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Market Update

June 2015

Share markets fall

Global share markets weakened, albeit modestly, in the three months ended 30 June. Stocks moved steadily higher for much of the period, driven by speculation softer economic data will prompt the US Federal Reserve (Fed) to delay raising interest rates until at least September and confirmation from its chair Janet Yellen that monetary policy will be tightened only gradually. Share markets also benefited early on from some encouraging US, European and Japanese earnings results, stronger Japanese and euro-zone growth figures and further Chinese stimulus. But it was an escalation in Greece's debt crisis toward the end of the period that ultimately dragged markets into the red. Investors had been hopeful that an agreement between the country and its creditors could be reached ahead of the 30 June deadline; however a deal failed to materialise after Prime Minister Alexis Tsipras made the unexpected decision to call a referendum on whether to accept creditors' demands for budget reforms. The market's reaction to the move was swift, with stocks plummeting as investors quickly cut their risk exposure. Making matters worse, Greece subsequently failed to make a EUR1.6 billion loan repayment to the International Monetary Fund; the first time ever that a developed country has defaulted on its debt to the Washington-based institution.

Australian shares also fell in the second quarter; the local market hurt by sharp declines across the 'Big Four' banks, the Reserve Bank of Australia (RBA)'s decision to downgrade its domestic growth forecast and the escalation of Greece's debt crisis late in the period.

The RBA cuts interest rates

In May, the RBA cut the official cash rate to a new low of just 2.00%. The decision followed a similar move in February and came on the back of a softer domestic growth outlook, a still-strong Australian dollar (AUD), a benign inflation backdrop and declining commodity prices. Whilst the move itself didn't surprise the market, the jump in the AUD immediately following the bank's announcement did. The jump in the currency was blamed on the bank's failure to signal a clear easing bias in its post-meeting statement. That said, RBA Governor Glenn Stevens did say in a subsequent speech that the central bank remains open to the possibility of further policy easing. However, he also noted that any such decision would be dependent upon the relative strength/ weakness of upcoming key economic data.

Market Update

Australian dollar rises

The AUD made modest gains in the second quarter; the local currency benefiting from speculation the RBA may be done with cutting interest rates, some better-than-expected economic data and general US dollar (USD) weakness. The AUD rose 0.6% against the USD and 2.4% against the Japanese yen. It fell 5.4% against the British pound and 2.9% against the euro while the Australian Trade-Weighted Index[1] closed the period up 0.8%.

Domestic growth beats forecasts

The Australian economy expanded by more than expected in the first quarter of 2015 with gross domestic product rising 0.9% in the three months ended 31 March. The market had anticipated growth of 0.7%. Contributing to the outcome was a jump in exports and stronger household spending. On an annual basis, the economy grew 2.3%; down slightly from the 2.5% growth recorded in the 12 months ended 31 December.

Looking ahead

Oil prices, European Central Bank quantitative easing, Fed rate hike speculation and concerns over Greece's future in the euro-zone have all dominated financial markets so far this year. In the US, the economy continues to move forward but some investors are taking a step back. And we can't blame them since the headwinds to US financial markets are gathering strength. High stock valuations, a strong USD and lower profit margins are making it a challenging environment. Paradoxically, even stronger jobs data is no longer good news because it simply brings forward the likely date of the first Fed rate hike.

The puzzle of euro-zone economic growth, corporate earnings and policy action is being solved. Growth is back and earnings are rising, while monetary and fiscal policies are decisively reflationary. In other words, the tailwinds are working their magic and euro-zone assets are reflecting this new reality. Greece, for now, remains something of an unknown quantity as it continues to test previously unchartered waters.

Economic growth in the Asia Pacific region looks to be well behaved as we move into the second half of 2015. The strong numbers delivered by China, Australia and New Zealand in 2014 have come off the boil, but their slowdowns are orderly. Elsewhere, the recovery in Japan is gathering strength and a convincing reform program is underway in India. Overall, regional share markets are performing well. They remain reasonably valued, but we do see lower returns in the year ahead.

[1] The trade-weighted index for the AUD is an indicator of movements in the average value of the AUD against the currencies of our trading partners.

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