

MARKET WATCH

MAY 2014

Market and economic overview

Australia

The Reserve Bank of Australia (RBA) held the cash rate steady at 2.5% at its 6 May 2014 meeting. There was no change to the Board's neutral policy 'guidance' and signal that there is likely to be "a period of stability in interest rates".

The RBA continues to see moderate growth in consumer demand and a solid expansion in housing construction. The RBA remains watchful as the sources of growth transition from mining to non-mining. The RBA expects investment spending in mining to "decline significantly" while seeing only "tentative" signs of a pick-up in other sectors. The RBA is also weary of the Australian dollar (AUD) as it "remains high by historical standards".

The RBA released its Statement on Monetary Policy and updated its GDP and inflation forecasts. The RBA lifted its GDP growth forecast by 0.25% to 3% for June 2014, but lowered its December 2014 forecast to 2.75% (-0.25%), and below trend, largely due to the stronger AUD.

The RBA slightly revised down its near term CPI forecast from 3.25% to 3% for June 2014, while upgrading its inflation forecasts for 2015 due to the depreciation of the AUD.

Australia's 2014-15 Commonwealth Budget was released and estimates a deficit of \$A29.8bn, or 1.8% of GDP. This is a solid improvement on the \$A49.9bn 3.1% of GDP, deficit estimated for 2013/14.

Australia's net debt is now expected to peak at 14.6% of GDP at June 2017, up from 12.5% at June 2014 and a low of -3.8% of GDP (i.e. net assets) at June 2008.

Employment rose by a solid 14,200 in April, following three months of solid gains totalling 92,200.

The unemployment rate held steady at 5.8%, down from its recent peak of 6% in February, while the participation rate fell from 64.8% to 64.7%.

United States

There was no meeting of the Federal Open Market Committee (FOMC) of the US Federal Reserve in May, however the Minutes of the April meeting were released. The Committee expects that if the economy continued to develop as anticipated, the pace of asset purchases will likely be reduced at future meetings gradually, but remain contingent on the Committee's outlook for the labour market and inflation.

Stanley Fischer was sworn in as a member of the Board of Governors of the Federal Reserve System and is also nominated to become Vice Chair of the Board; however this is still pending before Senate. Prior to his appointment, Dr Fischer was Governor of the Bank of Israel from 2005 to 2013.

Q1 2014 GDP growth was revised down sharply from +0.1% to -1% on an annualised quarter-on-quarter basis and down from 2.6% per year in Q4 2013. The downward revision was almost entirely due to a larger drag on inventory investment, as well as weaker net exports and government spending; all impacted by a cold winter.

Existing home sales rose 1.3% to 4.65m in April. Prior to this rise, existing home sales were down 13% between July 2013 and March 2014. New home sales rose 6.4% after a weak March while housing starts rose 13.2% to place housing starts back over the 1 million mark.

Europe

The European Central Bank (ECB) left its main policy rates and forward guidance unchanged at its 8 May 2014 meeting.

Expectations of further easing at the next meeting on 5 June, with a cut to the main policy rate from 0.25% to 0.1% and for deposit rate to be cut into negative territory grew with this commentary: "the Governing Council is unanimous in its commitment to using also unconventional instruments, within its mandate, in

order to cope effectively with risks of a too prolonged period of low inflation".

European Parliamentary elections were held from 22 to 25 May. Anti-establishment and Euroskeptic parties had their strongest showing in the 35 year history of EU elections, particularly in France and the UK.

United Kingdom

The Bank of England (BoE) left policy unchanged at its 8 May 2014 meeting, as expected. The Bank Rate was unchanged at 0.5% and the stock of asset purchases remained at £375b.

The GfK Consumer Confidence Indicator rose from -3 to 0, the first time there hasn't been a negative reading since April 2005.

UK CPI data rose 0.4% for April and 1.8% per year, up from 1.6%, in March which could be the low in the recent cycle.

The unemployment rate dropped to 6.8% in the three months to March, as 283,000 jobs were added, outstripping expectations of 248,000 in another strong show for the UK labour market.

Japan

The Bank of Japan's (BoJ) policy board convened on 21 May 2014 and decided by unanimous vote to leave current monetary policy settings unchanged, as expected. The BoJ will continue to carry out money market operations so that the monetary base increases by around ¥60-70trn a year.

Retail sales slumped by 13.7% in April, following a large increase to beat the national sales tax hike on 1 April.

As a result of this tax increase, Nationwide CPI rose to 3.4% per year in April, from 1.6% per year in March, the fastest pace since 1991 (the last time the sales tax was lifted).

China

The HSBC manufacturing flash PMI rose to a five month high of 49.7 in May, helping to support hopes of a sequential recovery into the second quarter.

The official PMI rose to 50.8 in May from 50.4 in April, broadly in line with expectations.

There were a number of targeted stimulus measures announced over May to help promote growth. These varied from Reserve Requirement Ratio (RRR) cuts for specific lenders to the Ministry of Finance urging government bodies to step up budget spending on projects that have fallen behind schedule. These measures should help the government achieve a 7+% growth rate over the coming quarters.

Australian dollar

The AUD increased by just 0.2% to finish May at \$US0.9310. The AUD traded in a wide range over the month, peaking at \$US0.9379 mid-month, before falling to \$US0.9226 on 22 May, and then rallying to month end despite weaker iron ore prices.

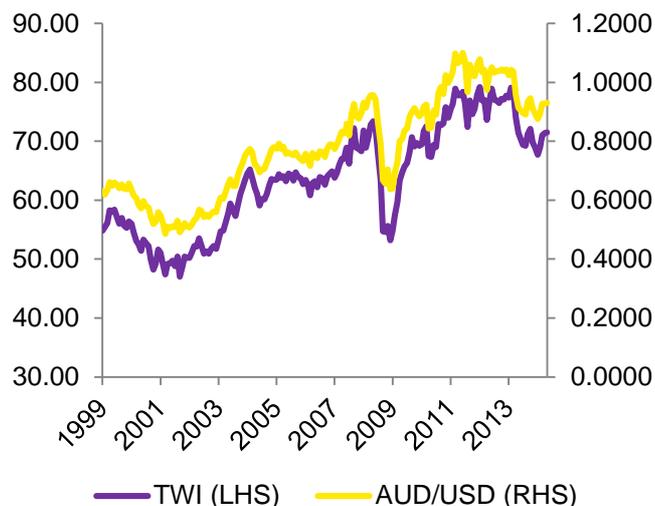
Commodities

A broad range of commodity prices mostly increased in May, although a few specific commodities fell sharply.

Energy prices were mixed, with US natural gas prices falling (-6.5%), following on from a sharp increase in April. Russia and China signed a long awaited natural gas deal in May, reportedly worth \$US400bn.

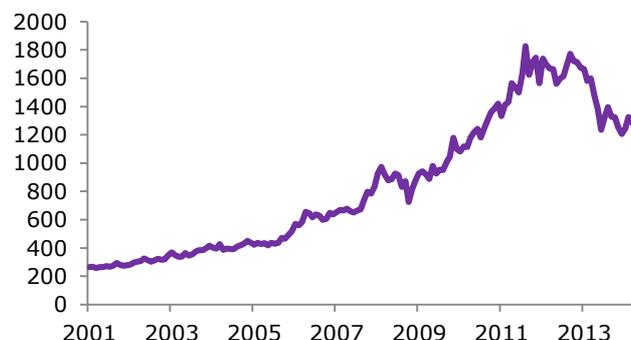
IRON ORE PRICE FELL SHARPLY ON INCREASED GLOBAL SUPPLY AND CHINA GROWTH CONCERNS

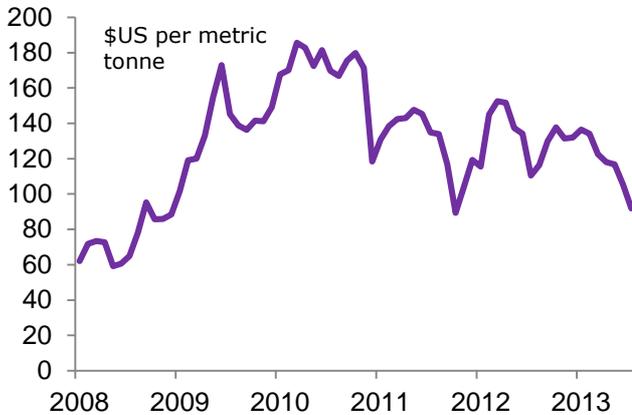
THE AUSTRALIA DOLLAR REMAINS UNCOMFORTABLY HIGH



Source: Bloomberg as at 31 May 2014. Past performance is not an indication of future performance.

Gold (\$US per Troy Ounce)





Source: Bloomberg as at 31 May 2014

Metals prices were mixed. Gold fell (-3.2%) while Nickel continued to rise (+5.0%) after strong gains in April, driven this month by a ban on nickel ore exports from Indonesia.

The iron ore price continued to fall, down a further 12.9% in May, and is now down 31.6% in 2014 to-date. Concerns over a slowdown in the Chinese property market continue to plague the market as did strong growth in supply, despite few signs of an inventory build-up at the ports or mills.

GOLD FELL IN MAY WITH EASING POLITICAL TENSIONS

Source: Bloomberg as at 31 May 2014. Past performance is not an indication of future performance.

Australian shares

Australian shares were little changed in May, with the S&P/ASX 200 Accumulation Index edging 0.7% higher.

There was a fair divergence in performance between different areas of the market. Industrials stocks tended to perform relatively well, with the Telecoms, Health Care and Utilities sectors all registering gains.

Energy stocks also tended to perform relatively well, partly reflecting progress made with various LNG projects that are owned and/or operated by ASX-listed companies. The first cargo of LNG was shipped from Oil Search's PNG LNG project in Papua New Guinea during the month.

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These gains were mostly offset by weakness in the Materials sector. Declining iron ore prices dampened investor sentiment and exerted downward pressure on miners' share prices.

Listed property

The Australian listed property sector increased by a modest 0.1% in May, as Australian government bond yields declined for a second consecutive month. Lower bond yields tend to be supportive of income-generative securities such as A-REITs.

Global shares

Global developed equity markets generally recorded modest gains in May amid a backdrop of falling global bond yields, improving US economic data and continued mergers & acquisitions activity.

The MSCI World Developed Markets Index increased by 1.6% in USD terms and 1.4% in AUD terms over the month.

The US S&P500 Index rose by a strong 2.1% during May to reach a new record high, continuing its momentum after a reasonable earnings period.

Lower bond yields and improving economic data helped the index higher. The S&P500 is now 23% higher than its previous peak in October 2007. The Nasdaq Index (+3.1%) rose after falls in April, while the Dow Jones rose a more moderate 0.8%.

Germany's DAX (+3.5%) and Spain's IBEX Index (+3.2%) both outperformed. Eurozone PMIs and Eurozone consumer confidence have been improving, assisting these markets.

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The Japanese Nikkei 225 (+2.3%) and Topix (+3.4%) Indices both rose in May on improving valuations. after four consecutive monthly falls

Global emerging markets

Emerging market (EM) equities outperformed their developed market counterparts in May. The MSCI EM Index returned 3.3% in USD terms and 3.2% in AUD terms. Easing tensions in the Ukraine post-elections and a good result in the Indian elections helped returns in May.

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