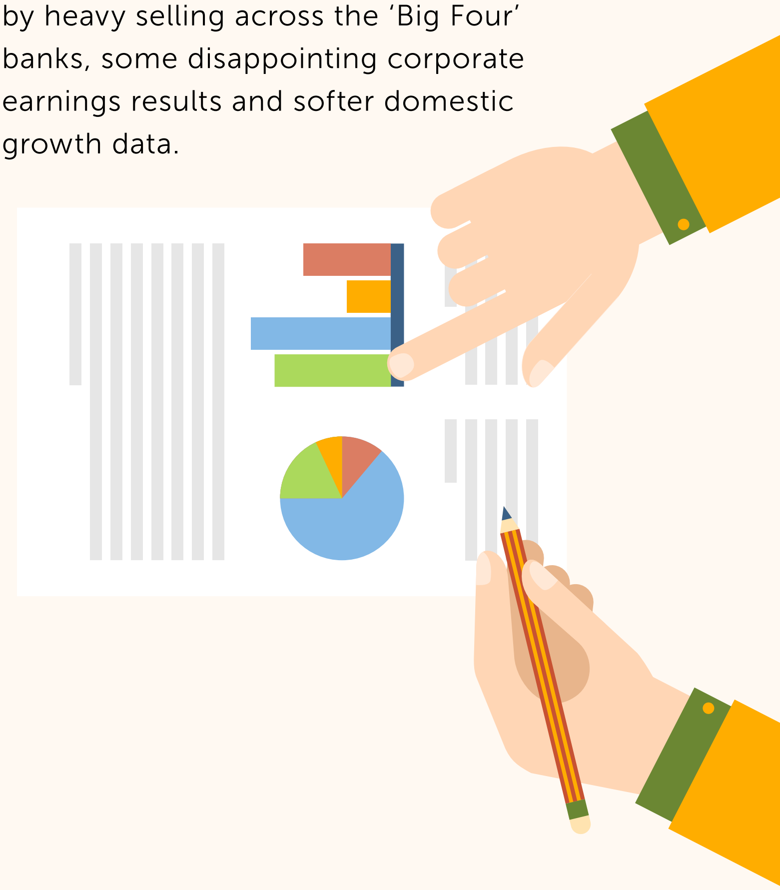
Market Update

September 2015

Share markets edge higher

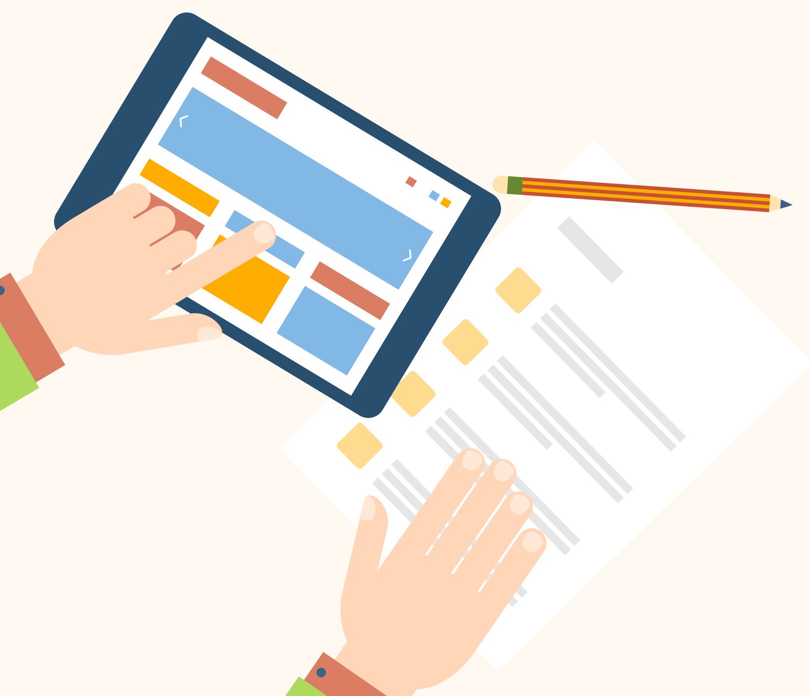
Global share markets made modest gains in unhedged Australian dollar (AUD) terms in the three months ended 30 September. In hedged AUD terms, share markets fared much worse as the AUD fell quite sharply over the period. Stocks began the quarter well, rising strongly on the back of news Greece had finally reached an agreement with its creditors that would see it remain in the euro-zone and some encouraging US and European earnings results. However, these early gains were soon countered by further heavy selling in Chinese stocks and increasing fears that slower growth in the world's second-biggest economy could derail the global recovery. Both developed and emerging share markets tanked as a result while commodity prices plummeted to multi-year lows. Share markets were also pressured by the US Federal Reserve (Fed)'s decision to leave interest rates on hold in September. Whilst stocks did move higher immediately following the Fed's announcement, they soon backtracked as investors worried the bank's decision to wait signalled a lack of confidence in the US recovery.

The Australian share market had a poor third quarter; the local market's decline driven by much the same themes as its global peers. However, Australian stocks were also negatively impacted by heavy selling across the 'Big Four' banks, some disappointing corporate earnings results and softer domestic growth data.



The RBA leaves interest rates on hold

The Reserve Bank of Australia (RBA) left the official cash rate unchanged at 2.00% throughout the period. Perhaps the most significant development over the quarter related to the RBA's thinking on the AUD. Specifically, in August officials removed the warning that a weaker currency is both "likely and necessary" and instead noted that the AUD "is adjusting to the significant declines in key commodity prices." It was the first time in almost 18 months that the RBA didn't make reference to the AUD being too high. Looking ahead, the latest communication from the RBA suggests the bank has adopted a more neutral stance on monetary policy with any move in interest rates likely to be determined by the relative strength/weakness of upcoming key economic data.



Australian dollar weaker

The AUD weakened in the third quarter; the local currency negatively impacted by Chinese and global growth concerns, softer domestic growth, further commodity price weakness, confusion over the timing of the Fed's first rate hike since 2006 and renewed efforts by RBA officials to talk down the currency. The AUD fell 10.5% against the Japanese yen, 9.2% against the euro, 8.7% against the US dollar and 5.4% against the British pound. The Australian Trade-Weighted Index[1] closed the period down 6.1%.

Domestic growth disappoints

The Australian economy expanded by less than expected in the second quarter with gross domestic product rising just 0.2% in the three months ended 30 June. The market had anticipated growth of 0.4%. It was only a strong jump in government spending that prevented the economy from contracting for the first time since the first quarter of 2011. On an annual basis, the economy grew 2.0%; down from the 2.3% growth recorded in the 12 months ended 31 March.

Looking ahead

Market volatility remains elevated, with previous assertions of steady US economic growth, moderate Fed monetary policy and a soft landing in China now unable to be taken for granted. As a result, financial markets are struggling to find direction, making it all the more important for investors to separate market noise from signal.

Our core views about the global economy have been broadly unchanged since the beginning of the year. We still anticipate moderate growth in the US, we think the European recovery will continue to gather pace and we expect Japan's economy to gradually improve. We also believe emerging market economies will remain under pressure and that China's slowdown has further to run.

In the US, it's our view that caution over China and heightened market volatility were what forced the Fed to leave interest rates on hold in September. We're expecting one rate rise before the end of the year – most likely in December – and another four rate hikes in 2016. Looking ahead, we see the US economy expanding 2.50% over the next 12 months and the US 10-year Treasury yield at 2.80%.

We remain positive on the euro-zone; our view based on expectations of healthy growth momentum, double-digit growth in corporate profits, supportive central bank policy and relatively attractive equity market valuations.

However, we're less upbeat about the Asia-Pacific region where we see 'growing pains' in China, further headwinds for commodity prices in Australasia and unconvincing momentum in Japan.

[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.