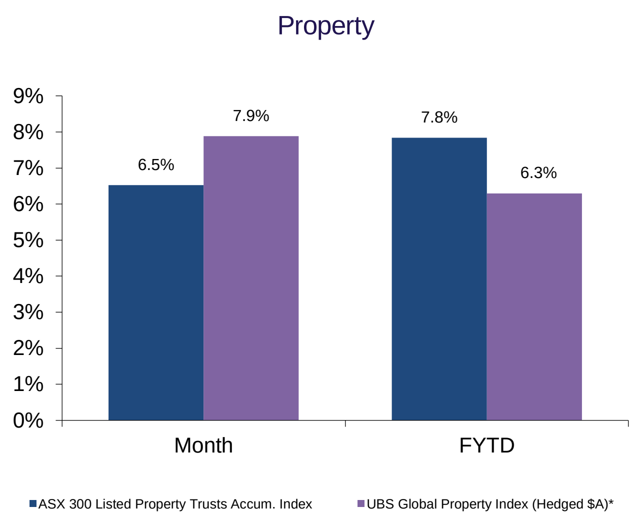
Both international and Australian fixed interest had a positive month over October. Both the Australian and international composite indices delivered 1.0%.

Sovereign yields across most regions continued to fall over the month. The Australian yield curve flattened as the long end rallied more than the short end reflecting concerns over Australia's growth outlook.



The Australian dollar ended the month slightly positive against other major currencies after falling sharply last month.

Similar to what we have seen over the financial year to date, with continued central bank policy divergence (US and UK likely to begin rate normalisation policies while Europe and Japan are increasing their accommodative policies), it is likely that the Australian dollar will continue to depreciate against the USD and GBP.



Australian and international listed property trusts recovered strongly in October with international listed property trusts outperforming their Australian counterpart.

31-Oct-14	Index value	Month	3 months	FYTD	1 year
Australian equities					
S&P/ASX 300 Accum. Index	47,022	4.3%	-0.7%	3.7%	6.1%
S&P/ASX 300 Accum. Industrials Index	93,357	5.8%	1.8%	5.7%	9.4%
S&P/ASX 300 Accum. Resources Index	20,485	-2.0%	-10.5%	-4.4%	-6.6%
ASX Small Caps Accum. Index	5,378	-0.5%	-3.8%	0.9%	-3.3%
International equities					
MSCI World ex-Aus Index ($A)*	5,771	0.1%	6.1%	5.8%	17.4%
MSCI World ex-Aus Index (Hedged $A)*	1,160	1.3%	3.5%	2.7%	15.1%
MSCI Emerging Markets Index ($A)*	484	0.7%	1.3%	4.8%	8.4%
MSCI World ex-Aus Small Cap Index ($A)	362	1.2%	4.5%	1.6%	12.1%
US (S&P 500 Index in USD)	2,018	2.3%	4.5%	2.9%	14.9%
United Kingdom (FTSE 100 Index in GBP)	6,546	-1.2%	-2.7%	-2.9%	-2.7%
Japan (Nikkei 225 Index in JPY)	16,414	1.5%	5.1%	8.3%	14.6%
Europe (Stoxx 50 Index in EUR)	3,113	-3.5%	-0.1%	-3.6%	1.5%
China (Shanghai Composite Index in CNY)	2,420	2.4%	9.9%	18.2%	13.0%
AUD versus …					
USD	0.88	0.6%	-5.6%	-6.5%	-7.2%
JPY	97.02	1.3%	1.3%	1.7%	3.9%
GBP	0.55	2.3%	0.0%	-0.4%	-7.0%
EUR	0.70	1.4%	0.5%	1.3%	1.0%
Property					
ASX 300 Listed Property Trusts Accum. Index	32,625	6.5%	2.7%	7.8%	16.5%
UBS Global Property Index (Hedged $A)*	1,991	7.9%	5.3%	6.3%	18.5%
Australian Fixed Interest					
UBSA Composite Bond Index	8,104	1.0%	1.6%	1.9%	7.1%
UBSA Government Bond Index	8,439	1.2%	1.8%	2.2%	6.9%
UBSA Corporate Bond Index	8,267	0.6%	1.3%	1.8%	6.6%
UBSA Bank Bill Index	8,137	0.2%	0.7%	0.9%	2.7%
Global Fixed Interest					
Citi Group WGBI ex-Aus (Hedged $A)	-	0.9%	2.4%	3.1%	8.1%
Barclay's Global Agg. Bond Index (Hedged $A)	-	1.0%	2.3%	2.8%	7.9%
Oil and commodities					
Crude Oil ($/bbl)	81	-11.6%	-18.0%	-23.6%	-16.4%
Copper Spot ($/tonne)	6,762	0.6%	-5.2%	-4.0%	-6.6%
Gold Spot ($/ounce)	1,172	-3.3%	-8.7%	-11.4%	-11.8%
Fixed income (yields) as at …	**31-Oct-14**	**30-Sep-14**	**31-Jul-14**	**30-Jun-14**	**31-Oct-13**
Australia Bank Bill	2.72	2.69	2.64	2.68	2.58
Australia 10 Year Government Bond	3.29	3.48	3.51	3.54	4.02
US 10 Year Government Bond	2.34	2.49	2.56	2.53	2.55
UK 10 Year Government Bond	2.25	2.43	2.60	2.67	2.62
Germany 10 Year Government Bond	0.84	0.95	1.16	1.25	1.67
Japan 10 Year Government Bond	0.46	0.53	0.54	0.57	0.60

* Net dividends reinvested